EFFECTS OF INNOVATION STRATEGIES ON PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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CITATION: Sumiyu, F. B. (2013), Effects of innovation strategies on performance of commercial banks in Kenya, *International Journal of Social Sciences and Entrepreneurship,* Vol.1, Issue 3, 1 (3), 198-207

ABSTRACT

Innovation involves acting on the creative ideas to make some specific and tangible difference in the domain in which the innovation occurs. Innovation is defined as the successful implementation of creative ideas within an organization. The objective of this paper was to establish the effects of innovation strategies on performance of conmmercial banks in Kenya. The study was guided by the following objectives which include: To determine how technological innovations affects performance of commercial banks in Kenya; To establish how product innovations affects performance of commercial banks in Kenya; To determine how market innovations affects performance of commercial banks in Kenya and To establish how process innovations affects performance of commercial banks in Kenya. From the study, the researcher concluded that the new market innovation strategies adopted by commercial banks were availability of resources and capabilities, creating and nurturing strong brands, aggressive anti-competitors marketing campaigns, creating value through pricing, environmental analysis and response to changes, customer satisfaction and retention**.** The study recommended that for commercial banks to successfully adopt the innovation strategies, it should ensure that the staff are well knowledgeable/trained on the necessary skills required to adopt these strategies, the firm should also set aside enough budget for the adoption of these strategies and also there should be performance evaluation in the firm so as to ensure its success in the firm.

Key Words: *Innovation, Innovation strategy, Profitability, Product, and Technology*

Introduction

The ability to innovate is increasingly viewed as the single most important factor in developing and sustaining competitive advantage (Tidd, 2001). It is no longer adequate to do things better; it's about "doing new and better things (Slater and Narver, 1995). Much emphasis has been placed on building innovative organizations and the management of the innovation process, as essential elements of organizational survival (Brown, 1997). Bessant and Francis (1999) suggest that effective innovation must involve all areas of an organization with the potential to affect every discipline and process (McAdam, 2000). Innovation can be transformational, radical or incremental depending on the effect and nature of the change. Afuah (1998) suggests that innovations do not have to be breakthroughs or paradigm shifting; however Kim and Mauborgne (1999) maintain that organizations should strive for the larger innovations. One way to achieve growth and sustain performance is to foster and encourage creativity and innovative practices internally within the organization. Naturally, there must be a commitment from senior management to facilitate this kind of innovative working environment. In many fields, something new must be substantially different to be innovative, not an insignificant change, e.g., in the arts, economics, business and government policy. In economics, the change must increase value, customer value, or producer value. The goal of innovation is positive change, to make someone or something better. Innovation leading to increased productivity is the fundamental source of increasing wealth in an economy.

Statement of the Problem

Strategic management in the telecommunication sector demand that organizations should have effective systems in place to counter unpredictable events that can sustain their operations and minimize the risks involved through innovations. Only those organisations that are able to adapt to the changing environment and adopt new ideas and ways of doing business that can be guaranteed hope of survival. Some of the forces of change that have greatly influenced the performance of organizations include mainly technological advancement.

The importance of having a clearly defined new innovation strategy guiding the innovation process was recognized by Griffin (1997) and Cooper et al. (2003). Innovation strategy provides a clear direction and focuses the effort of the entire organization on a common innovation goal. The innovation strategy needs to specify how the importance of innovation will be communicated to employees to achieve their buy-in and must explicitly reflect the importance that management places on innovation.

Many banks have at some point undertaken some form of incremental innovative initiatives. Some of these banks consider that the cumulative gains in efficiency are much greater over time than those, which come from occasional radical changes (Raymond, 1998). However, many of these short- and medium-term gains are quickly eroded and absorbed into the industry standard and therefore cannot be depended upon as a prerequisite for survival and growth. Banks innovation pioneer Ken Lewis (Lewis and Lytton, 1997) suggests that his company, practice both incremental and radical innovation. In this bank periods of incremental innovation are interspersed when necessary with radical and transformational change. Despite the competitive environment that the Barclays, National and banks are operating in, they have consistently experienced trajectory growth in terms of branch net work, number of customer, asset base and currently it is the most capitalized bank in the Kenyan banking sector. It is therefore expected that for these banks to thrive in this competitive environment they must have adopted Innovative strategies to respond and adapt to the changes and challenges in their operating environment.

Locally, Gitonga (2003) did a study on innovation processes and the perceived role of the CEO in the banking industry. Odhiambo (2008) carried out a research on the innovation strategies at the Standard Chartered Bank. None of these studies have ever focused on the effects of innovation strategies on performance of the entire banking industry in Kenya. This is despite the fact that the banking industry environment has been affected adversely by the changing operating environment calling for adoption of innovation strategies to enhance a competitive edge in the markets. There is therefore a research gap that needs to be filled by carrying out an investigation into the effects of innovations on performance of commercial banks. It is this light that the researcher seeks to fill the academic gap that exists by carrying out an investigation into the innovation and effects of innovation strategies on performance of commercial banks.

General Objective

The general objective of this study is to investigate the effects of innovation strategies on performance of commercial bank.

Specific Objectives

The specific objectives of this study were:

i. To determine how technological innovations affects performance of commercial banks in Kenya.
ii. To establish how product innovations affects performance of commercial banks in Kenya.
iii. To determine how market innovations affects performance of commercial banks in Kenya.
iv. To establish how process innovations affects performance of commercial banks in Kenya.

Literature Review

Product Innovations

It is important to delineate just what product features are to be improved or radically changed. For this purpose, analysts have differentiated between “core” product features and help provided in evaluating, buying and using the core product. The amount of help or support provided will depend on the needs of particular customers. An appropriate premium price can normally be charged for support. Support provides a potentially profitable lever for gaining competitive advantage. It enables a supplier to sell the same core product to different customer groups as different offerings (Storey and Easingwood, 1998).

(i) Existing Product Improvement/ Development

Product innovation provides the most obvious means for generating revenues. Process innovation, on the other hand, provides the means for safeguarding and improving quality and also for saving costs. Improved and radically changed products are regarded as particularly important for long-term business growth (Hart, 1996). The power of product innovation in helping companies retain and grow competitive position is indisputable. Products have to be updated and completely renewed for retaining strong market presence.
Different terminologies have been used to categorize and describe product development. Cooper *et al* (2002), for example, embraces two distinct activities: old product development, which involves updating and improving existing products, and new product development, which involves a greater degree of innovational challenge. Meyer (1996) similarly categorized product development into primary and secondary innovations.

(ii) New Product Development

Product portfolio decisions are the manifestation of a firm’s innovation and marketing strategies. The common approach to managing new product development is to develop and manage a portfolio of specific projects (Wheelwright and Clark 1992). Practically speaking, choosing the product portfolio determines the firm’s strategy for the medium term future and is senior management responsibility (Storey *et al*. 1998; Cooper *et al*. 2002). Operationally, portfolio decisions involve two strategic components: a development strategy regarding the number and rate of new product introductions (introduction intensity), and a market entry strategy regarding the relative speed to market (pioneering intensity). Past research suggests that better-managed firms structure their portfolios by striking a balance in the product innovation portfolio across these strategic components. However, past research has not systematically decomposed the components of portfolio strategy to examine how the components work together in relation to financial performance.

(iii) Product Differentiation

It is the ability to sell its differentiated product at a price that exceeds what was spent to create it that allows the firm to outperform its rivals and earn above-average returns. A product can be differentiated in various ways. Unusual features, responsive customer service, rapid product innovations and technological leadership, perceived prestige and status, different tastes, and engineering design and performance are examples of approaches to differentiation (Porter, 1980). Differentiation is aimed at the broad market that involves the creation of a product or services that is perceived throughout its industry as unique. The company or business unit may then charge a premium for its product. This specialty can be associated with design, brand image, technology, features, dealers, network, or customers' service. Differentiation is a viable strategy for earning above average returns in a specific business because the resulting brand loyalty lowers customers' sensitivity to price. Increased costs can usually be passed on to the buyers. Buyers' loyalty can also serve as an entry barrier; new firms must develop their own distinctive competence to differentiate their products in some way in order to compete successfully. Examples of the successful use of a differentiation strategy are Hero Honda, Asian Paints, HLL, Nike athletic shoes, Apple Computer, and Mercedes-Benz automobiles. Research does suggest that a differentiation strategy is more likely to generate higher profits than is a low cost strategy because differentiation creates a better entry barrier. A low-cost strategy is more likely, however, to generate increases in market share

Market Innovations

Market innovation is concerned with improving the mix of target markets and how chosen markets are best served (Kim and Mauborgne, 1999). Its purpose is to identify better (new) potential markets; and better (new) ways to serve target markets. Market segmentation, which involves dividing a total potential market into smaller more manageable parts, is critically important if the aim is to develop the profitability of a business to the full. Incomplete market segmentation will result in a less than optimal mix of target markets, meaning that revenues, which might have been earned, are misread (Slater and Narver, 1995).

The market in which an enterprise offers its products can be a predictor of the effects of innovative activities. Strengths and weaknesses of competitors, demands raised by consumers, legal regulations, as well as ecological, health and other standards, motivate enterprises to develop products taking into account the situation in a particular market. Enterprises often find themselves having to modify their products sold on the international market, not only to achieve outstanding business performance and competitive advantage, but also to enter the market in the first place and to remain in it. Accordingly, the market range can have an impact on the effects of innovative activities. It is to be expected that the more present an enterprise is in the international market, the more oriented its innovation activities are towards improving product quality, ecological and health aspects, as well as towards complying with legal standards and various regulations.

Process Innovations

Process innovation embraces quality function deployment and business process reengineering (Cumming, 1998). It is a type of innovation, which is not easy, but its purpose is now well understood. An efficient supplier who keeps working on productivity gains can expect, over time, to develop products that offer the same performance at a lower cost. Such cost reductions may, or may not, be passed on to customers in the form of lower prices. Process innovation is important in both the supply of the core product as well as in the support part of any offer. Both components of an offer require quality standards to be met and maintained. In the case of services, which by their very nature rely on personal interactions to achieve results, the management of process innovation is a particularly challenging activity (Johne and Storey, 1998). Implementing and developing the innovation process requires energy to overcome the resistance to change. Therefore, it is essential that visionary and committed leadership provide the energy to overcome this resistance. Leaders in an innovative role must be competent and knowledgeable about their work, and must also excel at inspiring employees (Higgins, 1995).

Research Methodology

The research problem was studied through the use of a descriptive research design. The main focus of this study was quantitative. However some qualitative approach was used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study. The target population of this study will be the staff working at commercial banks Headquarters. The study focused more on the section and particularly on the top, middle and lower level management staff who are directly dealing with the day to day management of the banks since they are the ones conversant with the effects of innovation strategies on performance of their respective banks. Sample of responding staff was drawn from 387 top, middle and lower level managers from the staff working at commercial banks. Stratified random sampling technique was used since population of interest was not homogeneous and could be subdivided into groups or strata to obtain a representative sample. The study collected both primary and secondary data for the purpose of analyzing the effects of innovation strategies on performance of commercial banks. Primary data was collected using a questionnaire while secondary data was obtained from annual reports of the company.

Findings of the study and Discussions

Market Innovation Strategies

The researcher used the mean scores to present this information for easier interpretations. Using the response scale of 1-5, the researcher found that all these strategies were most frequently used by the organization as shown by high mean scores ranging from 4.6-4.9, with availability of resources and capabilities having the highest mean of 4.9. Creating value through pricing, creating and nurturing strong brands and aggressive anti-competitors marketing campaigns had a mean score of 4.7, customer satisfaction and retention had a score of 4.6 and environmental analysis and response to changes had a mean score of 4.5.

Most of the respondents were of the view that product innovation strategies had most impact on earning more profit for the banks. This was shown by a high mean score of 5. Innovation strategies also had most impact on faster business growth as shown by a mean score of 4.8; they helped the company to invest more and also in improving the productivity as shown by a mean score of 4.5.

Process Innovation

Most respondents reported that it was used more to get more customers as shown by a mean score of 4.8, to get more profit as shown by 4.3 and also to get better personnel shown by a mean score of 3.8. Process innovation strategies were moderately used to send business rivals out of business as shown by a mean score of 3.2.

The technological factors that mostly affected the adoption of innovative strategies by the banks were complexity and cost as shown by a mean score of 4.8 in each case, relative advantage as indicated by a mean score of 4.7 and image as shown by a mean score of 4.6. Compatibility also affected the adoption of the innovative strategies more as shown by a mean score of 4.3.

Technology Innovation

The general factors that have mostly affected the adoption of innovative strategies by the banks were high cost or too expensive projects as indicated by a mean score of 4.8 and lack of financial resources as shown by a mean score of 4.5. The other factors that affected the adoption of the innovative strategies more were; network problems/unreliable infrastructure and lack of skills and innovativeness shown by a mean score of 4.3 in each case, and lack of awareness and knowledgeable of innovative strategies as shown by a mean score of 4.2. No need for innovativeness had affected the adoption of innovative strategies to a less extent as shown by a low mean score of 1.8.

Regression Analysis

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
Market Performance	0.097	0.009	0.003	0.718
Product development	0.257	0.066	0.060	0.697
Customer satisfaction	0.365	0.085	0.076	0.564
competitive advantage	0.140	0.020	0.013	0.714

Source: Researcher, 2013

The above table presents the correlation and the coefficient of determination between profitability (dependent variable) and the independent variables (market performance, product development, customer satisfaction and competitive advantage). From the findings, the study found that there was a positive but weak relationship between the dependent variable and the independent variables.

Of all the four independent variables, customer satisfaction had the highest relationship with the bank's profitability of 0.365 followed by product development with 0.257. Market performance had the weakest relationship with the bank's profitability of 0.097, while competitive advantage came third with a correlation value of 0.140.
As aforementioned, of all four effects of innovation strategies, customer satisfaction had the highest coefficient of determination (strength of relationship between customer satisfaction and the bank's profitability) of 0.085 while product, competitive advantage and market performance had the value of 0.066, 0.020 and 0.009 respectively.

Table 4.1: Coefficient of Determination (R^2)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.742(a)	.194	.172	.46316

Source: Researcher, 2010
Predictors: (Constant), customer satisfaction, market performance, product development, competitive advantage
The four independent variables that were studied, explain only 19.4% of the bank's profitability as represented by the R^2. This therefore means the four independent variables only contribute about 19.4% to the bank's profit while other factors not studied in this research contributes 80.6% of the bank's profitability.
Therefore, further research should be conducted to investigate the other factors (80.6%) that contribute to the bank's profitability.

Table 4.2: Multiple Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.334	.311		4.285	.000
	Market performance	-.144	.164	-.193	-.876	.387
	Product development	0.0196	0.0481	0.0327	0.4069	0.6846
	Customer satisfaction	0.1981	0.0714	0.2325	2.7736	0.0062
	Competitive advantage	0.0288	0.0501	0.0484	0.5759	0.5655

Source: Researcher, 2010

Dependent Variable: innovation strategies employed by the bank leads to greater profitability.

The researcher conducted a multiple regression analysis so as to determine the relationship between the bank's profitability and the effects of innovation strategies. The regression equation ($Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4$) was:

$Y = 1.334 +-0.144\ X1 +0.0196X2 + 0.1981X3+ 0.0288\beta 4X4$

Whereby Y = bank's profitability

X1 = product development

X2 = market performance

X3 = customer satisfaction

X4 = competitive advantage

According to the regression equation established, taking all factors (customer satisfaction, market performance, product development, competitive advantage) constant at zero, the profitability of the bank as a result of innovation strategies will be 1.334. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in market performance will lead to a -0.144 decrease in profitability. This could be possible in the short run because market performance does not contribute directly and immediately to profitability. Market performance was identified as more of a cost in the short run because it involves trying to understand and interpret the factors in the operating environment and how the same impacts on the bank's performance. The full benefits of market performance would more often than not be realized in the long-term as compared to the other three independent variables studied. A unit increase in product development will lead to a 0.0196 increase in profitability; a unit increase in customer satisfaction will lead to a 0.1981increase in profitability while a unit increase in competitive advantage will lead to a 0.0288 increase in profitability. This infers that customer satisfaction contributed more to the profitability of the bank followed by product development.

Conclusions

From the study, the researcher concluded that the new market innovation strategies adopted by commercial banks were availability of resources and capabilities, creating and nurturing strong brands, aggressive anti-competitors marketing campaigns, creating value through pricing, environmental analysis and response to changes, customer satisfaction and retention**.**

The study also established that commercial banks adopted product innovation strategies which helped the banks to earn more profit, there was faster business growth, to invest more and also in improving the firm's productivity.

The study also concluded that the process innovation strategies adopted by the banks were philosophy (way of doing things), vision, performance evaluation, shared commitment by everyone in the organization and Clear Communication & Communications channels.

The researcher also concluded that the technological factors that affected the adoption of innovative strategies in the commercial banks were complexity, cost, relative advantage, image and compatibility.

Recommendations

From the findings and conclusions in this chapter, the study recommended that for all the commercial banks to earn more profit, increase number of customers, for their business to grow further and also for them to invest more they should embrace the adoption of the innovative strategies.

The study also recommended that for commercial banks to successfully adopt the innovation strategies, it should ensure that the staff are well knowledgeable/trained on the necessary skills required to adopt these strategies, the firm should also set aside enough budget for the adoption of these strategies and also there should be performance evaluation in the firm so as to ensure its success in the firm.

As also found in the earlier studies, the study also recommends that innovation strategies should have a major objective of developing strategies aimed at increasing profitability of the bank. The basis for innovation strategies revolve around decisions made by managers about the positioning of a business to maximize the value of the capabilities that distinguish it from its competitors. Failure to collect, analyze and act upon innovative information in an organized manner can lead to deterioration of the firm's profitability and ultimately the failure of the firm itself.

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