INFLUENCE OF FINANCIAL INNOVATION ON PROFITABILITY OF COMMERCIAL BANKS IN KENYA

KUBASU ALVIN OLUOCH

A THESIS SUBMITTED TO THE SCHOOL OF BUSINESS IN THE DEPARTMENT OF BUSINESS ADMINISTRATION IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF DEGREE OF MASTER OF BUSINESS ADMINSTRATION (FINANCE OPTION) OF TECHNICAL UNIVERSITY OF MOMBASA

2025

DECLARATION

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

Signature ………………………………. Date ………………………………..

KUBASU ALVIN OLUOCH

MBA/0004/2013

Supervisors

This thesis has been submitted with our approval as the University supervisors.

Signature ………………………………. Date ………………………………..

Isaac Otiende Ph.D.

TUM, KENYA

Signature ………………………………. Date ………………………………..

Stephen Mwanzia Ph.D.

TUM, KENYA

DEDICATION

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

ACKNOWLEDGEMENT

I firstly praise and glorify the Almighty GOD for His grace and blessings through Rt. Rev. Dr. Alphonse Mwaro Baya, the Bishop of Mombasa Diocese. My special thanks also goes to my well-able supervisors, Dr. Isaac Otiende and Dr. Stephen Mwanzia for their great insights, beneficial criticism, and timely response.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

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.