

# **PRODUCT INNOVATIONS AND FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT CO-OPERATIVES SOCIETIES IN KIRINYAGA COUNTY, KENYA**

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## **ABSTRACT**

Product innovations are crucial to sustain organizations' financial performance and raise their competitive strengths. SACCOS are the main drivers of economic and social development in rural areas of developing countries. In Kenya 81% of the population rely on the SACCOs to access financial services. However the use of SACCOs by Kenyans as a financial service provider has been declining. The SACCOs are faced with challenges of survival due to decline of members. The decline is attributed to the competition from banks which have embraced financial innovations. The study therefore investigated the effect of product innovations on financial performance of SACCOs in Kenya. The study adopted cross sectional descriptive survey research design. The target population was 60 SACCOs registered by SASRA to operate in Kirinyaga County. Stratified simple random sampling technique was used to obtain the sample size of fifty two SACCOs for the study. Primary data was collected using self-administered questionnaires while secondary data was obtained from audited financial statements. Primary and secondary data was

analyzed using SPSS. The findings of the study revealed that product innovations were positively correlated to financial performance. The study will be of great importance to Policy maker in developing SACCO's financial innovations regulatory framework. SACCO Managers will be able to adopt the product innovations that will improve financial performance of the SACCOs and their competitiveness. The study will further enlighten researchers with relevant information regarding product innovations. The study recommends that SACCOs should embrace product innovations in order to improve their financial performance. SACCOs should therefore introduce new deposit accounts in order to increase the amount of deposits. The SACCOs should also introduce credit cards and debit cards in order to increase their revenue. Similarly, the SACCOs should introduce electronic fund transfer since they have a positive effect of increasing commission fee based income

**Key Words:** *financial innovations, product innovations, financial performance, savings and credit co-operative societies (SACCOs).*

## **INTRODUCTION**

Savings and Credit Cooperative Society (SACCO) is a member-owned financial cooperative whose primary objective is to mobilize savings and afford members access to loans on competitive terms as a way of enhancing their socio-economic well-being (Kamonjo, 2014). It is formed by people having a common bond. They are important form of financial intermediary, which over the years has played a vital role in provision of financial services to their members (Bwana & Mwakujonga, 2013). In Kenya formal cooperatives started taking shape when European settlers formed the Lumbwa Cooperative Society in 1908. Currently SACCOs are credited in the world over for improving peoples' social-economic status. SACCOs are responding gradually to the dynamic and competitive financial environment and are adopting

new approaches to the original model. SACCOs movement in Kenya controls over Ksh 490 billion (\$5.5 billion) in form of assets and savings, an amount equivalent to 35% of the national budget.

### **Financial Innovation**

Financial innovation is the creation and popularization of new financial instruments, technologies, markets and institutions (Haliassos, 2013). It includes institutional, product and process innovation. Financial innovation can be defined as a positive change in financial intermediation or financial system (Juhakam, 2003). Financial innovation can also be referred as a process of creating and marketing of new types of securities. It is the life blood of efficient and responsive capital market (Onduko, 2013). According to Mosongo, Gichana, Ithai and Nguta (2013) financial innovations lowers the transaction cost of transferring funds from lower yielding money balances to higher yielding alternatives. Therefore, with financial innovation market participants attempt to minimize risk and to maximize returns. Changes in international financial environment and increasing integration of domestic environment lead to financial innovation.

### **Product Innovation**

Product innovation refers to innovations of new or modified financial services such as the introduction of new deposit accounts, credit card, debit card, leasing and hire purchase insurance among other financial products (Haliassos, 2013). Introducing new products to the market is an important way by which organizations adapt or respond to increasing global competition, rapidly changing customer demands, technological advancements, and shorter product life cycles (Brown & Eisenhardt, 2009). Developing new products is of the highest importance for the survival of firms. This not only refers to really new products, but firms also need to invest in modifying their existing products. Small and medium-sized companies such as SACCOs are no exception to this rule. Entrepreneurs embrace product innovations In order to respond to changes in market demand or to improve organization efficiency (Maulana, 2016).

### **Financial Performance**

Financial performance is a measure of how well a firm can utilize assets at their disposal to generate revenue (Kihumba, 2008). It is also used as a measure of a firm's overall financial strength over a given period of time, and the same is used to compare similar firms in the same industry or to compare industries or sectors in aggregation. There are many different ways used to measure financial performance, but all measures should be taken in aggregation. Common items used to measure financial performance are operating income, revenue from operations and cash flow from operations (Jayawardhera & Foley, 2000). The major ratios used to measure profitability include Return on Asset (ROA), Return on Equity (ROE) and Net Interest Margin (NIM) (Murthy, 2015).

## **Product Innovations and financial Performance of SACCOs**

Financial innovations are used by financial institutions as formidable strategic tool to outshine competition and are an essential means for the institutions to maintain their effectiveness and improve their performance in the market (Batiz & Woldesenbet, 2006). In the current dynamic and competitive business environment, a firm must continuously develop products in order to satisfy the constantly changing needs and desires of customers and maximize its set objectives in terms of sales volume, market share and profitability (Grundiche, 2004).

Product innovation offers a potential protection to a firm from market threats and competitors (Becheikh, Landry & Amara, 2006). Susman, Warren, Ding & Stites, (2006) proved that product innovation had positive and significant link with financial performance. All financial innovation strategies are implemented using a few basic techniques such as increasing or reducing risk, pooling risk, swapping income streams, splitting income streams and connecting long-term obligation into short-term ones (Onduko, 2013). Innovation strategy is determinant of Sacco financial performance and provides additional insight into the indirect contribution of the individual dimensions of innovation strategies to Sacco performance.

### **STATEMENT OF THE PROBLEM**

The SACCOs sector is vital for the growth of the developing economies such as Kenya. SACCOs have been playing a distinct and important role of providing financial services in rural areas and low income individuals in urban areas. However, member seeking financial services from SACCOs in Kenya has been declining (Kiragu, 2015). The decrease has been from 13.5% in the year 2009 to 9.1% in the year 2013. In the same period customers who accessed commercial banks for the same services grew from 13.5% to 29.2% (Kiragu, 2015). The SACCOs are faced with challenges of survival due to decline of members despite their geographical spread compared to other financial providers in the country (Kiragu, 2015). This trend in loss of customers is attributed to the competition from banks which have embraced financial innovations thus being able to offer better services like easy access transaction accounts and consumer loans through mobile and internet platforms (SASRA, 2014). This scenario has sparked off stiff competition for customers between SACCOs and these other Financial Institutions.

### **OBJECTIVE OF THE STUDY**

The objective of the study was to determine the effect of product innovations on financial performance of SACCOs in Kirinyaga County.

### **THEORETICAL REVIEW**

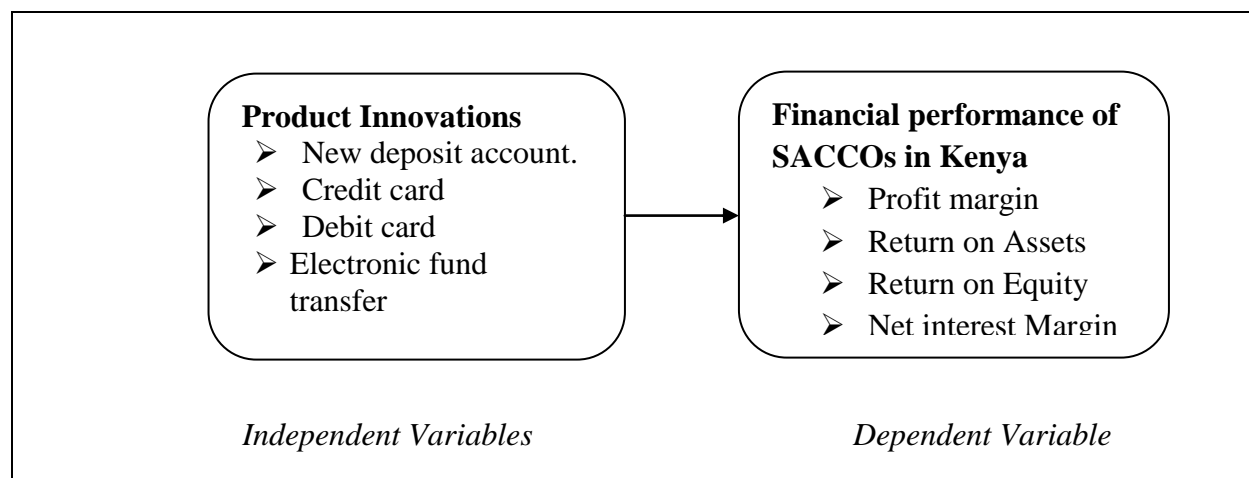
Economic theories can be used to explain the relationship between product innovation and financial performance of a SACCO. This study will adopt theory of changes in perceived market.

## Theory of Changes in Perceived Market

Allen and Gale (2005) described the theory of changes in perceived markets arise when existing markets fail to provide needed products. Allen and Gale noted that when markets turn hostile, it is no surprise that managers are tempted to extend their brands vertically that is to take their brands into seemingly attractive markets above or below their current position. These vertical extensions are sometimes a strategic imperative but they can be dangerous. The theory attempts to explain how a consumer's view on a certain good or services influences their behavior. Usually, consumer perception theory is used by marketers when designing a campaign for a product or brand. Changes are already being seen, with SACCOs beginning to improve their services. For instance, they have introduced friendly and fast credit services in their FOSAs where members can access loans in 24 hours. In addition members are not required to have guarantors. In spite of stiff competition these institutions have managed to sustain a large chunk of their membership.

## Conceptual Framework

The independent variable in this study was product innovation while dependable variable was financial performance of SACCOs in Kirinyaga County, Kenya as shown in Figure 2.1.



**Figure 1: Conceptual Framework**

## RESEARCH METHODOLOGY

### The Research Design

The study adopted cross sectional descriptive survey research design. Descriptive research is the investigation in which data is collected and analyzed in order to describe the specific phenomenon in its current trend, current events and linkages between different factors at the current time. Descriptive research design was chosen because it enables one to generalize the findings to a larger population.

## **The Target Population**

The targeted population was 60 SACCOs registered to operate in Kirinyaga County. The sampling frame for this study was the list of all SACCOs registered in Kirinyaga County.

## **Sampling Technique and Sample Size**

The study will use a sample of 52 SACCOs that was determined through Slovin's formula as shown in equation 1.

$$n = \frac{N}{1 + N(e)^2} \qquad n = \frac{60}{1 + 60(0.05)^2} = 52 \dots \dots \dots 1$$

Where: n is the Sample size, N is total population, e is the margin error of 0.05 based on 95% confidence level

Stratified simple random sampling technique was employed in selecting the SACCOs as shown in Table 1. The respondents were SACCO Managers thus one questionnaire was administered in each selected SACCO.

**Table 1: Sample Selection**

<b>Sub-County</b>	<b>Population</b>	<b>Sample size</b>	<b>Percentage</b>
Kirinyaga central	24	21	40
Kirinyaga east	16	14	27
Kirinyaga west	8	7	14
Kirinyaga south	12	10	19
<b>Total</b>	<b>60</b>	<b>52</b>	<b>100</b>

## **Data Collection Instruments**

Primary and secondary data was used in this study. Questionnaires were used to collect the primary data while the secondary data was obtained from various audited financial statements.

## **RESEARCH RESULTS**

### **Descriptive Finding and Discussion**

This section illustrates descriptive findings and discussions relative to the objectives of the study. The study sought to establish the effect of product innovations on the financial performance of a SACCO.

## **Product Innovation**

The study sought to assess the effect of product innovations on financial performance of SACCOs. The findings are shown in Table 2. As per the table the respondent strongly agreed that introduction of new deposit account (mean = 4.49; std dev = 0.556) has increased the amount of deposits. Respondents agreed that credit card (mean = 3.95; std dev = 0.605) had a positive effect of increasing commission fee based income, and debit card (mean = 3.90; std dev = 0.641) have expanded the income generating potential of the SACCOs. The study further indicated that EFT (mean = 3.69; std dev = 0.766) had a positive effect of increasing commission fee based income of the SACCOs. This implies that when a SACCO introduce new product like new deposit account, credit cards, debit cards and electronic fund transfer the SACCO will be able to increase revenue through commission charged to customers for using the new products.

The findings are consistent with the study findings by Misati, Njoroge, Kamau and Ouma (2010) which found that mobile banking as a product had expanded the range of services that a bank could offer and hence expanded incomes for banks. Similar findings were shown in a study in Uganda by Porteus (2006) and another one in Tunisia by Mabrouk and Mamoghli (2010) who concluded that mobile banking (product innovation ) helped to increase bank incomes and profitability.

**Table 2: Descriptive Statistic for Product Innovation**

	N	Min	Max	Mean	Std. Dev	Var.
The introduction of new deposit account has increased the amount of deposits	39	1	5	4.49	0.556	0.309
Credit card have had a positive effect of increasing commission fee based income	39	1	5	3.95	0.605	0.366
Debit card have expanded the income generating potential of the bank	39	1	5	3.90	0.641	0.410
Electronic funds transfer has had a positive effect of increasing commission fee based income.	39	1	5	3.69	0.766	0.587

## **Financial Performance**

The study sought to determine the respondent’s level of agreement with effect of financial innovation on the financial performance of the performance of SACCOs. Table 4.11 indicates that the respondents admitted (mean = 4.49; std dev = 0.556) that the rate of return on assets has improved over the years due to financial innovations. Respondent were also in agreement that over the years financial innovations has enhanced shareholders return (mean = 4.46; std dev = 0.505). The findings further indicates that net interest margin (mean = 4.28; std dev = 0.560) has increased as a result of financial innovation. The respondents also concurred with the statement

that profit margin has increased as a result of the SACCOs embracing more innovation (mean = 3.85; std dev = 0.587). This findings therefore illustrates that the variables are positively associated with the financial performance of SACCOs where increasing the independent variables would result to increase in the dependent variable. These findings concur with those of Kimani (2016) who found that innovation has positive effects on financial performance. He further asserted that innovation increases firms' profits, market share and savings and reduces the operating costs.

**Table 3: Descriptive Statistic for Financial Performance**

	N	Min	Max	Mean	Std. Dev	Var.
The rate of return on assets has improved over the years due to financial innovations	39	1	5	4.49	0.556	0.309
Shareholders return has improved over the years due to financial innovations.	39	1	5	4.46	0.505	0.255
Financial innovation has resulted to increase in net interest margin	39	1	5	4.28	0.560	0.313
Profit margin increase as SACCO embrace more innovation	39	1	5	3.85	0.587	0.344

### Correlation Analysis

Correlation analysis was used to determine the degree of association and significance of the variables. The results of the correlation analysis presented in Table 4 reveals that the relationship between product innovation and financial performance was positive and statistically significant ( $r=0.579$ ,  $p<0.01$ ). This implies that introduction of new products for instance new deposit account, credit cards and debit cards enhanced the financial performance of a SACCO. These findings are in agreement with a study by Nwokah, Elizabeth and Ofoegbu (2009) which found that product development facets of product innovations are positively and significantly correlated with the firms' performance in terms of profitability, sales turnover and customer loyalty.

**Table 4: Correlation between Product Innovation and Financial Performance of SACCOs**

		Service Delivery
<b>Product Innovation</b>	Pearson Correlation	.579
	Sig. (2-tailed)	.000
	N	39

\*\* . Correlation is significant at the 0.01 level (2-tailed).

### Regression Analysis model

Multiple regression analysis was conducted to ascertain the effect of financial innovation on financial performance of the SACCOs. The results in Table 5 shows that the value of R2 was



0.403 indicating that variation of 40.3% in financial performance of SACCOs can be contributed by financial innovation.

**Table 5: Model Summary**

<b>R</b>	<b>R Square</b>
.635 <sup>a</sup>	.403

a. Predictors: (Constant), Institutional Innovation, Product Innovation, Process Innovation.

### Analysis of Variance

The findings on the analysis of variance (ANOVA) presented in Table 6 shows that F-statistic value of 7.863 and P-value of 0.000. The P-value obtained was less than the conventional P value of 0.05. These findings imply that the regression model was significant in predicting the relationship between financial innovation and performance of SACCOs.

**Table 6: ANOVAb**

<b>Model</b>	<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1 Regression	30.908	3	10.303	7.863	.000 <sup>a</sup>
Residual	45.861	35	1.310		
Total	76.769	38			

a. Predictors: (Constant), Institutional Innovation, Product Innovation, Process Innovation.

b. Dependent Variable: Financial Performance

### Regression Coefficients

The findings in Table 7 show the coefficient and P values for the variables in the study. The results show that product (p = 0.000) and process innovation (p=0.024) were statistically significant at 95% whereas institutional innovation (p=0.076) was insignificant.

**Table 7: Regression Coefficientsa**

<b>Model</b>	<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>		<b>t</b>	<b>Sig.</b>
	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>			
1 (Constant)	4.917	2.612			1.882	.068
Product Innovation	.462	.119	.522		3.876	.000

a. Dependent Variable: Financial Performance

The regression model of the study was  $Y = \beta_0 + \beta_1 X_1 + \epsilon$

Substituting the coefficient in the model,

$$Y = 4.917 + 0.462X_1$$

The findings indicate that holding all other factors constant the financial performance of the SACCO will be 4.917. The regression coefficient for product innovation was (0.462,  $p < .05$ ), which indicates that a unit increase in product innovation will result to an increase of 0.462 units in financial performance. This implies that if a SACCO introduces a new product, the financial performance will improve. This finding concurs with study findings by consistent with a study done by Ahoya (2015) who found that product innovation had a positive and significant effect on financial performance of Kenya Commercial Bank.

## CONCLUSIONS

Product innovations have a positive relationship with financial performance. Introduction of new products lead to better financial performance. In particular, if a SACCO introduces new deposit accounts, the amount of deposits will increase thus increasing the financial performance. In addition, introduction of credit cards and debit cards has a positive effect of increasing commission fee based income. Similarly, introduction of electronic fund transfer has a positive effect of increasing commission fee based income.

## RECOMMENDATIONS

SACCOs should embrace product innovations in order to improve their financial performance. SACCOs should therefore introduce new deposit accounts in order to increase the amount of deposits. The SACCOs should also introduce credit cards and debit cards in order to increase their revenue. Similarly, the SACCOs should introduce electronic fund transfer since they have a positive effect of increasing commission fee based income.

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