

INNOVATIONS CAPABILITY ON THE PERFORMANCE OF COMMERCIAL BANKS IN KAKAMEGA COUNTY, KENYA

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Abstract: The banking sector plays a crucial role in the economic development of regions and countries, and understanding the factors that drive their performance is essential. This study aimed to establish the effect of innovations capability on the performance of commercial banks in Kakamega County, Kenya. This study was guided by Absorptive Capacity Theory. The research employed descriptive research design which allowed the researcher to take a broad view and apply the results to a wider population. Data collection instrument was questionnaire. Branch managers, Credit managers and customer care was targeted. The study adopted census sampling technique where all 33 respondents was picked from each of the 11 banking institutions, hence the sample size was 33 respondents. Piloting of the research instruments was done on a sample of 3 (10% of 33) respondents who were employees in commercial banks in Busia County. Questionnaires was circulated through the drop process and then selected. Collected data was subjected to various analyses using Statistical Package for Social Sciences (SPSS Version 25.0) software. Analyzed data was presented in the form of tables. Based on the findings, the study concluded that According to the results, innovation capability has a significant effect on performance of commercial banks in Kakamega, County. $\beta_1=0.803$, p value= 0.000). The relationship was considered significant since the p value 0.004 was less than the significant level of 0.05. The study came up with the following recommendations; the management of commercial banks should invest in culture that encourages continuous product/service innovations and creativity for the survival of the banks ensuring banks stay ahead of competitors in delivering unique value adding services.

1.0 INTRODUCTION

Organizations operate in dynamic environments that are competitive and full of uncertainty Binci et al (2022) and face significant formidable commercial obstacles brought on by the ever-evolving corporate landscape. The performance of commercial banks is vital for economic stability and growth, shaped by technological advancements, regulatory frameworks, and macroeconomic conditions. Smith and Johnson (2021) highlight that innovations like digital banking platforms and AI-driven analytics markedly enhance operational efficiencies and customer service within banks. These advancements streamline processes and elevate service delivery, thereby bolstering overall performance metrics (Smith & Johnson, 2021). Brown (2020) asserts that, regulatory adjustments significantly influence the operational landscape of commercial banks. Some of these regulatory adjustments include, adherence to rigorous standards such as Basel III necessitates banks to fortify capital adequacy and risk management frameworks. These measures are essential for promoting financial stability and have profound implications for banks' profitability and risk appetite (Brown, 2020). The regulatory framework serves as a cornerstone in mitigating systemic risks and enhancing market resilience, ensuring that banks operate within sustainable parameters. This regulatory environment underscores the critical balance between fostering innovation and maintaining robust governance to safeguard the interests of stakeholders and the broader economy (Almazari, 2019).

According to Johnson et al. (2022), variations in interest rates and economic growth rates significantly influence banks' performance. During economic upswings, heightened loan demand and wider interest margins typically bolster profitability (Johnson et al., 2022). Conversely, economic downturns can elevate credit risks and diminish profitability, emphasizing the critical role of economic stability in steering banks' performance trajectories (Johnson et al., 2022). These dynamics underscore the interconnectedness between broader economic trends and the operational resilience of banks, necessitating adaptive strategies to navigate cyclical fluctuations and maintain sustainable growth in dynamic financial environments (Johnson et al., 2022). Competition within the banking sector is pivotal in shaping banks' performance outcomes. Recent studies underscore that intense competitive pressures drive continuous innovation among banks to attract and retain customers (Smith, 2023). This dynamic compels banks to enhance service offerings, improve operational efficiency, and adopt advanced technologies, all of which contribute positively to their overall financial performance (Smith, 2023). The competitive environment fosters a culture of innovation and customer-centric strategies aimed at sustaining market leadership and profitability. These strategic initiatives not only enhance customer satisfaction but also strengthen banks' resilience and adaptive capabilities in a rapidly evolving financial landscape (Smith, 2023).

The global performance of commercial banks has been shaped by a confluence of factors in recent years. Technological innovations have revolutionized banking operations, with artificial intelligence and blockchain technology increasingly integrated into financial services (Li & Wang, 2022). These advancements have enhanced efficiency and customer service while posing challenges related to cybersecurity and data privacy (Jones & Patel, 2021). In Europe, commercial banks have navigated a complex operating environment characterized by prolonged low interest rates and intensified competition from fintech firms (Jones & Patel, 2021). While these conditions have compressed net interest margins, European banks have pursued consolidation strategies to achieve economies of scale and enhance profitability (Smith, 2023). Regulatory frameworks such as Basel III have played a crucial role in improving the resilience of European banks, albeit with compliance costs impacting profitability (Li & Wang, 2022). Despite these challenges, banks in countries like Germany and France have demonstrated robust asset quality and capital adequacy ratios, reflecting proactive risk management practices amidst economic uncertainties (Gupta & Sharma, 2024).

The performance of commercial banks in Egypt has reflected a dynamic market characterized by robust economic growth and ongoing financial sector reforms. Egyptian banks have capitalized on digital banking solutions to enhance customer service and operational efficiency (Abdel-Hakim & Ibrahim, 2022). The Central Bank of Egypt's proactive monetary policy stance has supported credit expansion and improved liquidity management across the banking sector (Sayed & Ali, 2021). Commercial banks in Tanzania have navigated a landscape influenced by economic diversification efforts and regulatory reforms aimed at enhancing financial inclusion. Banks have expanded their branch networks and adopted mobile banking platforms to reach underserved rural populations (Kamata & Mrema, 2024). However, challenges such as volatile macroeconomic conditions and regulatory changes have affected profitability margins and credit quality (Mwakyusa & Marwa, 2021).

The performance of commercial banks in Kenya has been characterized by robust growth driven by innovative mobile banking solutions and a supportive regulatory environment. Kenyan banks have leveraged partnerships with fintech firms to expand their digital service offerings and enhance financial inclusion (Ouma & Mwangi, 2023). The Central Bank of Kenya's regulatory reforms, including the adoption of risk-based supervision and enhanced consumer protection measures, have bolstered the resilience of the banking sector (Muthoni & Maina, 2020). According to CBK regulation annual report of (2018) the banking sector in Kenya faced a perfect storm stemming from a number of challenges that affected the efficiency of the industry. Key among these were the impact of the Banking (Amendment) Act 2016 interest rate caps, 2017 is the first complete year under the cost limits. A persistent drought which disrupted agricultural activity for a significant part of the year. Long running of elections in the second half of the year, and its accompanying uncertainty. The negative impact of the difficulties was seen in the decline in overall productivity before taxes in 2017 from Ksh.147.4 billion in 2016 by 9.6 per cent to over Ksh.133 billion in 2017, among other indicators. The hostile business and banking climate reduced lending, with gross lending declining from Ksh.2.29 trillion in 2016 by 5 per cent to Ksh.2.16 trillion in 2017. Several nations have endured financial distress to varying degrees in recent decades, and some have suffered chronic distress (Hardy, 2008).

An analysis in the literature shows that several local and international research studies centered on individual causes. Obamuyi (2013) conducted a study aimed at determining the factors contributing to bank profits in developing countries, and noted that expense control and increasing interests on income affect the bank profits. Furthermore, he noted that favorable

economic situations increase bank profits. Another recent study by Ongore and Kusa (2013) found that the board decisions affect Kenya's commercial banks' performance, and that macroeconomic factors impart little on the performance of a bank. The research did, however, omit the impact of industry-specific issues on the performance of specific banks in the country. There is limited literature available in Kenya on the impact of dynamic capabilities on bank performance. This research pursued to fill this gap. To establish the effect of innovations capability on the performance of commercial banks in Kakamega County, Kenya.

2.0. INNOVATIONS CAPABILITY AND PERFORMANCE OF COMMERCIAL BANKS

Innovation Capability refers to an organization's ability to develop new ideas, products, services, processes, or business models that create value and drive competitive advantage. It reflects the capacity to generate, absorb, and implement innovative solutions in response to changing market demands, technological advancements, and competitive pressures (Harris et al., 2020). Mwangi and Kimuyu (2020) explored the impact of innovation capability on risk management effectiveness within commercial banks in Kakamega. Their findings indicated a positive correlation between a bank's innovation capability and its ability to manage risks effectively. Banks with higher innovation capabilities were better equipped to anticipate and mitigate risks, thus enhancing overall risk management practices. The study concluded that fostering a culture of innovation could significantly bolster risk management strategies in banking operations. The study recommended that Kakamega's banks to prioritize continuous innovation in risk management processes to safeguard financial stability and sustain long-term growth.

Harris and Martinez (2020) investigated the strategic implications of innovation capability on market positioning and competitive strategy in commercial banks. Their research highlighted that banks employing innovative differentiation strategies effectively attract and retain customers, enhance brand reputation, and achieve sustainable growth. They found that innovation enables banks to introduce unique products and services that meet evolving customer needs, thereby gaining a competitive edge. The study concluded that fostering a culture of innovation and investing in strategic innovation initiatives are crucial for banks aiming to strengthen their market position and sustain long-term profitability. The research recommended aligning innovation efforts with customer insights, leveraging digital technologies, and fostering collaboration across departments to drive innovation-led growth strategies.

Johnson, Martinez, Wilson & Thompson (2021) studied the organizational dynamics and cultural factors that facilitate innovation capability in commercial banks. Their findings emphasized the critical role of leadership support, organizational culture, and continuous learning in fostering a sustainable innovation ecosystem. The study highlighted that banks with supportive leadership and a culture that encourages creativity and risk-taking are more successful in driving innovation. They identified that continuous learning and adaptation to market changes are essential for maintaining competitiveness and achieving long-term performance goals. The research concluded that creating a conducive environment for innovation, promoting knowledge sharing, and investing in technology and talent development are imperative for banks aiming to enhance innovation capability. Recommendations included establishing clear innovation goals, nurturing innovation champions across all levels, and integrating customer feedback into the innovation process to drive customer-centric solutions.

Duong, Nguyen Duong, Bui & Tran (2024) did a study on factors affecting the financial performance of banks in the era of digital transformation in Vietnam's Banking Industry. The research results showed that there were three main factors directly affecting bank financial performance including Deposit mobilisation, Bank profitability, and Loyalty respectively according to the level of impact. The study recommended that banks can specifically focus on managing the identified variables and deploying appropriate business strategies to enhance their financial performance for sustainable development in the digital age. Sarkar & Rakshit (2021) did a research on factors influencing the performance of commercial banks in India explores the determinants driving conventional banks in India. The findings highlighted several critical factors, including financial innovation, regulatory compliance, technological advancements, and market competition. Financial innovation, such as the introduction of new banking products and services, enhances bank performance by attracting a broader customer base. Regulatory compliance ensures stability and trust, while technological advancements improve operational efficiency and customer satisfaction. The study recommends that banks invest in cutting-edge technology to streamline operations and offer superior customer service.

Njoki & Nyamute (2023) did a research on factors affecting financial performance of commercial banks in Kenya. The findings identify several crucial factors, including asset quality, management efficiency, capital adequacy, and

macroeconomic conditions. High asset quality and efficient management practices are found to significantly enhance financial performance. Adequate capital buffers ensure banks' resilience against financial shocks, while favorable macroeconomic conditions, such as stable inflation and GDP growth, positively impact performance. The study recommends that banks prioritize maintaining high asset quality by managing non-performing loans effectively and adopting efficient management practices to optimize operations.

3.0. METHOD

This study adopted a descriptive research design. This study was constituted of a census survey of the 11 banks in Kakamega County respectively. Branch managers, Credit managers and customer care of the banks was targeted. The study adopted census survey which working with entire population. Branch managers, Credit managers and customer care was targeted. Data collection instrument was questionnaire and other information relevant to the study. A structured questionnaire was administered to the respondents. Piloting was done to test the validity and reliability of the data collection instrument. Once data is collected, it was crosschecked and verified for errors, completeness and consistency. It was coded, entered and analyzed descriptively using IBM Statistical Package for Social Sciences (SPSS 26). Pearson correlation analysis was used to test the relationship between variables in the study hypotheses. ANOVA multiple linear regression analysis was also be used to determine the statistical relationship between the independent variable and the dependent.

4.0. DISCUSSION

The study's first objective is to establish the effect of innovations capability on the performance of commercial banks in Kakamega County, Kenya. The reliability work environment was done where seven items were considered. The results from the respondents are presented in Table 4.1.

Table 4.1: Descriptive Results for Innovation capability

Opinion on innovation capability	1	2	3	4	5	M	STD
The bank actively invests in new technologies to enhance its service delivery	2.8%	11.9%	9.1%	43.4%	32.9%	3.9	1.07
Our bank's innovation capability significantly improves customer satisfaction and retention	7.7%	32.2%	15.4%	26.6%	18.2%	3.1	1.27
The implementation of innovative practices has led to an increase in the bank's market share	23.8%	13.6%	31.1%	24.5%	7.0%	3.2	1.27
Our bank's innovative solutions have reduced operational costs and increased efficiency	4.2%	12.6%	17.5%	38.5%	27.3%	3.7	1.12
The ability to innovate has improved our bank's competitive advantage in the local market	5.6%	8.4%	17.5%	42.0%	26.6%	3.8	1.11
Management support for innovation initiatives is crucial for enhancing the bank's performance. The bank regularly updates its products and services to meet evolving customer needs through innovation	4.9%	11.9%	11.9%	38.5%	32.9%	3.8	1.16
Aggregate score for innovation capability						3.4	1.22

Results in Table 4.1 indicate the extent of agreement among respondents on various aspects of the innovation capability. For respondents to a moderate extent agreed that the bank actively invests in new technologies to enhance its service delivery (Mean = 3.9; Standard Deviation = 1.07). Our bank's innovation capability significantly improves customer satisfaction and retention (Mean = 3.1; Standard Deviation = 1.27). Additionally, respondents agreed to a moderate extent the implementation of innovative practices has led to an increase in the bank's market share (Mean = 3.2; Standard Deviation = 1.27).

The respondents also to a moderate extent agreed that our bank's innovative solutions have reduced operational costs and increased efficiency (Mean = 3.7; Standard Deviation = 1.12). There is a moderate agreement that the ability to innovate has improved our bank's competitive advantage in the local market (Mean = 3.8; Standard Deviation = 1.11). Management

support for innovation initiatives is crucial for enhancing the bank's performance. The aggregate mean score and standard deviation for The bank regularly updates its products and services to meet evolving customer needs through innovation (Mean = 3.8; Standard Deviation = 1.16).

The findings reveal that respondents perceive the innovation capability should be observed in the commercial banks.

4.2. Performance of Commercial Banks

The study also assessed the effect of performance of commercial banks in Kakamega County, Kenya. The results from the respondents are presented in Table 4.2.

Table 4.2: Descriptive Results for Performance of Commercial Banks

	1	2	3	4	5	M	STD
Our bank has shown a consistent increase in revenue over the past year.	11.2%	23.8%	16.1%	32.9%	16.1%	3.2	1.28
The efficiency of our bank's operational processes has significantly improved in the last six months.	9.1%	12.6%	16.1%	43.4%	18.9%	3.5	1.20
Customer satisfaction with our bank's services has increased based on recent feedback surveys	10.5%	13.3%	13.3%	40.6%	22.4%	3.5	1.27
The productivity of our bank's employees has enhanced due to effective management and resources	9.8%	22.4%	11.2%	38.5%	18.2%	3.3	1.28
Our bank's market share has grown as a result of successful strategic initiatives.	4.9%	11.9%	9.8%	48.3%	25.2%	3.8	1.11
Our bank's profit margins have been consistently strong and reflect efficient cost management	4.9%	8.4%	7.7%	53.8%	25.2%	3.9	1.05
Aggregate score for Performance Of Commercial Banks						2.9	0.49

Regarding the bank has shown a consistent increase in revenue over the past year. (Mean = 3.2; Standard Deviation = 1.28). The efficiency of our bank's operational processes has significantly improved in the last six months (Mean = 3.5; Standard Deviation = 1.20). Additionally, respondents agree that customer satisfaction with our bank's services has increased based on recent feedback surveys (Mean = 3.5; Standard Deviation = 1.27).

Concerning the productivity of the bank's employees has enhanced due to effective management and resources (Mean = 3.3; Standard Deviation = 1.28). They strongly agree that the bank's market share has grown as a result of successful strategic initiatives (Mean = 3.8; Standard Deviation = 1.11). Moreover, respondents perceive the bank's profit margins have been consistently strong and reflect efficient cost management (Mean = 3.9; Standard Deviation = 1.05).

4.3 Inferential Statistics

Inferential statistics in the current study focused on correlation and regression analysis. Correlation analysis was used to determine the strength of the relationship while regression analysis was used to determine the relationship between dependent variable (performance of commercial banks in Kakamega County) and the independent variable (innovations capability).

4.3.1 Correlation Analysis

The present study used Pearson correlation analysis to determine the strength of association between independent variables (innovations capability) and the dependent variable (performance of commercial banks in Kakamega County) dependent

variable. Pearson correlation coefficient range between zero and one, where by the strength of association increase with increase in the value of the correlation coefficients. The current study employed Taylor (2018) correlation coefficient ratings where by 0.80 to 1.00 depicts a very strong relationship, 0.60 to 0.79 depicts strong, 0.40 to 0.59 depicts moderate, 0.20 to 0.39 depicts weak.

Table 4.3: Correlation Coefficients

		Performance of commercial banks	of Innovation capability
Performance Of commercial banks	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	30	
Innovation capability	Pearson Correlation	.612**	1
	Sig. (2-tailed)	.002	
	N	30	30

From the results, there was a very strong relationship between innovation capability and performance of commercial banks in Kakamega County. ($r = .612$, $p \text{ value} = 0.002$). The relationship was significant since the $p \text{ value} 0.002$ was less than 0.05 (significant level).

4.3.2 Regression Analysis

Multivariate regression analysis was used to assess the relationship between independent variables (innovation capability) and the dependent variable (performance of commercial banks in Kakamega County).

Table 4.4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.949	.611	.601	1.115

a. Predictors: (Constant), innovations capability.

The model summary was used to explain the variation in the dependent variable that could be explained by the independent variables. The r-squared for the relationship between the independent variables and the dependent variable was 0.611. This implied that 61.1% of the variation in the dependent variable (performance of commercial banks in Kakamega, County) could be explained by independent variables (innovations capability).

Table 4.5: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	91.303	1	34.321	73.903	.001 ^b
	Residual	10.237	29	.090		
	Total	11.540	30			

a. Dependent Variable: performance of commercial banks in Kakamega County

b. Predictors: (Constant), innovations capability

The ANOVA was used to determine whether the model was a good fit for the data. F calculated was 73.903. The $p \text{ value}$ was 0.000. The model was considered as a good fit for the data. Therefore, the model can be used to predict the influence of innovations capability on performance of commercial banks in Kakamega County.

Table 4. 5: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.724	.102		5.992	.000
	Innovation capability	.803	.310	2.995	2.54	.000

a. Dependent Variable: performance of commercial banks in Kakamega , County

Table 4.5 showed that if innovations capability are all held constant, performance of commercial banks in Kakamega, County would be at 0.675.

Performance of commercial banks in Kakamega, County = 0.724 + .803 (innovation capability).

The regression model was as follows:

$$Y = 0.724 + 0.803X_1$$

According to the results, innovation capability has a significant effect on performance of commercial banks in Kakamega County. $\beta_1=0.803$, p value= 0.000). The relationship was considered significant since the p value 0.004 was less than the significant level of 0.05.

5.0. CONCLUSIONS AND RECOMMENDATIONS

The study's first objective is to establish the effect of innovations capability on the performance of commercial banks in Kakamega County, Kenya. The findings showed that the bank actively invests in new technologies to enhance its service delivery and that bank's innovation capability significantly improves customer satisfaction and retention. Additionally, findings indicated that the implementation of innovative practices has led to an increase in the bank's market share and that bank's innovative solutions have reduced operational costs and increased efficiency. Further the findings implied that the ability to innovate has improved our bank's competitive advantage in the local market and that Management support for innovation initiatives is crucial for enhancing the bank's performance. The bank regularly updates its products and services to meet evolving customer needs through innovation.

Based on the findings, the study concluded that according to the results, innovation capability has a significant effect on performance of commercial banks in Kakamega, County. $\beta_1=0.803$, p value= 0.000). The relationship was considered significant since the p value 0.004 was less than the significant level of 0.05.

The study came up with the following recommendations; the management of commercial banks should invest in culture that encourages continuous product/service innovations and creativity for the survival of the banks ensuring banks stay ahead of competitors in delivering unique value adding services.

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