International Journal of Economics, Commerce and Management
United Kingdom Vol. V, Issue 7, July 2017
http://ijecm.co.uk/ ISSN 2348 0386

STRATEGIC INNOVATION AND PERFORMANCE OF COMMERCIAL BANKS

Patrick Mulinge
School of Business and Economics, Daystar University, Nairobi, Kenya

Joanes Kaleli Kyongo
School of Business and Economics, Daystar University, Nairobi, Kenya
jkyongo@daystar.ac.ke

Abstract

The study sought to establish the effect of strategic innovation on the performance of commercial banks in Kenya and the corresponding hypothesis was formulated and tested. The study targeted 150 employees of the Commercial Bank of Africa located at the head office in Nairobi, Kenya and 131 of them responded. The study adopted a descriptive research design. SPSS Version 21 was used to analyze data using simple linear regression analysis. Research findings from the test of hypothesis established that strategic innovation positively and significantly affected the performance of Commercial Bank of Africa. The study findings support the Blue Ocean Theory and Resource Based View Theory which explain the role of innovation and internal resources in organizational performance. The study contributes to knowledge by establishing that strategic innovation has a positive and significant effect on the performance of commercial banks.

Keywords: Strategic Innovation, Performance, Blue Ocean Theory, Resource Based View, Commercial Bank of Africa

INTRODUCTION

According to Gebauer, Worch and Truffer (2012), strategic innovation is the act of new markets to achieve value improvements for its customers, whereas organizational performance is a combination of financial and non-financial indicators which provide data on the amount of accomplishment of goals and objectives (Lebans & Euske, 2006). There is empirical evidence that strategic innovation contributes to bank performance (Wolff & Pett; 2004, Nyathira, 2009. However, most previous studies on linking strategic innovation to organizational performance have examined only one type of strategic innovation, operationalized organizational performance differently and carried out in other contexts.

Strategic Innovation

In today's perpetually evolving condition, for an organization to stay focused, it must innovate. Strategic innovation is aimed at attaining an advantage over other competitors through creation of customer value and new markets for the organization. According to Gebauer et al. (2012), strategic innovation can be isolated into two typologies, incremental and disruptive strategic innovation. In the incremental typology, there is value improvement on the existing customers and markets while disruptive typology is the creation of completely newly markets without competitors hence, this gives the organization a competitive advantage.

Historical studies on strategic innovation typologies have presumed a technological imperative which assumes that organizations usually plan innovation through Research and Development exercises and along these lines concentrate on product and process development (Gallouj & Weinstein, 1997; Miles, 2001). According to Damanpour, Walker, and Avellaneda, (2009) , for an organization to keep up and enhance their performance, they have to offer improved products and services and introduce innovation to the firm's product creation or its operation structures and managerial or organizational processes..

Organizational Performance

Organizational performance can be measured by return on investment (ROI), market share and market share growth, market share, sales, export proportions and growth rates in domestic and export sales growth, profitability, gross profit, revenue growth, stock price, sales growth, export growth, liquidity and operational efficiency and the Balanced Scorecard (Droge & Vickery, 1994; Sharma & Fisher, 1997; Anwar *et al*., 2012).

The current study has measured organization performance by return on equity, market share and profiability. The study adopted these measures because they are the ones commonly used to measure bank performance. This is according to Ogolla (2012) who argued that financial performance measures consist of return on assets, return on equity, profit and market share.

Commercial Banks in Kenya

Commercial banks in Kenya are licensed and regulated in accordance to provision of the Banking Act and regulations and prudential guidelines by the Central Bank of Kenya (CBK). According to CBK's annual report (2015), Kenyan financial sector had a total 42 Commercial banks among other financial institutions. According to CBK annual report (2015), the banking sector has been on steady growth path in terms of assets, deposits, profitability and in product offering, leveraging on diversification of alternative channels albeit the cut throat competition faced in the industry.

This decade and especially the last five years have witnessed a revolution in the banking industry. Not only have banks focused on banking the unbanked population, they have invested in technology, their employees, and processes (Kamau, 2009). Profitability arguably has increased across the banking industry. Although some of the banks have faced challenges in their operations leading to closure, others, especially the top tier banks, have thrived. The Central Bank of Kenya points out that performance of commercial banks has increased over the recent past (CBK, 2009).

The Commercial Bank of Africa (CBA) begun its operations in Tanzania in 1962 and has operated in the East African region for over 50 years. The bank belongs to tier one in classification according to asset base and it's the largest privately owned bank in Kenya. CBA currently has 29 branches spread among the large towns in Kenya. Regionally, CBA has presence in Tanzania with 14 branches and Uganda with 1 branch. In terms of capitalization, the bank is ranked number 6 with total assets of approximately 215 billion as at 31st December 2015 (CBK, 2015). CBA acknowledges the pivotal role played by technology in increasing operational efficiency hence, has continued to invest in evolving and cutting edge technology so that they can provide a seamless and stress free banking across all delivery channels (CBA, 2010).

CBA has also acknowledged and responded to the clients' needs to move banking from delivery of simple and well-designed financial services to offering 'couture' banking solutions (CBA, 2013). In line with its brand promise of 'time for more' for its customers, CBA has continued to invest in evolving technologies and has achieved significant milestones (CBA, 2013). The bank improved its delivery channels in 2012 to include other electronic channels such as mobile banking channels, online banking channels, ATMs and self-service options hence ensuring a complete set of electronic delivery channels for customers with more convenience. The bank's partnership with Safaricom also saw the mobile-centric banking service provided by CBA through Safaricom's M-Pesa platform grow gradually by the end of December 2013, CBA through Mshwari had acquired 5.6 million new clients (CBA , 2013).

Strategic Innovation and Organizational Performance

Most previous studies have concentrated on the innovation-performance connections which provide a positive affirmation that a higher creativity brings about expanded organization performance (Damanpour & Evan, 1984; Wu et al., 2003). A study by Miller (2001) found that majority of organizations employ technical improvement in order to gain an upper hand in their market. A comparative research by Wolff and Pett (2004) and Walker (2004) on the effect of product and process innovations on organizational performance showed that specific product changes are emphatically connected with organizational growth.

A study carried out by Aswani (2010) found out that strategic innovation and performance of state funded colleges were positively correlated. Accordingly, Kemoli (2010) on his review on key innovations and performance of listed commercial banks in Kenya established that banks have veered off from the current industry norms and were now occupied with coming up with new and noteworthy customer value proposition and they had embedded strategic innovation in their corporate strategy. Wachira (2013) on her study on the effect of technological innovation on the financial performance of commercial banks in Kenya found out that technology was a driving force on banks' performance and highlighted its intensity in driving the banks' profitability. The cited studies dwelt only on one type of strategic innovation and used different measures of bank performance. Thus, the hypothesis, **H_1:** Strategic innovation has significant effect on organizational performance.

METHODOLOGY

The study adopted a descriptive research design. Primary data was collected from 13` employees of Commercial Bank of Africa, Headquarters, and Nairobi whereas secondary data on bank's financial performance was extracted and computed from the bank's audited accounts for the years 2011-2015. A pre-test was done, and based on the pre-test results, the instrument was amended accordingly. Data was analyzed using SPSS version 21. A reliability test was performed using Cronbach Alpha. Table 1 presents the reliability test results.

Table 1: Reliability Test Results

Variable	No of Items	α=Alpha	Comment
Product Innovation	4	0.877	Reliable
Process Innovation	4	0.883	Reliable
Human Resource Innovation	5	0.702	Reliable
Technological Innovation	5	0.793	Reliable
Organization Performance	16	0.951	Reliable

Table 1 indicates that the coefficients for the study constructs were above the minimum acceptable level of 0.70 as suggested by Nunnaly and Bernstein (1994). This means that the data collected was reliable for analysis.

ANALYSIS AND FINDINGS

The study used both descriptive and inferential statistics to analyze the data. Simple linear regression was used to establish the nature and magnitude of the relationship between the independent and the dependent variable and to test the hypothesized relationship. The Beta value shows the amount of change in the dependent variable caused by the independent variable. The F statistic measures the goodness of fit of the model. The model used was: $Y= \beta_0 + \beta_1 X_1 + \epsilon$, where Y= bank performance; $\beta_{0=}$ Intercept; β1=Coefficients; X_1 =Strategic innovation and ϵ=Error term.

Response Rate

The number of questionnaires issued out was 150 and a total of 131 questionnaires were properly filled in and brought back as shown in Table 2.

Table 2: Response Rate

Response	Frequency	Percent
Returned	131	87.33%
Unreturned	19	12.67%
Total	**150**	**100%**

From Table 2, 131 respondents returned the questionnaire, a response rate of 87.33%. A response rate above 50% is described to be sufficient for a descriptive survey (Mugenda & Mugenda 2003).

Level of Education

The study sought to determine the highest level of education of the respondents. Table 3 shows the results of the analysis.

Table 3: Level of Education

	Frequency	Percent
Diploma	7	5
Graduate	73	56
Post Graduate	51	39
Total	**131**	**100**

From the results in Table 3, the respondents who had their highest level of education being graduates comprised of 56% of the total respondents, while those who had post-graduate qualifications comprised of 39% of the total respondents ; the rest of the respondents had their highest education level as diploma qualification which comprised of 6% of the respondents. The study required the respondents to understand the questions in the questionnaire and give valid answers. The results shows the complexity of banking industry in Kenya with most of their workforce possessing a first or second degree. Perhaps, this may be the reason as to why most banks have been recording good results.

Test of the Hypothesis

To determine the effect of strategic innovation on performance, a simple linear regression analysis was performed. Table 4 presents the results of the analysis.

Table 4: Effects of Strategic Innovation on the Performance of Commercial Bank of Africa

Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.975[a]	.951	.949	0.09366

ANOVA

Model	**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
Regression	21.3	4	5.325	607.061	.000
Residual	1.105	126	0.009		
Total	22.405	130			

Regression of Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.096	0.100		0.966	0.336
Product Innovation	0.133	0.020	0.163	6.625	0.000
Process Innovation	0.172	0.016	0.226	11.020	0.000
Human Resource Innovation	0.067	0.024	0.071	2.828	0.005
Technological Innovation	0.608	0.014	0.889	41.999	0.000

Predictor Variable: Strategic Innovation   Dependent Variable: Organizational Performance

Table 4 shows that R=0.975, meaning that there is a very high correlation between strategic innovation and performance. The coefficient of determination also known as the R square is 0.951. This means that strategic innovation explains 95.1% of the variation in bank performance. This means that only 4.9% is explained by other factors that are not part of this study. The Analysis of Variance shows that the independent variable is a good predictor of performance of the Commercial Bank of Africa. This was supported by an F statistic of 607.061 which was statistically significant ($p< 0.05$). The regression coefficients show the individual contribution of each type of strategic innovation on performance. For each one unit use in product innovation, process innovation, human resource innovation, and technological innovation, performance increased by 0.133 0.172 , 0.067 and 0.608 . The finding of this study is consistent with those of a study by Wolff and Pett (2004) and Walker (2004) who established that particular product improvements had a positive correlation with organizational performance.

CONCLUSION

The study aimed to determine the effect of strategic innovation on the performance of commercial banks with particular reference to the Commercial bank of Africa.. The study was conducted through a descriptive design. The study adopted both descriptive and inferential statistics to analyze the data. The study tested and confirmed the hypothesis that strategic innovation has a positive and significant effect on the performance of Commercial banks in Kenya. This implies that banks that embrace strategic innovation expect positive and significant effect on their performance.

REFERENCES

Anwar, M.R., Djakfar, L.D., & Abdulhafidha, A.K. (2012). Human resources performance and Competency of management by using a method of Balanced Scorecard. *International Journal of Civil & Environmental Engineering*, 12 (4).

Aswani, K. M. (2010). *Effects of marketing strategies on the performance of insurance companies in Kenya* (Doctoral Dissertation).

Damanpour, F., Walker, R. M., & Avellaneda, C. N. (2009). Combinative effects of innovation types and organizational performance: A longitudinal study of service organizations. *Journal of management studies*, *46*(4), 650-675.

Droge, C., Vickey, S., & Markland, R.E. (1994). Sources and outcomes of competitive advantage: an exploratory study in the furniture industry. *Decision Sciences*, *25* (5), 669-689.

Gallouj, F., & Weinstein, O. (1997). Innovation in services. *Research policy*, *26*(4-5), 537-556.

Gebauer, H., Worch, H., & Truffer, B. (2012). Absorptive capacity, learning processes and combinative capabilities as determinants of strategic innovation. *European Management Journal*, *30*(1), 57-73.

Kemoli, T. A. (2012). *Strategic Innovation and Performance of Commercial Banks Listed in the Nairobi Securities Exchange* (Doctoral Dissertation, University of Nairobi).

Lai, F., Hutchinson, J., Li, D., & Bai, C. (2007). An empirical assessment and application of SERVQUAL in mainland China's mobile communications industry. *International Journal of Quality & Reliability Management*, *24*(3), 244-262.

Lebans, M., & Euske, K. (2006). A conceptual and operational delineation of performance. *Business Performance Measurement*. Cambridge University Press, Cambridge

Mugenda O. & Mugenda, A. (2003). *Research Method: Quantitative and Qualitative* Approaches. Nairobi: Africa Centre for Technology Studies (ACTS). Nunnally, J.C., & Bernstein, I.H. (1994). *Psychometric Theory*. (2nd ed.). McGraw-Hill, New York.

Nyathira, N. C. (2012). *Financial innovation and its effect on financial performance of commercial banks in Kenya* (Doctoral Dissertation, University of Nairobi).

Ogolla, B. A. (2012). *Debt recovery as an operational strategy used by NIC bank to manage non-performing loans portfolio* (Doctoral Dissertation).

Sharma, B., & Fisher, T. (1997). Functional strategies and competitiveness; an empirical analysis using data from Australian Manufacturing. *Benchmarking for Quality Management and Technology*, 4 (42), 86-294.

Wachira, E. W. (2013). *The effect of technological innovation on the financial performance of commercial banks in Kenya* (Doctoral Dissertation, University of Nairobi).

Wolff, J. A., & Pett, T. L. (2004). Small-business internationalization: the relationship between firm resources and export competitive patterns in exporting. *International Journal of Management and Decision Making*, *5*(2-3), 246-262.