Financial Innovation and its Impact on Financial Performance of Commercial Banks in Nepal

Padam Dongol

Ph.D. Research Scholar

Lincoln University College, Malaysia

Email address: padamdongol2000@gmail.com

Abstract:

Banks need higher performances for their growth and sustainability. In this regard, the financial innovation of the banks put some additional efforts to keep the banking sectors in a safer place to conduct the financial transaction between depositors and borrowers. With this view, the research study aimed to identify financial innovation and its impact on the financial performance of commercial banks in Nepal. The target population included in this study is 115 staff from different branches of commercial banks. Out of the total population, 74 (64.34%) respondents were selected as a sample for the study based on the purposive sampling method. A total of 27 commercial banks are operating in a nation; the study covered only 10 banks as a sample based on the merger and acquisitions in nature. The study also adopted a descriptive survey design with a questionnaire being the basic tool for the collection of primary data. From the study, it was revealed that the impact of internet banking service plays important role in the banking sector to make customers satisfy and also increase the financial performance of banks.

Keywords: **Financial Innovation, Financial Performance, Commercial Banks, Internet Banking.**

I. INTRODUCTION

The banking sector plays an important role in the financial life of a business, and the significance of banks can be noticed from the fact that they are considered to be the life-blood of the modern business economy. Although no wealth is made by banks, their essential activities facilitate the method of production, exchange, and distribution of wealth. Commercial banks play a major role in the economic resource allocation of countries. They utilized the funds from savers to investors continuously (Ongore & Kusa, 2013). Commercial banks work as a facilitator for achieving sustainable economic growth of the nation through providing efficient monetary intermediation. A good financial system promotes investment opportunities, mobilizing savings of the customers, efficiently allocating financial resources, and makes trade easy (Jha & Hui, 2012**).** Within the financial services industry, innovation is observed as the act of creating and popularizing new financial instruments, technologies, institutions, and markets, which facilitate access to information, trading, and means of payment (Solans, 2003). Financial innovation and change in monetary procedures and control follow one another and Central banks have therefore to vary their tools, targets, and operating procedures from time to time to deal with innovation and make sure the sustainability of the financial system (Misati, Njoroge, Kamau & Ouma, 2010). Financial innovations have been catalyzed by technological developments in the telecommunications sector, and secondly, financial innovations have altered not only bank products and services but also bank production processes (Frame & White, 2004). Financial innovation has a great influence on the financial market in terms of new technology products and services provided to the customers. Thus, financial innovations should be made through the proper analysis of different risk factors and costs associated to avoid harm to a bank's performance. Innovation is important to get success continuously in any organization (Kimberly, 1979).

In the context of Nepal, banking sectors have improved their services through adopting different financial innovations. In recent years, financial innovations such as automated teller machines (ATM), internet banking, mobile banking, electronic fund transfer, the use of credit cards increasing day by day. In addition, Electronic Funds Transfer transaction-based payments have also increased. Customers of the banking sector now have easy to access fast, efficient, and convenient banking services. Despite the significance of financial innovation, the effect of innovation on financial performance was still misunderstood for two main reasons, first, there was inadequate understanding about the drivers of innovation and secondly, innovation's impact on bank's financial performance remained lowly untested (Mabrouk & Mamoghli, 2010). However, the research conducted on the impact of financial innovation on bank's performance has to be found very limited especially in the Nepalese banking sectors. Thus, the importance of the study on financial innovation on banks performance is necessary for commercial banks of Nepal. So, this study sought to analyze the current financial innovation and its impact on the financial performance of banks.

II. OBJECTIVES

The general objective of the study was to identify financial innovation and its impact on the financial performance of banks. The study used the following specific objectives:

i) To investigate the effect of internet banking and the financial performance of commercial banks.
ii) To establish the effect of mobile banking and the financial performance of commercial banks.
iii) To analyze the effect of SMS (Short Message Service) and the financial performance of commercial banks.

III. LITERATURE REVIEW

Financial innovation is defined in broad terms as '…the act of creating and then popularizing new financial instruments as well as new financial technologies, institutions, and markets …' (Tufano 2003). Tufano argues that innovations can be categorized into process and product innovations, where product innovations are denoted by new financial instruments, while process innovations are epitomized by innovative methods of distributing the financial products, dispensing transactions, and pricing them. According to Tufano (2002), financial innovation is that the act of making then popularizing new financial instruments also as new financial technologies, institutions, and markets. Financial innovation is that the catalysts behind the evolving financial services, industry, and restructuring of monetary markets. It represents the systematic process of change in instruments, institutions, and operating policies that determine the structure of a monetary system.

A financial institution's competitive advantage distinctiveness can be known due to successful innovations especially in a highly unstable working environment thus placed banking institutions in a unique competitive position and lead to higher-level financial performance. (Roberts & Amit, 2003). Innovations are classified as intensive electronic banking services for financial institutions, their distribution ways are more but having a cost below the sector average (Pigni, Ravarini, Tagliavini, & Vitari, 2002). Oyewole, Abba, Gambo, & Abam, (2013) found that education plays a crucial role in contributing to the success of the internet and electronic banking. The levels of education of customers including the working of the Institution's websites, ATMs are strong factors due to internet banking. The study of the literature review shows that financial innovation is important to banks and financial institutions in the modernized economy. It has also made a significant impact on the banking sectors to develop new and innovative products and services to the customers in the current market. Thus, theories such as innovation diffusion and Schumpeter theory of innovation are explained below:

3.1 Innovation Diffusion Theory

Innovation Diffusion Theory seeks to explain the flow of innovations within an organization. According to Rogers (2003), various factors lead to the diffusion of innovations from one point to another. For example, if there is a relative advantage of the innovation when compared to the already existing tools, the innovation will be regarded as an improvement and may be adopted in the entire organization. Innovations are also weighed on the ease of use, if they can be put on trial before being commenced in full and if their inputs and outputs can be measured with ease. It is important to note that ease of use is viewed as subjective since expertise is not uniform across all people.

3.2 Schumpeter Theory of Innovation

Schumpeter (1934) explained that innovations are always happening in the industry and for this reason; institutions need to be cognizant of them. This theory argues that even before innovations have been accepted by firms other innovations usually emerge leading to a new cycle again. It is for this reason that there are a variety of innovations that commercial banks implement to boost their financial performance. Financial innovation is involved in creating new opportunities for more profits while at the same shouldering the hazards linked to its existence. New dimensions present risks and thus banks must have mitigating measures. As discussed by Schumpeter (1934), innovations are enhanced by entrepreneurs who are independent and are willing to take risks as an act of will. This theory is important since it helps in explaining why commercial banks are involved in innovations and also explained the causes of innovations.

IV. CONCEPTTUAL FRAMEWORK

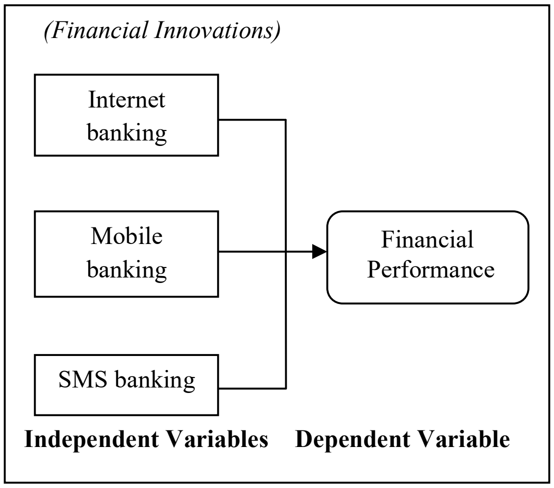


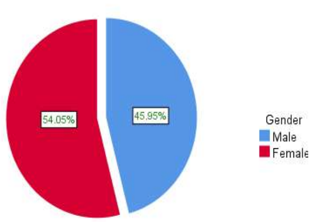
FIGURE 1: Conceptual Framework

V. METHODOLOGY

The research applied a descriptive research design. Descriptive research involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data (Babbie, 2002). According to Cooper and Schindler (2000), descriptive statistics discover and measure cause and effect relationships among variables. Thus, descriptive research is that the investigation during which quality data is collected and analyzed to explain a phenomenon in its current trends, events, and linkages between various factors at the present time, which is the concern of the study. The population of the study consisted of 27 commercial banks that are currently operating in Nepal. The study covered 10 sample banks based on the merger and acquisitions in nature. The primary data were collected through questionnaires from the staff of different sample banks.

VI. SUMMARY OF FINDINGS

6.1 Demographic Data



(Source: Researcher, 2021)

FIGURE 2: Classification of respondents by gender

The study showed that out of a total of 74 respondents, 40 (54.05%) respondents are found to be female, and the remaining 34 (34.95%) respondents are found to be male. From the assigned questionnaire to the respondents, it can be said that female respondents found more than male respondents of the study.

TABLE 1: Classification of respondents by age group

Years	Frequency	Percent
20 - 29	55	74.3
30 - 39	16	21.6
40 - 49	2	2.7
50 and above	1	1.4
Total	**74**	**100**

Table 1 shows the classification of respondents by age group. From the study, it was found that most of the employees working in the commercial banks in Nepal age between 20 to 29 years which represents 74.3 % of total respondents. Likewise, the employees who are working-age between 30 to 39 years are 16 respondents which represent 21.6% and 2 respondents are to be found between the ages 40 to 49 years which represents only 2.7 % of total respondents. 1 respondent is found to be age 50 and above. Thus, it can be said the employees' age between 20 to 29 years dominant the commercial banks in Nepal.

TABLE 2: Qualification of respondents

	Frequency	Percent
Bachelor's level	29	39.2
Master level	44	59.5
Other	1	1.4
Total	**74**	**100**

Table 2 shows that the qualification of respondents working in commercial banks. The study further indicated that 44 respondents having Master level education which covers 59.5% of total respondents. Likewise, 29 respondents having Bachelor's level which indicates 39.2% of total respondents of the study. From the study, it can be seen that the commercial banks has given the first priority to the Master level education and then only for Bachelor's level.

TABLE 3: Working experience in the banking sectors

	Frequency	Percent
1- 5 years	62	83.8
6 - 10 years	5	6.8
11 - 15 years	6	8.1

Over 15 years	1	1.4
Total	**74**	**100**

Table 3 depicts the employees working experience in the commercial banks. From the study, it was found that 62 respondents are working between 1 to 5 years in a bank which represents 83.8% of the total respondents. In the same way, 5 respondents are found between 6 to 10 years which represents the 6.8%. Likewise, employees having working experience between 11 to 15 years is 6 which represent 8.1%. 1 respondent is found above 15 years experience in the banks. More respondents are found in this study below 5 years working experience in the banks.

6.2 Descriptive statistics

6.2.1 Internet banking and financial performance of banks

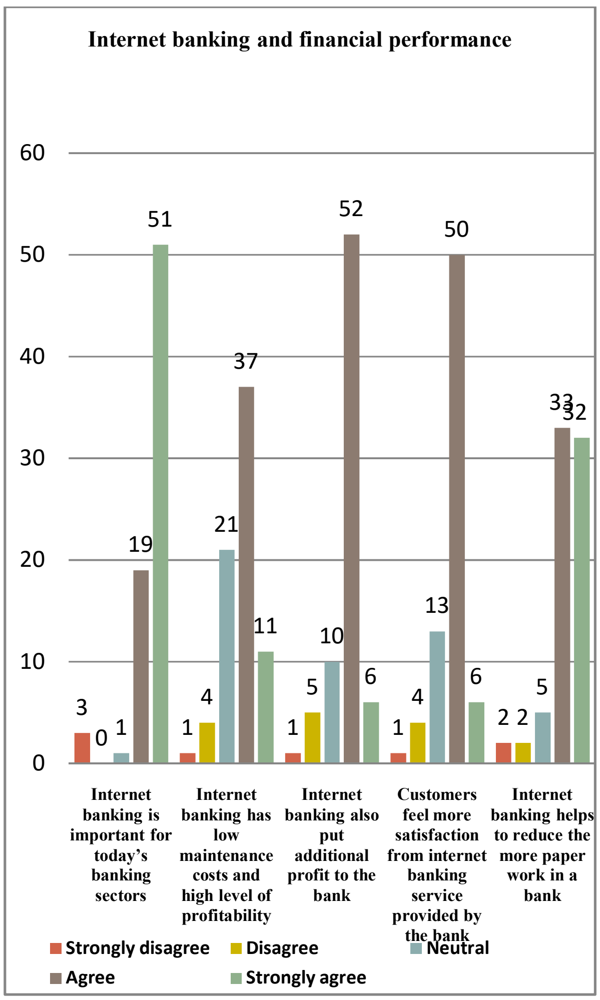


FIGURE 3: Internet banking and financial performance of banks

Figure 3 shows that the relationship between internet banking and the financial performance of commercial banks. The study found that 51 respondents which represent 68.91% of the sample population forward their decision on strongly agree while 19 respondents which represent 25.67% put agree, 3 respondents found strongly disagree with this statement. 1 respondent showed indifferent decision related to the statement.

Similarly, internet banking has low maintenance cost and high level of profitability, 37 respondents which represent 50% put their decision on agreeing, 21 respondents which represent 28.37% are indifferent to the statement. 11 respondents representing 14.86% strongly agree with the statement and only 4 respondents representing 5.40% found in disagree with the statement.

On the assumption of internet banking also put additional profit to the bank, 52 respondents which represent 70.27% agree with the statement, 10 respondents which represent 13.51% indifferent with the statement, 6 respondents which represent 8.1% strongly agree, and 5 respondents which represent 6.75% put to disagree with the statement.

On whether customers feel more satisfaction from internet banking service provided by the bank, the majority of the respondents representing 67.56% of the sample population agree with the statement, 13 respondents which represent 17.56% found to be indifferent to the statement, 6 respondents which represent 8.1% strongly agree with the statement and only 4 respondents representing 5.4% keep similar opinion towards disagreeing.

On the assumption that internet banking helps to reduce more paperwork in a bank, the study found that out of total 74 sample population, 33 respondents and 32 respondents representing 44.59% and 43.24 % put their opinion towards agreeing and strongly agree with the statement respectively, 5 respondents representing 6.75% are indifferent with the statement and only 2 respondents put their decision on disagreeing and strongly disagree with the statement.

6.2.2 Mobile banking and financial performance of the banks

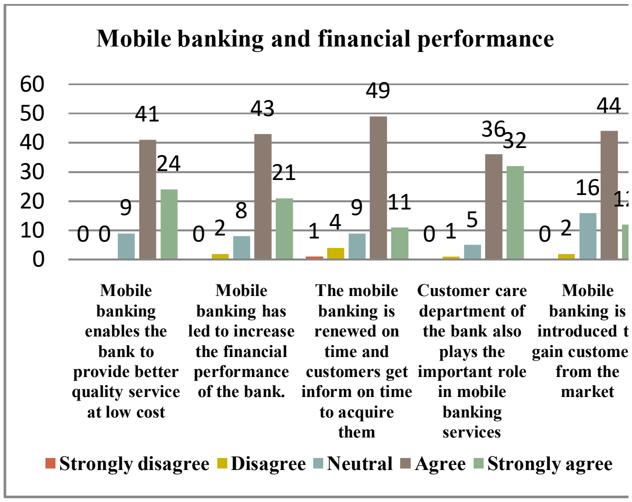


FIGURE 4: Mobile banking and financial performance of banks

Figure 4 shows that the relationship between mobile banking and the financial performance of commercial banks. The study revealed that 41 respondents which represent 55.40% of the sample population put similar opinion in agreeing with the statement while 24 respondents which represent 32.43% put strongly agree and 9 respondents found to be indifferent to this statement. No one respondent is found in disagrees and strongly disagree with the statement.

Similarly, mobile banking has led to an increase in the financial performance of the bank, 43 respondents which represent 58.10 % put their decision on agreeing, 21 respondents which represent 28.37% strongly agree and 8 respondents representing 10.81% are indifferent with the statement only 2 respondents representing 2.7 % found in disagree with the statement.

On the assumption of mobile banking is renewed on time and customers get information on time to acquire, 49 respondents which represent 66.21% agree with the statement, 11 respondents which represent 14.86 % strongly agree with the statement, 9 respondents which represents 12.16% indifferent with the statement, 4 respondents which represent 5.4 % put to disagree with the statement and 1 respondent found to be in strongly disagree with the statement.

On whether the customer care department of the bank also plays important role in the mobile banking service, the majority of the respondents representing 48.64 % of the sample population agree with the statement, 32 respondents which represent 43.24 % strongly agree with the statement, 5 respondents representing 6.75% found to be indifferent with the statement and only 1 respondent found in disagree with the statement.

On the assumption of mobile banking is introduced to gain customers from the market, out of a total 74 sample population, 44 respondents representing 59.45% put similar opinion towards agreeing, 16 respondents representing 21.62% indifferent with the statement, 12 respondents representing 1621% strongly disagree with the statement and few numbers of respondents put to disagree with the statement.

6.2.3 SMS banking and financial performance of the bank

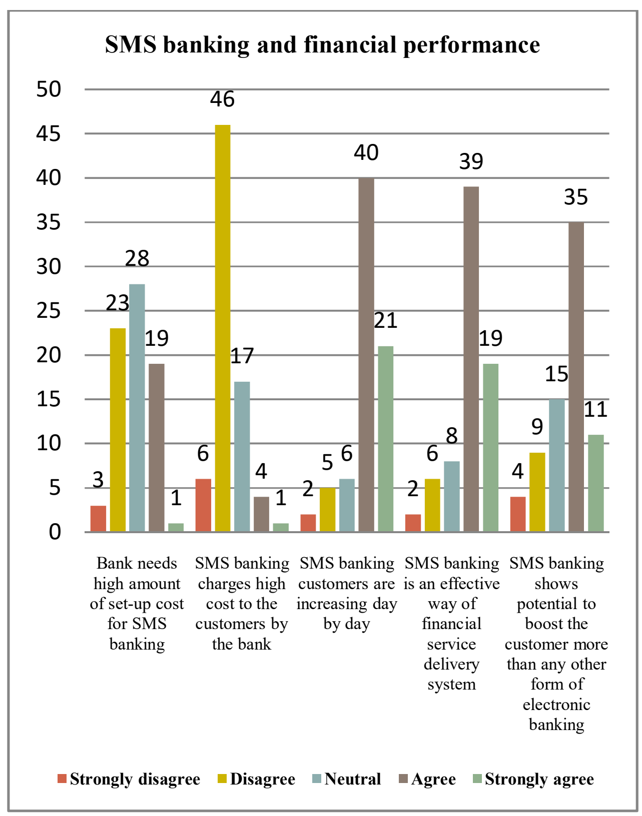


FIGURE 5: SMS banking and financial performance of banks

Figure 5 shows that the relationship between SMS banking and the financial performance of commercial banks. The study revealed that 28 respondents which represent 37.83 % are found in indifferent with the statement, 23 respondents which represent 31.08 % put disagree and 19 respondents representing 25.67% agree with the statement, 3 respondent in the line of strongly disagree and only 1 respondent indicated they strongly agree with the statement.

Similarly, SMS banking charges high cost to the customers by the banks, 46 respondents which represents 62.16 % put their decision on disagreeing, 17 respondents which represent 22.97% indifferent, and 6 respondents representing 8.10% are found to strongly disagree with the statement, 4 respondents representing 5.4 % found in agree with the statement and 1 respondent found strongly agree with the statement.

On the assumption of SMS mobile banking customers are increasing day by day, 40 respondents which represent 54.05 % agree with the statement, 21 respondents which represent 28.37% strongly agree with the statement, 6 respondents which represents 8.1% indifferent with the statement, 5 respondents which represent 6.75 % put to disagree with the statement and 2 respondents found to be in strongly disagree with the statement.

On whether SMS banking is an effective way of financial service delivery system, the majority of the respondents representing 52.70 % of the sample population agree with the statement, 19 respondents which represent 25.67% strongly agree with the statement, 8 respondents representing 10.81% found to be indifferent with the statement and 6 respondent found in disagree with the statement and only 2 respondents are found in strongly disagree with the statement.

On the assumption of SMS banking shows potential to boost the customer more than any other form of electronic banking, out of total 74 sample population, 35 respondents representing 47.29% put similar opinion towards agreeing, 15 respondents representing 20.27 % indifferent with the statement, 11 respondents representing 14.86% strongly agree, 9 respondents representing 12.16% disagree and 4 respondents put to disagree with the statement.

VII. DISCUSSION OF FINDINGS

The study collected a total of 74 questionnaires from the respondents out of 100 questionnaires distributed to different branches of the sample banks. It represents a 74% respondent rate. Mugenda and Mugenda (2003) explained that a response rate of 50% is adequate for the study, 60 % is considered as good and above 70% response rate is excellent for the data analysis. The objectives of the study were to investigate the effect of internet banking and financial performance of commercial banks, to establish the effect of mobile banking and financial performance of commercial banks, and to analyze the effect of SMS and financial performance of commercial banks. The study used a descriptive research design to illustrate the current banking scenario of financial innovation and its impact on the performance of banks. The researcher used a questionnaire to collect the primary data from the staff of different branches of the banks. To assign a clear picture of the study, all response variables were measured in terms of an interval scale from 1 to 5 where 1 refers to strongly disagree and 5 refers to strongly agree. From the study, 45.95% of the respondents were male and 54.05 % were female. Based on age, the respondents who have age between 20 -29 working more currently in the banks representing 74.3% of the sample study, and only 1 employee is found the age more than 50 and above. On the highest level of qualification, 59.5% of the respondents had a master's degree but none of the respondents had a Ph.D. From the findings of the study, the majority of the respondents had worked in commercial banks between 1 – 5 years, and only 1 respondent was found more than 15 years worked in the bank.

Based on the findings of the study, the majority of the respondents which represents 68.91% indicated that internet banking is important for today's banking sectors. Many respondents found to be agreed that internet banking services added more customers and also reduce the paperwork for the transaction of customers which helps to put some additional profit to the banks.

The study findings that 55.40% of respondents put the same decision in agreeing the mobile banking enables the bank to provide better quality service at a low cost in its daily operation. The majority of the respondents agree that mobile banking increases the financial activities of the banks and along with the introduction of mobile banking services attached more customers to the banks.

Based on the findings of the SMS banking service provided by the banks, the majority of the respondents representing 52.70 % agree that SMS banking helps to keep the financial activities effectively. The further findings of the study show that the majority of the respondents (62.16%) put **to** disagree with the statement about SMS banking charges high cost to the customers by the banks and also found that 37.83% of respondents keep neutral decision regarding the high cost required to install the SMS banking system in the banks.

VIII. CONCLUSION

The findings of the study concluded as follows:

Internet banking and bank's performance

From the study, it can be observed that internet banking plays important role in today's banking sector and it also helps to eliminate most of the paperwork in the banks. In addition, more customers are satisfied with the internet banking service and also increase the profit of the banks in the current scenario. The study concluded that internet banking service has a positive impact on a bank's performance.

Mobile banking and bank's performance

From the study of mobile banking and bank's performance, it can be found that bank provides better service with the help of mobile banking innovation. At present condition, customers are interested to take advantage of the mobile banking service provided by the banks to conduct their financial transactions. Despite competition in the market most of the banks are successful to attract new customers due to the mobile banking service provided by the banks.

SMS (Short Message Service) banking and bank's performance

The study found that today's banking sector needs to operate the SMS banking service because customers are found to be satisfied by receiving instant messages of their transactions. The study also reveals that optimal fees charged by the banks to the customers for providing an effective way of the financial delivery system help to add a customer from the competitive market.

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