

**INFLUENCE OF FINANCIAL INNOVATION ON PROFITABILITY OF
COMMERCIAL BANKS IN KENYA**

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DECLARATION

This thesis is my original work and has not been presented for a degree award in any other university.

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DEDICATION

To my God and saviour Jesus Christ who is ever faithful restoring me beyond measure and to my wife Subira Kubasu.

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TABLE OF CONTENTS

DECLARATION	ii
DEDICATION	iii
ACKNOWLEDGEMENT	iv
LIST OF TABLES	xi
LIST OF FIGURES	xiii
ACRONYMS AND ABBREVIATIONS.....	xiv
DEFINITION OF TERMS.....	xv
ABSTRACT	xvii
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background to the Study	1
1.1.1 The Global Perspective of Financial Innovation and Profitability	2
1.1.2 The Regional Perspective of Financial Innovation and Profitability	4
1.1.3 The Local Perspective of Financial Innovation and Profitability	6
1.1.4 Profile of Commercial Banks	7
1.2 Statement of the Problem	7
1.3 Objective of the Study	8
1.3.1 General Objective	8
1.3.2 Specific Objectives	8
1.4 Research Hypotheses	9
1.5 Significance of the Study	9
1.6 The Scope of Study	10
1.7 Limitations of the Study	10

CHAPTER TWO	10
LITERATURE REVIEW	12
2.1 Introduction.....	12
2.2 Theoretical Framework.....	12
2.2.1 Transaction Cost Theory	12
2.2.2 Abernathy and Utterback Model	13
2.2.3 Diffusion Theory of Innovation.....	14
2.2.4 Financial Intermediation Theory.....	14
2.3 Conceptual Framework	15
2.4 Review of Variables	16
2.4.1 Financial Product Innovation and Profitability	17
2.4.2 Financial Process Innovation and Profitability	18
2.4.3 Financial Marketing Innovation and Profitability	19
2.4.4 Organizational Innovation and Profitability	20
2.4.5 Measuring Profitability.....	20
2.5 Empirical Review	21
2.6 Critique of Existing Literature.....	22
2.7 Research Gap.....	23
2.8 Summary	24
CHAPTER THREE	25
RESEARCH METHODOLOGY	25
3.1 Introduction.....	25
3.2 Research Design.....	25
3.3 Target Population.....	25

3.4 Sampling Frame.....	26
3.5 Sample and Sampling Technique.....	26
3.5.1 Sampling Technique	26
3.5.2 Sample Size.....	27
3.6 Data Collection Instruments	28
3.7 Data Collection Procedure	28
3.8 Pilot Testing.....	29
3.8.1 Reliability of Research Instrument.....	29
3.8.2 Validity of Research Instrument	29
3.9 Data Analysis and Presentation	30
3.10 Diagnostic Tests	30
3.10.1 Measures of Normality	30
3.10.2 Multicollinearity	31
3.10.3 Auto Correlation.....	31
3.10.4 Linearity Test	31
3.10.5: Heteroscedasticity Test.....	31
3.11 Variable Operationalization and Measurement	32
3.12 Hypothesis Testing.....	33
3.13 Ethical Considerations.....	33
CHAPTER FOUR.....	35
RESEARCH FINDINGS AND DISCUSSION	35
4.1 Introduction.....	35
4.2 Response Rate	35
4.3 Pilot Test	36

4.3.1 Reliability Test of the Research Instrument.....	36
4.3.2 Validity Test of the Research Instruments.....	37
4.4 Diagnostic Tests.....	38
4.4.1 Normality Test.....	38
4.4.2 Autocorrelation Test	38
4.4.3 Multicollinearity Test.....	39
4.4.4 Linearity Test	40
4.4.5: Heteroscedasticity test.....	43
4.5: Demographic Results.....	44
4.5.1 Level of Education.....	44
4.5.2: Duration of Experience.....	45
4.6 Descriptive Statistics	46
4.6.1 Descriptive Results from Secondary Data	46
4.7 Descriptive Results from Primary Data	47
4.7.1 Influence of Financial Product Innovation on Profitability of Commercial Banks in Kenya	48
4.7.2 Influence of Financial Process Innovation on Profitability of Commercial Banks.....	47
4.7.3: Influence of Financial Marketing Innovation on Profitability of Commercial Banks.....	50
4.7.4: Influence of Organization Innovation on Profitability of Commercial Banks	51
4.7.5: Profitability.....	51
4.8 Inferential Statistics	52

4.8.1 Correlation Statistics	52
4.8.2 Model Estimation	54
4.8.3 Analysis of Variance	54
4.8.4 Regression Coefficient Analysis	55
4.8.5 Hypotheses Testing.....	57
4.9 Discussion of Key Findings.....	58
4.9.1 Influence of Financial Product Innovation on Profitability of Commercial Banks in Kenya.....	59
4.9.2 Influence of Financial Process Innovation on Profitability of Commercial Banks in Kenya	59
4.9.3 Influence of Financial Marketing Innovation on Profitability of Commercial Banks in Kenya	60
4.9.4 Influence of Organizational Innovation on Profitability of Commercial Banks in Kenya.....	60
CHAPTER FIVE.....	62
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.....	62
5.1 Introduction.....	62
5.2 Summary	62
5.2.1 Financial Product Innovation and Profitability of Commercial Banks in Kenya	62
5.2.2 Financial Process Innovation and Profitability of Commercial Banks in Kenya	62
5.2.3 Financial Marketing Innovation and Profitability of Commercial Banks in Kenya	63

5.2.4 Organizational Innovation and Profitability of Commercial Banks in Kenya	63
5.3 Conclusions	63
5.4 Recommendations	64
5.5 Suggestions for Further Studies	65
REFERENCES	66
APPENDICES	70
Appendix I: Introduction Letter	70
Appendix II: Questionnaire	71
Appendix III: Secondary Data Collection Sheet.....	77
Appendix IV: Research Permit NACOSTI.....	79
Appendix V: List of Commercial Banks in Mombasa County	81

LIST OF TABLES

Table 3.1: Target Population	26
Table 3.2: Sample Size.....	28
Table 4.1: Response Rate	35
Table 4.2: Reliability Test Results.....	34
Table 4.3 Validity Test Results	35
Table 4.4: Normality Test Results.....	44
Table 4.5: Autocorrelation Test Results.....	39
Table 4.6 Multicollinearity Results	40
Table 4.7: Linearity Test Results.....	41
Table 4.8 Linearity Test Results.....	42
Table 4.9: Linearity Test Results.....	42
Table 4.10: Linearity Test Results.....	42
Table 4.11: Breusch Pagan Test.....	44
Table 4.12: Level of Education.....	45
Table 4.13 : Duration of Experience.....	45
Table 4.14: Influence of Financial Product Innovation on Profitability	48
Table 4.15: Influence of Financial Process Innovation on Profitability.....	49
Table4.16: Influence of Financial Marketing Innovation on profitability.....	56
Table 4.17: Influence of Organizational Innovation on Profitability	51
Table 4.18: Profitability	56
Table 4.19: Correlation Analysis Results.....	53
Table: 4.20: Coefficient Results of the Model	56
Table 4.21: Model Summary	54

Table 4.22: ANOVA.....	55
Table 4.23: Test of Hypotheses	58

LIST OF FIGURES

Figure 2.1: Conceptual Framework	15
Figure 4.1: Return on Assets.....	50
Figure 4.2: Return on Equity.....	50

ACRONYMS AND ABBREVIATIONS

ABSA	Amalgamated Banks of South Africa
ANOVA	Analysis of Variance
ATM	Automated Teller Machine
CBK	Central Bank of Kenya
EFT	Electronic Funds Transfer
ICT	Information and Communications Technology
KCB	Kenya Commercial Bank
KMO	Kaiser Meyer Olkin
KSHS	Kenya Shillings
LTD	Limited
NACOSTI	National Commission for Science, Technology and Innovation
NPL	Non-performing Loan
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
RTGS	Real Time Gross Settlement
SACCO	Savings and Credit Co-operative Society
SGS	School of Graduate Studies
SPSS	Statistical Package of Social sciences
TUM	Technical University of Mombasa
USA	United States of America
VIF	Variance Inflation Factor

DEFINITION OF TERMS

Accounts Innovation	Refers to new deposit accounts opened by commercial banks, tailor made to suit the needs of a specific target group, (CBK 2017).
Commercial Banks	Are those banks whose operations are supervised by the Central bank of Kenya. These financial institutions accept deposits, lend money and engage in funds transfer with an aim of making profit (Mueni, 2019).
Financial Innovation	The process of designing and subsequent creation of awareness of new financial instruments. Some of the new financial instruments include new deposit accounts, debit cards and internet banking (Kiplimo, 2019).
Financial Marketing Innovation	Financial Marketing innovation is concerned with new promotional techniques involving major shift in product design, promotion or pricing so as to serve the market better (Chanaron, 2018).
Financial Product Innovation	Development of a new product or modifying an existing product in order to raise revenue, share performance and profitability, (Alkhawaldeh, 2020).
Interbank transfers	Relates to an introduced payment system product, PesaLink, which provides a secure platform for money transfer across accounts held with banks and managed by Kenya Bankers Association (CBK, 2018).

Profitability	It is how well financial indicators are applied to determine whether a firm achieves it's main goal of maximizing returns (Otieno, 2020).
Smart Contract	Establishment of new types of collaborations between commercial banks and other financial institutions like Fintechs (CBK,2020).
Organizational Innovation	These are innovation of financial system as whole for the structure of the financial sector that relates to changes in business structures, to the establishment of new types of financial intermediaries, or to changes in the legal and supervisory framework. Important examples include the use of the group mechanism to retail financial services, formalizing informal finance systems, reducing the access barriers for women, or setting up a completely new service structure (Mohamed, 2019).
Unsecured Loans	Refers to credit extended mainly to individuals or house holds without any collateral (CBK, 2020). It is a category that is most relevant to the bank as it contributes substantive income to banks due to the interest charged.

ABSTRACT

The main purpose of this study was to examine the influence of financial innovation on profitability of commercial banks in Kenya. Commercial banks are engaging in financial innovation as a response to the complexity of the ever-changing business environment characterized by uncontrollable events and technological advancement. The general objective of the study was to examine the influence of financial innovation on profitability of commercial banks in Kenya. The specific objectives were to determine the influence of financial product innovation, financial process innovation, financial marketing innovation and organizational innovation on the profitability of commercial banks in Kenya. Theories applied in the study were Transaction Cost theory, Abernathy and Utterback theory, Diffusion of Innovation theory and Financial Intermediation theory. The study adopted descriptive design, with a target population of 102 respondents and sampling size calculated using Krejcie and Morgan formula to determine the sample size of 77. Primary data was collected by administering structured questionnaires on senior management whereas secondary data was obtained from published CBK'S annual reports for a five-year period between 2018 and 2022. The reliability of data collection instrument was accepted at Cronbach's reliability coefficient of 0.8. All the diagnostic tests done including normality test, autocorrelation test, multicollinearity test, linearity and heteroscedasticity test confirmed the reliability of the regression model. Statistical analysis was carried out using SPSS Statistics for Windows, version 27 and data presented using tables and graphs. Hypothesis testing was done using multiple regression with the results revealing that all the four innovation factors have a positive and significant influence on profitability. The R square results of .746 indicated that independent variables explain 74.6% of the variations in dependent variable. The study therefore recommended that there is need for bank managers to continuously invest in developing new products and processes as they increase bank incomes. Additionally, financial experts to use the study findings in advising managers on the ideal business model and structures that greatly reduce costs hence increasing profits.