FINANCIAL INNOVATION AND FINANCIAL PERFORMANCE: A CASE OF SACCOs IN NAIROBI COUNTY.

Mosongo, Enock*; Gichana, Ignatius**; Ithai, Julius*** Nguta Munene****

*Co-Operative University College
**Department of accounting & Finance, Meru University
***Department of Accounting & Finance, Meru University
****School of businss and economics, Meru University

Abstract

The study's overall objective was to investigate whether there was a relationship between financial innovation and financial performance among the Sacco in Nairobi County.

The study adopted descriptive research design for the purpose of accessing the study's general intent. The study's target population comprised of 41 Sacco registered under the commissioner for cooperatives in Nairobi County. Stratified random sampling was used to select respondents from each of the sampled Sacco. A self administered questionnaire was delivered to the respondents and collected after completion. Data was analyzed using SPSS. The T- test, F-test and ANOVA was used to examine the data with the objective determining whether there is a significant relationship between financial innovation and financial performance among the SACCOs in Nairobi County.

From the finding the study concludes that Sacco adopted various types' financial innovation that lead to financial performance, these include process innovation, product innovation, and institutional innovation. Institutional innovation had greatest impact on financial performance, followed by product innovation and last was process innovation. The study further concludes that there was a positive relationship between financial innovation and financial performance among Sacco in Nairobi County.

The study recommend that for Sacco to be highly competitive and relevant in the market they must employ various types of financial innovation, emphasis also should be on education and training on various groups include members, staff of the Sacco, elective members of the Sacco, committee members, and managers of the Sacco, and government to support Sacco by creating laws which protect Sacco from exploitation from the market and Sacco to form alliance with other financial institutions in order to have economy of scale.

Corresponding author: julius ithai <ithai8888@yahoo.com>

INTRODUCTION

SACCOs operate under complex and dynamic environment which is unique and specific to the sector. This has contributed to either collapse or deteriorating performance for those survived. This is due to numerous challenges encountered in this volatile environment. Generally, these challenges are caused by economic and macro economic factors like deficiency in contemporary skills, stiff competition from their competitors, Economic liberalization and regulation of business.

These challenges posed a threat to survival of the Sacco sector and called for better ways of managing and running of the Sacco and this was through innovation. The following are some of the innovations which have boosted the Sacco sector: institutional innovation, product

innovation and process innovation.

In today's global and dynamic competitive environment, the ability to innovate is increasingly viewed as the single most important factor in developing and sustaining competitive advantage (Tiddy, 2001). It is no longer adequate to do things better; it's about doing new and better things (Slater and Narver, 1995). Much emphasis has been placed on building innovative organization and the management of the innovation process, as essential elements of organization service (Brown, 1997). Bessant and Francis (1999) suggest that effective innovation must involve all areas of a Sacco with the potential to affect synergy discipline and process (Mc Adam, 2000). Innovation can be transformational, radical or incremental depending on the effect and nature of the change. Afuah (1998) suggests that innovations do not have to be breakthrough or paradigm shifting. However, Kim and Mauborgne (1999) maintain that organizations should strive for the larger innovations.

Innovation for these institutions is normally defined as the introduction of a new product such as mobile banking, using ATM, operating FOSA and many more to a market or the production of an existing one in a new manner Merton (1995). According to Drucker (1985), innovation is specific tool of entrepreneurs; the means by which they exploit change as an opportunity for different business or different service.

As Kirton (1976) has shown, creativity is not always about having original ideas. Sometime it involves generating something from nothing. More frequently, it results from elaborating on the present, from putting old things together in a new way or from taking something away to create something simpler or better. Cortese (2001) reported that the incredible period of experimentation and creativity of the past five years has changed the business environment irrevocably.

Financial innovation can be termed 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 new types of securities. It is the life blood of efficient and responsive capital market (Russo, 1991).

According to Akhatar (1984), financial innovations lower 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 the International Financial Environment and the increasing integration of domestic operations lead to financial innovation. Financial innovation is faster promoted when the financial authorities recognize the obsolescence of the existing statutory framework. Allan and Gale (1994), Lawrence and Scott (2001) contend that there are three types of financial innovations, which are Institutional innovations, Process innovations and Product innovations.

Financial Performance of SACCOs

The report by Sacco Society Regulation authority (SASRA) evaluates the performance of the Sacco subsector based on the financial data and information extracted from audited financial statements and reports for the period 2006 to 2010. It is a legal requirement that the audited accounts of a Sacco society be registered with the Commissioner for Cooperatives Development before presentation to members at the annual general meeting. However, not all active Sacco societies comply with this requirement (SASRA Report, 2012).

The total assets for the Sacco subsector stood at Ksh.216 billion in December 2010, a growth of 11% from the Ksh.194 billion recorded in 2009. The growth in assets was funded mainly by member deposits and share capital at Ksh.164 billion comparing favorably with loans and advances which accounted for 73% (or Ksh.158 billion) of the total assets. This reinforces the

fact that SACCOs' core business is to lend to their members. The balance of the funds is financed by retained earnings and loans from commercial banks, KUSCCO and other financial institutions.

Sacco societies in Nairobi County which were estimated at 1369 in 2010 accounted for over 50% of the total assets and deposits in the entire subsector. This is mainly because they are salary based Sacco, thus providing a stable source of deposits and market to lend. The same trend is replicated of the deposits and assets. (Co-operatives Star Times, 2010).

These Sacco further comprise both deposit and non-deposit taking. In the current legal framework a Deposit Taking Sacco (D.T Sacco) is that Sacco operating a front office savings activity (FOSA). Sacco comprises over 50% of all cooperatives in Kenya and as financial institutions; they play a critical role of financial intermediation in Kenya's financial landscape focusing mostly on personal development (SACCOs Review, 2012).

From the study, of the 41 surveyed SACCOs most of these SACCOs largely dependent on innovation in order to survive in the market. These facts support the idea that SACCOs have improved their financial performance with innovation as supported by the foregoing studies.

Problem of Research

Although extensive studies have been done mostly in developed countries on financial innovation and financial performance, literature and data on Kenya's long-term financial innovation and financial performance programs is limited with very little evidence of any studies evaluating the relationship between financial innovation and financial performance. Therefore there is knowledge gap in empirical literature review needed to be filled by this research. This study therefore aims to determine the relationship between financial innovation and financial performance among Sacco in Nairobi County.

Methodology

Descriptive research design was adopted as portended by Mugenda and Mugenda (2003). This research design enabled the study to determine the relationship between Financial Innovation and Financial Performances among Sacco in Nairobi. The study population consisted of all 1371 SACCOs registered under Cooperative Societies Act in Nairobi. The list of the Sacco was obtained from the Ministry of Cooperative Development and Marketing as at 31st December 2012.

Stratified random sampling was used to study the population of 1371 Sacco in Nairobi County. This population was divided into smaller groups known as strata. In stratified random sampling, the strata are formed based on members' shared attributes or characteristics. A random sample from each stratum was then taken in a number proportional to the stratum's size when compared to the population. These subsets of the strata are then pooled to form a random sample of 41 Sacco. The researcher collected data from a selected sample of 41 Sacco based in Nairobi County.

Primary data was collected using the close-ended questionnaires that were appropriate as they provide a standard set of questions for all respondents. The targeted respondents were employees of the Sacco, members of the Sacco and other officers of co-operative societies. Drop and Pick later method was used. Secondary source of data was used in collecting data which include: Sacco monthly reports, SACCOs journals, Audited financial statements of SACCOs, SACCOs star times, SACCOs manuals and other relevant books containing information on annual earnings of the Sacco in Kenya.

The researcher carried out a pilot study of pretest the validity and reliability of data collected using the questionnaire by selecting 5 individuals from the target population of the staff and

members of SACCOs in Nairobi. A pilot study was conducted aimed at determining the validity and reliability of the questionnaire. According to Mugenda and Mugenda (2003), in a research study, the reliability coefficient can be computed to indicate how reliable data are. A coefficient of at least 0.80 indicates a high degree of data reliability. The survey instrument was subjected to overall reliability analysis and was found to be highly reliable with a Cronbach alpha = 0.911, much higher than the standard as portended by Hair et al. (2010).
(Std Cronbach alpha = 0.906).

Results, Analysis and Discussion

The study targeted 41 respondents in collecting data with regard to financial innovations and its effects on financial performance of SACCOs in Nairobi County. Out of the 41 targeted respondent companies, 30 filled in and returned the questionnaires comprising 70% of the targeted respondents.

Institutional Innovation

The study established that institutional innovations which include: restructuring, mobile banking, insurance services and investment banking services affect performance of Co-operative movements in Kenya. It is believed that institutional innovation strategies impact on the Co operative firms' performance.

Product Innovation Strategies

It was established that product innovation strategies which include: new deposit accounts, credit cards, debit cards, personal loans and money transfer services affected performance of SACCOs. The study found that product replacement contributed to the SACCOs profitability. The respondents indicated that product development and product repositioning were important in both the supply of the core product as well as in the support part of any offer and they also agreed that the SACCOs product development strategy aimed at youthful generation.

Process Innovation Strategies

The study found that process innovation strategies such as reduction of costs and conformance to regulations contributed to the SACCOs profitability. It was deduced that use of technology innovations promoted a friendly and helpful staff hence customer satisfaction and that the innovations ensured that the services given to customers were of high quality.

Model Summary

Model	R	R- squared	Adjusted R-square	Std error of estimate
Product innovation	0.430	0.185	0.151	0.8825
Process innovation	0.326	0.106	0.069	0.8825
Institutional innovation	0.475	0.226	0.194	0.8201

Source: Author, (2013)

The table above presents the correlation co-efficient (R) and the co-efficient of determination (R2) between financial performance as the dependent variable and the independent variables

(institutional, process and products innovations). From the findings, the study found that there was a positive relationship between the dependent variable (financial performance) and the independent variables (institutional, process and product innovations). Of the three independent variables, Institutional innovation had the highest relationship with financial performance with a correlation of 0.475 followed by product innovation with 0.430 while process innovation had the weakest relationship with performance of SACCOs 0.326.

Coefficient of Determination

Model	R	R-Square	Adjusted R-square	Std error of the estimate
1	0.681	0.463	0.361	0.752

Source: Author (2012).

From the findings, 46.3% of financial performance is attributed to the combination of the three independent variables investigated in this survey. A further 53.7% of financial performance is attributed to other factors not investigated in this survey

Multiple Regression Analysis

Model		Unstandardized coefficients		standardized coefficients	T	Sig
		B	Std Error	Beta		
1	Constant	0.853	1.068	0	0.799	0.433
	Product	0.169	0.193	0.08	-0.358	0.724
	Process	0.128	0.25	-0.242	-0.891	0.383
	Institutional	0.205	0.16	0.346	1.284	0.213

Source: Author (2012)

The statistical model shows that when the independent variables (institutional, process and product innovations) and dependent variables interact, the model has a correlation coefficient (R) of 0.681 and co-efficient of determination (R-square) of 0.463 signifying a positive relationship between two variables.

Analysis of Variances (ANOVA)

	Sum of square	Df	Mean square	F	Sig
Regression	3.861	3	0.644	1.460	
Residual	25.133	25	0.441		0.209a
Total	28.995	28			

Source: Author (2012).

The analysis of variance (ANOVA) shows that F – value is (1.460 at 0.209) significance level (P> 0.05) suggesting that the relationship between the two (independent and dependent variables) could be out of chance and nothing else.

The researcher conducted a multiple regression analysis so as to determine the relationship between the SACCOs performance and the three attribute investigated in this study.

The regression model was Y= 0.853+0.205x1 + 0.169X2 + 0.128X3+ 0

Whereby: Y = Financial Performance, X1=Institutional Innovation, X2=Product Innovation, X3=Process Innovation and ei=Error Term

According to this model, it can be seen that taking all other independent variables value at zero, the financial performance of the Sacco as a result of these independent variables will be 0.853. A unit increases in institutional innovation will lead to 0.205 increases in financial performance. A unit increase in product innovation will lead to a 0.169 increases in financial performance while a unit increase in process innovation will lead to a 0.128 increases in financial performance. This therefore implies that all the three variables have a positive relationship to financial performance of SACCOs in Nairobi County.

Conclusion

The study established that financial innovation affect the financial performance of SACCOs to a great extent. In addition the study revealed that institutional innovation strategies adopted by the SACCOs affect the performance of SACCOs to a great extent on the various factors. Institutional innovation by SACCOs revealed that mobile banking, restructuring, insurance services and investment banking played a key role in realization of financial performance of the Sacco among others.

Products innovation contributed also to great extent to financial performance of Sacco. The study revealed that new deposit accounts, credit card, debit card, personal unsecured loan, money transfer services and product tailored to favor certain group also help in realizing high market share in the sector.

The study further established that process innovation adopted by the sales affected the financial performance of the Sacco to a great extent the study established that most SACCOs created value through office automation, use of computer, electronic money transfer, internet banks transaction, ATM transactions and clients data management software created strong products employed to enhance customers satisfaction. Process innovation strategies revealed that new products innovation process and conformance to regulation was used as a process innovation strategies hence contributing to financial performance of Sacco.

From the findings, the study concludes that Sacco need to adopt various types of financial innovation effectively to prevent them from failing in their obligations and meeting their objectives: minimizing loan defaulters, cash loss and ensuring the SACCOs perform better increasing the returns on assets and helps the Sacco in attaining maximum financial returns that lead to financial performance

Further, the study concludes that SACCOs adopt various types of financial innovation that lead to financial performance, these include process innovation, product innovation, and institutional innovation. Institutional innovation had the greatest impact on financial performance, followed by product innovation and last was process innovation.

The study further concludes that there was a positive relationship between financial innovation and financial performance among SACCOs in Nairobi County, depicting the relationship between financial innovation and financial performance as shown by the model below

$$Y= 0.853+0.205x1 + 0.169X2 + 0.128X3+ 0$$

Recommendations

Given the findings from this study there are a number of policy recommendations that can be adopted by the SACCOs' management in adopting financial innovation to increase financial performance. A policy recommendation is simply written policy advice prepared for some

group that has the authority to make decision. The Sacco policy recommendations are the key indicators through which SACCOs policy decision will be made in most level of SACCOs.
Sacco has suffered credit losses through relaxed lending standards, unguaranteed credits, and the borrower's perception. The study recommends that SACCOs should make fairly accurate personality morale profile assessment of prospective and current borrowers and guarantors. This will minimize credit losses by securing the borrowers guarantee.
The study recommends that, it is important to have an informed Membership; an uninformed membership, the ICA says is the greatest threat to any. The ICA stresses that cooperatives and SACCOs in return, should provide education and training for their members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperatives. The education of SACCO members is absolutely necessary for maintaining democracy, member control and transparency within the SACCO.
The study also recommends that co-operatives need to employ combination of various types of financial innovation such as product, process and institutional innovations in order to form a strategic alliance with other MFIs and Banks for managing cases beyond their capacity.
The government should support SACCOs to offer a wider variety of products and services to their members other than just simple deposits and credits to encourage higher savings rate. Implementing new products can give new life to SACCOs and renewed interest from the public and their members and the government should make better legislation, which protects member's savings and prudential supervision of the industry. The study establishes that there existed a positive relationship between financial innovation and financial performances among Sacco in Nairobi County.

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