

Effect of Institutional Innovation on Financial Performance of Deposit Taking Savings and Credit Cooperative Societies in Nakuru County, Kenya

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DOI: <https://doi.org/10.47772/IJRISS.2026.100601278>

Received: 26 June 2026; Accepted: 01 July 2026; Published: 17 July 2026

ABSTRACT

Savings and Credit Cooperative Societies (SACCOs) in Kenya operate in complex and ever changing environment where there are issues that contribute to their poor performance and threaten their growth and survival. In the recent times, SACCOs have faced stiff competition, from new players that have entered the market to offer financial services which SACCOs offer. These challenges have left some of the SACCOs unable to meet their financial obligations as well as offering the services as expected by their customers. The competitors have targeted the middle and low income earners who form the main component of the SACCOs' market. In addition, commercial banks are now flexible and able to penetrate more into the rural areas where they were not accessible and the SACCOs had taken dominance to offer their services. SACCOs in Kenya are a source of employment for many people. They contribute a great portion of government revenue in form of taxes all of which stand to suffer losses should the poor performance of these SACCOs remain unchecked. The purpose of this study therefore was to examine the effect of institutional innovation on financial performance of deposit taking savings and credit cooperative societies in Nakuru County, Kenya. The study employed a descriptive research design where a population of 35 senior managers of SACCOs in Nakuru County were sampled and targeted. A questionnaire was used to collect data which was administered to all the 36 senior managers. The descriptive analysis gave an overall mean score of 4.42 on 1-5 likert scale. Regression analysis and ANOVA were also used to analyze the data and test the research study hypothesis. The findings of the study indicated that; there was a positive and moderate relationship between institutional innovation and financial performance of deposit taking SACCOs in Kenya and an increase in institutional innovation could lead to increased financial performance. The adjusted R square was 0.438 indicating that institutional innovation can explain 43.8 percent of financial performance. Secondly, institutional innovation had a positive and significant effect on the financial performance of deposit taking savings and credit cooperative societies in Kenya ($F = 24.335$, $p < 0.05$). In the modelling it was noted that the constant was zero and could therefore not be included in the model. The study concluded that the level of institutional innovation will contribute to the performance of SACCOs in Nakuru county.

Keywords: SACCO, Nakuru County, Institutional Innovation, Deposit Taking

INTRODUCTION

The history of SACCOs in Kenya started way back in 1930 when the Kenya Farmers' Association (KFA) was registered as a cooperative society. It then took over the role of supply of farm inputs played by Lumbwa cooperative society (Gardeklint, 2009). These cooperatives were introduced, recognized and controlled by the government of Kenya KUSCCO (2006). From independence, the number of cooperative societies had continued to grow saving and cooperative societies (SACCO) comprising over 50% of all cooperative and as financial institutions they play a critical role of financial intermediation in the financial landscape focusing mostly on SACCO development SACCOs review. The SACCOs are owned, governed and managed by their members who have the same common bond, which is, working for the same employer, belonging to the same church, labor union, social fraternity or living and working in the same community. However, most SACCOs have recently opened their membership to all regardless of the race, religion, color, gender or status. These

members agree to pull together save their funds in the SACCO offer loans to each other at reasonable rates of interest. Interest that is charged on loans covers the interest cost on saving and administration. The members become the co-owners and decide how their money will be used for the benefit of all of them. Innovations are driven by the need to overcome the challenges that are being presented by the business environment. It is innovations ensure that firms have competitive advantage in the market. Robert and Amit (2003) note that since the business environment is highly changing there is a dire need of seeking to create new products given that innovation is a generic objective among firms that want to be or remain competitive in the market. Due to need of efficiency and sustained performance, innovations are an inherent objective that is being sought by many modern organizations irrespective of whether they are involved in production of goods or provision of services. According to (Beaver, 2002) the companies and countries seeking to be competitive must be innovative. Evidently, therefore, innovation is a tool for enhancing the position of firms and countries in the markets. This study considered financial innovations. Innovations help in reducing the cost of providing the existing products and services Nofie (2011) therefore financial innovation is a tool of ensuring that the SACCO works effectively and efficiently in customer satisfaction. It has been proven that institutions that meet customers' expectations are highly regarded. SACCOs accept deposits from individual and institutions for safe custody or interest earning. The SACCOs should facilitate the access of such funds to the owners where and when they are needed accordingly. Therefore, financial innovation has resulted to cost efficiency in many SACCOs. According to (Chinniah, 2011) most financial innovations are enabled by the emergency of computers and technological improvements. The automated teller machine for instance is an innovation that is fostered by advancement in information and communication technology (ICT). Online banking and electronic banking are examples of financial innovations that have been adopted by many financial institutions. Automated teller machines use is on the rise since inception in the 1990s. It is important to note that SACCOs in Kenya are regulated by the SACCO societies regulatory authority (SASRA). The use of mobile phone banking and other financial innovations in Kenya has in turn increased the number of players in the finance industry and has ensured efficiency in service delivery Ignazio (2007) in addition the adoption and success of M-pesa has revolutionized the SACCO sector in Kenya. Financial performance is a measure against standard or prescribed indicators of effectiveness, efficiency and environmental responsibilities such as cycle time, productivity, water reduction and regulatory compliance. According to (Sulvian, 2011) achieving and sustaining operational performance is more important than ever in today challenging economic environment. Cost pressure, changing customer expectations, stronger competitors and other industry and market disruption are collectively causing a tremendous strain on operational capabilities and performance. Operation Performance excellence is no longer a desired end state but a near term requirement for any successful company. The performance of savings and credit cooperative societies' (SACCOs) contributes to the operation and growth of an economy through various roles. This includes that of intermediaries and provision of payment settlement facilities. SACCOs must execute these roles faultiness in order to promote confidence and stability in the system. The traditional role of SACCO's has been to encourage mobilization of saving and provide loans at affordable rate to encourage investment culture of its members. This can only be done successfully and for sustainable period through management of credit, liquidity and risk factor essentially because a SACCO is funded primarily by members; it has an obligation to ensure that the risk which members' funds are exposed is minimized (Johnson & Susan, 2012). Additionally, SACCOs facilitate business through the deposit of funds and the provision of credit to customers, provide 24-hour access to funds and facilitate safety of the saving and investments. SACCOs must continuously upgrade their technologies, products and services in order to facilitate economic transactions and economic growth while maintaining its focus on the minimization and management of risk (CGAP, 2009). The government looks upon SACCOs in addressing the socio- economic needs of the citizen, notably the provision of banking services to the previously unbanked, as well as assisting the financial education of the public. Therefore, sound management and regulation of all SACCO in the system is crucial. Most modern financial systems contribute to economic development and improvement in living standards by providing various services to the rest of the economy. These include clearing and settlement systems to facilitate trade, channeling financial resources between savers and borrowers and various products to deal with risk and uncertainty. Studies have been conducted on financial innovation locally and internationally. Mutuku (2014) conducted a study on relationship between financial innovation and efficiency of SACCO's in Kenya. Maorwe (2012) studied the factors that influence the implementation of strategic plans in SACCO in Imenti North District. Muthui (2013) conducted a study on the effects of ICT on corporate strategy of SACCO's in Nyeri County. From existing literature, there is scanty data

on the effects of financial innovation on performance of deposit taking SACCOs. Furthermore, in spite of a descriptive literature on financial innovation there is scarcity of empirical studies on effects of product, process, market and institution innovation and its effects on financial performance of the SACCOs. This study therefore, sought to fill this gap by examining the effects of institutional innovation on financial performance of SACCO's in Nakuru County.

LITERATURE REVIEW

Institutional innovation relates to changes in business structure, to the establishment of new types of financial intermediaries, or to changes in the legal and supervisory framework. Important examples include the use of the group mechanism to retail financial services, formalizing informal financial systems, reducing the access barriers for women, or setting up a completely new service structure (Schrieder & Heidhues, 1995). In the study of the effect of institution innovation on financial performance, Watiri (2013) sought to establish the contribution of agency banking in financial performance of commercial banks Kenya. The study adopted a descriptive survey. Its findings were that the low transaction cost through agency banking had a positive impact on financial performance of Kenya commercial banks. The study concluded that agency banking had a positive effect on institution innovation and the transaction cost reducing in the deposit taking SACCOs leads to a positive effect on financial performance. As argued by Kwaning et al. (2007) studied on the impact of organization restructuring on the financial performance of public banks a case of agricultural development banks in Ghana. With a case study of sample bank they found out that restructuring of is beneficial in a number of ways not only by lowering operation cost but also in formulation and implementation of strategies. This study will therefore analyze the restructuring put in place by SACCOs meant to reduce operational cost and any challenges that they are facing in their obligation to increase their financial performance. According to (Fame & Lawrence, 2001) institutional innovations in financial institutions system entail the, establishment of new types of financial intermediaries and change in legal, changes in the business structure and supervisory framework. In Salim and Sulaiman (2011) hypothesis that the organizational innovation is positively related to company performance. It is noted that indeed organizational innovation led to company performance. It is concluded that innovations can be a source of competitive advantage if a firm understands customer needs, competitors' actions and technological development and act accordingly to stay at par with rivals. Boachie-Mensahand (2015) notes that innovation in general accounts for over fifty percent of the variation in firm performance. Specifically, the study establishes that organizational innovation or institution innovation among various types of innovation significantly and positively influences performance of an institution. It can therefore be suggested that performance of microfinance institution can be driven by institutional innovativeness. It is observed that to further enhance firm performance management ought to focus on the firm activities aligned towards renewing routines, procedures and processes in an innovative manner in a firm. According to Mugo (2014) noted that institutional innovativeness noted in mobile banking, partnerships, financial trainings; branch networking and opening up new branches enhance institutions growth. Moreover, it is ascertained that institutional innovation through redesigning of the institution to strategically serve the target market to enable institutions to enjoy economies of scale and more so, using technology enable the institutions to cut down cost and reduce interest rates. Institutional innovations are characterized by entrepreneurship, leadership, ownership, governance as well as technology.

RESEARCH METHODOLOGY

This study was carried out in Nakuru County in Kenya. Descriptive research design was used and the target population was all the seven deposit taking SACCOs operating in Nakuru County with unit of analysis if 35 senior managers in the SACCOs. These deposit taking SACCOs were; Boresha, Cosmopolitan, Egerton, Stima, Tower, Vision Afrika and Harambee SACCO. Due to the size of the target population, the study adopted census as a method of determination of the sample size. Therefore, the sample size was equal to the target population of 35. The target population was 35 senior managers who influence the innovative decisions made in their respective SACCOs. They were either, the head of departments, section managers and branch managers of all the seven licensed and deposit taking SACCOs operating in Nakuru County as at 31st December 2024. The study collected primary data using a questionnaire. The closed ended questions were more preferred as they are easier and quicker for respondents to answer and an in analyzing the data. A

structured questionnaire was preferred as an instrument for the study as it was practical to the research problem and the size of the population, also large amount of information can be collected from a large number of people in a short period of time and in relatively cost effective way (Mugenda & Mugenda, 2012).

To test for reliability of primary data, a pilot study was done, where the questionnaire was administered in licensed deposit taking SACCOs in Nyandarua County, which is a neighboring county. These SACCOs are Viktas SACCO, Muki SACCO, and Nyala SACCO. Validity is the extent to which research results can be accurately interpreted and generalized to other populations. It is the extent to which research instruments measure what they are intended to measure (Oso & Onen, 2011). To ensure validity of the primary data, the questionnaire was subjected to thorough examination by an expert in the area of SACCOs in Kenya. On the basis of the evaluation, the instrument was adjusted appropriately before subjecting it to the final data collection exercise. The review comments were used to ensure that validity was enhanced.

Drop and pick method was used to collect the primary data. Before data collection, the researcher had assured the respondents confidentiality and integrity of the information given by the respondents. The researcher dropped the questionnaires with the respondents and picked them at a later date when they were already filled. The researcher ensured that the questionnaires completeness at the time of picking. The study adopted descriptive and inferential data analysis techniques. In the descriptive data analysis, descriptive statistics such as mean and standard deviation were computed. In the inferential data analysis, modelling was done. The regression model was done in order to assess the effect of innovation on financial performance of the SACCOs in Nakuru County in Kenya. Model summary used $Y = \beta_0 + \beta_1 X_1 + \varepsilon$ where; Y = Financial Performance, β_0 = Constant, β_1 was Coefficient indicating effect of independence variable on the dependent variable, X_1 = Institution Innovation. The F-test was used to measure the goodness of fit. The study measured the statistical significance of the variables by evaluating the p-values. Variables were significant because the p-value were less than 0.05 which is alpha value at 95% confidence level.

RESULTS AND DISCUSSION

This study applied two levels of data analysis; descriptive and inferential data analysis. In the descriptive data analysis, mean and standard deviations for varies constructs were computed. The mean score for the businesses having a clear business structure was 4.42 and a standard deviation of 0.807 on a likert scale of 1-5. On whether advanced technologies were adopted by these SACCOs, the mean score of 3.90 with a standard deviation of 0.957 were obtained. Whether these SACCOs were guided by clear legal framework a mean score of 4.52 and standard deviation of 1.006 were obtained. On a supervisory framework that monitors SACCOs a mean score of 4.55 and a standard deviation of 0.826 were obtained. The overall mean score was for all the constructs was 4.42. This indicated that the respondents were of the view that institutional innovation has an effect on financial performance of the deposit taking SACCOs in Kenya.

Inferential data analysis was the second step where R and adjusted R square, ANOVA and regression coefficients were determined. R value was 0.675 which indicated that there was a positive and moderate relationship between institutional innovation and financial performance of deposit taking SACCOs in Kenya. This further means that an increase in institutional innovation will bring about increased financial performance in the deposit taking SACCOs. The adjusted R square was 0.438 implying that 43.8 percent of the variations in the financial performance of licensed deposit taking SACCOs can be attributed to institutional innovation. The remaining 56.2 percent of the variations in the financial performance of deposit taking SACCOs can be attributed to other factors other than institutional innovation.

Table 1 Model Summary of Institutional Innovation and Financial Performance of SACCOs

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.675	0.456	0.438	0.57524

The ANOVA table 2 indicates that the model fit is appropriate for this data since the p value is 0.000 and less than 0.05, F value is 4.335 which is significant at 0.000. Therefore, the model is significant in predicting the financial performance of licensed deposit taking SACCOs in Nakuru County. The study therefore rejects the null hypothesis that there is no statistically significant effect of institutional innovation on financial performance of licensed deposit taking SACCOs. The conclusion therefore is that, institutional innovation has statistically significant effect on the financial performance of licensed deposit taking SACCOs.

Table 2 ANOVA for Institutional Innovation and Financial Performance of SACCOs

Model		Sum of Squares	df	Mean Square	F	Sig.
11	Regression	8.053	1	8.053	24.335	.000
	Residual	9.596	33	.3199		
	Total	17.649	34			

The table 3 shows that there was a positive beta coefficient of 0.726 as indicated in the coefficient's matrix with a p-value = 0.00 and a constant of .393 with a p-value of 0.513. It was noted that the p-value for the constant was greater than 0.05 and therefore the insignificant. The constant was rendered insignificant and therefore equal to zero. The constant does not qualify to be included in the final equation. Institutional innovation contributes significantly to the model. Therefore, the model can provide information needed to predict financial performance of licensed deposit taking SACCOs from institutional innovation. The linear relationship between institutional innovation and financial performance of licensed deposit taking SACCOs in Kenya can also be modeled as $Y = \beta_0 + \beta_1 X_1 + \varepsilon$ and since $\beta_0 = 0$ $\beta_1 = 0.726$ then the bivariate regression equation becomes $Y = 0.726X_1$. The regression equation implies that a unit increase in institutional innovation leads to an increase of positive 0.726 units in financial performance of licensed deposit taking SACCOs in Nakuru County and that in the absence of institutional innovation, the financial performance will be positive 0.

Table 3 Regression Coefficients of the Relationship between Institutional Innovation and Financial Performance of SACCOs

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.393	.592		.663	.513
	Institutional Innovation	.726	.147	.675	4.933	.000
a. Dependent Variable: Financial Performance						

CONCLUSION

Based on the findings, the study concluded that, institutional innovation has a significant positive effect on financial performance of deposit taking SACCOs in Nakuru County. Institutional innovation is achieved through having an advanced business technology, clear business structure and ensuring all the deposit taking SACCO operations are guided by clear legal framework and having supervisory framework to monitor the operations of the SACCOs.

RECOMMENDATIONS

Based on the conclusions from the findings, the study made the following recommendations; The licensed deposit taking SACCOs should undertake institutional innovations so that there is a clear business structure to make the operations effective and geared towards enhancing the financial performance, adopt advanced technologies that facilitate service delivery and enable the licensed deposit taking SACCO to achieve cost effectiveness.

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