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Product Innovation And Organizational Performance Of Microfinance Institutions In Nairobi City County, Kenya

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Abstract
Microfinance Institutions organizational performance has exhibited rising non-performing loans, reduced asset growth and member dissatisfaction. This study sought to establish the effect of product innovation on organizational performance of microfinance institutions in Nairobi City County with possible recommendations on effective strategies for policy and practical applications to enhance performance of the sector. Four theories guided the study; diffusion of innovation theory, balanced scorecard, transactional cost theory and Schumpeter entrepreneurial innovation theory. Descriptive statistics was used to describe strategic innovation and organizational performance. A total of 205 senior managers from 41 Microfinance institutions headquartered in Nairobi City County consisted part of the target population. The study used 60% of the population to derive a sample of 123. Participants were selected randomly using a systematic sampling process. Structured questionnaire enabled the collection of primary data. Content validity, face and expert validity were used to enhance validity of the instrument. Cronbach alpha enabled the analysis of the instrument's reliability with 0.7 considered as the thresh hold and acceptable reliability value. Pilot study was done in Kiambu County targeting four microfinance institutions with 14 respondents. Descriptive statistics, Karl Pearson correlation and multiple linear regression aided the analysis of primary data. The findings were presented in tabular format, graphs and charts. Confidentially, anonymity and consent guided the research process. The results showed that product innovation significantly improved organizational performance of microfinance institutions in Nairobi City County. The study concluded that microfinance institutions may need to adopt product innovation to meet the needs of their customers thereby improve organizational performance. The study made recommendations that product innovation may be used to tap into new markets, meet emerging customer preferences and increase sales.
Key Words: *Product Innovation, Organizational Performance, Microfinance Institutions, Strategic Innovation*

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I. Background Of The Study

In a changing business environment, microfinance institutions need to innovate to enhance their organizational performance so as to survive and remain competitive (AlQershi *et al.,* 2020). Good performing microfinance institutions generate more revenues, reach more people and are self-sustaining. However, realizing the mission has been challenging as many MFIs are not profitable hence delayed progress which hinders their contribution in economic development, member satisfaction and poverty alleviation (Ibrahim & Mohamed, 2020).

The MFI sector in Europe dates back to 1852 with 50% of the MFIs serving the wine sector. In Germany, the wine sector MFIs were established in 1868 to promote members' business activities which is similar to the MFIs in Austria, Italy, Spain and Portugal. Organizational performance of the European MFIs between the year 2000 to 2018 reveals how there has been a decline of MFIs from 264 to 160. Additionally, there has been reduction in membership from 61,600 to 36,900 which has drastically reduced MFIs' organizational performance (Richter & Hanf, 2021).

In Sub-Saharan Africa, the performance of 43 MFIs between 2013-2017 shows how the sector has experienced decreased return on assets by -1.08% in 2015 which fell again by -0.28% while return on equity dropped from 7.36% in 2013 to -0.3.20% in 2014. There was a drop in 2015 by -3.62% and further decline after small growth by 1.75% in 2017 (Ibrahim & Mohamed, 2020). In Tanzania, MFIs have continued to provide savings and credit products to low-income houses and making significant contribution in the country at large enabling the government to put in place regulations, capacity building and standards development to enhance organizational performance of the sector. However, performance of MFIs has decreased evidenced in high default

rate, poor funds management and low awareness by the community on better utilization of funds hence affecting performance (Solomon & Makuya, 2022).

The Kenyan MFI's performance is determined by membership growth, loan, assets and deposits. In the year 2014 to 2018, the institutions recorded a decline in asset from 2.50% in 2014 to 2.25% in 2018. A similar trend was also observed in return on equity from 33.09% in 2014 to 21.89% in 2018. Additionally, due to poor performance, there were three MFIs that were de-registered in 2014 while two got de-registered in 2016 (Otieno et al., 2021). A recent analysis of the institutions performance in Kenya showed that between 2019/2020 there was a decrease in asset growth from 2.75% 2019/2020 to 10.10% in 2020/2021. For the total deposits, MFIs recorded a decrease in the same period from 13.41% to 9.92% and decline in gross loans from 13.16% to 10.00% in the same period (SASRA, 2022).

Performance of the MFIs in Nyeri County has been challenging with over 50% of the institutions considered as either dormant or have collapsed (Waweru & Waithaka, 2023). In 2021, a total of 175 MFIs were registered to undertake their business operations. However, there were four whose licenses were revoked as they did not comply with regulatory requirements due to poor performance. One of these MFIs was Comoco Sacco MFI based in Nairobi City County. This shows that just like other MFIs that are experiencing performance challenges, MFIs in Nairobi City County have similar problems experienced by the sector evidenced in reduction in total assets, gross loans and reduction in total deposits (SASRA, 2022).

Globally, there have been attempts to overcome organizational performance challenge where Almansour et al. (2019) highlight how capital structure has been considered as critical to the improvement of organizational performance among Jordanian microfinance institutions using training skills, management training and loan sizes. In Kenya, Joseph and Kibera (2019) add that organizational performance may be improved using organizational culture to promote behavior change and encourage learning for purposes of identifying new solutions to the improvement of organizational performance where adhocracy culture, market, clan and hierarchal culture were used. Mwangi (2023) also used strategic change as a solution to organizational performance within the financial institutions in Nairobi City County where technical and administrative change has been found to account for 73% of variation in organizational performance. Even though product innovation entails improvement in consumer preferred products and the development of distinctive products that go beyond customer expectation while raising sales revenue, enhancement of profits and performance of the organization (Christa & Kristinae, 2021), reviewed studies however, considered corporate governance, organizational culture, capital structure and strategic change as determinants to organizational performance.

Statement of the Problem and Study Objectives

Despite the significant role played by microfinance institutions in Kenya's economic development, Otieno et al. (2021) note that some MFIs in Nairobi City County were de-registered due to non-compliance to statutory regulations and failure in meeting member needs. MFIs have also recorded reduced return on asset growth between 2016 to 2021 from 2.45% to 2.40% in 2018 and further dropping to 1.59% in 2021 (SASRA, 2021).

Aila et al. (2021) study concentrated on strategic information communication technology as an influence to organizational performance while capital adequacy was viewed as a determinant of performance (Shibutse et al., 2019). A report by Muthama and Warui (2021) highlighted how non-performing loans of more than 90 days interest had negative impact in performance. Even though product innovation is essential element in organizational performance enhancement through customer satisfaction, generation of revenue and reputation development, there are scanty materials on studies in Nairobi City County that has linked product innovation and organizational performance of MFIs (Nduati, 2020).

A study by Nagwan et al. (2020) considered strategic innovation in Yemeni manufacturing sector. This study used competitive advantage as the dependent variable, targeted manufacturing industry and had a different geographical location. In Thailand however, Thatrak (2021) investigated how competitive performance was achieved through strategic innovation. Kioko et al (2021) however, looked at how product enhanced corporate reputation. The study was done in Kenya but was based in Machakos County with different population. The study sought to determine whether product innovation affects organizational performance of microfinance institutions in Nairobi City County, Kenya.

II. Theoretical Review

Balanced Scorecard Model

Proponents of the model were Kaplan and Norton (1992) discussing measures that could be used by management to enhance performance. In the following year 1993, the proponents published another article "Putting the Balanced Scorecard to work" which showed how the model could be successfully applied in different contexts (Lopes, 1996). Later, another publication was made, "Translating strategy into action: The Balanced Scorecard" (Kaplan & Norton, 1996). The three publications explained how the model could be used to measure

organizational performance while also incorporating strategies to support organizational mission in different contexts of work.

The idea behind the BSC was to help overcome shortcomings of performance measurement that was mainly focused on financial measurement. The BSC reinforced management performance measures by developing a model that incorporated strategic measurement and organizational mission for more detailed performance measurement. The BSC has been widely practiced by profit making organizations, non-governmental and public institutions (Sarigul & Coskun, 2021).

Diffusion of Innovation Theory

Rogers (1957) was the first proponent of the theory through a dissertation paper where the author discussed diffusion of different innovations in agriculture within the rural communities of Iowa. Diffusion of innovation has since been applied in different contexts; public health, education, technology and business. Rogers (2003) noted that diffusion occurs in different channels to a targeted group within a social system. Diffusion of innovation theory evaluates how different information technology and digital innovations are moved from their initial stages to the clients through adoption (Zhang et al., 2015). The study used the theory to analyse the level of innovation adopted by MFIs in Nairobi City County. Particularly, product innovation, process, technological and market innovation were used to understand the rate of their diffusion within the MFIs in Nairobi City County.

Product Innovation and Organizational Performance

Nandal et al. (2021) analysis focused on product innovation of selected organizations in India where quota sampling of automobile companies was used to categorize the population into four groups. Purposive sampling enabled the identification of 423 respondents from four organizations. It was established that organizations were developing new products to address changing customer needs. This study used purposive sampling. The current study used probability sampling to establish if there is any positive significant effect when a different population of MFI is considered.

Rahma et al. (2020) however, adopted a balance scorecard model using a target population of DP World organization based in United Arab Emirates (UAE) where controlled poll was used consisting of 403 experts. Partial least square and structural equation modeling aided the analysis. It was found that DP World was constantly seeking for new opportunities to develop new services and products that meet customer needs. The study had grammatical errors which could have reduced validity of responses. The study's dependent variable was organizational learning. The current study improved the use of English language to enhance validity as well as incorporate a different dependent variable.

An investigation by Kimotho and Muturi (2019) employed descriptive research design that targeted 14 registered MFIs in Kenya with specific variables under consideration; new deposit accounts, credit cards, debit cards and withdrawal accounts. Data collection was achieved using structured questionnaire. Descriptive statistics aided the analysis of primary data. The findings indicated that MFIs had developed new deposit accounts where customers were using more of credit and debit cards. Correlation showed that product innovation had a strong relationship ($r=0.848$) with MFI performance. Product innovation was also found to have significant effect ($\beta=0.306$, $p=0.000$) on performance of MFIs in Kenya.

III. Research Methodology

The study used descriptive design to describe the object and make generalization of the findings (Omair, 2015). The design was chosen as it allowed complete description and understanding of the problem (Ansari et al. 2022). The target population consisted of all 41 Deposit Taking MFIs headquartered in Nairobi City County as described in SASRA (2023) supervisory report. The unit of observation consisted of 205 heads of departments from finance, operations, marketing, ICT and credit department.

The research used Bartlett et al. (2001) who recommends a sample of 50% from the population. Additionally, Israel (1992) suggests the incorporation of 10% to the sample to cater for non-response. The study therefore used 60% of the population to generate a sample of 123 respondents. Systematic random sampling was used to identify the number of respondents from the population (Sharma, 2017).

The study used self-administered semi-structured questionnaire to obtain responses as was economical and allowed the collection of mass data within a short period (Taherdoost, 2021). The study sought for authorization letter from Kenyatta University to collect public data. The researcher also obtained permission from National Commission of Science, Technology and Innovation (NACOSTI) to collect public data. Pilot study was done using 10% of the sample randomly selected from Deposit Taking Saccos located in Kiambu County translating to 14 respondents.

Content validity was used to ensure that the instrument covered all the study concepts adequately. Expert validity was used by working with supervisors and university panelists while face validity enabled the development of the instrument in a simple and more appealing layout (Alias, et al., 2019). Cronbach alpha enabled

the determination of internal consistency (de Barros Ahrens et al., 2020) where 0.7 values were viewed as the cutoff point (Kuok & Yamat, 2019).

Descriptive statistics was used in data analysis incorporating mean, standard deviation and frequency tables. Karl Pearson Product Moment of correlation was categorized into negative, positive and zero (-1, +1) values (Senthilnathan, 2019). Multiple linear regression was used to predict variable relationship as it was considered suitable when using more than one independent variable to determine the outcome of a dependent variable.

The study sought for informed consent from respondents before engagement in the study so as to enable respondents to participate willingly in the research. The researcher adhered to data protection laws by maintaining anonymity of respondents, respecting confidentiality and privacy of participants and giving them opportunity to participate at their own time (Ubi et al., 2020).

IV. Findings

Response Rate

The researcher distributed 123 questionnaires to respondents where 112 were duly filled and returned as indicated in Table 1.

Table 1. Response Rate

Response	Frequency	Percentage
Responded	112	91%
Not responded	11	9%
Total	**136**	**100%**

Source: Research (2024)

The results displayed in Table 1, showed that response rate was 91% while those who did not respond consisted of 9%. Wu et al. (2022) argue that studies with response rate below 80% may not produce a good representation of intended population thereby introduce non-response biasness and erode quality of the data. From the results, the study achieved 91% response rate hence enhanced quality and adequately represented the population of interest to the study.

Product Innovation and Organizational Performance

Product innovation is the introduction of new products into the market or modification of existing features for a particular product (Nandal et al., 2021). The first objective was product innovation which was analysed using loan products, savings, product specifications, quality and competitiveness of products as presented in Table 2.

Table 2. Product Innovation

Product Innovation	N	Min	Max	Mean	Std. Dev.
My organization has innovated new loan products to meet customer needs.	112	4	5	4.83	0.38
New innovative savings products have resulted to more sales.	112	1	5	4.62	0.80
Modification of existing product specifications have lead to more customer adoption.	112	1	5	4.41	0.73
Changes in product quality has lead to more demand of the products.	111	2	5	4.56	0.85
My organization's products are competitive.	112	2	5	4.31	0.82
Total Average				**4.546**	**0.71**

Source: Research (2024)

The results in Table 2, show that respondents agreed to the statement that "my organization has innovated new loan products to meet customer needs" mean score 4.83, standard deviation of 0.38. This shows that microfinance institutions are developing new innovative products to meet emerging customer needs thereby improving organizational performance. Nadal et al. (2021) found that automobile companies in India were developing innovative products to meet customer needs which is in line with the current findings. The results also agree with Rahma et al. (2020) who reported how UAE DP World was engaged in new products development to take advantage of emerging opportunities in customer demand.

Equally, it was established that new innovative savings products resulted to enhanced sales with respondents indicating their agreement with a mean score of 4.62, standard deviation of 080. It was revealed that microfinance institutions were engaged in modification of existing products specification which resulted to enhanced adoption by customers having been rated with a mean score of 4.41, standard deviation of 0.73. Respondents expressed their level of agreement to the statement that "changes in product quality lead to more product demand", mean score of 4.56, standard deviation of 0.85 while to the statement that "my organization's

products are competitive" was ranked at 4.31 mean score with a standard deviation of 0.82. The aggregate mean score for product innovation was 4.55 (SD=0.71) hence respondents agreed that product innovation enhanced organizational performance of microfinance institutions in Nairobi City County.

Kimotho and Muturi (2019) investigation revealed that Kenyan MFIs were developing new deposit accounts that enhanced customer access to more credit and debit cards thereby increasing organizational performance. This study showed that with improvements in product quality, modification of product features and new innovative products results to high demand from customers for more credit, savings and debit card thereby enhancing MFIs organizational performance in Nairobi City County, Kenya.

Schumpeter (1939) proposed the Schumpeterian theory of entrepreneurship to recognize how organizations are taking advantage of environmental opportunities using R&D to develop new products. The findings noted how MFIs in Nairobi City County are expanding their market opportunities through the enhancement of product features and introducing new accounts to meet customer needs thereby agreeing with theory of entrepreneurship.

Correlation Analysis

Correlation is a statistical technique that analyses the strength of the relationship between variables under investigation. Pearson correlation was used to quantify the relationship between strategic innovation and organizational performance of MFI s in Nairobi City County. The values between +1 and-1 were used to establish the strength of the relationship categorized inform of weak (<0.4), moderate (0.4-0.69) and strong (ab0ve 0.7). The study included a confidence interval to enable the estimation of relationship to the target population from the sample derived (Schober & Vetter, 2020). Table 3 illustrates the results.

Table 3. Correlation Analysis

Variables		Product Innovation	Organizational Performance
Product Innovation	Pearson Correlation	1	.905**
	Sig. (2-tailed)		.000
	N	111	111
Organizational Performance	Pearson Correlation	.905**	1
	Sig. (2-tailed)	0.000	
	N	111	111

From Table 3, the results established that product innovation had a positive and strong relationship with organizational performance (r=0.905, p value=0.000). This showed that product innovation is positively related to organizational performance of microfinance institutions in Nairobi City County, Kenya. The results do not agree with Nadupoi et al. (2022) who targeted microfinance institutions in Narok County and established a weak and significant correlation (r=0.190, p=0.019). Xio et al. (2022) study on large manufacturing firms in China revealed a positive relationship between the variables. However, this study did not indicate the strength of the relationship even though the direction demonstrates alignment with the current study which proved that when product innovation increases, there is improvement in MFIs performance.

A similar finding was also observed by Nakato et al. who investigated SME performance in Kampala and reported that product innovation enabled organizations to enhance their performance through direct relationship that existed between the variables. It is only the study of Kariuki and Mangana (2024) evaluation of MFI performance in Kenya that reported how product innovation had a strong relationship (r=0.820, p=0.003) hence demonstrating the direction and the strength of the relationship thereby agreeing with the current findings of a strong and positive relationship between product innovation and organizational performance.

Regression Model Summary

Table 4. Summary of Regression Model

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	·905[a]	0.873	0.868	0.26282
a. Predictors: (Constant) Product Innovation				

Source: Research (2024)

From the results in Table 4, the study established that R was 0.905, also in this model was the correlation coefficient which indicated the model's high quality in predicting organizational performance of MFIs in Nairobi City County. Further, it was found that R Square was 0.873 hence, 87.3% of product innovation accounted for the variation of organizational performance. The other 12.7% was however outside the scope of the study. The adjusted R Square was 0.868, an indication that after making adjustments in the model, 86.8% of strategic innovation accounted for changes in organizational performance. The results produced higher Square in

comparison to Nadupoi et al. (2022) who observed an Square of 0.036 thereby signifying that 3.6% of strategic innovation resulted to organizational performance of MFIs in Narok County.

Analysis of Variance (ANOVA)

Table 5. Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	50.849	4	12.712	184.044	.000[b]
	Residual	7.391	107	0.069		
	Total	**58.240**	**111**			

Source: Research (2024)

Analysis displayed in Table 5, shows that F (4,107) =184.044, p value<0.5 hence there was a significant difference in the mean as well as demonstrated that the model was a good fit for the data in predicting organizational performance of MFIs in Nairobi City County.

Regression Coefficient

The study analysed strategic innovation using regression coefficient to establish which predictor variable needed to be included in the model. Variables that demonstrated statistical significance (p values<0.05) were included in the model to predict organizational performance (Dhakal, 2018). Table 6 presented the findings.

Table 6. Regression Coefficient.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	0.695	0.132		5.276	0.000
	Product Innovation	0.257	0.109	0.257	2.372	0.019

a. Dependent Variable: Organizational Performance

Source: Research (2024)

The results indicated in Table 6 showed that when all things are constant, organizational performance would rise by 0.695, p value 0.000. However, an introduction of product innovation would increase organizational performance by 0.257, p value=0.019. This showed that product innovation had significant effect in performance of MFIs in Nairobi City County. The results relate with Ukpabio et al (2019) who observed how product innovation significantly (β=0.155, P<0.05) affected organizational performance.

Organizational performance= 0.695+0.257(Product Innovation)

Qualitative Analysis

The researcher provided open-ended questionnaire to respondents where feedback was obtained according to the research objectives; product innovation, process innovation, technology innovation and market innovation of microfinance institutions in Nairobi City County, Kenya.

Product Innovation

On the first objective, the study noted how microfinance institutions were able to tailor products, develop different product range to meet customers' needs as provided by Respondent 1;

"Through innovation, the organisation is able to tailor the product available to meet our customers need at their convenience and opens up new market opportunities. Members are able to get a range of products based on their segments, whether biashara, check off, mortgage or asset finance. A positive growth has been noted". (Respondent, 1)

This demonstrated the role that product innovation plays in meeting diverse needs of the MFI sector by availing required products, and meeting every need of the MFI segments which resulted to positive growth. The results agree with the closed ended questionnaire which found that innovative products lead to more sales, increased adoption of MFI products as they were meeting the needs of the members hence confirming that product innovation influence organizational performance. Further response from Respondent 5 indicated;

"My organization has recorded more sales, it opens up new market opportunities, ease access of funds and increased membership" (Respondent, 5).

The results indicate that with product innovation, microfinance institutions are able to tap into new market opportunities by serving emerging needs and hence increase membership necessary in bringing more deposit and accessing loan product and therefore increase organizational performance. With increased sales and membership, the results demonstrate high demand for MFI products which is in line with the questionnaire finding

that product innovation lead to increased demand for MFI products thereby improving organizational performance.

V. Summary Of The Findings, Conclusions And Recommendations

The objective of the study was to find out the effect of product innovation on organizational performance of microfinance institutions in Nairobi City County, Kenya. From the descriptive analysis, the results showed how innovative products enabled the enhancement of organizational performance as new products were used in meeting emerging customer needs. This was evidenced in increased customer adoption and satisfaction of customer demands. The results indicated how innovation lead to the development of competitive products and services witnessed in new loan products development. Qualitative results showed how MFIs were developing innovative products that resulted to more sales and customer convenience as well as growth in membership which improved organizational performance.

The correlation results further noted strong, positive and significant relationship to organizational performance which showed that as MFIs engaged in product innovation, there were chances of increasing organizational performance. Regression coefficient demonstrated the statistical significant effect in the enhancement of organizational performance of MFIs in Nairobi City County.

The study concludes that microfinance institutions have innovated products that have resulted to more sales and are now meeting customer demands due to the development of competitive products. Conclusion is made that product innovation significantly affect organizational performance of MFIs in Nairobi City County, Kenya.

Microfinance institutions play integral role in economic development of the country while advancing socio-economic status of their members. Their performance, is therefore important to the policy makers to support government economic objectives. The study recommends formulation of policies that will support partnership in research and development thereby lead to introduction of new innovative products for the improvement of organizational performance. It is recommended that the regulatory may enhance capacity building of the MFI sector to enable the formulation of unique products aimed at meeting emerging needs of the membership. The study recommends that microfinance institutions in Nairobi City may incorporate product innovation as it was found to enhance performance. Product innovation may also be used to reach new markets, provide solutions to emerging customer needs and increase organizational sales for enhanced performance.

This study was based on product innovation and organizational performance that focused on microfinance institutions in Nairobi City County, Kenya. The recommendation is made that future studies may focus in other counties to establish any difference in the findings. Future study may include the third variables to determine their effect in moderating or mediating the relationship between product innovation and organizational performance. These variables may include; government regulations, organizational resources and capability as well as environmental factors.

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