Journal of Management Studies and Development
Vol. 5, No. 01, pp. 83-91
journal.iistr.org/index.php/JMSD
DOI: 10.56741/IISTR.jmsd.002018

Financial Innovation and Its Effect on Financial Performance

The Case of Commercial Bank of Ethiopia, Nekemte Town Branches

[1]Gudata Abara Chali*
Corresponding Author: *gudataa@gmail.com
[1] Wallaga University, Oromia, Ethiopia

ARTICLE INFO

Article history
Received 24 January 2026
Revised 10 February 2026
Accepted 13 February 2026

ABSTRACT

This study examines the effect of financial innovation on the financial performance of the Commercial Bank of Ethiopia (CBE) in Nekemte Town. As banking shifts toward revenue-oriented digital strategies, identifying high-impact technologies is essential. A census survey of 56 branch managers and vice-managers from ten branches was analyzed using Pearson correlation and multiple regression (SPSS 26). Five innovation dimensions were evaluated: product innovation, process innovation, mobile banking, technology transfer, and remittance technology. Findings reveal that remittance technology is the strongest predictor of financial performance ($\beta = 0.661$, $p < 0.01$), followed by process innovation ($\beta = 0.213$) and mobile banking ($\beta = 0.193$). The regression model explains 92.7% of performance variance ($R^2 = 0.927$), indicating substantial explanatory power. The results suggest that profitability in regional markets depends largely on efficient payment and fund transfer systems. The study recommends expanding digital onboarding services and exploring blockchain solutions to reduce transaction costs and strengthen competitive advantage.

Keywords
Commercial Bank of Ethiopia
Financial Innovation
Financial Performance
Mobile Banking
Remittance Technology

This is an open-access article under the CC–BY-SA license.

Introduction

Financial services institutions constitute a fundamental pillar of the modern economy by enabling payment systems, mobilizing savings, allocating credit, and managing financial risk. Commercial banks, in particular, play a central role in economic stability and growth by intermediating funds between surplus and deficit units [1],[2]. Although the core intermediation functions of the Commercial Bank of Ethiopia (CBE) have remained largely unchanged, the structure and operational logic of the banking industry have experienced a profound transformation driven by financial liberalization, intensifying global competition, and rapid advances in Information and Communications Technology (ICT) [3],[4].

In the Ethiopian context, the banking sector has recently shifted from a strategic emphasis on internal cost efficiency toward a revenue-oriented model that leverages digital distribution channels. This transition mirrors global banking trends, where digital platforms are increasingly used to deepen customer relationships rather than merely automate back-office functions [5]. Bank managers are now under growing pressure to increase the "share of wallet," defined as the proportion of a customer's total financial activity captured by a single institution [6]. Consequently, banks have accelerated the adoption of mobile banking, platform automation, electronic payment systems, and innovative remittance technologies to enhance customer engagement and retention [7].

These developments are particularly salient in regional commercial hubs such as Nekemte Town, where economic activity is characterized by vibrant trade, agricultural income flows, and substantial domestic remittance volumes within the Oromia region. The growing penetration of mobile phones and digital literacy among younger and urbanizing populations has further intensified demand for convenient, technology-enabled financial services [8]. In such settings, digital banking innovations are not merely optional enhancements but strategic instruments for mobilizing deposits, expanding transaction volumes, and reducing customer migration to competing financial institutions.

Despite the increasing diffusion of digital tools, the empirical relationship between financial innovation and bank performance in Ethiopia remains insufficiently explored. Existing studies predominantly focus on macro-level indicators, national financial inclusion metrics, or broad innovation-performance correlations that overlook internal operational mechanisms [9],[10]. At the branch level, particularly in secondary towns, there is a notable lack of evidence on how specific technologies—such as electronic remittance platforms, Electronic Funds Transfer (EFT), or Point of Sale (POS) systems—translate into measurable performance outcomes like return on assets (ROA) or return on equity (ROE) [11].

This research gap is critical, as branch-level performance is shaped not only by market demand but also by internal process efficiencies, transaction speed, and service reliability.

Ignoring these variables risks oversimplifying the innovation–performance nexus and obscuring the mechanisms through which technology creates value within bank operations [12],[13]. Understanding these dynamics is particularly relevant for state-owned banks such as CBE, which must balance commercial objectives with broader developmental mandates.

The theoretical foundation for examining financial innovation in this context can be traced to Silber's [14] constraint-induced innovation theory, which posits that firms innovate primarily to overcome internal or external constraints that limit profitability or operational effectiveness. In the case of CBE, geographical dispersion, limited branch accessibility, and reliance on manual processes historically constrained service delivery. The introduction of mobile and internet banking platforms represents a strategic response to these limitations, enabling the bank to extend services beyond physical branch boundaries [7],[14].

This perspective aligns closely with transaction cost economics, as articulated by Coase [15] and later expanded by Williamson [16]. From this viewpoint, financial innovations are adopted to reduce transaction, contracting, and information search costs. In Nekemte branches, the deployment of EFT and POS systems directly addresses the high costs and risks associated with manual cash handling, long processing times, and reconciliation errors. By streamlining transactions and enhancing operational efficiency, such technologies have the potential to improve branch-level financial performance while simultaneously enhancing customer satisfaction and trust [4],[16].

Research Methodology

A. Research Design

This study adopted a quantitative research approach using a combination of descriptive and explanatory research designs. The descriptive component was employed to systematically capture the current status and extent of financial innovation practices implemented across Commercial Bank of Ethiopia (CBE) branches in Nekemte Town. In parallel, the explanatory design enabled the examination of causal relationships between financial innovation and bank performance, thereby moving beyond mere description toward analytical inference.

Specifically, the study investigated the effect of five innovation-related independent variables on financial performance as the dependent variable. Financial performance was operationalized using standard accounting-based indicators derived from audited financial statements. The conceptual framework, illustrated in Figure 1, depicts a path model in which the selected technological innovation variables are hypothesized to exert direct effects on branch-level financial performance. This framework provided a structured basis for hypothesis formulation and guided the empirical analysis.

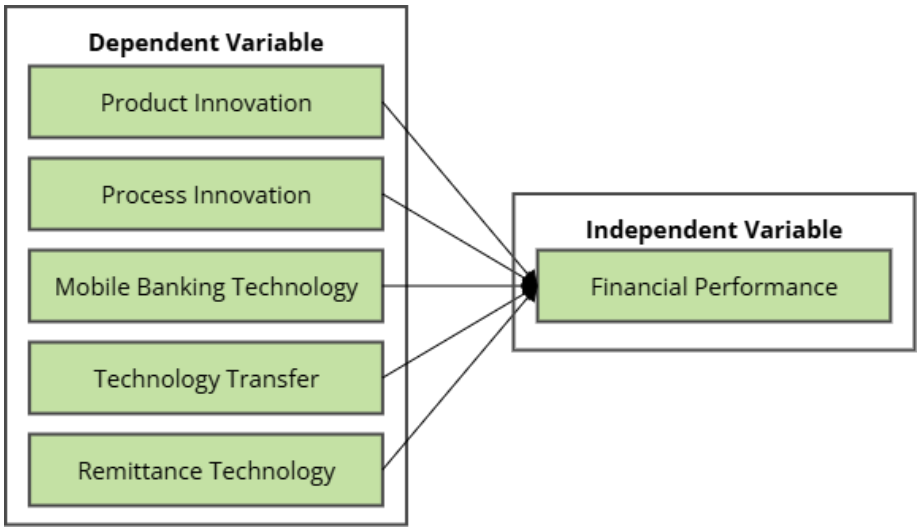


Fig. 1. The Relationship Between Innovation and Performance

B. Target Population and Data Collection

The target population consisted of 56 top-level personnel, including branch managers and vice-managers, drawn from ten CBE branches operating in Nekemte Town and the corresponding district office. Given the relatively small and accessible population, a census approach was adopted to ensure complete coverage of all eligible respondents and to eliminate potential sampling bias.

Primary data were collected using structured questionnaires designed with five-point Likert-scale items to capture respondents' perceptions of innovation adoption and operational effectiveness. To enhance measurement reliability, the instrument focused on clearly defined innovation dimensions aligned with the conceptual framework. Secondary data were obtained from the bank's annual financial reports covering the period from 2020 to 2024. The integration of perceptual survey data with objective financial records strengthened the robustness of the analysis and allowed for a more comprehensive assessment of innovation-driven performance outcomes.

Results and Discussion

A. Demographic Characteristics of Respondents

The demographic analysis reveals that respondents possess profiles well aligned with the analytical demands of this study. The workforce is predominantly mature and professionally experienced, with 48% of respondents falling within the 41–50 age group. This age distribution suggests prolonged exposure to organizational routines and technological transitions, enhancing the reliability of perceptual responses related to innovation and performance [17]. Gender composition was relatively balanced, with male respondents accounting for 58% of the sample, reflecting the broader staffing pattern of the Ethiopian banking sector [10].

Educational attainment was notably high, as 78% of respondents held a Bachelor's degree, indicating strong analytical capacity and familiarity with financial and technological concepts. Importantly, 66% of respondents were drawn from the Finance department, which substantially strengthens the credibility of responses related to profitability, asset utilization, and operational efficiency. Prior research emphasizes that respondents with direct financial responsibilities are better positioned to assess performance impacts of innovation initiatives [4],[5]. Overall, the demographic profile supports the validity of the dataset and provides a solid foundation for interpreting the regression results.

B. Regression Results and Model Adequacy

The multiple regression analysis demonstrates a strong and statistically robust relationship between financial innovation and bank performance at the branch level. The estimated model (Table 1), expressed as:

$$Y = 0.482 + 0.095X_1 + 0.213X_2 + 0.193X_3 + 0.005X_4 + 0.661X_5 + \varepsilon \quad (1)$$

It explains 92.7% of the variance in financial performance (R^2 = 0.927), with an adjusted R^2 of 0.918 (Table 2). This exceptionally high explanatory power suggests that innovation-related variables collectively constitute the dominant drivers of branch-level performance in the Nekemte market. Similar magnitudes have been reported in emerging-market banking studies where technology adoption directly reshapes transaction structures and revenue streams [7],[11].

Table 1. Regression Coefficients of Innovation Predictors

Predictor	Unstandardized B	Std. Error	Beta	t	Sig.
(Constant)	.482	.268	-	1.797	.079
Product Innovation	.095	.037	.106	2.546	.014
Process Innovation	.213	.096	.225	2.224	.031
Mobile Banking	.193	.084	.172	2.303	.026
Technology Transfer	.005	.010	.020	.475	.037
Remittance Technology	.661	.094	.620	7.025	.000

Table 2. Model Summary

Metric	Value
R	.963
R-Square	.927
Adjusted R-Square	.918
Std. Error of the Estimate	.263

Model diagnostics further confirm the robustness of the findings. Cronbach's Alpha values exceeding 0.70 across all constructs indicate acceptable internal consistency [18]. Normal probability plots confirm that residuals are normally distributed, validating the assumptions underlying ordinary least squares estimation [19].

C. Dominance of Remittance Technology

The most striking result is the overwhelming influence of Remittance Technology (X_5), which recorded the largest standardized coefficient (β = 0.620) and a highly significant p-value (p = 0.000). This finding confirms that the ability to process domestic and international remittances efficiently is the single most important determinant of profitability for CBE branches in Nekemte. In a regional economy characterized by labor mobility and inter-regional income transfers, remittance services generate high transaction volumes, stable fee-based income, and sustained customer engagement [8].

This result strongly supports Silber's [14] constraint-induced innovation theory, which argues that financial institutions innovate primarily to overcome structural limitations. In this context, remittance technology mitigates geographic and institutional frictions that historically constrained money transfers. From a transaction cost economics perspective, digital remittance platforms significantly reduce search, processing, and enforcement costs, thereby enhancing operational efficiency and profitability [15],[16]. Comparable findings in African banking contexts suggest that remittance-driven revenues are particularly impactful in semi-urban markets with limited alternative financial instruments [9].

D. Effects of Process and Product Innovation

Process innovation emerged as a significant predictor of performance (β = 0.213, p = 0.031), underscoring the role of operational efficiency in revenue generation. Innovations such as reduced waiting times, business process reengineering (BPR), and workflow automation increase transaction throughput and customer satisfaction, particularly in high-traffic town branches [13]. Rather than merely reducing costs, process innovation enhances income potential by enabling branches to serve a larger customer base more quickly and reliably.

Product innovation also demonstrated a positive and statistically significant effect (β = 0.106, p = 0.014). Although its impact was smaller than that of process or remittance innovation, this finding indicates that diversified financial products contribute to incremental performance gains. Product differentiation allows banks to capture niche customer segments and deepen financial relationships, reinforcing the "share of wallet" strategy emphasized in contemporary banking literature [5],[6].

E. Mobile Banking and Technology Transfer

Mobile banking showed a meaningful positive impact on performance (β = 0.172, p = 0.026), reflecting growing customer reliance on digital self-service platforms. This result aligns with prior studies highlighting mobile banking as a catalyst for financial inclusion and transaction growth in developing economies [7],[8].

In contrast, technology transfer (X_4) exhibited a statistically weak and economically negligible effect (β = 0.020). This suggests that simply importing or adopting technologies

without adequate contextual adaptation, training, or integration may not yield immediate performance benefits. This finding echoes resource-based arguments that competitive advantage arises not from technology acquisition alone, but from its effective internal deployment and complementary capabilities [4],[20].

F. Synthesis and Implications

Collectively, the results demonstrate that not all innovations contribute equally to bank performance. In the Nekemte context, revenue-generating technologies—particularly remittance systems—far outweigh supportive or background innovations in their measurable financial impact. Remittance platforms directly expand fee-based income streams, increase transaction volumes, and strengthen customer retention, thereby creating immediate and observable returns on investment. In contrast, supportive innovations such as internal process automation or incremental service digitization tend to enhance operational efficiency without necessarily translating into short-term profitability gains. This distinction reinforces the argument that innovation effectiveness is contingent upon market structure, customer demand, and institutional readiness in emerging economies [10], [11].

Furthermore, the findings align with contemporary banking innovation studies emphasizing strategic alignment between technology adoption and revenue architecture [21], [22]. In developing financial ecosystems, banks often operate under resource constraints, making selective innovation prioritization essential for sustainable growth [23]. Remittance technologies, in particular, serve as financial inclusion enablers while simultaneously generating stable non-interest income, thus strengthening competitive positioning [24]. The Nekemte case therefore illustrates how context-sensitive innovation strategies can outperform uniform digital transformation models frequently advocated in global banking discourse. By demonstrating that high-impact financial technologies yield disproportionate performance effects, this study extends existing scholarship on innovation-performance linkage in emerging-market banking environments and underscores the need for pragmatic, revenue-oriented digital investment frameworks [25].

Conclusions and Recommendations

This study concludes that financial innovation has evolved from a strategic option into a fundamental survival requirement for Commercial Bank of Ethiopia branches operating in Nekemte Town. The exceptionally high coefficient of determination ($R^2 = 0.927$) indicates that nearly 93% of the variation in branch-level financial performance is explained by the innovation variables examined, underscoring the centrality of technological transformation in contemporary banking operations. Among the innovation dimensions analyzed, remittance technology emerged as the most influential determinant of profitability, reflecting the structural importance of domestic and international money transfers within the regional

economy. Mobile banking also demonstrated a strong positive effect, confirming its role as a critical channel for transaction efficiency, customer engagement, and revenue diversification in a digitally evolving market environment.

Based on these findings, several strategic recommendations are proposed. First, CBE should prioritize the strengthening of its remittance infrastructure by introducing real-time international transfer tracking systems. Such enhancements would increase transparency, reduce perceived transaction risk, and reinforce customer trust, particularly among remittance-dependent households. Second, the bank should accelerate the transition toward fully digital customer onboarding processes to minimize congestion and operational strain at physical branches in Nekemte. Digital onboarding would not only improve service efficiency but also expand outreach to younger and geographically dispersed customers. Finally, CBE is encouraged to leverage advanced data analytics to personalize mobile banking interfaces and service offerings. By utilizing customer transaction data to tailor dashboards and product recommendations, the bank can effectively increase its share of wallet, deepen customer relationships, and sustain competitive advantage in an increasingly technology-driven banking landscape.

Conflict of Interest

The authors declare no conflict of interest.

References

[1] G. Gorton and A. Metrick, "Regulating the shadow banking system," *Brookings Papers on Economic Activity*, vol. 2010, no. 2, pp. 261–312, 2010, doi: 10.1353/eca.2010.0016.

[2] T. W. Rejekiningsih, A. S. Kurnia, and F. X. Sugiyanto, "Analysis of efficiency of intermediation functions from financial institutions and consumer surplus of funds in Indonesia," *International Journal of Economics and Finance Studies*, vol. 14, no. 1, pp. 377–408, 2022.

[3] S. Claessens and N. Van Horen, "The impact of the global financial crisis on banking globalization," *IMF Economic Review*, vol. 63, no. 4, pp. 868–918, 2015, doi: 10.1057/imfer.2015.30.

[4] W. S. Frame and L. J. White, "Technological change, financial innovation, and diffusion in banking," in *The Oxford Handbook of Banking*, 2nd ed., A. N. Berger, P. Molyneux, and J. O. S. Wilson, Eds. Oxford, U.K.: Oxford University Press, 2014, pp. 271–291, doi: 10.1093/oxfordhb/9780199640935.013.0012.

[5] X. Vives, "Digital disruption in banking," *Annual Review of Financial Economics*, vol. 11, pp. 243–272, 2019, doi: 10.1146/annurev-financial-100719-120854.

[6] S. Gupta and D. R. Lehmann, *Managing Customers as Investments: The Strategic Value of Customers in the Long Run*. Upper Saddle River, NJ, USA: Wharton School Publishing, 2005.

[7] P. K. Ozili, "Impact of digital finance on financial inclusion and stability," *Borsa Istanbul Review*, vol. 18, no. 4, pp. 329–340, 2018, doi: 10.1016/j.bir.2017.12.003.

[8] A. Demirgüç-Kunt, L. Klapper, D. Singer, S. Ansar, and J. Hess, *The Global Findex Database 2021: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19*. Washington, DC, USA: World Bank, 2022, doi: 10.1596/978-1-4648-1897-4.

[9] S. A. Asongu and N. M. Odhiambo, "How enhancing information and communication technology has affected inequality in Africa," *Information Development*, vol. 35, no. 1, pp. 51–73, 2019, doi: 10.1177/0266666917735817.

[10] T. Beck, T. Chen, C. Lin, and F. M. Song, "Financial innovation: The bright and the dark sides," *Journal of Banking & Finance*, vol. 72, pp. 28–51, 2018, doi: 10.1016/j.jbankfin.2016.06.012.

[11] A. Maredza, S. Ikhide, and D. Makina, "Financial innovation and bank performance: Evidence from emerging markets," *Research in International Business and Finance*, vol. 56, p. 101375, 2021, doi: 10.1016/j.ribaf.2020.101375.
[12] C. U. Mammah and P. Ohazurike, "Strategic branch management in commercial banks: Driving profitability through operational efficiency," *International Journal of Research in Marketing Management and Sales*, vol. 7, no. 2, pp. 233–242, 2025.
[13] F. Damanpour, R. M. Walker, and C. N. Avellaneda, "Combinative effects of innovation types and organizational performance: A longitudinal study of service organizations," *Journal of Management Studies*, vol. 46, no. 4, pp. 650–675, 2009, doi: 10.1111/j.1467-6486.2008.00814.x.
[14] W. L. Silber, "The process of financial innovation," *The American Economic Review*, vol. 73, no. 2, pp. 89–95, 1983.
[15] R. H. Coase, "The nature of the firm," *Economica*, vol. 4, no. 16, pp. 386–405, 1937, doi: 10.1111/j.1468-0335.1937.tb00002.x.
[16] O. E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York, NY, USA: Free Press, 1985.
[17] F. Damanpour and M. Schneider, "Phases of the adoption of innovation in organizations: Effects of environment, organization and top managers," *British Journal of Management*, vol. 17, no. 3, pp. 215–236, 2006, doi: 10.1111/j.1467-8551.2006.00498.x.
[18] J. F. Hair, W. C. Black, B. J. Babin, and R. E. Anderson, *Multivariate Data Analysis*, 8th ed. Boston, MA, USA: Cengage Learning, 2019.
[19] D. N. Gujarati and D. C. Porter, *Basic Econometrics*, 5th ed. New York, NY, USA: McGraw-Hill/Irwin, 2009.
[20] J. Barney, "Firm resources and sustained competitive advantage," *Journal of Management*, vol. 17, no. 1, pp. 99–120, 1991, doi: 10.1177/014920639101700108.
[21] World Bank, *Digital Financial Services and Economic Development*, Washington, DC, USA: World Bank, 2023.
[22] Bank for International Settlements, *Innovations in Payments and Financial Market Infrastructures*, Basel, Switzerland: BIS, 2022.
[23] International Monetary Fund, *Fintech and the Future of Financial Services*, Washington, DC, USA: IMF, 2022.
[24] I. Agur, S. M. Peria, and C. Rochon, "Digital financial services and the pandemic: Opportunities and risks for emerging and developing economies," International Monetary Fund, Special Series on COVID-19, 2020.
[25] D. Arnold and P. Jeffery, "The digital disruption of banking and payment services," in *Research Handbook on Digital Transformations*, Cheltenham, U.K.: Edward Elgar Publishing, 2016, pp. 103–120.

Authors



Gudata Abara Chali is a researcher and Assistant professor affiliated with the Department of Management at Wallaga University in Nekemte, Oromia, Ethiopia. He focuses his work on management topics with a particular emphasis on leadership styles and their impact on employee performance within Ethiopia's public sector. Based in Nekemte, he communicates research findings and collaborates with colleagues to advance understanding of how transformational leadership influences organizational outcomes in public institutions. (email: gudataa@gmail.com).