

THE EFFECT OF AGENT BANKING ON FINANCIAL INCLUSION IN KENYA

By

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DECLARATION

This research project is my own work and has not been submitted for award of any degree in any other university and where other people's research work has been used, they have been duly acknowledged.

Signed.....



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09/11/2012

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This research project has been submitted for examination with my approval as the university supervisor.

Signed.....



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DEDICATION

This project is dedicated to all the people who are committed to enhancing financial inclusion in Africa

ACKNOWLEDGMENT.

My sincere gratitude to my supervisor, Mr. Ondigo for his patience, my parents Rose and John for their support and my colleagues at Co-operative Bank for their positive criticism. I cannot also forget to acknowledge the reference of other writers whose work was of great importance to my study.

ABSTRACT

Financial inclusion of the total population of a country people is every government's goal. The world over and especially in the developing countries, governments are working on various strategies and regulatory frameworks to ensure they reach all those excluded. Every governments dream is to have an efficient and inclusive financial system for purposes of resource mobilization. In Kenya, Vision 2030 is premised on a safe, efficient and inclusive financial system where savings and investment rates will more than double. The financial sector is expected to play a pivotal role in mobilizing the substantial resources required to finance the envisaged flagship projects. The government through the central bank has therefore been trying exploring and implementing innovative models that will deepen Kenya's financial sector to support savings and investment growth. One of the initiatives has been the agent banking model

The objective of the study therefore was to investigate the relationship between agent banking and financial inclusion in Kenya. The study utilized descriptive survey research method so as to elicit a broad range of information from various sources identified from the research area. In summary, the study investigated agent banking in Kenya with emphasis on the factors contributing to financial exclusion, both natural barriers such as rough terrains and man-made barriers such as high charges on financial services and limited access due to limited bank branches.

The findings of the study were that agent banking is continuously improving and growing and as it grows, the level of financial inclusion is also growing proportionately. The study findings show that increasing the area covered by agents within the country has had the effects of increasing the reach of the financial services to the people thus raising the levels of financial inclusion because a certain cliché of the population would not visit the bank branches for various reasons included in the study. The findings in summary show that agent banking has the effect of increasing the level of financial inclusion in the country. The study therefore recommends that agency banking as a means of enhancing financial inclusion be highly supported and encouraged by all players- the banks, government, and licencing bodies especially local authorities; so as to reduce the high compliance costs in bureaucracy in registration. The study further recommends adoption of agency banking by all banks operating in the retail market.

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LIST OF ABBREVIATIONS AND ACRONYMS

ANOVA	Analysis of Variance
ATM	Automated Teller Machines
CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
FSD	Financial Sector Deepening
GSM	Global system for mobile communications
ICT	Information Communication Technology
NBFIS	Non-bank Finance Institutions
PC	Personal Computer
PDA	Personal digital assistant
PIN	Personal Identification Number
PLC	Public Limited Company
POS	Point of Sale
SBI	State Bank of India
SIM	Subscriber Identity Module
SMS	Short Message Service
SPSS	Statistical Packages for Social Sciences
USA	United States of America

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

In Kenya and the rest of the developing countries, access to financial services has always been limited. Banks and other financial service providers have not been able to penetrate all parts and reach all people but the last two years have seen a new phase in the banking industry with the launch of agent banking which has significantly increased access and reach of financial services to the people even in the remote areas. Banks have been able to do this through. The Finance Act, 2009, allowed banks to start agents to deliver financial services. Financial institutions are motivated to begin this model by the many cost advantages it offers and the advantages are not only to the financial institution but also to the individuals and the agent. For the clients, advantages are in the form of Lower transaction cost (closer to client's home; client would visit store anyway for groceries, etc.), longer opening hours, shorter lines than in branches, more accessible for illiterates and the very poor who might feel intimidated in branches).

For the agents, advantages are in the form of increased sales from additional foot-traffic, differentiation from other businesses, reputation from affiliation with well-known financial institution, additional revenue from commissions and incentives while for financial institutions, there are huge savings on cost of construction of bank premises and leasing costs, when banks are using the Agency premises; human resource expenses reduce, the banks do not have to employ new staff to manage the agency and the cost of training if any is to the bare minimum, Savings on equipment like furniture and computers, increased customer base and market share, increased coverage with low-cost solution in areas with potentially less number and volume of transactions, increased revenue from additional investment, interest, and fee income, improved indirect branch productivity by reducing congestion in the branch outlets

In Kenya currently there are eight banks offering agent banking. These are Equity Bank, Co-operative Bank, Kenya Commercial Bank, Post Bank, NIC, Eco bank, Family Bank and Diamond Trust Bank. Agent banking beginnings in Kenya date to May 2010 when the Central bank came up with the guideline on agent banking after a thorough study on countries which had

been engaging in the same. There being a regulatory framework, the banks moved very fast to take up the new model banking.

1.1.1 Financial Inclusion

Financial inclusion is the delivery of financial services at affordable costs to sections of disadvantaged and low income segments of society (Business dictionary, 2011). It is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. Due to the direct correlation between financial exclusion and poverty, financial inclusion is now a common objective for many central banks among the developing nations. According to the Melinda and Bill Gates Foundation, financial inclusion can't happen on its own and governments need to make a policy to increase the same since unlike any other product or service, it can't find a market of its own.

Financial inclusion can't happen on its own without deliberate effort and more so through government intervention due to the following reasons: Unavailability of financial services in some regions; it has been found that financial services are used only by a section of the population. There is demand for these services but it has not been provided. The excluded regions are rural, poor regions and also those living in harsh climatic conditions where it is difficult to provide these financial services. The excluded population then has to rely on informal sector (moneylenders etc) for availing finance that is usually at exorbitant rates. This leads to a vicious cycle (Wainaina, 2009). First, high cost of finance implies that first poor person has to earn much more than someone who has access to lower cost finance. Second, the major portion of the earnings is paid to the money lender and the person can never come out of the poverty.

Another reason for exclusion is the high cost of financial services; it has been seen that the poor living in urban areas don't utilize the financial services as they find them costly and thus are unaffordable. Hence, even if financial services are available, the high costs deter the poor from accessing them. For example, to open a checking account in Cameroon, the minimum deposit requirement is over 700 dollars, an amount higher than the average GDP per capita of that country, while no minimum amounts are required in South Africa or Swaziland. Annual fees to

maintain a checking account exceed 25 percent of GDP per capita in Sierra Leone, while there are no such fees in the Philippines. In Bangladesh, Pakistan and Philippines, to get a small business loan processed requires more than a month, while the wait is only a day in Denmark. The fees for transferring 250 dollars internationally are 50 dollars in the Dominican Republic, but only 30 cents in Belgium (World Bank report, 2008).

Non-price barriers are other reasons inhibiting financial inclusion. Access to formal financial services requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents and thus are excluded from these services. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

Behavioral aspects also inhibit financial inclusion to some extent. Research in behavioral economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

The Government of Kenya through the CBK is among the most active in the developing countries in efforts to enhance financial inclusion. In Africa, Kenya is second after South Africa in terms of financial inclusion (National Financial Access Survey of 2009). Various initiatives have been undertaken to enhance this including developing a framework under which banks would carry on agent banking and licensing of deposit taking micro-finance institutions among others.

1.1.2 Agent banking

Agent banking is the conducting of and offering financial services to clients of a financial institution, mostly a bank through a third party contracted by the institution to conduct business on its behalf under the normal traditional agency arrangement where the bank is the principle. To provide a level playing ground, a regulator (mostly the central banks of the various countries) is put in place to draw rules / guidelines under which agent banking business is to be carried out including what is allowable and what is not allowable based on the risk levels involved. In lay

man's language, agent banking is where banks are allowed to engage third parties to provide certain banking services. The benefits of this model to the client are in the form of Lower transaction cost (closer to client's home; client would visit store anyway for groceries, etc.), longer opening hours, shorter lines than in branches, more accessible for illiterates and the very poor who might feel intimidated in branches) while for financial institutions, there are huge savings on cost of construction of bank premises and leasing costs, when banks are using the Agency premises. The agents benefit from increased foot traffic, an enhanced name and publicity besides sharing in the banks commissions on transactions done at the agent premises.

1.1.3 The effect of agent banking on Financial Inclusion

According to the Governor of the Central Bank of Kenya, the traditional banking methods, limited reach of people to the bank branches located mainly in the highly populous towns. Sections of population have been left out of the formal financial sector, for the mere reason that they are not located in densely populated areas or they are located in low market residential areas. Such populations have been left out and as way to address this exclusion; the government through the CBK has come up with agent banking. Agent banking increases the reach of banks to the people from the traditional branch network which is limited in growth by several factors such as the cost of building up branches and the affiliated set up costs including the staffing costs and other costs which when compared to the benefits, i.e the cost benefit analysis of setting branches in such areas, is negative. Agency banking is expected to be the solution to this problem since banks will expand rapidly riding on the infrastructure and manpower of third parties (the agents). This will not only benefit the banks cost wise, but will and is enabling them reach that extra person that would never have been reached and included into the formal financial sector had it not been for agent banking. The banks are motivated by the extra popularity, further reach and ultimately profitability but unconsciously, as they spread agent banking for the above reasons, more and more of the previously excluded populations are being reached (Veniard, 2010).

1.1.4 Commercial Banks in Kenya

In the dynamic and competitive world, players will always be very keen on locking up their niche markets. The Kenyan banking industry is not different and reacts similarly; currently, only four million Kenyans have bank accounts (CBK annual reports, 2010). Activity of one player is

followed by a counter move. The recent past has seen the Kenyan banking industry move to agency banking. Most of the commercial banks offering retail banking services have taken it up.

Out of a total of forty three banks, eleven have been licensed by CBK to carry on agency banking and out of these eleven; eight have already rolled out the service. Co-operative Bank, Equity Bank, Kenya Commercial Bank, NIC bank PLC, Diamond Trust Bank, Eco Bank, Family Bank and Post Bank are vigorously recruiting agents. They have been very quick to take up agency banking first of all, to ensure that none of their customers is taken up by the competition, through being given easy and readily accessible avenues of reaching their accounts through agents who are located in just about all the shopping centers countrywide. All players in the banking industry are therefore working very hard to ensure they are well represented by agents countrywide to not only maintain the existing customers but also reach that extra customer and market that would have otherwise remained untapped had the bank(s) not recruited agents in those places (Wainaina, 2009). In Kenya, the upper rift , parts of Eastern and North Eastern province have large numbers of financially excluded populations which provides banks with the opportunity of getting more customers, more deposits, more transactional income and larger asset books and all this going on smoothly and at low cost through the agent banking model which lets banks be represented in all areas without incurring the high cost of putting and maintaining branches which would prove negative from a cost benefit analysis. As the banks reap from increased reach, the society also gains by having more people included in the formal financial sector (Kabbucho and Coetzee, 2010).

1.2 Research Problem

Agency banking, the offering of selected bank services through third parties appointed by the banks is expected to be one of the solutions to reaching sections of the disadvantaged in society providing them with affordable financial services and access to credit (Beck et al, 2007). With a wider distribution of agents and their availability in nearly all towns and shopping centers as opposed to the limited traditional branch network, it is expected access to financial services should become more enhanced. Due to the huge savings made by reaching people without the expense of having to build branches, employ staff and incur the various other expenses of running a branch, it follows that financial services at these points should be offered at slightly

lower prices and in addition benefits those who are geographically disadvantaged by availing the services closer to them. To the banking industry besides the cost savings, banks have penetrated and reached people they would never have reached particularly in the very remote areas (Kimunya, 2002).

Governments worldwide are working on solutions to ensure delivery of financial services at affordable costs to all the citizens but they are more so concerned about the sections of the population that are disadvantaged and the low income segments of the society. The common objective is ensuring access to financial services and working towards including all since there is a direct correlation between financial exclusion and poverty. While in Europe and North America, income distribution as well as distribution of resources is largely even, making infrastructural and financial development largely uniform and hence leaving no portions of disadvantaged and low income segments that could suffer exclusion. In Latin and South America, financial inclusion has been a key concern. The Governments in these regions have embraced and supported agency banking in their banking sectors largely to cater for populations that would otherwise be financially excluded (Ignacio, 2009).

In Kenya, economic and social development is premised on a safe, efficient and inclusive financial system where savings and investment rates will more than double (Vision 2030). The financial sector is expected to play a pivotal role in mobilizing the substantial resources required to finance the envisaged flagship projects. The government through the central bank has therefore been working on getting innovative models that will include all in Kenya's formal financial sector to support savings and investment growth. According to Ignacio, 2009, Reaching the unbanked people and areas has been a major challenge. Occasioned by harsh climatic conditions, rough terrain, rural and poor regions are the worst hit (Kimunya, 2002). Very few financial institutions have the will to go into these areas especially bearing in mind that the places with such harsh conditions also attract fewer people thus the population densities there are very low, Financial institutions are not willing to spend large amounts of resources building branches which will not serve adequate numbers for them to break even profit wise. This study aims at bringing out the impact agent banking has had in overcoming exclusion in the country

Many studies have been done on agency banking, but the studies are not exhaustive because agency banking is still at its formative stages and a lot of new developments and new changes are coming up on a daily basis. Ndome (2011) in a study of agent banking and its adoption in Nairobi - adoption of its services among the residents of Kawangware area in Nairobi Kenya; focused on a low end residential area within the city of Nairobi and it was evident that the services were very welcome by the residents with lots of transactions being done at the agent points. His focus was on adoption of the services and not financial inclusion but the high utilization of agent services was an indicator of some level of exclusion that was existent and which no one paid attention to.

Wambari (2009) in his study on mobile banking in the developing countries noted that Kenya was one of a small number of pioneering countries where financial services have started to be offered by mobile network operators to people. There is considerable interest in the development of these services since it offers the prospect of providing services to people who presently do not have bank accounts. His concerns were; the extent of access to financial services, the attitudes towards mobile banking by small businesses and the effects and challenges of implementing mobile banking. A lot of growth and positive adoption was noted and mobile banking being the backbone of agent banking it infers growth of the two.

The central bank of Kenya and Financial sector development did a study on measures to open up banking channels to non-bank agents using leading internal firms in this area (Bankable Frontier Associates). The findings, together with an outline of the draft guidelines, were presented to industry stakeholders at a workshop in early January 2010. The study (Regulation and supervision of bank channels: Policy options for Kenya) re-examined the role of branches and also looked into the policy options for future regulation of commercial banking channels. The work looked carefully at relevant evidence from around the world, examining the overall impact on access and risk of various approaches and the way in which branchless banking was to be implemented through agent banking. The findings were that agent banking could effectively reduce the cost of transacting since the cost of setting up branches and operational costs would be significantly reduced and some costs eliminated totally (CBK 2010)

In most countries agency banking is in the definition stages where regulators – the central banks - are also learning more about it and sealing loop holes and addressing issues as they arise. There are lots of changes and most central banks are going through stages where there is the felt need to review their guidelines to flex a bit where they have been too tight and also tighten regulations particularly where issues of fraud may arise. In Kenya for example, agents are not allowed by the CBK guidelines to appraise customers for loan applications but it is expected that this shall be reviewed, since most commercial banks are giving this feedback to the regulator as one of the additional services they would wish to offer through agents. With these changes and the stage we are at on agent banking in the country, the impact of agent banking on financial inclusion has not been studied exhaustively. What is the effect of agent banking on financial inclusion?

1.3 Objective of the Study

To investigate the effect of agent banking and financial inclusion in Kenya

1.4 Value of the Study

The study sought to find out the various barriers to total financial inclusion i.e. why some sections of the population are excluded. The study will show how agent banking has helped to enhance financial inclusion by reaching the frontiers that wouldn't have been reached had it not for agent banking. This will increase and build on the existing theory and knowledge and update this theory on the changes that agent banking is going through as it develops by the day.

The study will also be important in policy formulation. It will be of great interest and importance to the government since it will help in the formulation and (or) modification of the various policies to assist remove any outstanding hindrances to financial inclusion through various methods such as increasing incentives to motivate further inclusion and changing or modifying the regulatory framework to further enhance inclusion(Wainaina,2009).

In practice, this study will be of importance to the banks because they will know how much they are gaining through agent banking by reaching that extra person they would not have reached had they not engaged agents to help on agent banking. The study will provide information to the public and all players; the agent, customers, banks, the regulator (CBK) on the impact of agent

banking on reaching the previously unreached segments of the society. This information on the current status of agent banking will also form part of the academic contribution of this study

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the various theories relevant to agent banking, gives an overview of agent banking including the rationale for the same. It further goes ahead to look at the infrastructure of agent banking – mobile banking, which is offered by Non-Bank Finance Institutions (NBFIs). It addresses and reviews past studies on the subject and critically reviews relevant literature on this area.

2.2 Theoretical Literature Review.

This study will be based in the following theories that the researcher deems necessary for his research.

2.2.1 Entrepreneurship Theory

Entrepreneurship theory responds to the question which functions entrepreneurs have to perform in order to make sure that they can survive or be successful in competition. The term “entrepreneur” was coined in the French language in the 17th Century and disseminated rapidly. In 1725, Cantillon, seeking to understand the very nature of commerce, wrote his seminal work on the entrepreneur as a person willing to take risks and able to manage uncertainty which was published posthum in 1755 (Cantillon, 1755). Many follow-up publications enriched the initial thoughts in the following decades and up till now there is a considerable variety of entrepreneurial functions under discussion (Hébert – Link, 1988; Schoppe et al., 1995).

Barreto (1989) analyzed the development of entrepreneurship theory and identified four striking functions: coordination (referring to Say), arbitrage (with reference to Kirzner), innovation (based on Schumpeter), and risk management (according to Cantillon, Hawley, and Knight). The functions fit perfectly to the discussion in the above section. However, they are not derived the way Schneider (1987) did who intends to explain the evolution of firms as institutions. The different functions are more or less collected from a literature review but not aligned within an overarching framework with functional contexts explaining the start-up, the development and the

potential breakdown of firms. Schneider's approach is appealing from this point of view, although we can ask ourselves whether we consider the risk-taking function original for the constitution of a firm. If we want to understand why firms are founded by entrepreneurs we arrive at the point that something new has to be created as a source of income. According to that, innovation appears to be much more basic than bearing uncertainty. Nevertheless, managing uncertainty is closely connected with any kind of innovation. However, it cannot be regarded as the usual trigger of venturing.

2.2.2 Agency Theory

The agency theory views the company as a link of contracts among self-interested individuals rather than a unified, profit-maximizing entity. Agents need constant supervision and management, which raises agency costs or coordination costs. Information technology, by reducing the costs of acquiring and analyzing information, permits organizations to reduce overall management costs, and allows them to grow in revenues while shrinking the numbers of middle management and clerical workers (Laudon & Laudon, 1996).

Although this definition of agency theory views their associated costs as costs the company incurs, I believe the customer also incurs agency costs in dealing with a company. For example, the interaction with sales people, dealing with employees in problem situations, or just looking for an employee to ask for assistance, involve agency costs for the customer. Agency costs do not necessarily have to constitute monetary costs, as the definition might assume.

2.2.3 Dynamic Capability Theory

Teece et al. (1997) define dynamic capabilities as 'the ability to integrate, build, and reconfigure internal and external competencies to address 'rapidly-changing environments'. The concept of dynamic capabilities arose from a key shortcoming of the resource-based view of the firm. The resource-based view has been criticized for ignoring factors surrounding resources, instead assuming that they simply 'exist'. Considerations such as how resources are developed, how they are integrated within the firm and how they are released have been addressed by the dynamic capability theory. Dynamic capabilities attempt to bridge these gaps by adopting a process approach; by acting as a buffer between firm resources and the changing business

environment, dynamic resources help a firm adjust its resource mix and thereby maintain the sustainability of the firm's competitive advantage which otherwise might be quickly eroded. While the resource-based view emphasizes resource choice or the selecting of appropriate resources, dynamic capability emphasizes resource development and renewal.

2.2.4 Micro Theories of Governance: The Governance of the Firm and its Managers

Most micro theories of governance come under the perspective of efficiency. The function of a governance mechanism or, more generally, a governance system, is to contribute to the efficiency of the firm. Thus, mechanisms such as the board of directors or hostile takeover bids would, by ensuring a better discipline of the managers, contribute to the increase of efficiency of the firm that creates more value. However, if most of the theories retain this criterion, they attribute it differing contents. The different micro theories also focus on a particular interpretation of economic Darwinism, leading to the creation of a relationship between selection through inter-firm competition and the efficiency of the governance systems. According to the principle of natural selection adapted to the field of governance, only efficient systems that ensure the regulation of firms leading to the creation of sustainable value, survive on the long term. Consequently, the systems observed would be considered efficient. This association between survival and efficiency, contested by certain modern biological works, produces a critique known as Panglossianism. In the field of corporate governance, this critique aims for a conclusion, often associated with the functionalist perspective, according to which the governance systems observed would be the most efficient possible.

In other words, the efficiency of first-degree would be guaranteed and the systems should systematically and automatically reach optimum performance. In the disciplinary perspectives of governance, most criticized in this regard, the existing governance systems are however not presumed efficient in the absolute, but only in a relative and precarious manner – particularly because of institutional and organizational innovations –, and after taking the costs of adaptation into account, according to the principle of remediability. In particular, this principle is not opposed to path dependence and therefore, the contingent nature of efficiency according to the historical development of the institutional framework. Other theories belonging to economics or more often to sociology or strategic management, propose an explanation other than efficiency in

the sense that the reasons put forth are connected, for example, to research and appropriation of rents produced by firms by coercion, creation of dependency or influence. Mechanisms such as the board of directors, the Directors' network or the hostile takeover bids are therefore viewed as means of acquiring power in order to collect wealth and not as a disciplinary lever to achieve greater efficiency. These theories are sometimes based on an integrative logic in which the managers or the firm are supposed to obey a collective rationality greater than themselves, for example, of a social class or a network. In other cases, particularly in connection with the New Institutional Sociology approach, they provide justification of inter-organizational nature for certain governance mechanisms. For example, the board of directors and directors' network would serve only to fulfill a function of social legitimization, ensuring the distribution of cognitive or normative models between organizations – for example, shareholder value – without this function necessarily having an effect on the efficiency of the organizations. The latter theories, however rarely focusing on the firm, do not strictly speaking; constitute micro theories of governance systems, as do the theories of efficiency. Therefore, they will not be included in this presentation.

2.3 Overview of Agency Banking

A banking agent is a retail or postal outlet contracted by a financial institution or a mobile network operator to process clients' transactions. Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction and lets clients deposit, withdraw, and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer (Tarazi, 2010). Banking agents can be pharmacies, supermarkets, convenience stores, lottery outlets, post offices, and many more.

Globally, these retailers and post offices are increasingly utilized as important distribution channels for financial institutions. The points of service range from post offices in the Outback of Australia where clients from all banks can conduct their transactions, to rural France where the Bank Credit Agricole uses corner stores to provide financial services, to small lottery outlets in Brazil at which clients can receive their social payments and access their bank accounts.

Banking agents are usually equipped with a combination of point-of-sale (POS) card reader, mobile phone, barcode scanner to scan bills for bill payment transactions, Personal Identification Number identification number (PIN) pads, and sometimes personal computers (PCs) that connect with the bank's server using a personal dial-up or other data connection. Clients that transact at the agent use a magstripe bank card or their mobile phone to access their bank account or e-wallet respectively. Identification of customers is normally done through a PIN, but could also involve biometrics. With regard to the transaction verification, authorization, and settlement platform, banking agents are similar to any other remote bank branch.

Banking agents help financial institutions to divert existing customers from crowded branches providing a “complementary”, often more convenient channel. Other financial institutions, especially in developing markets, use agents to reach an “additional” client segment or geography. Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch. In such environments banking agents that piggy back on existing retail infrastructure – and lower set up and running cost - can play a vital role in offering many low-income people their first-time access to a range of financial services. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch (Tarazi, 2010).

2.3.1 Rationale for Banking Agents

Banking agents help financial institutions to divert existing customers from crowded branches providing a complementary and often more convenient channel. Other financial institutions, especially in developing markets use agents to reach an additional client segment or geography. Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch (Ignacio, 2009). In such environments banking agents that piggy back on existing retail infrastructure – and lower set up and running cost - can play a vital role in offering many low-income people their first-time access to a range of financial services. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch.

Banking agents are the backbone of mobile banking, i.e., performing transactions over a mobile device, most often a mobile phone. To enable clients to convert cash into electronic money and vice versa which can send be sent over their mobile phone, clients will have to visit a branch, automated teller machine (ATM), or banking agent. Especially in remote and rural locations, where cash is still the most important way to pay and transact, a mobile banking service is dependent on banking agents to enable clients to effectively use the service. For the client, there is no difference in accessing his or her bank account at the agent or in a branch or at an ATM.

The agency relationship begins upon vetting and appraisal by the bank and subsequent approval by the central bank upon which the agent signs a contract with the bank, however, besides signing a contract with the financial institution it will be working for, the banking agent also has to open a bank account at the same. In addition, the store has to deposit a certain amount of cash into that account which will serve as the banking agent's "working capital." In many cases, rather than asking the agent to come up with the cash deposit, the financial institution will extend the store a credit line. The size of the credit line is normally not standardized, but adapted individually to each agent depending on its size, the expected volume of transactions and how long the agent has already been working with the bank. In case the agent's credit line had reached its limits, and the agent's bank account does not have sufficient funds, to cover the received funds, the POS will block and can only be de blocked if the funds have been deposited in the next bank account.

2.3.2 Mobile Banking in the World

Mobile banking is used in many parts of the world with little or no infrastructure, especially remote and rural area (Sirken, 2009). This aspect of mobile commerce is also popular in countries where most of their population is unbanked. In most of these places, banks can only be found in big cities, and customers have to travel hundreds of miles to the nearest bank. By 2012, it is estimated that there will be 1.7 billion people with a mobile phone but not a bank account and as many as 364 million unbanked people could be reached by agent-networked banking through mobile phones, this is according to the World Bank report on agency banking.

In Iran, banks such as Parsian, Tejarat, Mellat, Saderat, Sepah, Edbi, and Bankmelli offer the service. Banco Industrial provides the service in Guatemala. Citizens of Mexico can access mobile banking with Omnilife, Bancomer and MPower Venture. Kenya's Safaricom (part of the Vodafone Group) has the M-Pesa Service, which is mainly used to transfer limited amounts of money, but increasingly used to pay utility bills as well. In 2009, Zain launched their own mobile money transfer business, known as ZAP, in Kenya and other African countries. Telenor Pakistan has also launched a mobile banking solution, in coordination with Taameer Bank, under the label Easy Paisa, which was begun in Q4 2009. Eko India Financial Services, the business correspondent of State Bank of India (SBI) and ICICI Bank, provides bank accounts, deposit, withdrawal and remittance services, micro-insurance, and micro-finance facilities to its customers (nearly 80% of whom are migrants or the unbanked section of the population) through mobile banking (World Bank, 2006).

In the year 2010, mobile banking users soared over 100 percent in Kenya, China, Brazil and USA with 200 percent, 150 percent, 110 percent and 100 percent respectively. Dutch Bangla Bank launched the very first mobile banking service in Bangladesh on 31 March 2011. There are around 160 million people in Bangladesh, of which, only 13 per cent have bank accounts. With this solution, Dutch-Bangla Bank can now reach out to the rural and unbanked population, of which, 45 per cent are mobile phone users. Under the service, any mobile handset with subscription to any of the six existing mobile operators of Bangladesh would be able to utilize the service. Under the mobile banking services, bank-nominated agents perform banking activities on behalf of the banks, like opening mobile banking account, providing cash services (receipts and payments) and dealing with small credits. Cash withdrawal from a mobile account can also be done from an ATM validating each transaction by 'mobile phone & PIN' instead of 'card & PIN'.

The most commonly offered services that are being delivered through mobile banking system are person-to-person (e.g. fund transfer), person-to-business (e.g. merchant payment, utility bill payment), business-to-person (e.g. salary/commission disbursement), government-to-person (disbursement of government allowance) transactions. Pioneering banks, microfinance institutions, and mobile operators started to experiment with banking agent networks in various

countries around the world such as Brazil, Peru, Colombia, Kenya, Mexico, Pakistan, the Philippines, and South Africa. Latin-American is the region with the strongest development towards banking agents (Ignacio, 2009). Here governments concerned about expanding financial sector infrastructure have adjusted regulation and are providing incentives for banks to reach new geographies and new client segments through banking agents.

Brazil is probably the most developed market where banking agents have significantly increased financial system infrastructure. Seventy-four institutions are currently managing around 105,000 points of sale in Brazil that reach all 5,561 municipalities. Within only 5 years, the banking agent network facilitated 12.4m new bank accounts and today the network comprises 56 percent of all points of sale in the Brazilian financial system. Financial institutions in other Latin-American markets such as Peru, Colombia, and Mexico have started to learn from the Brazilian experience, adjusted their regulation, and established their own banking agent networks. Pioneers in other regions can be found in Kenya, Mongolia, South Africa, and the Philippines (WB Report, 2010).

2.3.4 Trends in Mobile Banking

Over the last few years, the mobile and wireless market has been one of the fastest growing markets in the world and it is still growing at a rapid pace. According to the GSM Association and Ovum, the number of mobile subscribers exceeded 2 billion in September 2005 and the rate of growth is half a billion every four years. According to a study by financial consultancy Celent, over 35% of online banking households will be using mobile banking by end of 2012, up from less than 1% from 2005. Upwards of 70% of bank center call volume is projected to come from mobile phones. Mobile banking will eventually allow users to make payments at the physical point of sale. "Mobile contactless payments" will make up 10% of the contactless market by 2010. Another study from 2010 by Berg Insight forecasts that the number of mobile banking users in the US will grow from 12 million in 2009 to 86 million in 2015. The same study also predicts that the European market will grow from 7 million mobile banking users in 2009 to 115 million users in 2015.

2.3.5 Agency Banking in Kenya

As recently as 2009, just 23% of Kenyan adults had access to formal financial services. Financial inclusion has risen in recent years, with aggressive expansion by Kenyan banks. Kenya now has over 1,300 retail bank branches, up from 534 in 2005. Several factors have driven service expansion: the recovery of the Kenyan economy since 2003, advances in technology that support the administration of a large number of small bank accounts; and the wildfire spread of mobile money services that created a dual dynamic of both competition and co-operation with the communications and banking sector (Sirken, 2009).

An effective agent is well trained; trusted by customers; strategically and conveniently located; and properly incentivized to follow procedures, keep sufficient float on hand, and serve customers. Banks typically select established retail outlets, while mobile networks are more inclined to use smaller “mom and pop” shops or kiosks. Some providers choose to outsource agent recruiting and training. Either way, the size and growth of the network has to be carefully planned to ensure there are enough agents to serve the customers and that there are enough customers to keep the agents interested in providing the service.

Safaricom, the single most successful mobile money deployment, invested heavily in developing the M-PESA agent network with a focus on a consistent customer experience (Sirken, 2009). Each one of its 20,000 agents provides the same services (i.e., signing up new customers and facilitating cash-in/cash-out transactions), follows the same procedures, and has the same branding on the shop. Other providers have chosen to assign different roles to different agents, which has resulted in difficult tradeoffs. For example, MTN Uganda separated the “field-based” account opening function from the “static” cash-in/cash-out function in order to speed up client acquisition, but this created a situation in which customers signed up even though they didn’t need the service or couldn’t find an agent to start transacting. When an agent can both open accounts and facilitate transactions, it not only offers greater incentive for the agent to provide the service to customers, but it encourages customers to use the service as well. If customers cannot transact immediately upon opening an account, they lose the “instant gratification” of being able to use the account (Coetzee, 2008). This situation is well illustrated by the Orange Money deployment in West Africa, which has a registration process that takes up to a week. As a

result of this long wait time, only 6,000 of its first 120,000 customers, or 5 percent, actively used the account.

Following the 2010 launch of the M-KESHO account, an Equity Bank account that is connected to an M-PESA account, allowing clients to make transfers to and from M-PESA, most banks acknowledge that they have little choice but to seek integration with mobile money. The link up with Equity Bank, the precursor in this integration, offered several advantages: the bank piggybacked on Safaricom's extensive mobile money agent network, whereas Safaricom can now offer access to savings services to its M-PESA clients. It also draws more cash into the formal financial sector where it is available for intermediation. Telkom Orange's mobile money service, Orange Money, has followed suit by partnering with Equity Bank. Orange customers can use their SIM card as a bank account number, which allows them to make deposits and withdrawals and pay bills using the mobile money menu. The customer also receives an Orange Money debit card that grants access to Equity ATMs. The mobile money sector is developing rapidly: Recently, Safaricom entered into a co-operation with Western Union so that M-PESA account holders can receive remittances straight into their mobile money account, and now offers a pre-paid Visa card together with I&M Bank.

In May 2010, the Central Bank of Kenya (CBK) released regulations to govern a new agency banking model. The regulations allow banks to offer services through third party agents approved by the CBK. CBK approved agents are essentially bank vetted profit-making entities that have been in business for at least 18 months and can afford to fund float accounts to facilitate payments. Effectively, the agency banking model provides an extension into a market already targeted: Co-op Bank and Equity have both succeeded with business models aimed at low income customers. Up-market banks may follow suit. Under the CBK regulations, agents can offer a number of banking services, including cash deposits and withdrawals, fund transfers, bill payments, loan payments, payment of benefits and salaries, and collection of account and loan applications. However, agents are limited to cash-only transactions and cannot assess loan applications. The CBK regulations require that agents have secure operating systems capable of carrying out real time transactions, generating an audit trail, and protecting data confidentiality and integrity. This is all driven by technology: Transactions can be made via mobile phone, a

POS system, or internet banking, and must be reflected immediately on the bank's side in the core banking system.

2.3.6 Mobile Banking

Mobile banking (also known as M-Banking) is a term used for performing balance checks, account transactions, payments, credit applications and other banking transactions through a mobile device such as a mobile phone or Personal Digital Assistant (PDA). The earliest mobile banking services were offered over SMS, a service known as SMS banking. With the introduction of the first primitive smart phones with WAP support enabling the use of the mobile web in 1999, the first European banks started to offer mobile banking on this platform to their customers.

Mobile banking has until recently (2010) most often been performed via SMS or the Mobile Web. Apple's initial success with Iphone and the rapid growth of phones based on Google's Android (operating system) have led to increasing use of special client programs, called apps, downloaded to the mobile device. A wide spectrum of Mobile/branchless banking models is evolving. However, no matter what business model, if mobile banking is being used to attract low-income populations in often rural locations, the business model will depend on banking agents, i.e., retail or postal outlets that process financial transactions on behalf telcos or banks. The banking agent is an important part of the mobile banking business model since customer care, service quality, and cash management will depend on them. Many telcos will work through their local airtime resellers. However, banks in Colombia, Brazil, Peru, and other markets use pharmacies, bakeries, etc. These models differ primarily on the question that who will establish the relationship (account opening, deposit taking, lending etc.) to the end customer, the Bank or the Non-Bank/Telecommunication Company (Telco). Another difference lies in the nature of agency agreement between bank and the Non-Bank. Models of branchless banking can be classified into three broad categories - Bank Focused, Bank-Led and Nonbank-Led.

2.3.6.1 Bank-focused Model

The bank-focused model emerges when a traditional bank uses non-traditional low-cost delivery channels to provide banking services to its existing customers. Examples range from use of

automatic teller machines (ATMs) to internet banking or mobile phone banking to provide certain limited banking services to banks' customers. This model is additive in nature and may be seen as a modest extension of conventional branch-based banking.

2.3.6.2 Bank-led Model

The bank-led model offers a distinct alternative to conventional branch-based banking in that customer conducts financial transactions at a whole range of retail agents (or through mobile phone) instead of at bank branches or through bank employees. This model promises the potential to substantially increase the financial services outreach by using a different delivery channel (retailers/ mobile phones), a different trade partner (telco / chain store) having experience and target market distinct from traditional banks, and may be significantly cheaper than the bank-based alternatives. The bank-led model may be implemented by either using correspondent arrangements or by creating a JV between Bank and Telco/non-bank. In this model customer account relationship rests with the bank.

2.3.6.3 Non-Bank-led Model

The non-bank-led model is where a bank has a limited role in the day-to-day account management. Typically its role in this model is limited to safe-keeping of funds. Account management functions are conducted by a non-bank (e.g. telco) who has direct contact with individual customers.

A specific sequence of SMS messages will enable the system to verify if the client has sufficient funds in his or her wallet and authorize a deposit or withdrawal transaction at the agent. When depositing money, the merchant receives cash and the system credits the client's bank account or mobile wallet. In the same way the client can also withdraw money at the merchant: through exchanging an SMS to provide authorization, the merchant hands the client cash and debits the merchant's account. Kenya's M-PESA mobile banking service, for example, allows customers of the mobile phone operator Safaricom to hold cash balances which are recorded on their SIM cards. Cash may be deposited or withdrawn from M-PESA accounts at Safaricom retail outlets located throughout the country, and may be transferred electronically from person to person as well as used to pay bills to companies (Sirken, 2009).

2.3.7 Challenges of Agency Banking for Banks

There are of course challenges that the banks need to address to avoid losing customers and maintaining the Banker- Customer relationship. The customer is still the responsibility of the Banks and the same has not been delegated to the Agency. Some of the challenges that need to be addressed are: Confidentiality; Every year Banks ensure that their staff members sign secrecy forms and maintain confidentiality for all customer information. This should be looked at as these agency employees are not bank employees.

Security; Most of these agencies are in areas that are what would be considered 'high Risk'. The Bank needs to audit the security measures being taken by the agencies to ensure the customer can transact confidently without having to look behind their backs.

Customer service to the bank customer; Service is a huge challenge for the banks as they need to train and retrain the Agents so as to maintain high levels of customer service.

Issues of Fraud; The agency staff will be a target by fraudsters as they are aware that they will not be able to easily identify fraudulent transactions for example identification of documents for originality is a challenge.

2.3.8 Why Banks have Embraced Agency Banking

Most of the major Banks in Kenya and parts of South America have embraced Agency Banking as a way of improving their services to their customers and cutting a niche for themselves in an ever competitive market (Ignacio, 2009). There are also huge savings on cost of construction of bank premises and leasing costs when banks are using the Agency premises. Human Resource expenses have reduced. The banks do not have to employ new staff to manage the agency and the cost of training if any is to the bare minimum and there is also savings on equipment like furniture and computers.

2.4 Empirical Review

According to them, Kendall et al., (2010), in developing countries there is an estimate of 0.9 accounts per adult and 28% banked adults. They stated that the rise of financial inclusion as an important policy goal is due in part to mounting evidence that access to financial products can

make a positive difference in the lives of the public. The European Commission Manuscript 2008 defines financial exclusion as a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong. They also stated that there is some widespread recognition that financial exclusion can be referred to as part of a much wider social exclusion, faced by some groups who lack access to quality essential services such as jobs, housing, education or health care.

Kempson and Whyley (2000), in their study, established six types of financial exclusion:

Physical access exclusion: This, they stated, is brought about by the closure of local banks or building societies and lack of reliable transport to reach alternatives.

Access exclusion: This type of access is restricted through risk assessment, with people being denied a product or service as they are perceived to be high risks.

Condition exclusion: This is when conditions are attached to products or services thereby making them inaccessible to some.

Price exclusion: This occurs when products are available but at a price that is unaffordable.

Marketing exclusion, where sales and marketing activity is targeted on some groups, or areas, at the expense of others.

Self exclusion, when individuals do not seek financial products and services for reasons including fear of failure, fear of temptation or lack of awareness

Kempson (2006) stated that various types of people with the right means of identifying themselves fail to meet the banks requirements to open an account. People like the homeless and unemployed. Everywhere around the world, banks require a certain proof of identity before some kinds of services can be offered. This was also attributed to stricter money laundering rules by Brussels (2006) stating that it is in response to avoid terrorist attacks, with some people being unable to satisfy required identification. Leyshon and Thrift (1995, cited in the European Commission, 2008) stated that people with limited income and with some disabilities represent a high risk to the financial institutions, who then avoid such geographical locations where these people reside, this leads to financial exclusion

According to the World Bank (2008, cited in Honohan and King, (2009), the causes of financial exclusion were broken down into: insufficient income; discrimination; contractual/information framework; and price and product features. In their research, Honohan and King (2009) looked to see the reasons that none financial user give for not using financial products. He asked if it could be fixed by the financial providers in terms of quality of service, location or relevance of product. Kempson (2006) gave some explanations to the reasons why people are financially excluded. He said that these reasons could vary from country to country. He stated the importance of bank required identification and documents, the terms and conditions of bank accounts, levels of bank charges, physical access and cultural barriers in financial inclusion

Tequila Effect (1994) or the Asian financial crisis (1997), this crisis highlighted the immense value of financial stability and motivated a review of the policy tools available to prevent costly breakdowns of the financial system. Since financial inclusion has gained a much higher profile as a policy goal in recent years, it is important to inquire to what extent there are trade-offs between the objectives of maintaining systemic stability and including a growing number of users of financial services. This appears even more relevant since the origin of the current crisis in the subprime market at least initially suggested destabilizing spillovers from the lower end of the market to the remainder of the system. And of particular concern in many developing countries is the additional regulatory uncertainty arising from the rapidly proliferating, technology-driven policy solutions that boost small-scale transactions flowing through the national payment system.

Recent empirical evidence using household data indicates that access to basic financial services such as savings, payments and credit can make a substantial positive difference in improving poor people's lives (Caskey *et al.*, 2006; Dupas and Robinson 2009). For firms, especially small and medium enterprises (SMEs), access to finance is often the main obstacle to growth (Schiffer and Weder, 2001; Cressy, 2002; IADB, 2004; and Beck *et al.*, 2005, 2006, and 2008). The strong relationship between financial development and economic growth is well documented in the literature (King and Levine, 1993; Beck *et al.*, 2000; Demirgüç-Kunt and Maksimovic, 1998; Beck *et al.*, 2004; Levine, 2005; Klapper *et al.*, 2006; Demirgüç-Kunt *et al.*,2008). In more

recent years the debate expanded to include the notion of financial exclusion as a barrier to economic development and the need to build inclusive financial systems (Beck *et al.*, 2008).

A number of studies have been conducted on the macroeconomic impacts of mobile phones in developing countries. A few, such as Hardy (1980) and Waverman, Meschi, and Fuss (2005), did not focus on Africa, and none of them has yet analyzed the channel of financial inclusion. ICT and mobile phone penetration can indeed reduce the transaction costs of financial intermediaries including formal commercial banks, microfinance institutions and cooperatives, and therefore expand their businesses. ICT also facilitate the emergence of branchless banking by increasing the flexibility of businesses. In an increasing number of developing countries, branchless banking has been booming in the last few years and it has the potential to provide financial services to low-income households who are not reached by traditional bank networks, especially those living in remote and rural areas. In June 2009, the GSM Association (GSMA) claimed that almost 400 million people who currently do not have a bank account could benefit from mobile financial transactions as small as a few USD dozen cents (Prodhan, 2009).

In a first research attempt on the relationship between branchless banking models and financial inclusion in Colombia, early experiences have shown that branchless banking through agents can significantly reduce set-up and delivery costs, offering cash-in/cash-out operations only or a broader range of financial services to customers who usually feel more comfortable banking at their local merchants than at traditional bank branches. Despite much international attention and enthusiasm from many development organizations and private businesses, branchless banking does not provide a fit-for-all solution of financial inclusion (Ivatury & Pickens, 2006). Admittedly, the development of any branchless banking scheme takes quite a lot of time and preparation because it implies analyzing and taking action regarding the business case of each actor involved, the customer value proposition, and the local legal and regulatory environment. According to the employees' forum on disability (2007), access to finance services like bank accounts, is a fundamental step towards the attainment of broader indicators of social and economic inclusion.

According to Olsen (2001) financial exclusion of the poor in the UK is generally considered to mean a lack of access to banking services. It has been interpreted as being caused by the closure of bank branches and building society offices and thus ignores the possibility of informal-sector lending offering a substitute for bank services in remote areas.

The World Bank (2009) found that financial inclusion policies such as offering basic accounts, transferring government payments to individual accounts, and encouraging saving through matched and tax-advantaged savings accounts are concentrated in high-income countries and far from widespread. When implemented in developing countries, they usually work only if participating financial institutions see them as a viable business proposition.

According to Oluba, (2008), Millions of adult Nigerians do not have any kind of dealing with financial institutions even at the community banking. The Nigerian banking survey states that more than 53% of Nigerian adults lack access to finance. Only 3% of the adult population use micro finance banks. Santiago et al., (2005 cited in Oluba, 2008) noted that the access to financial services in developing countries is limited and it would be useful to provide wider access to those services as it can be helpful to reduce the volume of currency outside the banks and also enhance the development and use of financial products.

According to the Financial Sector development-FSD (2000), the increase in financial inclusion in the case of the United Kingdom has been boosted by significant developments in the financial services sector which included re-regulation of the UK financial markets; developments of information technology; and the 1990s recession. Leyshon and Thrift, (1995 cited in Amaeshi et al., 2007) stated that these factors spurred a “flight of quality” approach to servicing customers. According to Smith and Aigbe (2010), one of the key drivers of the Nigerian banking performance in 2009 was the “flight of depositors”. They stated that while some banks experienced declines in their deposit base, there was a boost in the deposit base of banks that were perceived to be stronger. Sanusi L. S (2010) also stated in his address of the public that one of the factors that brought about a down turn in the Nigerian banking sector was the lack of consumer sophistication. He said that banks failed to impose market discipline and take advantage of the consumers. Augusto O. (2005) stated that one of the problems of the Nigerian

banking sector is the failure of banks to see from the perspective of the customers. They failed to analyze the customers need for better services and diversified delivery channels. They also failed to ensure that banking customers can access services at lower costs

Ndome (2011) did a study of agent banking and its adoption in Nairobi –adoption of its services among the residents of Kawangware area in Nairobi Kenya. His study focused on a low end residential area within the city of Nairobi and it was evident that the services were very welcome by the residents with lots of transactions being done at the agent points. His focus was on adoption of the services and not financial inclusion but the high utilization of agent services was an indicator of some level of exclusion was existent and no one had paid attention to it

Wambari (2009) in his study on mobile banking in the developing countries noted that Kenya was one of a small number of pioneering countries where financial services have started to be offered by mobile network operators to people. There is considerable interest in the development of these services since it offers the prospect of providing services to people who presently do not have bank accounts. His concerns were; the extent of access to financial services, the attitudes towards mobile banking by small Businesses and the effects and challenges of implementing mobile banking. A lot of growth and positive adoption was noted and mobile banking being the backbone of agent banking it infers growth of the two.

The central bank of Kenya and Financial sector development did a study on measures to open up banking channels to non-bank agents using leading internal firms in this area (Bankable Frontier Associates). The findings, together with an outline of the draft guidelines, were presented to industry stakeholders at a workshop in early January 2010. The study (Regulation and supervision of bank channels: Policy options for Kenya) re-examined the role of branches and also looked into the policy options for future regulation of commercial banking channels. The work looked carefully at relevant evidence from around the world, examining the overall impact on access and risk of various approaches and the way in which branchless banking was to be implemented through agent banking.. The findings were that agent banking could effectively reduce the cost of transacting since the cost of setting up branches and operational costs would be significantly reduced and some costs eliminated totally (CBK 2010)

2.5 Summary of Literature Review.

From the review of literature done it is evident that a lot of studies have been done on agency mobile money transfer especially on MPESA and ZAP from Safaricom and Zain respectively, both mobile operators in Kenya but no studies have been done on the agents under the banking industry with a focus on the impact of agent banking on financial inclusion in Kenya. This is partly due to the fact that agency banking is not an old concept in the country since it only began in May 2011 when the central bank of Kenya came up with the guideline to be used by the banks. The studies that have been done across Africa and the South America are not be representative because the level of development of agency banking and the banking industry performances are totally different across these regions and we are still at the formative stages. In Kenya we have a very competitive industry that is very customer focused. This study will therefore concentrate on Kenya focusing on how agent banking has impacted on financial inclusion which is an area which has not been studied in Kenya since the concept of agent banking is still relatively new.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter focuses on research design and methodology that was applied in carrying out the study. It deals with research design, variables, and location of study, targeted population, sampling techniques and sample size, research instrument, pilot study, validity and reliability of research instruments, data collection and data analysis techniques.

3.2 Research Design

The research methodology utilized a cross sectional survey because the study was across the banking industry in Kenya and also involves descriptive and inferential statistics. Descriptive research is an innovative tool for researchers. It presents an opportunity to fuse both quantitative and qualitative data as a means to reconstruct the "what is" of a topic. Descriptive research designs help provide answers to the questions of who, what, when, where, and how associated with a particular research problem. This way the study was able to bring out agent banking as it is. The cross-sectional survey was also used because the relevant data was collected at some point in time. The vast nature of the project and the time limitation was the other reason for choosing a cross-sectional study. The cross sectional survey also easily provides a lot of information normally obtained from the large population. (Kothari, 2004).

3.3 Population

The target population of the study was all the agents carrying on agency banking in Kenya. There are currently about eleven thousand agents recruited by all banks. Since data on the agents and their performance is readily available from the Central Bank of Kenya, then the researcher will not need to get and work with a sample from the population since it was equally easy obtaining the data and working on the entire population.

3.4 Data Collection

Secondary data was used for this study since it is easily accessible, cheaper and for this case very accurate. The CBK guideline on agent banking requires that all banks offering agent banking must furnish the Central Bank(of Kenya) with data and other information on agent operations including information on; Nature, value, volume and geographical distribution of operations / transactions, Incidents of fraud, theft or robbery, Customer complaints and remedial measures taken to address customer complaints. Failure to submit this data accurately and on time (not later than the tenth day of the following month attracts administrative sanctions

3.5 Data Analysis.

The data obtained from the survey was first checked to look for missing details or characteristics. After determining financial inclusion and the variables affecting agent banking, the relationship between the two variables was determined. This involved regressing financial inclusion as the independent variable in the regression equation while the dependent variables will be the various measures of agent banking such as the number of transactions per agent in a day, number of agents per square kilometer and the volumes of money handled by the agents. The regression equation is expected to assume the following expression;

$$Y = \alpha + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \epsilon$$

Where:

y = financial inclusion

α = constant/the intercept (financial inclusion is not only influenced by agent banking. α therefore represents financial inclusion influenced by other factors not related to agent banking).

X1, X2 and X3 = the measures of agent banking - the number of agents per month from each bank, number of transactions per month from the agents of each bank, volume of money flowing through the agents per month for each bank respectively

β_1 , β_2 and β_3 = coefficients indicating the various levels of importance (weight of each factor).

The statistics were obtained from the central Bank of Kenya over a period of seven months

between January and July 2012 and the incremental average obtained per variable which was what was represented as X1, X2 and X3. Statistical tools were then used to analyze the data in order to provide for meaningful distribution of scores. For this purpose, Statistical Packages - Statistical Packages for Social Sciences (SPSS) and R-statistics were used in the analysis. The packages are able to execute such high level analysis as the analysis of variance (ANOVA), the Chi-square tests, the comparison of several means and many other calculations.

CHAPTER FOUR

DATA ANALYSIS FINDINGS AND DISCUSSION

4.1 Introduction

This chapter covers data analysis in a descriptive and inferential manner. It gives the various research findings with a note to the research findings alongside. For the inferential analysis, the study used the Pearson correlation, the panel data regression analysis and the t-test statistics. It shows the performance of agent banking per bank for their agents in terms of the number of transactions performed, volume of money flowing through the agents and the number of agents as at September 2012. Chi-square tests were also carried out to compare the banks with agent banking services and those without them in terms of their overall performance (profitability)

4.2 Descriptive statistics

Descriptive analysis helps the study to describe the relevant aspects of the phenomena under consideration and provide detailed information about each relevant variable.

Table 4.1 Evaluation of Commercial banks agency banking 2012 (Financial inclusion)

	April	May	June	July	Overall index evaluation
Kenya Commercial Bank	2.39	3.28	3.38	4.11	3.98
Equity bank	3.99	4.08	4.45	4.66	4.63
Co-operative Bank of Kenya	2.66	3.42	3.58	4.22	4.16
Family Bank	1.99	3.08	3.45	4.08	3.02
NIC Bank	1.99	2.08	2.45	3.08	3.63
Diamond Trust bank	1.99	2.08	2.45	3.08	3.64
Chase Bank	1.66	2.11	2.16	2.22	2.18
Post bank	1.553	2.22	3.22	3.922	2.637
Yearly performance	15%	20%	30%	35%	100%

Source: Research findings

The findings in Table 4.1 indicates that out of a total of 43 banks, 8 have rolled out the agency banking service with Equity bank, Co-operative bank and Kenya commercial bank showing significance performance index as shown by the overall evaluation of 4.63, 4.16 and 3.98 respectively. However other banks that have rolled up the service (Family Bank, NIC Bank, Diamond Trust bank, Chase bank and Post bank) did not show much significance performance index. The findings further showed that yearly performance improved significantly from January to April 2011 as shown by 35% (April), 30% (May), 20 % (June) and 15 % (July) respectively. This implies that agency banking is continuously improving leading to significant increased financial inclusion in those banks that have rolled up the service due to its convenience and efficiency in operation.

Table 4.2: Performance of agency banking as per number of agents, number of transactions per agent and volume of money flowing through the agents as per 2011

	Number of agents	Number of transactions per agent	Volume of money flowing through the agents	Mean	Std. Deviation
Kenya Commercial Bank	2,000	3600	7,200,000	2.667	0.4721
Equity bank	6,000	6790	40,740,000	1.9817	0.48034
Co-operative Bank of Kenya	4,000	5090	20,360,000	2.0628	0.08968
Family Bank	100	0	0	0	0
Diamond Trust bank	100	4299	429,900	3.1211	0.9043
ECO bank	1000	0	0	0	0
Post bank	1,000	1389	1,389,000	3.599	0.678
Total	53,677	21,426	209,430,845	2.505	0.4533

Source: Research findings

From the findings Equity bank registered highest (6,000) number of agents as per the year 2012, followed by Co-operative bank, Kenya commercial bank and Post bank as indicated by 4,000, 2,000 and 1,000 respectively. Further the study indicates that equity bank registered the highest number of transactions per agent, followed by co-operative bank and Kenya commercial bank as indicated by 6790, 5090 and 3600 respectively. This implies that banks have continuously performed significantly in agency banking leading to improved financial inclusion.

4.3 Data Analysis- Advance (Inferential Analyses)

Under the advance analysis, correlation analysis was first used to measure the degree of association between different variables under consideration. While the regression analysis was used to determine the impact of the agency banking on financial inclusion of rolled up commercial banks, the Chi-square test statistics was used to ascertain whether there is a significant difference in the agency banking and financial inclusion. Finally, the t-test statistics was also used to find out if a significant difference occurred in the performance of banks with agency banking and those without agency banking.

4.3.1 Pearson's Correlation Coefficient Analysis for agency banking and financial inclusion in Kenya

In this section, the study measured the degree of association between the agency banking functions and financial inclusion i.e. if the agency banking services (number of agents, number of transactions per agent and volume of money flowing through the agents) will increase financial performance of commercial banks. From the a priori stated in the previous chapter, a positive relationship is expected between the measures of agency banking and financial inclusion. Table 4.3 and 4.4 presents the correlation coefficients for all the services considered in this study.

Table 4.3: Pearson's Correlation Coefficients Matrix for the Model (Financial inclusion)

		Number of agents	Number of transactions per agent	Volume of money flowing through the agents	of Financial inclusion
Number of agents	Pearson Correlation	1	-.681(**)	-.486(**)	.539(**)
	Sig. (2-tailed)		.000	.000	.000
	N	53,677	53,677	53,677	53,677
Number of transactions per agent	Pearson Correlation		1	.609(**)	.596(**)
	Sig. (2-tailed)			.001	.000
	N	53,677	53,677	53,677	53,677
Volume of money flowing through the agents	Pearson Correlation			1	.525
	Sig. (2-tailed)				.076
	N	53,677	53,677	53,677	53,677
Financial inclusion	Pearson Correlation				1
	Sig. (2-tailed)				.076
	N	53,677	53,677	53,677	53,677

** Correlation is significant at the 0.01 level (2-tailed).

Source: Research findings

From the correlation result for model, volume of money flowing through the agents has a strong negative correlation of .625 with financial inclusion which is significant at 1% and 5%. This indicates that volume of money flowing through the agents have a positive effect on the level of financial inclusion in Kenya since it indicates increased usage volume of financial services.. Number of agents and the number of the transactions per agent also showed a significant effect on financial inclusion. The outcome from the statistics is consistent with earlier studies by Lipton and Lorsch (1992); Jensen (1993); Yermack (1996); Bennedsen et al (2006); Harris and Raviv (2005). They all argued that larger volume of transactions indicated furthering of financial inclusion.

Table 4.4: Chi-Square Test: two-sample assuming equal variances Banks rolled up agency banking service and Banks not rolled up agency banking service

	(Banks rolled up agency banking service)	(Banks not rolled up agency banking service)
Mean	0.062177643	0.023739
Variance	0.00233563	1.38085E-05
Observations	8	4
Hypothesized Mean Difference	0	
Df	7	
t Stat	2.958540189	
P(T<=t) one-tail	0.00554419	
t Critical one-tail	1.770933383	
P(T<=t) two-tail	0.01108838	
t Critical two-tail	2.160368652	
Mean	0.062177643	0.023739

Source: Research findings

From the Chi-square results, the efficiently rolled up agency banking banks recorded a mean of 0.0621 in terms of the overall performance.(profitability) while the non-efficient banks recorded a mean of 0.0237. However, the variance for the efficient banks and the no-efficient banks are 0.0023 and 1.3808 respectively.

Furthermore, at two- tailed, the t- calculated of 2.9585 is seen to be greater than the t-tabulated of 2.1603.

4.4 Interpretation of findings

The findings indicates that out of a total of 43 banks, 8 have rolled out the agency banking service with Equity bank, Co-operative bank and Kenya commercial bank showing significance performance index. However other banks that have rolled up the service (Family Bank, NIC Bank, Diamond Trust bank, Chase bank and Post bank) did not show much significance performance index. The findings further showed that the monthly performance improved significantly from January to July 2012. This implies that agency banking is continuously improving leading to increased financial inclusion facilitated by those banks that have rolled up the service due to its convenience and efficiency in operation.

From the findings Equity bank registered the highest number of agents as per the year 2011, followed by Co-operative bank, Kenya commercial bank and family bank. Further the study indicates that equity bank registered the highest number of transactions per agent, followed by co-operative bank and Kenya commercial bank respectively. This implies that banks that have continuously increased coverage in all viable areas with agents have increased the levels of financial inclusion.

From the correlation result for model, volume of money flowing through the agents has a strong negative correlation of with financial inclusion. This implies that volume of money flowing through the agents have a positive effect on the level of financial inclusion in Kenya. Number of agents and the number of the transactions per agent also showed significant contribution to financial inclusion. The outcome from the statistics is consistent with earlier studies by Lipton and Lorsch (1992); Jensen (1993); Yermack (1996); Bennedsen et al (2006); Harris and Raviv (2005). They all argued that larger volume of transactions indicated enhanced financial inclusion.

From the t-test result, the efficient rolled up agency banking banks recorded a higher mean while the non-efficient banks recorded a slightly lower mean. However, the variance for the efficient banks and the no-efficient banks also varied significantly. The performance of those banks with well-established agent networks changed significantly showing growth as the previously unreached people starting using the bank services through the agents thus enhancing the institutions profitability due to the wider reach.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the study and makes conclusion based on the results. The implications from the findings and areas for further research are also presented. This section presents the findings from the study in comparison to what other scholars have said as noted under literature review.

5.2 Summary

The study aimed to establish the status of agency banking in the country and the contribution of agent banking to financial inclusion. It was found that agent banking and financial inclusion have a strong positive relationship and that an enhanced and stronger agent network has the effect of enabling more people and particularly the marginalized access financial services. The banks with strong agent networks had better performance overall in terms of the percentage increase of their profitability as compared to those banks which were not carrying out agent banking or those with very limited agent networks such as Family Bank.

5.3 Conclusion

From the findings above, it can be concluded that majority of the banks in the country have not embraced agency banking with only few 11 out of the 43 licensed and only 8 out of the licensed rolled up with the agency banking service. It can further be concluded from the findings that Equity bank is the most performing commercial bank as far as agency banking is concerned followed by co-operative bank and Kenya commercial bank. It can be further seen that agency banking has the effect of increasing financial inclusion. This can be enhanced by increasing the number of agents within the country and supporting the existing agents to ensure they do more transactions and have the capacity to handle even high volume transactions without turning customers away. The study also concluded and confirmed that it is not only the banks which benefit in terms of better profit; the agents, bank customers and government benefit as indicated elsewhere in the earlier chapters of the document. Agent banking actually increases financial inclusion levels in the country significantly

5.4 Recommendations for Policy

The study recommends that agency banking as a means of enhancing financial inclusion be highly supported and encouraged by all players – the banks and the government through the regulator (CBK) and other bodies / ministries that interact with agencies such as the ministry of local government. These bodies should work towards ensuring minimum set up costs, especially the licensing of businesses by the local authorities who charge agents exorbitantly to allow as well as easing the documents required before approval by the central Bank, some of which make the application process very lengthy particularly for the businesses which are joint ventures.

The government should support the program more often and reduce the high compliance costs, bureaucracy in registration and high cost of taxation. Other areas that the study recommends include the government dealing with the cumbersome laws and regulations, corruption and illegal permits and licenses. The study recommends that regulations be efficient to enable more banks to embrace agency banking service. The study further recommends that all commercial banks should embrace agency banking through adoption of improved technology for information security to make it more reliable to the customers. This will increase customer confidence in the agents and hence volume of transactions which will lead to higher levels financial inclusion.

Limitations of the Study

Agent banking is a relatively new concept in the Kenyan banking industry literature on local studies is therefore limited.

There was a restriction in obtaining the data until the researcher proved it was for academic purposes only.

The study looked at the country in general but the agents and customers in different localities have different problems.- the reason for exclusion varies with the place

5.5 Areas for Further research

There is need for further research to be undertaken which may include studies on;

The factors affecting the Relationship between the agent banks and the banks;

The role of the government in supporting the adoption of agency banking in the country;

The impact of agency banking to the banking sector among other related studies.

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APPENDIX 1: LIST OF LOCAL COMMERCIAL BANKS

There are no sources in the current document. This is a list of notable commercial banks in Kenya [1]

Licensed commercial banks

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank
6. Brighton Kalekye Bank
7. CFC Stanbic Bank
8. Chase Bank (Kenya)
9. Citibank
10. Commercial Bank of Africa
11. Consolidated Bank of Kenya
12. Cooperative Bank of Kenya
13. Credit Bank
14. Development Bank of Kenya
15. Diamond Trust Bank
16. Dubai Bank Kenya
17. Ecobank
18. Equatorial Commercial Bank
19. Equity Bank
20. Family Bank
21. Fidelity Commercial Bank Limited
22. Fina Bank
23. First Community Bank
24. Giro Commercial Bank
25. Guardian Bank
26. Gulf African Bank
27. Habib Bank
28. Habib Bank AG Zurich
29. I&M Bank
30. Imperial Bank Kenya
31. Jamii Bora Bank
32. Kenya Commercial Bank
33. K-Rep Bank
34. Middle East Bank Kenya
35. National Bank of Kenya
36. NIC Bank
37. Oriental Commercial Bank
38. Paramount Universal Bank
39. Prime Bank (Kenya)
40. Standard Chartered Kenya
41. Trans National Bank Kenya
42. United Bank for Africa[2]
43. Victoria Commercial Bank

APPENDIX II: BANKS WITH AGENT BANKING SERVICES

1. Equity Bank Limited
2. Cooperative Bank
3. Family Bank
4. Kenya Commercial Bank
5. Diamond Trust Bank
6. Chase Bank Limited
7. Post Bank
8. NIC Bank