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Influence of Product Innovation on Performance of Agency Banking in Commercial Banks in Kenya

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Abstract:

The paper seeks to establish the influence of product innovation on the performance of agency banking in commercial banks in Kenya. The study was informed by the diffusion theory of innovation. The study used a descriptive survey research design. The target population for this study was the 18 commercial banks in Kenya licensed by the Central Bank of Kenya to operate agency banking. The branch managers were the key target respondents in the study. Primary and secondary data were collected using questionnaires and a checklist guide, respectively. Reliability and validity tests were undertaken, and data collected were analyzed using SPSS software. Inferential analysis was carried out to establish the relationship between the independent variables and the dependent variable. The study established that product innovation significantly influenced the performance of agency banking among commercial banks in Kenya. Through the introduction of new products and making improvements to the existing products, and differentiating the products from their peers in the market, better customer attraction was achieved, thus enhancing performance. The study concluded that product innovation is essential in steering the performance of agency banking, thus recommending that the commercial banks, through management, ought to uphold innovation as a way of enhancing the performance of agency banking.

Keywords: Strategic management, product innovation, agency banking, commercial banks, performance

1. Introduction

1.1. Background of the Study

In the current turbulent and fast-paced business environment, strategy has become the way of operation with every organization seeking to unveil new strategies as well as enhance the existing strategy as a way of steering up their performance through competitiveness (Afèche, Zhe & Costis, 2018; Akhavan & Jafari, 2012). Holmes and James (2010) define strategy as the unique planned action that an organization takes as a way of coming up with better ways of operating to foster performance and gain competitive advantage. Thompson and Strickland (2010) posit that a firm's strategy is the game plan that management has for positioning the company in its chosen market arena, competing successfully, pleasing customers, and achieving good business performance. One of the main strategies that modern firms are embracing to sustain their performance is product innovation. It is one of the aspects that define the current business formulations and the success of the business in the 21st century (Dajani, 2016). Organizational innovation is the introduction of new organizational business management methods in the workplace and/or the relationship between a company and external agents (Paul, 2012). According to Gunday et al. (2011) and Loshali and Krishnan (2013), organizational innovations are strongly linked with all administrative efforts to renew organizational routines, procedures, mechanisms, systems, etc., and to renew teamwork, sharing of information, coordination, collaboration, learning, and innovation.

Product innovation is considered a source of sustainable competitive advantage (Sayem, 2012; Lear, 2012). Also, organizational innovations are strongly associated with all administrative efforts to renew organizational routines, procedures, mechanisms, systems, etc., and to promote teamwork, sharing of information, coordination, collaboration, learning, and innovation (Gunday, 2011).

Dubbé (2011) and Jooste and Fourie (2010) refer to innovation as 'the introduction of a new thing or method. Innovativeness refers to 'a firm's capacity to engage in a new enterprise, that is, the introduction of new processes, products, or ideas in the organization' (Owolabi & Makinde, 2012; Ismail, Omar & Bidmeshgipour, 2010). This capacity to

innovate is one of the most important factors influencing business performance. Therefore, innovativeness is amongst the unique culture which embeds in the tangible and intangible resources leading a firm towards successful business performance (Paul, 2012; O'Reilly & Tushman, 2011).

Agency banking is recognized as an outstanding strategy for enhancing the banking process and enabling commercial banks to enhance performance and competitiveness. However, for such a strategy to be successful, there is the need to:

- Innovate the product and putting more measures to develop, and
- Enhance its viability

According to Mwate (2016), to enhance the success of any strategy, there ought to be improvements in terms of innovation through which more about the strategy is explored that enhances its viability. This also remains the case when it comes to the success of agency banking. New product lines channeled through the agencies and improvements to the existing products would enhance the success of agency banking (Kinyanjui, 2011).

Commercial banks are known to be among the most vulnerable organizations in the business world due to the numerous innovations, technological changes, and high regulations involved. Despite the banking sector being crucial in economic performance through the enhancement of savings and issuance of loans, they face a lot of dynamics, most of which threaten their performance (Choudhry & Masek, 2013). Therefore, similar or even more commercial banks require very well-meant strategies to foster performance. One of the major dimensions that modern-day banks are taking for competitiveness is agency banking.

Commercial banks are licensed and regulated under the Banking Act cap 488; deposits taking microfinance institutions are regulated under Micro Finance Act, and the forex bureaus under the Central Bank of Kenya Act cap 491 (CBK, 2017). During the quarter ended 30th June, 2017, the sector comprised:

- 39 commercial banks,
- 1 mortgage finance company,
- 9 microfinance banks,
- 8 representative offices of foreign banks,
- 97 foreign exchange bureaus,
- 5 money remittance providers, and
- 2 credit reference bureaus (CBK, 2017)

Out of the 39 commercial banks, 26 banks are locally owned where 3 banks are local public banks, and 23 are local private banks, while 15 commercial banks are foreign-owned, with more than 50% of their shareholding vested in the hands of foreigners. The locally owned commercial banks command the biggest market share with more than 79% of the assets base. Other commercial banks not included in the list as per the guideline of the CBK include:

- Charterhouse Bank, which is under statutory management,
- Fidelity Commercial, which is undergoing acquisition, and
- Imperial Commercial Bank & Chase Bank, which are in receivership (CBK, 2017)

Agency banking leverages heavily on ICT and is a component of branchless banking that allows financial institutions to offer financial services outside the traditional brick-and-mortar bank premises (Mas, 2008). It allows customers to conduct a limited range of financial transactions at third-party agency banking outlets (King'ang'ai, Kigabo & Kibachia, 2016). The agency banking outlets are mandated to manage transactions (deposits, payments, and cash withdrawals, among others) (CGAP, 2006) on behalf of commercial banks and are remunerated on a fee-for-service basis. They are linked to the bank's servers using a telephone line, cable, or satellite link and use Point of Sale (POS) devices and Visa Card readers to offer services (Ndungu, 2014).

To keep up with international trends regarding the use of agency banking to enhance financial inclusion, in Kenya, the government amended the Banking Act (2010) with the Finance Act (2010) to facilitate the use of third parties by banks to provide banking services. Additionally, the Central Bank of Kenya amended the Banking Regulations and issued Agency banking Regulations (2010) to allow commercial banks to contract third-party retail agents to provide financial services on their behalf.

Agency banking partnership has helped banks to take financial services closer to people, more importantly, to areas that lack them (Parsons & Urdapilleta, 2016). The agents operate as satellite branches. The agency banking concept has increased access to financial services to the unbanked population and is gaining popularity countrywide. However, one-third of the Kenyan population currently lacks access to formal banking services (CBK Annual report, 2017). Agency banking has become increasingly popular, especially in remote and rural locations where most commercial banks have not set up conventional branches to service their clients and depend on agency banking platforms to access and serve their clientele (Parsons & Urdapilleta, 2016).

1.2. Statement of the Problem

The commercial banks' operating agency banking continue to show mixed performance on the agency segment of their business with some banks like Equity bank, KCB, and Cooperative Bank posting good performance while other banks like NIC Bank, Credit Bank, Ecobank, Jamii Bora showing mixed performance of the agency segment of their business (CBK 2017). Other commercial banks which have not adopted agency banking, like Stanbic Chartered Bank, Commercial Bank of Africa, and Citi Bank, continue to register better performance compared to their peers in the same tier who have embraced agency banking (CBK, 2019). This shows a growing concern about the impact of agency banking on the performance of commercial banks in Kenya, which is the focus of the study. Previous empirical evidence has shown that product

innovation is one of the key drivers that enable the business strategy to be impactful. As a strategy of commercial banks, agency banking would require supportive and effective drivers to be successful. Owing to the lack of adequate literature and evidence on how product innovation has been embraced in commercial banks towards supporting agency banking, this study seeks to assess the influence of product innovation on the performance of agency banking in commercial banks in Kenya.

1.3. Specific Objectives

- To determine the influence of product innovation on the performance of commercial banks in Kenya
- To analyze the moderating role of firm characteristics on the relationship between product innovation and performance of agency banking in commercial banks in Kenya

1.4. Research Hypotheses

The study sought to test the following null hypotheses:

- H_{01} : Product Innovation has no significant influence on the performance of agency banking in commercial banks in Kenya
- H_{02} : Firm characteristics have no significant moderating effect on the relationship between product innovation and the performance of agency banking in commercial banks in Kenya

2. Literature Review

2.1. Theoretical Review

This study has been anchored on the diffusion theory of innovation. The diffusion theory of innovations is a theory that was first introduced by Rogers (2003). The theory seeks to explain how, why, and at what rate new ideas and technology spread. The scholar aimed to identify how organizations can use to enhance innovation and thus increase their sustainability. As cited by Perla, Tonetti, and Waugh (2015), Rogers termed innovation as the degree to which organizations come up with new ideas and implement them in order to gain more returns. The process of adopting new innovations has been studied for over 30 years, and one of the most popular adoption models has been described by Rogers in his book, *Diffusion of Innovations* (Syverson, 2011).

According to Lashkari (2016), diffusion research involves technological innovations, so Rogers (2003) usually used the word 'technology' and 'innovation' as synonyms. For Rogers, 'a technology is a design for instrumental action that reduces the uncertainty in the cause-effect relationships involved in achieving a desired outcome'. Adoption of innovation is a decision of 'full use of an innovation as the best course of action available', and rejection is a decision 'not to adopt an innovation'. Commercial banks have to focus on innovation for them to achieve their mandate (Tesot, 2012; Carlo, Lyytinen & Rose, 2012; Saraf, Liang, Xue, & Hu, 2013). This, therefore, makes the theory essential in the study of instigating the influence of product innovation on the performance of agency banking in commercial banks in Kenya.

2.2. Conceptual Framework

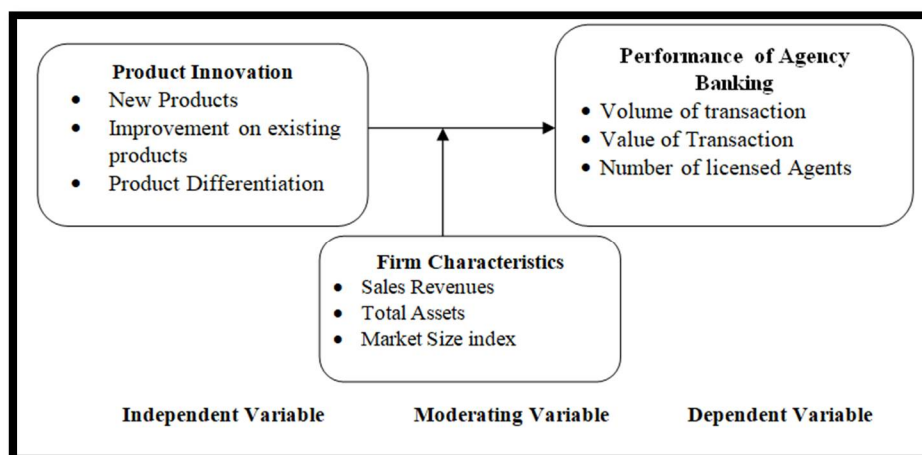


Figure 1: Conceptual Framework

2.3. Empirical Review

Wachira (2013) conducted a study on the effects of innovation on the financial performance of commercial banks in Kenya. The researcher aimed to find out the innovations that commercial banks had applied and invested in to increase their financial performance. The study adopted a cross-sectional descriptive research design and had a sample population of 39 respondents from all the commercial banks in Kenya. The study found that innovations enabled commercial banks to enlarge and increase the no. of customers. According to Kirugi and Mwebia (2016), while in support of Wachira (2013), commercial banks performed better when more innovative ideas were put in place, and many of them, as a result, emerged to be the market leaders.

Elsewhere, Cherotich, Sang, Shisia, and Mutungu (2015) conducted a study on the effects of product innovations and the performance of commercial banks in Kenya. The scholars used a dependent variable- Return on Equity (ROE), while the independent variables were:

- The value of cheques cleared,
- Value of RTGS transfers, and
- Value of EFTs Cleared

A descriptive design and a study sample of 39 commercial banks in Kenya were used. The study found that bank innovations had a statistically significant influence on income, return on assets and profitability, and customer deposits of commercial banks. As cited by Cherotich et al. (2015), Nader (2011) stated that organizational expansion was a result of innovations and bringing in new ideas from all dimensions while the management takes the front stand to enhance this.

Mbogo (2013), on the other hand, conducted a study on the relationship between bank product innovations and the performance of commercial banks in Kenya. The study aimed to determine the effects of innovations on customer deposits, return on total assets, profitability, and overall income of commercial banks. The study used a descriptive research design and targeted managing employees in commercial banks in Kenya. Innovations were found to have a high prediction power in terms of grouping banks using predictive discriminant analysis. It is, therefore, essential for the Central bank of Kenya to consider grouping banks based on their market share of innovations and link the ranking to their profitability (Francesca & Claeys, 2010). This ranking will provide some competition among banks and lead to better customer service.

3. Research Methodology

3.1. Design and Research Philosophy

The study used the positivism paradigm as the research philosophy. The paradigm uses a quantitative approach involving data collection and numerical data analysis (Christensen, Johnson & Turner, 2011). It relies on numerical evidence to draw the results or to test hypotheses.

The study employed a descriptive research design. The design was deemed appropriate for the study due to its ability to incorporate several aspects in a study and give the researcher a wide room to choose from, thus enhancing a better understanding of the research problem.

3.2. Target Population

The study targeted 18 commercial banks with agency banking. The study focused on branches of these commercial banks and specifically those that are based in Nairobi. There are a total of 303 bank branches in Nairobi County. Branch managers from these branches formed the unit of observation in the study. The study used a census where all the 303 respondents were surveyed.

3.3. Data Collection and Analysis

A structured questionnaire was used to collect the primary data for the study. A drop-and-pick method and online means were used to administer the questionnaire. The data were analyzed using descriptive and inferential statistics.

Descriptive statistics such as frequency distribution and measures of central tendency were used to analyze the demographic data. Regression analysis was used to test the hypotheses of the study.

4. Research Findings

4.1. Response Rate

A total of 303 questionnaires were issued to the respondents. Out of these, a total of 251 questionnaires were returned fully filled, implying a response rate of 82.8%.

4.1.1. Product Innovation

The study sought to establish the influence of product innovation on the performance of agency banking in commercial banks in Kenya. The study sought to determine the influence of introducing new products, improving the existing products, and differentiating product lines on the performance of agency banking among commercial banks in Kenya.

The respondents were asked to indicate their level of agreement on specific statements on product innovation. A five-point Likert scale was adopted. The findings are shown in table 1. The banks considered the ideas contributed by their employees on new product development. Involving employees and other stakeholders in innovation has been termed to be a key driver toward firm innovativeness and performance (Dubbé, 2011). The findings are in line with those by Jerop and Juma (2014), who found that most of the commercial banks in Kenya were keen to invest in innovation and improvement of their products as a way of gaining competitiveness and steering their performance. Through innovation in products, the banks can find better ways to capture new markets and establish better ways to reap from agency banking.

Statement	Mean	Std. Dev.
The bank has an adequate budget to support the development of new products	3.72	0.97
Bank staff at the branches contribute new ideas on the development of new products in the bank	3.90	1.06
The bank's new products in agency banking are well-communicated to the agents	3.79	1.11
The bank has an adequate budget to support the improvement of existing agency banking products	2.29	1.10
The staff at my bank are well-informed and educated on new improvements to existing agency banking products	3.68	1.12
The bank communicates adequately to agents operating agency banking about any new improvements to existing products	3.72	0.99
My bank has committed adequate resources to differentiate the agency products and services from other banks	3.56	1.14
Our agency banking products and services are properly differentiated in the market	3.78	1.10
My bank adequately trains our agents on the unique features of our agency banking products to differentiate from other banks	3.68	1.12

Table 1: Level of Agreement with Statements on Product Innovation

4.1.2. Correlation between Product Innovation and Agency Banking Performance

According to Cuestas and Regis (2013), linearity refers to a situation where a dependent variable has a linear relationship with one or more independent variables and, thus, can be computed as the linear function of the independent variable(s). In this study, a linearity test was carried out where the Goodness of Fit test was applied. This helped summarize the discrepancy between the observed and projected values under a statistical model. If the F significance value for the nonlinear component is below the critical value ($P < .05$), then there is significant nonlinearity (David, 2012). As the findings in table 2 reveal that all the coefficients for the variables had significant correlations of 0.000, which is below the standard p-value of 0.05. Hence, there was linearity between the independent variables and the dependent variable.

		Performance of Agency	Product Innovation
Performance of Agency Banking	Pearson Correlation	1	.573
	Sig. (2-tailed)		.000
	N	251	251
Product Innovation	Pearson Correlation	.573	1
	Sig. (2-tailed)	.000	
	N	251	251

Table 2: Correlation Results

4.2. Hypothesis Testing for Product Innovation and Performance of Agency Banking

- H_{01} : Product Innovation has no significant influence on the performance of agency banking in commercial banks in Kenya

The first objective of the study was to establish the influence of product innovation on the performance of agency banking in commercial banks in Kenya. The linear regression model was carried out to reveal the relationship between the two variables, and the findings are presented herein. The model summary in table 3 reveals that the R Square (R^2) for the model was 0.329. This implies that product innovation influences up to 32.9% variation in the performance of agency banking. This confirms that product innovation has an influence on the performance of agency banking in commercial banks in Kenya.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.573 ^a	.329	.326	2.91066

a. Predictors: (Constant), Product Innovation
Table 3: Model Summary for Product Innovation

The Analysis of Variance (ANOVA) results are shown in table 4. As the findings indicate, the F-Statistics for the model was 121.982 at a significant level of $0.000 < 0.05$. This implies that there is a significant influence of product innovation on the performance of agency banking. Zachmann (2012) stated that when product innovation is well-thought and directed towards meeting customer needs, it significantly influences organizational performance by giving it a modern approach to new products and improving existing ones.

	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1033.422	1	1033.422	121.982	.000 ^b
	Residual	2109.510	249	8.472		
	Total	3142.932	250			
a. Dependent Variable: Performance of Agency Banking						
b. Predictors: (Constant), Product Innovation						

Table 4: Analysis of Variance (ANOVA) for Product Innovation

The regression coefficients results, as shown in table 4, revealed that the Beta (β) coefficient for product innovation was 0.234, which implies that a unit change in product innovation would lead to an increase in the performance of agency banking by up to 23.4%. The P-value for product innovation was 0.000, which is less than the standard P-value of 0.05. This implies that there is a significant and positive relationship between product innovation and the performance of agency banking. On this merit, we, therefore, reject the null hypothesis that there is no significant influence of product innovation on the performance of agency banking in commercial banks in Kenya.

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.149	.953		-1.206	.229
	Product Innovation	.234	.021	.573	11.045	.000
a. Dependent Variable: Performance of Agency Banking						

Table 5: Regression Coefficients for Product Innovation

4.3. Firm Characteristics

The study sought to analyze the moderating effect of firm characteristics on the performance of agency banking in commercial banks in Kenya. The major aspects of firm characteristics focused on in the study included:

- The age of the firm,
- The size of the board, and
- The size of the bank

The respondents were further asked to indicate their levels of agreement or disagreement on given statements regarding firm characteristics and agency banking. The findings are shown in table 6. This implies that some banks had some agent outlets close-down while others did not. The Central Bank of Kenya (2018) notes that smaller banks had some of their agent outlets closed down as a result of the declined performance of the banks and low customer uptake of a given bank's products.

Statement	Mean	Std. Dev.
The age of the bank is significant to the performance of agency banking	2.47	1.94
The size of the board of directors of the bank is significant to the performance of agency banking	3.59	0.93
The size of a bank is significant to the performance of agency banking	3.61	1.08
Through agency banking, the bank has reduced the number of transactions and enquiries in the conventional banking halls	3.00	1.22
The bank has used agency banking to save on operational costs, thus enhancing the value of transactions	3.04	1.32
The number of registered agents in our bank has increased over time and significantly contributed to the performance of the bank	3.13	1.38

Table 6: Level of Agreement with Statements on Firm Characteristics

4.3.1. Correlation between Firm Characteristics and Agency Banking Performance

The correlation results are shown in table 7. The results reveal that firm characteristics strongly and significantly correlate with the performance of agency banking, as shown by the Pearson correlation coefficient of 0.619 at a significant level of $0.000 < 0.05$.

		Performance of Agency	Firm Characteristics
Performance of Agency Banking	Pearson Correlation	1	.619
	Sig. (2-tailed)		.000
	N	251	251
Firm Characteristics	Pearson Correlation	.619	1
	Sig. (2-tailed)	.000	
	N	251	251

Table 7: Correlation between Firm Characteristics and Agency Banking Performance

4.3.1.1. Moderating Effect of Firm Characteristics

Firm characteristics have no significant moderating effect on the relationship between product innovation and the performance of agency banking in commercial banks in Kenya.

Table 8 shows the regression model coefficient after the introduction of the moderated through the interaction effect. As the results indicate, when product innovation is interacted with firm characteristics, it enhances performance by 49% ($\beta = 0.490$) at a significant level of $0.000 < 0.05$. This is an indication that firm characteristics significantly and positively moderate the relationship between product innovation and the performance of agency banking. Therefore, the null hypothesis that there is no moderating effect of firm characteristics on the relationship between product innovation and agency banking performance is rejected.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.		
	B	Std. Error	Beta				
1	(Constant)	-37.049	30.149		-1.229	.220	
	Product Innovation * Firm Characteristics	.490	.099		.325	4.950	.000

a. Dependent Variable: Performance of Agency Banking

Table 8: Regression Coefficients (Moderated)

4.4. Performance of Agency Banking

The study sought to establish the performance of agency banking in Kenyan commercial banks. The main aspects used to measure performance were:

- The volume of transactions through agency banking,
- The value of the transactions, and
- The number of licensed agents

In 2018, the value of banking transactions undertaken through agents increased from Ksh.1 trillion (USD 10.4 billion) in December 2017 to Ksh.1.18 trillion (USD 11.7 billion) in December 2018. The increase was attributed to the growth of transactions relating to the transfer of funds, cash deposits, and cash withdrawals. These transactions experienced a growth of 21.8 percent, 14.4 percent, and 7.6 percent, respectively, from the previous year. The increase in the number and the value of transactions underlines Kenyans' growing confidence and acceptability of the agency banking model by banks and the public. Despite the overall increase in the value of transactions, there was a decline in transactions relating to the payment of retirement and social benefits and payment of bills in the year 2018, as highlighted in table 9. The decline in the payment of retirement and social benefits was due to the change from the old card-based system to the new Inua Jamii payment model 'Choice Model', which provides multiple payment systems based on bank accounts that promise flexibility for the beneficiaries.

Transactions	2017	2018	% change	Cumulative (2010 to 2018)
Cash Deposits	791,701.83	906,043.63	14.40%	3,038,084.66
Cash Withdrawals	175,242.56	269,160.40	7.60%	1,068,849.41
Payment of Bills	13,683.15	11,568.45	-15.50%	44,791.31
Payment of Retirement and Social Benefits	18,990.50	1,096.46	-94.20%	39,143.78
Transfer of Funds	376.11	458.06	21.80%	1,163.95
Total	1,074,820.40	1,188,326.99	10.60%	4,192,033.11

Table 9: Value of Transactions in Kshs.'M'

5. Conclusion and Recommendations

5.1. Conclusion

The study concluded that product innovation significantly influenced the performance of agency banking in commercial banks in Kenya. The key aspects of product innovation upheld by the banks were:

- Introducing new products in agency banking,
- Improving the existing products, and
- Differentiating the product

Through product innovation, agency banking by commercial banks can distinguish itself from the others, thus steering its preference among the customers.

5.2. Recommendations

The management of commercial banks ought to embrace product innovation that encompasses the effectiveness of agency banking and meets customer needs and expectations. Through product innovation, commercial banks can differentiate their agency banking products from those of the competitors, thus ensuring the performance of the banking method. While most customers are willing to embrace agency banking, there is a need to be more innovative in terms of providing what is actually required and trying to go beyond the expectations of the customers. This could be achieved through product innovation by frequently redesigning the product, differentiating it from the competitors, and coming up with new products that are in line with the main one – agency banking. The management of commercial banks should ensure that the product innovation strategies are aligned with the firm characteristics to enhance the performance of agency banking.

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