International Research Journal Of Economics and Finance

Vol 4, Issue 3, pp 339-344, Nov 1, 2022, © International Research Journal Publishers, ISSN 2710-2742 (online) www.irjp.org

FINANCIAL INNOVATION AND ITS EFFECT ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN NEPAL

***Pramod Sapkota**

*Scholar, Toronto Metropolitan University, Canada

Accepted, October 27, 2022

ABSTRACT

In a modern economy, innovation is unquestionably a significant phenomena in every industry. In general, the utilisation of new concepts or methods is referred to as innovation. Commercial banks' creation of novel goods, services, or manufacturing techniques constitutes financial innovation. The study assessed financial innovation and its effect on financial performance of commercial banks in Nepal. The causal research design was used to carry out this study. Secondary data was derived from sources such as official records, reports, archives, and financial statements. The study targeted 30 commercial banks in Nepal. The relationship between the dependent variable and the independent variables are determined by a regression model. Variables data was analysed using Statistical tools. The study's findings make it clear that financial innovation in payment systems leads to enhanced commercial banks' financial performance, which benefits the banking industry as a whole. The association between financial success and the volume of Real Time Gross Settlement transactions, mobile banking, internet banking, and third-party wallets all show a favourable correlation. Financial innovation offers commercial bank customers greater ease, effectiveness, and security, increasing demand (uptake) for the new technologies. Banks and regulators should innovate to better serve customers. With faster transaction speeds, transaction volumes and commissions can rise. Government regulators should encourage banks to engage in financial innovation while strictly controlling such innovations to ensure payment system integrity. Financial innovation drives economic growth. Faster, more secure payment systems boost commercial and economic growth in all sectors, as well as financial deepening and development.

Keywords: *Financial Innovation, Financial Performance, Commercial Banks, Nepal*

INTRODUCTION

Over the past 10 years, technological progress has had an effect not only on how businesses run but also on how they are run (Grayson & Hodges, 2017). The banking industry has seen technological changes that have led to online banking and mobile banking, which have changed how financial institutions work. Financial institutions that offer banking services online and through mobile apps have brought many benefits to their customers by using the internet and m-banking. Innovations in information and telecommunications technology have continued to change the way banks do business. Over the past ten years, there have been big changes in the financial sector's institutions. The global banking industry has one thing in common: it is becoming more volatile and competitive, which has forced commercial banks to be the first to try new things so they can stay in business. Banks have cut costs by focusing more on customer satisfaction through better products and services by using new strategies made possible by technological advances (Hallunovi & Berdo, 2018).

Financial services companies offer payment services and other financial products that help people and businesses take part in the economy as a whole. They keep the modern capitalist society going by giving people ways to invest their savings, get credit, and deal with risks. Even though the main things that commercial banks do haven't changed much over the past few decades, the structure of the industry has changed a lot. This change is caused by the rapid development of new financial instruments, the explosive growth of information technology, and the loosening of rules at home (Tidd, 2021). With this change, there is more pressure on managers and workers to improve productivity and financial performance in a big way. Competition has made the business world move quickly, so companies have to change to stay in business.

The forces that Bara and Mudzingiri (2016) talk about have pushed financial innovation in the banking industry, especially when it comes to new ways of getting money to people, such as internet and mobile banking. As the industry has given customers more ways to get to their accounts, it has added a lot of costs to each institution. To deal with these costs, there was a big push to cut costs, and many banks were able to get a lot of the costs out of the back office. Most of these cost savings came from back office automation, which is a new technology that has just been finished. Now, after adding a lot of costs by adding distribution channels and cutting as much as they could in the back office, banks have realised that the key to making money is to bring in more money (Cainelli et al., 2020). Now, banks have to think of new ways to make money through their distribution system. The most common way to put this in a category is as an effort to increase the customer share of wallet. The share of wallet is how much of a customer's total financial relationship with a bank that bank has. The most important innovations that increase revenue right now are platform automation for branch and call centre employees and the newest distribution channels, internet and mobile banking. Even though these innovations have some things in common, they are all different ways for commercial banks to reach their customers (Chaffey & Ellis-Chadwick, 2018).

In order to stay competitive, financial institutions have made technological improvements. This is because there are a lot of problems in the outside operating environment. Banks know that they need to be different from their competitors if they want to be the best in their field (Chen et al., 2017). Due to the bureaucratic systems of banks, many rural poor were not able to open accounts because they did not meet the requirements. Because of competition, banks had to simplify their processes and come up with new ways to do so, one of which was the development of m-banking products.

Even though it's clear that financial innovation is a big part of why banks do well, the effect of innovation on performance is still not well understood for two main reasons. Studies have been done on how financial innovation affects the effectiveness of monetary policy, but not many have tried to find a link between financial innovation and how well banks do financially. Most of the existing studies also take a simple approach to the relationship between innovation and performance. They don't look at the things that lead to innovation inside and outside of the banking organisation, which could all have an effect on this relationship.

Objective

The objective of the study is to assess financial innovation and its effect on the financial performance of commercial banks in Nepal.

LITERATURE REVIEW

Theoretical Review

Technology Acceptance Model

Technology Acceptance Theory (TAT), created by Davis (1989) and Bagozzi, Davis, and Warshaw (1992), is a theory about how customers adopt new technology that is typically evaluated in relation to the use that a given system is predicted to provide in terms of convenience usability and the predicted impression of its usefulness. The explicit impact of technology and the usability elements that truly influence the user's acceptance are not fully addressed by the fundamental construct of TAM, according to previous authors' studies on the validity of TAMs in predicting people's acceptance (Moon & Kim, 2001). After conducting a survey in Finland to determine the actual impact of perceived usefulness, Pikkarainen, Pikkarainen, Karjaluoto, and Pahnila (2004) came to the conclusion that it encouraged use of technologies that are friendly and independent for use in offering services by banks in the twenty-first century. Customers value the usefulness of the services they receive, according to Gerrard and Cunningham (2003). These include paying utility bills, checking account balances, applying for loans, sending money overseas, and obtaining necessary mutual fund information. This theory was pertinent to this study because it explained why commercial banks should implement mobile banking and short message service (SMS) banking in order to make it more convenient for consumers and help them perform better financially. The hypothesis was also used to investigate how different mobile banking services impact commercial banks' financial performance.

Financial Innovation Theory

Silber (1983) developed the constraint-induced financial innovation theory. According to this hypothesis, the primary motivation for financial innovation is for financial institutions to find ways to increase their profits as quickly as possible. Attempting to maximise one's profits is not without its challenges, some of which come from the outside, in the form of policies, and from the inside, in the form of management decisions made by the firm. These limits not only ensure the continuity of administration, but they also lower the efficiency of the financial institution; hence, financial institutions work hard to get rid of them even though they do both of these things. The field of microeconomics is where the constraint-induced innovation theory discusses financial innovation; as such, this field is both original and typical. However, it places an overwhelming emphasis on "innovation in the face of adversity." As a result, it is not capable of commendably expressing the phenomena of financial innovation that is rising in the trend of liberal finance.

Empirical Review

A study by Stavins (2011) in the US on community banks studied the effect of consumer characteristics on the use of payment instruments. It indicated that consumers differed on how they used payment options depending on gender, size of transactions and occupation. The study further established that community banks that adopted many payment options did better than their peers. This shows that innovation provides firms with commercially superior products, better mechanisms to cope with environmental uncertainties, and an increased ability to create new resource configurations (Stavins, 2011). This study further revealed that in the short-term, innovative firms can capture early mover advantages such as securing relationships with key suppliers, carving out attractive market share and forging customer loyalty. In the longer term, innovative firms can influence regulatory regimes and have strategic competitive advantages that their peers. Concerning products and services, mortgage loans are one set of products that have experienced a great deal of change globally. Around 1980s, long-term fully amortizing fixed-rate mortgages were the norm. These products were offered primarily by thrift institutions. Moreover, these loans required substantial down payments and a good credit history; and the accumulated equity was relatively illiquid.

According to ATM & Debit News (2017), there were approximately 26.5 billion debit transactions in the U.S. during 2016. This is up from 6.5 billion transactions in 2009 – a four-fold increase. Much of the research pertaining to debit cards relates to identifying the most likely users of this payment instrument. Such demand-side explorations have been conducted individually as well as jointly across multiple payment options. Stavins (2011), for example, used data from the 2008 Survey of Consumer Finances (SCF) and finds that debit usage is positively related to educational attainment, homeownership status, marital status, business ownership, and being a white collar worker; and is also positively related to amount of transactions with a bank.

In relation to bill payments Islam (2013) did a paper seeking to establish the impact of m-banking as an emerging issue in Bangladesh. In terms of methodology the paper used descriptive design whereby collection of data was primary sources thus personal interview method. The gathered facts of the survey were examined in several analytical tools and methods. The study found out that mobile banking delivers services that are outside the known branches through branchless banking by adopting ICT in addition to using retail agents that are non-financial who operate for 365 days. The study established a positive impact on m-banking payments, withdrawals and deposits. According to the study results mobile banking is reliable, reduced costs, speedy and carrying out operations which reduce errors from the interaction of staff in the old banking systems. However, there was a research gap this paper sought to fill since this study was conducted on mobile banking as an emerging issue in Bangladesh whereas the current study focused on mobile banking services and financial firm performance.

METHODOLOGY

The causal research design was used to carry out this study. According to Cooper and Schindler (2006), a causal study is designed to establish the influence of one variable(s) on another variable(s) which depicts causation. Causal research is typically structured with a clearly stated objective of discovering associations and causal relationships among different variables. This design is perceived to be suited to this study in that it involves collection, verification, and synthesis of evidence to establish facts that defend or refute a hypothesis. This design involved use of secondary sources of data. Secondary data was derived from sources such as official records, reports, archives, and financial statements. The study targeted 30 commercial banks in Nepal. The relationship between the dependent variable and the independent variables are determined by a regression model. Variables data was analysed using Statistical tools.

RESULTS

Table 1: Regression model output

	Coefficients	Standard error	T.Statistics	P value
(Constant)	2.362	0.351	6.729345	0.521
RTGS	0.776	0.2225	3.48764	0.001
Mobile Banking	0.677	0.125	5.416	0.000
Internet Banking	0.414	0.092	4.5	0.002
Third Party Wallet	0.411	0.087	4.724138	0.000
Regression	Statistics			
Multiple R		0.744	Standard	2.357
R Square		0.553	Observations	30
Adjusted R Square		0.472		

Table 1 shows that value of multiple R 0.744 is indicating that financial innovations are correlated with financial performance positively. This correlation is strong correlation among the variables according to the correlation's basic criteria, which are in correlation with the strong relationship i.e. between 0.5 to 1 ranges. The value of R-square was 0.553, which means that 55.3% of the total variation in the value of financial performance due to the effect of the independent variables. The adjusted R square was 0.472, which shows R square on an adjusted basis, the independent variables were collectively 47.2% related to the dependent variable. The remaining percentages of the variability in the dependent variable are left unexplained by the explanatory variables used in the study. By analysing the result presented in table 1, the study found a positive coefficient in RTGS 0.776 indicating there is a positive effect between RTGS and financial performance. Mobile banking internet banking and third part wallet also had a positive coefficient of 0.677, 0.414 and 0.41 respectively indicating a positive relationship. All the variables had a positive relationship with financial performance.

CONCLUSION

From the study results, it is evident that financial innovation in payment systems result into improved financial performance of commercial banks and thereby to that of the banking sector as a whole. This is supported by the positive correlation between financial performance and Real Time Gross Settlement transactions turnover, mobile banking, internet banking and third-party wallet. Financial innovation presents more convenience, efficiency and security to commercial banks customers resulting to more demand (uptake) for the new innovations.

RECOMMENDATIONS

From the study findings, the following recommendations are proposed. First, banks as well as the regulatory bodies should strive to innovate for better and cheaper ways of serving customers. With shorter transaction turnaround times, transactions volumes can be significantly increased and by extension commission charges there from. Government through the financial sector regulatory authorities, should encourage banks to engage in financial innovation but at the same time closely regulating such developments to assure on the integrity of more so the payment systems. Financial innovation is the engine of sustainable economic growth. Faster and more secure payment systems spurs development of businesses and economic growth in all other sectors in addition to facilitating financial deepening and in the achievement of the Vision of "Prosperous Nepal, Happy Nepali."

REFERENCES

Bagozzi, R. P., Davis, F. D., & Warshaw, P. R. (1992). Development and test of a theory of technological learning and usage. *Human relations*, *45*(7), 659-686.

Bara, A., & Mudzingiri, C. (2016). Financial innovation and economic growth: evidence from Zimbabwe. *Investment Management and Financial Innovations*, (13, Iss. 2), 65-75.

Cainelli, E., Arrigoni, F., & Vedovelli, L. (2020). White matter injury and neurodevelopmental disabilities: A cross-disease (dis) connection. *Progress in Neurobiology*, *193*, 101845.

Chaffey, D., & Ellis-Chadwick, F. (2019). *Digital marketing: strategy, implementation & practice*. Pearson uk.

Chen, Z., Li, Y., Wu, Y., & Luo, J. (2017). The transition from traditional banking to mobile internet finance: an organizational innovation perspective-a comparative study of Citibank and ICBC. *Financial Innovation*, *3*(1), 1-16.

Cooper, D. R., Schindler, P. S., & Sun, J. (2006). *Business research methods* (Vol. 9, pp. 1-744). New York: Mcgraw-hill.

Davis, F. D. (1989). Perceived usefulness, perceived ease of use, and user acceptance of information technology. *MIS quarterly*, 319-340.

Gerrard, P., & Cunningham, J. B. (2003). The diffusion of internet banking among Singapore consumers. *International journal of bank marketing*.

Grayson, D., & Hodges, A. (2017). *Corporate social opportunity!: Seven steps to make corporate social responsibility work for your business*. Routledge.

Hallunovi, A., & Berdo, M. (2018). The role of electronic banking on the financial performance of commercial banks: Albania. In *Science and innovation* (pp. 121-126).

Islam, M. S. (2013). Mobile banking: An emerging issue in Bangladesh. *ASA University Review*, *7*(1), 123-130.

Moon, J. W., & Kim, Y. G. (2001). Extending the TAM for a World-Wide-Web context. *Information & management*, *38*(4), 217-230.

Niehans, J. (1989). Transaction costs. In *Money* (pp. 320-327). Palgrave Macmillan, London.

Pikkarainen, T., Pikkarainen, K., Karjaluoto, H., & Pahnila, S. (2004). Consumer acceptance of online banking: an extension of the technology acceptance model. *Internet research*.

Silber, W. L. (1983). The process of financial innovation. *The American Economic Review*, *73*(2), 89-95.

Stavins, R. N. (2011). The problem of the commons: still unsettled after 100 years. *American Economic Review*, *101*(1), 81-108.

Tidd, J. (2021). A review and critical assessment of the ISO56002 innovation management systems standard: Evidence and limitations. *International Journal of Innovation Management*, *25*(01), 2150049.