Effect of Price Skimming Strategies and Profitability of the Commercial Banks in Kericho County, Kenya

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Abstract: **Profitability of banking sector in Kenya has been declining since 2013. Some of the factors include high competition, capping of interest, pricing strategies among others. Pricing strategies in banking has not been considered despite underlying symptoms of declining growth in assets, loan and deposit. Therefore, there is need to investigate the pricing strategies used in commercial banks in Kenya. The study sought to establish the effect of pricing strategies on profitability of commercial banks in Kericho County, Kenya. The study adopted a descriptive survey design. The design is chosen because the target population was dispersed over a wide geographical area. The design was useful in helping the researcher to obtain both quantitative and qualitative data from the target population. The target respondents were 62 comprising of members of the pricing committees, who include the heads of strategy and planning, the general managers, marketing managers, sales managers, and finance managers in KCB, Equity, Standard Chartered, Co-operative, SBM Bank, Barclays, Trans-national bank, Sidian, DTB, National bank and Family Bank Kenya. The researcher used census sampling design to select 62 respondents representing the whole targeted population. Both closed and open ended questionnaires were utilized in data collection. Data analysis was done using ANOVA and multiple regression analysis with the help of Statistical Package for Social Science version 21.0. The study found out that there was significant relationship between price skimming strategies and profitability of the commercial banks. The study concluded that price skimming strategy provided new product to commercial banks and hence increased profitability. The study recommended that price skimming should be encouraged through encouraging product segmentation since it enables organization to develop new produces.**

Keywords: **Price Skimming Strategies, Profitability**

I. INTRODUCTION

Organizations globally focus on ensuring high performance, profitability and customer loyalty in their business. Corporate profitability is one of the measures of organization performance based on the financial management. High profitability benefit stakeholders in the organization especially the shareholders, employees and board of directors. Investors, suppliers and customers are also beneficiaries on highly profitable organization. Therefore, profitable business is highly valued by stakeholder based on the monetary reward, benefit, profit, interest, payback and dividend it offers to them. However, profitability is dictated by internal and external environment of the business (Toni, Milan, Saciloto, & Larentis, 2017). The competitive model from Porter revealed that competitiveness of enterprises are mainly affected by buyers' bargaining power, suppliers bargaining power, rivalries, substitute products and new entry (Wang, 2014). Pricing on the other hand is a component that has direct impact on the competitiveness of an organization since it is affected by buyers' bargaining power in term of discount and demand, suppliers bargaining power in term of cost, rivalries pricing strategy, price of substitute products and price of new entry. Despite the limitation of Porter model, price affects organization competitiveness which is highly linked with profitability.

Price is viewed in school of economics as a component that determine the profit from the different between buying and selling price. In the school of accounting school focus price as part of sales which when less cost of sales one get gross profit. However, price is view as a strategy that can be used to improve sales and thereafter increase profitability. Pricing strategies are based on price decision made by top management to improve the competitiveness of the organization with an aim of improving profitability (Sammut-Bonnici & Channon, 2014). Price strategies are mainly affected by corporate image, geographical location, discounts, price discrimination a price sensitivity which affect the buyers' bargaining power as results of substitute awareness, end benefit effects, total expenditure effects, shared cost effects and sunk investment effects. However, the role of developing pricing strategies lies with the top management. Where they need to take into consideration the effect of pricing service has impact on marketing structure, technology among other changes in extern environment.

Commercial banks among other financial institution are focused in gaining higher performance in a competitive environment. Central Bank of Kenya is the main regulator to Kenyan Commercial banks in ensuring that the bank competes favorably as well as it safeguards the customer, investors and suppliers. According to Kenya Bankers Association 2019 report indicated that the banks encountered difficulties due to aftershock in 2015 and 2016 as result of interest rate capping. The banking sector contribute to KES 2.5 trillion outstanding loans as in the the period of 2018 making 52 percentage of the real GDP. The banks non-performing loan has also rised. In 2016 the non performing loan was at 9.4%, subsequently in 2017 it had raised to 12.3 percent and 12.0 percent in 2018. The rise of non performing loans indicate low profitability of commercial banks in Kenya. The growth in asset also has reduced drasticaly from the highes of 30.0% in 2008 however significant drop started in 2013 from 25.0% to the lowest growth in 2017 with 6.0%. The report also indicated a decline in growth of deposit from 2013 with 30.0% to minimum of 7% in 2016. This trend of asset, loans and deposit decline and increase of non performance loan as enough reasons to worry about the Commercial Banks within Kenya. The income subsequently has been dropping with 2017 registering a negative growth of 4.79%. This is a decline in profitability.

Due to low and declining profitability in the banking sector. Subsequently, Imperial bank, Chase Bank and National Banking 2019 are some of the banks that have undergone receivership. This has lead also changes in majority of the bank also investing in insurance, real estate investment among other investment to remain afloat in the the banking industry. The Central bank of Kenya improves the economy by using monetary policy as a mechanism to influence the demand and supply of money and thus affecting pricing of bank services. The introduction of the CBR was to signal financial institutions toward a desired direction in their operation. The CBR rate is the rate which the CBK as a lender of last resort slap on banks that are unable to meet the shortfalls in their clearing account. However, on the other hand capping was found to be counterproductive as means of regulating interest rate in commercial by CBK (Central Bank of Kenya Report, 2018).. The introduction in 2017 and later relaxation in 2019 has seen change is banks profitability and changes in lending among the commercial banks in Kenya. Therefore, there is need to investigate on the pricing policies and techniques of commercial banks in Kenya.

The price of products and services is one of the major factors that are considered by those who purchase. Pricing is the process of establishing a price by taking into consideration the components, policies, objectives and strategies of the organization in relation to pricing. When pricing is being analyzed, the 4P's that is price, place, promotion and product must be taken into consideration. Heads of both public and private organizations do not have a choice but to make critical decisions on pricing. Bett (2018) argued that pricing affect customer loyalty though the research did not focus on performance of the organization.

Price Skimming strategy utilizes the concept that any consumer would pay a price that is below reservation prices. Skimming strategy is widely used pricing strategy where highest possible price is set for profits maximization for a new product facing high demand; however the price can be lowered as results of competition from new entrance (Nyaga & Muema, 2017). Many organizations use skimming method while introducing new products. Where they set high prices for the product resulting to marginal profit is high which encourage competitors to develop similar product. Subsequently by lowering the company becomes competitive over the new substitute developed by the competitors (Shavandi & Zare, 2013). According to Muzammil (2014) the technique is not only for customer acceptance and profitability but also be competitive against the new entrance. Banks also engage in price skimming against their competitors so as to woo more customers to be loyal to a brand or product. These also are normally done when launching a new product in a competitive market. However, for skimming to take place there must be must be sufficient customer for the product, low unit cost, unfavorable prices and price association with quality.

Profitability is the ability of a firm to generate more money than total cost of production. It is expressed in terms of numbers that measure "how much a company makes with what it has or has taken in". It is a relative measure of business success and is usually expressed as an income to cost ratio. Simply expressed, it is Earnings minus Costs (Hutt & Speh, 2010). According to Stierwald (2010), bank profitability is regarded as return on investment measured in terms of the resources the organization has. The ultimate objective of any organization is to generate profits in any investment they make. In this regard, any business operation must be gainful at long run in order to sustain its performance. Business continuity is highly dependent on whether it is able to sustain itself and generate profits for the investor. Furthermore, profits directly dictate the performance of an organization.

II. STATEMENT OF THE PROBLEM

Kericho County is dominated by highly competitive financial sectors such as banks, SACCOs and microfinance institutions fighting for customers. The introduction of SACCOs and other microfinance institutions have created stiff competition hence lowering the profits of the commercial banks. This has been attributed to commercial bank clients moving to SACCOs and microfinance institutions. With regard to this some commercial banks are recording losses. Some of the banks that have registered loss includes National Bank of Kenya reported a loss for the financial year 2014/2015 while the Cooperative bank of Kenya had reported a drop in their profits in 2014 resulting to restructuring. Since 1986, Kenya banking system has been affected by issues, which has led to the downfall of more than 40 commercial banks (Gitonga, 2014) with the recent ones in 2015 and 2016 being Imperial and Chase Banks respectively as well as National Bank of Kenya recently. According to the CBK report, lately there has been a decline in the growth of commercial banks in Kenya due to the emergence of Sacco's therefore decreasing their profits too. There are also decline of growth of total asset, deposits and loan while non-performing loan have increased (Kenya Bankers Association, 2018). This have led to decline in profitability in the banking sector which require research in the pricing strategies in place.

Most of the literature that are available concerning issues affecting commercial banks' profitability combined the micro and macro factors with few focused on internal factors, that effect profitability with most studies carried out in other countries (Kosmidou, Tanna, & Pasiouras, 2006; Grygorenko, 2009; Thi, Khanh, Thuy, & Thuy, 2018). Few studies if any have been done in Kenya and no research has been carried out in Kericho County focusing on the role of pricing strategies on profitability. Some of the studies are done using different methodology which includes empirical evidence by Guerreiro, Comachione, & Kassai (2012) as well as Netseva-Porcheva (2017), Comparison analysis by Chantapong (2005), the uses of inteview schedules by Njega (2016). However the current study addressed the weakness of the varous studies by using descriptive research design where primary data were collected from banks using questionnaires. The study investigated the influence of pricing on the profitability of the commercial banks. Commercial banks in Kericho were focused based on its representation of more than 10 branches in a dynamic economy especially profitability in terms of net profits, earning, and interest.

III. LITERATURE REVIEW

Theoretical Review

This study was guided by capital asset pricing theory which was developed by William Sharpe in 1964 and its main proponents include DeBont and Thaler (1987). The basic principle in this theory is that risks can be either systematic or unsystematic. The theory further points out those systematic risks are caused by external factors beyond organization's control. These factors include government regulations through policies, inflation and political environment. On the other hand, the unsystematic risks are caused by internal factors which can be within organization control and these factors include: quality management, public relations and entry of new competitors.

Based on the basic tenets of this theory, commercial banks experience several risks cause external factors which the banks may not be able to avoid but they can only be shaped by market forces. Since pricing is may be controlled by the commercial banks, it is considered to be the most tool affecting profitability of the banks hence should be the main focus. The theory is critical to the study as it addresses the aspect of price skimming strategy which is applied to newly developed products (Bett, 2018).

The theory is applicable as means of determining pricing based on external factors for systematic risk and internal factors for unsystematic risk. This enables the organization to determine market force before setting their price. Some concepts are adopted in competition based pricing, value based pricing, skimming pricing and cost plus pricing. However, the theory is not able to determine the impact of these pricing strategies on the profitability of the organization.

Empirical Literature Review

Muzammil (2014) investigated market skimming in relation to technological and innovative products. Companies that produce innovative, quality and reputable products are able to adopt market skimming pricing strategies. The technology adopted must be acceptable by the customer and have high market value. Therefore, the study aimed at identifying factors associated with market skimming pricing. The target population were the users of personal computers where technology, innovation, brand image and product quality were considered in association with market skimming pricing. A survey was conducted using questionnaires as the data collection instrument. The findings revealed that technology, innovation, brand image and product quality had positive significant effect on market skimming pricings. The variables explained 27% of the market skimming pricings.

Nyaga and Muema (2017) investigated the effect of skimming pricing strategy on the profitability of insurance firms in Kenya. The variables were examined using descriptive research design which focused on 45 insurance companies operating in Kenya by the end of 2012. The study also reviewed data for the past 5 years. The target population was 900 sales employees where a sample of 90 respondents. Two employees were purposefully selected per insurance company. Questionnaires were deployed and analyzed using both inferential and descriptive statistics. The results from correlation and regression model used indicated a positive significant association between skimming pricing strategies used and the profitability of the organization.

IV. RESEARCH METHODOLOGY

The study adopted a descriptive survey design. The design is chosen because the target population was dispersed over a wide geographical area. The design was useful in helping the researcher to obtain both quantitative and qualitative data from the target population. The target respondents were 62 comprising of members of the pricing committees, who include the heads of strategy and planning, the general managers, marketing managers, sales managers, and finance managers in KCB, Equity, Standard Chartered, Co-operative, SBM Bank, Barclays, Trans-national bank, Sidian, DTB, National bank and Family Bank Kenya. The researcher used census sampling design to select 62 respondents representing the whole targeted population. Both closed and open ended questionnaires were utilized in data collection. Data analysis was done using ANOVA and multiple regression analysis with the help of Statistical Package for Social Science version 21.0.

V. FINDINGS

The findings of the study sought to determine the influence of price skimming strategies and profitability of the commercial banks in Kericho County, Kenya. The findings are presented in Table 1.

Table 1: Price Skimming Strategies and Profitability

Question	5 (SA)	4 (A)	3(N)	2 (D)	1(SD)	Mean	SD
Product segmentation leads to the development of new products	17(29.3%)	36(62.1%)	5(8.6%)	0(0.0%)	0(0.0%)	4.21	0.59
Product segmentation affect profitability	0(0.0%)	36(62.1%)	22(37.9%)	0(0.0%)	0(0.0%)	3.62	0.49
Product are segmented based on the returns of the products	23(39.7%)	31(53.4%)	4(6.9%)	0(0.0%)	0(0.0%)	4.33	0.60
Banks uses product segmentation to control profit through interest gained	13(22.4%)	37(63.8%)	8(13.8%)	0(0.0%)	0(0.0%)	4.09	0.60

Source: Research data (2019)

Table 4.8 indicates results of price skimming strategy. Product segmentation led the banks to develop new product (mean of 4.21). Product segmentation was low in variation (standard deviation of 0.59). Skimming based on the product segmentation enabled the banking institution to develop new products.

The segmentation of product somehow enabled the bank to be profitable (mean of 3.62). It indicated a low variation (standard deviation of 0.49) on profitability. It implied that to some extent segmentation improve profitability of the organization.

Each segment product would produce their own returns (mean of 4.33). Variation in product segmentation was low (standard deviation of 0.60). It is important for product segment so that product that is not profitable would be modified or closed.

Banks used product segmentation to control profit through interest gained to a greater extent (mean of 4.09). The variation was low concerning banks use of product segmentation (standard deviation of 0.60). Grygorenko (2009) pricing strategies affected profitability. Kamau (2013) argued that differentiated differentiation influenced sales.

Table 2: ANOVA on Price Skimming Strategy and Profitability

		Sum of Squares	df	Mean Square	F	Sig.
Profitable * Price Skimming Strategy	Between Groups (Combined)	3.817	2	1.908	10.955	.000
	Within Groups	9.580	55	.174		
	Total	13.397	57			

Source: Research data (2019)

Table 2 indicated that price skimming strategy significantly affected the profitability of the organization (F= 10.955, P = 0.000 <0.05). Price skimming strategy affects organization profitability.

VI. CONCLUSIONS AND RECOMMENDATIONS

The study concluded also that price skimming strategy had positive significant impact on the profitability of the commercial banks. This enables commercial banks use product segmentation to enable development of new products. It enables the banks to gain profit through new products and interest gained. Product segmentation enables the banks to utilize skimming or prices. Segmentation was also done based on the returns of the products as well as profitability.

The study recommended that price skimming should be encouraged through encouraging product segmentation since it enables organization to develop new produces. The study reveals that new products that concentrated in different market segment would not only assist the banks in increase profit through skimming but also improve customers. Pricing skimming also improves innovativeness with the commercial banks; therefore the study would encourage organization to involve research and development as well as market team for new product in both banking sector and non-banking sector.

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