EFFECT OF STRATEGIC INNOVATION ON FIRM PERFORMANCE IN COMMERCIAL BANKS SECTOR IN KENYA

BY

Isabel Njeri Njihia

Dissertation Submitted in Partial Fulfilment of the Requirements for the Award of Master of Business Administration, Strategic Management and Leadership from St. Paul's University

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MBA/LMR/5420/16

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Supervisor: Dr Julius Kahuthia

Co-supervisor: Mr Paul Kamaku

August 2018

DECLARATION

This Dissertation is a product of my work and is not the result of anything done in collaboration. It has not been presented to any other institution. I agree that this dissertation may be available for reference and photocopying, at the discretion of the University.

SIGNATURE OF STUDENT: _____DATE:_____

Isabel Njeri Njihia

Word Count: 21,186

We confirm that this thesis was done by the student under our supervision.

SIGNATURE OF SUPERVISOR 1: _____ DATE: _____

Dr Julius Kahuthia

SIGNATURE OF SUPERVISOR 2: _____ DATE: _____

Mr Paul Kamaku

DEDICATION

This work is dedicated to all strong women. Those who believe in themselves and see the good in other women. To us.

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LIST OF ABBREVIATIONS

ATM	Automatic Teller Machine
CBK	Central Bank of Kenya
FDI	Foreign Direct Investment
FDIP	Brookings Financial and Digital Inclusion Project
IMF	International Monetary Fund
NIM	Net interest margin
NPL	Non-Performing Loan
ROA	Return on assets
ROE	Return on equity

DEFINITION OF TERMS

Strategy describes the direction and scope of an organisation over the long-term. It creates an advantage for the organisation through its configuration of resources to meet the needs of markets and to fulfil stakeholder expectations (Teece, 2010).

Innovation is improving solutions to satisfy new conditions. It is the result of articulating customer needs, or existing market conditions with the aim to increase the efficiency in products and services in the market (Boston Consulting Group, 2009).

Strategic innovation refers to the process an organisation undergoes to reinvent or redesign its strategy to expedite business growth, generate value for the company and its customers, and create competitive advantage. This type of innovation is essential for organizations to adapt to the speed of technology change. (Schilling, 2010)

Firm refers to a business organisation, such as a corporation, limited liability company or partnership that sells goods or services to make a profit (Jones, 2010). The term is commonly used interchangeably with business or enterprise.

Customer deposit is the money customers entrust to a bank for safe holding. Deposits are considered liabilities owed to the depositors (Business Dictionary, 2011).

Firm performance is a measure of a company that depends on its efficiency as well as the market where it operates (Laforet, 2008). In the financial sector, it is referred to as financial stability. Different financial measures are used to evaluate firm performance. Some of these are revenue, return on equity, return on assets, profit margin, sales growth, capital adequacy, liquidity ratio, and stock prices, among others (Iftekhar, Schmiedel, & Song, 2009).

ABSTRACT

The dynamic performance of the banking sector has been attributed to many factors, a good portion being common to firms in all industries, including social, economic, political, environmental, and cultural. In general, the banking sector is susceptible to the environmental factors, as well as internal factors. This dissertation sought to study the implementation of strategic innovation and its influence on firm performance. The scope of the study is commercial banks in Kenya. The research objective was to determine the effect of strategic innovation on the firm performance of the commercial banks sector in Kenya. Specific research objectives were: to determine the influence of innovation process management on the firm performance;to evaluate the effect of strategic alignment on the firm performance; to establish the influence of industry foresight on the firm performance; and to determine the impact of customer insight on the firm performance of commercial banks in Kenya. The study was anchored of the Resource Based Theory of the firm, Disruptive innovation theory and the Blue Ocean Strategy. An analysis of both primary and secondary data was undertakenthrough multilinear regression with the help of Statistical Package for Social Sciences tool.Firm performance of the banks was informed by the Return on Assets for a period of five years. Strategic innovation was approached from the four dimensions of a managed innovation process, industry foresight, strategic alignment and customer insight. The study followed the descriptive research design. Data collection was carried out through semi-structured self-administered questionnaires for primary data and tabulated forms for the secondary data. The administered questionnaires tested reliable returning a Cronbach's alpha coefficient of 0.7. The study population was 41 banks from which 10 were sampled using stratified sampling through proportionate and simple random sampling. 60 respondents across the 10 banks were targeted, with a response rate of 83 percent. From the findings, the study concludes thatcommercial banks'implementation ofinnovation process management, strategic alignment, industry foresight and customer insighthad a significant and positive effect on the firmperformance of commercial banks in Kenya. The results of the analysis was presented using tables, figures and narratives.The study recommends that the management of commercial banks in Kenya should adequately finance the innovation process management which is capital intensive to accrue the benefits from this process full implementation. Management should continuously build the capacity of the employees to effectively execute the bank's strategy that should be adaptable to the dynamic market forces.Another recommendation is the institutionalization of research to inform decisions being made from industry foresight.The management of commercial banks in Kenya should move away from brick and mortar model of banking to more customer centric banking model like commercial mobile banking. Further research was recommended to replicate the study across other financial institutions including insurance companies, SACCOs and micro-finance institutions.

CHAPTER ONE: INTRODUCTION

1.1 Background

The world today has undergone massive changes. Innovation is on the forefront in both emergent and advanced economies, in the global competition for talent, resources and market share. Stiff competition among existing players has left firms with no option but to find ways to attain competitive advantage through innovation. A company's competitiveness globally is determined by the ability and capability to meet the dynamic needs of customers (Peteraf, 2013). In addition to goods and services designed to meet their needs, today's demanding consumers are more informed, connected and keen to buy products and services that are of high quality, are dependable and have competitive prices. The firm with a capacity to innovate is in a better position to compete in markets than one which lacks the innovative ability (Morrison, 2014).

Firm performance refers to the productivity of the company in the context of the market where it operates. According to Bharadwaj (2000) it is a relevant construct in strategic management and is frequently used as a dependent variable. In finance, it is referred to as financial stability. Firm performance can be measured in financial and non-financial indicators. Simpson and Kohers (2012) list some of the financial measures to include sales growth, revenue, profit margins, return on equity, return on assets, stock prices, liquidity ratio and capital adequacy. These indicators can also inform the evaluation of firm performance in relation to that of the competitors. In banking, ratios used include the percentages of: nonperforming assets; nonperforming loans (NPLs), and reserves.

The dynamism and global competitiveness in today's business environment have made innovation feisty and pertinent due to three crucial trends: overarching international competition, flagellant and dynamic markets, and varied and advanced technologies encumbered by change overdrive (Hobday & Grantham, 2012).

1.1.1 Strategic Innovation

Innovation can be described as both the radical and incremental changes in thinking, processes, services and things (Mckeown, 2008). In economic terms, the change must increase value, customer value, or producer value. Innovation leading to increased productivity is the fundamental source of increasing wealth in an economy. Schumpeter (1950), as cited in Stevenson &Jarillo (2007) viewed innovations as representing improvement employing product or process utility. This change, as a result, increases the demand and therefore the volume of sales. Drucker (2014) defines innovation as both conceptual and perception. As a concept, innovation prescribes frameworks, models, and processes. As a perception, innovation may carry different meanings for the individual, organisation and the customer. Innovation as a process must is viewed as a series of changes taking place in a holistic system. It must take into consideration the hardware, knowledge, market environment, the social contexts of the organisation (Godin & Lane, 2013).

There is consensus among several authors that innovation implies the introduction of a new thing or technique. It is the amalgamation, expression or synthesis of knowledge in original, relevant, valued new products, processes or services (Birkinshaw, Hamel & Mol, 2008). Often, creativity is appreciated as the basis for innovation. Birkinshaw *et al* (2008) present the premise that a creative idea and the ability to convert that idea into action to make a difference sets the stage for innovation to take place. The desire outcome is a specific and tangible change in the products, services or business processes provided by an organization. It therefore follows that innovation can be viewed as the successful implementation of creative ideas within an organisation. Ortt and van der Duin (2008) present that in this view, creativity by individuals and teams is a starting point for innovation. It must be noted however, that while creativity is necessary for innovation, it may not be a sufficient condition for it.

The field of Strategy has advanced considerably in the previous a quarter century. Firms have figured out how to examine their aggressive condition, characterize their position, create focused and corporate favourable circumstances, and comprehend

dangers to managing advantage even with testing focused dangers(Teece, 2010). Distinctive methodologies including mechanical association, the asset based view, dynamic capacities, and diversion hypothesis have helped academicians and specialists comprehend the flow of rivalry and create suggestions on how firms ought to characterize their aggressive and corporate procedures (Najmaei, 2010).In any case, drivers, for example, globalization, deregulation, or mechanical change, just to say a couple, are significantly changing the focused amusement. Researchers and specialists concur that the quickest developing firms in this new condition seem to have exploited these auxiliary changes to contend "in an unexpected way" and enhance in their plans of action. IBM's 2006 and 2008 Global CEO Study (Najmaei, 2010), for instance, demonstrate that best administration in an expansive scope of enterprises are currently looking for direction on the most proficient method to advance in their business models to enhance their capacity to both make and capture value.

New strategies for the bottom of the pyramid in developing markets have additionally directed specialists and experts towards the systematic study of strategic innovation. Academicians working in this field concur that for firms to be effective in the dynamic market conditions, they have togenerate novel ideas (Leitner&Güldenberg, 2010). The aim to reach the bottom of the pyramid is key in the development and implementation of any strategy successfully. While it is uncontroversial that for organizations to flourish, the management team must have a decent comprehension of how strategic innovation works, many authors, up until now, just offered early experiences on the issue (Teece, 2010). In truth, there isn't yet concurrence on what are the highlights of managing and nurturing strategic innovation. Moreover, there is little documentation linking the dimensions of strategic innovation and the overall performance of commercial banks in Kenya. Strategic innovation makes it possible for firms to remain competitive in today’s volatile markets and sustain or create new competitive advantage. It has been associated with strategic entrepreneurship, strategic change and value innovation, and may take various forms: imitation, market-based strategy, technology-based strategy and market and technology-based strategy (Baden & Pitt, 2010).

Imitation involves little or only marginal innovation involved. A company copies the value proposals together with the existing business processes. External factors such as industry growth may affect the success of this approach. Market-based strategy innovationbrings into the industry new value proposals or diversifies the organization into new market segments and markets. The organisation creates demand by redefining the customer is, and the value they desire in the products of services, such as features, the price, and accessibility (Laforet, 2008). Technology-based innovationintroduces new management technologies and practices in the industry. It reconfigures how things are done increases both efficiency and productivity, which shifts the competitive advantage to the firm's favour. Market and technology-based innovation comprises of introducing new value proposals and defining a new market while leveraging technology and new ideas(Ling, Peng & Kao, 2008).

The innovation of corporate strategies may include considerations such as the products and services to be developed or redesigned; the markets in which to compete; the business model to employ; business processes to be optimized; the growth of the customer base; targeting customers through branding and positioning; increasing the efficiency of the supply chain and value chain; and the definition of the go-to-market strategy. According to Drucker (2014), the main drivers of strategic innovation are entrepreneurial leadership, diversified Top Management Teams and deliberate learning mechanisms, so that high growth can be achieved through value pioneering and not only by technology pioneering.

Innovations can be incremental or radical, first mover or late mover and imitative or inventive. Chandler (2000) indicates that some innovations are built on existing products, services, or procedures, and are incremental. Others involve more significant degrees of difference and are more radical than progressive. Some innovators aim to lead, while others are happy to be in second place. Solan (2003) describes innovation in the financial industry to be generating modern financial implements including institution and technologies and disseminating these into markets, to promote information access, means of payment and trading. Strategic innovation results in the creation of growth strategies, product categories, services or

business models that change the game and produce increased value for the consumers, customers and the firm(O'Gorman,2010). The mention of strategic innovation is often associated with projects transpired from the executive level. Such may involve changing the business model.

Building on the fundamentals of traditional approaches of strategy, strategic innovation challenges the firm to look beyond its existing boundaries and models, calling for an imaginative consideration of the unlimited opportunities that lie beyond (Goetsch& Davis, 2014). It is essential for organisations to adapt to the speed of technology change. It is also a common term used to refer to the application of innovation in corporate strategy. Strategy deals with who our customers are, what value we provide, and how we deliver the value. Strategic innovation involves the dramatic redefinition of the customer, the concept of customer value and the redesign of the end-to-end value chain architecture.

Helfat, Finkelstein, Mitchell and Winter (2009) reiterate that strategic innovation is critical for firms to remain competitive in today's volatile markets and sustain or create a new competitive advantage. Strategic innovation has been associated with strategic entrepreneurship, strategic change and value innovation, and may take various forms: imitation, market-based strategy innovation, technology-based innovation or market and technology-based innovation. Jones (2010) while highlighting the forms of innovation describes imitation as involving little or only marginal innovation. A company copies the existing value proposals along with the production, sales and marketing processes. The success if this approach may be affected by external factors such as industry growth.

Market-based strategy innovation concentrates on generating new value proposals or by expanding to new market segments and markets. According to Laforet (2008) this involves establishing demand for unique products and services in the sector. Market definition at this point includes issues of identifying the customer, and their needs concerning the product features, accessibility, and price. Technology-based innovation entails introducing new management approaches and applied technology. Kristensson, Matthing, and Johansson (2008) reason that it involves the reorganisation

of how things are done increases both efficiency and productivity, which shifts the competitive advantage to the firm's favour. Market and technology-based innovation entails presenting new value and forming a new market leveraging technology and new ideas.

Strategic innovation employs a holistic multi-level approach, blending conventional and modern methods to strategy (Shrader & Siegel, 2007). It deploys current activities including applying industry intelligence, seeking customer comprehension and striving to align activities with organisational strategic targets as a foundation. These are supplemented with models and methodologies, combined with far-sighted, idealistic thinking that imaginatively explores long-term possibilities, as well as logical, practical execution of activities aimed to short-term, measurable impact(O'Gorman,2010).

The strategic innovation framework prescribed by Palmer and Kaplan (2007) outlines the following seven dimensions whose aggregate outcomes drive growth. A managed innovation process: Empowering the interaction among the external views along with the internal competences and activities of the organisation. Surpassing the apparent inspires the thoughts to delve into an assortment of new likelihoods. Industry foresight: There is a top led outlook that strives to comprehend the change driving forces. These forces include emerging trends, innovative technologies, underlying forces of competition, possible disturbances and substitute situations(Ortt, & van der Duin, 2008).

1.1.2 Firm Performance

Firm performance is a measure of how well a firm can use assets from its primary mode of business and generate revenues (Bharadwaj, 2000). It reflects the firm's financial running across a duration of time. Firm performance can be a basis for the assessment of related firms(McKelvie, Brattström, &Wennberg, 2017). It can also associate industries or sectors. Firms adopt different techniques to gauge their overall running, in line with the organisation objectives. Bagorogoza and Waal (2010) highlight that a majority of firms favour financial indicators over the nonfinancial.

The Return on equity and Return on assets are some of the most typical measures of financial performance of a given firm (Bagorogoza& Waal, 2010).

Firm performance is the results of achieving the firm's goals, both internal and external (Lin, Peng & Kao, 2008). Grant and Ashford (2008) present performance as a multidimensional construct, whose synonyms, include growth and success among others. Firm performance is the organisation's scorecard of meeting its objectives (Lin *et al.,* 2008). Firm performance is in nature a multidimensional construct that consists of four elements. These elements are: customer-focused performance, including customer satisfaction, and product or service performance; financial and market performance, including revenue, profits, market position, cash-to-cash cycle time, and earnings per share; human resource performance, including employee satisfaction; and organizational effectiveness, including time to market, level of innovation, and production and supply chain flexibility (Baden & Pitt, 2010).

1.1.3 The Banking Sector in Kenya

The Central Bank of Kenya in the Quarterly Economic Review September 2017 describes the banking sector as comprising 42 Commercial Banks, 1 Mortgage Finance Company, 13 Microfinance Banks, 8 Representative Offices of Foreign Banks, 74 Foreign Exchange Bureaus, 18 Money Remittance Providers and three credit reference bureaus. Kenya's vision 2030 highlights the banking industry as crucial to the achievement of its strategic goal of sustainable growth. The strategy outlines targets such as promoting a saving and investments culture, increasing Foreign Direct Investment (FDI), protecting the economy against external concerns. The plan is to thrust Kenya to be the leader in Eastern and Southern Africa. The Global Competitiveness Index (GCI) report (2018), Kenya ranked 91 (an improvement from the previous rank of 96, with a score of 3.9) overall of the 137 countries. While the general elections may have reduced performance, the report notes that Kenya is among the best-improved country year after year. However, the poor performance in the business sophistication and innovation pillars is highlighted as an area of concern. (WEF, 2018).

Misati, Njoroge, Kamau and Ouma (2010) review the financial industry development in Kenya in three phases. The first is the period between the 1970s to early 1980s. The banking sector dominated the industry and was painted with authoritarianism. The government utilised direct instruments of monetary policy to allocate credit to investments. Controls on the interest rate, exchange rate and allocation of credit were some of the strategies employed (Misati*et al.,* 2010). Phase two saw the beginning of Structural Adjustment Programmes in the late 1980s and early 1990s. Liberation policies came with the reduction of the controls on interest rates, exchange rates and capital accounts(Bagorogoza, & de Waal,2010). The focus of these changes was to spark small spreads of interest rates, increased savings that would, in turn, improve the availability of financial resources, enhanced efficiency in credit allocation and boost investments. The use of indirect tools in monetary policy formulation brought in some form of liberalisation in the industry.

The third phase, running from the late 1990s to date is often referred to as the age of financial innovation, characterised by the emergence of Islamic banking, automatic teller machines (ATMs), and virtual currency (Misati*et al*., 2010). The Central Bank of Kenya(CBK) issues guidelines and supervises the banking industry, which is governed by several acts of parliament including the Companies Act, the Banking Act, the Central Bank of Kenya Act.

The banking industry in Kenya has seen radical changes over the last decade. From an influx of new investors to banks going into receivership. While some banks record high profits and undertake ambitious expansion projects, some in the same market are liquidated leading to losses for their shareholders and customers. Experts have blamed the shift of how business is carried out in the banking industry on several factors, key among them being the advancement of information technology that has in turn boosted consumer awareness of services that are available and opening up a world of choices for them. Perception of the target market has also received attention as a factor that determines the success or failure of a bank.

This dissertation took a comprehensive look at how banks reinvent themselves for sustainability in the existing market and how they create new markets to survive. The

results of this study would be useful for the greater management team that seeks to stay ahead, including strategy, operations, customer relations, sales and marketing, communication and information technology managers. The results appeal to policy makers in general to create a safe environment that encourages and nurtures innovation for progress. The expected outcome is to promote collaboration among the different functions in the banking industry for the successful implementation of innovative ideas, leveraging on documented best practices and avoiding known pitfalls.

1.2 Statement of the Problem

World Bank's estimates from the 2014 Findex survey program indicate a 75% uptake of bank accounts among the adults(Demirgüç-Kunt, Klapper, Singer & Van Oudheusden, 2015). Furthermore, Kenya is celebrated globally as a leader in financial inclusion, ranking 1st among 21 developing economies, according to The Brookings Financial and Digital Inclusion Project (FDIP).

The financial industry in Kenya is one of the dynamic sectors of the economy (Odhiambo, 2008). Characterized by the adoption of digital branches, the emergence of agency banking, internet banking, adoption of mobile banking and the competition from mobile network operators, the industry is dynamically finding new and better ways to transform business processes. Traditional banking halls and paper-based transactions are gradually being replaced by recent trends such as agency banking, chip and pin machines commonly known as PDQ machines and cards, bunch note acceptors and the Kenya Interbank transaction switch (Gure&Karugu, 2018). As it is with all industries, there are the early adopters as well as the late adopters.

According to the CBK 2016 report, the banking sector's total assets were Ksh. 3.6 trillion, gross loans were Ksh. 2.4 trillion, deposit base was Ksh. 2.6 trillion while the profit before tax was Ksh. 38.4 billion at the end of quarter one. The number of bank customer deposit accounts and loan accounts stood at 37,455,795 and 7,163,560 respectively. At the time, the sector comprised 43 commercial banks, and one of the banks was under receivership.

While some of the banks are evidently leading the industry, there are some that are struggling, and a few put into receivership, and some even collapsed. This dissertation seeks to determine the relationship between strategic innovation and firm performance. The Central Bank of Kenya (2017) presents that while seven banks hold 80 percent of the population's cash, other banks are starved of liquidity. The regulator further proposes the need to design means of distributing the liquidity for the health of the industry, and as a result, promoting competition and growth. This study sought to determine whether strategic innovation has had a role to play in the firm performance of commercial banks in Kenya, and consequently in the distribution of liquidity among the players in the banking sector in Kenya.

1.3 Objectives

This section outlines the goals which the study sought to address.

1.3.1 Main Objective

This study sought to establish the effect of strategic innovation on the firm performance of commercial banks in Kenya.

1.3.2 Specific Objectives

The following specific objectives guide this study;

i.) To determine the influence of innovation process management on the firm performance of commercial banks in Kenya.
ii.) To evaluate the effect of strategic alignment on the firm performance of commercial banks in Kenya.
iii.) To establish the influence of industry foresight on the firm performance of commercial banks in Kenya.
iv.) To determine the impact of customer insight on the firm performance of commercial banks in Kenya.

1.4 Research Questions

i.) How does innovation process managementinfluence the firm performance?

ii.) How does strategic alignment affect firm performance?

iii.) What is the effect of industry foresight on firm performance?

iv.) What is the effect of customer insight on firm performance?

1.5 Scope of the Study

This study targetedthe 41 commercial banks registered by the Central Bank of Kenya. It focused on four dimensions of strategic innovation in the context of commercial banks. Assessing how innovation process management, strategic alignment, customer insight and industry foresight were perceived in the banks, the study analysed how these affected the firm performance. The targeted respondents were managers in charge of strategy, operations, customer relations, sales and marketing, communication and information technology at the headquarters of their respective banks.

1.6 Significance of the Study

This study is of interest to strategic management teams, scholars, governments, as well as sectors related to the banking industry including insurance and microfinance institutions. Strategic management teams would benefit from the findings on the influence of the strategic innovation dimensions studied here in to the firm performance of their institutions. It would also inform the teams to intently relook at their operational efficiencies in pursuing their strategic goals. The findings would be valuable in designing efficient programmes to ensure strategic innovation is encouraged, promoted and nurtured with in the institution.

Governments can greatly benefit from the results of this study in the process of developing policies. Acknowledging the dynamism that is the world today, it is critical to invest in research and development programmes to ensure that existing policies enable the banking industry to thrive rather than impede its growth.

The findings of this study can inspire scholars to pursue further inquiry. Organisations in general can also benefit from the findings of this study. By following the methodology to self-evaluate, they can use the results as a basis to rethink their innovation process and strengthen them for better results.

1.7 Limitations of the Study

The major limitation of this study was the lack of willingness to truthfully give information as requested for in the questionnaire. To curb this, every questionnaire was accompanied by a copy of the researcher's introduction letter that assured the respondents that the information gathered would only be for research purposes and the results would only be published after analysis, and not as raw data.

The other limitation was the room for biasness in answering some of the questions in the questionnaire, since in most cases it was not possible to verify the extent to which a practice was carried out, for instance. To counter this limitation, the questionnaire provided a wide scale for the respondent to encourage objectivity.

Non-responsive respondents were also encountered. This was accommodated by giving more time for responding to the questionnaire. Follow up calls and visits ensured that the number returned is adequate, as well as follow up on administered questionnaires. The use of focal persons at the banks helped to reduce the number of non-responsive respondents.

Another challenge was time constraint. While the researcher had set aside four weeks for data collection, this had to be adjusted to five weeks to allow for a better response rate.

CHAPTER 2: LITERATURE REVIEW

2.1. Introduction

This chapter reviews the literature on strategic innovation and firm performance. It provides an overview of the theoretical and empirical review, outlining the underlying theories and presents the research gaps and the conceptual framework for the study.

2.2. Theoretical Framework

Trochim (2006) outlines the purpose of a theoretical framework as that of providing guidance to the research. It facilitates the identification of the variables to measure, and the statistical characteristics to look out for in the perspective of the study objectives. This research was founded on the following theoretical schools of thought: Resource based Theory, the Disruptive Innovation theory and the Blue Ocean Strategy

2.2.1 Resource Based Theory

The conventional strategic development process starts by looking at the relative position of a firm in a specific industry. By taking into consideration the firm's environment and then trying to assess what strategy would best maximize the firm's performance. After years of further inquiry, researchers agreed that solely scrutinising the industry and positioning may be misleading, for two major reasons: lots of studies fail to prove the relationship between firm performance and industry; and the positioning within the industry is mostly determined by the firm's resource base(Peteraf, 2013).While Porter's view as cited in Grant (1999), calls for an external outlook on firm performance, the Resource-Based Theory, by contrast, calls for an "inside-out" outlook in the process of strategy formulation(Bharadwaj, 2000). It focuses on the resources the firm possesses. From this, an assessment of their potential for value generation is carried out, which in turn informs strategy development. It then follows that the strategy defined is designed to capture the maximum value in a sustainable way.

Resource-based theory contends that the possession of strategic resources provides an organization with a golden opportunity to develop competitive advantages over its rivals (Barney, 1991). According to Barney(1991), these competitive advantages in turn can help the organization enjoy strong profits.

A strategic resource is an asset that can be described as valuable, rare, difficult to imitate, and non-substitutable (Wernerfelt,1995). A resource is only valuable to the extent that it helps a firm create strategies that capitalize on opportunities and keep threats at bay. Competitors often have a hard time duplicating resources that are difficult to imitate. Hard to imitate resources may be protected by various legal means, including trademarks, patents, and copyrights. Some resources are hard to copy because they evolve over time and as such, reflect unique aspects of the firm. A resource is non-substitutable when competitors cannot find alternative ways to gain the benefits that a resource provides. For firms whose strategic resources have these qualities, they can provide not only a competitive advantage but also a sustained competitive advantage. Sustainability in this case refers to the ability of the resource to endure over time and propel the firm to success in the future. Though resources that do not carry all these qualities are still useful, they are unlikely to provide long-term benefits to the firm. For example, a resource that is valuable and rare but that can be imitated, might provide a competitive edge in the short term, but competitors can overcome such an advantage eventually. On occasion, events in the environment can turn a common resource into a strategic resource.

The tangibility of a firm's resources is an important consideration within the resource-based theory. Tangible resources are resources that can be readily seen, touched, and quantified and include properties, equipment and cash. On the other hand, intangible resources are quite difficult to see, touch, or quantify. Intangible resources include the knowledge and skills of employees, a firm's reputation, and a firm's culture. In comparison, intangible resources are more likely to meet the criteria for strategic resources (i.e., valuable, rare, difficult to imitate, and non-substitutable) than are

tangible resources. Executives who wish to achieve long-term competitive advantages should therefore place a premium on trying to nurture and develop their firms' intangible resources. Capabilities are another key concept within resource-based theory. Capabilities capture the potential value that resources have to offer and tend to arise over time as a firm takes actions that build on its strategic resources. Capabilities are needed to bundle up, manage, and exploit resources in a way that provides value addition to customers and creates a competitive edge for the firm. Some firms develop a dynamic capability. This means that the firm is skilled at continually updating its array of capabilities to keep pace with changes in its environment.

The Resource Based View of the firm supports this study by validating the variable of innovation management process and industry foresight. For a firm to remain competitive, it must have a clear inventory of its capabilities and use these to inform strategy development. Being aware of the resources that the competition has is important to develop ideas that will help the firm use its capabilities to ensure it generates a sustainable competitive advantage.

2.2.2. Disruptive Innovation Theory

Disruptive innovation refers to an improvement that unsettles an existing market and value network by introducing new ones. This innovation eventually displaces the recognized market leader firms, products, or even alliances. Christensen(2013) describes disruptive innovation as a process by which a product or service initially takes a hold at the bottom of a market and in simple applications, steadily moving up market and ultimately displaces the established competing firms.

Bailey, Baines, Wilson, and Clark (2009) observe that traditionally, management at established companies have consciously made the strategic decision to let new industry entrants take over the low-end of the market.This follows that school of thought that the low end of the market is often the least profitable, and by removing it from your customer base, larger companies expect to become more profitable(Christensen, 2013).In today's dynamic markets, customers' needs are

constantly evolving, causing companies to play catch up through innovating faster. The result is usually products or services that are laden with features, making them too complex, and expensive for a large portion of the target market (Laforet, 2008).In the past, companies perceived to be innovative were those that charged the highest prices to their top tier clientele. Characterized as demanding and sophisticated these customers would pay high prices, leading to great profitability for the company(Agnihotri, 2016).

More recently, smaller companies are taking advantage at the evolution of the customer needs and the increase in awareness. Companies have realised that there is an open door at the bottom of the market, where innovation is way less demanding in resources and the benefits immense (Ling, Peng & Kao, 2008). An example of a disruptive innovation in Kenya's banking industry is Equity Bank. Entering a market that was at the time perceived to be saturated, Equity Bank lowered their opening balances to levels so low that attracted students and the lower income earners. This in turn attracted the SMEs, which are the backbone of Kenya's economy (Misati, 2010). Increasing accessibility to banking, their customer growth was so high, that in no time they were leading in the market. While initially Equity Bank had to make do with lower gross margins, the number of customer eventually paid off, and continues to do so. To remain the leaders, firms must keep an eye on the unattractive lower tiers of the market create space for disruptive competitors to emerge.

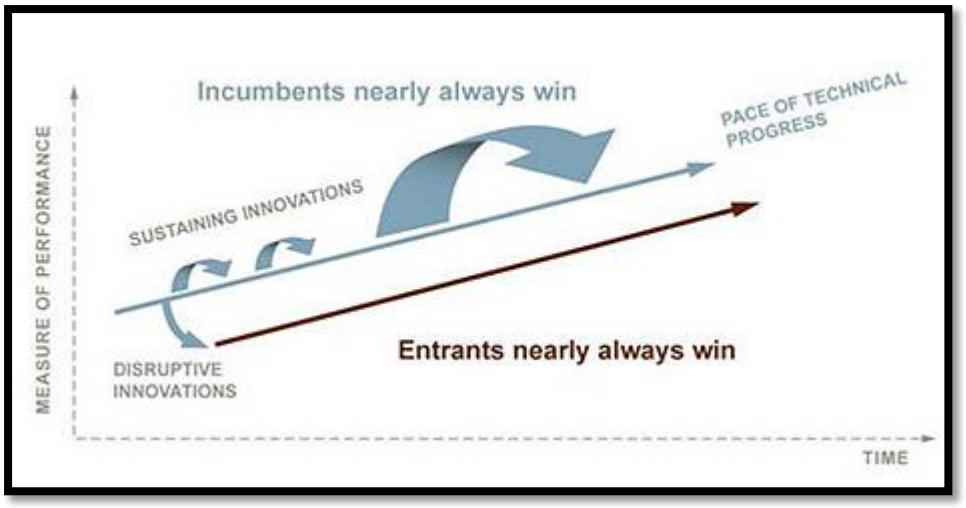


Figure 2.1: Disruptive innovations

Source: Christensen, 2013

Implementation of strategic innovation processes

Although strategic innovation initiatives are majorly led by senior leaders, there is need to nurture a culture of innovation that encourages collaboration across the organization. Some renowned companies that have successfully applied strategic innovation principles include Apple, IBM, Ikea and Nintendo. Apple grew their customer base by expanding the use of computers from businesses to individuals; IBM moved to providing whole solutions instead of limiting their products to hardware; Ikea standardized their products; and Nintendo launched Wii, expanding its customer base to women, adults and the elderly.

For this study, theory of disruptive innovation theory supports the variables of strategic alignment, customer insight and industry foresight. Understanding the customer's needs more than the customer may understand them is critical in informing strategic product and service development.

On the other hand, in developing marketing strategies that give the organization a competitive advantage, it is critical to have a comprehensive understanding of the

organization’s internal strengths and potential against those of the competition. It is also fundamental to invest in market research to monitor changes in the industry and identify potential trends that may change the way business is done. This must be backed up by the refining of internal processes to ensure that the organization is fit to leverage these opportunities efficiently, and in a timely manner for maximum benefit.

As the disruptive innovation theory prescribes the advantage of firms to develop and test products quickly versus waiting to perfect the product, companies may need to consider releasing ‘work-in-progress’ versions of their innovative products to test their functionality and acceptability. This way, resources allocated for innovation can be optimized to accurately test as many ideas as possible and inform the selection of the most viable ideas for further development and launch. According to Christensen (2013) testing products that respond to customers’ existing needs is more beneficial than a perfect product that is often too evolved for the need. This, the author states, eliminates the resource waste incurred when companies strive to release a product that is perfect, only for them to over-shoot less demanding customers who are willing to pay less for a basic version of the product.

The disruptive innovation theory dictates that strategic alignment is key in successful innovation pursuits. It is critical that the organization's structure and resources are linked with itsstrategy and business environment. This study looks at the ability and current activities of the banks in relation to the implementation of strategic innovation as a whole.

2.2.3. Blue Ocean Strategy

Blue Ocean strategy was coined as a marketing theory in 2005. It builds the firm’s sustainability by making the competition irrelevant. Its name is derived from viewing the market universe as two types of oceans: red oceans and blue oceans. The red oceans represent all the industries and known market spaces in existence. On this type, companies try to outperform rivals to obtain market share, with products often becoming commodities and fierce competition turning the red ocean bloody. In

contrast the blue oceans represent all the industries, products and services that are not yet in existence, in other words, the unknown market space. The blue oceans, characterized by untapped demand, offer the greatest potential for profitable growth. But there can be a downside to the blue ocean as well, as it is largely unexplored ground that often has a significant amount of risk.

In their publication Blue Ocean Strategy, Kimand Mauborgne (2005) present a systematic approach to making the competition irrelevant and outlines principles and stool any organization can use to create and capture their own blue oceans. Following a study of more than 150 strategic moves globally, spanning over 100 years and covering 30 industries, the authors debate that long-term success comes not from fighting competitors, but from creating blue oceans; untapped new market spaces ready for growth. They advocate on focusing efforts in creating uncontested market space, therefore making the competition irrelevant.

Kim and Mauborgne (2005) contend that while traditional strategies that are based on competition, also referred to as red ocean strategies, are necessary, they are not sufficient to support sustainable high performance. They call for companies to go beyond competing and seize new profit and growth opportunities by creating blue oceans. The authors argue that competition based strategies assume that an industry's structural conditions are set, and that firms are obligated to compete within the prevailing conditions, what academes refer to as environmental determinism.

In order to remain competitive, red ocean strategists emphasize on leveraging improvements over the competition. This is often achieved through evaluating the competitions actions toiling to enhance it. In this approach, seizing the biggest market share is perceived as a win-lose game, where one’s gain is only possible through another’s loss. Roth, Melkonyan, Kaivo-Oja, Manke, and Dana (2016) present that rivalry is based on supply as the defining variable of strategy. In this scenario, value and cost are considered trade-offs, and the firm is left with the choice of either a differentiation position. Given that the cumulative profits of the industry are regulated by underlying factors, it is follows that firms essentially seek to seize and redistribute

the existing wealth, instead of creating new wealth. The focus is competition, dividing up the red ocean, where growth is increasingly limited.

Agnihotri (2016) asserts that the Blue ocean strategy is based on the view that market boundaries and industry structure are not set and can be remodelled by the actions and principles of the industry players. This is what the authors call the reconstructionist view. On the assumption that structure and market boundaries only exist in the managers' minds, Blue Ocean strategists are not limited by the current market configurations in their rationale. According to this line of thought, there exists additional demand elsewhere that remains obtainable. The bottom line of the problem is to establish this demand. Hanafi, Daud, Islam, Bahrin., Ramli, and Isa (2017) maintain that this approach necessitates a paradigm shift from centring on supply to demand; focusing on value innovation rather than competition, the creation of innovative value to unlock new demand, being the goal. Additionally, this approach demands the concurrent search of both product differentiation as well as cost leadership (Leitner&Güldenberg,2010). By changing the market configuration, the Blue Ocean strategy renders the idea of competition irrelevant and creating new wealth by growing demand. This strategy therefore allows firms to largely play win-win game, with high payoff possibilities.The developers of this theory talk about four actions that can help firms create a blue ocean strategy; focusing less on their competitors and more on alternatives; focusing less on their customers, and more on non-customers, or potential new customers (Kim &Mauborgne, 2014). These actions are established by identifying the factors that the industry takes for granted which should be eliminated; those that should be reduced well below the industry's standard; those that should be raised well above the industry's standard; and those that should be created that the industry has never offered.

Authors caution that careful attention must be given to sustainability in the implementation of the Blue Ocean theory as there can be no one-size-fits-all formula governing the innovation mechanism of an organization.In an investigation on the Blue Ocean Theory and private companies, Todd(2016) concentrated on sustainability amid financial downturns, private business strategies for progress. The

subjective study revealedthat all the interviewed businesses implemented at least one of the principles of the Blue Ocean strategy.

According to the developers of this theory, a commercially viable Blue Ocean idea is said to pass through four tests on buyer utility, price, cost and adoption. First, the idea must attract and retain exceptional buyer utility (Leavy, 2018). The price must then be determined in such a way as to make the product or service easily accessible to the mass market of targeted customers. To ensure that the idea is strategically profitable, it must be feasible to attain a cost target that results in profit. Finally, should there be hurdles affecting the actualization of the business idea or the adoption of the product or service, these must be addressed upfront (Leavy, 2018). A summary can be explained in the diagram below.

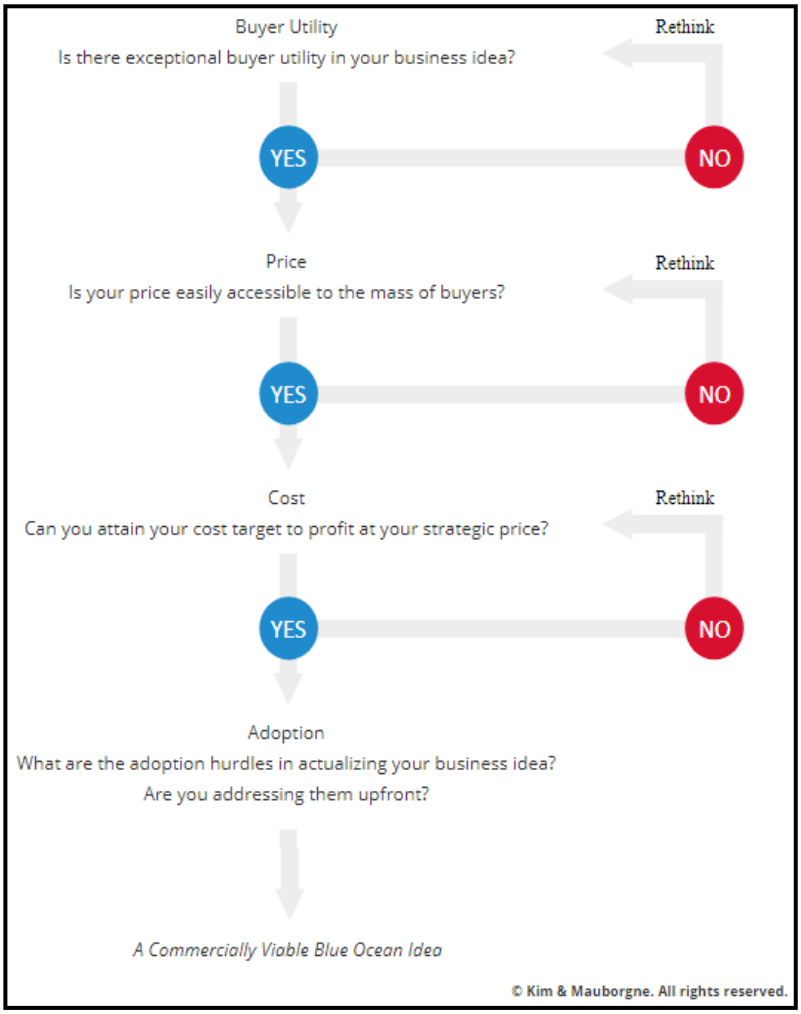


Figure 2.2 Testing the viability of a Blue Ocean Idea

Source Kim and Mauborgne, 2005

The theory of the Blue Ocean Strategy supports this study in the context of commercial banks in Kenya striving to survive in the competitive environment that is the banking industry. It supports the variable of industry foresight. The strategy dictates that in order to stay afloat in the populated industry, the banks must develop survival mechanisms that include implementing ideas beyond the obvious and identifying markets that may not necessarily be the conventional market for banks. Following the Blue Ocean Strategy principles, this study seeks to inquire on the

generation and implementation of ideas in the organization, seeking to strengthen its position in the market. It seeks to assess the extent to which strategic innovation is currently being implemented in commercial banks in Kenya, and the effect of its implementation, or lack of.

2.3. Empirical Literature Review

2.3.1 Firm Performance

Several authors agree that innovation is essential for business survival and especially in highly competitive markets. Such markets characteristics pose challenges to firms trying to differentiate products and services. Serrat (2017) poses that innovation is of great consequence for various reasons: it allows businesses to expand their customer base by refreshing the market with new and improved products; it is a key component of competitive advantage and helps companies stay ahead of competitors before rivals' innovations take market share; it supports the ability to charge a premium; it provides incremental revenue and profit and increases shareholder value. Studies have shown that businesses that do not pursue growth through new product and service development are likely to decline as their existing sales portfolio inevitably matures (McKelvie, Brattström&Wennberg, 2017).

Firm performance is a relevant construct in strategic management research and frequently used as a dependent variable. Despite this relevance, there is hardly a consensus about its definition, dimensionality and measurement, what limits advances in research and understanding of the concept. According to Richard, Devinney., Yip and Johnson(2009), firm performance comprises the actual output or results of an organization as measured against its intended outputs (or goals and objectives).Richard et al. (2009) state that organizational performance encompasses three specific areas of firm outcomes: financial performance (profits, return on assets, return on investment, etc.); product market performance (sales, market share, etc.); and shareholder return (total shareholder return, economic value added, etc.).Santos and Brito (2012) proposed a measurement model for firm performance, based on subjective indicators. The model is grounded in stakeholder theory and a review of

empirical articles. This model contains six dimensions: profitability, growth, customer satisfaction, employee satisfaction, social performance, and environmental performance.

A measure of performance of a firm may not only depend on the efficiency of the company itself but also on the market where it operates(McKelvie, Brattström, &Wennberg, 2017). In the financial sector, it also known as financial stability or financial health. There are different financial measures that can be used in order to evaluate the performance of a company. Some of the common financial measures are: revenue, return on equity, return on assets, profit margin, sales growth, capital adequacy, liquidity ratio, and stock prices, among others. Depending on the industry on which the company operates, some financial ratios will be more meaningful than others(Leitner&Güldenberg, 2010). For instance, in a manufacturing company, total unit sales, return on assets and inventory turnover may be key ratios to monitor, while for financial institutions, stock prices, cash flow, revenue and operating income may the key ratios to monitor. For companies in the consulting business, return on assets and inventory turnover may not be meaningful given the fact that it is not an asset intensive industry (Bharadwaj, 2000). Another factor to consider in order to evaluate the performance of a company is the relative value of the financial measures of the company in relation to competitors within the same specific industry, because each industry is unique and making comparison across industries may provide bias interpretation about the performance of a company. For instance, comparing return on assets between a manufacturing company and a consulting company may be meaningless because while one of them is asset intensive, the other one is not(González-Páramo, 2017). Some of the variables collected to measure the financial health of banks are: nonperforming loans (NPLs) as a percentage of loans, nonperforming assets as percentage of assets, and reserves as a percentage of NPLs.Firm performance is also acknowledged as the power of a business to implement activities better than its competitors.

2.3.2 Strategic Alignment and Firm Performance

Strategic innovation originated as a concept in academic literature in the 1990's and provides companies with the opportunity for substantial value creation(Schilling, 2010). While previous research has shown how the learning or process aspects of a company foster strategic innovation capacity, or the ability of a company to systematically create strategic innovation initiatives, Schilling(2010) notes that an understanding of the role of the organisation's strategic plan and its implementation asa driver of strategic innovation is limited. The link between Strategy Processes, People, Culture and Resources remains hazy in many organizations (McKenzie, 2010). Despite a heightened awareness and interest by both scholars and practitioners in studying and better understanding strategic innovation, it is still regarded as an emerging field of inquiry. Additionally, limited research has been conducted on strategic innovation in the context of Kenyan commercial banks.

Strategic management is seen as a systematic process which aims at maximizing the utilization of resources in relation to organizational objectives which are in conformity with the demands of the business environment (Gure&Karugu, 2018). Strategic management normally looks beyond the mere day-to-day operations of the business, as it is long term in nature. Hence it aims at creating a good future, without neglecting the present, thereby providing an appropriate platform for reacting to changes in business environment.Strategic alignment referred to as the process of understanding the nature of a business through the correlation of business processes and strategies. El-Awad, Gabrielsson, andPolitis (2017) emphasise the need to ensure the configuration of the organization's resources is in line with its aspirations. This includes its structures, resources and internal processes. It is critical that all these aspects are clearly articulated in its internal and external communication. Traditionally, organizations solely relied on their internal understanding of their vision and mission, with the assumption that it is not dependent on the customer(Bailey, Baines, Wilson, & Clark, 2009). Bailey *et al*(2009)demonstrate that the engagement of the customers in the coining of an organization's vision, mission

and therefore the strategic plan is key for its success and survival, especially in a service oriented industry like banking.

Strategic alignment aims at bringing the actions of an organization's business divisions and staff members into line with the organization's planned objectives. According to Tidd and Bessant(2014), the ability of a business to achieve their strategic goals greatly benefits from executing comprehensive strategic alignment to ensure that all or most of its resources are jointly working toward the stated strategic goals. In the context of banks, it follows that the operational activities such as internal communication, human resource management and customer relations must be designed in such a way that contributes to the achievement of its strategic goals(Leavy, 2018). Strategic alignment helps organizationsdefine what matters most to the organization and then create a road map to achieving the organization's purpose. Strategic alignment requires planning, a willingness to reassess and adjust regularly and a workforce that feels involved and responsible for the organization achieving its objectives(Teece, 2010).

2.3.3 Customer Insight and Firm Performance

Customer insight is about looking at the firm through the eyes of the customer (Greenberg, 2010). It involves collecting and analysing information on the customer and their relationship to the firm. It entails answering questions such as: Are clients staying? How happy are your clients? How do you find new business? Are you making the most of your existing clients?Do you monitor your clients' needs?

According to Kristensson, Matthingand Johansson (2008), to maintain a healthy client base with consistent revenue, it is critical tomonitor indicators including: the rate of increase or reduction in your total client base; how long clients stay with your firm; how often you acquire new clients; why they leave; the strength of your client relationships. While some customer turnover is unavoidable, there is need to monitor and keep it under control(Kristensson *et al*, 2008).Some sources say it costs between five and ten times more to acquire new customers than to keep existing ones. This

calls for the need to improve retention by cross-selling other services to them and regularly reviewing the firm's offerings to ensure that relevance is maintained.

While dealing with customer satisfaction, authors Bailey, Baines, Wilson and Clark(2009) note that it is critical to curb the likelihood of dissatisfaction by developing a system to invite and track client feedback. Receiving timely feedback on whether the customer is happy with the quality of work, the level of service and the loyalty you show them is vital in correcting mistakes early enough.New business can come from many different sources, such as referrals, invitations to put forward a proposal (RFPs), networking, marketing or seminars(Greenberg, 2010). Keep track of where your new clients come from. It pays to know which sources are working and which aren't. It'll help fine tune your business development efforts.Also, be clear about your firm's strengths.It is essential to have a clear picture of the customers potential value compared to their current value. If there's a gap, work must be done towards closing it, as this translates into increased revenue for the firm. Calculate the costs of moving clients to more profitable services.

Many experts advocate on the need to check in with clients regularly. Be sure to track all these communications so that past conversations can be built upon making the customer feel understood. Regular, thoughtful contact improves client satisfaction and retention, and it makes it easier to upsell additional services. Set goals to have these sorts of big-picture talks periodically (Ghosh, Jani &Dekhil, 2017).

A study conducted by Williams and Naumann(2011) found that there are significant, and moderate-to-strong associations between customer satisfaction levels and a firm's financial and market performance. The findings specifically highlighted strong links between customer satisfaction, and retention, and revenue, earnings per share, and stock price.

2.3.4 Industry Foresight and Firm Performance

It is argued that to understand the competitive advantage of firms over time it was necessary to examine its internal attributes rather than looking to external frameworks such as industry structure analysis. These internal attributes related to the ability to

sense as well as shape opportunities through developing industry foresight. Secondly, to seize opportunities – all the foresight in the world counts for nothing if one cannot exploit those opportunities. Thirdly, the ability to renew and refresh organizational and managerial competences to build sustained competitiveness.

The reason why the development of internal capabilities has become so important in today's world can be attributed to a number of factors:Globalized competition with rapid technological change creating opportunities and threats; The rise of the information-enabled economy; The systemic nature of innovation – multiple inventions need to be combined in order to create viable product and services; The drive for new organizational forms and morphing of core competences, places significant emphasis on managerial know-how.

The interest in industry foresight has always been fuelled by the expectation that foresight practices, processes, and organizational units will boost the ability ofa firm to attain superior performance (Vecchiato, 2015). Berger (1964) as citedby Vecchiato (2015) reports on the early workof Gaston Berger in the 1950s that emphasized the need to create futureperspectives that are shared in a management team.These representations can clarify the ultimate aims for which an organization strives and facilitate backward planning to inform the choiceof means (Grant, 1999). Grant(1999) argues that high profitability is only available for firms that canovercome crises by "competing for the future", which they contrastedagainst firms that compete by restructuring and downsizing. Developing foresight is based on a clear understanding of how changes in technologies, trends, demographics, regulations and lifestyles can be seized upon to rewrite the rules of competition and open up new markets. What one is looking for are those cues and weak signals that provide clues to the likely paths ahead. Most emerging trajectories are, of course, hard to discern but discipline can be brought to bear to the process.

2.3.5 Innovation Process Management and Firm Performance

Tidd and Bessant (2014) prescribe that the control systems of firms that are rigorous in implementing strategic management practices must stimulate innovation,

proactiveness, and risk-taking. Further, strategic controls base performance on strategically relevant criteria as opposed to objective financial information (Chandler, 2000). El-Awad, Gabrielsson and Politis (2017) conclude that sustainable innovation results from the development and institutionalization of a mind-set and processes that support repeatable innovative actions. Building organizational capacity for sustainable innovation is critical to successfully nurturing the culture of innovation among the team members as exemplified by companies such as Apple, IBM, Ikea and Nintendo.

Birkinshaw, Hamel and Mol (2008) advocate that innovation should be built into business routines at three distinct levels – at the Annual Business Planning (ABP) process, through structured 'themed' Quarterly Innovation Workshops (QIWs), and ad hoc day to day activities. Some of the routines are 'proactive' by nature – a conscious focus on bringing ideas and concepts forward into the innovation process – such as ABP meetings and QIWs. Some routines are 'passive' or 'reactive', such as creating a culture of innovation where day to day activities and management seek to enable innovations to flourish.

The application of innovation in the context of organizations can be achieved through several paths as outlined by Teece (2010). Product or service innovation facilitates the development of goods or services that are new or substantially improve in terms of function, convenience or technical capabilities. Process innovation sees the implementation of new or significantly improved production or delivery methods. Business model innovation changes the way business is done. Organisational innovation creates or changes the business structures, practices and models. Marketing innovation develops alternative marketing techniques to deliver improvements in price, position, packaging, product design or promotion (Serrat, 2017). Supply chain innovation improves the way that materials are sourced from suppliers or improving methods of product delivery to customers. Financial innovation brings together basic financial concepts including credit, risk-sharing, ownership or liquidity to produce new financial services, products or ways of managing business operations.

Schilling (2010) notes that while these channels may be considered autonomous in nature, authors concur that for efficiency in practice, strategic innovation must follow an organisation-wide coordinated and comprehensive approach. For example, as financial innovation aims to position the organisation to adapt to new circumstances and develop new value chains as the compliance and legislative environment evolves, the finance function cannot achieve this on their own. Furthermore, it must be acknowledged that with the potential benefits of innovation also come the risks, as prescribed by Smith and Tuschman (2005). These risks may include operational risks such as failure to meet specifications, costs, or deadlines. Consumers may also resist the innovation and the investment yield may be less than forecasted. Innovating organisations cite a key challenge in innovation as managing the balance between process and product innovations(Roth, Melkonyan, Kaivo-Oja, Manke, & Dana, 2016). While process innovations can enhance shareholder satisfaction by improving efficiencies, product innovations can develop customer satisfaction. However, the latter may occur at the risk of expensive research and development which can erode shareholder returns.

There are several basic success factors when introducing and running innovation processed withinan organization. An emphasis should be put on opportunities of high potential and value and the rapid disposal of lesser value ideas. This is done through a strong and generally known sifting process utilizing the V-SAFE process, or comparable. Idea generation, being a creative process that many organisations use in order to figure out solutions to any number of difficult challenges, involves coming up with many ideas in a group discussion, selecting the best idea or ideas, working to create a plan to implement the idea, and then actually taking that idea and putting it into practice. The idea can be tangible, something you can touch or see, or intangible, something symbolic or cultural.Documentation reveals that some of the most renowned companies such as Procter & Gamble and General Electric have aggressively incorporated the management of innovation into their business model. Their principal goal is to drive growth and then to improve shareholder value. Analysts agree that the companies and brands that lead innovation are the catalysts for growth (Greenberg, 2010).

According to Sushanta and Ho (2006), banks that embrace technology innovations record an increase in deposits through the different channels, affording them higher average employee compensation. Iftekhar, Schmiedel and Song (2009) advise that to ensure that customers are persuaded; banks must innovate well and communicate the innovations in an appealing and effective manner. Further, O'Gorman (2010) maintains that the management process in every firm, as are the management practices, processes, constructs or models. González-Páramo (2017) adds that management strategies and practices that are tailored towards imitation rather than innovation would therefore not be efficient in gaining competitive advantage.

Evidence shows that the banking sector in Kenya is growing. The sector registered improved performance at year end in 2016, recording 10.0 percent growth in pre-tax profits during the year (CBK, 2017). The Central Bank of Kenya also noted strong capitalization levels because of retention of profits and additional capital injection. With the industry showing promising growth trends, it is only paramount that the players find new ways of enlarging the pie through strategic innovation, before laying claim to their stake. The growth could be leveraged as a win-win game for the banks that design unexpected ways to tap into the untapped demand in the market.

Baker, Jones, Cao and Song (2011) assert that the dynamic strategic alignment competency is an enduring organizational competency built on organizational processes and routines that provides a source of competitive advantage. The first stage in the innovation cycle is ideas generation. Ideas will often arise from observation of a current or future problem. They could be inspired by the organisation's objectives or by a new market situation that suddenly becomes an opportunity. It entails procedures of making, creating, and imparting thoughts which are unique, concrete, or visual. The process incorporates the way toward building through the thought, advancing the idea, building up the idea, and conveying the idea to the real world.One technique involves getting into groups and coming up with ideas, known as brainstorming, and this is a tried and true method. This technique has many variations. Some teams use a traditional brainstorming approach and simply let their minds wander while they speak up whenever something promising occurs to them or by passing papers with

ideas written so that others can physically add to the group thinking. Other teams may utilize a modified approach where they think of ideas that achieve the opposite of their desired outcome to get thinking out of the box.

Once the opportunity has been recognised, it needs to be evaluated. An important test for an idea is that it matches the goals of the organisation and available resources – people, finance and facilities. If there is alignment with the objectives of the organisation, the idea moves to a new stage where it can be investigated and further developed. The development phase may involve further research into the opportunity or the patenting of the concept. Prototypes may well be designed, developed and tested at this stage. The decision to start selling the innovation is a critical stage. This is when significant resources are often required to support the launch. Sometimes an organisation might wait at the end of the development phase for suitable market conditions. The final stage of the innovation cycle is commercialisation, where the innovation is marketed and sold to the customer. The innovation now moves out of the organisation's control and into the hands of the users. This is the hardest stage of the innovation cycle for organisations to 'manage'. It is crucial that the organisation monitors the innovation's performance so that any shortcomings are corrected. Innovative organisations will typically be working on new innovations that will eventually replace older ones. This is important as product life cycles show reduced growth for older products and services. Growth may even begin to decline eventually, therefore impacting an organisation's ability to expand. New incremental innovations or changes to the product allow growth to continue. Companies typically generate far more technical innovations than they can possibly hope to bring to market effectively. There is a need for structured management and processes to handle innovation from the ideas stage to commercialisation.

There are several techniques that facilitate innovation process management. one of them is a framework referred to as the 'innovation funnel'. This framework provides structure and discipline and facilitates the innovation process. In addition, it can promote faster development of innovations that drive growth. As it defines and tracks innovations according to predetermined criteria, 'gates' are provided to control

innovation resource decisions. This allows the passage of projects more likely to succeed by eliminating those more likely to fail as early as possible. Innovation process management activities are typically categorised into four stages: concept, feasibility, development and implementation. In the Concept stage, the focus is on generating ideas and concepts and assessing them against strategic fit, market opportunity, organisational impact and the chances of success, to decide which are worth exploring further. During the Feasibility testing, projects are selected for further development based on an evaluation of market acceptability, the investment risk/reward, and the availability of the required resources (people, facilities and money). At the Development stage the Market launch is dependent on satisfactory feedback of the product prototype or service pilot, an evaluation of likely competitor response, and ability to deliver the required supply chain, marketing and pricing/margins. Implementation stage sees the executing the innovation business plan, monitoring the launch and performing post launch reviews to understand whether the implementation has been successful and what, if any, changes need to be made.

2.4. Research gaps

The table below shows some of the studies on strategic innovation and firm performance that were reviewed in this study.

Table 2.1: Research Gaps

Author	Year	Title	Main findings	Gaps	How gaps were addressed
Gure, A. K., &Karugu, J.	2018	Strategic management practices and performance of small and micro enterprises in Nairobi City County, Kenya.	Small and medium sized enterprises that implemented some form of strategic management reported better financial health	The study looked at strategic management broadly	This study paid particular attention to strategic innovation in the context of commercial banks

Author	Year	Title	Main findings	Gaps	How gaps were addressed
González-Páramo, J. M.	2017	Financial innovation in the digital age: Challenges for regulation and supervision.	The banking industry performance is greatly affected by innovation.	Study confined to financial systems and products	This study looked at strategic innovation as a whole
Demirgüç-Kunt, Klapper, Singer & Van Oudheusden	2015	Measuring Firm Performance in Latin America and the Caribbean	While businesses were growing their workforce, gains in revenues were lagging. This trend was stronger in the manufacturing sector than in services.	The study focused in the Latin America and the Caribbean	This study examined the influence of strategic innovation on firm performance in Kenya
Ho, S. J., & Mallick, S. K	2006	The impact of information technology on the banking industry: theory and empirics.	Employing information technology had a positive impact on the overall performance	The study was limited to information technology	The study took a broader look at the factors influencing firm performance specifically

Source: Author and Literature review, 2018

2.5 Conceptual Framework

A conceptual framework, as defined by Kombo and Tromp (2009), is a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. It is intended to assist the researcher develop understanding of the position under study and to clearly communicate it. When well-articulated, the conceptual framework has the potential in making meaning of ensuing outcomes. Ravitch and Riggan (2016) view the conceptual framework as a component to be

examined, reviewed and re-evaluated because of the research as it explains the possible connections between the variables.

In this context, the conceptual framework below expresses the relationship between strategic innovation and firm performance. The framework conceptualizes that strategic innovation, through the lens of its dimensions, influences the commercial banks' firm performance as established by return on assets. Strategic innovation was approached from the angle of the following dimensions: strategic alignment, customer insight, industry foresight and innovation process management (Kaplan, 2007).

Strategic alignment implies the internal support among key stakeholders on the common visions, goals and actions (McKelvie*et al*, 2017). Consumer/customer insight calls for a bottom-up perspective, a deep understanding of both the spoken and unspoken requirements of customers, both current and targeted. Core technologies and competencies refer to the set of internal capabilities, organisational competencies and assets that have the potential to be leveraged to deliver value to customers, including technologies, intellectual property, brand equity and strategic relationships (Baden & Pitt, 2010).

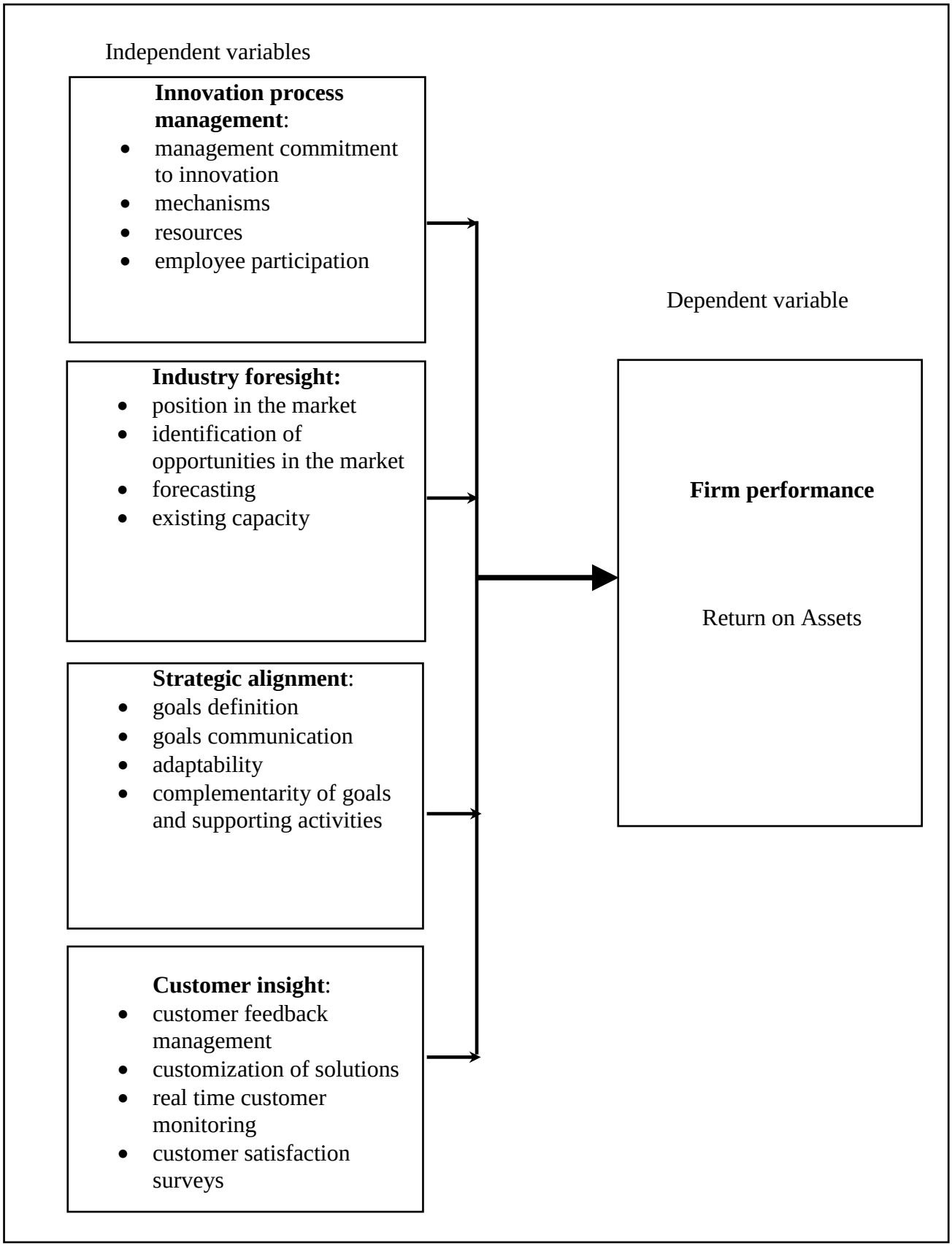


Figure 2.3: Conceptual framework

Source: Author, 2018

CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research methodology to be employed. It describes the research design, identifies the target population, and explains the sample design, data collection and data analysis procedure that was applied.

3.2 Research Design

This study adopted a descriptive research design. The design was appropriate for this study as it allowed the use of both qualitative and quantitative methodologies which are complementary. The quantitative approach allowed for collection of readily analysable data while the qualitative approach allowed for collection of in-depth information as the respondents explained their answers. This research design is also free from subjectivity and is cost effective (Nsubuga, 2006).

3.3 Target Population

The target population was 10 banks from a population of 41, representing 25 per cent of the total population. From each of the 10 banks, the study targetedsix managers in charge of strategy, operations, customer relations, sales and marketing, communication and information technology to respond to the questionnaire. The targeted respondents were 60 across 10 banks.

3.4 Sampling Techniques

Out of the 41 banks registered with the CBK as at December 2017, two were in receivership, one under statutory management and one had no peer group indicated. This reduced thebank population to 37.At the time of the research, the study sought information from 27% of the banks that were selected through stratified sampling using proportionate quota sampling and simple random sampling. The banks were first classified into peer groups. The banks in each category were arranged alphabetically.Using a sample size of 10, the selection of a representative number of banks from each category was done using simple random sampling technique.

Purposive sampling was applied to select specific respondents targeted for data gathering. From each of the selected banks, six respondents were targeted, being drawn from the strategy, operations, customer relations, sales and marketing, communication and information technology. The respondents were managerial level employees of the bank.. The respondents were selected by them being decision makers and implementers on strategic issues of the bank.

Table 3.2 Sampling Frame

Peer group	**Population Proportion**	**Targeted number from peer group**	**Randomly selected banks**
Small	18	5	1. Consolidated Bank of Kenya Ltd. 2. Gulf African Bank Limited 3. Paramount Bank Ltd. 4. UBA Kenya Bank Ltd.
Medium	13	4	5. Bank of India 6. Family Bank Ltd. 7. National Industrial Credit Bank Ltd.
Large	6	2	8. Barclays Bank of Kenya Ltd. 9. Equity Bank Ltd.
Total	37	11	9

Source: CBK, 2017

3.5 Data Collection Tools

The study was based on both primary and secondary data. Questionnaires was used for primary data. The questionnaire contained both open ended and closed ended

questions and was developed and administered to obtain information from the 45 respondents. Data was collected using drop and pick later method.

The secondary data was accessed from governing institutions in Kenya's banking sector including the Central Bank and the Kenya Bankers Association, as well as international sources like World Bank Findex reports(Demirgüç-Kunt*et al*, 2015).. Public financial statements of each bank also made up the secondary data of this study.

3.6 Reliability Test

The questionnaire was discussed with two randomly selected lecturers for further validation. Their views were incorporated to improve the questionnaire.To enhance the reliability of the questionnaires as a primary tool for data collection for purposes of the study, a pilot test was conducted. A pre-test among 3 respondents in Microfinance banks was conducted. The researcher administered questionnaires for the 3 respondents to participate in the pre-test, but they did not participate in the main study. Reliability was analysed using the 3 questionnaires administered to the randomly selected employees. Cronbach's alpha correlation coefficient was used to test the reliability of the questionnaire. A coefficient of 0.7 was appropriate for the study since the higher the score the more reliable the generated data. (Sekaran 2003).

3.7 Data Collection Procedure

Questionnaires were self-administered using the drop and pick technique. The researcher distributed the questionnaire to the participants and picked later when they completed. The researcher adequately briefed the respondents on the contents of the questionnaire before leaving it with them. The respondents were allowed up to seven days to fill in the questionnaire. This was done to increase the response rate as some of the respondents might were quite busy with their work schedules.

3.8 Data Analysis

The study collected both quantitative and qualitative data from open and closed-ended questions in the questionnaire.

3.8.1 Qualitative Data

Open ended questions in the questionnaire collected qualitative data. Content analysis was carried out, developing a thematic framework from arising key issues (Nsubuga, 2006).

3.8.2 Quantitative Data

In analysing the quantitative data, the study used Statistical Package for Social Sciences (Version 22). Measures of central tendency, dispersion, frequencies and percentage were applied for the quantitative variables (Kothari, 2004). The findings are presented in Chapter four.

Linear Regression

The study also used inferential statistics to further analyse quantitative data. The multiple linear regression analysis ascertained the implication of each independent variable on firm performance. Results are said to be statistically significant within the 0.05 significance level. The significance was determined by the t-value, which indicates how many standard error-means the sample diverges from the tested value (Kothari, 2004).

Below is the multiple linear regression model

$Y=\alpha+\beta_1X_1 + \beta_2X_2+ \beta_3X_3 + \beta_4X_4+ \varepsilon.$

Y= dependent variable (firm performance)

X_1= managed innovation process,

X_2=industry foresight,

X_3=strategic alignment,

X_4= customer insight

α= constant,

ε= error term,

β=coefficient of independent variable (β_1=coefficient of managed innovation process, β_2 = coefficient of industry foresight, β_3 = coefficient of strategic alignment, β_4 = coefficient of customer insight).

CHAPTER 4: ANALYSIS, INTERPRETATION AND PRESENTATION

4.1 Introduction

The chapter presents the findings on the study on effect of strategic innovation on firm performance in the commercial banking sector in Kenya. The specific objectives included; to determine the influence of innovation process management on the firm performance of commercial banks in Kenya; to evaluate the effect of strategic alignment on the firm performance of commercial banks in Kenya; to establish the influence of industry foresight on the firm performance of commercial banks in Kenya and to determine the impact of customer insight on the firm performance of commercial banks in Kenya.

4.2 Response Rate

The study had a sample size of 60respondents to whom questionnaires were administered to as indicated on Table 4.1 below.

Table 4.1Response rate

Response Rate	
Questionnaires administered	60
Questionnaires returned	50
Response rate (%)	**83.3%**

Source Survey data, 2018.

As indicated in Table 4.1 above, only 50 of the respondents returned the questionnaires duly filled in contributing to a response rate of 83.3%. This response rate was sufficient and representative and conforms to Mugenda and Mugenda (2008) stipulation that; a response rate of 50% is adequate; 60% is good while 70% and over is excellent for analysis and statistical reporting.

Table 4.2 Reliability Test Results

Variable	Number of items	Cronbach alpha values	Comment
Innovation process management	9	0.732	Reliable
Customer insight	6	0.726	Reliable
Strategic alignment	8	0.714	Reliable
Industry foresight	8	0.707	Reliable
Aggregate score	**31**	**0.719**	**Reliable**

Source Pilot study, 2018

From the pilot study results the study established that the Cronbach alpha values were higher above 0.7 for all the study variables that included; innovation process management(0.732), customer insight(0.726), strategic alignment(0.714) and industry foresight (0.707)on firm performance of commercial banks in Kenya. This was an indication that there was internal consistency and high reliability among the items/variables (innovation process management, customer insight, strategic alignment and industry foresight) in measuring the concept of interest (firm performance of commercial banks in Kenya).

4.3 Background Information

This section provides background information about the study respondents. The background information that was sought in the study included; department, number of years they had been in banking industry; and the department they worked in.

Table 4.3 Background information

Identify your department	Frequency	Percent
Human resource	8	16
Operations	10	20
Customer relations	8	16
Administration	8	16
Information technology	6	12
Communication	10	20
Total	**50**	**100**
What is your work experience in years in the banking industry?	Frequency	Percent
Less than 1 years	15	30
1-5 years	22	44
6-10 years	8	16
Over 10 years	5	10
Total	**50**	**100**
What is your highest formal qualification?	Frequency	Percent
Diploma	11	22
Degree	27	54
Masters	12	24
Total	**50**	**100**

Source Survey data, 2018.

From the findings, there was fair distribution of respondents from the six departments that they came from as follows; human resource (16%), operations (20%), customer relations (16%) and administration (16%), information technology(12%) and communication(20%).This implied that there was fair distribution of opinion from the six targeted departments that were responsible for strategic innovations among banks hence good quality of data collected.

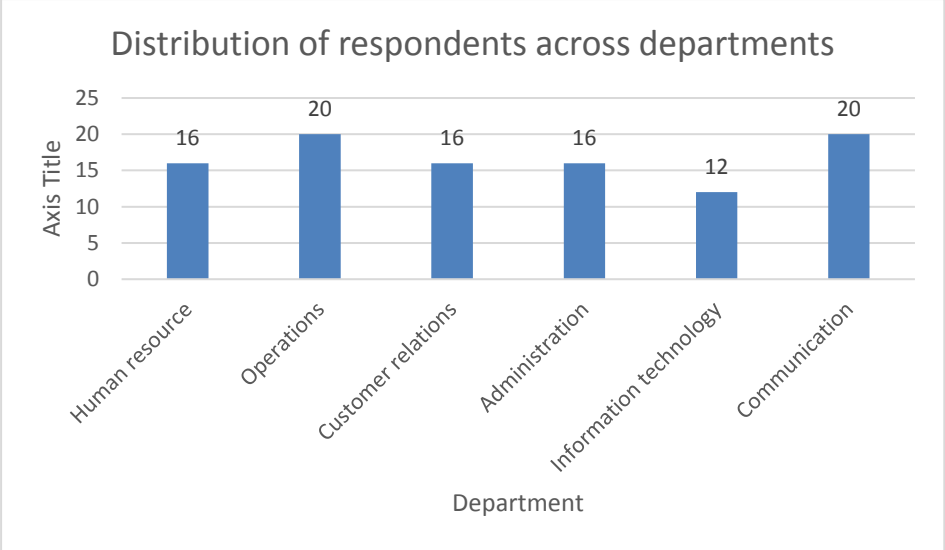


Figure 4.1 Distribution of respondents across departments

Source: Survey data, 2018

The study established that 44% of the respondents had worked in the banking industryfor 1-5 years, 30% for less than one year, 16% for 6-10 years while 10% had worked in the banking industry for over 10 years. This implies that most of the employees had a work experience of between 1-5 years which was long enough to give reliable data on effect of strategic innovations on firm performance among commercial banks.

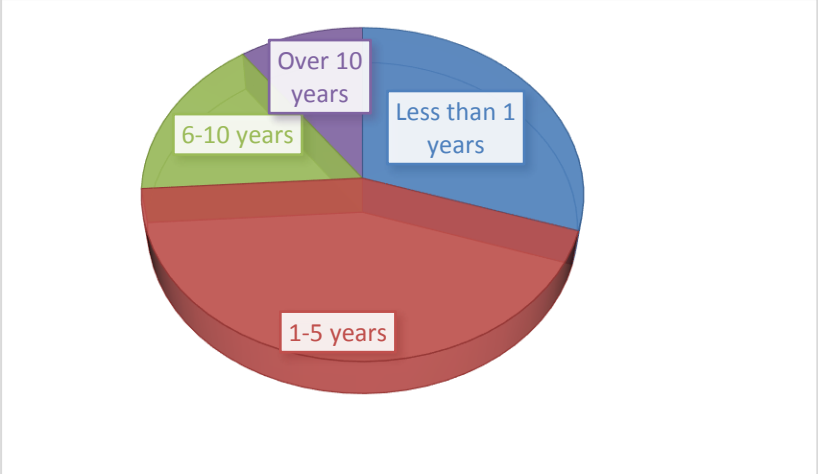


Figure 4.2: Distribution of respondents on work experience

Source: Survey data, 2018

In terms of education, 54% were degree holders, 24% were master's degree holders while 22% were diploma holders. It implies that the respondents were highly trained in their jobs given the sound educational background. Therefore, they could give credible information on the study.

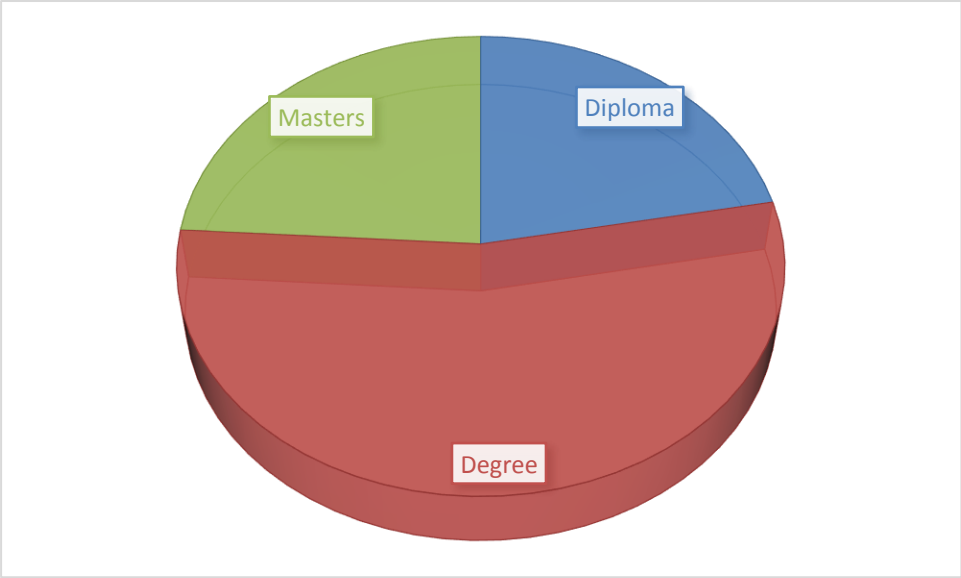


Figure 4.3: Respondents' formal education

Source: Survey data, 2018

4.4 Innovation Process Management and Firm Performance

The first objective was to determine the influence of innovation process management on the firm performance of commercial banks in Kenya.

Table 4.4Innovation process management and firm performance

Innovation process management and firm performance	Mean	Std Dev
The department has a clearly defined innovation management process	4.04	0.80711
The department regularly evaluate and review the process to ensure effectiveness	4.04	0.66884
All the people in the department work together towards great innovations and they do not do things on their own	4.00	0.60609
The department properly evaluates and tests its innovations before taking them to market	3.96	0.72731
The department measures execution of providing services or products from customer's perspective	3.96	0.66884
The process of finding ideas is permanent and involves all employees	3.94	0.86685
Employees are inspired and motivated to find and submit ideas	3.92	0.69517
There is open communication and information flow from within and outside the bank on new ideas	3.84	0.61809
Employees believe that a clearly defined innovation management process could help the organization to achieve goals better	3.28	0.88156
Aggregate score	**3.87**	**0.72670**

Source Survey data, 2018.

According to the findings, majority of the respondentsagreed that banks leveraged on innovation process management to enhance theperformance of commercial banks in Kenya based on the overall mean score of innovation process management at 3.87.

More specifically, they were in agreement with innovation processmanagement constructs that; the department has a clearly defined innovation management process (Mean=4.04); the department regularly evaluate and review the process to ensure effectiveness (Mean=4.04); all the people in the department work together towards great innovations and they do not do things on their own (Mean=4.00); the department properly evaluates and tests its innovations before taking them to market (Mean=3.96); the department measures execution of providing services or products from customer's perspective (Mean=3.96); the process of finding ideas is permanent and involves all employees (Mean=3.94); employees are inspired and motivated to find and submit ideas (Mean=3.92); there is open communication and information flow from within and outside the bank on new ideas (Mean=3.84); employees believe that a clearly defined innovation management process could help your organization to achieve goals better (Mean=3.28) respectively.

This depicts that innovation process management was a strategic innovation that banks heavily deployed to enhance their firm performance. Through the innovation process management, commercial banks were able to innovate in their product and service offering. They also understood and effectively meet the evolving customer banking needs, hence achieving customer satisfaction that lead to improve firm performance. Through innovation process management, the banks leveraged on open communication and information flow to respond to the emerging internal and external changes as a resulting of market force that had a bearing on their firm performance.

These findings are consistent with those of Sanders (2014), that concluded that innovation process management is positively related to performance regardless of the competition intensity. This is one of the few studies to empirically examine process management as three core elements. Previous studies utilized a single construct of process management or multiple manufacturing practices such as customer/supplier involvement, statistical quality control, process focus, and cross-functional teams to measure process management. Using this measurement approach demonstrates how process management can influence both efficiency and innovation.

4.5 Strategic alignment and firm performance

The second objective was to evaluate the effect of strategic alignment on the firm performance of commercial banks in Kenya.

Table 4.5 Strategic Alignment and Firm Performance

Strategic alignment and firm performance	Mean	Std Dev
All employees are knowledgeable on what their goals are	3.94	0.58589
There is a clear link between the goals and supporting activities	3.9	0.67763
All employees are involved in the individual goal setting in line with the bank's goals	3.9	0.58029
All goals are SMART (specific, measurable, achievable, relevant and time-bound)	3.88	0.71827
All new rules and procedures are in line with the goals and mission of the bank	3.88	0.74615
The bank's current capability supports the achievement of your business strategy	3.88	0.71827
The bank's current human resources support the achievement of the business strategy	3.86	0.70015
The bank's business strategy strongly supports fulfilment of its purpose	3.86	0.85738
There is only one version of the bank's vision among the employees	3.86	0.67036
There is a tracking mechanism of foreseeable changes in customer sentiment and behaviour.	3.82	0.89648
Aggregatescore	**3.88**	**0.7150**

Source Survey data, 2018.

According to the findings, most of the respondentsagreed that banks applied strategic alignment to improve performance of commercial banks in Kenya based on the overall mean score of strategic alignment at 3.88. More specifically, they agreed with strategic alignment constructs that;

all employees are knowledgeable on what their goals are (Mean=3.94); there is a clear link between the goals and supporting activities (Mean=3.9); all employees are involved in the individual goal setting in line with the bank's goals (Mean=3.9); all goals are SMART (specific, measurable, achievable, relevant and time-bound) (Mean=3.88); all new rules and procedures are in line with the goals and mission of the bank (Mean=3.88); the bank's current capability supports the achievement of your business strategy (Mean=3.88); the bank's current human resources support the achievement of your business strategy (Mean=3.86); the bank's business strategy strongly supports fulfilment of its purpose (Mean=3.86); there is only one version of the bank's vision among the employees (Mean=3.86); there is a tracking mechanism of foreseeable changes in customer sentiment and behaviour (Mean=3.82) respectively.

From the foregoing, it was deduced that banks in Kenya used strategic alignment as one of their operational strategies to enhance their firm performance. Through strategic alignment, there was shared vision and synergy among the staff in executing the bank corporate goals and plans. Similarly, the commercial banks' business strategy was aligned with the human resources hence likely to be effectively executed as employees understood and owned the strategy implementation process while being flexible to the changes encountered.These findings agree with those of Kathuria, Joshi and Porth (2007) that concluded as firms grow and diversify, becoming multi-business organizations, the importance of horizontal alignment is elevated. The study, based on a thorough review of both theoretical and empirical research, sought to examine evidence of alignment-performance relationship within firms.

4.6 Industry foresight and firm performance

The third objective was to establish the influence of industry foresight on the firm performance of commercial banks in Kenya.

Table 4.6 Industry Foresight and Firm Performance

Industry foresight and firm performance	Mean	Std Dev
The bank has the expertise concerning the current developments in the banking industry	3.96	0.66884
The bank has specified plans to build its expertise in the future development in the banking industry	3.84	0.71027
There is systematic identification and exploration of attractive opportunities in the industry	3.76	0.6869
The employees are well aware of the bank's position in the market	3.74	0.72309
There is a mechanism for consolidating ideas on leveraging opportunities in the industry	3.74	0.69429
There is regular assessment of new business opportunities with respect to market attractiveness and suitability to the bank	3.72	1.01096
Aggregatescore	**3.79**	**0.7490**

Source Survey Data, 2018.

According to the findings, most of the respondentsagreed that banks leveraged on industry foresight to improve performance of commercial banks in Kenya based on the overall mean score of industry foresight at 3.79. More specifically, they were in agreement with industry foresight constructs that; the bank has the expertise concerning the current developments in the banking industry (Mean=3.96); the bank has specified plans to build its expertise in the future development in the banking industry (Mean=3.84); there is systematic identification and exploration of attractive opportunities in the industry (Mean=3.76); the employees are well aware of the bank's position in the market (Mean=3.74); there is a mechanism for consolidating

ideas on leveraging opportunities in the industry (Mean=3.74); there is regular assessment of new business opportunities with respect to market attractiveness and suitability to the bank (Mean=3.72) respectively.

From the findings, it is evident that industry foresight was one of the strategic innovations that banks in Kenya employed to increase their competitive advantage in the market place. By understanding the banking sector dynamics such as regulation, technology swift, changing consumer needs and other market forces, banks using the industry foresight were better placed to respond accordingly to such changes to remain sustainable and competitive. These findings are in line with those of Day and Wenseley (1988) that concluded that effective strategy moves are grounded in valid and insightful monitoring of the current competitive position coupled with evidence that reveals the skills and resources affording the most leverage on future cost and differentiation advantages.

4.7 Customer insight and firm performance

The fourth objective was to determine the impact of customer insight on the firm performance of commercial banks in Kenya.

Table 4.7 Customer Insight and Firm Performance

Customer insight and firm performance	Mean	Std Dev
The bank continually monitors customers' activities	3.74	0.96489
There is real-time reviewing of customer information and generation of metrics that inform analyses	3.62	0.83029
Customer satisfaction surveys are regularly carried out	3.6	0.60609
In-person interviews or surveys asking open-ended questions are regularly conducted	3.6	0.60609
Front office employees are often able to accurately customize solutions for the client	3.58	0.75835
Disgruntled clients are often converted by attending to the unpleasant event	3.5	0.99488
The bank can spot patterns in customer behaviour, or to predict	3.42	0.9916

Customer insight and firm performance	Mean	Std Dev
The bank continually monitors customers' activities their response	3.74	0.96489
The bank has implemented database marketing for their products and services	3.36	0.89807
Aggregate score	**3.55**	**0.8312**

Source Survey data, 2018.

According to the findings, the majority of the respondents were in agreement that banks used customer insight to enhance performance of commercial banks in Kenya based on the overall mean score of customer insight at 3.55. More specifically, they were in agreement with customer insight constructs that; the bank continually monitors customers' activities (Mean=3.74); there is real-time reviewing of customer information and generation of metrics that inform analyses (Mean=3.62); customer satisfaction surveys are regularly carried out (Mean=3.6); in-person interviews or surveys asking open-ended questions are regularly conducted (Mean=3.6); front office employees are often able to accurately customize solutions for the client (Mean=3.58); disgruntled clients are often converted by attending to the unpleasant event (Mean=3.5); the bank is able to spot patterns in customer behaviour, or to predict their response (Mean=3.42); the bank has implemented database marketing for their products and services (Mean=3.36) respectively.

This depicts that customer insight was a critical strategic innovation that banks in Kenya leveraged to increase their market reach by meeting customer needs, hence increasing their performance against stiff competition from other financial service providers. Through customer insight, the banks effectively monitored the changing customer needs and responded to them improving the customer experience and satisfaction. Similarly, they were able to deal with customer complaints and learn from them. It further gave the banks leverage in marketing their products from the customer database created through customer insight as a strategic innovation. The findings collaborate with those of Payne and Frow (2005).The authors propose a conceptual framework for customer relationship management (CRM) that helps broaden the understanding of CRM and its role in enhancingcustomer value and, as a

result, shareholder value. They emphasize the need for a cross-functional, process-oriented approach that positions CRM at a strategic level. They identify five key cross-functional CRM processes: a strategy development process, a value creation process, a multichannel integration process, an information management process, and a performance assessment process (Payne &Frow, 2005).

4.8 Firm Performance

Financial performance as the study dependent variable was measured using Return on Asset (ROA), a ratio of net income to total assets for the selected ten commercial banks for a five-year period (2013-2017).

Table 4.8 Return on Asset (ROA)

Year	N	Mean	Std. Deviation
2013	10	0.09	2.923
2014	10	0.10	2.692
2015	10	0.12	1.042
2016	10	0.15	1.016
2017	10	0.18	1.003

Source Survey data, 2018.

ROA as the measure of financial performance of commercial banks was 0.09 in 2013 while the uppermost ROA value was 0.18 in 2017. This implied a significant positive improvement in ROA mean values by 1.00 (100%). This points to an improved financial performance of the banks in Kenya over the five-year period (2013 to 2017) which was attributed to the banks robust investment in strategic innovation including; innovation process management, strategic alignment, industry foresight and customer insight employed by the commercial banks in Kenya. There was significant variation on standard deviation implying great variation of financial performance between the tier 1 and the rest of tier 1 and 3 commercial banks.

4.9 Relationship Between Strategic Innovationsand Firm Performance

To confirm relationship between strategic innovation and firm performance of commercial banks in Kenya, the study used multiple regression analysis.

4.9.1 Model Summary

The model summary findings are as shown in Table 4.9 below.

Table 4.9 Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.855	0.731	0.642	0.6273

Source Survey data, 2018

Table 4.9 indicates that the four strategic innovations explains 73.1% of the firm performance of commercial banks in Kenya as represented by the R^2 while other elements not studied influence firm performance of commercial banks in Kenyaby 26.9%.

4.9.2 ANOVA Results

ANOVAwasusedtotesttheclaimthatthereisnosignificantrelationshipbetweentheindependent variables (strategic innovations) and the dependent variable (firm performance of commercial banks in Kenya). The study ANOVA results are as shown in Table 4.10 below.

Table 4.10 ANOVA results

Model		**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
1	Regression	11.729	4	11.729	9.475	.0179[a]
	Residual	15.418	45	0.211		
	Total	27.147	**49**			

Source Survey data, 2018

The significance value is 0.0179which is less than p=0.05 thus the model is statistically significant in predicting how strategic innovations influence firm performance of commercial banks in Kenya. hence, the null hypothesis is rejected. The F critical at 5% level of significance was 3.23. Since F calculated is greater than the F critical (value = 9.475), this shows that the overall model was significant in predicting the influence of strategic innovations on firm performance of commercial banks in Kenya.

4.9.3 Coefficient of Determination

The following linear regression model was adopted to help determine the nature of this relationship: $Y= ß0 + ß_1 X_1+ ß_2 X_2+ ß_3 X_3+ ß_4 X_4+ \epsilon$; Where Y is the dependent variable (firm performance), ϵ is the constant (intercept), ß is are the regression coefficients and X_1, X_2, X_3 and X_4 are innovation process management, customer insight, strategic alignment and industry foresight respectively.

Table 4.11 Coefficient of Determination

	Unstandardized Coefficients		**Standardized Coefficients**		
Model	**B**	**Std. Error**	**Beta**	**t**	**Sig.**
Constant	3.312	.328		10.089	.000
Innovation Process Management	0.752	0.1032	0.152	4.223	.0179
Customer Insight	0.545	0.2178	0.116	3.936	.0251
Strategic Alignment	0.487	0.3425	0.054	3.724	.0269
Industry Foresight	0.439	0.1937	0.263	3.247	.0454

Source Survey Data, 2018

At 5% level of significance, all the four variables were statistically significant as their p-value were within the acceptable threshold of ($p < 0.05$). From the findings, positive effect on firm performance was found on all the four strategic innovations, that is, innovation process management, customer insight, strategic alignment and industry foresight withregression coefficient values: $ß_0$=3.312, $ß_1$=0.752, $ß_2$=0.545, $ß_3$=0.487

and $ß_4$=0.439 respectively. The regression model can therefore be expressed as follows:

$$\mathbf{Y= 3.312+0.752X_1+ 0.545X_2+ 0.487X_3+} 0.439\mathbf{X_4}$$

Firm performance = 3.312 + 0.752 Innovation Process Management

+ 0.545 Customer Insight

+ 0.487 Strategic Alignment

+ 0.439 Industry Foresight

From this regression equation, taking all factors constant at zero, the firm performance would be 3.312. These findings indicate that taking all otherindependentvariablesatzero,aunitincreaseinthe innovation process management will lead to 0.752 increase in firm performance; aunitincreaseinthe customer insight will lead to 0.545 increase in firm performance; aunitincreaseinthe strategic alignment will lead to 0.487 increase in firm performance while aunitincreaseinthe industry foresight will lead to 0.487 increase in firm performance. The findings imply that innovation process management as a strategic innovation contribute the most to firm performance followed by customer insight, strategic alignment and industry foresight respectively.

At 5% level of significance and 95% level of confidence, innovation process management had a 0.0179 level of significance, customer insight had 0.0251 significance level, strategic alignment had a 0.0269 level of significance while industry foresight had 0.0454 significance level. The significance values obtained indicate that the most significant strategic innovation influencing firm performance of commercial banks in Kenya is innovation process management, customer insight, strategic alignment and industry foresight respectively.

CHAPTER 5: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter presents the summary of key findings on the study on effect of strategic innovation on firm performance in the commercial banking sector in Kenya. it also presents the conclusions drawn thereof and the recommendations based on the study specific objectives. It finally presents areas for further studies.

5.2 Summary

5.2.1 Innovation Process Management and Firm Performance

The study established that commercial banks leveraged on innovation process management to enhance performance of commercial banks in Kenya based on the overall mean score of innovation process management at 3.87. More specifically, it was established that; the banks have a clearly defined innovation management process (Mean=4.04); they regularly evaluate and review the process to ensure effectiveness (Mean=4.04); all the people in the department collaborate towards great innovations (Mean=4.00); generally, the banks properly evaluates and tests its innovations before taking them to market (Mean=3.96); the banks measure execution of providing services or products from customer's perspective (Mean=3.96); the process of finding ideas is permanent and involves all employees (Mean=3.94); employees are inspired and motivated to find and submit ideas (Mean=3.92); there is open communication and information flow from within and outside the bank on new ideas (Mean=3.84); employees believe that a clearly defined innovation management process could help your organization to achieve goals better (Mean=3.28) respectively.

Therefore, innovation process management was a strategic innovation that banks heavily deployed to enhance their firm performance. Through the innovation process management, commercial banks were able to innovate in their product and service offering. They also understood and effectively meet the evolving customer banking needs, hence achieving customer satisfaction that lead to improve firm performance. Through innovation process management, the banks leveraged on open

communication and information flow to respond to the emerging internal and external changes as a resulting of market force that had a bearing on their firm performance.

5.2.2 Strategic Alignment and Firm Performance

The study revealed that banks applied strategic alignment to improve performance of commercial banks in Kenya based on the overall mean score of strategic alignment at 3.88. More specifically, it was revealed that; all employees are knowledgeable on what their goals are (Mean=3.94); there is a clear link between the goals and supporting activities (Mean=3.9); all employees are involved in the individual goal setting in line with the bank's goals (Mean=3.9); all goals are SMART (specific, measurable, achievable, relevant and time-bound) (Mean=3.88); all new rules and procedures are in line with the goals and mission of the bank (Mean=3.88); the bank's current capability supports the achievement of your business strategy (Mean=3.88); the bank's current human resources support the achievement of your business strategy (Mean=3.86); the bank's business strategy strongly supports fulfilment of its purpose (Mean=3.86); there is only one version of the bank's vision among the employees (Mean=3.86); there is a tracking mechanism of foreseeable changes in customer sentiment and behavior (Mean=3.82) respectively.

From the foregoing, it is evident that banks in Kenya relied onstrategic alignment to enhance their firm performance. Through strategic alignment, there was shared vision and synergy among the staff in executing the bank corporate goals and plans. Similarly, the commercial banks' business strategy was aligned with the human resources hence likely to be effectively executed as employees understood and owned the strategy implementation process while being flexible to the changes encountered.

5.2.3 Industry Foresight and Firm Performance

The study determined that commercial banks in Kenya are leveraging on industry foresight to improve performance of commercial banks in Kenya based on the overall mean score of industry foresight at 3.79. More specifically, study determined that; the bank has the expertise concerning the current developments in the banking industry (Mean=3.96); the bank has specified plans to build its expertise in the future

development in the banking industry (Mean=3.84); there is systematic identification and exploration of attractive opportunities in the industry (Mean=3.76); the employees are well aware of the bank's position in the market (Mean=3.74); there is a mechanism for consolidating ideas on leveraging opportunities in the industry (Mean=3.74); there is regular assessment of new business opportunities with respect to market attractiveness and suitability to the bank (Mean=3.72) respectively.

Thus, industry foresight was one of the strategic innovations that banks in Kenya employed to increase their competitive advantage in the market place. By understanding the banking sector dynamics such as regulation, technology swift, changing consumer needs and other market forces, banks using the industry foresight were better placed to respond accordingly to such changes to remain sustainable and competitive.

5.2.4 Customer Insight and Firm Performance

The study established that banks used customer insight to enhance performance of commercial banks in Kenya based on the overall mean score of customer insight at 3.55. More specifically, study established that; the bank continually monitors customers' activities (Mean=3.74); there is real-time reviewing of customer information and generation of metrics that inform analyses (Mean=3.62); customer satisfaction surveys are regularly carried out (Mean=3.6); in-person interviews or surveys asking open-ended questions are regularly conducted (Mean=3.6); front office employees are often able to accurately customize solutions for the client (Mean=3.58); disgruntled clients are often converted by attending to the unpleasant event (Mean=3.5); the bank is able to spot patterns in customer behaviour, or to predict their response (Mean=3.42); the bank has implemented database marketing for their products and services (Mean=3.36) respectively.

Therefore, customer insight was a critical strategic innovation that banks in Kenya leveraged to increase their market reach by meeting customer needs, hence increasing their performance against stiff competition from other financial service providers. Through customer insight, the banks effectively monitored the changing customer

needs and responded to them improving the customer experience and satisfaction. Similarly, they were able to deal with customer complaints and learn from them. It further gave the banks leverage in marketing their products from the customer database created through customer insight as a strategic innovation.

In terms of commercial banks' financial performance Return on Asset (ROA) was 0.09 in 2013 while the uppermost ROA value was 0.18 in 2017. There was a significant positive increase in ROA mean values by 1.00 (100%). Therefore, there was improved financial performance among commercial banks in Kenya over the five-year period (2013 to 2017) which was likely to be attributed to among other things the robust strategic innovation including; innovation process management, strategic alignment, industry foresight and customer insight employed by the commercial banks in Kenya.

5.3 Conclusions

The study concludes that commercial banks leveraged on innovation process management to enhance performance of commercial banks in Kenya. Therefore, innovation process management was a strategic innovation that banks heavily deployed to enhance their firm performance. Through the innovation process management, commercial banks were able to innovate in their product and service offering. They also understood and effectively met the evolving customer banking needs, hence achieving customer satisfaction that in turn lead to higher firm performance. Through innovation process management, the banks leveraged on open communication and information flow to respond to the emerging internal and external changes as a resulting of market force that had a bearing on their firm performance.

It was also concluded that banks applied strategic alignment to improve performance of commercial banks in Kenya. Thus, commercial banks in Kenya used strategic alignment as one of their strategic innovations to enhance their firm performance. Through strategic alignment, there was shared vision and synergy among the staff in executing the bank corporate goals and plans. Similarly, the commercial banks' business strategy was aligned with the human resources hence likely to be effectively

executed as employees understood and owned the strategy implementation process while being flexible to the changes encountered.

The study further concludes that banks leveraged on industry foresight to improve performance of commercial banks in Kenya. Therefore, industry foresight was one of the strategic innovations that banks in Kenya employed to increase their competitive advantage in the market place. By understanding the banking sector dynamics such as regulation, technology swift, changing consumer needs and other market forces, banks using the industry foresight were better placed to respond accordingly to such changes to remain sustainable and competitive.

In addition, it was concluded that banks used customer insight to enhance performance of commercial banks in Kenya. Therefore, customer insight was a critical strategic innovation that banks in Kenya leveraged to increase their market reach by meeting customer needs, hence increasing their performance against stiff competition from other financial service providers. Through customer insight, the banks effectively monitored the changing customer needs and responded to them improving the customer experience and satisfaction. Similarly, they were able to deal with customer complaints and learn from them. It further gave the banks leverage in marketing their products from the customer database created through customer insight as a strategic innovation.

The improved financial performance among commercial banks in Kenya over the five-year period (2013 to 2017) registered was likely attributed to the robust investment in strategic innovation including; innovation process management, strategic alignment, industry foresight and customer insight employed by the commercial banks in Kenya.

5.4 Recommendations with Policy Implications

The study established that innovation process management was a strategic innovation that banks heavily deployed to enhance their firm performance. Therefore, the study recommends that the management of commercial banks in Kenya should adequately

finance the innovation process management which is capital intensive to accrue the benefits from this process full implementation.

The study established that through strategic alignment, there was shared vision and synergy among the staff in executing the bank corporate goals and plans. Therefore, the study recommends that the management of commercial banks in Kenya should continuously build the capacity of the employees to effectively execute the bank's strategy that keeps changing to the market forces that keep changing.

The study established that industry foresight was one of the strategic innovations that banks in Kenya employed to increase their competitive advantage in the market place. Therefore, the study recommends that the management of commercial banks in Kenya should institutionalize research to inform decisions being made from industry foresight as a strategic innovation among banks.

The study established that customer insight was a critical strategic innovation that banks in Kenya leveraged to increase their market reach by meeting customer needs, hence increasing their performance against stiff competition from other financial service providers. Therefore, the study recommends that the management of commercial banks in Kenya should move away from brick and mortar model of banking to more customer centric banking model like commercial mobile banking.

The results of this study present justification on the need for continuous research and development of the banking industry by the government of Kenya. To ensure healthy competition and sustainable business practices, there is need to create an enabling environment for innovation with in the industry, while at the same time protecting the customer from extreme exploitation.

5.5 Areas for Further Research

Similar studies should be conducted among other financial institutions apart from commercial banks for comparison and generalization of the study findings established in this study. The financial institutions should include micro-finance institutions, SACCOs and deposit taking micro-finance institutions. This is because there exists

contextual, regulatory and operational differences between commercial banks and the other financial institutions.

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World Bank's Findex survey 2014

APPENDICES

APPENDIX 1: List of commercial banks in Kenya

1. African Banking Corporation Ltd
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda (K) Ltd.
4. Bank of India
5. Barclays Bank of Kenya Ltd.
6. CFC Stanbic Bank Ltd.
7. Charterhouse Bank Ltd.
8. Chase Bank (K) Ltd.
9. Citibank N.A Kenya
10. Commercial Bank of Africa Ltd.
11. Consolidated Bank of Kenya Ltd.
12. Co-operative Bank of Kenya Ltd.
13. Credit Bank Ltd.
14. Development Bank of Kenya Ltd.
15. Diamond Trust Bank (K) Ltd.
16. Dubai Bank Kenya Ltd.
17. Ecobank Kenya Ltd.
18. Equatorial Commercial Bank Ltd.
19. Equity Bank Ltd.
20. Family Bank Ltd.
21. Fidelity Commercial Bank Ltd.
22. Fina Bank Ltd.
23. First Community Bank Ltd.
24. Giro Commercial Bank Ltd.
25. Guardian Bank Ltd.
26. Gulf African Bank Limited
27. Habib Bank A.G Zurich
28. Habib Bank Ltd.
29. Investment & Mortgages Bank Ltd.
30. Jamii Bora Bank Ltd.
31. Kenya Commercial Bank Ltd.
32. K-Rep Bank Ltd.
33. Middle East Bank (K) Ltd.
34. National Bank of Kenya Ltd.
35. National Industrial Credit Bank Ltd.
36. Oriental Commercial Bank Ltd.
37. Paramount Universal Bank Ltd.
38. Prime Bank Ltd.
39. Standard Chartered Bank (K) Ltd.
40. Trans-National Bank Ltd.
41. UBA Kenya Bank Ltd.
42. Victoria Commercial Bank Ltd

Source: Central Bank of Kenya in 2017

APPENDIX 2: Letter of introduction

Isabel Njeri Njihia

Tel: +254721970447

Email:
mbalmr542016@spu.ac.ke

Date

To

Dear Sir/Madam,

RE: COLLECTION OF RESEARCH DATA

I am a student at St Paul's University, pursuing a Masters of Business Administration, specializing in Strategic Management and Leadership. As prescribed by the course, I am undertaking a research on the 'Effect of strategic innovation on firm performance in the commercial bank sector in Kenya'. Given your strategic position and role in your institution, you have been selected as one of the respondents in this study. I would like to request for your kind assistance in the data collection stage, which is critical for the success of this study. Kindly take some time to respond to all the questions on the attached questionnaire. You have my assurance that the information collected is only for the purpose of this study and was treated with confidentiality.Your completion of questionnaire within the next few days is highly appreciated.

Thank you for your consideration, and timely response.

Yours sincerely,

Isabel Njeri Njihia

Student registration number: MBA/LMR/5420/16

APPENDIX 3: Questionnaire

This questionnaire is designed to collect data regarding '*Effect of strategic innovation on firm performance in the commercial bank sector in Kenya*'. This research is in partial fulfilment of the requirements for the award of a Master of Business Administration, Strategic Management and Leadership from St. Paul's University. The questionnaire consists of two parts; kindly answer all the questions.

Your response is highly appreciated. Thank you!

Section A: General information

1. Name of bank: _____
2. Identify your department:

   Human resource [ ] Operations [ ] Customer relations [ ]

   Administration [ ] Other[ ] (Specify……)

3. What is your designation? …….
4. What is your work experience in years in the banking industry?

   0-5 yrs [ ] 5-10 yrs [ ] 10-15yrs [ ] Over 15 yrs [ ]

5. What is your highest formal qualification?

   Certificate/ Diploma [ ] Undergraduate [ ]

   Post graduate level [ ] Other
   (Specify……)

Section B: Effect of strategic innovation on firm performance in the commercial bank sector in Kenya'

Statement	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**
***Instructions**:* The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
1. **Innovation management process**					
a) The department has a clearly defined innovation management process					
b) The department regularly evaluate and review the process to ensure effectiveness					
c) All the people in the department work together towards great innovations and they do not do things on their own					
d) The department properly evaluates and tests its innovations before taking them to market					
e) The department measures execution of providing services or products from customer's perspective					
f) The process of finding ideas is permanent and involves all employees					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
g) Employees are inspired and motivated to find and submit ideas					
h) There is open communication and information flow from within and outside the bank on new ideas					
i) You believe that a clearly defined innovation management process could help your organization to achieve goals better					
Additional Comments:					
2. Industry foresight					
a) The bank has the expertise concerning the current developments in the banking industry					
b) The bank has specified plans to build its expertise in the future development in the banking industry					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
c) There is systematic identification and exploration of attractive opportunities in the industry					
d) The employees are well aware of the bank's position in the market					
e) There is a mechanism for consolidating ideas on leveraging opportunities in the industry					
f) There is regular assessment of new business opportunities with respect to market attractiveness and suitability to the bank					
Additional Comments:					
3. Strategic alignment					
a) All employees are knowledgeable on what their goals are					
b) There is a clear link between the					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
goals and supporting activities					
c) All employees are involved in the individual goal setting in line with the bank's goals					
d) All goals are SMART(specific, measureable, achievable, relevant and time-bound)					
e) All new rules and procedures are in line with the goals and mission of the bank					
f) The bank's current capability supports the achievement of your business strategy					
g) The bank's current human resources supports the achievement of your business strategy					
h) The bank's business strategy strongly supports fulfillment of its purpose					
i) There is only one version of the bank's vision among the employees					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
j) There is a tracking mechanism of foreseeable changes in customer sentiment and behavior.					
Additional Comments:					
4. Customer insight					
a) The bank continually monitors customers' activities					
b) There is real-time reviewing of customer information and generation of metrics that inform analyses					
c) Customer satisfaction surveys are regularly carried out					
d) In-person interviews or surveys asking open-ended questions are regularly conducted					
e) Front office employees are often able to accurately customize					

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Instructions: The following statements relates to influence of innovation process management; strategic alignment, industry foresight and customer insight on the firm performance of commercial banks as clearly categorised. please indicate your level of agreement with each of the statements based on your experience in your current*bank.*					
solutions for the client					
f) Disgruntled clients are often converted by attending to the unpleasant event					
g) The bank is able to spot patterns in customer behavior, or to predict their response					
h) The bank has implemented database marketing for their products and services					
Additional Comments:					

Thank you for your time and participation

APPENDIX 4: Secondary data collection sheet

ROA (2013 – 2017) (Kshs in Billions)

Name of Bank	**2013**	**2014**	**2015**	**2016**	**2017**
Equatorial Bank	0.04	0.05	0.07	0.09	0.13
Paramount Bank	0.10	0.12	0.12	0.15	0.19
Bank of India	0.11	0.11	0.12	0.15	0.17
BBK	0.15	0.15	0.16	0.18	0.22
Consolidated Bank	0.04	0.05	0.09	0.13	0.16
Victoria Commercial Bank Ltd	0.03	0.05	0.08	0.13	0.16
Gulf African Bank	0.07	0.07	0.08	0.13	0.16
Family Bank	0.12	0.11	0.14	0.16	0.20
Equity Bank	0.16	0.17	0.20	0.22	0.24
NIC	0.11	0.11	0.13	0.17	0.19
Average	**0.09**	**0.10**	**0.12**	**0.15**	**0.18**

ROA = a/b = (net income / total assets)