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Product Differentiation Strategy and Perceived Financial Performance of Commercial Banks in Uganda: Moderating Effect of Managerial Discretion

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Abstract:
Background: *The link between product differentiation strategy and firm performance has been extensively explored, with some previous studies revealing a significant relationship between these two constructs, while other have indicated an insignificant relationship between the two constructs. Other previous studies have furthered the inquiry and found that the link between product differentiation strategy and firm performance depends on factors such as technological capabilities, managerial and marketing capabilities, and competitive intensity. However, the factor of managerial discretion and how it moderates the relationship between product differentiation strategy and firm financial performance has not received necessary empirical attention. This study sought to fill this empirical gap using evidence from selected commercial banks in Uganda.*

Materials and Methods: *The study employed a cross-sectional design. The target population comprised of 210 Senior Managers and Chief Executives of 10 selected commercial banks in Uganda, chosen because of their relatively consistent superior financial performance in the last five years. A sample of 137 individuals was calculated using Yamane's (1967) formula, and the technique of stratified proportionate random sampling was used in selecting sample subjects. Data was collected from these individuals using structured questionnaires, and analyzed descriptively (using frequencies, percentages, means and standard deviations) and inferentially using partial least squares structural equation modelling (PLS-SEM).*

Results: *The coefficient of the interaction term between managerial discretion and product differentiation strategy (MD*PD) was found positive and significant ($\beta = 0.3421$, $\rho<0.05$). Accordingly, the null hypothesis that managerial discretion does not significantly affect the relationship between product differentiation strategy and financial performance of commercial banks in Uganda was rejected. It is concluded that managerial discretion is an important factor in the adoption of product differentiation strategies for purposes of enhancing perceived financial performance of commercial banks in Uganda. The study therefore recommends that commercial banks in Uganda should avail Chief Executives with the necessary and adequate latitude to implement product differentiation strategies if they are to maximize financial performance.*
Key Words: Product differentiation strategy, financial performance, managerial discretion, commercial banks, Uganda

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I. Introduction

Over the years, the global banking business environment has increasingly been characterized by intense competition from within and without (Chen, Nazir, Hashmi, & Shaikh, 2019). De-regulation, privatization and liberalization have been the biggest drivers of external competition (Vives, 2016), while competition from within is largely attributed to enormous number of banking service providers, providing more or less the same products and/or service[1]. There are a number of options for managing the competition phenomenon at the disposal of commercial banks, but prominent among these is the formulation and implementation of competitive strategies.

Competitive strategies refer to the various actions that firms undertake to endure and/or resist pressures arising out of internal and external competition so as to gain a competitive advantage in the market[2]. Competitive strategies are majorly categorized into two: cost leadership and product differentiation strategies (Porter, 1980). Firms seeking to achieve superior performance can choose to adopt either a cost leadership or differentiation strategy but not both simultaneously as this would lead to getting stuck in the middle leading to resource wastage and poor performance (Porter, 1980).

Product differentiation strategy, which is the focus of this study, and its effect of firm performance, has been extensively studied with varying outcomes. Some studies show that a significant relationship between product differentiation and firm performance (Violinda, Dirgantara, & Sufian, 2016; Adegbite, Osinowo, Omisore, & Ayinde, 2019; Ghahroudi & Sagheb, 2018), while others show no significant relationship between the two concepts (Acquaaha & Agyapong, 2015; Kharub, Patle, & Sharma, 2015; Demba, Ogal, & Muli, 2018). There is also research indicating that the linkage between product differentiation strategy and firm performance is contingent on factors such as technological capabilities (Ortega, 2015), managerial and marketing capabilities (Acquaaha & Agyapong, 2015), and competitive intensity (Atikiya, 2015) among others.

However, the moderating role of managerial discretion on the relationship between product differentiation strategy and commercial bank financial performance has not received the necessary and adequate empirical attention more so, in Uganda. Managerial discretion is the latitude that executives have to affect company activities (Lopez-Cotarelo, 2018). It has been observed that Chief executives who have full authority over the formulation and implementation of company strategies are able to envision a wide range of alternatives and create multiple courses of action that can have a positive bearing on their organizational outcomes (Carpenter & Golden, 2017). Further still, it has been observed that Chief Executives with full authority over formulation and implementation of company strategies are able to make use of the organization's abundant resources to foresee change and choose from a wide spectrum of alternatives (Peteraf & Reed, 2015). In another research, factors that impact on material management and marketing performance were reviewed by Adegbuyi, et al, (2018) and result shows that effective material management facilitated by IT applications plays significant roles in promoting marketing performance and business development in general among the businesses in Africa. Thus, the purpose of this study was to find out whether managerial discretion moderates the relationship between product differentiation strategy and commercial bank financial performance using evidence from commercial banks in Uganda.

II. Material and Methods

Study Design This cross-sectional study was conducted on Senior Managers and Chief Executives of 10 selected commercial banks in Uganda from 31st August – 21st September 2020. Senior Managers and Chief Executives were selected because they are the principal originators of the banks' business strategies including competitive strategies.

Study Location: The study was conducted at 10 selected commercial banks in Uganda specifically at the Headquarter Offices. The choice of the 10 commercial banks was informed by the fact that they had consistently performed well financially over the last five years compared to the remaining 15 commercial banks in the country. In addition, Headquarter Offices were selected because they are the seats of the banks' Senior Managers and Chief Executives.

Study Duration: The study lasted from 31st August to 21st September 2020.

Sample size: The total number of Senior Managers in the 10 selected commercial banks who sit at the Headquarter Offices was 210 individuals. From these, a sample of 135 individuals was chosen to participate in this study for purposes of data collection.

Sample size calculation: The sample size was determined using Yamanne's (1967) formula, which is stated as follows.

$$n = \frac{N}{1 + Ne^2}$$

By the above formula, the sample size was calculated as follows.

$$n = \frac{210}{1 + 210\ (0.05)^2} = 137.7$$

Subjects & selection method: The study population comprised of Senior Managers and Chief Executives of 10 selected commercial banks in Uganda. Banking strategy is usually the preserve of Chief Executives and Senior Managers. Therefore, Senior Managers and Chief Executives were chosen because they constituted the principal originators of the banks' business strategies including the competitive strategies. A sample of Senior Managers was selected from each bank using the technique of stratified proportionate random sampling. By this method, the population was divided into 10 groups representing commercial banks, and a random sample of Senior Managers which was proportional to the size of the entire population was drawn from each commercial bank. The choice of this technique was based on the fact that the population size varied across the 10 commercial banks. One Chief Executive was selected from each commercial bank under consideration through purposive sampling as is all demonstrated in Table 1.

Table 1: Shows the population, sample size and sampling techniques

Commercial Bank	Population Size	Sample Proportion	Sample Size	Senior Managers	Chief Executives
Absa Bank	16	(16/210)*137	10	9	1
Bank of Africa	18	(18/210)*137	12	11	1
Bank of Baroda	18	(18/210)*137	12	11	1
Centenary Bank	31	(31/210)*137	20	19	1
Citi Bank	12	(12/210)*137	8	7	1
DFCU Bank	22	(22/210)*137	14	13	1
Equity Bank	27	(27/210)*137	17	16	1
Housing Finance Bank	20	(20/210)*137	13	12	1
Stanbic Bank	28	(28/210)*137	19	18	1
Standard Chartered Bank	18	(18/210)*137	12	11	1
Total	**210**		**137**	**127**	**10**

Procedure methodology

After obtaining written permission to conduct the study at the selected sites, a structured questionnaire was designed for purposes of collecting data from Senior Managers of the commercial banks under consideration. The self-administered questionnaire solicited for data on socio-demographics of respondents as well as data on constructs of product differentiation strategy, financial performance and managerial discretion. The construct of product differentiation strategy was assessed using 10 items sourced from literature related to the extent to which the banks offer a range of products to their customers, strive to make their products different, have unique service delivery channels, offer products with unique characteristics, and ensure branding is a major component of their service delivery package among others. As is indicated in Table 2, the construct of financial performance was assessed using three items related to respondents' perceived satisfaction with the banks' ROA, ROI and Net Profits over the last five years. The construct of managerial discretion was assessed using two items related to whether the Chief Executive had fully authority over the formulation and implementation of the banks' competitive strategy. All responses to the items measuring the above constructs were rated on a likert scale comprised of 5 points starting from 1=strongly disagree to 5=strongly agree. The questionnaire was distributed across the bank with the assistance of two knowledgeable and trained data collection assistants. The questionnaire was pre-tested prior before being administered. Data was also obtained from Chief Executives of the banks through conducting key informant interviews.

Table 2: Shows the items used in measuring the study constructs

Construct	Notation	Item
Product differentiation (PD)	PD1	The bank offers a broad range of products to its customers
	PD2	The bank strives to make its products different
	PD3	The bank's service delivery channels are unique
	PD4	The bank offers products with unique characteristics
	PD5	Branding is a major component of the bank's service delivery package
	PD6	Employees are regularly trained to offer unique services
	PD7	Technology is a major part of the bank's product differentiation
	PD8	The bank continuously develops new products for customers
	PD9	The bank's marketing channels are unique
	PD10	The bank's customer relation service package is unique
Financial performance (FP)	FP1	I am satisfied with my bank's ROI over the last 5 years
	FP2	I am satisfied with my bank's ROA over the last 5 years
	FP3	I am satisfied with my bank's net profits over the last 5 years?
Managerial discretion (MD)	MD1	Chief Executive has full authority over formulation of the bank's competitive strategies
	MD2	The Chief Executive has full authority over implementation of the bank's competitive strategies

Statistical analysis

Both descriptive and inferential statistical techniques of data analysis were employed in this study. The descriptive statistics used in the study included frequencies, percentages, means and standard deviations. In addition, the study employed the inferential technique of structural equation modeling (SEM). SEM is a multivariate analysis technique that is used in analyzing structural relationships that exist between measured variables and latent constructs (Hair, Hult, Ringle, & Sarstedt, 2017). There are two major ways of conducting SEM including covariance based SEM (CB-SEM) and partial least squares SEM (PLS-SEM). However, the latter was chosen for the purpose of this study. PLS-SEM has been found to be more appropriate for models which contain a large number of exogenous latent variables explaining relatively few endogenous latent variables (Hair, Risher, Sarstedt, & Ringle, 2019; Ju & Sohn, 2015), and this was the case in this study. In addition, PLS-SEM was applied in this study because it has been found to be robust in managing nonnormalized data (Ramayah, Cheah, Chuah, Ting, & Memon, 2016), which was a high possibility in this study. Finally, the analysis technique was chosen because, even with a relatively small sample size as the case was with this study, it makes it possible to assess interactions with multiple indices between latent variables (Hair, Ringle, & Sarstedt, 2015).

III. Result

Respondents' Profile

A total of 137 questionnaires were administered to Senior Managers of selected commercial banks in Uganda during the study. However, 135 were successfully filled representing 98.5% response rate. From Table 3, the socio-demographic profile of respondents indicates that most respondents were male (5.6%), aged between 40 – 49 years (65.3%), and had been employed in their positions for a duration ranging from 5 – 10 years (67.8%).

Table 3: Shows respondents' socio-demographic profile

Construct	Category	Frequency	Percentage
Gender	Male	79	58.6
	Female	56	41.4
Age	Less than 30 years	0	0
	30 – 39 years	25	18.2
	40 – 49 years	88	65.3
	50 years & above	22	16.5
Employment duration	Less than 5 years	20	14.8
	5 – 10 years	92	67.8
	11 – 15 years	21	15.7
	More than 15 years	2	1.7

Mean and standard deviation of study constructs

The constructs of product differentiation strategy, financial performance and managerial discretion were measured using 10, 3 and 2 items respectively. Respondents were asked to indicate the extent to which they agreed or disagreed with these items, and their responses were rated on a scale of 5 points starting from 1=strongly disagree to 5=strongly agree. Table 4 presents a summary of the index values for items measuring financial performance, product differentiation strategy, and managerial discretion.

Table 4: Mean and standard deviations for study constructs

Construct	No. of items	Mean	Standard deviation
Financial performance	3	3.89	1.065
Differentiation strategy	10	4.05	0.879
Managerial discretion	2	3.95	1.042

The mean index values indicted in the table show that, on average, most respondents were satisfied with the financial performance of their banks over the last five years, most of them agree that their banks are implementing well the strategy of product differentiation, and that their Chief Executives have full authority over the formulation and implementation of product differentiation strategies for their banks. The standard deviation index values corresponding to the mean values are all small, implying that the responses on the items were not far from expected.

Evaluation of measurement model

The measurement model used in this study was evaluated for purposes of ensuring that the specified model was valid and reliable. In order to assess the validity and reliability of the specified model, the following computations were undertaken--factor loadings, Cronbach's Alpha, composite reliability (CR), and average variance extracted (AVE) as well as the discriminant analysis associated with the study constructs. The factor loading measured the variance explained by a variable on a particular construct. As a rule of the thumb, only items with factor loadings above 0.5 were accepted. The Cronbach's Alpha measure was used in assessing the reliability or internal consistency of a set of items corresponding to a given construct, and as a rule of a thumb, this measure was expected to be above 0.7. The composite reliability (CR) is a measure of how well assigned items measure a construct. Acceptable CR values should be higher than 0.6 (Bagozzi & Yi, 2012). AVE measures the amount of variance that is captured by a construct relative to the amount of variance attributed to a measurement error. AVE is expected to be above 0.5 (Gorondutsea & Gawuna, 2017). All these statistics were generated using the technique of confirmatory factor analysis (CFA) and Table 5 presents a summary of the results.

Table 5: Shows item loadings and cross loading

Construct	Item	Loadings	Cronbach's Alpha	CR	AVE
Product differentiation (PD)	PD1	0.739	0.742	0.822	0.535
	PD7	0.783			
	PD8	0.629			
	PD9	0.704			
Financial performance (FP)	FP1	0.70	0.735	0.802	0.546
Managerial discretion (MD)	MD2	0.650	0.702	0.705	0.552

From Table 4, 6 PDs and 2 FPs were deleted because they had factor loadings below 0.5 as theoretically recommended (Ramayah, Cheah, Chuah, Ting, & Memon, 2016). The remaining items posted CR values ranged from 0.802 – 0.822 and AVE values ranged from 0.535 – 0.546, meaning that convergent validity was established. In addition to establishing convergent validity, discriminant validity was also ascertained. From the findings in Table 6, discriminant validity was established in this study.

Table 6: Shows results of discriminant validity

		1	2	3
1	Product differentiation	1		
2	Managerial discretion	0.625	1	
3	Financial performance	0.545	0.675	1

Evaluation of structural model

After assessing the measurement model, the next step entailed examining the structural model for this study. The purpose of evaluating the structural model was to assess test the hypothesized relationship between the study constructs. The hypothesis tested for the purpose of this study was: managerial discretion does not significantly affect the relationship between product differentiation strategy and financial performance (return on investment, return on assets and net profit after tax) of commercial banks in Uganda. The findings are summarized in Table 7.

Table 7: Shows results of hypothesis testing

	Beta	Std. Error	t-value	p-value
H1: PD -> FP1	0.5841	0.021	29.430	<0.001
H2: MD*PD -> FP1	0.3421	0.093	3.705	0.046

From Table 7, the coefficient of product differentiation strategy (PD) is positive and statistically significant ($\beta = 0.5841$, $\rho<0.05$), suggesting that proper adoption and implementation of a product differentiation strategy is associated with enhanced commercial bank financial performance particularly in terms of ROI. In addition, the coefficient of the interaction term between managerial discretion and product differentiation strategy (MD*PD) is positive and significant ($\beta = 0.3421$, $\rho<0.05$). This implies that a unit increase in managerial discretion, increases the effect of product differentiation strategy on commercial bank financial performance in terms of ROI by a proportion of 34.2%. Therefore, the null hypothesis that managerial discretion does not significantly affect the relationship between product differentiation strategy and financial performance of commercial banks in Uganda is rejected, and the conclusion is that managerial discretion significantly affects the relationship between product differentiation strategy and financial performance of commercial banks in Uganda.

IV. Discussion

The empirical link between product differentiation strategy and firm performance has been extensively explored. Some previous studies have revealed a significant relationship between these two constructs (Violinda, Dirgantara, & Sufian, 2016; Adegbite, Osinowo, Omisore, & Ayinde, 2019; Ghahroudi & Sagheb, 2018), while other have indicated an insignificant relationship between the two constructs (Acquaaha & Agyapong, 2015; Kharub, Patle, & Sharma, 2015; Demba, Ogal, & Muli, 2018). Yet, other previous studies have furthered the inquiry and found that the link between product differentiation strategy and firm performance depends on factors such as technological capabilities (Ortega, 2015), managerial and marketing capabilities (Acquaaha & Agyapong, 2015), and competitive intensity (Atikiya, 2015). However, the factor of managerial discretion and how it moderates the relationship between product differentiation strategy and firm financial performance has not received necessary empirical attention. This study was motivated by the desire to fill this empirical gap using evidence from selected commercial banks in Uganda.

The results presented in the above section have clearly showed that managerial discretion is an important factor that moderates the relationship between product differentiation strategy and perceived financial performance of commercial banks in Uganda. This means that any efforts aimed at enhancing the financial performance of commercial banks through proper adoption of product differentiation strategies can only succeed through full exploitation of Chief Executives' discretionary powers over the implementation of product differentiation strategies. This is because Chief executives who have full authority over the formulation and implementation of company strategies are able to envision a wide range of alternatives and create multiple courses of action that can have a positive bearing on their organizational outcomes (Carpenter & Golden, 2017). In addition, Chief Executives with full authority over formulation and implementation of company strategies are able to make use of the organization's abundant resources to foresee change and choose from a wide spectrum of alternatives (Peteraf & Reed, 2015).

V. Conclusion

The objective of this study was to investigate the moderating effect of managerial discretion on the relationship between product differentiation strategy and perceived financial performance of commercial banks in Uganda. The coefficient of the interaction terms between managerial discretion and product differentiation strategy was positive and statistically in relation to the financial performance indicator of ROI. The hypothesis that managerial discretion does not significantly affect the relationship between product differentiation strategy and financial performance of commercial banks in Uganda has been rejected, and the study concludes that managerial discretion is an important factor in the proper adoption and implementation of the product differentiation strategy for purposes of enhancing perceived financial performance of commercial banks in Uganda. The study therefore recommends that commercial banks in Uganda should avail Chief Executives with the necessary and adequate latitude to implement the product differentiation strategy if they are to maximize financial performance.

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