

**CUSTOMER INTERACTION AND INNOVATION PERFORMANCE
AT COMMERCIAL BANKS IN KENYA**

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DECLARATION

I hereby declare that this research pproject is my original work and has not been submitted for a degree in any other learning institution

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ABSTRACT

In the present day business environment, customers expect firms to increasingly customize their products and services to meet their demands that keep on changing on the day-to-day basis. At the same time, firms need to produce superior products and understand the markets as a whole, but the ability of firms to orient themselves to interact successfully with their individual customers will differentiate them in the future. Advances in technology have resulted in increasing opportunities for interactions between firms and customers, between customers, and between firms. The research objective was to establish the customer interaction practices employed by Banks in Kenya and also determine relationship between innovation and a firms' financial performance. The research design adopted was descriptive research design. Data was collected using a questionnaire which consisted of both open and closed ended questions. The data collected was analyzed using descriptive statistics and also an inferential analysis involving a regression was performed. The study found out that customer involvement in the product development is important in the service industry in establishing a relationship that will be beneficial to the customer and the bank. A bank-customer interaction can be accomplished by adopting different modes of interaction and the method chosen by a bank should be one that will lead to more customers being incorporated in the process and at the same time result in greater benefit in a firm's product development. In addition, a bank interaction facilitates customer connection and collaboration with each other through sharing of information which help create businesses among themselves. The findings from the research conclude that firms must adopt customer-based performance metrics and institute employee rewards and incentives based on these metrics, instead of using aggregate-level measures, such as sales and market share growth, to evaluate marketing performance.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Developing countries are a growing presence in an integrated global economy and attracting attention of service firms from more advanced nations, experiencing rapid growth due to deregulation, globalization and technological changes (Kouznetsov, 2009). Given these dynamics in the service industry, managers are constantly seeking to provide better service offerings to their customers and one of the ways to achieve the same is to involve the customers in the whole exercise of innovation and service delivery. A customer interaction therefore becomes imperative especially in a business context where high level of competition is being experienced. A customer-firm interaction (CFI) occurs when there is direct face-to-face contact between the consumer and the service firm (Mills, 2006). He points out that in the service organization, varying levels of interactions occurs since the simultaneous production and consumption of the offering requires these firms to interact with their customers to a greater degree than manufacturing firms. At the same time, organizations must decide upon the level of direct face-to-face interaction they will have with customers during service production since different organizations offer different services that will require varying levels of interactions. However, within the same industry, such as the banking industry, the type of interaction will be the same.

Durkin et al., (2003), observe that when CFI occurs, customers are better able to gain knowledge about the abilities of their particular service provider unlike a situation where the interaction between the customer and the provider is indirect or cosmetic in which the amount of knowledge the customer can gain about the provider's abilities is limited, since there is restricted interaction with the production process. However, if interactions are intense, then a greater degree of knowledge regarding the provider's abilities at service production is acquired by the customer - except in highly specialized area. This knowledge reduces customers' perceived uncertainty surrounding the service offering as well as their search and evaluation costs when considering future purchases (Jones,

Mothersbaugh, & Beatty, 2000). Thus, service organizations with high levels of customer interaction are likely to retain their current customers, as switching and evaluation costs of considering alternate suppliers, deter buyers from leaving their current provider. In the banking services that can involve remote accessing, there will be need to undertake extensive interaction that with the customers to establish the effectiveness of the system as well as the reliability and security of the system. The product range offered by banks keep on changing frequently due to the changing needs of the customers and with this, constant interaction with the customers will be necessary as well.

In the product development process, Ottenbacher & Harrington (2010) point out that despite an increased effort in proposing a structured and formal process of new service development (NSD), the failure rate remains high and one reason for this high failure rate is the lack of customer input and interaction during the process. Therefore, both NSD models by Alam & Perry (2002) suggest customer interaction at various stages of NSD. In addition, they also claim that the customers have fundamentally changed the dynamic of new product and service development. Some have even gone further by arguing that NSD can only occur as a result of partnering with customers and cannot be developed on individual organizational merits (Agarwal & Selen, 2009). They therefore claim that the nature of customer interaction is critically important for an effective NSD and that a number of issues must be considered in a customer interaction program. Interactions help firms refine their knowledge about customer tastes and preferences and the effective and efficient management of interactions and the interfaces at which these interactions occur are increasingly being recognized as sources of lasting competitive advantage (Rayport & Jaworski 2005). According to Oula (2012), the adoption of internet banking among the Kenyan banks has varied among the institutions depending on the level of customer interaction that the banks initiated with their customers. This means that the Kenyan banks success in internet banking has to involve customers' desires on the features and ease of usage of the system.

1.1.1 Customer Interaction

An interaction orientation reflects a firm's ability to interact with its individual customers and to take advantage of information obtained from them through successive interactions to achieve profitable customer relationships (Golden et al., 2005). However, they observe that no comprehensive construct exists in the literature that captures the key elements of an interaction orientation and addressed this gap by developing interaction orientation as a composite construct that consists of an organization's fundamental belief (the customer concept) and the relevant processes (interaction response capacity) and practices (customer empowerment and customer value management) that supplement this fundamental belief. Thus, at the core of interaction orientation is the specific notion of the customer concept—the belief that the unit of analysis of every marketing action and reaction should be the individual customer.

Service firms are advised to adopt customer interaction philosophy for their innovation activities because customer interaction in NSD can offer many benefits, including developing superior services, reduced cycle time and rapid diffusion of innovation (Berry et al., 2006). Despite these benefits, the issue of customer interaction has been a contentious topic. Several scholars and practitioners believe that a firm should interact with the customers because it is a necessity for a successful innovation (Im and Workman, 2004), while several others have raised doubts about the benefits of customer interaction (Brown, 2001; Hamel and Prahalad, 1994). They caution that merely following customer suggestions could lead to trivial innovations because average customers are inherently short-sighted and do not necessarily know what they really want. The observation is in tandem with the working principle of the Apple co-founder Steve Jobs who had little accommodation of the customer inputs during the innovation process and claimed that people don't know what they want until you show it to them (www.imdb.comm, accessed on 11.06.2013)

In the case of a banker-customer interactions, two components can be identified; the content of the interaction and the interaction process. Content can be classified as consisting of economic, information and social exchange (Czepiel 2000). Although economic exchange, i.e. the exchange of money and services, predominates in retail

banking, information exchange and social exchange are important too. For example, information exchange, which refers to the giving and receiving of information, reveals itself in the counseling and financial planning advice which banks provide to customers. Similarly, social exchange, i.e contact between two (or more) people, has traditionally been important in banking and possibly explains why branch networks remain attractive to certain segments of the customer base even though they may not be as convenient or even as cost effective as alternative delivery channels. Hence it is important for a firm to interact with its customers and to take advantage of information obtained from them through successive interactions to achieve profitable customer relationship. This interaction can also be a source of innovation and fruitful modification of existing product.

1.1.2 Innovation Performance

Pavitt (2005) defines innovation as the implementation of a new or significantly improved product (good or service), or process of coming up with a new marketing method, or a new organizational method in business practices, workplace organization or external relations. The minimum requirement for an innovation is that the product, process, marketing method or organizational method must be new (or significantly improved) to the firm. Innovations have been seen principally as the means to turn research results into commercially successful products. Innovations can stem from adopting new technologies or processes from other fields, or from new ways of doing business, or from new ways of marketing products and services (Biemens, 2002).

The capability-based theory of competitive advantage suggests that a firm can achieve sustainable competitive advantage through distinctive capabilities possessed by the firm (Prahalad and Hamel, 2000) and that the firm must constantly re-invest to maintain and expand existing capabilities in order to inhibit imitability. The resource-based theory further argues that competitive advantages lie in the heterogeneous firm-specific resources possessed by the firm. Resources include “all assets, capabilities, organisational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve efficiency and

effectiveness” (Barney 1991, p. 101). Accordingly, organizational capabilities including the ability to innovate new products and services are viewed as a resource. Although capabilities are resource dependant resources do not exclusively determine what the firm can do and how well it can do it. A key ingredient in this relationship is entrepreneurial key decision maker of the firm. In general, the capability-based theory recognizes the crucial role played by the entrepreneurial key decision makers of the firm in building and sustaining a competitive advantage

Besides investigations in identifying the drivers of performance, we have seen substantial research efforts in benchmarking the efficiency of commercial banks (Berger and Humphrey, 1997). Efficiency measurements, of course, imply an a priori knowledge of the inputs and outputs of a bank. For example, research on operational efficiency—the most widely studied efficiency issue, assumes as inputs the resources of a bank (e.g. personnel, technology, space etc) and as output some measurable form of the services provided (e.g., number of accounts serviced, or loans and other transactions processed etc). More recent innovative studies benchmark the effects of human resource management practices (Harker and Hunter 1997), look into the efficiency of alternative delivery processes (Frei, 1995), and investigate the effects of the environment (Athanasopoulos et al. 1997). These efficiency benchmarks are constructive: not only they identify the most efficient unit—bank, branch or delivery process, but they also aid in explaining efficiency differences, Berger and Mester (1997).

The service-profit chain of Heskett et al. (1994) clarifies the role of quality, and its inter-relationships with operational aspects of a service organization resulting from application of innovations. The arguments in Heskett et al. proceed as follows: profit and growth are stimulated primarily by customer loyalty; loyalty is a direct result of customer satisfaction; satisfaction is largely influenced by the value of services provided to customers; value is created by satisfied, loyal and productive employees and finally employee satisfaction results primarily from high-quality support services and policies that enable employees to deliver results to customers.

1.1.3 Commercial Banks in Kenya

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalized in 1995 and exchange controls lifted. The CBK, which falls under the National Treasury Cabinet Secretary docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. As at December 2012 there were forty six banking and non-bank institutions, fifteen micro finance institutions and one hundred and nine foreign exchange bureaus. According to the Central bank of Kenya (2012), there are a total of 45 licensed commercial banks in the country and one mortgage finance company. Out of the 45 institutions, 32 are locally owned and 13 are foreign owned. The locally owned financial institution comprise 3 banks with significant shareholding by government and state corporations, 28 commercial banks and 1 mortgage finance institution. However out of all the banks only 10 of them are listed in the Nairobi stock exchange having met the conditions of listing and applied for the same. The Central bank of Kenya annual supervision report (2012) categorizes the financial institutions into three tiers; Large, Medium and Small in terms of net assets. Out of the 45 institutions, 13 were in the large peer group with aggregate net assets of over Ksh. 15 billion. The medium peer group comprise of 17 institutions with net assets ranging between Ksh. 5 billion and 15 billion, whereas the small peer group had 15 institutions with net assets of less than Ksh. 5 billion.

In the coming period, according to the CBK (2012), diversification into other financial services is also expected as consumers increasingly seek “one stop financial supermarket.” These developments are expected to enhance banking products being offered and bring more Kenyans into the banking space. However, the main challenges facing the banking sector today include the Finance Act 2008, which took effect on 1 January 2009 that requires banks and mortgage firms to build a minimum core capital of Ksh 1 billion by December 2012. This requirement, it is hoped, will transform small banks into more stable organization. The implementation of this requirement poses a challenge to some of the existing banks and they may be forced to merge in order to

comply with the act. Owing to deregulation, new technology and changing consumer behavior, the competition in the banking sector is getting fiercer. In the Kenyan banking sector the intensified competition has recently resulted in a number of banks adopting agency banking and new electronic distribution channels. The Kenyan banking industry has continued to grow both in terms of new local and foreign entrants, customer and deposit base, regionalization and increased scrutiny from the regulators specifically the Central Bank of Kenya. This new shift in the Kenyan banking industry can be attributed to the liberalization of the sector, increased adoption of information technology and improved business environment due to reforms being undertaken in the political, economic, social and cultural fields. With these changes, the level of competition in the banking industry has reached an all level high and coupled with an enlightened customer and increased scrutiny from the regulators, local banks have had to shift their attention to distribution strategies as a source of competitive advantage.

1.2 Problem Statement

In the management literature numerous studies support the idea that an emphasis on innovation can increase firm performance through leveraging its dynamic capabilities (Barney, 2001), capturing market share (Hitt, Bierman, Shimizu, & Kochhar, 2001), exploiting experience and learning curve effects (Pittaway et al., 2004). In addition Lusch et al (2007) point out that a firm's ability to innovate will help in preempting scarce resources, creating reputation effects and adopting a service dominant logic. However other scholars also acknowledge that such an emphasis alone may not always result in higher levels of firm performance since when rivals are able to imitate the products or services of a first-mover, it can adversely affect the ability of the innovator to sustain an advantage, as the imitator may be able to avoid development costs, pricing mistakes, and learn from the first mover's experience (Lee, et al., 2000). This will be of particular concern for innovators within service organizations, such as banking institutions, because protecting new service innovations is difficult due to the intangibility of the offering and also since the sector is highly regulated as far as introduction of new products is concerned since the approval of Central Bank will have to be sought. As a result, these types of firms typically cannot depend on patents or other legal protections to ensure the

efficacy of their innovations. Thus, in order for these firms to increase their commitment to innovation, other barriers must be in place to reduce the impact of ease of imitation by rivals. One such barrier is the existence of a relationship between the service firm and the customer.

Several studies on the importance and application of innovation have been undertaken locally. Mwangi (2009) undertook a research on the Factors influencing financial innovation in Kenyan securities market; a case study of firms listed in the NSE. In his study, he found out that firms pursuing innovation-based competitive strategy build and nurture distinctive market-focused learning capabilities, which in turn enable such firms to outperform their competitors by creating superior value to their customers. In his research, Odhiambo (2010) studied on Innovation strategies at the Standard Chartered (k) ltd. He found out that for firms to be innovative they should encourage creativity in its learning process and this will to a higher platform of quality and innovation: creative quality and value innovation. Gathai (2009) undertook a research on the Innovation strategies adopted by Equity bank ltd. She found out that in order for a firm to embrace innovation, the top management should be involved and direct resources to the team involved in the innovation processes. The above studies quoted however have not recognized the importance of the customer in the innovation process. A customer has an important role in providing insights into a new product innovation and this present research will seek to address this deficiency by examining the impact of customer interaction on a firm's innovation performance. This gap therefore leads to the following research questions: what are the customer interaction practices employed by commercial banks in Kenya and what is the relationship between customer interaction and innovation performance at the Kenyan Banking Sector?

1.3 Research Objectives

The study objectives will be:

- i) To establish the customer interaction practices employed by Commercial Banks in Kenya;
- ii) To establish the relationship between customer interaction process and innovation performance among commercial banks in Kenya.

1.4 Value of the Study

The study will be beneficial to various stakeholders; it will be a source of information to the banking institutions in Kenya as it will be able to evaluate the customer interaction practices vis a vis firms innovation performance.

The study will enable policy makers obtain knowledge of banking industry dynamics and the appropriate strategies to be applied to enhance performance and therefore obtain guidance from this study in designing appropriate policies that will regulate the industry.

To the academicians the study will contribute to the existing literature in the field of customer interaction and innovation process. It should also act as a stimulus for further research to refine and extend the present study especially in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Kenya's banking sector is a cut-throat business arena, with 44 players including multinationals all scrambling for a slice of the pie. Banks such as Equity Bank have revolutionized the banking concept in Kenya and made banking accessible to a majority of the Kenyan population who could not afford the exorbitant bank charges or meet the complex requirements demanded by other banks. The Kenyan banking sector remains sound and resilient and at the same time developing and deepening faster than the overall economy (CBK, 2012). Stress tests conducted by the Central Bank indicated that the sector remains sound and resilient. It is noteworthy that the financial sector is developing and deepening faster than the overall economy. It grew by 9.0% in 2010 and 7.8% in 2011 while the economy grew by 5.8% and 4.4% in 2010 and 2011 respectively. This has been driven by financial infrastructure that has enabled financial inclusion. The growth of micro deposit accounts (accounts with average balances of Ksh 100,000 and below) has been a critical contributor to the development and deepening of the banking sector.

These accounts have increased from about 2.14 million in 2005 to 14.0 million in June 2012. The number of loan accounts remains low at just over 2 million and will need to increase substantially to catalyze reduced unit costs of loans. In this regard, the Central Bank will continue to work with Government and the banking sector to implement reforms geared towards reducing the cost of credit to increase the number of Kenyans able to access credit (CBK, 2012).

Innovation in the form of final products and services is an implementation of knowledge from the customer, defined as the insights, ideas, thoughts, and information the organization receives from its customers. These insights can be about current products and services, customer trends and future needs, and ideas for product innovations. Ideas for successful product innovations are most likely to come from end users and customers of the products and not from within the organization. An organization must therefore

actively seek out such knowledge in order to be better prepared to implement product enhancements and innovations. Sometimes, through this form of innovation, firms can change their business models or processes and offer different services (Desouza & Awazu, 2004)

Organizations take ideas from customers, process them, incorporate them into finished products, and then deliver them to customers. The organization's value is normally tied to the internal and external value generated. The ideal organization will recognize and appreciate the customer dimension in every interaction and build it into its internal innovation process. Successful customer innovation programs are based on systematic interactions among three key entities: the organization, products and services, and customers. These three entities interact with each other in a series of innovation stages: the idea generation and development stage; the design, testing and refinement stage; and the commercialization stage. Jan Carlzon, former President of Scandinavian Airline Services called these instances "moments of truth". He defined them as "any time a customer comes into contact with any aspect of your business, however remote, the customer has an opportunity to form an impression."

However, little research exists on the role of firm–customer collaboration in nurturing firm's innovation processes. The objective of this section is to try and identify the potential gaps on the studies that have been conducted in this area. In order to fill this gap, this paper develops a conceptual contribution for understanding customer involvement in bank's innovation, by examining customer firm interaction, innovation process and role of customer interaction on a banks' innovation process.

2.2 Customer Firm Interaction

One of the unique aspects of service organizations is the simultaneous production and consumption of the services offered and because of the intangible nature of services, these firms must interact to a greater degree with their customers than their manufacturing counterparts (Mills, 2006). During service production, an interaction occurs between the firm and its customers where information is exchanged for the



purposes of producing the offering. The amount of information exchanged is a byproduct of the level of customer-firm interaction, which is determined by how a service firm chooses to structure its production process (Skaggs & Huffman, 2003). Thus, the degree of these interactions, and hence the level of information exchanged, varies among service providers in which some service organizations may choose to produce their service in a manner such that little customer firm interaction (CFI) is required, with interactions being generally indirect or automated.

Mills (2006) note that during customer firm interaction customers gain information about their provider and when CFI is high, the in-depth interactions lead to personal exchanges between the customer and the firm. While these exchanges allow the firm to access needed information from the customer, they also allow the customer to obtain greater information about the organization. The information obtained from direct interactions allows customers to acquire knowledge regarding such things as their provider's skills, abilities, and level of commitment in providing the service in question; in short, it gives customers knowledge about the firm's overall ability at service production. In the case of banks, a company that wishes for example to undertake initial public offering (IPO) or seek advice on syndicate financing, will be able to assess the capacity of the bank to undertake such an exercise through interacting with the banks. For example the Kenya government signed a \$600M two year loan with three foreign banks namely; Citi Group, Standard Chartered plc and Standard Bank group limited. Such a transaction can only be undertaken through establishment of an effective CFI under which both parties assess the capacity of the other party to meet their respective side of the bargain. Conversely, low levels of CFI grant customers minimal information regarding the provider. As a result, customers of these types of firms know comparatively little about the abilities of the provider. We suggest that this difference in the information resulting from the level of CFI has implications for a service firm's innovation activity.

A number of customer interaction strategies have been documented in the literature that highlight the key issues involved in customer interaction in NSD. For example, based on studies in Swedish Telecom industry, Magnusson et al. (2003), Matthing et al. (2006,

2004) and Kristensson et al. (2008) emphasize the importance of customers as key sources of novel service ideas and recommend the involvement of only innovative customers in new service development (NSD). Mirroring this finding, Carbonell et al. (2009) state that customer interaction has a strong influence on the performance of new services. Commenting on the modes of interaction, Ojasalo (2009) opines that the customers should play an active role in NSD and become an intrinsic part of the innovation team. Focusing on the boundary-spanning roles of service firms' employees, Stevens and Dimitriadis (2004) stress the need to integrate right skills and people at the right stage of NSD. Similarly, a recent study emphasizes the role of front-line employees in NSD and suggests that service managers should provide training to their employees so that they fully understand their tasks and responsibilities for service innovation (Cadwallader et al., 2010). More specifically, Alam (2006) proposes that customer interaction during the front fuzzy end, i.e. the stages of idea generation, screening and concept development are more important than other later stages of the development process.

Selecting appropriate customers for interaction is also a key issue in the literature. For example, in selecting customers as development partners, the relationship between firms and customers is very important. In particular, Eisingerich et al. (2009) focus on the issue of relationship with the customers and argue that the exchange of knowledge between exchange partners such as customers depend on the type of relationship the firm has. They stress the need of networking and claim that a close relationship provides service firms with access to rich information and tacit knowledge that can have firms identify proper ways of developing new services. For successful customer interaction, the service firms also need to motivate the customers to participate in the NSD process (Auh et al., 2007; Bettencourt et al., 2002; Chan et al., 2010; Lengnick-Hall et al., 2000). Building on the studies related to the motivation for interaction Chan et al. (2010) further argue that motivation becomes a challenge when dealing with customers from a different cultural background. Another challenge of customer interaction noted by Hoyer et al. (2010) is the information overload and infeasibility of the service ideas provided by the customers. They also stressed the need for more research on the challenges to customer interaction

because little is known about this issue in the extant literature. This project will build on the work of Hoyer et al by contextualizing in the Kenyan banking industry.

2.3 Innovation Process

Pavitt (2005) defines innovation as the implementation of a new or significantly improved product (good or service), or process of coming up with a new marketing method, or a new organizational method in business practices, workplace organization or external relations. The minimum requirement for an innovation is that the product, process, marketing method or organizational method must be new (or significantly improved) to the firm. Innovations have been seen principally as the means to turn research results into commercially successful products. Innovations can stem from adopting new technologies or processes from other fields, or from new ways of doing business, or from new ways of marketing products and services (Biemens, 1992).

However, Koigi (2011) – as a leader of one of the Kenyan banks - points out that innovation, though good, is filled with dangers and pitfalls. Innovations such as outsourcing of services like tea / snack preparation, cleaning, photocopying and other employment intensive areas that officers have customarily filled with friends and relatives are difficult undertakings, requiring buy-in from all stakeholders, internal and external. She further notes that innovation challenges the organizations reputation, introduces the danger of mission drift, high costs, and resistance from the staff and loss of both good and surplus staff. To overcome these hurdles, leaders need to focus on the results they intend to achieve, manage on performance, identify and relate with all stakeholders and focus on products that meet the customer's needs rather than solely on financial results which kills innovation. This study focuses on a bank that has been late in adopting innovation in such a competitive Kenyan banking industry.

The capability-based theory of competitive advantage suggests that a firm can achieve sustainable competitive advantage through distinctive capabilities possessed by the firm (Grant, 1991; Prahalad and Hamel, 1990) and that the firm must constantly re-invest to maintain and expand existing capabilities in order to inhibit imitability. The resource-based theory further argues that competitive advantages lie in the heterogeneous firm-

specific resources possessed by the firm (Montgomery and Wernerfelt, 2008). Resources include “all assets, capabilities, organisational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve efficiency and effectiveness” (Barney 1991, p. 101). Accordingly, organizational capabilities including the ability to innovate new products and services are viewed as a resource. Although capabilities are resource dependant resources do not exclusively determine what the firm can do and how well it can do it. A key ingredient in this relationship is entrepreneurial decision maker of the firm. In general, the capability-based theory recognizes the crucial role played by the entrepreneurial key decision makers of the firm in building and sustaining a competitive advantage

Ancona and Caldwell (2002), observed that competitive innovations processes have been found to yield: improved product quality; creation of new markets; extension of the product range; reduced labor costs; improved production processes; reduced materials; reduced environmental damage; replacement of products/services; reduced energy consumption; and conformance to regulations. This position can be said to be true in the case of Equity bank, a firm which came into the market after other players and has established itself as a market leader. This position has not come from a sheer luck but through the firm being able to develop products that appeal to the customer all the time round. Other banks such as Cooperative bank, Housing Finance, Kenya Commercial Bank have followed suit in realizing the need of product innovation by going a step further to employ an innovation leader tasked with developing new exciting products and services that keep the Banks at the cutting edge of innovation in the industry. This study focuses on a bank that has been late in adopting innovation.

Innovation made by firms are driven and determined by various factors in the environment including customer-supplier relations (Von Hippel, 2001); market conditions (Ancona and Caldwell, 2002); network studies, market conditions and external knowledge infrastructures (Nelson, 2003). In Kenya for example, majority of the banks clients will be of ages below 45 years and who are tech savvy and with this development, banks have had to develop products that will require the use of the internet

and this has given rise to internet banking in almost all the banks at present. This means that all banking innovation is tied to the customer needs. Each of these is a potential source of “ideas, practices, and material artifacts” for innovation. For network relationships to contribute positively to innovativeness, therefore, it may be necessary to emphasize “weak ties” (as opposed to “strong ties”) because weak ties provide more diverse and rich links to the kind of novel and unique information that may be needed to generate innovative activity (Granovetter, 2003). Apart from the external factors, internal factors such as cultural factors, structural links, internal competencies and maintaining an internal awareness of the importance of newness to innovation may aid a firm’s innovation efforts.

2.3.1 Innovation in the banking sector

Innovation has always been a sought after area for organizations in any country. Innovation is identified as the main driver for companies to prosper, grow and sustain a high profitability (Christensen, 2007). Wolfe, (1994) suggests that the term ‘innovation’ can be defined in terms of a new or innovative idea applied to initiating or improving a product, process, or service. Innovation has been a buzz word in banking right from beginning. The attempt towards innovation has been more so in developing countries due to their country’s emergence and growth, more or less, in all the sectors. The banking industry has been on an unprecedented growth trend during the past decade in the country (Tidd, 2007).

The banking sector today is fast paced and is constantly in the throes of change, with new regulations, new processes and new policies in place. Technology has played a critical role in the past in shaping the way things are today, and will continue to do more than ever before. From being just a support function, technology is now regarded largely as a strategic function aiding banking organizations (Chesbrough, 2007). Most of the success achieved by this industry can be attributed to the ever changing innovative trends in technology. Service operations like Service Delivery Systems and Service Quality have dramatically become customer-centric during the past decade. The importance of service delivery and its impact on improving satisfaction and retention of customers, improving

sales and market share, and improving corporate image cannot be overstated. (Lewis et al., 1994).

Banks in Kenya and other countries have largely implemented service delivery technology as a way of augmenting the services traditionally provided by bank personnel. Implementation results both from the need to reduce the cost of delivering service primarily through personnel, and the corresponding need to meet the challenge posed by technologically innovative competitors (Byers and Lederer, 2001). Some of the reasons for the awareness by the banks regarding these challenges are impact of deregulation, rapid global competition and networking, the rise in personal wealth and increasing customer expectations. Many external forces like political, economic, social and technological and internal forces like customers, employees, organization structure, product development, service delivery have great impact on the innovation in banking (Chanaka Jayawardhena and Paul Foley, 2000).

2.4 Role of Customer Interaction on a Banks' Innovation Process

A customer-firm interaction (CFI) occurs when there is direct face-to-face contact between the consumer and the service firm. Interaction to varying degrees is typical for service organizations, since the simultaneous production and consumption of the offering requires these firms to interact with their customers to a greater degree than manufacturing firms. With today's technological advances, however, there are many different ways for firms to interact with customers (i.e. Internet or automated communication). Organizations must decide upon the level of direct face-to-face (CFI) interaction they will have with customers during service production. Thus, the degree of CFI is a firm-level decision and is the result of how a service organization structures its production process (Skaggs & Huffman, 2003). For example, some insurance companies structure service production so that there is little in the way of customer interaction, performing most of their transaction via the internet or telephone. Other insurance companies open numerous branch offices and require face-to-face interactions with customers. Therefore, within the same industry firms have varying levels of CFI.

Service firms are advised to adopt customer interaction philosophy for their innovation activities because customer interaction in NSD can offer many benefits, including developing superior services, reduced cycle time and rapid diffusion of innovation (Alam, 2002; Berry et al., 2006). When CFI occurs, customers are better able to gain knowledge about the abilities of their particular service provider and if the interaction between the customer and the provider is indirect or cosmetic, the amount of knowledge the customer can gain about the provider's abilities is limited, since there is restricted interaction with the production process (Durkin et al., 2003). However, if interactions are intense, then a greater degree of knowledge regarding the provider's abilities at service production is acquired by the customer. This knowledge reduces customers' perceived uncertainty surrounding the service offering as well as their search and evaluation costs when considering future purchases. Together, these act to increase the customer's perceived cost of switching to a rival's offering. In addition, Jones, et al. (2000) found that these switching costs lead customers to stay with their current provider, even when the satisfaction with the current provider is seen as low. Thus, service organizations with high levels of CFI are more likely to retain their current customers, as the switching and evaluation costs of considering alternate suppliers, deter buyers from leaving their current provider (Rumelt, 1987).

When CFI is high, the in-depth interactions lead to personal exchanges between the customer and the firm. While these exchanges allow the firm to access needed information from the customer, they also allow the customer to obtain greater information about the organization (Eriksson & Vaghult, 2000). The information obtained from direct interactions allows customers to acquire knowledge regarding such things as their provider's skills, abilities, and level of commitment in providing the service in question; in short, it gives customers knowledge about the firm's overall ability at service production. Conversely, low levels of CFI grant customers minimal information regarding the provider. As a result, customers of these types of firms know comparatively little about the abilities of the provider. We suggest that this difference in the information resulting from the level of CFI has implications for a service firm's innovation activity.

Harrison (2001) posits that firms in business markets need to adapt to the specific needs of important customers in order to develop a competitive market. In the banking industry, small- and medium-sized enterprises (SMEs) are considered important customers, offering the greatest profit opportunity for banks. Through establishing profound relationships with such business units, banks can attain a greater number of satisfied customers and, consequently, gain a greater share of the financial market (Ting, 2006). The length of banking relationships is characteristic for businesses with complex long-term relationships and according to marketing theory; banks should strive to adapt to the needs of their SME customers (Vegholm and Silver, 2008).

Putting customers at the heart of an organization's product-market definition is the first rule of effective customer-orientation management and many organizations get into difficulties through an inappropriate vision of customers and their needs (Nwankwo, 2005). Customer-focus is critical to business profitability, a necessary antecedent of competitive advantage and a hallmark of successful business. Consequently, probing the factors which could facilitate this orientation and how it could be measured in organizations has continued to engage the attention of researchers. In transaction costs terms, the status quo effect that results from uncertainty and the loss aversion bias is actually the result of increased perceived switching costs on the part of customers (Williamson, 1985). Numerous studies using physical products have shown that customers tend to stay with their existing product rather than switch to that of a competitor, even though the competing product may be marginally superior. Here, the physicality of the product in their possession allows customers to have an understanding of its benefits. The thought of adopting a new product introduces uncertainty and hence increases perceived switching costs, thereby inducing customers to stay with their current product (Gourville, 2007).

Mills (2006) observe that in the service industry, their products are somewhat different because of the intangible nature of services where what is sold is typically a process and it is the knowledge of this process that will aid in customers' determination of the benefits derived from their current provider. What a customer gives up when switching providers

is his/her familiarity with the existing provider's abilities in service production. When this familiarity is high, the benefits from the current provider are well understood. This increases the relative level of uncertainty involved in switching providers, thereby increasing the perceived switching costs. However, when knowledge of the current provider's production abilities is low, the level of relative uncertainty between current and potential providers is reduced, which in turn reduces perceived switching costs. Therefore while customers generally tend to overweight their relationship with their current provider (Gourville, 2007), it is believed that this effect is pronounced in organizations where there are high levels of CFI. Here customers have amassed a much larger amount of knowledge and familiarity with the production process. Therefore, the perceived costs associated with switching providers will be much higher.

2.4.1 Customer – Advisory Panel

A firm may form an advisory panel of selected customers and ask them to occasionally provide input at various stages of the NSD process. Customer-advisory program has long been used for tangible products, but it is slowly evolving for services as well. Dorfman (2005) reported the use of customer-advisory panels in several well-known American service firms for their NSD efforts. These service firms actively collaborate with selected customers to keep up with the evolving needs of the market and incorporate the collected insights into their NSD efforts. According to Harrison (2001), many firms in the developing countries have also started adopting this customer interaction to boost their financial performance.

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actually the result of increased perceived switching costs on the part of customers (Williamson, 1985).

2.4.2 Observation of Customers

A firm may obtain new service ideas and information by simply watching a service delivery process. Customers' needs and choices are often susceptible to a variety of influences, such as the number and features of alternatives and the timing of purchase. Customers may also be less reliable in suggesting their future needs in a face-to-face interview (Mills, 2006). In contrast, observation of customers and their behaviour may better identify the needs and choices of customers. For example, a banking firm may send its financial advisers to several importers to generate ideas by examining transactions related to the cross-border payments and receivables. The financial advisers may for example observe that the client firms are dealing with multiple global banks for their cross-border transactions and generally unhappy with the inefficiencies and the costs associated with that arrangement. Based on this observation, the firm got an idea for a new international clearing-house. This technique of customer observation, also referred to as ethnography, can identify "unstated" or "unspoken" customer needs and detect the contradictions between what customers say and what actually they do (Goffin and Lemke, 2004).

Harrison (2001) posits that firms in business markets need to adapt to the specific needs of important customers in order to develop a competitive market. In the banking industry, small- and medium-sized enterprises (SMEs) are considered important customers, offering the greatest profit opportunity for banks. Through establishing profound relationships with such business units, banks can attain a greater number of satisfied customers and, consequently, gain a greater share of the financial market (Ting, 2006). The length of banking relationships is characteristic for businesses with complex long-term relationships and according to marketing theory, banks should strive to adapt to the needs of their SME customers (Vegholm and Silver, 2008).

2.4.3 Customer Visits

Service managers may visit their customers regularly to discuss new service opportunities. In addition, this customer visit can help to conduct experiments in which the customers may observe mock service delivery processes and provide feedback on the merits of the service concepts (Gourville, 2007). He gave an example of while developing a new fire insurance product, a team of product managers of an insurance firm visited a customer's office and simulated a claim processing exercise. During this mock session the firm tested the product, made service design changes and also added several new attributes to the service concept.

Mills (2006) posit that in the service industry, their products are somewhat different because of the intangible nature of services where what is sold is typically a process and it is the knowledge of this process that will aid in customers' determination of the benefits derived from their current provider. What a customer gives up when switching providers is his/her familiarity with the existing provider's abilities in service production. When this familiarity is high, the benefits from the current provider are well understood. This increases the relative level of uncertainty involved in switching providers, thereby increasing the perceived switching costs.

2.4.4 Informal Customer - Manager Mixers

Instead of the prolonged retreats or summits, a firm can occasionally organize informal gatherings and engage in dialogues with their key customers concerning new services. Examples are occasional innovation lunches and dinners where employees and customers interact informally (Dorfman, 2005). The product manager can bring key customers to their head office regularly and conduct mini conferences, innovation seminars and idea clinics and even organize picnics and barbeques and such events can be extremely productive.

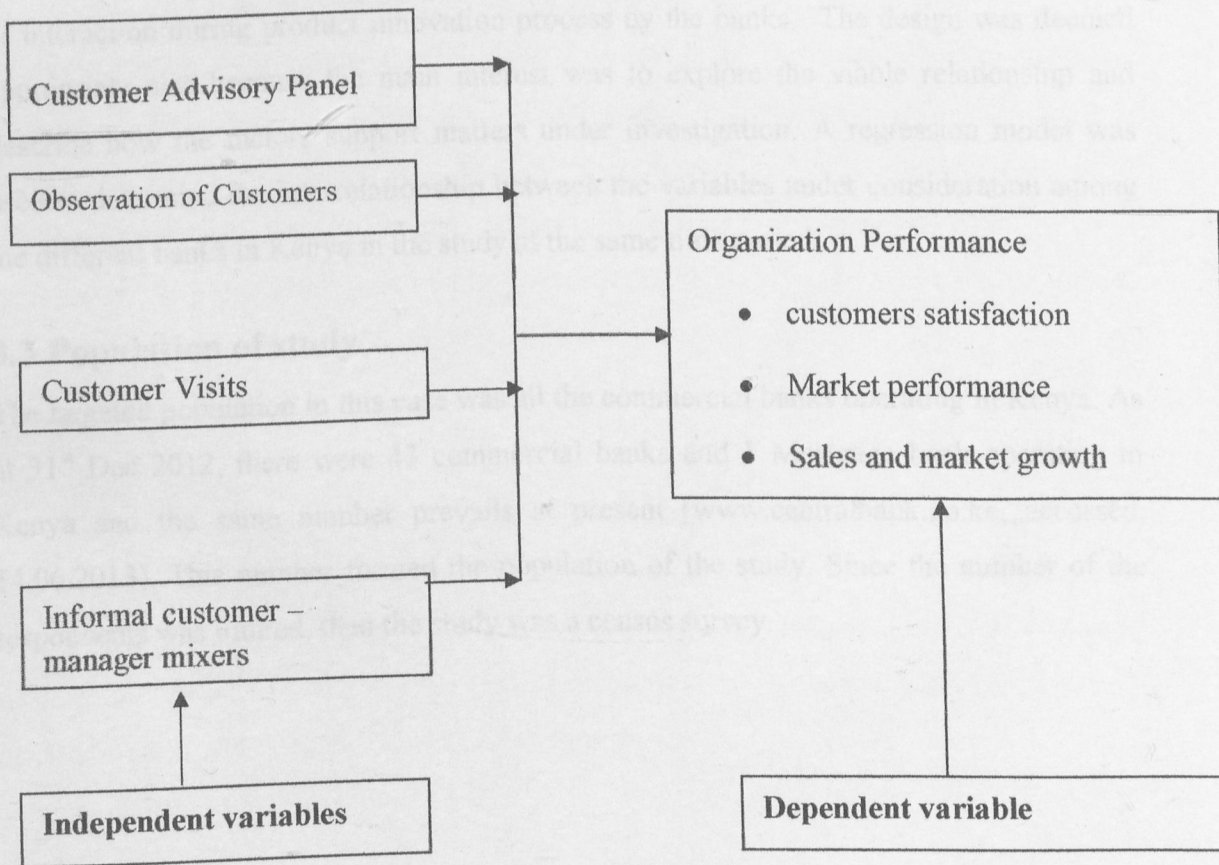
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2.5 Conceptual Framework

A conceptual framework can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation (Reichel and Ramey, 1987). The schematic diagrams below will not only guide the study but will also show the inter-relatedness among the key variables in the study as illustrated in Fig. 2.0.

Fig. 2.0 Schematic diagram showing variable relationships



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter describes the research design that was used and includes the research design, the target population, sampling design, data collection instruments and procedures, and the techniques for data analysis.

3.2 Research Design

This study was based upon the premise that banks engage in various forms of interaction in their innovation process with their customers. As a result, a descriptive and cross sectional research design was used in this study. A descriptive research design was adopted in the study because the study was concerned about a univariate question in which the researchers will ask questions about the size, form, distribution and existence of interaction during product innovation process by the banks. The design was deemed appropriate also because the main interest was to explore the viable relationship and describe how the factors support matters under investigation. A regression model was used to determine the interrelationship between the variables under consideration among the different banks in Kenya in the study at the same time period.

3.3 Population of study

The targeted population in this case was all the commercial banks operating in Kenya. As at 31st Dec 2012, there were 43 commercial banks and 1 Mortgage bank operating in Kenya and the same number prevails at present (www.centralbank.go.ke, accessed, 14.06.2013). This number formed the population of the study. Since the number of the respondents was limited, then the study was a census survey.

3.4 Data collection

The study used both primary and secondary data. The primary data was collected by use of the structured questionnaire while secondary data was collected from the financial reports of the firms. A questionnaire was appropriate in this study because new explanations of the observed practices were found and assumptions underlying any of the practices examined in more detail. Further a questionnaire provided disaggregated data that can be used to examine the practices of firms on an individual basis rather than on an aggregated basis (Graham and Harvey, 2001). The questionnaires were hand delivered to the respondents' offices with a request to fill in the questionnaire in one week time where upon they were collected. The target respondents were the finance managers or individuals concerned with product development and interaction with the customers and composed of Finance managers, business development managers and the Marketing managers. The survey instrument involved both closed and open-ended questions. The open-ended questionnaire sought to encourage respondents to share as much information as possible in an unconstrained manner while the closed-ended questionnaire involved "questions" that could be answered by simply checking a box from a pre-determined set of responses presented in a five-point Likert scale. A five point likert scale requires individuals to make a decision on their level of agreement, generally on a five-point scale (i.e strongly Agree ,Agree, Disagree, Strongly Disagree).Each item is of equal value so that respondents are scored rather than items and this is likely to produce a highly reliable scale that is easy to read and complete. They are also more expansive, easy to collect and analyze data.

3.5 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations) and regression analysis. The dependent variable in the study was organizational performance. The independent variables for the study were Customer interaction that was proxied by the customer advisory panel, observation of customers, customer visits and informal customer manager mixers.

Organizational Performance = $f(X_1, X_2, X_3, X_4, X_5, X_6)$;

DATA ANALYSIS RESULTS AND DISCUSSION

More specifically, the regression will be of the form;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \alpha$$

- Where Y = Organizational performance
- β_0 = Constant
- X_1 = Customer – advisory panel
- X_2 = Observation of customers,
- X_3 = Customer visits
- X_4 = Informal customer manager mixers

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The research objective was to establish the customer interaction practices employed by Banks in Kenya establish the relationship between customer interaction process and firms innovation performance and also establish the relationship between innovation and a firms' financial performance. This chapter presents the analysis, results and the discussion. The findings are presented in percentages and frequency distributions, mean and standard deviations. A total of 43 questionnaires were issued out. Of the 43 questionnaires issued out, only 33 were returned. This represented a response rate of 77% and this was considered satisfactory for the analysis.

4.2 Demographic and Respondents profile

The demographic information considered in this study included age of the respondents, and the length of period the banks had been in existence.

4.2.1 Age of the Respondents

Adoption of innovations by firms offering computer banking services in greatly influenced by age. They initially offer their new technology-based service innovations to younger consumers who are more highly educated and have higher income and are more likely to have access to computer banking than their older, less affluent counterparts. This may help in reducing risks and maximizing the returns of the investments in the new technology.

The respondents were asked to indicate their age and the results are presented in Table 4.1 below.

Table 4.1: Age of the Respondents

	Frequency	Percent
21- 30 years	8	24%
31-40 years	16	48%
41-50 years	6	18%
Over 50 years	3	10%
Total	33	100

The findings on the respondents' age bracket in Table 4.1, was that 48% of the respondents were 31 to 40 years old, 18% of the respondents were 41 to 50 years old while 24% indicated that they were less than 30 years old. The results indicates that majority of the respondents were above 30 years, graduates and therefore will be able to understand better the need for a customer interaction during the innovation process of the firm.

4.2.2 Operation period of the Bank

The number of years an organization has been in operations determines the level of customer interaction and investment in innovations. This two can impact on the firm's performance. The respondents were asked to indicate the duration in which their bank had been in operation and the findings are indicated in Table 4.2.

Table 4.2: The banks operation period

	Frequency	Percent
Under 10 years	4	12%
11-15 years	3	9%
16-25 years	6	18%
Over 26 years	20	50%
Total	33	100

From the research findings in Table 4.4 it was established that 50% of the commercial banks have been in operation for over 25 years, 21% have been in operation for less than 15 years and the balance of the banks had been in operation between 15 and 25 years. This results mean that there is an even spread of the banks in terms of the length of operations and this means that the results generated will be representative. This is because the length of operation has an effect with the level of customer base as well as the product innovation phase and it will therefore be expected that as they a bank continuous in its operations a number of innovational experience will be catered and this will be invaluable source of information for this research.

4.3 Customer Interaction Process in the Banks

This section of the questionnaire sought to establish the customer interaction process in the banks. The interaction of the customer with the banks during the development of products forms the basis of acceptability of the final product. On the question of whether the banks appreciate the role of customer interaction during product development process, all the respondents answered to the affirmative. This means that all the banks involve their customers in development of various products and this involvement will take different forms.

A bank-customer interaction can be accomplished by adopting different modes of interaction. The method chosen that a bank adopts should be one that will lead to more customers being incorporated in the process and at the same time result in greater benefit in a firm's product development. On the question of the popular methods used by the Kenyan commercial banks when interacting with their customers, it became evident that most commercial banks use different modes of interaction at different times and product innovation. However, induction of customers in new product development, observation of the customers on how they receive services and through customer visits came out as popular approaches that are used by the commercial banks. However, organizing innovation retreats and summits and also organizing informal customer-manager mixers such as lunches, dinners or breakfast meeting was found to be the least popular methods adopted by the firm. This finding in which different banks employ different interaction

modes is similar to the one made by Harrison (2001) who posited that firms in business markets need to adapt to the specific needs of important customers in order to develop a competitive market. It is therefore imperative that the banks adopt appropriate method of CFI that will be able to give it necessary competitiveness and market share. However, this finding also contradicts the position made by Song et al., (1999) who observed that firms with high levels of CFI create competitive barriers, thereby allowing them to profit from their investments in innovation. On the other hand, service firms with low levels of CFI can apparently increase performance by economizing on such investments. This therefore means that firms within a sector should resist the temptation to jump onto the innovation bandwagon without carefully considering the presence or absence of competitive barriers resulting from their firm's particular level of CFI.

4.3.1 Features of the customer-bank interaction

The adoption of an appropriate mode of customer firm interaction is not enough. As Czepiel (2000) observed, the same interaction should have several features that will aim to make the meeting more fruitful and participatory as possible. Towards this end, the researcher sought to establish the existence of various features in the interaction and the results are presented in Table 4.3 below.

Table 4.3: The characteristics of Bank-customer interaction

	Mean	Std. Deviation
There is little customer firm interaction (CFI) required during the banks innovation process	2.4000	1.31389
From the interaction customers gain to know more about the bank and high level of interaction lead to personal exchanges between the customer and the firm	4.6000	.50262
Customers get to know about the banks skills, abilities, and level of commitment in providing the service in question	4.3000	.92338
There has been an increase in service adaptability as a result of the interaction	4.4500	.68633

An improvement in service focus has been witnessed in the bank as a result of the customer firm interaction	4.7000	.47016
The customers interaction has continually connected them with the firm and actively shape the nature of transactions	4.1000	.64072
Interaction has facilitated customer connection and collaboration with each other by sharing information; praise; criticism; suggestions; and ideas about its products, services, and policies.	4.0500	.82558
Overall mean	3.5	0.766

The respondents were requested to indicate the features that the customer firm interaction that have adopted has in a five point Likert scale. The range was ‘very low extent (1)’ to ‘very great extent’ (5). The results as represented in the table above show that there been in service focus in the banks as a result of the customer firm interaction compared to the period before the interaction was implemented in the banks (M=4.700) as well as that from the interaction customers gain to know more about the bank and high level of interaction lead to personal exchanges between the customer and the firm (M=4.6). This findings show that with the customer interaction, there is improved customer satisfaction due to the point that since the customers were involved in the development of the products, they will given inputs on how the innovation should be tailored to meet their needs and out of this, the resultant product will be able to measure to their expectation. Different stakeholders are partakers of these products and their input before the eventual rollout will greatly enhance their quality. This binding will support that of Ancona and Caldwell (2002), who observed that competitive innovations processes have been found to yield: improved product quality and production processes; reduced materials; reduced environmental damage; and conformance to regulations. Hence it follows that banks should appreciate the widespread nature of its clientele and seek to involve them in the design and improvement of the product features.

The other finding of the study was that the customer – bank interaction has facilitated customer connection and collaboration with each other by sharing information; praise;

criticism; suggestions; and ideas about its products, services, and policies (mean, 4.05). This finding appreciates the position that a bank has customers of diverse business background and the interactions with these customers enable the bank to form a joint point where these customers meet to share their individual business experience and out of this identify points of collaborations with one another. This finding explains why different banks such as Kenya Commercial bank, Standard Chartered bank and Barclay's banks have come up with business clubs that bring together their business club customers and these clubs have organized foreign educational trips to source for business opportunities for these customers. Most of the respondents therefore observed that bank-customer interaction has had a beneficial effect on the level of customer satisfaction.

4.4 Customer Interaction Practices

This section of the questionnaire sought to establish the customer interaction practices adopted by different banks. The respondents were asked to indicate the effect that various customer interaction practices has had on the performance of the firms in a scale, ranging from 1 (strongly disagree) to 5 (strongly agree). The customer interaction practices considered included customer-advisory, observation of customers, customer visits, and informal customer-manager mixers. The scores of strongly disagree have been taken to represent a variable which had a mean score of 0 to 2.5 on the continuous likert scale; ($0 \leq S.E. < 2.4$). The scores of 'moderate' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous likert scale: ($2.5 \leq M.E. < 3.4$) and the score of both agree and strongly agree have been taken to represent a variable which had a mean score of 3.5 to 5.0 on a continuous likert scale; ($3.5 \leq L.E. < 5.0$). The results are presented in table 4.4.

Table 4.4: Customer Interaction Practices

Customer advisory panel		
Selected customers are asked to provide input at various stages of the new service development	3.1500	.87509
The advisory panels, enables collaboration with customers on evolving needs of the market and incorporate the collected insights into our product efforts	3.8000	1.00525
The close relationship with the customers on the product development, has created a competitive advantage to the bank	4.1500	.81273
The collaboration has reduced the switching frequency of customers from the bank	3.8000	1.39925
Overall Mean	3.725	1.02308
Observation of customers		
Observation of customer action enables the bank to identify a particular need	4.3000	.73270
Customers may be unreliable on describing their needs and its through observing their activities that the bank has been able to identify their needs	4.3500	.81273
Through observation, the bank has been able to adapt to the changing needs of the customers and tailor our products their specification	4.1500	.98809
Establishment customer relationships has created a more satisfied customers base	4.6000	.75394
Overall Mean	4.35	0.821865
Customer visits		
The bank visits customers regularly and this visit has help to conduct experiments in which the customers may observe mock service delivery processes	4.1000	1.02084
The customer visit has provided feedback on the merits of the service concepts being offered by the bank	4.3000	.86450

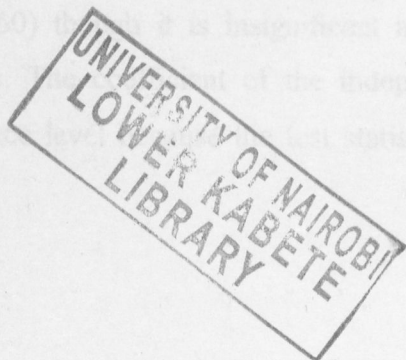
From the visits to the customer premises, the bank has been able to explain in much more details the services that are available to the customers offered by the bank	4.3000	.57124
Overall Mean	4.23	0.614145
Informal Customer - Manager mixers		
The bank occasionally organize informal gatherings and engage in dialogues with their key customers concerning new services and from the same meetings, both	3.6000	1.14248
Our banks product manager bring key customers to their head office regularly and conduct mini conferences, innovation seminars and idea clinics and even organize picnics and barbeques and such events have turned out to be productive.	4.0000	1.16980
Overall Mean	3.8	1.42024

The findings in Table 4.4 show that observation of the customer's activities is the most effective customer interaction practice with the overall mean 4.35 and standard deviation 0.821865. The low standard deviation under this practice shows that majority of the banks consider this practice as a common and popular among them. The observation of customer action enables the bank to identify a particular need and from the same be able to develop a product that will meet the need of the customers. For a bank that will be the first to introduce such a product, it creates such level of competitiveness that any other bank that will be following might not arouse much interest especially if its not differentiated. A local example is the M-Shwari product was introduced by the Commercial bank of Africa. The product has been such a success and with the introduction of similar products such as M-BENKI by KCB, it will take some time and many resources in form of advertising to capture the lost market back. The needs of customers keep on changing depending on the business environment. The bank should therefore be proactive enough to identify the products that its customers require out of the changing demands (M=4.6, SD=0.75394). It therefore means that a bank should keep

close watch on the activities of its customers so that they can be able to develop appropriate products that will meet the needs of the customers. As Mills (2006) observed, customers' needs and choices are often susceptible to a variety of influences, such as the number and features of alternatives and the timing of purchase. Customers may also be less reliable in suggesting their future needs in a face-to-face interview and as a result, a bank should observe the activities of the customer and come up with an appropriate product.

Closely related to the observation of customer activities is the banks practice of visiting the work place of the customers (Overall mean, 4.23, SD= 0.614145). It was found that when a bank visits customers regularly, this helps in conducting experiments in which the customers may observe mock service delivery processes. The customer visit was thus found to provide feedback on the merits of the service concepts being offered by the bank and from these feedbacks, the bank can be able to adjust its services to improve or cater for the needs that are not presently being covered. A similar observation was made by Mills (2006) who noted that in the service industry, products are somewhat different because of the intangible nature of services where what is sold is typically a process and it is the knowledge of this process that will aid in customers' determination of the benefits derived from their current provider.

The findings from this section therefore shows that there are different customer interaction practices that can be adopted by a bank and it is incumbent upon the bank to identify the most appropriate customer interaction practice. It should also be noted that a bank should tailor its practice to a particular practice since the effectiveness of a specific practice will depend on the type of customers and nature of product being offered by the bank.



4.5 Regression Analysis

The effect of the firm's customer interaction practices on the banks performance was carried out by use of a regression. The measures of performance was carried out with the performance being measured by variables including sales growth, market share growth, total cost reduction, reduction of response time for product design change and accuracy of order processing. From these performance measures an average is determined from which it is regressed with the averages results of the independent variables. From Table 4.5 below, the established multiple linear regression equation becomes:

$$Y = 37.160 + 1.863X_1 + 3.292X_2 + 1.020X_3 + 2.387X_4$$

Table 4.5: Results of General Least Square

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	37.160	24.29		2.614	0.011		
X ₁	1.863	3.461	0.108	1.038	0.302	0.902	1.109
X ₂	3.292	4.389	0.039	0.381	0.704	0.934	1.071
X ₃	1.020	3.190	0.020	0.189	0.850	0.833	1.201
X ₄	2.387	4.848	0.029	0.270	0.788	0.854	1.171

Source: Research Data, 2013

The coefficient of intercept C has a value (37.160) though it is insignificant at 95% confidence level that was applied in the analysis. The coefficient of the independent variables (X₁ – X₄) is significant at 5% significance level because the test statistics (t-

values) are less than the critical value of 1,697 at the 5% significance level. The coefficient of the customer advisory practice is the highest of the independent variables and this means that a unit increase in the customer advisory service will increase the banks performance by 1.863 units. Of all the independent variables, observation of customers was found to be that practice that affects the most the banks performance.

The variance inflation factor (VIF) quantifies the severity of multicollinearity in an ordinary least squares regression analysis. It provides an index that measures how much the variance of an estimated regression coefficient is increased because of collinearity. The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

	1064.643	40	0.6234	3.905	0.004
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It is observed from Table 4.11 that the calculated F-value (3.905) is more than the table value (F-value = 2.01 at 5% significance level). In addition the p-value < 0.05 and this means that there is a significant effect of customer interaction practices on the banks performance.

4.6 F Test for the Full Model

To ascertain the extent of difference in customer interaction and banks performance, ANOVA Test was applied. ANOVA is carried out for each customer interaction practices (independent variable) versus the banks performance (dependant variable) at $F_{0.05}$.

Table 4.6: ANOVA

Model	Sum of Squares (SS)	df	Mean Square (MS)	F	p-value
Regression(ESS)	947.142	32	.0614	5.905	0.004
Residual(RSS)	117.501	8	0.562		
Total(TSS)	1064.643	40	0.6234	5.905	0.004

It is observed from Table 4.11 that the calculated F-value (5.905) is more than the table value (F value =2.61 at 5% significance level). In addition the p-value ≤ 0.05 and this means that there is a significant effect of customer interaction practices on the banks performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary

The interaction mode and increased customer participation, provides opportunities for banks to enhance their product quality and improving customer satisfaction and therefore retention. The study found out that customer involvement in the product development is important in the service industry in establishing a relationship that will be beneficial to the customer and the bank. Customer-bank interaction involves both the quantity and quality of direct interaction between the customer and the firm in terms of the information exchange and the level of customer involvement during the exchange. It was found that the bank-customer interaction help firms refine their knowledge about customer tastes and an effective and efficient management of interactions and the interfaces at which these interactions occur are increasingly being recognized as sources of lasting competitive advantage to the bank.

A bank-customer interaction can be accomplished by adopting different modes of interaction and the method chosen by a bank should be one that will lead to more customers being incorporated in the process and at the same time result in greater benefit in a firm's product development. The study found that different banks employ different interaction practices for different products depending on the type of customers. However, the most common practices used by the banks include, induction of customers in new product development, observation of the customers on when receiving services, customer visits and informal customer-manager mix. This findings show that with customer interaction, there is improved customer satisfaction due to their inputs being incorporated

at the development stage. The innovation should be tailored to meet customer needs and out of this, the resultant product will be able to measure to their expectation.

The other finding of the study was that the customer – bank interaction has facilitated customer connection and collaboration with each other by sharing information; praise; criticism; suggestions; and ideas about its products, services, and policies. This finding appreciates the position that a bank has customers of diverse business background and the interactions with these customers enable the bank to form a joint point where these customers meet to share their individual business experience and out of this identify points of collaborations with one another.

The observation of customer action enables the bank to identify a particular need and from the same be able to develop a product that will meet the need of the customers. It was also found that when a bank visits customers regularly, it helps in conducting experiments in which the customers may observe mock service delivery processes. The customer visit was also found to provide feedback on the merits of the service concepts being offered by the bank and from these feedbacks, the bank can be able to adjust its services to improve or cater for the needs that are not presently being covered.

5.3 Conclusion

There is consensus within the service industry that competitive barriers are necessary for successful innovation. At the same time, due to the intangibility of the offering, such barriers are difficult to erect in service firms. This study examined customer bank interaction as one way for service firms to erect barriers and protect their innovation investments. In particular, the results suggest that high levels of CFI act to create isolating mechanisms in the form of perceived customer switching and evaluation costs, which reduce the risk of customer defection as competitors introduce imitations into the marketplace. Service firms requiring high level of customer interaction respond to this risk reduction by committing greater resources to innovation in new services and delivery methods, which in turn create a performance advantage.

These results lend support to the findings of Crosby et al. (2000), who suggested that contact personnel play an important role in building relationships with customers. The present findings also support those of Shamdasan and Balakrishan (2003), who found that the attitude and expertise of contact personnel have a strong influence on relationship quality. In a similar vein, Hsieh and Hiang (2004) found that the quality of interaction between customers and service personnel had a significant influence on the performance of the banks.

5.4 Recommendation

Today, firms are learning to succeed by adopting an interaction orientation. Firms still need to produce superior products, sell smarter, and understand the market as a whole, but the ability of firms to orient themselves to interact successfully with their individual customers will differentiate firms in the future.

The findings from the research have several implications for firms. Firms must adopt customer-based performance metrics and institute employee rewards and incentives based on these metrics, instead of using aggregate-level measures, such as sales and market share growth, to evaluate marketing performance. Firms should also develop their outsourcing capabilities by adopting sound contracting procedures so that they can offer diverse products and services that meet their individual customers' desire. An interaction orientation is relevant not only to business-to business industries but also to business-to-consumer industries. Firms should focus on building an interaction orientation, regardless of whether the competitive intensity is high or low. Although the research establishes that organizations embracing an interaction orientation perform better, longitudinal studies would help understand whether the nature of the benefits accrued is indeed long-term.

The research findings are not conclusive and therefore suggest further study of Customer relationship management (CRM) for sustainable benefits accruing from customer firm interaction. More and more companies are adopting customer-centric strategies, programs, tools, and technology for efficient and effective customer relationship management. They are realizing the need for in-depth and integrated customer knowledge

in order to build close cooperative and partnering relationships with their customers. The emergence of new channels and technologies is significantly altering how companies interface with their customers, a development bringing about a greater degree of integration between marketing, sales, and customer service functions in organizations. For practitioners, CRM represents an enterprise approach to developing full-knowledge about customer behavior

Selecting the innovative users can be challenging thus need for further research. The involvement of customers may provide a deeper understanding of the customer needs which for one increases the likelihood that the new service ideas will meet customers' needs. Matthing et al.(2006) have explored the identification of innovative customers (i.e. end-users and consumers) and the effectiveness of employing such customers to generate new service ideas in technology-based services. They suggested that people's technology readiness (TR) is a good predictor of their propensity to adopt new technology-based services. They further go on arguing that the technology readiness seems to be positively correlated with the ability to actively seek new technologies and solve problems related to them. Finally, technology readiness also is positively correlated with willingness to participate in new technology-based service development. Thus the technology readiness index (TRI) appears to be a robust tool that is appropriate for identifying users who are likely to be most effective and helpful in the process of developing new technology-based services. However, are the businesses willing to carry closer co-operation with all of their customers? In this regard, Alam (2006) reported that, for instance, financial firms are, indeed, carefully selecting customers to participate in their service development processes. In most cases customers are selected based on a close relationship because confidentiality is a major issue. Thus, it is important to select customers whom already are known and can be trusted. The customers can be selected also based on other factors. Lee et al. (2003) found out that firms offering computer banking services, initially offer their new technology-based service innovations to younger consumers who are more highly educated and have higher income and are more likely to have access to computer banking than their older, less affluent counterparts. This may help in reducing risks and maximizing the returns of the investments in the new technology.

Specific insights have also been reported for the analysis of the commercial bank that provided the data, although these insights are not necessarily generalizable due to the unique nature of the Banks we deal with. Confidentiality among commercial bank may also have hindered disclosure of vital information that would have enriched the study.

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APPENDIX I: QUESTIONNAIRE

PART A: DEMOGRAPHIC AND RESPONDENTS PROFILE

1. Name of your organization.....
2. What is your age bracket? (Tick as applicable).
 - a) Under 20 years []
 - b) 21 – 30 years []
 - c) 31 – 40 years []
 - d) 41- 50 years []
 - e) Over 50 years []
3. For how long has your organization been in existence?
 - a) Under 5 years []
 - b) 6-10 years []
 1. 11-15 years []
 - d) Over 16 years []

PART B: Customer Interaction Process in the Organization

4. As a bank do you appreciate the role of customer interaction during product development process? Yes () No ()
5. Below are several possible modes of interaction that a bank can adopt; please indicate the popular modes adopted by your organization
 - Organize innovation retreats and summits ()
 - Induct customers in NSD team ()
 - Develop customer-advisory panel ()
 - Observe customers how they receive services ()
 - Visit customers' sites ()
 - Organize informal customer-manager mixers, such as lunches, dinners, etc. ()
6. The following statements give various characteristics of the level of interaction between the bank and customers. In a scale of 1-5 please indicate the extent of the banks interaction and also its effect in the innovation process. (Use the scale below to tick the most appropriate response).
5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent

		5	4	3	2	1
	Customer Interaction					
1	There is little customer firm interaction (CFI) required during the banks innovation process					
2	From the interaction customers gain to know more about the bank and high level of interaction lead to personal exchanges between the customer and the firm					
3	Customers get to know about the banks skills, abilities, and level of commitment in providing the service in question					
4	There has been an increase in service adaptability as a result of the interaction					
5	An improvement in service focus has been witnessed in the bank as a result of the customer firm interaction					
6	The customers interaction has continually connected them with the firm and actively shape the nature of transactions					
7	Interaction has facilitated customer connection and collaboration with each other by sharing information; praise; criticism; suggestions; and ideas about its products, services, and policies.					

7. A number of customers – firm interaction practices can be adopted by a bank. Below are some of the practices in a scale of 1 -5, please indicate the extent to which you agree with the statements.

Key:

- 5) Very great extent () 4) Great extent () 3) Moderate extent ()
 2) Low extent () 1) Very low extent ()

		5	4	3	2	1
	Customer – Advisory Panel					
1	A panel of selected customers are asked occasionally to provide input at various stages of the new service development					
2	From the same advisory panels, the bank has been able to collaborate with selected customers to keep up with the evolving needs of the market and incorporate the collected insights into our product efforts					
3	By developing a close relationship with the customers on the product development, we have been able to maintain our competitive advantage and thus becoming the hallmark of a successful business					

4	The collaboration has reduced the switching frequency of customers from the bank					
Observation of Customers						
1	The Customers' needs and choices are often susceptible to a variety of influences and it is through the bank observing their actions that a particular need is identified					
2	Customers may be unreliable on describing their needs and its through observing their activities that the bank has been able to identify their needs					
3	Through observation, the bank has been able to adapt to the changing needs of the customers and tailor our products their specification.					
4	Through establishing profound relationships with such business units, the bank has been able to attain a greater number of satisfied customers and, consequently, gain a greater share of the financial market					
Customer Visits						
1	The bank visits customers regularly and this visit has help to conduct experiments in which the customers may observe mock service delivery processes					
2	The customer visit has provided feedback on the merits of the service concepts being offered by the bank					
3	From the visits to the customer premises, the bank has been able to explain in much more details the services that are available to the customers offered by the bank					
Informal Customer - Manager Mixers						
1	The bank occasionally organize informal gatherings and engage in dialogues with their key customers concerning new services and from the same meetings, both					
2	Our banks product manager bring key customers to their head office regularly and conduct mini conferences, innovation seminars and idea clinics and even organize picnics and barbeques and such events have turned out to be productive.					

8) The statements below describe the effects of customer firm interaction on the financial performance of the bank. Please indicate the extent to which your bank performance has been influenced by the customer firm interaction adopted:

Key:

- 6) Very great extent () 4) Great extent () 3) Moderate extent ()
 1) Low extent () 1) Very low extent ()

		5	4	3	2	1
1	Sale growth					
2	Market share growth					
3	Total cost reduction					
4	Return on investment					
5	Return on assets					
6	Financial liquidity					
7	The reduction of response time for product design change					
8	The reduction of response time for product volume changes					
9	The accuracy of order processing for customers					

THANK YOU FOR YOUR TIME

APPENDIX II: COMMERCIAL BANKS IN KENYA

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank
6. Brighton Kalekye Bank
7. CFC Stanbic Bank
8. Chase Bank (Kenya)
9. Citibank
10. Commercial Bank of Africa
11. Consolidated Bank of Kenya
12. Cooperative Bank of Kenya
13. Credit Bank
14. Development Bank of Kenya
15. Diamond Trust Bank
16. Dubai Bank Kenya
17. Ecobank
18. Equatorial Commercial Bank
19. Equity Bank
20. Family Bank
21. Fidelity Commercial Bank Limited
22. Fina Bank
23. First Community Bank
24. Giro Commercial Bank
25. Guardian Bank
26. Gulf African Bank

27. Habib Bank
28. Habib Bank AG Zurich
29. I&M Bank
30. Imperial Bank Kenya
31. Jamii Bora Bank
32. Kenya Commercial Bank
33. K-Rep Bank
34. Middle East Bank Kenya
35. National Bank of Kenya
36. NIC Bank
37. Oriental Commercial Bank
38. Paramount Universal Bank
39. Prime Bank (Kenya)
40. Standard Chartered Kenya
41. Trans National Bank Kenya
42. United Bank for Africa
43. Victoria Commercial Bank

Source: Central bank of Kenya (2013),