Product Innovation as a Predictor of Organizational Performance among Micro Finance Banks in Mombasa County, Kenya

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Abstract: The microfinance industry in Kenya is rapidly expanding and has established itself as an important subsector of the official financial market. The performance of microfinance banks, however, has declined, according to the Central Bank of Kenya study. The purpose of this paper was to determine how product innovation influences microfinance bank performance in Mombasa County, Kenya. The explanatory research design was utilized. Thirteen microfinance banks in Mombasa County were the study's target population. Five managers from each organization's sales, finance, planning, logistics, and information technology departments were the target respondents. Primary data was collected using structured questionnaires. Descriptive and inferential statistics were used to analyze the data. Findings revealed that product innovation had a positive and significant influence on microfinance bank performance (β = 0.647, p<0.05). The study concluded that product innovation significantly contributes towards the performance of microfinance banks. The recommendations were that microfinance banks’ management should review policies relating to product innovation. In particular, the following aspects of product innovation should be strengthened: diversification, quality improvement and technical specification.

Keywords: Product innovation, organization performance, Microfinance banks

1. INTRODUCTION

Microfinance is a way of improving the poor's potential, which is often disregarded by commercial banks and other lending institutions, and leads to long-term entrepreneurial activity through providing financial services such as loans, deposits, and insurance (Anand & Kanwal, 2011). Microfinance is related to services that help clients in developed countries who are facing severe financial difficulties. Microfinance has combined with micro-loans over the years, often without conventional collateral, to better the lives of consumers and their families or to fund small businesses (Addisalem, 2015). Microfinance industry has shown tremendous development and has become a critical part of formal financial market. Nonetheless, micro finance firms have been experiencing poor performance in terms of profitability (Central Bank of Kenya [CBK], 2018). This is a risky trend that could negatively impact on stakeholders’ returns.

For businesses to achieve long-term competitive advantage and financial performance, strategic innovation is needed (Nybakk & Jenssen, 2012). Innovation in strategy is seen as the ability to provide organizational guidance by explaining the path of business activity, concentrating efforts by promoting teamwork, facilitating organizational understanding, and reducing complexity and inconsistency (Mintzberg et al., 2011). It is believed that in a service sector such as the financial sector, where competition can increase rapidly and new entrants can easily join in, it requires sustained strategic thinking about what is happening (Schmenner, 2013).

China has developed a strategic innovation plan to address emerging economic and social challenges (Fabre & Grumbach, 2012). With a 19.8% share of global production in 2010, China surpassed the United States as the world's largest producer, ending 110 years as the world's largest and largest producer of goods (Chandra, 2012). Since joining the World Trade Organization (WTO) in 2001, China's Golden Age (2002-2007) was fueled primarily by investments in property, production and equipment, and exports, with average annual growth rates of 29 and 24 percent, respectively. The rise
of China's manufacturing industry is tied to the acceptance of strategic advancements, particularly the broad adoption of modern technologies.

In Nigeria, innovation is a key factor in expanding medical care in the country (Ukiri, 2013). Innovation is essential for the expansion of health insurance and pursuing comprehensive health care in the country. With a population of around 170 million people, there is an urgent need to move forward and consider the various elements to address the problem and the plausible reasons for the country's wide and diverse market fragment.

At the local level, banking institutions work in a tightly controlled space that requires a certain level of consistency in disclosing sensitive information. In order to achieve and manage organizational results, these organizations need to acquire adaptive skills in the face of constant change, fierce competition, demographic changes, and changing consumer needs (Central Bank of Kenya [CBK], 2013). With this in mind, these organizations understand that following a conventional approach leads to conventional results. These companies have introduced innovative business models that not only offer added value to consumers, but also give them a bonus to achieve strategic competitiveness in the new competitive climate (Lilly & Juma, 2014).

2. STATEMENT OF THE PROBLEM

In numerous countries, microfinance has grown exponentially, and it is now a significant part of the official financial system (Assefa, Hermes & Meesters, 2010). The legitimacy of the micro banking system necessitates a diverse set of industries. Poor performance affects the ability of microfinance banks to withstand negative shocks, which affects their solvency (Yenesew, 2014). Despite the growth of microfinance banks in Kenya, the CBK report (2018) states that the company has suffered a financial loss from Ksh. 1.2 billion in fiscal 2018. This is a drastic decrease in profit in the previous year of Ksh. 2.3 billion. There are clear indications that the company is facing serious productivity problems.

Past studies have been carried out on product innovation and organization performance. However, these studies present various research gaps. Some of the studies (Akpoviroro, Amos & Oladipo, 2019; Macharia & Tirimba, 2018; Orji, Andah, Chima & Abba, 2017) indicate contextual gaps because they were done in other locations. Other studies (Chemitei & Mukatia, 2019; Granja & Moreira, 2019) reveal conceptual gaps since they focused on different concepts from the current study. In addition, studies such as (Chemitei & Mukatia, 2019; El Chaarani & El Abiad, 2018) present methodological gaps given that they used different research methods from the ones adopted by the current study. Against the background of the above research gaps, this paper aimed to examine how product innovation affects microfinance banks performance in Mombasa County, Kenya.

3. LITERATURE REVIEW

3.1. Diffusions of Innovations Theory

This theory was developed by Rodgers (1962) to describe how an idea or product gains traction and spreads through time to a population or social structure. In addition, theory forms the basis for recognizing and embracing innovation. The process begins with innovation (an idea, practice, or object that potential users perceive as new and should be seen as desirable for adaptation). The characteristics of innovation help explain different levels of perceptions about innovation. These characteristics lead to innovations being introduced at different levels (Rogers, 2003).

Berlyne (1962) argues that the presence of innovation is seen as an uncertainty in the minds of prospective adoptive parents. In this situation, the lack of predictability and data is accompanied by uncertainty. Diffusion between interacting social network participants is described by Rodgers (1995) as a method of exchanging data based on uncertainty minimization requirement. Uncertainty can be described as the extent to which a set of decisions about the occurrence of a specific event, as well as the relative likelihood of each of those decisions, are taken into account. Those involved in innovation are encouraged to look for data to reduce this uncertainty (Rogers, 1995).

The theory acknowledges the processing and sharing of knowledge through communication networks in order to achieve a common understanding of creativity. To put it another way, individual adopters must have expertise and experience, which can be shared or passed on to others (Dearing & Cox,
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2018; Zhang, Yu, Yan & Spil, 2015). Therefore, based on the principles of the theory, it is relatively significant and viable in the current study since it has been found to strongly link the tenets of coming up with new ideas, products and processes. These innovations are therefore disseminated to other individuals and this makes the innovation popular. In this paper, the theory underpins the product innovation variable.

3.2. Balanced Scorecard Model

Kaplan and Norton (1992) balanced scoring theory arose from a recognized need to measure success beyond degrees. If you focus only on financial results, companies won't have the information they need to thrive in today’s environment. Financial results show past results, but do not indicate the current status or possible future location of the organization. In addition, a balanced scorecard provides a framework and language that individuals can use to describe their strategies in a consistent and reliable manner (Thakkar et al., 2007). The balanced card theory's ultimate aim is to quantify the factors that drive a company's valuation and directly affect its performance.

There are four perspectives related to balance sheets: financial, customer, internal, and educational (Kaplan & Norton, 1992). Goals from a financial standpoint should serve as the focal point for all other goals. They reflect the predicted final financial result for a balanced scorecard. Some of the measures include ROI, profitability, sales growth, sales, and cash flow. From a customer point of view, the company identifies the customers and market segments in which the company decides to compete. Market share, customer engagement, customer acquisition, and customer retention are the most important metrics to monitor (Al Sawalqa, Holloway & Alam, 2011).

The internal viewpoint reflects on the processes that are most relevant to achieving consumer and shareholder goals within the company. In this context, evaluation is based on creativity, processes, and customer support. The learning perspective focuses on defining goals and metrics to promote learning in a business. Employee abilities, information systems, motivation, empowerment, and order are all discussed from a particular viewpoint (Ahmed et al., 2011).

The Balanced Scorecard theory applies to this study as it provides managers with the tools necessary to turn their strategy into a scorecard communicate with them throughout the company, measure progress towards specific goals and inform key people about the status of the scorecard and identify the root cause of the problem. This research considers market share, profitability, efficiency, and customer happiness as indicators of organizational success. All of these measurements fall under one of Balanced Map Theory's four perspectives. The theory advances the dependent variable in this paper, which is organization performance.

3.3. Empirical Review

In Nakuru, Kenya, Chemitei and Mukatia (2019) investigated the impact of product innovation on the viability of microfinance organizations. A formal questionnaire was used to interview 30 industrial managers of microfinance institutions for this report, which used descriptive research techniques. Product innovation had a substantial direct impact on the viability of the firms, according to the report. Individual managers of specific microfinance companies should use ingenuity and innovation to develop unique practices to ensure they are still one step ahead of the pack, resulting in increased profitability, according to this report. However, the study was based in Nakuru where the findings may not apply to Mombasa County as it is the case in the current study. The study thus presents a contextual gap.

Macharia and Tirimba (2018) evaluated the effect of product innovation factors on SACCO deposit financial results. As predictors of product developments, this study looks at the store network, product selection, product position, and product prices. The study found that store chains, product reach, product position, and product prices had a strong direct relationship with the financial results of these deposits using a descriptive research design for SACCO with 30 deposits in Nairobi City County (2013-2017). However, the study suggests a contextual gap as the focus was on savings in Nairobi.

Granja and Moreira (2019) seek to build a link between product innovation and disruption in the credit market. This is supported by barcode data from micro-consumer products that are used to provide new evidence that credit market failures have had a significant effect on the speed, novelty
and effectiveness of product innovation during the recent financial crisis. This study acknowledges that disruptions in the credit market do not affect the speed at which new products are introduced to the company's existing product lines, but limit their expansion into new product lines. It is also emphasized that products entered into a new category by a credit-constrained company during the financial crisis generated less revenue than products entered into a new category by the same firm during normal times. However, despite the findings, the study presents a conceptual gap since its focus is on market disruptions and failed to explain the impact product innovation has on financial performance.

Orji, Andah, Chima and Abba (2017) assessed the impact of new products on the profitability of Nigerian custodians. This study uses primary and secondary data. The results show that there is a relationship between new product creation and fiduciary profitability in Nigeria. Therefore, it can be concluded that inadequate knowledge about the benefits of new product innovation causes a low profit maximization rate in the bank. The results, however, have been criticized because of the low response rates, which decreases the generality of the findings for the entire Nigerian banking population.

3.4. Conceptual Framework

The diagram predicts the relationship between the research constructs as shown in Figure 1.

3.5. Research Methodology

The explanatory research design was utilized. The research design chosen in this study has been widely used in past similar research studies (Oketch, Kilika & Kinyua, 2020; Mugambi & Kinyua, 2020; King’oo, Kimencu & Kinyua, 2020; Gatuyu & Kinyua, 2020; Kiprono & Kinyua, 2021; Ojiambo & Kinyua, 2022). Thirteen microfinance banks in Mombasa County were the study's target population. Five managers from each organization's sales, finance, planning, logistics, and information technology departments were the target respondents. As a result, 65 managers were targeted. A census of all microfinance institutions was conducted. Primary data was collected using structured questionnaires. Descriptive and inferential statistics were used to analyze the data.

5. Results and Discussion

5.1. Descriptive Analysis

This section presents descriptive statistics findings on product innovation and organization performance.

5.2. Product Innovation

Research participants were asked to respond to questions on measurable aspects of product innovation. The results of the analysis of responses gathered are presented in Table 1.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
<th>Mean</th>
<th>Std. dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is product diversification in our organization.</td>
<td>1.9%</td>
<td>11.3%</td>
<td>5.7%</td>
<td>49.1%</td>
<td>32.1%</td>
<td>3.98</td>
<td>1.01</td>
</tr>
<tr>
<td>We are involved in improving the quality of our products.</td>
<td>1.9%</td>
<td>11.3%</td>
<td>11.3%</td>
<td>47.2%</td>
<td>28.3%</td>
<td>3.89</td>
<td>1.01</td>
</tr>
</tbody>
</table>
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Through enhanced technical specification, our organization has been able to achieve product innovation.  

Through enhanced technical specification, our organization has been able to achieve product innovation.  

We’ve put a lot of money into product research and development.  

Management meets on a frequent basis to explore ways to improve products.  

Aggregate score

<table>
<thead>
<tr>
<th>Statement (N=53)</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>M</th>
<th>Std. dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>As a result of strategic innovation, our company’s market share has grown.</td>
<td>3.8%</td>
<td>11.3%</td>
<td>5.7%</td>
<td>39.6%</td>
<td>39.6%</td>
<td>4.00</td>
<td>1.13</td>
</tr>
<tr>
<td>Our company’s profitability has increased as a result of strategic innovation.</td>
<td>3.8%</td>
<td>5.7%</td>
<td>3.8%</td>
<td>28.3%</td>
<td>58.5%</td>
<td>4.32</td>
<td>1.05</td>
</tr>
<tr>
<td>Our organization’s efficiency has improved due to strategic innovation.</td>
<td>3.8%</td>
<td>13.2%</td>
<td>0.0%</td>
<td>30.2%</td>
<td>52.8%</td>
<td>4.15</td>
<td>1.18</td>
</tr>
<tr>
<td>Strategic innovation has led to increased customer satisfaction.</td>
<td>1.9%</td>
<td>9.4%</td>
<td>3.8%</td>
<td>32.1%</td>
<td>52.8%</td>
<td>4.25</td>
<td>1.04</td>
</tr>
<tr>
<td>Our organization’s effectiveness has improved due to strategic innovation.</td>
<td>3.8%</td>
<td>9.4%</td>
<td>3.8%</td>
<td>30.2%</td>
<td>52.8%</td>
<td>4.19</td>
<td>1.13</td>
</tr>
<tr>
<td>Aggregate score</td>
<td>4.18</td>
<td>1.11</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Data (2021)

As indicated in Table 2, the respondents agreed that the organization has product diversification (M=3.98), that they are involved in improving product quality (M=3.89), that the organization has been able to achieve product innovation (M=4.08), that the organization has heavily invested in product research and development (M=4.06), and that the management meets regularly to discuss how to improve products (M=4.19). The findings suggested that the respondents acknowledged the significance of product innovation and that their institutions had embraced product innovation.

5.3. Organizational Performance

Research participants were asked to respond to questions on measurable aspects of organizational performance. The results of the analysis of responses gathered are presented in Table 2.

Table 2. Descriptive statistics on Organizational Performance

6. Inferential Statistics

This section presents correlation and regression analysis findings on the relationship between product innovation and organization performance.

6.1. Correlation Analysis

The correlation analysis was done to determine the connection between product innovation and organization performance. Results are shown in Table 3.

Table 3. Correlation Results

<table>
<thead>
<tr>
<th>Performance</th>
<th>Pearson Correlation</th>
<th>Sig. (2-tailed)</th>
<th>Product innovation</th>
<th>Pearson Correlation</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Correlation is significant at the 0.01 level (2-tailed).</strong></td>
<td>.647**</td>
<td>.000</td>
<td>1.000</td>
<td>.000</td>
<td>.000</td>
</tr>
</tbody>
</table>

Source: Field Data (2021)
Table 3 reveals that product innovation exhibited a positive and significant relationship with microfinance bank performance \((r = 0.647, P = 0.000)\) at the 5% level of significance. This meant that as product innovation increased, so will microfinance bank performance. Orji, Andah, Chima, and Abba (2017) discovered a correlation between new product invention and business profitability.

### 6.2. Regression Analysis

Regression analysis was conducted to determine the effect of product innovation on microfinance bank performance. The model summary, ANOVA and regression coefficients results are shown in Table 4, 5 and 6 respectively.

**Table 4. Model summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>(R)</th>
<th>(R^2)</th>
<th>Adjusted (R^2)</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.647 (a)</td>
<td>0.418</td>
<td>0.407</td>
<td>0.5346463</td>
</tr>
</tbody>
</table>

\(a.\) Predictors: (Constant), Product Innovation

**Source:** Field Data (2021)

The adjusted \(R^2\) of 0.407 is reported in Table 4 (model summary). This meant that product innovation would account for 40.7 percent of changes in microfinance bank performance when taken together.

**Table 5. Analysis of Variance**

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>10.483</td>
<td>1</td>
<td>10.483</td>
<td>36.673</td>
<td>0.000 (b)</td>
</tr>
<tr>
<td>Residual</td>
<td>14.578</td>
<td>51</td>
<td>0.286</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>25.061</td>
<td>52</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(a.\) Dependent Variable: Organizational Performance

**Source:** Field Data (2021)

Table 5 shows that the F statistic is 36.673 and the \(P\) value is 0.000. The proposed model was statistically significant (excellent fit) in predicting the dependent variable because the \(P\) value was smaller than the conventional value (0.05). This implied that product innovation is a significant predictor of organization performance.

**Table 6. Regression Coefficients**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>0.276</td>
</tr>
<tr>
<td></td>
<td>Product innovation</td>
<td>0.967</td>
</tr>
</tbody>
</table>

\(a.\) Dependent Variable: Organizational Performance

**Source:** Field Data (2021)

The output of regression coefficients aided in estimation of the statistical equation (i) presented below.

**Performance of Microfinance banks = 0.647 Product innovation**

According to the regression results in Table 6, product innovation has a positive and substantial impact on microfinance bank performance \((\beta = 0.647, P<0.05)\). Microfinance banks' performance would improve by 0.647 units if product innovation increased by one unit, according to the research. The study outcomes were consistent with those of Chemitei and Mukatia (2019) who found out that product innovation had a substantial positive impact on the viability of microfinance institutions. Similar, the findings concurred with Macharia and Tirimba (2018) assertion that product reach, product position, and product prices had a strong direct relationship with the financial performance. Furthermore, the findings were consistent with those of Orji et al. (2017), who discovered a link between new product development and business profitability.
7. **CONCLUSION**

The study concludes that product innovation had a major impact on microfinance bank success. The study also discovered that market innovation has a favorable and significant impact on microfinance bank performance. As a result, the conclusion was that market innovation has a major impact on microfinance bank success.

8. **RECOMMENDATIONS**

The microfinance banks’ management should review policies relating to product innovation. In particular, the following aspects of product innovation should be strengthened: diversification, quality improvement and technical specification.

**REFERENCES**


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