

IMPACT OF COST LEADERSHIP AND DIFFERENTIATION ON PROFITABILITY IN INDONESIAN CONSUMER GOODS

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Abstract. The intense competition in the consumer goods industry requires companies to implement appropriate and effective business strategies to enhance profitability. This study aims to analyze the effect of cost leadership and differentiation strategies on the profitability of consumer goods companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 period. The research sample consists of 31 companies selected from a population of 49, using purposive sampling based on predetermined criteria. Data were analyzed using linear regression with IBM SPSS 26. The cost leadership strategy is measured using the Total Sales to Total Assets ratio, while the differentiation strategy is measured using the Sales to COGS ratio. Profitability measured by Return on Assets (ROA) and Net Profit Margin (NPM). The results show that the cost leadership strategy has a significant effect on ROA but not on NPM. In contrast, the differentiation strategy has a significant effect on both Return on Assets and Net Profit Margin. When applied simultaneously, both strategies significantly influence company profitability, with the differentiation strategy having a stronger impact than the cost leadership strategy. Therefore, companies are advised to combine both strategies to improve their competitiveness and profitability. Investors should consider companies that implement a differentiation strategy and those that adopt a combination of cost leadership and differentiation strategies when making investment decisions.

Keywords: *cost leadership, differentiation strategy, profitability, return on assets, net profit margin*

Introduction

The consumer goods industry in Indonesia has experienced rapid growth in line with the increasing demand for daily consumer products. However, this growth is accompanied by complex challenges, including intensifying competition among companies, shifting consumer preferences, and economic fluctuations that affect production costs and consumers' purchasing power. In response to these challenges, companies must continuously adapt and develop effective business strategies in order to remain competitive and enhance their profitability. Porter's theory about competitive advantage, proposed that the business strategies used to achieve a competitive edge consist of cost leadership, differentiation, and focus strategies (Porter, 2008a). Among these, cost leadership and differentiation strategies are the two most commonly employed approaches in the consumer goods industry. The cost leadership strategy emphasizes cost efficiency with the goal of minimizing operational expenditures, thereby enabling companies to offer lower prices than their competitors (Kimiti et al., 2020; Datta, 2010). In contrast, the differentiation strategy focuses on creating unique products or services that deliver significant added value in the eyes of customers (Soomro et al., 2023; Holt, 2022). Companies adopting this strategy emphasize product innovation, quality enhancement, and brand image reinforcement to build customer loyalty (Valipour et al., 2012).

Profitability is a key indicator used to measure the effectiveness of business strategies implemented by a company. It reflects a firm's ability to generate profit

efficiently and effectively from its operational activities (Rashid, 2021). Internal factors such as cost management and asset utilization, as well as external factors such as market conditions and economic policies, can influence a company's profitability. Highly profitable firms are generally capable of managing assets efficiently, applying optimal business strategies, and maintaining sufficient financial capacity to support long-term growth (Porter, 2004). The consumer goods industry is one of Indonesia's key sectors, providing a variety of essential products such as food, beverages, and household items. Data from the Indonesia Stock Exchange (IDX) indicate that the average sales in this sector fluctuated during the 2019-2023 period, increasing from IDR 15.62 trillion in 2019 to IDR 18.93 trillion in 2023. Although sales continued to grow, the growth rate began to slow after 2022 due to rising inflation and production costs. According to Statistics Indonesia, inflation surged from 1.68% in 2020 to 5.51% in 2022, driven by economic recovery and higher raw material prices (Widyastuti, 2024). Meanwhile, the Business Competition Index Survey by the Indonesian Competition Commission (Setiawan et al., 2025) identified a high level of competition in the sector, pushing companies to adopt innovative business strategies to sustain profitability.

The implementation of cost leadership and differentiation strategies has been the focus of numerous studies, although the findings remain inconsistent. For example, research by Banker et al. (2014) found that the differentiation strategy positively affects profitability through product innovation and brand development. Conversely, other studies, such as Suryanto and Anggraini (2020) argue that the cost leadership strategy is more effective in improving profit margins. In light of these findings, this study aims to examine the influence of cost leadership and differentiation strategies on the profitability of consumer goods companies listed on the Indonesia Stock Exchange during the 2019-2023 period.

Literature review

Competitive advantage theory

The theory of competitive advantage was introduced by Porter (2008a). This theory explains how companies can achieve and sustain a superior position compared to their competitors in the market. According to Porter (2008a), competitive advantage refers to a company's ability to deliver greater value to its customers than its competitors. This value may take the form of superior product or service features, more affordable pricing, or more satisfying after-sales service.

Porter's five forces theory

Porter's Five Forces Theory was developed by Michael Porter to analyze how companies can achieve competitive advantage within an industry by understanding five key forces that shape competition. According to Porter (2008b), the Five Forces model determines the competitive structure and the level of profitability within an industry. Two major factors that influence a firm's profitability are the industry structure and the firm's relative position within that industry. The more favorable the industry structure and the stronger the firm's position, the greater the potential for sustainable profitability. According to Porter (2008b) the five forces include the threat of new entrants, the threat of substitute products or services, the bargaining power of suppliers, the bargaining power of buyers, and the intensity of rivalry among existing competitors.

Resource-Based View (RBV) theory

The Resource-Based View (RBV), developed by Wernerfelt (1984), emphasizes the importance of a firm's internal resources and capabilities as the primary foundation for competition and performance. The RBV model highlights the significance of acquiring or developing resources and capabilities that are valuable and difficult or even impossible for competitors to imitate. According to the RBV, an organization's resources can be classified into three categories: physical resources, human resources, and organizational resources. Furthermore, Barney (1991) stated that resources must meet the VRIN criteria Valuable, Rare, Inimitable, and Non-substitutable in order to contribute to a firm's competitive advantage. In the context of business strategy, RBV serves as a crucial foundation for understanding how companies can implement cost leadership and differentiation strategies to achieve efficiency and innovation.

Firm profitability

Profitability refers to a company's ability to generate earnings by effectively utilizing its available resources. According to Kishore and Nandhini (2024) as well as Brigham et al. (2009), profitability reflects the outcome of managerial decisions and policies, making it a primary indicator of the effectiveness of business strategies implemented by the company. Kaplan and Norton (2001) through the Balanced Scorecard framework, emphasized that profitability reflects the successful execution of business strategies and can be measured using various financial ratios such as Net Profit Margin (NPM), Return on Assets (ROA), and Return on Equity (ROE). A high level of profitability provides companies with the flexibility to expand their markets, increase production capacity, and invest in research and development (R&D) to drive innovation. Conversely, low profitability requires companies to improve cost efficiency, reevaluate their business strategies, and prioritize projects with the most favorable financial impact. In this study, company profitability is measured using Return on Assets (ROA) and Net Profit Margin (NPM). ROA (net income after tax/total assets) reflects how effectively a company can generate profit from its total assets. A high Return on Assets (ROA) indicates that the company is effective in utilizing and managing its assets to generate profits. Conversely, a low ROA suggests that the company faces challenges in maximizing net income through the utilization of its existing assets. Meanwhile, NPM (net income after tax/sales) represents the company's capacity to generate net profit at a given level of sales. A high Net Profit Margin (NPM) reflects strong company performance in generating significant profits. Conversely, a low profit margin indicates a lack of ability to earn substantial profits (*Figure 1*).

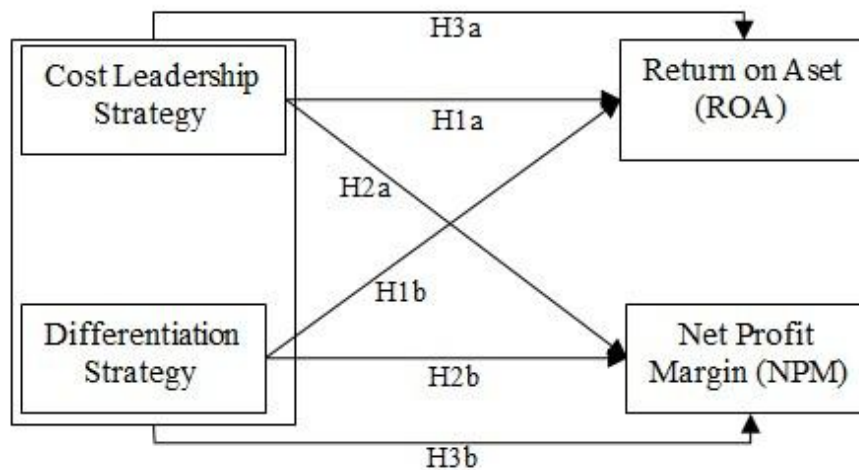


Figure 1. Hypothesis model.

Cost leadership strategy

Cost leadership strategy can be defined as a business approach that seeks to provide the best value to customers at a lower price than competitors while maintaining an acceptable level of quality (Mohamed et al., 2019). When a company is able to offer products or services with good quality standards at significantly lower costs than the industry average, it is said to have an advantage in terms of both cost and pricing (Suzan, 2021). Despite the intense competitive pressure, firms operating with low costs tend to generate returns above the industry average (Agashe and Khan, 2018). By focusing on controlling both fixed and variable costs, companies can optimize their asset utilization and enhance the return generated from each unit of asset. This is consistent with the findings of previous studies which revealed that implementing a cost leadership strategy significantly improves Return on Assets (ROA) through production efficiency and cost waste reduction (Jerab and Mabrouk, 2023; Kanju and Isanzu, 2023; Mbugua and Kinyua, 2022). Furthermore, this strategy allows firms to maximize profit per unit sold, thereby directly improving Net Profit Margin (NPM). Suryanto and Anggraini (2020) also found that, compared to differentiation strategy, cost leadership strategy exerts a greater influence on firm performance as measured by NPM. In this study, the Total Sales to Total Assets ratio is used to measure the cost leadership strategy, as it reflects how effectively a company utilizes its assets to generate sales. Moreover, this ratio indicates the company's ability to achieve high sales volumes without requiring substantial investment in assets, thereby ensuring efficient resource management. The higher this ratio, the more effective the company is in achieving high sales volume without significant investment in assets, reflecting cost control a key characteristic of the cost leadership strategy.

H1a: Cost leadership strategy has a significant effect on Return on Assets (ROA).

H1b: Cost leadership strategy has a significant effect on Net Profit Margin (NPM).

Differentiation strategy

Differentiation strategy refers to a business approach that emphasizes product superiority, innovation, and the introduction of new products to the market with the aim

of creating a unique value proposition compared to offerings by other firms (Sari and Nugraha, 2024). A company that adopts a differentiation strategy aims to foster customer loyalty by providing unique offerings, allowing the firm to charge premium prices as customers perceive greater value in the product or service (Zhang, 2025). In relation to Return on Assets (ROA), the differentiation strategy contributes positively by increasing net income through premium pricing on unique products. Higher net income with constant assets leads to improved ROA, as the firm maximizes returns per asset unit. Islami et al. (2020) found a significant positive impact of differentiation strategy on firm performance (ROA). Additionally, in terms of NPM, the strategy enhances profit margins by enabling higher selling prices relative to production costs. Research conducted by Suzan (2021) also confirmed a positive influence of differentiation strategy on firm performance (NPM). In this study, the differentiation strategy is measured using the Sales to Cost of Goods Sold (COGS) ratio, as this ratio reflects a company's ability to set higher prices relative to its production costs. A higher Sales/COGS ratio indicates that the company allocates more resources toward innovation and quality improvement; however, in return, it is also able to charge higher selling prices.

H2a: Differentiation strategy has a significant effect on Return on Assets (ROA).

H2b: Differentiation strategy has a significant effect on Net Profit Margin (NPM).

Cost leadership and differentiation strategies have fundamentally different focal points. However, according to the Five Forces theory, implementing a combination of both strategies allows firms to strengthen their bargaining power with customers and suppliers, reduce competitive threats, and raise entry barriers for new entrants, thereby securing their market position. Research by Acquaah and Yasai-Ardekani (2008) also indicated that combining cost leadership and differentiation strategies can enhance profitability and competitiveness in dynamic and competitive markets. Hendijani and Saeidi Saei (2024) further emphasized that companies that successfully integrate cost leadership and differentiation strategies are more likely to achieve sustainable competitive advantage. The combination of these strategies allows firms to leverage cost efficiency while creating unique product or service value, enabling broader market reach and increased profitability.

H3a: Cost leadership strategy and differentiation strategy simultaneously have a significant effect on Return on Assets (ROA).

H3b: Cost leadership strategy and differentiation strategy simultaneously have a significant effect on Net Profit Margin (NPM).

Materials and Methods

This study employs an explanatory research method with a quantitative approach. The population consists of 49 companies in the consumer goods sector, and the sample was selected using a purposive sampling technique based on several criteria, including the continuous publication of financial statements, financial reporting in Indonesian Rupiah, and the availability of data relevant to the research variables. After the selection process, 31 companies met the criteria and were included in the research sample. Data collection was conducted through documentation methods, using secondary data

obtained from the companies' annual financial reports available on the Indonesia Stock Exchange (IDX) and other relevant literature sources. Data processing was carried out using IBM SPSS Statistics 26 software. The data analysis techniques include descriptive analysis and linear regression analysis.

Results and Discussion

Before conducting hypothesis testing, classical assumption tests were first performed to ensure that the data met the requirements for regression analysis. The results of the classical assumption tests are presented in *Table 1*. Based on *Table 2*, the results of data processing and subsequent analysis are as follows: CLS has a positive and significant influence on ROA, with a regression coefficient value of 3.656 and a significant value of 0.004 (<0.05). This indicates that each one-unit increase in the cost leadership strategy leads to a 3.656 increase in ROA. CLS has a negative effect on NPM, with a regression coefficient of -0.965. However, the effect of the Cost Leadership Strategy (CLS) on the Net Profit Margin (NPM) was found to be not significant, with a significant value of 0.505>0.05. The Effect of Differentiation Strategy (DS) has a positive effect on Return on Assets (ROA), with a regression coefficient of 3.200 and a significant value of 0.020 (<0.05). This also means that each one-unit increase in the differentiation strategy will increase NPM by 5.608. DS also has a positive influence on NPM, with a regression coefficient of 5.608 and a significant value of 0.000 (<0.05). This indicates that each one-unit increase in the cost leadership strategy (CLS) will decrease ROA by 0.965. Cost Leadership Strategy and Differentiation Strategy simultaneously have a positive effect on ROA, as evidenced by an F-statistic of 10.001>F-table 3.07 and a significance value of 0.000 (<0.05). The regression coefficient for CLS, valued at 4.517, indicates that each one-unit increase in the cost leadership strategy will increase ROA by 4.517, while the coefficient for the differentiation strategy (DS), valued at 4.288, suggests that each one-unit increase in the differentiation strategy will increase ROA by 4.288. The results show that Cost Leadership Strategy and Differentiation Strategy simultaneously have a positive influence on NPM, supported by an F-statistic of 6.961>F-table 3.07 and a significance level of 0.001 (<0.05). The regression coefficient for CLS, valued at 0.197, suggests that each one-unit increase in the cost leadership strategy will increase NPM by 0.197, whereas the DS coefficient of 5.657 indicates that each one-unit increase in the differentiation strategy will increase NPM by 5.657.

Table 1. Classical assumption test results.

Classical assumption tests	ROA	NPM	Conclusion
Normality Test	Asymp. sig. 0.174>0.05	Asymp. sig. 0.064>0.05	The data are normally distributed
Multicollinearity Test	Tolerance: 0.0889>0.10 VIF: 1.125<10	Tolerance: 0.0889>0.10 VIF: 1.125<10	There is no indication of multicollinearity
Heteroscedasticity Test	CLS: Sig. 0.668>0.05 DS: Sig. 0.387>0.05	White test: C-square statistic (32.488) < C-square table (150.989)	There is no indication of heteroscedasticity
Autocorrelation Test	Du<DW<4-DU 1.739<1.942<2.260	Du<DW<4-DU 1.739<1.954<2.260	There is no autocorrelation

Table 2. Summary of data processing results.

Path	R ²	Regression equation	t-test	Sig.
Cost leadership Strategy on ROA	6.8%	ROA = 1.142 + 3.656 CLS	t-stat (2.978) > t-table (1.979)	0.004<0.05
Cost leadership Strategy on NPM	0.4%	NPM = 3.281 - 0.965 CLS	t-stat (-0.668) < t-	0.505>0.05

Differentiation strategy on ROA	4.4%	ROA = 0.667 + 3.200 DS	table (1.979) t-stat (2.350) > t-table (1.979)	0.020<0.05
Differentiation strategy on NPM	10.4%	ROA = 0.667 + 3.200 DS	t-stat (3.744) > t-table (1.979)	0.000<0.05
Cost leadership and Differentiation strategy on ROA	14.3%	ROA = -1.968 + 4.517 CLS + 4.288 DS	F stat (10.001) > F table (3.08)	0.000<0.05
Cost leadership and Differentiation strategy on NPM	10.4%	NPM = -1.053 + 0.197 CLS + 5.657 DS	F stat (6.961) > F table (3.08)	0.001<0.05

The influence of Cost Leadership Strategy (CLS) on Return on Assets (RoA)

Based on the analysis results, the Cost Leadership Strategy (CLS) has a significant influence on Return on Assets (ROA). This strategy emphasizes cost efficiency in both production and operational activities without compromising product quality. Such efficiency enables companies to offer more competitive prices, increase sales volume, and optimize asset utilization. Cost efficiency is often achieved through mechanisms such as bulk purchasing of raw materials, thereby enhancing overall profitability. These findings are consistent with the Competitive Advantage Theory proposed by Porter (2008a) which states that operational efficiency through reduced production and distribution costs can lead to increased net income. Additionally, the relevance of the Five Forces Theory is evident, as the cost leadership strategy reduces the threat of competition from rivals unable to match the low-price offerings. The consistency of this result is also supported by the study conducted by Suryanto and Anggraini (2020) which found a positive effect of cost leadership strategy on ROA.

The influence of Cost Leadership Strategy (CLS) on Net Profit Margin (NPM)

This study finds that the cost leadership strategy does not have a significant effect on Net Profit Margin (NPM). This result can be explained by the strategy's emphasis on increasing sales volume through lower selling prices, which leads to thinner profit margins per unit. Furthermore, fixed costs such as investments in automation and economies of scale limit the potential increase in NPM. These findings align with the Five Forces Theory, which highlights external challenges such as price competition and supplier bargaining power that constrain the cost efficiency potential in improving profit margins. This result is also consistent with the findings of Banker et al. (2014), which suggest that this strategy tends to enhance asset turnover rather than net profit margin.

The influence of Differentiation Strategy (DS) on Return on Assets (RoA)

The results of the study indicate that the differentiation strategy has a significant effect on Return on Assets (ROA). This strategy enables companies to offer unique and value-added products, allowing them to charge premium prices and increase revenue. The differentiation strategy can also help improve asset efficiency by enhancing sales turnover and customer loyalty. With higher revenue generated from existing assets, companies are able to improve their ROA. These findings are supported by the Competitive Advantage Theory and the Resource-Based View, both of which regard product differentiation as a unique resource that provides added value and competitive advantage. This result is also consistent with the study by Islami et al. (2020) which found a positive influence of differentiation strategy on ROA.

The influence of Differentiation Strategy (DS) on Net Profit Margin (NPM)

The results of the study show that the differentiation strategy has a significant effect on Net Profit Margin (NPM). Differentiated products offer added value perceived by consumers, enabling companies to raise prices without reducing demand. This leads to higher revenue and increased net profit. Moreover, although differentiation requires substantial investment in innovation and marketing, the ability to set higher prices offsets these costs, thereby improving profit margins. This finding aligns with the Competitive Advantage Theory, which emphasizes that differentiation enables firms to sustain premium pricing and enhance profitability. The study by Suzan (2021) also supports the significant influence of differentiation strategy on NPM.

The influence of Cost Leadership (CLS) and Differentiation Strategy (DS) on Return on Assets (RoA)

The results of the study indicate that cost leadership strategy and differentiation strategy simultaneously have a significant effect on Return on Assets (ROA). This strategic combination enables companies to enhance operational efficiency while simultaneously creating added value through unique products or services. Furthermore, it allows firms to reduce operational costs while generating higher revenues through premium pricing. Additionally, the optimization of existing assets facilitates faster asset turnover without requiring significant new investments, ultimately contributing to improved ROA. These findings are consistent with the Resource-Based View (RBV) theory, which posits that the effective management of internal resources enables firms to optimize efficiency and achieve sustainable competitive advantage. The Five Forces theory also supports this result, emphasizing how strategic combinations help firms mitigate pressure from competitors and customers. Studies by Hendijani and Saeidi Saei (2024) as well as Acquaah and Yasai-Ardekani (2008) likewise show that such a dual strategy positively impacts asset utilization efficiency and overall firm profitability.

The influence of Cost Leadership (CLS) and Differentiation Strategy (DS) on Net Profit Margin (NPM)

The results of the study indicate that cost leadership strategy and differentiation strategy simultaneously have a significant effect on Net Profit Margin (NPM). This combination enables companies to optimize cost efficiency while maintaining product value, creating a balance between operational efficiency and market appeal. Cost efficiency allows firms to offer products at competitive prices to increase sales volume, while product differentiation provides the opportunity to set premium prices that generate higher net profit margins. This strategic synergy balances cost reduction with revenue maximization, thereby driving improvements in NPM. These findings are supported by the Resource-Based View (RBV) theory, which posits that a combination of efficiency management and innovation creates a competitive advantage that is difficult for competitors to replicate. Additionally, the Five Forces Theory supports this conclusion by highlighting how companies can strengthen their bargaining power with suppliers and customers through the implementation of an effective hybrid strategy. Research by Hendijani and Saeidi Saei (2024) as well as Acquaah and Yasai-Ardekani (2008) reinforces the notion that combining these strategies enhances firm profitability by simultaneously achieving efficiency and added value.

Conclusion

This study reveals that the Cost Leadership Strategy (CLS) has a significant effect on the profitability of companies in the consumer goods industry, but only with respect to Return on Assets (ROA), and not on Net Profit Margin (NPM). This suggests that cost-efficiency strategies can improve returns through asset efficiency, but do not directly increase net profit margins. Differentiation Strategy (DS), on the other hand, has a significant impact on both ROA and NPM, indicating that product innovation and uniqueness not only enhance asset efficiency but also improve the firm's profit margins. Simultaneously, the combination of CLS and DS significantly influences profitability in terms of ROA and NPM, with differentiation strategy showing a more substantial impact than cost leadership. These findings emphasize the importance of integrating both approaches to enhance competitiveness and financial performance in a highly competitive industry. These findings suggest that a balanced approach between cost efficiency and product innovation can enhance competitiveness and corporate profitability. Future research can expand the scope of variables by including external factors such as market dynamics, changes in consumer preferences, and operational digitalization, which can affect the efficiency and effectiveness of business strategies. Applying more advanced analysis methods, such as Structural Equation Modeling (SEM) or a longitudinal approach, can provide deeper insights into the causal relationships between variables. Further research can also explore other industry sectors to examine the consistency of these findings across different business contexts.

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Conflict of interest

The authors confirm that there is no conflict of interest involve with any parties in this research study.

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