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Effect of Innovative Strategies on the Performance of Small and Medium Enterprises in Nairobi County, Kenya

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Abstract

In a progressively challenging environment, innovation is extensively considered as the most vital source of competitiveness, because it creates a constant improvement that assists the organizations to endure. Innovation also leads to product and process enhancements thus enhancing efficiency. Innovation is often a necessity for organizations with strictly limited funds and resources yet are trying to remain profitable and competitive. Therefore, this study sought to establish the influence innovation strategies on performance of small and medium enterprises in Nairobi City County. The specific objectives were to determine the effect of product innovation, service innovation, marketing innovation and process innovation on organizational performance in SMEs. The study used a descriptive research design. A total of 398 Small and Medium Enterprises was used where the enterprise owners was used as the respondents. Primary data was collected through the administration of the questionnaires. Descriptive and inferential statistics analysis was conducted. A regression model was used to determine the effect of innovation strategies on performance of Small and Medium Enterprises in Nairobi County. The regression of coefficients results show that product innovation and organizational performance of SMEs is positively and significantly related. The results further indicated that service innovation and organizational performance of SMEs is positively and significantly related. The results further indicated that marketing innovation and organizational performance of SMEs is positively and significantly related. Lastly, results showed that process innovation and organizational performance of SMEs is positively and significantly related. The study concluded that innovation strategies positively influences performance of SMEs in Kenya. The study recommends that the SMEs should invest in innovative technology to survive intense competition currently experienced in the SMEs. Further, the study recommends that the SMEs should continuously produce new products and re-engineer existing products to prolong the product life cycle. Further, the study recommends that the SMEs should design an innovative marketing strategy that makes customers feel a part of the enterprise through social responsibility and promotions. The study recommended that the SMEs should invest in benchmarking with the technology in the industry.

Keywords: *Product Innovation, Service Innovation, Marketing Innovation, Process Innovation & Small and Medium Enterprises.*

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1.1 Introduction

In a progressively challenging environment, innovation is extensively considered as the most vital source of competitiveness, because it creates a constant improvement that assists the organizations to endure, it leads to product and process enhancements, be more efficient (Lomineishvili, 2021). Innovation is often a necessity for organizations with strictly limited funds and resources yet are trying to remain profitable and competitive (Shin, 2017). Most business organizations are forced to think differently and creatively about how to utilise their resources and environment just to survive. Increasingly, innovation is inescapable for most organizations as they seek to remain sustainable (Kankanhalli, Zuiderwijk & Tayi, 2017). Innovation is one of the key features of entrepreneurial behaviour that has been significantly linked to Small and Medium Enterprises [SMEs] (Petersen & Kruss, 2019). Innovation is widely acknowledged as a core factor to increased productivity and competitiveness. It is one of the key practices underpinning the survival and competitiveness of firms in a competitive globalised environment (Del Vecchio, Di Minin, Petruzzelli, Panniello & Pirri, 2018).

Innovation has played an important role in German enterprises. German investment into research and development of 2.9% of GDP stands above all other European countries driven by innovation (World Bank, 2019). Innovation procedure of Turkish assembling firms has driven them to enhance their budgetary execution (Karabulut, 2019). The innovation technique drives these organizations to enhance their client execution, internal business processes execution and learning and development performance. An innovation system ought to in this manner be reliable to mission, vision, objectives and methodologies of a firm (Demir, 2017). Firms ought to be committed to put resources into innovative work, construct inventive items and accomplish substantial execution to be competitive (Kleiner-Schäfer, 2020).

Locally, SMEs are supported in their innovation activities by less visible or less commonly known informal institutional links (Muigai & Gitau, 2018). Informal institutions may include personal and family contacts, community and social networks, informal credit for incremental innovation and adoption (Kiveu, Namusonge & Muathe, 2019). Government policy intervention aimed at improving innovativeness among SMEs seems to presume demand-pull strategies, such as reservation of markets for SMEs products, will automatically facilitate SMEs to develop their innovativeness (Chege & Wang, 2020). When the SMEs innovation policies have adopted supply side strategies such as improving access to technology, the policy framework has tended to assume existence of an underlying homogenous SMEs sector, which is in sharp contrast to reality. As a result, SMEs innovativeness in Kenya remain under developed, a factor that Mendi and Mudida (2018) argues contributes to the low survival and growth of SMEs.

1.2 Statement of the Problem

According to IMF (2018), SMEs in Kenya are not innovative enough and this is negatively affecting their performance.The SMEs have not fully integrated innovation to enhance performance and as a result remain sustainable (Kiveu, Namusonge & Muathe, 2019). A survey conducted by Kenya National Bureau of Statistics indicated that 400,000 MSEs dying annually (KNBS, 2020). In the last five years 2.2 Million micro enterprises have been closed. Most of these SMEs are normally closed because of increased operating costs, declining income and losses incurred from the business and an indication of insufficient innovation (Chege & Wang, 2020).

Despite SMEs being acknowledged as being better placed to innovate, most of these enterprises remain uncompetitive as compared to their larger counterparts. This study posits that innovation

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is a fundamental input towards increasing performance of the SMES by way of adopting innovation in enhancing their products, services, marketing and their service delivery processes.

Studies conducted in this area present research gaps; Kiilu and Peter (2020) examined the entrepreneurial innovation processes on firm performance in Kenya. The study presents a conceptual gap as it focused on large organizations while the current study focused on SMEs. Mwangi and Namusonge (2017) study on the influence of innovation on small and medium Enterprise (SME) growth focused on garment manufacturing industries in Nakuru County while the current study expounded to various sectors. Gachara and Munjuri (2018) conducted a study on innovation challenges encountered by Small and Medium Enterprises using innovation challenges, technological challenges, legal and policy challenges and environmental challenges. However, the study presents a conceptual gap as it focused on the innovation challenges while the current study focused on innovation constructs that include service innovation, product innovation, marketing innovation and process innovation. Onyejiaku and Chinyere (2018) study on innovation strategies and enterprise competitiveness in developing West Africa Economies presents a methodological gap as it was conducted in Western Africa while the current study was conducted locally. Therefore, this study sought to establish the effect of innovation on performance of small and medium enterprises in Nairobi City County.

1.3 Objective of the Study

The purpose of this study was to determine the effect of innovative strategies on performance of SMEs in Nairobi County, Kenya.

The study was guided by the following specific research objectives;

i. To determine the effect of product innovation on performance of SMEs in Nairobi County.
ii. To establish the effect of service innovation on performance of SMEs in Nairobi County.
iii. To evaluate the effect of marketing innovation on performance of SMEs in Nairobi County.
iv. To evaluate the effect of process innovation on performance of SMEs in Nairobi County.

1.4 Research Questions

The study sought to answer the following research questions;

i. What is the effect of product innovation on performance of SMEs in Nairobi County?
ii. What is the effect of service innovation on performance of SMEs in Nairobi County?
iii. To what extent does marketing innovation on performance of SMEs in Nairobi County?
iv. What is the effect of process innovation on performance of SMEs in Nairobi County?

2.1 Literature Review

2.2 Theoretical Framework: Diffusion of Innovation Theory

Rogers (1962) authored diffusion of innovation theory. The diffusion of innovations theory describes the pattern and speed at which new ideas, practices, or products spread through a population. Diffusion of Innovation Theory conceptualizes a thought or item picks up energy and diffuses (or spreads) through an explicit populace or social framework. The final product of this dispersion is that individuals, as a major aspect of a social framework, adopt another thought, behavior, or service/product (Rogers, 1962).

The stages, by which a person adopts an innovation, and whereby diffusion is accomplished, include awareness of the need for an innovation, decision to adopt (or reject) the innovation, initial

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use of the innovation to test it, and continued use of the innovation. There are five main factors that influence adoption of an innovation, and each of these factors is at play to a different extent in the five adopter categories. There are five adopter categories that include innovators, early adopters, early majority, late majority and laggards (Rogers, 1962).

Innovators are characterized by those who want to be the first to try the innovation. Early adopters are characterized by those who are comfortable with change and adopting new ideas. Early Majority are characterized by those who adopt innovations before the average person. Late majority are characterized by those who are skeptical of change and will only adopt an innovation after it has been generally accepted and adopted by the majority of the population. Laggards are characterized by those who are very traditional and conservative they are the last to make the changeover to new technologies. This category is the hardest to appeal to (Rogers, 1962).

The theory is relevant as it informs the innovation process in an organization. The innovation may come in form of product, service, process and marketing. According to the theory, the SMEs can be categorized depending on the level of technology adoption that is innovators, early adopters, early majority, late majority and laggards.

2.3 Empirical Review

2.3.1 Product innovation and performance

Kawira (2021) assessed the effect of product and service innovation on the performance of Micro, Small and Medium Enterprises in Kenya. The aim of this study was to analyse the effect of innovation on firm competitiveness in manufacturing SMEs in Nairobi County, Kenya. Data was collected from a sample of 284 enterprises for the period 2012–2014. Multiple linear regression was used to analyse the effect of innovation on competitiveness. Findings indicate 97% of the manufacturing SMEs were innovating with majority implementing incremental innovations. Process, marketing and organisational innovations had positive significant effect on competitiveness, while product innovation had positive non-significant effect. The study recommends the implementation of innovations with high novelty by SMEs to increase their competitiveness. This can be facilitated by SMEs forming linkages and cooperating in innovation with knowledge generating institutions.

Hurley and Knight (2014) stated that product innovation enabled the organization to protect itself against threats from the competitors. Studies have also proved that there is positive correlation between the performance of the organization and positive product innovation (Buyus, Erickson & Jacobson, 2003). Espallardo and Ballester (2019) in a study carried out in an organization established that product innovation had a positive impact on the organization's performance in its industry. Varis and Littunen (2010) established that the more an organization was able to introduce new products into the market the more customers associated with that organization as it is assumed the organization is performing well. SMEs have a number of draw backs when it comes to innovation process as compared to large organizations (Rhee, Park & Lee, 2019).

2.3.2 Service innovation and performance

Makgopa (2020) assessed the influence of service innovation practices on business performance in South Africa. Complexity theory served as the underlying conceptual lens that enabled this research to answer the research questions and attain the research objectives. A mixed research method was used to gain an in-depth understanding of the implementation of service innovation practices in service organizations. The study results revealed the positive relationship between

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service innovation practices and business performance (profit growth/maximisation, organisational competitiveness, and organisational reputation).

Mohamud (2017) explored the relationships between service innovation, customer value creation (CVC) and customer satisfaction (CS) with specific emphasis to Ghanaian telecommunication operators. The study unveiled that a service firm's ability to achieve CS is dependent on how telecommunication operators harness and deploy their service innovation activities. In addition, the study showed that CVC mediated the relationship between service innovation and CS. The study concluded that, service innovation must create value for customers in order to enhance CS.

Lin (2013) examined the impact of service innovation on performance in developing countries such as China. The study constructed an integrative model linking service innovation, service quality and performance then collected 277 samples in the Chinese tourism sector. The study found that service innovation affects firm performance through direct and indirect paths where service quality plays a positive mediating role. The direct impact is larger than the indirect one; secondly, the innovation mode is cost-reductive, which focuses on eliminating internal cost rather than improving service quality. Thirdly, the assessment of service quality emphasizes the dimensions of assurance and reliability. The study concluded that service innovation has a positive impact on performance.

2.3.3 Marketing innovation and performance

Osano (2019) examined the purpose of this study was to investigate the role of global market strategy on the global expansion of Kenyan firms. The research study used descriptive and inferential design as a chosen design. The researcher used multiple/multivariate regression analysis to determine the functional relationship between the independent variables and the dependent variable. The global market strategy variables considered include market strategy incorporating: global advertising and promotion, external advisory services, foreign market specialization, competitive pricing strategies, and focus on quality products/services; foreign market intelligence on locating markets, trade restrictions, competition overseas, and market and investment opportunities; and logistics and distribution incorporating: handling of documentation, distribution coordination, warehousing, arranging transportation, and collaboration with large firms.

Marketing innovation takes into account marketing activities in the process innovation such as the marketing of new products that meet the needs of customers. Marketing Innovation plays a very important role in ensuring and increasing the success of innovation. Marketing innovation covers all innovation management activities that help to promote market success of new products and services (Casidy, Nyadzayo, & Mohan, 2019). It is the successful marketing of a new product or service for the satisfaction of customer needs. It anticipates future needs and helps identify future and new market opportunities. A firm has two core functions that are "Marketing and Innovation for him, marketing and innovation are the couple that guarantees the success of the company. In marketing management the main mission is to increase sales, the focus is therefore on customer and market orientation.

According to Fiore, Silvestri, Contò and Pellegrini (2017), marketing and innovation management have to couple because marketing is effective when there is innovation in marketing tasks. Adoption of marketing innovation tools is needed to meet new challenges of business competitiveness Marketing and innovation are two entities that complement each other for the firm's performance. Having a unique original product highly improve sales and customer growth. On this fact, Hendrayati and Gaffar (2016) have thus affirmed that the performance of the

innovation leads to the marketing performance. Marketing innovation is the implementation of a new marketing method that involves significant changes in product design or packaging, product placement, product promotion or pricing (OECD, 2005).

2.3.4 Process innovation and performance

Agyei-Mensah (2017) conducted a study to examine the effect of process innovation on performance in the banking industry with a case of UT Bank in Ghana. The study adopted a descriptive research design. The study findings indicated that process innovation had a moderate relationship with organizational performance. The study recommended that banks become more proactive in developing products and services that create value for customers. Banks must also empower their frontline executives to become more customer oriented as that presents an opportunity to get customer inputs toward innovative decision making.

Alshorman (2020) assessed the effect of process innovation on business performance of product industries in Malaysia. The quantitative research design approach was used in this study to collect data from 386 respondents selected from the product industries in Malaysia. The required data were obtained using simple random sampling by a validated questionnaire. Furthermore, the data collected from the survey were analyzed using Structural Equation Modelling (SEM). The results of this study showed that there is a significant relationship between process innovation and design management with business performance as well as design management mediate the relationship between process innovation and business performance of product industries in Malaysia. In addition, the study established that process innovation leads to better business performance, which will benefit the product industries in the future.

Kowo, Akinbola and Akinrinola (2018) assessed the effect of process innovation organizational performance. A total of 114 questionnaires were administered to major telecommunication operator employees in Lagos State, Nigeria to get primary data that treated and tested appropriate research questions and hypotheses accordingly. The study adopted survey method. SPSS was also employed in testing the research hypothesis. The study found out that process innovation has a significant effect on organizational performance and there exist a significant relationship between service modification and sales volume.

Kenfac and Yang (2013) explored how regions in Sweden conducted process development in the waste administration division. The explanation of four municipalities in Sweden (Kalmar, Mörbylånga, Nybro and Torsas) was to assess the impacts of process development in waste collection forms on districts' exhibitions in Sweden by the utilization of grounded theory technique. Amid this investigation, it was found that, the utilization of process innovation positively affect the regions budgetary and clients performance. Additionally, the significance of process development as a well ordered process and not an abrupt change was found to be critical for a successful process innovation. Applying corporate social obligation as a self-direction instrument inside an organization, which add to environmental sustainability for organization; also showed positive relation with municipalities' performances.

2.5 Conceptual Framework

As defined by Hennink, Hutter and Bailey (2020), conceptual frameworks are maps inferred or derived from specific illustrations or circumstances that help to show the relationships between an interplay of variables graphically and diagrammatically. This study focused on 4 variables representing actions that are characteristic of innovation and these are technological advancement,

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service innovation, product innovation, and market innovation. An illustrative representation of the variables explored by this study is shown in Figure 1.

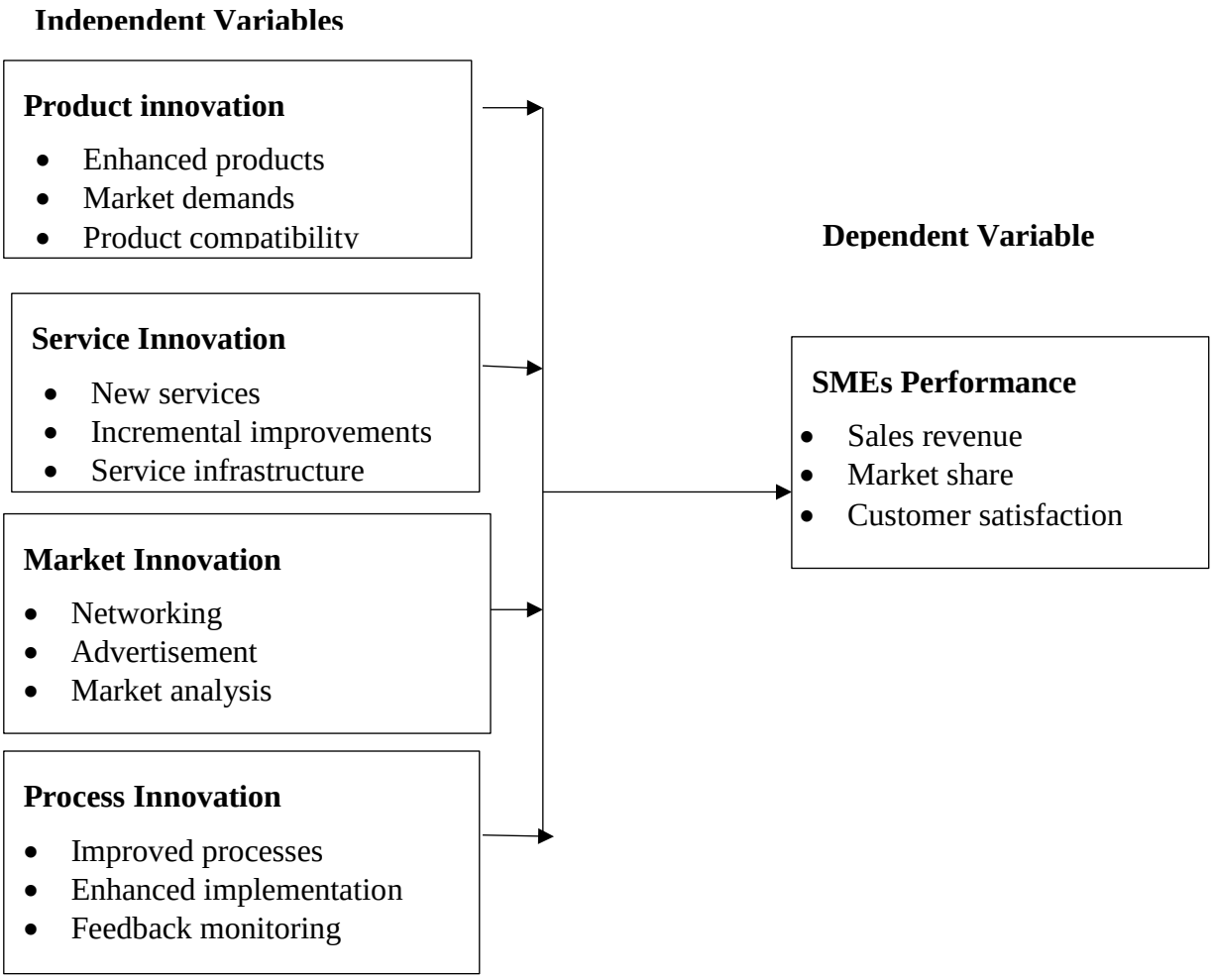

Figure 1: Conceptual Framework

The conceptual framework depicts the independent variables as and product innovation, service innovation, market innovation and process innovation. The indicators for product innovation include enhanced products, market demands and product compatibility. The indicators for service innovation are new services, incremental improvements and service infrastructure. The indicators for market innovation includes networking, advertisement and market analysis. The indicators for process innovation includes improved processes, enhanced implementation and feedback monitoring. The dependent variable is performance which is indicated by sales revenue, market share and customer satisfaction.

3.1 Research Methodology

The study used a descriptive research design. A total of 398 Small and Medium Enterprises was used where the enterprise owners was used as the respondents. Primary data was collected through the administration of the questionnaires. Descriptive and inferential statistics analysis was

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conducted. A regression model was used to determine the effect of innovation strategies on performance of Small and Medium Enterprises in Nairobi County.

4.1 Results and Discussion

The study administered 398 questionnaires to managers and supervisors of the Small and Medium Enterprises and a response rate of 84.9% was achieved.

4.2 Correlation Analysis

Correlation analysis was conducted to establish the relationship between the independent and dependent variables. The correlation matrix is presented in Table 1.

Table 1: Correlation Matrix

	Organizational Performance	Product Innovation	Service Innovation	Marketing Innovation	Process Innovation
Organizational Performance	1.000				
Product Innovation	.750**	1.000			
	0.000				
Service Innovation	.674**	.526**	1.000		
	0.000	0.000			
Marketing Innovation	.757**	.560**	.500**	1.000	
	0.000	0.000	0.000		
Process Innovation	.677**	.596**	.684**	.683**	1.000
	0.000	0.000	0.000	0.000	

The results in Table 1 revealed that product innovation and organizational performance of SMEs is positively and significantly related (r= 0.750**, p=0.000). The results further indicated that service innovation and organizational performance of SMEs is positively and significantly related (r= .674**, p=0.000). Marketing innovation and organizational performance of SMEs is positively and significantly related (r= .757**, p=0.000). Lastly, results showed that process innovation and organizational performance of SMEs is positively and significantly related (r= .677**, p=0.000). This implies that an increase in product innovation, service innovation, marketing innovation and process innovation leads to an increase on organizational performance of SMEs since the coefficients are positively related.

4.3 Regression Analysis

The study carried out regression analysis to establish the statistical significance relationship between product innovation, service innovation, marketing innovation and process innovation on organizational performance of SMEs. According to Chatterjee and Hadi (2015), regression analysis is a statistical process of estimating the relationship among variables. It includes many techniques for modeling and analyzing several variables, when the focus is on the relationship

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between a dependent and one or more independent variables. The results presented in Table 2 present the fitness of model used of the regression model in explaining the study phenomena.

Table 2: Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.816a	0.666	0.662	0.339

The variables product innovation, service innovation, marketing innovation and process innovation were found to be satisfactory variables in explaining organizational performance of SMEs. This is supported by coefficient of determination also known as the R square of 0.666. This means that product innovation, service innovation, marketing innovation and process innovation explain 66.6% of the variations in the dependent variable, which is organizational performance of SMEs. This results further means that the model applied to link the relationship of the variables was satisfactory.

The Analysis of Variance (ANOVA) results are shown in Table3.

Table 3: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	76.1	4	19.025	165.525	.000b
Residual	38.159	332	0.115		
Total	114.259	336			

The findings further confirm that the regression model is significant and supported by F= 84.263, p<0.000) since p-values was 0.000 which is less than 0.05. The study conducted a regression of coefficient analysis to establish the statistical significance relationship between the independents variables notably product innovation, service innovation, marketing innovation and process innovation on the dependent variable that was organizational performance of SMEs.

The regression of coefficient results are as shown in Table 4.

Table 4: Regression of Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	2.653	0.058		45.762	0.000
Product Innovation	0.144	0.027	0.297	5.366	0.000
Service Innovation	0.053	0.026	0.105	2.064	0.040
Marketing Innovation	0.180	0.028	0.347	6.527	0.000
Process Innovation	0.078	0.024	0.161	3.300	0.001

$Y = 2.653 + 0.144X_1 + 0.053X_2 + 0.180X_3 + 0.078X_4$

Y = Organizational performance; X_1 = Product Innovation; X_2 = Service Innovation; X_3 = Marketing Innovation; X_4 = Process Innovation

β_0= Constant Term; β_1, β_2, β_3, β_4= Beta coefficients; ε = Error Term.

The constant of 2.653 showed that when product innovation, service innovation, marketing innovation and process innovation are held constant, organizational performance of SMEs would

remain at 2.653 units. The regression of coefficients results show that product innovation and organizational performance of SMEs is positively and significantly related (β=0.144, p=0.000). The results further indicated that service innovation and organizational performance of SMEs is positively and significantly related (β=0.053, p=0.040). The results further indicated that marketing innovation and organizational performance of SMEs is positively and significantly related (β=0.180, p=0.028). Lastly, results showed that process innovation and organizational performance of SMEs is positively and significantly related (β=0.078, p=0.000).

4.4 Summary of Findings

The first objective of the study was to determine the effect of product innovation on performance of SMEs in Nairobi County. Correlation results indicated that product innovation and performance of SMEs is positively and significantly related. The regression of coefficients results show that product innovation and performance of SMEs is positively and significantly related. The results indicated that a unitary increase in product innovation leads to increase in performance of SMEs by 0.144 units holding other factors constant.

The second objective of the study was to determine the effect of service innovation on performance of SMEs in Nairobi County. Correlation results indicated that service innovation and performance of SMEs is positively and significantly related. The regression of coefficients results show that service innovation and performance of SMEs is positively and significantly related. The results indicated that a unitary increase in service innovation leads to increase in performance of SMEs by 0.053 units holding other factors constant.

The third objective of the study was to determine the effect of marketing innovation on performance of SMEs in Nairobi County. Correlation results indicated that marketing innovation and performance of SMEs is positively and significantly related. The regression of coefficients results show that marketing innovation and performance of SMEs is positively and significantly related. The results indicated that a unitary increase in marketing innovation leads to increase in performance of SMEs by 0.180 units holding other factors constant.

The fourth objective of the study was to determine the effect of process innovation on performance of SMEs in Nairobi County. Correlation results indicated that process innovation and performance of SMEs is positively and significantly related. The regression of coefficients results show that process innovation and performance of SMEs is positively and significantly related. The results indicated that a unitary increase in process innovation leads to increase in performance of SMEs by 0.078 units holding other factors constant.

5.1 Conclusion

Based on the findings, the study concluded that innovation strategies influences performance of SMEs in Kenya. Innovation enables organizations meet customer needs or specification by improving the quality of the products / services because the customer needs and preferences keep on changing and also achieving a competitive advantage. Regression results reveal that innovation significantly affects the performance of SMEs. The effects of product innovation, service innovation, marketing innovation and process innovation are statistically significant among these SMEs. The study, hence, concludes that innovation has a positive effect on business performance. Lastly, the SMEs have adopted the use of technology and systems of operations that has increased the sales revenue, market share, customer satisfaction in service delivery and general improvement of the organization's savings.

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6.1 Recommendations

The study recommends that the SMEs should invest in innovative technology to survive intense competition currently experienced in the SMEs. The study recommended that SMEs should invest in automating routine tasks to improve efficiency in the production process. The study further recommends that the SMEs should adopt business process reengineering. This will reduce production costs and improve overall performance.

Further, the study recommends that the SMEs should continuously produce new products and re-engineer existing products to prolong the product life cycle. This will increase the SMEs returns. In addition, SMEs should invest on increasing product portfolio to spread the market risk and enhance performance. The study recommends that SMEs should keenly invest in technology to support SMEs strategy. The study recommends that SMEs should have a process feedback channel that captures customer complaints and effectively use the complaints to improve service and products.

Further, the study recommends that the SMEs should design an innovative marketing strategy that makes customers feel a part of the enterprise through social responsibility and promotions. The study recommended that the SMEs should invest in benchmarking with the technology in the industry to cut a niche without necessarily reinventing the wheel.

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