EFFECTS OF AGENCY BANKING ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

I, the undersigned, declare that this research project is my original work and has not been submitted for the award of a degree in any other university or academic institution.

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

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May God bless you.

DEDICATION

I dedicate my work to my loving husband Mr Sammy Orwenyo for his encouragement and sacrifices he made to enable me complete this project. His care and concern has led me to achieve my dream. I also dedicate this work to my son Mosi Munashe Orwenyo for being understanding and patient as i pursue my education.

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LIST OF ABBREVIATIONS.

ANM	Agent Network Management
CBK	Central Bank of Kenya
Co-op Bank	Cooperative Bank of Kenya limited
I&M Bank	Investment and mortgage Bank
IRA	Insurance Regulatory Authority
KCB	Kenya Commercial Bank
KYC	Know Your Customer
MFI’s	Micro Finance Institutions
SME	Small and Medium Enterprises
SWOT	Strength Weaknesses Opportunities Threats
WIBA	Worker Injury Benefits Act
ROA	Return on Assets
ROI	Return on Investments

ABSTRACT

The banking industry is very volatile with innovation and competition taking centre stage. This forces banks to change their strategies to suit the industry and improve their financial performance. In the recent past the banking industry in Kenya has embraced diversification of products and services with the current move being agency banking services that supports branchless banking in commercial banks. The study sought to determine the effects of agency banking on the financial performance of commercial banks.

The study variables tested included cash withdrawal; cash deposits and cash transfer through agents with total capital as a control variable. A descriptive research design was adapted that utilised only secondary data from the commercial banks audited financial statements and CBK reports ranging from 2012 to 2015. Data was analysed using SPSS and the results presented in tables. The findings from the analysis indicates that agency banking on its own has minimal effect on the financial performance of commercial banks in fact the correlation depicts an inverse relationship, however when aggregated with other variables that affect commercial banks performance a strong positive correlation is evident.

CHAPTER ONE: INTRODUCTION

1.1 Background of The Study

According to Porter's industry analysis (1980) identifies five competitive forces, they include rivalry among firms, bargaining power of suppliers, threat of new entrants, threat of substitutes, and bargaining power of customer. These elements affect the environment in which banks operates and therefore brings about competitive pressures and profit reduction in the banks.

Cherotich, (2014) noted that financial innovations in Kenya's banking sector has a positive impact on the banks financial performance. It has a significant effect on the bank's profitability and in turn enables the organization to gain competitive advantage. One of the financial innovations is diversification of products and services by banks through agency banking and bancassurance and is purely aimed at improving bank's financial performance.

Most banks have therefore implemented various strategies to cope with the adverse effects of the industrial competition and improve profitability and growth. I&M bank like most banks has sort to implement product and service diversification to remain relevant and increase profitability. The bank introduced agency banking products and bancassurance services with an aim of improving the bank's financial performance, spread its risk and increase shareholders Value.

1.1.1 Agency Banking

Agency Banking is a model whereby retail outlets such as shops act as agents for banks in areas where banks and other financial institutions do not have sufficient incentive or capacity to establish formal branches. In May 2010 CBK rolled out agency banking model that allows commercial banks to engage third parties to offer specified banking services on their behalf. Full implementation of agency banking by commercial banks took place in 2011.

The agency banking model allows customers to walk to retail shops with either their phones or either debit card or prepaid to access banking services and in return the agent earns commission for each transaction. The agents mobilise cash deposits and withdrawal, they assist in funds transfer, facilitate bills payments, airtime purchase, bancassurance and salary payments. The bank customers can also make enquiry of their accounts status through agents. Agents may also collect account opening forms and distribute loan application forms on behalf of the bank.

The CBK report of 2014 clearly states that “The legislative reforms of 2010 and 2013, allowed both commercial banks and microfinance banks to contact approved third party retail outlets to offer banking services through their marketing agents and self-managed agencies. The Banking act also allow for sub-contracting of agents and the use of Agent Network Managers.” Over the years agency banking for commercial banks has really gained penetration in the banking sector. It is noted that by 2014 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents marking an improvement from 13 commercial banks and no microfinance in the year 2013 giving a 52.4% increase in the same. In 2015 9 more commercial banks contracted for agency banking. Equity Bank leading with 13,767 agents, Kenya Commercial Bank with 9,687 and Cooperative Bank with 8,765 being the banks with highest number of agents in the year 2014.

There has been reduction in physical bank branches expansion that is partly attributed to the adoption of alternative delivery channels such as mobile banking, internet banking and agency banking. It further states that in 2015 banks continued to leverage on technology to enhance efficiency and provide convenience to their customers (CBK, 2015).

1.1.2 Agency Banking and The Bank’s Financial Performance.

Mintzberg (1994) defines strategy as “ a plan of how or means of getting from here to there, it could be a pattern in actions over time or even a position that reflects decisions to offer particular products or services in a particular market and finally as a perspective that is in terms of vision and direction”. It is basically a plan that allows a firm to attain its mission. Similarly Johnson et al. (2008) defines strategy as the direction and scope of an organization over long term, which achieves advantage in a changing environment through its configuration of resources and competences.

Strategies are formulated at the corporate level and are made by the top managers. Banks like any other firms have strategies that set their direction and scope. It is purely through strategies that they will be able to survive in the ever volatile banking industry.

Agency banking is aimed at achieving growth by mobilisation of deposits through collecting low cost deposits, increase customer base through new customer acquisition drives, increase in financial transaction volumes through cash withdrawals and cash deposits facilitated through agency banking. CBK (2015) stated that due to the banks robust ICT platforms the banks have been able to implement agency banking services that allow their customers to carry out banking services that entails cash withdrawals and deposits from a third party acting in the capacity of the bank. With transactions being posted into customers' accounts on a real time basis. Banks continued to leverage on technology to improve efficiency and provide convenience to their customers this enhance stability and growth of the banking sector.

Wawira (2013) noted that the use of bank agents to reach customers had a positive implication on the financial performance of commercial banks in Kenya. Most banks confirmed that agency banking enabled the banks to reach out to many potential clients without investing so much in opening branches hence it's being rated as a cost effective measure. Agency banking contributes to deposit mobilisation this is because of its low transaction cost that has a positive impact on the financial performance of commercial banks in Kenya with many of the banks recording high amount of deposits and thus creating enough pool of funds against which lending can be instituted. The increased market share gained through agency banking had a positive effect on the financial performance of commercial banks this is because the increased market share allowed banks to enjoy economies of scale in their operations which in turn improved profitability.

1.1.3 Commercial Banks in Kenya

A commercial bank may be defined as a financial institution that is authorized by law to receive money from individuals and businesses and in turn lend out money to them. They are profit-oriented financial institution that are open to the public and serve businesses, individuals and institutions. The banks serve the functions of mobilizing funds through their various accounts, provide lending services to customers, funds transfer services, custodial services, Forex services, advice on investments and facilitate international trade.

In Kenya Commercial banks are licensed and regulated by CBK. There are 44 licensed commercial banks in Kenya, the banks are made up of both locally and foreign owned banks. The banks are grouped into three tiers based on the impact of the banks failure on the economic system. Tier one banks are deemed to be the safest with reduced probability of failure and is made up of 6 banks controlling a market share of 49.9%, Tier two banks are made up of 16 banks with a controlling market share of 41.7%. Finally the lowest is the Tier three banks with 21 small banks with market share of 8.4% (CBK, 2015).

The commercial banks have wide branch network within Kenya and some even regionally. The banks adapt to the ever changing environmental conditions and embrace modern technologies to remain relevant and meet their customers demand. The banking industry has witnessed a range of product innovation with the current wave being branchless banking through agency banking.

1.2 The Research Problem

In the banking industry today the business environment is volatile and very dynamic. Banks are therefore forced to analyse these environmental changes and realign their business strategies. There is need to link strategy to business environment. Emphasis on operational efficiency, cost reduction, regulatory impact and revenue replacement as the basic aspects driving change in the banking sector. To remain relevant and competitive in the banking sector banks need to be IT architectures and revamp their operations to serve purpose. Banks also need to repackage their products and services through financial innovation and improve their marketing strategies (KPMG, 2012).

CBK (2011) notes that there was an increase in access to financial services that is a key indicator of financial sector performance. This being linked to the effective and efficient innovations realised in the banking sector, with main emphasis on the mobile money revolution and the adoption of the agency banking branchless banking model.

CBK (2014) noted that indeed consumer needs are ever changing leading to innovation of financial products, technological advances and the use of multiple delivery channels. This helps to ensure that banks remain competitive, expand their product base, increase delivery channels, and improve their marketing systems and techniques therefore boosting their service quality levels and financial performance.

Njuguna (2013) concluded that adoption of financial innovations has improved commercial banks in terms of enhanced operations, growth and even earnings. The banks have registered growth in market share and deposits that has reciprocated to liquidity and enhanced competitive advantage. CBK (2015) confirms that banks continued to roll out new banking products to remain competitive and diversify their revenue source through bancassurance. The agency banking data for banks revealed that there was a 47% increase in cash deposits, 42 % increase in cash withdrawal, 128% increase in bills payment and 28.48% increase in funds transfer through agency banking between the year 2013 and 2014.

Research has been done in this area to explore the effects of agency banking model on commercial bank's performance. Wawira (2013) did a study on the contributions of agency banking on financial performance of commercial banks in kenya, Ondieki (2015) and Kambua (2015) all did a studies on the effect of agency banking on financial performance of commercial banks in Kenya with their period of consideration being 2012 to 2014.

Commercial banks heavily rely on interest income, commission and fees income from other sources such as agency banking takes up a very small proportion of the banks overall income. In the recent past, however the no of commercial banks seeking to implement agency banking in Kenya seems to increase. Currently no research has been done right from the implementation period (2011) to date. The study therefore seeks to establish the effect of agency banking on the financial performance of commercial banks since. It will cover the periods ranging from its implementation in 2011 up to December 2015.

1.3The Research Objective

The research objective was to establish the effects of agency banking on the financial performance of commercial banks in Kenya.

1.4 Justification of the Study

The study will be useful to scholars. It will give an insight of the contribution of agency banking to the banking industry in general. The findings of the study will contribute to the existing knowledge and used as a basis for further research in this area. The theories that will be applied in this study can be used in a similar study in future. Also this study will highlight areas of potential future research.

The research will provides beneficial information that may be used to carry out SWOT analysis of the commercial banks engaging in agency banking. The SWOT analysis may highlight some areas that need tightening of policies or even implementation of new policies in regards to agency banking.

The banking industry will also benefit since it will have ready information on the actual contribution of agency banking to the economy and the banking industry. The regulatory body CBK will gain since the information from this report can be used to assess the viability of agency banking and bancassurance whether it serves purpose. The information from this study can be used by CBK to formulate or amend its agency banking policies.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter analysed theories related to the research topic. It concentrated on agency theory concept that forms the basis of agency banking business relations, the Nonbank-led theory of banking and the financial intermediation theory. A number of research studies have similarly been done in relation to the agency banking concept of banking and its impact on the bank. This chapter reviewed both these theories and empirical studies.

2.2 Theoretical Literature Review

2.2.1 Agency Theory

Jensen and Meckling (1976) defines agency relationship that it is a contract in which the principal engages some other person called an agent to perform specified services on their behalf. They further noted that the agent has some decision making authority delegated to him by the principal.

The concept of agency generally refers to the relationship that exists between two parties, where one called the principal and the other an agent is contracted to represent the principal in transactions with third party. This relationship forms a business structure where the principal hires the agent to perform a service on the principals' behalf. Here decision making authority is delegated to the agent by the Principal and there ought to be goal congruence in the agency relationship.

CBK (2011) notes that in May 2010 CBK introduced the agency banking model that allows third parties to offer specific banking services to the customers on behalf commercial banks. Agency as defined by the Banking Act in relation to a bank, is “the right given to a person by the bank to receive on its behalf from its customers any applications for loans or advances, money due to it, deposits, or, facilitate payments to such clients on its behalf” (Hawkins, 2011).

Agency banking in the banking context depicts an agency relationship, where the agent will provide banking services to banks customers. The bank being the principal and the agency banking agents being the agents providing banking services to the bank’s customers who are the third parties. In this relationship bank agents offer banking services where the customers can transact without having to go to the physical bank.

2.2.2 Nonbank-led Theory

In non-bank-led theory clients do not deal directly with the bank branches. The bank's customer's deal with a firm other than a bank that may either be a prepaid card issuer or a mobile network operator. The agents act as the contact point with the client. Banking through retail agents is a new business strategy that is being embraced by both the regulating bodies and the policy makers. The concept is aimed at extending financial services to rural unbanked communities. Agent banking relies on the information and communication technologies that converges the commercial banks, customers and bank agents to be able to share record and communicate transaction on real time, reliably and cost effectively over vast distances. Agency banking therefore serves the purposes of reducing cost of financial services delivery thereby enhancing profitability, easing congestion in banking halls and increase financial inclusion even in remote areas (Kumar et al .2006)

The nonbank led model poses a risk to the bank related to money laundering related frauds hence KYC plays critical role in this model, furthermore most countries including Kenya have regulatory framework governing the agent and their operation. CBK has clear regulations on agency banking and bancassurance. The model in key in this study as it brings out the agent relationship between banks and their clients through agency banking transactions. It also highlights the potential financial benefits the banks aim at achieving.

2.2.3 Financial Intermediation Theory

A financial intermediary is basically an entity that acts as the middleman between two parties in any financial transaction. It may be a bank, mutual funds, insurance firms or pension funds. Financial intermediaries provide a number of benefits including financial safety, liquidity, and benefits of economies of scale. The Theory of Financial Intermediation is based on three approaches, this includes; the theory of monetary regulation, the theory of information asymmetry and transactional cost theory.

Informational asymmetry theory was founded in the 1960's by Gurley and Shaw affirms that intermediaries arise as a result of informational asymmetry in the imperfect market. The information asymmetry in the imperfect market led transactional costs that are high there by causing the need to reduce the impacts of imperfection. Intermediaries are therefore set up to bring down some specific transactional costs bringing together resources of individual customers thereby causing the bank to enjoy economies scale. Benston and Smith Junior (1976), developed the theory of transaction cost, it mainly focused on the effect of transactional technologies as a result of financial intermediation. The intermediaries by virtue of their function are able to processing huge volumes of data at high efficiencies, they therefore exploit economies of scale at the level of transactional technologies. (Alexandru *et al.,* 2009).

Guttentag and Lindsay in 1968 developed the approach to financial intermediation based on the theory of monetary regulation, as stated by Arthur and Iris (2003). The emphasis here is that financial intermediation has its basis on the regulation of production of money, saving and financing with in the economy. The regulations affect the liquidity and solvency of intermediaries involved. Currently with the changes in the banking industry banks find it increasingly difficult to keep up with maintaining their profit margins as a result of increased competition and other legislations in the banking sector. The banks have in turn changed their operational strategies and created business alliances with other entities like the insurance industry to be able to sustain profitability, enhance liquidity and keep up with the competition.
Agency banking in this context is aimed at reducing certain transactional cost such as the cost of setting up new branches and timely delivery of financial services. The agency banking model is conducted in properly drafted procedure guideline to be used by the commercial banks and is closely monitored and regulated by CBK. In May 2010 CBK rolled out the Guideline on Agent Banking and further developed inspection procedures for agents contracted by banks. The appointed agent's activities are monitored by CBK through periodic returns submitted by banks (CBK, 2011).

2.3 Determinants of Commercial Banks Financial Performance

Financial performance is the measure of an organization all round financial health over a specified period of time. It is primarily a subjective measure of how well an organization can use its total assets to generate revenue. The determinants of commercial banks performance are broadly categorised into external and internal determinants of banks performance.

Nassreddine, Fatma and Anis (2013) in their study identified and analysed the determinants of financial performance. They looked at the two broad categories and noted that the internal determinants include capitalization, liquidity, credit quality, efficiency, control, degree of diversification, amount of bank deposit, governance, and market share. On the other hand the external determinants of financial performance of banks identified include the economic environment, inflation and interest rates.

2.3.1 Market Share

A market share is defines as percentage of an industry's total sales earned by a particular firm over a period of time. It is basically a firm's portion of total sales in relation to the industry or market in which it operates. To Investors the market share plays an important role since an increase or a decrease may indicate strength of the firm's products or services.

Its implication is that as market for a product or service increases, the firm is also growing its revenues. It is worth noting that is increasing its market share will lead to increase in revenue. The increase in market share allows a company to attain high scales of operations and improve profitability. Generally firms are aiming at increasing their market share, they may achieve this through marketing strategies such as prices reduction, product-services diversification and innovation or using advertising.

2.3.2 Commercial Bank's Liquidity

Commercial bank's liquidity depicts their ability meet obligations as and when they fall due and also to fund its assets. Liquidity is one of the strongest financial stability indicators, this is because a drop in liquidity in one bank may cause systemic crisis in the banking sector due to their interconnected operations CBK (2015). The banks liquidity is measured using liquidity ratio. The liquidity ratio is a computation that is used to measure a firm's ability to pay its short-term debts. The liquidity ratios can be categorized into three. The current, the acid ratio, and the cash ratio. These three ratios are often grouped together by financial analysts when attempting to accurately measure the liquidity of a company.

2.3.3 Capitalization

Capitalization is the sum of a company’s retained earnings, stock, and long-term debt. Capitalization is an assessment of a firm's capital structure it gives the firm’s book value of capital. One of the financing duties of the finance mangers is to determine the proportion of debt to equity the firm should hold. Proper decisions ought to be made when determining the capital structure since it directly affects the financial performance of any firm.

Ronoh and Ntoiti (2015) concluded that indeed the capital structure of commercial is significant and may affect their financial performance adversely. They further noted that the listed commercial banks capital structure should not be raised beyond their optimal level and that the banks should ensure they only maintain the statutory required capital as required by CBK.

2.3.4 Degree of Diversification

Diversification is basically the process by which a firm expands its business opportunities through additional market potential of an existing product. It can be achieved through market penetration or pricing strategies. CBK (2011) noted that because of diversification and financial innovation banks are able to implement agency banking model to increase provision of their banking services. The model enables them use third party outlets such as retail shops, pharmacies or supermarkets to deliver specific financial services. The commercial banks in turn reduce some of their transaction costs and positively impact on their financial performance.

2.4 Empirical Literature Review

Machiuka, (2010) in her study set out to establish the forms of business growth strategies applied by commercial banks in Kenya. She noted that commercial banks in Kenya have employed business growth strategies. Their strategy includes product development as the main strategy, market development and diversification strategies. Innovation taking centre stage in the highly competitive banking industry Machiuka concluded that most banks diversified into agency banking and bancassurance product and service plus they increased their mortgage sales and stock brokerage in order to boost growth.

Hawkins (2011) carried out study on the role of agency banking in improving financial inclusion in South Africa. She carried out an analysis to determine whether banking agents are capable of selling financial services, originate accounts, mobilise cash deposits and facilitate withdrawal of the same. Primary data collection was used through interviewing of bankers, policy makers and regulators.

In the agency banking model there is mutual dependence between a mobile network, agency network, and the banks business strategies. In her study she notes that banks in their quest to serve low-income customers have implemented agency banking. She confirms that agency banking contributed to account opening, funds mobilisation both withdrawal and deposits. Furthermore she noted possible barriers to agency banking in South Africa these includes; unclear regulation on agency banking, dominance of major retail and banking groups. Lack of sensitization of agents, cost of agency, cash handling cost attributed to agency banking, difficulties in selecting agents.

She concludes that addressing these barriers is necessary to improve financial services inclusion in South Africa. There is need to improve the agency banking regulation by putting in place regular monitoring and measurement structures. In South Africa there is the need to enhance the mobile financial services. However elimination of these barriers on its own is not enough to fully improve financial inclusion (Hawkins, 2011).

Sanford (2013) carried out a survey in Brazil to establish whether agents improve financial inclusion. He noted that technological innovation such as ATMs, Smart cards and mobile phones that make branchless banking possible, highly expand financial access while at the same time enhances cost reduction. He sought out to establish the benefits of agent banking in bringing financial services to the underserved populations of the Brazilians, he confirmed that there has been growth in the number of banking correspondents in the country since the introduction of agency banking while the number of the bank branches remained unchanged. This is greatly attributed to the penetration of banking services to the remote areas through agency banking. Deposits and withdrawals were also noted to have grown. Furthermore, Sanford (2013) concluded that agents generate significant efficiency by bringing bills payment and financial services closer to the people in developing countries. This has increased bank transactions and profitability.

Mwando (2013) in his study on contribution of agency banking on financial performance of commercial banks in Kenya concluded that agency banking resulted to low cost of transaction that had a positive effect on financial results of the commercial banks in Kenya. He further noted that agency banking improved accessibility of banking services by customers, the numerous agents spread in all regions of the banks network through banking agents boosted this accessibility. The commercial banks in turn realised a positive impact on their financial performance. The use of banking agents enabled the banks retain and even increase their market share, this increased market share enabled the banks enjoy economies of scale and have improved profitability thus enhanced growth.

Barasa and Mwirigi (2013) carried a study on agency banking role in enhancing financial sector deepening in emerging markets, with their main focus on Kenya, they sought to establish benefits of agency banking and analyse the contribution of agency banking in enhancing access to banking services by the unbanked. Their study was a qualitative exploratory study with a targeted population of the coastal city of Mombasa, Kenya. They used 40 registered outlets that covered a sample of 400 people. Primary data collection was used aided by structured questionnaires thereon descriptive statistics was used to analyse and present study findings.

In their study they noted that benefits of agency banking both to the customers and the banks. The banks are said to benefit from increased sales, reduced expansion costs, lower cost of service and improved efficiency. The banks customers benefited from decentralization that brings the bank closer to them, one stop shop effect of agents, access to longer banking hours through agents, lower service costs, decongestion in the banking halls. The two also noted challenges brought about by the use of agents; issues of confidentiality, security, customer service, increase in levels of fraud and even systems issues such as network failure.

Their study concluded that agency banking plays a vital role in financial service inclusion to reach the unbanked. It provides almost all banking products at the reach of customers and that the agents serve an important role in electronic money banking. The agency banking model improves individual banks competitive advantage, increase customer base and the level of service absorption per customer. However they noted that there is need to establish training centres to facilitate comprehensive training of the agents (Barasa and Mwirigi, 2013).

Product diversification may range from a firm exploring new markets, new technology and innovation. In the banking industry product diversification has contributed to an influx in development and growth during the past few years. It is worth noting that this has become a major catalyst for economic and social development in many countries. Otieno and Moronge (2014) carried out a study on the influence of product diversification on the financial performance of selected commercial banks in Kenya. They were guided by main aim to ascertain the impact of product diversification on the financial performance of selected commercial banks in Kenya. Their study was within the scope of new markets, technology, innovativeness, information flow and performance of the respective banks in Kenya.

They adopted a descriptive research design and used SPSS to analyse the data collected. They found that indeed technology, information flow, new markets and innovativeness had positive impact on financial performance of banks. The correlation matrices derived from the study confirmed the existence of positive correlation between financial performances with; technology, innovation, new markets and information flow. They confirmed that the use of financial innovation like agency banking that also embraces modern technology influences banks performance (Otieno and Moronge, 2014).

Ferdous, Mosharrafa and Farzana (2015) in their study of agent banking in Bangladesh with the theme of a new era in financial institution by enhancing customers' accessibility and profitability of banks. The three aimed at determining the effect of agent banking on enhancing customer's accessibility and profitability of Bangladeshi commercial banks. They appreciated that agent banking had become an important operation of banks in bringing their services closer to the people at the base. They assessed factors that contributed to or hindered the utilization of agency banking in Bangladesh.

In the study they noted that factors that facilitated agent banking included customer service, convenience and establishment of SME business in the rural areas. Some of the prohibiting factors included lack of activity of mobile financial services and prohibited to do some services by the agents. From the analysis of their study it was conclude that agent banking facilitated cost reduction in the banks, this is because in an underutilized branch there exists a significantly higher cost per transaction, however since the agent banking systems; receive a commission when transactions are realized this causes costs reduction in banks.

Ferdous, Mosharrafa and Farzana (2015) further concluded that by bringing the banking channel closer to the customers through agent transaction platforms, closing down on the proximity increased the customer's willingness to transact in several bank services. They affirmed that agent banking systems are cost effective for transactional accounts that have low balances but with frequent transactions. Agent banking enhanced customers' accessibility and profitability of banks in Bangladesh.

Muasya and Kerongo (2015) carried a survey on commercial banks in kilindindi, Mombasa to determine the effects of agency banking on access to financial services. Their main objective was to analyses the role of agency banking in enhancing access to financial services. They sort out to establish whether agency banking in the rural parts of Kenya has positively contributed to access to financial services by the rural populations. They used a descriptive survey research design in their study with a sample population of 35 agency banking outlets in Kilindini, Mombasa. The variables tested included costs associated with agency banking, bills payments through agency banking and financial services awareness. Correlation and regression analysis were used to analyse the data.

They found that through agency banking banks have decreased their transactional costs associated with setting up new branches and the distance covered to access the branches. On this note they confirmed a positive correlation between cost and accessibility to financial services in that if cost reduce accessibility increases. In their study they also confirmed that a positive relationship exist between access to financial services and bills payments. Through agency banking customers are able to pay their bills without having to queue in the bank branches. Agency banking has enhanced cashless transactions and promoted financial inclusion. In this study it is affirmed that agency banking promoted financial services awareness and generally access to financial services (Muasya and Kerongo, 2015).

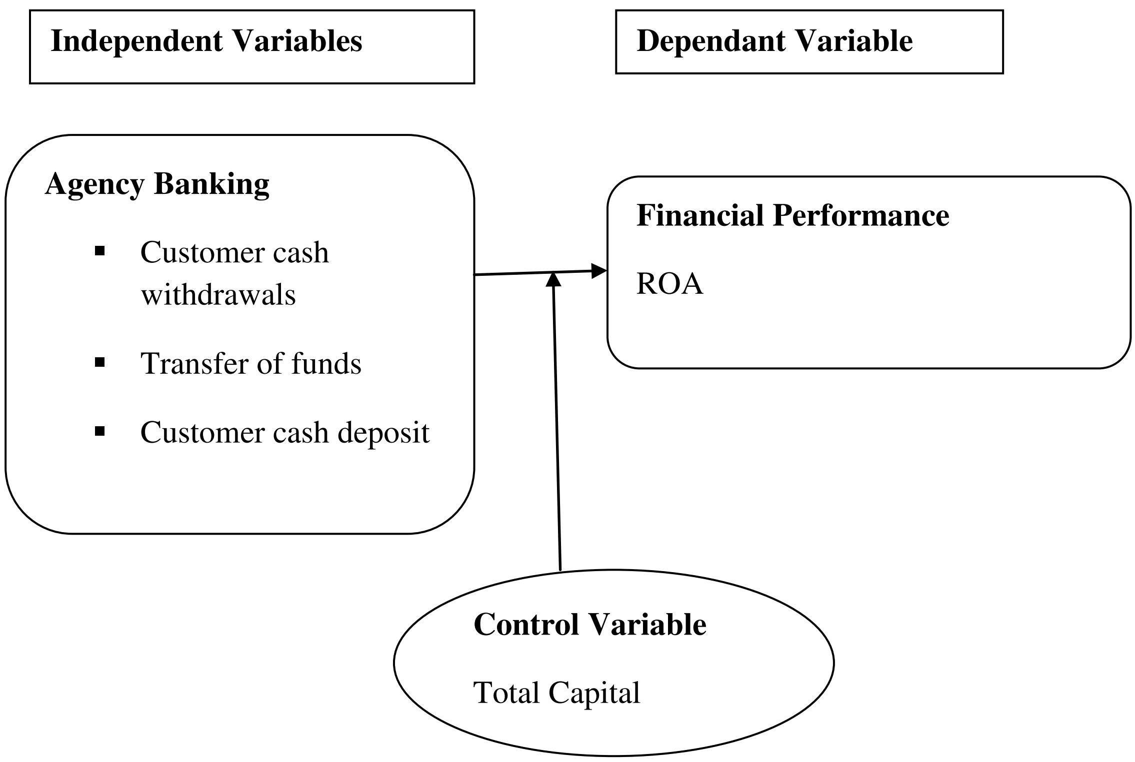
King'ang'ai, Kigabo, Kihonge and Kibachia (2016) carried out a study on agency banking effects on commercial banks financial performance, with the case study focusing on four commercial banks in Rwanda. In this study the variables analysed included accessibility of agent, availability of agents, customer identification, customer verification, increase customer base, market penetration, customer deposits, low cost of withdrawal, transaction and transaction commission.

They made use of descriptive research design with a population sample of four commercial banks in Rwanda that had implemented agency banking as at December 2015.These banks includes KCB, Bank of Kigali, Equity Bank and Cogenbanque. The use of the four banks enabled them use census to collect data since the population was minimal. Both primary and secondary data were used to collect data and analysis done using SPSS.

From their study they noted that low transaction cost due to agency banking had a positive effect on the financial performance of Rwanda's commercial banks. They further confirmed that agency banking improved accessibility of financial services by customers and bringing forth improved financial performance to the banks. Similarly agency banking enabled the banks increase their market share and consequently impacting positively to the banks financial performance through benefits of economies of scale.

King'ang'ai, Kigabo, Kihonge and Kibachia (2016) study concluded that Central Bank regulation of agency banking promoted efficiency and confidence of in the banking sector leading to improved public trust in the financial system. Agency banking improved financial inclusion by making financial services accessible to the rural unbanked population. The low cost transaction as a result of agency banking led to high deposit mobilisation and improved liquidity of the commercial banks and the general financial performance of the banks.

2.5 Conceptual Framework



2.6 Summary of Literature Review

This chapter has highlighted research study findings from both the theoretical studies and empirical studies in relation to our research topic. It is worth noting that they all put much emphasis on the benefits of banks financial performance derived from engaging in agency banking. Different studies have been done to confirm that indeed agency banking has implications on commercial banks financial performance.

Agency banking result from new business structure of agency relations, thus the study has clearly brought this out through discussion of agency relations and theory. The agency banking concept enables the bank to bring banking closer to their clients without having them at physical bank branches as put forth through Nonbank-led theory. Financial intermediation theory brings about the origin of agency banking and the purpose it is aimed to serve and also the fact that agency banking is guided by proper structures put in place by CBK.

Empirical literature review in this chapter range from both local to international research studies. All these studies confirm that agency banking has implications on the financial performance of the banks. However the studies do not address the issue of the effect of banks classification, their market share difference, and the differing clientele on the impact of banking through retail agent on financial performance of commercial banks.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

Kothari (2004) defines research methodology as a way to systematic solve the research study problem. It brings out the various steps a researcher will adopt in studying his research problem and the logic steps behind it.

The chapter explains the research methodology that was used for the study. It describes the research design used, the population and sample design, data collection and analysis respectively.

3.2 Research Design

Kothari (2004) defines a research design as a blue print that gives an advance plan of what data collection and analysis techniques to be used in the research project. The design ought to minimise bias and maximise reliability of data collected and analysed.

Polit and Hungler (1999) define a descriptive research as a research design that involves the data collection that gives a description of situations, individuals or groups. This type of research design is aimed at observing, describing and finally documenting the various aspects of a situation as it naturally occurs.

The research project was a census that adapted a descriptive research design that consisted of numerical techniques of summarizing data. It has a dependant variable that is financial performance of commercial banks that was measured by ROA and an independent variable which is agency banking measured by customer cash deposits, withdrawals and funds transfer specifically transacted through agency banking.

3.3 Population

Population is basically the entire set of relevant units or data to be analysed. It is the summation of all cases that agree to some defined set of specification. The population consists of audited financial reports of the 17 commercial banks engaging in agency banking. Census of all their financial statements and CBK reports was done since the population 17 commercial banks and 5 (2011-2015) years financial reports is small enough to accommodate a census, hence no sampling will was done.

3.4 Data Collection

Secondary data collection was used for this study and was done mainly through examination of records. The various audited financial statements of the commercial banks that have adapted agency banking as at December 2015 and the CBK Bank supervisory annual reports were examined. Data on banks net profits and total assets over the years was used to compute the bank's ROA this was obtained from the banks audited profit and loss account and balance sheet.

Data on value of customer cash deposits and withdrawals through agents over the five years was obtained from the CBK supervisory reports. Data on number of transaction in regards to transfer of funds and the individual commercial bank value of total capital was obtained from the CBK supervisory reports.

3.5 Reliability Test

The study will used secondary data from credible sources that includes audited financial statements of commercial banks that have agency banking product and CBK bank supervisory reports. Data from these sources is credible since they are published by those charged with information assurance. The use of census in this study ensured reliability since the entire population was tested and no sampling done.

3.6 Validity Test

This study adapted a descriptive design that analysed the cause effect relationship that is the impact of agent banking on commercial banks financial performance. The analysis tool of SPSS version 20 used confirms validity of the data and justifies the regression model. The study used correlation and variance analysis to bring out the relationship that exists between the variables under study. The data analysed and analytical tool used in this study will provide similar results when applied by various users.

3.7 Data Analysis

Data analysis can be defined as the computation of various measures and determination of the relationship that exists among groups' data. It helps in interpretation of data, drawing conclusion and making decisions based on the data analysed. The study had a multiple regression model to analyse the effect of agency banking on financial performance. The analysis was done using the analytical statistical tool of SPSS version 20.

3.7.1 Analytical model

The study applied a multiple linear regression model to measure the impact of banking through agents on commercial banks financial performance.

$$\mathbf{Y = \alpha + \beta 1 lnX1 + \beta 2 lnX2 + \beta 3 lnX3 + \beta 4 lnX4 + €}$$

Y Return on assets (Financial performance measure).

α	Regression constant.
X1	Log of value of customer cash deposit by agents.
X2	Log of value of customer cash withdrawals through agents.
X3	Log of value of transfer of funds done through agents.
X4	Log of value of Total Capital of commercial banks engaging in agency banking. (Control Variable)
€	Coefficient of standard error.
β1 up to β4	Regression coefficients

3.7.2 Test of Significance

Analysis of variance (ANOVA) was used to bring out the level of significance of using the data from the financial statements and CBK reports for the study. The use of data from audited financial statements and CBK reports assures credibility and reliability of the study. Analysis of Variance confirms existence of linear relationship between the dependant variable in this case ROA and the Predictor variables that is customer cash deposits, customer cash withdrawals and funds transfer through agency banking and finally the predictor variable of total capital. The data analysis was carried out at 95% confidence and the hypothesis Ho: $\beta1$, $\beta2$, $\beta3$, $\beta4$ … $\beta k \neq 0$ was also confirmed.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter gives analysis of findings from the research study done. The study was the effects of agency banking on financial performance of commercial banks from its implementation year of 2011 to December 2015. 17 commercial banks engaging in agency banking were used. Data comprised purely of secondary data from both audited financial statements of the 17 commercial banks and the CBK report with in the range of 2011 to 2015.

4.2 Data Validity

Table 4.1: ANOVA

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	260.578	4	65.144	15.494	.000[b]
	Residual	336.355	80	4.204		
	Total	596.932	84			

a. Dependent Variable: ROA

b. Predictors: (Constant), TOTAL_CAPITAL, CASH_TRANSFER, CASH_WITHDRAWAL, CASH_DEPOSIT

Source: Research findings

The research study used ANOVA to test the significance of the regression model at a confidence level of 95%. From the above table 95% confidence level was applied and the p value of 0% was established (0% > 5%) and an F value of 15.494 derived that is greater than F-critical value of 2.58. The findings show that the multiple regression model used is indeed significant.

4.3Desriptive Statistics

Table 4.2: Descriptive Statistics

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
ROA	85	-4.80	10.40	3.4009	2.66577	7.106
CASH_DEPOSIT	85	21.23	23.59	22.7300	.83922	.704
CASH_WITHDRAWAL	85	20.62	22.78	21.9840	.76389	.584
CASH_TRANSFER	85	9.84	14.99	13.4160	1.84924	3.420
TOTAL_CAPITAL	85	20.00	25.00	22.8824	1.37505	1.891
Valid N (listwise)	85					

Source: Research findings

The study had five variables one dependant which is financial performance measured as ROA, and the predictor variables customer cash deposits, cash withdrawal, cash transfers and total capital were analysed. From the table above the analysis shows that ROA has a mean of 3.4009, cash deposits 22.7300, cash withdrawals 21.9840, cash transfer 13.4160 and total capital that is the control variable has a mean of 22.8824. The study also highlighted that ROA has the highest standard deviation of 2.66577 and cash withdrawals has the least of 0.7638.

4.4 Correlation

The study used Pearson correlation to analyze the relationship between ROA and cash deposits, cash withdrawal, cash transfer and total capital. Pearson product-moment correlation coefficient measures the magnitude of linear relations between variables and is denoted by “r”. Here the coefficient of correlation ranges from +1 to -1. From the table below the findings confirm that there is a strong positive correlation between ROA and Total capital of commercial banks has a correlation coefficient of 0.610.

There seems to be a weak negative correlation between ROA and cash deposit, cash withdrawal and cash transferred through agency banking. This is depicted by correlations coefficients of -0.064, -0.065, -0.047 respectively.

Table 4.3: Correlation

Correlations		
		ROA
ROA	Pearson Correlation	1
	Sig. (2-tailed)	
	N	85
CASH_DEPOSIT	Pearson Correlation	-0.064
	Sig. (2-tailed)	0.559
	N	85
CASH_WITHDRAWAL	Pearson Correlation	-0.065
	Sig. (2-tailed)	0.556
	N	85
CASH_TRANSFER	Pearson Correlation	-0.047
	Sig. (2-tailed)	0.673
	N	85
TOTAL_CAPITAL	Pearson Correlation	.610**
	Sig. (2-tailed)	0
	N	85

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Source: Research findings

4.5 Regression Analysis

This part brings forth research findings based on regression model that was used in the study. It gives the relationship between the dependent variable ROA and the independent variables (cash deposits, cash withdrawals, customer cash transfer, and total capital).

Table 4.4: The Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.661[a]	.437	.408	2.05047

a. Predictors: (Constant), TOTAL_CAPITAL, CASH_TRANSFER, CASH_WITHDRAWAL, CASH_DEPOSIT

Source: Research findings

From the table above the correlation between the ROA and cash deposits, withdrawal, and transfer by agents and the total capital, Correlation coefficient R=0.661. R of 0.661> 0.5 showing a strong positive correlation existing between the dependant and the independent variables. The findings also give the coefficient of determination denoted as the R square that gives the proportion change in ROA that can be explained by changes in the independent variables. From my table above R square is 0.437 that implies that 43.7% of change in ROA can be explained by changes in cash deposits, cash withdrawals, cash transfers and total capital.

Table 4.5: Coefficients

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	36.261	35.547		1.020	.311
	CASH_DEPOSIT	14.250	21.651	4.486	.658	.512
	CASH_WITHDRAWAL	-17.987	23.726	-5.154	-.758	.451
	CASH_TRANSFER	.652	.504	.452	1.295	.199
	TOTAL_CAPITAL	1.308	.168	.675	7.774	.000

a. Dependent Variable: ROA

Source: Research findings

From our regression equation model the analysis findings state that the regression constant is 36.261, the beta coefficients of the independent variables; cash deposit is 14.250, cash withdrawal -17.987, cash transfer 0.652, and total capital 1.308. the interpretation is that a unit change in cash deposits through agent will cause 14.250 change in ROA, a unit change in cash withdrawal brings about -17.897 change in ROA this being an inverse relation. Similarly a unit change in cash transfer causes 0.652 changes in ROA and finally a unit change in Total capital causes 1.308 change in ROA. The analysis was done at 95% confidence level.

The new regression model with the beta coefficients is as below;

$$\mathbf{Y= 36.261 + 14.250 \ln X1 - 17.987 \ln X2 + 0.652 \ln X3 + 1.308 \ln X4}$$

4.6 Research Findings

From the research findings on correlation of ROA with the individual variable's, there exists a strong correlation that is positive between ROA and total capital at 0.610, this implies that as total capital increase ROA also increase. The correlation between ROA and Cash deposits is -0.064 approximately -0.1 this denotes that there exists an inverse relationship between Cash deposits and ROA. If RAO is increasing Cash deposits are decreasing.

The relationship between ROA and cash withdrawal is also inverse at a correlation of -0.064, similarly as ROA decrease customer cash withdrawals increase. Customer cash transfers relation with ROA is -0.047 that is approximately 0 correlation implying that there is insignificant change in ROA with any change in funds transferred through agency banking.

However the general regression analysis as per the model used in this study depicts a general strong positive relations between ROA and all the other four variable under study at R = 0.661. The coefficient of determination R squared = 0.437 explained as

43% change in ROA can be explained by the changes of customer cash deposits, customer cash withdrawals, customer transfer and total capital of the commercial banks

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter gives the study's findings from the analysis carried, a conclusion in line with the study and gives recommendation on the same. It goes further to highlight limitation of the study and suggests possible areas for future research.

5.2 Summary of Findings

From the descriptive statistics ROA has a mean of 3.4009, customer cash deposits has a mean of 22.73, cash withdrawal has 21.984, cash transfer has 13.416 and total capital has a mean of 22.8824. ROA has the highest standard deviation of 2.66577 and cash withdrawal has the lowest of 0.76389.

Correlation analysis gave a result of a strong positive correlation between total capital and ROA at 0.610, correlation between ROA and cash deposits -0.064 that depicts a weak negative correlation. Cash withdrawal and ROA had -0.064 correlation and cash transfer through agents and ROA had -0.047 correlation that similarly depicts a weak negative correlation.

The study variables all together had a strong positive correlation with a correlation coefficient of R= 0.661 and a coefficient of determination R Squared = 0.437. From the coefficient of determination it is concluded that 43.7% of change in ROA can be explained by changes independent variables that is cash deposits, cash withdrawals, cash transfers and total capital. All the analysis done was at 95% confidence level. From the analysis of variance (ANOVA) also computed at 95% confidence level it supports the regression model used with the P-vales of 0% being less than 5% and F-value of 15.494 that is greater than the F-critical of 2.58.

5.3 Conclusion

The study draws a conclusion that there exist an inverse relationship between ROA with cash withdrawals and deposit from banks when analysed individually. That when ROA increase cash withdrawal and cash deposits through agents decrease. This may be because cash deposits are a liability to the bank and any increase in liability decreases the firm's net assets. Fees and commission earned by the bank as a result of customer cash withdrawal takes up a smaller portion of the banks income, a further decision of this income stream to determine the income through agency gives an even smaller proportion. Increase in cash withdrawals reduces the firm's liquidity and may reduce the firm's ability to lend thus decrease profitability that affects ROA.

Transfer of funds analysed alone alongside ROA gives a weak negative correlation that tends to 0 (zero) implying presence of insignificant change in ROA with any change in funds transferred though agency banking. This may be explained by the fact that most customers using agency banking transfer funds to their various sub accounts within the same commercial bank. This does not affect the profitability or improve the liquidity of the bank hence the insignificant effect.

When the variables are analysed together using regression model with ROA as the dependent variable and cash deposits, withdrawals and transfers through agent together with total capital as independent variable's, gives a strong positive correlation. This shows that as ROA increase, cash deposits, cash withdrawal, cash transfer and total capital will all also increase simultaneously.

5.4 Recommendation

As at December 2015 commercial banks have heavily relied on interest income, however with capping of interest rates this year commercial banks will be forced to seek alternative ways of generating income. This may include investment in non-interest income products and services such as agency banking, bancassurance, internet banking and also enhance their alternate channels for branchless banking.

Agency banking in itself uses technology that is up to date to enable the customers transact and the transaction updated on real-time. Therefore commercial banks need to leverage on technology to enhance efficiency and convenience to their customers. There is also the need to create awareness through marketing to promote and grow agency banking. This is because currently 90% of the agents are in 3 banks with the largest physical branch presence namely. These are Equity Bank with 16,734 agents, KCB with 11,948 agents and Co-operative Bank with 7,956 agents.

5.5 Limitation of the Study

The use of secondary data only for analysis in the study may pose a limitation. This is because the use of both secondary and primary data together would explore the study in-depth. This limitation was however mitigated by using data from credible sources only. The variable of deposits and total capital may be affected since one of the commercial banks Chase bank that is part of the banks with agency banking products was put under receivership due to liquidity issues as on 7th April 2016. This implies that as at December 2015 the deposits and capital it holds may not show the true position of the bank's financials.

Finally commercial banks performance is affected by a number of other variables such as liquidity levels, market share, degree of diversification amongst other variable's, other than agency banking as the study sought to examine. There is need to explore all the variable's alongside each other to determine the actual effect of each when analysed alongside the rest of the variable's.

5.6 Suggestions for Further Study

This study was about the effects of agency banking on financial performance of commercial banks. Future study can also be done on the contribution of agency banking in promoting commercial banks liquidity. Another study can be done on the impact of agency banking on commercial banks market share. Also a study can be carried out on the contribution of agency banking in promoting financial inclusion in the Micro Finance Institutions (MFI's)

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APENDIX I: List of Banks Engaging in Agency Banking

List of Commercial Bank Engaging in Agency Banking	
As at 31st December 2015	
1	African Banking Corporation (ABC)
2	Barclays Bank

3	Chase Bank (K) Ltd.
4	Citi Bank Ltd
5	Consolidated Bank
6	Co-operative Bank of Kenya Ltd
7	Diamond Trust Bank Kenya Ltd
8	Eco bank
9	Equity Bank Ltd.
10	Family Bank Ltd.
11	First Community Bank
12	I & M Ltd
13	Jamii Bora Bank
14	Kenya Commercial Bank Ltd.
15	National Bank of kenya
16	NIC Bank Ltd
17	Sidian Bank

Source: CBK Reports 2015

APENDIX II: Type and Values of Transactions Undertaken Through Agent Banking

Type of Transaction	Value of the transaction "Millions"

	2011	2012	2013	2014	2015
VALUE OF CUSTOMER CASH DEPOSIT	28,293	101,170.6	160,789.9	236,045.47	297,417.2922
VALUE OF CUSTOMER CASH WITHDRAWAL	15,319	49,609.5	73,893.5	104,999.73	133,349.6571
VALUE OF TRANSFER OF FUNDS	0.32	14.2	27.1	28.47	55,231.8
	43,612.32	**150,794.3**	**234,710.5**	**341,073.67**	**430,822.1811**

Source: CBK Reports from years 2011 to 2015

APENDIX III: Commercial Banks ROA

ROA (%)						
		2011	**2012**	**2013**	**2014**	**2015**
1	African Banking Corporation (ABC)	4.12	2.9	2.9	1.49	1.61
2	Barclays Bank Ltd	7.18	7	5.8	5.44	5.01
3	Chase Bank (K) Ltd.	2.33	2.7	2.9	3.08	1.2
4	Citi Bank Ltd	6.43	10.4	7	5.22	6.33
5	Consolidated Bank	1.61	1	-0.8	-1.82	0.35

6	Co-operative Bank of Kenya Ltd	3.68	4.8	4.7	4.43	4.14
7	Diamond Trust Bank Kenya Ltd	4.19	4.9	4.9	4.47	3.69
8	Eco bank	0.45	-4.8	-3.3	-1.09	0.18
9	Equity Bank Ltd.	6.84	7.4	7.7	7.26	6.56
10	Family Bank Ltd.	2.01	2.7	4	4.24	3.55
11	First Community Bank	1.28	2.9	1.8	0.67	0.07
12	I & M Ltd	5.8	5.2	5.5	5.64	5.66
13	Jamii Bora Bank	-1.79	1.5	1.3	0.73	0.22
14	Kenya Commercial Bank Ltd.	4.98	5.2	5.5	5.93	5.01
15	National Bank of Kenya	3.56	1.7	1.9	1.9	-1.34
16	NIC Bank Ltd	4.57	4.2	4.6	4.44	3.99
17	Sidian Bank	2.75	3.2	4.2	4.61	2.72

Source: a) Commercial Banks audited financial statements from 2011 to 2015

b) CBK Reports from years 2011 to 2015

APENDIX IV: Value of Commercial Bank's Total Capital

Value of Total Capital						
		2011	**2012**	**2013**	**2014**	**2015**
1	African Banking Corporation (ABC)	1,599,000,000	1,739,000,000	1,873,000,000	3,012,000,000	2,945,000,000
2	Barclays Bank Ltd	33,478,000,000	32,169,000,000	33,172,000,000	38,419,000,000	41,222,000,000
3	Chase Bank (K) Ltd.	2,844,000,000	4,982,000,000	7,086,000,000	10,376,000,000	18,036,070,000
4	Citi Bank Ltd	15,680,000,000	17,225,000,000	15,786,000,000	19,101,000,000	18,057,000,000
5	Consolidated Bank	1,190,000,000	1,143,000,000	1,217,000,000	1,312,000,000	1,444,000,000

6	Co-operative Bank of Kenya Ltd	22,622,000,000	34,542,000,000	43,195,000,000	63,372,000,000	55,534,000,000
7	Diamond Trust Bank Kenya Ltd	9,718,000,000	13,511,000,000	18,484,000,000	30,299,000,000	25,065,000,000
8	Eco bank	4,557,000,000	6,275,000,000	7,018,000,000	9,904,000,000	6,530,000,000
9	Equity Bank Ltd.	27,633,000,000	44,741,000,000	44,151,000,000	52,887,000,000	47,552,000,000
10	Family Bank Ltd.	3,150,000,000	4,786,000,000	5,896,000,000	13,884,000,000	10,551,000,000
11	First Community Bank	767,000,000	1,008,000,000	1,140,000,000	2,024,000,000	1,423,000,000
12	I & M Ltd	11,584,000,000	12,109,000,000	18,547,000,000	26,544,000,000	22,863,000,000
13	Jamii Bora Bank	771,000,000	1,338,000,000	1,447,000,000	2,300,000,000	2,273,000,000
14	Kenya Commercial Bank Ltd.	39,920,000,000	44,925,000,000	61,199,000,000	61,072,000,000	71,210,000,000
15	National Bank of kenya	10,004,000,000	10,027,000,000	10,927,000,000	10,531,000,000	11,206,000,000
16	NIC Bank Ltd	9,623,000,000	13,246,000,000	14,108,000,000	30,357,000,000	27,340,000,000
17	Sidian Bank	1,546,000,000	1,492,000,000	1,852,000,000	3,785,000,000	2,379,000,000

Source: a) CBK Reports from years 2011 to 2015

b) Commercial Banks audited financial statements from 2011 to 2015