

**EFFECT OF AGENCY BANKING ON THE FINANCIAL PERFORMANCE OF
COMMERCIAL BANKS IN KENYA**

BY

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DECLARATION

I declare that this research project is my own work and it has not been submitted for any degree or examination in any other university.

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

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DEDICATION

I dedicate this research project to my parents – Edward Okongo Oburu and Monica Gesare, brothers – Kizito and Bruno, sisters – Stella, Lilian, Christine and friend Naom. Thank you, for your requisite resources for my education and especially for their guidance, love and understanding on the importance of pursuing a Masters of Business Administration Course.

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ABSTRACT

This research studied the effect of agency banking on financial performance of selected commercial banks in Kenya. In obtaining the information regarding the current status of the phenomenon descriptive research design was used with respect to the variables. The study targeted the commercial bank that has implemented agency banking. According to CBK (2017) 18 commercial banks have since adopted agency banking. Secondary data was used in obtaining data from bank supervision reports, audited financial statements of commercial banks that have adopted agency banking as at December 2017. Data collected include cash transactions (withdrawals and deposits) through agents, and number of existing agents and number of accounts opened through agents over a five-year period from 2012 so as to compute the banks ROA that was obtained from the banks audited statement of comprehensive income and statement of financial position. A summary statistic of the research variables was generated from the data analysis focusing on the agency banking and financial performance indicators for the period of 5 years. To ascertain this chi-square test and a comparative analysis of the trends in financial performance for the 5-year period in comparison with the agency banking measured in terms of the rate of growth in the amount of cash deposited and withdrawn using bank agents and the number of new accounts opened by the agent. The Chi-Square test was used to determine if an association between variables reflects a real link between agency banking and financial performance. The research determined that improvement in agency banking enhances the financial Performance of Kenyan Commercial Banks. The studied independent variables described a significant 33% of the improvement in financial performance of as denoted by adjusted R^2 (0.33). Hence this implies that the independent variables contribute 33% of improvement in financial performance while other aspects as well as random variations not explored in this study contribute 77% of the financial performance. This research found that there is a substantial effect on financial performance in agency banking. The research therefore suggests that organizations/commercial banks ought to ensure that they continually invest and explore other ways of enhancing agency banking for purposes of seeking competitive advantages that result in efficiency, reduction of unearning assets and thus better asset utilization.

ABBREVIATIONS AND ACRONYMS

ATM	-	Automated Teller Machines
CBK	-	Central Bank of Kenya
EFTS	-	Electronic Fund Transfer
ICT	-	Information Communication Technology
NSE	-	Nairobi Stock Exchange
ROA	-	Return on Assets
RTGS	-	Real Gross Settlements
SMS	-	Short Message Service
SPSS	-	Statistical Package for Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

The operations of the banking industry have been changed drastically by Information technology. Henderson & Venkatraman (1993) posits that technological advancements in banking sector has made the industry highly competitive and some firms are experiencing high performance due to competitive advantage. The banking sector in developing economies especially Africa has experienced myriad of changes through adoption of technology such as Electronic Funds Transfer (EFTs), Real Time Gross settlement (RTGS), Automatic Teller Machines (ATM) cards, SMS banking and agency banking (Bold, 2011).

Agency banking is a segment of electronic banking where selected agents are allowed to provide selected financial services for the banks through contractual agreement. Agents earn revenue on commission basis according to the transactions conducted. Agency banking entail services such as cash deposits; cash withdrawals; balance enquiry; card-less deposits (via sim-banking); disbursement and repayment of loans; issuing of mini bank statements; salary payment; and forced pin change (CBK, 2014). Agency banking also play a critical role increasing accessibility of banking services to the customers such as loans and mortgages applications and credit cards since only a few transactions at the banks are needed (Purcell et al, 2003).

This study was guided by several theories such as the agency theory which was developed to explain the issues regarding risk sharing, agency problem and the association between agents and principals (Jensen &Meckling, 1976). Financial intermediary theory claims that financial intermediaries improve the efficiency of resource allocation by reducing transaction costs caused

by imperfect information between the lenders and borrowers (Akerlof, 1970). The bank-focused theory explains cost reduction of banking sector by using nonconventional service delivery channels to meet the needs of the clients. Technological innovations such as automated teller machines have improved the quality of service to both premise considers how the use of nonconventional delivery. Other related theories discussed include bank led theory which is a branchless banking service through contracted retail agents where the banks develop financial products and services and then engage the retail agent (Lyman, Ivatury and Staschen, 2006). Through its provision of services, it provides conventional branch-based services that customer's carryout instead of queuing at the bank. This aim at reducing time spent in the bank.

In countries like Peru, agent networks are concentrated in urban areas. This clearly shows how effective agency banking is perceived in Peru. The agency banking is made for ease of congestion in banks, and transferring low-value transactions from the bank branches to the bank agents. According to Oxford Policy Management (2011), many bank agents are located closer to the branch of the same bank. Ignacio et al (2008) posits that financial institutions adopt agency banking in order to reduce cost of service distribution, and minimizing the banking risks. Kinyanjui (2016) studied the roles of agency banking on the financial and determined that security and infrastructure cost play an important role in agency banking to improve banks financial performance. This indicates that agency banking require effective security systems such as risk based approach and effective monitoring systems to control large cash transactions in agent networks.

1.1.1 Agency Banking

Agency banking model is known for providing convenient and friendlier service to under banked population through engaged agents under a valid agency agreement. The agency banking solutions allows banks customers to access basic banking transactions at a location convenient to them like retail outlets such as shops, post offices, pharmacies or the bank agent can travel to the customer, thus, Increasing the reach of financial services through agents enables the population to access financial services without creating additional risk and cost to the bank. The rolling out of the model by CBK in May 2010 permitted banks to introduce a third party to provide selected banking services on their behalf. Commercial banks did full implementation of agency banking in 2011.

The Agency Banking solution delivers financial inclusion for unbanked and under banked customers who live in remote locations without access to brick and mortar branches. By increasing the number of touch points providing financial access, whilst reducing transaction costs. The Agency Banking is a key part of the monetary inclusion strategy that is being implemented in Kenya that is aimed to help increase the number of customers hence translating to high transactions which will aid the overall banks performance.

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 year’s agency banking for commercial banks has really gained penetration in the banking sector.

It is evident that agency banking has been introduced in many countries around the world. Countries such as Mexico have more than twenty thousand banking agents while Kenya the

number of agents have grown with a change of 13.9% from 2016 to 2017 by 53,833 and 61,290 respectively (CBK 2017). Colombia and Brazil have more numbers than Mexico. The increase in the use of agents in Africa particularly in Kenya is attributed by the financial sector reforms like the mobile phone technology which has greatly contributed to the increase of agency banking. This has made commercial banks to practice financial inclusion to the under banked by lowering the cost of services (Jayanty, 2011). Although agency banking still remains a new model in Kenya it has not reached to all parts of the country.

Statistics from CBK 2017 shows the distribution of agents where 89% are with 3 banks with the branch presence namely Equity Bank with 28,663 agents, KCB with 14,466 and Co-op Bank with 11,207 agents. Bank customers in Kenya transacted Kshs 734 billion in 2017, up from 442 billion in 2016).

1.1.2 Financial Performance

Amidu and Abor (2006) described ways of measuring financial performance. These include; profitability, cash flow, sales growth and market to book value. The portion of earnings not paid out to investors is ideally reinvested back to the company in order to provide for future earnings growth. Investors are very keen in finding out how much of the earnings is issued out to investors and how much is kept back to the company. Earnings kept from the investors are known as retained earnings, which ideally should be reinvested to provide for future earnings growth. They hope that the firms used their retained earnings to either maximize their current operations or invest it to recoup higher profits.

Financial performance gauges how a firm can efficiently utilize its assets to maximize its profits. For every organization, financial performance measure is vital for managing the performance

despite the arguments on the importance non-financial and financial factors. The decision makers for businesses use financial performance to assess the success of business strategies employed by the firm. The business growth is an indicator of success if it is due to improved financial performance (Brealy, Myers & Marcus, 2007).

The measure of financial performance can be done in several ways. These include: Profitability which describe how much wealthy a company is making after paying for all the expenses and other charges. The profits and the firms' performance are directly related, implying that high profits indicate firm's performance and converse is also true. Financial performance can also be measured using Cash flow and its value is obtained after subtracting the cash amount at the start of the financial year from amount of cash at the end of the financial year. Positive cash flows indicate a positive financial performance while a negative one indicate poor performance.

Financial performance can also be measured by the strength of the balance sheet. This is the company's resources relative to its obligations at a specific point in time. More assets and fewer liabilities results in a stronger balance sheet. A strong balance sheet is highly preferred. Several ratios can be calculated from the balance to measure the performance of financial institution e.g.; Return on Assets, Return on Investments, Return on Equity, etc (Brealy, Myers & Marcus, 2007).

Isolation and a lack of infrastructure compound the issues facing those living in remote rural areas when it comes to accessing financial services. Agency Banking opens the door to greater financial freedom by extending business hours to customers and offering greater convenience to the rural population facing challenges due to poor infrastructure

1.1.3 Agency Banking and Financial Performance

Information and Communications Technology (ICT), influences heavily on agency banking which is a branchless banking Agency Banking opens the door to greater financial freedom by extending business hours to customers and offering greater convenience to the rural population facing challenges due to poor infrastructure (Mas & Siedek, 2008). Venkatesh & Morris (2003) define agency-banking as an agreement through which accredited financial institutions engage third parties in offering banking services on their behalf. Agency banking has successfully been implemented in emerging economies, notably in Latin America. Countries that have utilized the agency banking model to grow their financial services, include, India, The Philippines, Pakistan, South Africa and Kenya (Bloodgood, 2010).

Banks were allowed to contact third parties (agents) to provide financial services after the amendment of the Finance Act (2010) on their behalf. Agents are allowed to undertake the services such as; cash deposit, cash withdrawals, payment of salaries, loan applications, repayments, transfer of funds and documents collection (Byers & Ledere, 2002). In developing countries customers crowd in banking halls and waste time in queues hence banks have resulted to agency banking s such as mobile banking and agency banking to decongest the banks and save the customers time (Mas & Mireya, 2010). Banking agency provide more complementary and suitable channels of gain access to bank services to their customers (Kitaka, 2001).

1.1.4 Commercial Banks in Kenya

Kenya had 43 commercial banks registered and regulated by CBK. The Kenyan banking sector in Kenya recorded a performance improvement in 2016 notwithstanding the marginal economic growth in net assets and customer deposits. The Central Bank continues to ease the monetary

policy. This is contributed by the strength in the exchange rate, realign interest rates and the need to facilitate the uptake of credit in private sector in the economy.

18 of 43 banks have embraced agency banking in various form. Many of the banks have engaged business entrepreneurs to run agency banking along their businesses which has proven to be convenient to the customers in terms of banking hours which are extended and convenience in terms of providing for the services.

According to CBK, (2017) statistics show that the number of banks offering agency banking rose from 8 in 2011 to 17. As at December 2011, more than eight million transactions valued at Ksh.43.6 billion were facilitated within the agency, this represented a 3% of the overall deposit base in the banking sector (CBK, 2011). Kenya Commercial Bank (KCB), Co-operative Bank (Co-op Bank) and Equity Bank, rolled out agent banking networks.

1.2 Research Problem

Golding et al (2008) perceived that there are variants concerning technology adoption by developing and developed nations. Considering the rampant dependence of information systems and invention of new technologies in conducting varied transactions, the effect of technology acceptance in transactions remains to be a significant matter (Zarea & Salamzadeh, 2012).

Agency banking has become popular among the retail banks in Kenya due to decongesting the banks in a bid to save on time spent which has been a concern among the banks as well as customers. However, most people still prefer conducting their banking services in the banking halls thus frustrating the agent banking models' intention. These include business owners, a group of people who ought to maximize on the options available as opposed to the use of the traditional brick and mortar system.

Globally, Kentur et al., (2013) investigated the expansion of bank outreach through retail partnership in Peru. Rodrigez (2014) evaluated the impact of agency banking adoption in Mexico and Omar (2014) researched to determine the factors leading to adoption of agency banking in India.

Locally, Kinyanjui (2013) looked at the importance of adopting agency banking Kenya and clinched that security and infrastructure cost related to agency banking is vital in improving the financial performance. Njoroge (2016) investigated the adoption of technology and banking agency in Rural Kenya and noted that the customers who accessed the agency banking services were a small percentage despite existence of agency banking services in the sector.

From the analysis of Wafula & Wanjala (2017) concluded that enhancement of customer service, reduction of cost and banks presence in remote areas were influenced by the implementation agency banking in rural areas in Kenya. The earlier researchers conducted on agency banking have presented varied outcomes from different researchers. Mwangi (2012) examined the role of agency banking as a diversifiable strategy by banks. Descriptive design was used and the results concluded that agency banking is useful in the financial performance where banks use it to expand their services to rural areas hence stimulate their product and services.

Some studies have confirmed a significant positive effect of agency banking however others have disagreed. However, the studies have weaknesses, some studies failed to bring out the analytical model used in the analysis, in some studies, the period of the study was very short. Therefore, the necessity of this study which will take into consideration of the banks that have embraced agency banking all in answering the research problem of the effects of agency banking on financial performance of commercial banks in Kenya from 2013 to 2017.

1.3 Research Objective

This research examined the effect of agency banking on financial performance of selected commercial banks in Kenya.

1.4 Value of the Study

The study was of great use to the scholars to conduct academic research. It will act as a source of empirical literature and will act as a ground in conducting further studies on agency banking.

The findings of this research will act as a strategic tool for the managers to make decisions on agency banking. From the analysis of the profits, they were able to decide to adopt agency banking fully or stop the implementation by examining the costs and the profits associated with the model of agency banking.

The study was of great use to the telecommunication service provider's companies Safaricom, and Airtel on the decision making on the continued partnership with commercial banks. The telecommunication service providers will evaluate the financial gains from the partnerships with the commercial banks. If there are little financial gains associated with the partnerships, the companies will think of terminating the contracts.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter contains a review of literature on the effects of agency banking on financial performance of commercial banks. Also, the findings of other researchers are included.

2.2 Theoretical Review

This study based on five theories; agency theory, financial intermediation theory, bank focused theory, bank led theory and nonbank led theory to shade more light on the effect of agency banking as explained below.

2.2.1 Agency Theory

This theory emerged in 1970s from Stephen Ross and Barry Mitnick from economics and institutional theory disciplines. Agency theory was developed to explain the issues regarding risk sharing, agency problem and the association between agents and principals (Jensen &Meckling, 1976). Armstrong (1991) posits that in real life, complex issues exist in agency relationships. However, Agency theory has a weakness since it supports simplistic contractual agreements between agent and principal. Issues related to political, social, cultural, and historical have been overlooked despite being key in making contractual agreements.

Agency banking has contributed significantly to reduction of expansion and staffing costs of the commercial banks. Automated teller machines (ATMs), branches and banking agents all work within operation strategies of banks in making decisions hence it is important for bank to poses clear strategic rationale while setting up bank agent (Siedek, 2008). Through agency banking,

commercial banks are able to ease congestion in branches by diverting some of the customers to a complementary. In developing countries, agency banking is utilized to increase customer base by reaching to more clients especially in rural areas. Establishing branches in rural areas is uneconomical since the values of transactions are below the costs related to setting up a fully operational branch.

Banking agents have low establishment costs since they can operate on existing retail stall making it possible for low-income earners to access financial services. Siedek (2008) posits that low-income people are more comfortable in accessing financial services in banking agents compared to marble branch. Agent banking also play a critical role increasing accessibility of banking services to the customers such as loans and mortgages applications and credit cards since only a few transactions at the banks are needed (Makini et al, 2003). Agency banking business is more profitable than branch networks since agents require less paper work and less staff compared to branches (Kentur, 2003).

However, security and confidentiality challenges have been facing agent banking in maintaining strong customer relationship. Banks have to ensure their customer's information is maintained with high confidentiality by ensuring the staff signs secrecy forms regularly. This is a challenge to the bank since the staffs at agent banks are not part of the bank staffs hence do not sign the secrecy forms. Security is another key challenge. Majority of the agencies in urban regions are located in high populated areas posing high risks to customers while doing their transactions. The bank has to monitor the security measures put in place by the agencies to maintain customer confidentiality. Recently, the quality of service rendered in agencies has become a huge challenge. The operating hours, customer relationship and delayed transactions have characterized agencies. According to Banker (2011) agents need to be trained properly on customer service as well as detecting

fraudsters who are majorly targeting agencies. For the banks to fully reap the benefits of agency banking, they have a task force of addressing all these challenges.

Agency banking performance indicators include; deposit mobilization increase, competitive abilities and product attributes. Technology has taken the Centre stage in establishing strong interaction between the customers and local retail banks. The technological advancement in banking industry has led to virtual banks hence changing the performance indicators making it difficult for the bank management to adopt successful agent banking strategy (CBK, 2009). The management have been left with few areas to compete on which include; brand image, convenience, accessibility and product innovation.

2.2.2 Financial Intermediation Theory

Akerlof (1970) developed the theory, due to asymmetrical information challenges witnessed in 1970's. Financial intermediaries improve the efficiency of resource allocation by reducing transaction costs caused by imperfect information between the lenders and borrowers. Information asymmetry can either be "ex-ante" or "ex-post". Riley et al (1979) defines ex-ante information asymmetry as a situation where lenders cannot detect high credit risk borrowers before granting them loans. Imperfect information entails adverse selection, credit rationing, moral hazards, screening and monitoring function of the bank. Modiglian and Miller theorem argues that clients make their own portfolio decisions and hence no need for intermediaries. Banks don't need the intermediaries since they allocate resources efficiently. However, the need for intermediaries has grown due to pricing models and trading strategies leading to economic significance in financial intermediation

2.2.3 Bank-Focused Theory

The bank-focused theory explains cost reduction of banking sector by using nonconventional service delivery channels to meet the needs of the clients. Technological innovations such as automated teller machines have improved the quality of service to both premise considers how the use of nonconventional delivery. Agent banking model has also improved the customer confidentiality by boosting the operating efficiency (Kapoor, 2011). Banks associated with agency banking have proved to enjoy a competitive edge over the banks which have not adopted agency banking lead to better financial performance.

2.2.4 Bank Led Theory

This theory was developed by Cameron in 1972 during the time of transformation of money-lenders into merchant's banks during the origin of modern banking. Bank-led theory consists a chain of three main players; customer, bank and retail agent. The chain of events happens when the banks develops financial services which are delivered to the customer through retail agents. The bank responsibility is to open and hold the account, retail agent verifies customers' personal details, carrying out in-person transactions, collecting loans and small deposits, and processing applications (Accenture, 2010). The bank establishes good communication system between the customer and retail agents by providing electronic technology to the agent retail. Bank led model plays a significant role in maintaining financial institutions and customer interaction by providing financial and non-financial services through retail agents. Security and poor agent staff training are main challenges facing the retail agent as well as conventional branch based banking.

2.3 Determinants on the Financial Performance of Commercial Banks

Banks have adopted innovations because it enables business entities to become more competitive in the provision of services to drive the business entities in the better satisfaction of the customer

desires in the market this will improve financial performance. The determinants of financial performance of commercial banks include corporate governance, macroeconomic: factors, liquidity, management efficiency and capital adequacy.

2.3.1 Corporate Governance

The performance of a business entity is normally guided by the involvement of various parties including the owners of the business entity and the managers together who are motivated by the spirit of attaining the objectives of the business entity. The objectives of the business entity can be achieved only by good business practices among the stakeholders hence the need for corporate governance which acts as a constitution for business entities (Friedman, 1970). A legal framework is therefore needed for running the company for purposes of protecting the owners from bad managers and the business from owners who may take advantage of the limited liability status. Accountability is key for the success of any business entity. Commercial banks in Kenya should always make sure that all time they practice good corporate governance practices since they normally improve the financial performance.

2.3.2 Macroeconomic Factors

The macroeconomic factors include exchange in fluctuation rates, inflation, interest rate changes and political factors. The significance of exchange rate fluctuations on the effect of financial performance can be as an outcome of poor international relations among the countries in the world which will adversely affect the performance. On the other hand, when good international relationships exist, there is minimal fluctuation in exchange rates hence improved financial performance for the commercial banks. Inflation is also a key factor which influences the performance of commercial banks. High inflation rates affect the financial performance negatively

while low inflation rates are favorable for the commercial banks. When interest rates are high they scare away the borrowers hence the profit for banks decline.

In Kenya for example, since the interest rate capping many commercial banks have reported declined profits because the lending levels has been affected ultimately reducing the interest income. Many banks have been forced to scale down most of its operations as a result of declined profits. Political stability in a country is good for investment opportunities since it is able to attract more investment opportunities hence increased financial performance. If there is political instability, the rate of business activities slows down and the effect is felt in every sector of an economy hence poor financial performance.

2.3.3 Liquidity

Liquidity is the measure of how first a security can be turned into cash. Liquidity is a key factor in the determination of the profits of the commercial banks. If an entity is able to meet its obligations, then the entity is operating efficiently. Efficient management of the resources will improve the financial performance (Dang, 2010). With enough levels of liquidity, the commercial banks are guaranteed higher profits. Liquidity in the commercial banks is normally assessed from amounts of the deposits and the total assets of commercial banks the higher the customer deposit to total assets the higher the liquidity and vice versa.

2.3.4 Management Efficiency

Every business entity is always determined in ensuring the resources are not wasted since the same resources are meant to improve the operations of an entity (Rosen, 2013). It is the duty of the management of the commercial banks to ensure that the bank's operational expenses are kept as minimal as possible while at the same time ensuring the profits are maximized management

efficiency can be achieved by employment of the competent staff in the commercial banks. Competent staff will ensure any risks associated with any bank operations are minimal this will lead to improved financial performance. The management should put adequate control systems to monitor the operations in the commercial banks. This will ensure minimal losses among our commercial banks this will translate to improved financial performance. Management efficiency is measured by earnings growth rate.

2.3.5 Capital Adequacy

The financial performance will depend on the amount of money available in the banks to support their operations. Banks with a relatively high amount of money to cater for their operations tend to perform better than those with strained resources. One of the reasons which bring about capital inadequacy is the bank-run which is brought about by the fear of customers losing their money as a result of collapsing of commercial banks. Therefore, commercial banks need to set up emergence funds to cater for bank-runs. Other risks which are faced by commercial banks include credit risk which is due to high default rates from the customers. Therefore, the commercial banks should maintain adequate levels of capital to cater for these uncertainties.

2.4 Empirical Review

Liberalization in financial services has led to increased competition in the banking industry especially in the developing countries triggering more researches on agency banking adoption. Technology has been the key player in expanding banking industry through development of ATMs and mobile banking. Rodrigez (2014) evaluated the impact of agency banking adoption on commercial banks in Mexico where Stratified sampling was used in the study of five regions in Mexico. The results showed that agency banking improved access networks and transactions efficiency beefed up making transactions easier and faster in Mexico. Despite the evident agency

banking benefits, respondents claimed agents were insecure for making high value transactions and hence they preferred branches to agents. Omar (2014) investigated the contribution of agency banking to financial sector in India. Random sampling was used and 400 respondents from 40 registered commercial banks were chosen to participate in the study. The findings revealed that agency banking enhanced operational efficiency and effectiveness of commercial banks.

Makini et.al (2013) investigated the role of consumer education of agency banking in the urban settings. The study was carried out in Nyanza region specifically in Siaya county, the questionnaire was used and the findings were analyzed using descriptive research design. The results showed that agency banking education plays an important role where telecom companies have not fully embraced the technology. This however needs to be championed by banks that have agency banking in improving their values and transactions. The study only used descriptive analysis in a limited setting to generalize the findings. However, this study will incorporate the 17 banks that have embraced agency banking in Kenya.

In an investigation on expansion of bank outreach, Kentur et al., (2013) carried out a study in Peru on bank outreach through retail partnership. In Peru, agency banking has been incorporated with other business operations such as pharmacies and grocery stores so as to improve the banking services outreach. The results showed that 20% of the population can easily access financial services through agents. The agents carry out approximately 48 million transactions per year while ATMs transactions are three times more generate twice the total value from agents. In 2012, approximately 35% of the transactions were done in agents, 20% in ATMs while 45% were done in traditional bank branches (CGAP, 2013).

Njoroge (2017) investigated the adoption of technology and the banking agency in Rural Kenya. 20 commercial banks were randomly selected and descriptive analysis was employed. The results

showed a small percentage despite existence of agency banking services in the sector. This was contributed by insecurity, lack of confidentiality and inexperienced agents' staff with poor customer service. From the analysis of Wafula & Wanjala (2017) concluded that enhancement of customer service, reduction of cost and banks presence in remote areas were influenced by the implementation agency banking in rural areas in Kenya.

A study carried in Colombia on agency banking studied the model (Lozano and Mandrile, 2010) examined traditional banking with view of identifying the available platforms of agency networks that have been implemented. Benefits of branchless banking in Colombia MFI gave an overview of the prevailing network. Its finding posited a new model where MFI act as agency banks.

Kinyanjui (2013) had focused on embracing agency banking roles by commercial banks in Kenya and concluded that security and infrastructure cost related to agency banking have a significant role in improving their performance of financial organizations particularly in banking. Primary data was gathered from all the banks operating in Kenya. From the results of 43 banks, 8 had implemented agency banking and had significantly enhanced their financial performance. The agency banking benefits were associated with its low transaction costs and convenience. The agents helped in deposit mobilization hence increased the funds available for granting loans. However, other banks such family bank, Post bank and Diamond Trust bank had not significantly benefited the agency banking adoption.

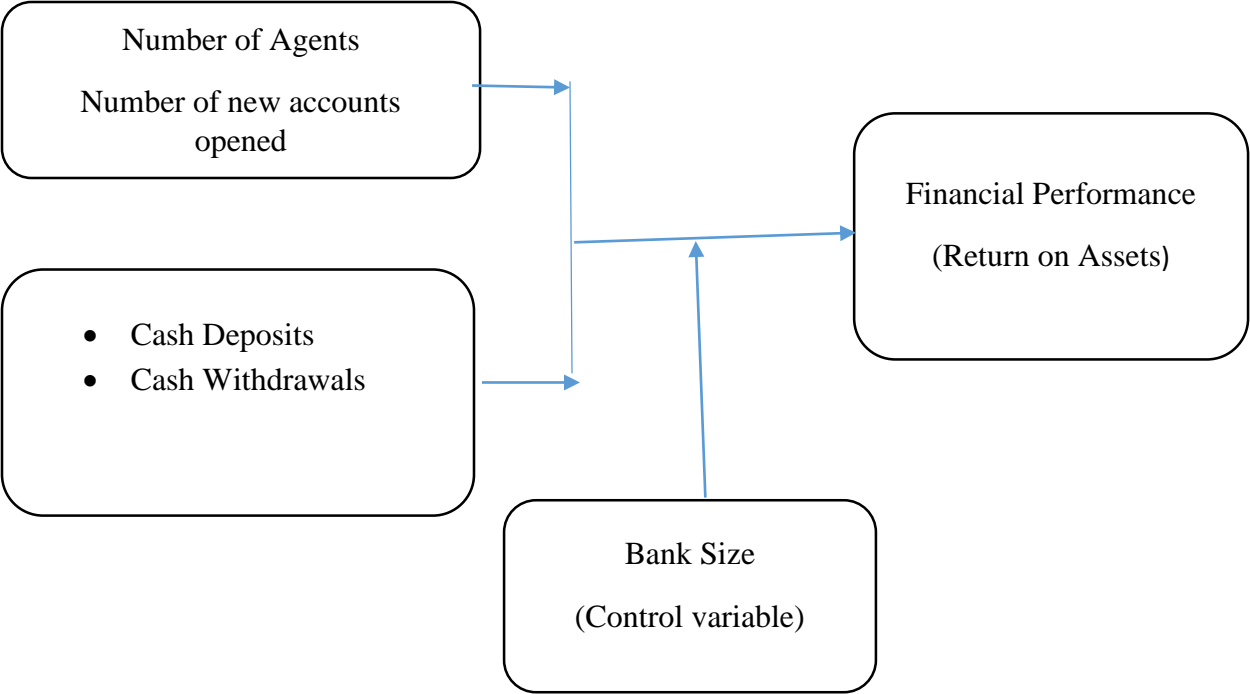
2.5 Conceptual Framework

The framework describes the relationship between the independent and the dependent variables in a research study (Mugenda & Mugenda 2013). In examining the effects of agency banking the following framework was of great assistance among selected commercial banks in Kenya.

Financial performance is the dependent variable and was measured using ROA which is the financial ratio that shows the net profit in relation to the total assets is. The independent variables will include; the number of agents and volume of agent transactions measured by the total transactions. The bank size was the control variable. The study is conceptualized in a framework explaining the relationship between the independent variables and the dependent variables as shown in the schematic diagram below.

Independent Variables

Dependent Variable



Source: Researcher 2018

Figure 2.1: Conceptual Framework

2.6 Summary of Literature Review

The literature review is based on the Agency theory, Intermediation theory, Bank-Led theory, and Bank-Focused theory. Several empirical studies have also been discussed in the literature review. Kentur et al., (2013) investigated the expansion of bank outreach through retail partnership in Peru. Rodrigez (2014) evaluated the impact of agency banking adoption in Mexico and Omar (2014) conducted a research study to determine factors leading to adoption of agency banking in India. Locally, Kinyanjui (2013) looked at the role of agency banking adoption by commercial banks in Kenya and concluded that security and infrastructure cost related to agency banking play a significant role in improving their financial performance. Njoroge (2016) investigated technology adoption and the banking agency in Rural Kenya and noted that the customers who accessed the agency banking services were a small percentage despite existence of agency banking services in the sector. From the analysis of Wafula & Wanjala (2017) concluded that enhancement of customer service, reduction of cost and banks presence in remote areas were influenced by the implementation agency banking in rural areas in the country.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The design and methodology of the research are set out in this chapter. The sources of data used, their method of collection and how the analysis was carried out is also detailed through this section.

3.2 Research Design

The study adopted descriptive research design. Descriptive study relays and measures basis of outcome of relationship among variables (cooper, 2006). Descriptive research design was used to obtain information concerning the current status of the phenomenon with respect to variables or conditions in a situation. It also involves correlation study which investigates the association among variables. This research design summarizes the various variables under the study.

3.3 Target Population

Cooper and Schidler (2008) indicated that a population is a collection about which reference can be based on. the study targeted the commercial bank that have implemented agency banking. No sampling was done since banks that have adopted agency banking are 18 (CBK 2017)

3.4 Data Collection

There are several ways and tools of collecting information (Kamau, 2014). The means and the devices employed are dictated by the characteristics of the data under study, research topic & query, purpose of the study, research design and expected data and results. The used secondary data to obtain information from bank supervision reports, audited financial statements of commercial banks that have adopted agency banking as at December 2017. Data collected included

cash transactions (withdrawals and deposits) through agents, and number of existing agents and number of accounts opened through agents over a five-year period from 2012 so as to compute the banks ROA that was obtained from the banks audited statement of comprehensive income and financial position for a period of 5 years.

3.5 Validity of the Instrument

Patton, (2000) explains validity as the extent to which a test accurately measure what is intended to be measured. It has to do with how accurately the data in the study will represent its variables. Validity of the instrument was determined, where the data obtained was checked against the objective of the study.

3.6 Reliability of the Instrument

A reliable instrument produces the expected results when used more than once to collect data from the same subjects randomly drawn from the population (Njunji, 2009). Test-retest method was used to determine the reliability of the questionnaire. The instruments were administered randomly to the selected commercial banks. Mugenda and Mugenda (2007) explained that validity enhanced reliability of an instrument. Hence, a valid instrument is reliable but a reliable instrument may not be valid.

3.7 Data Analysis Techniques

Mugenda (2005) defined data analysis as the process of bringing order and meaning to the information collected. Secondary data was collected, coded and tabulated according to each dependent and independent variable and analyzed using the descriptive statistics in terms of the mean, standard deviations, minimum and maximum values. The obtained data was analyzed using

the SPSS. The analysis aimed at establishing the effect of agency banking on financial performance of 18 banks that have embraced agency banking as of December 2017 (CBK 2017). Regression analysis was performed on the data to determine the effect of agency banking (independent variable) on the banks performance (dependent Variable).

To determine the factors of the bank's performance the researcher used the regression model given below;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where:

Y = Financial performance which was measured by Return on Asset (ROA) given by annual earnings divided by total assets.

α = Constant performance when all the independent variables are zero

X_1 = Log on Number of Agents

X_2 = Ratio of cash deposit done through bank agents divided by total cash deposit.

X_3 = Ratio of cash withdrawals done through bank agents divided by total cash withdrawal

X_4 = Number of new accounts opened through agency banking

X_5 = size of the bank as measured by log of total assets

$\beta_1, \beta_2, \beta_3$ & β_4 are regression coefficients of X_1, X_2, X_3 & X_4

ϵ = Error term

The significance of the coefficients was used at 95% confidence interval where T- statistics was employed, that is the number of Agents, account opened, cash Deposits, cash withdrawals and the Bank size. In assessing the significance of the overall model an F-test at 95% confidence interval was as shown in the linear regression model above.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This part provides how the data gathered is analyzed and also provides an interpretation of such analytical outcomes and turns the findings into useful research information that can be used to make informed business decisions. The analytical process has been guided by the research methodology outlined in chapter three. The research data was gathered exclusively through secondary data.

4.2 Descriptive Statistics

The study targeted at assessing the effect of agency banking on the financial performance of Kenyan Commercial Banks in Kenya. A summary statistic of the research variables was generated from the data analysis focusing on the agency banking and financial performance indicators for the period of 5 years. The section was important since it enabled correlation analysis to be undertaken so as to understand how agency banking has contributed to the improvements of commercial banks in Kenya.

The analysis is the aggregate summary of the average change in the number of agents, return on assets and the rate of growth in the amount of cash deposited and withdrawn using bank agents as well as the number of new accounts opened by bank agents the period of 5 years. This is important because this study was a comparative study that compares the performance of the Kenyan Commercial Banks with agency banking measured in relation to growth in number of agents and the rate of growth in the amount of cash deposited and withdrawal using bank agents of the previous years.

The section was important to understand how the Kenyan Commercial Banks performed owing to agency banking. The analysis is the aggregate summary of the average number of agents, return on assets, and the rate of growth in the amount of cash deposited and withdrawn using bank agents as well as growth in the number of accounts opened by bank agents for the 5-year period. This is important because this study was a comparative study that compares the performance of the Kenyan Commercial Banks with agency banking.

Table 4.1 Summary Statistics

	Number of agents	Return on Assets	cash deposited by agents (Million)	cash withdrawn using bank agents (Million)	number of new accounts opened
Mean	12,837.00	0.35	19.02	21.05	3,956.77
Standard Deviation	113.34	0.02	0.23	0.30	129.00
Kurtosis	0.12	- 0.31	0.09	- 0.23	0.09
Skewness	0.22	0.34	0.87	- 0.84	- 0.72
Range	1,498.00	0.18	13.14	12.71	2,453.00
Minimum	482.00	0.21	11.09	12.34	1,567.00
Maximum	1,980.00	0.39	24.23	25.05	4,020.00
Count	90	90	90	90	90

The findings show that the mean annual Number of agents for the Kenyan Commercial Banks for the period of 5 years was 12,837.00 and a standard deviation of 113.34, while the average annual

return on assets for the 5-year period was 35% with a standard deviation of 0.02. The average annual amount of cash deposited and withdrawn using bank agents for Kenyan Commercial Banks for the 5-year period was Kshs.19.02 billion and Kshs. 21.05 billion with standard deviations of shs. 230 million and 300 million respectively

4.2.1 Trend Analysis

A trend analysis of the growth rate of agency banking performance indicators was undertaken to establish the change in financial performance for Kenyan Commercial Banks as result of adoption of agency banking.

Table 4.3 Trend Analysis

Growth rate (year)	Number of agents	Return on Assets	cash deposited by agents	cash withdrawn using bank agents	number of new accounts opened
Year 1 To 2	6%	4%	8%	9%	11%
Year 2 To 3	7%	4%	10%	11%	13%
Year 3 To 4	9%	5%	12%	13%	16%
Year 4 To 5	10%	5%	14%	16%	19%
Average growth rate	8%	5%	11%	12%	15%

The findings indicate that the average annual growth rate in number of agents the five-year period increased by 8% annually while the average annual growth rate in ROA for the Commercial Banks

in Kenya for the five-year period increased by an average of 5% annually. The average annual growth rate in the amount of cash deposited and withdrawn using bank agents for the Kenyan Commercial Banks for the five-year period increased at an average rate of 11% and 12% annually. The average annual growth rate in the number of new accounts opened using bank agents for the Kenyan Commercial Banks for the five-year period increased at an average rate of 15% annually.

4.3 Effect of Agency Banking on Financial Performance

To ascertain this chi-square test and a comparative analysis of the trends in financial performance for the 5-year period in comparison with the rate of growth in the amount of cash deposited and withdrawals using bank agents and the number of new accounts opened by the agent. This was done using the above mentioned annual agency banking and financial performance indicators of changes specifically measuring total changes in return on assets. In assessing the link among agency banking and financial performance the researcher used correlation analysis. The independent variable (agency banking) was correlated against the dependent variables financial performance indicators. The findings were summarized and presented.

Table 4.4 Correlation Analysis

	Number of agents	cash deposited by agents	cash withdrawn using bank agents	number of new accounts opened	Return on Assets
Number of agents	1				
Cash deposited by agents	0.073	1			
Cash withdrawn using bank agents	0.094	0.065	1		
Number of new accounts opened	0.182	-0.133	0.246	1	
Return on Assets	0.02	0.241	-0.049	0.056	1

Findings in table 4.4 above suggested that there was a strong positive Correlation among agency

banking and financial performance. This implies that there a strong positive correlation of 0.02 between changes in the ROA by Kenyan Commercial Banks and increase in the number of registered agents. An increase in the rate of growth in the amount of cash deposited using bank agent’s results in an almost proportional increase of 0.241 with ROA by Kenyan Commercial Banks. The findings indicate that a correlation of -0.049 existed between the rate of growth in the amount of cash withdrawn using bank agents and ROA. The results suggest that a strong positive link of 0.056 existed between the rate at which new accounts are opened and the rate of growth in ROA for commercial banks. This show that there is correlation among agency banking and the financial performance of banks

4.3.1 Chi-Square Test

Chi-square was used in determining if there exist an association between agency banking and financial performance of Kenyan Commercial Banks. The method was used to determine whether an association or a relationship among two study variables drawn from a sample is likely to reflect if the difference exists between the variables. It thus tests the probability (p-value) that the seen link between the two variables has happened by chance, i.e. as a result of sampling error

Table 4.5. Chi Square-Tests

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	18.989a	17	0.033
Likelihood Ratio	16.398	17	0.034
N of Valid Cases	90		

According to the findings in the above table, the significance figure was 0.033, which shows there was a statistically significant impact of agency banking on financial performance of Kenyan Commercial Banks. This is because the significance figure was less than 0.05 ($p \leq 0.05$).

4.4 Regression Analysis

In assessing the association among the variables used a regression model was employed to measure the performance of Commercial Banks in Kenya. The dependent variable is financial performance of the Kenyan Commercial Banks whereas the independent variable is agency banking. The following analytical model was utilized for the analysis of the effect of the dependent as well as independent variables.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where:

Y = Financial performance which was measured by Return on Asset (ROA) given by annual earnings divided by total assets.

α = Constant performance when all the independent variables are zero

X_1 = Log on Number of Agents

X_2 = Ratio of cash deposit done through bank agents divided by total cash deposit.

X_3 = Ratio of cash withdrawals done through bank agents divided by total cash withdrawal transactions

X_4 = Number of new accounts opened through agency banking

X_5 = is the size of the bank as measured by log of total assets

α = Constant

ϵ = error term

The research used statistical package for social sciences (SPSS V 21.0) to code, enter as well as evaluate the extents of the multiple regressions.

Table 4.6: Model Summary**Relation Between Agency Banking and Financial Performance**

<i>Regression Statistics</i>	
Multiple R	0.36
R Square	0.34
Adjusted R Square	0.33
Standard Error	0.04
Observations	90

The R-Squared is basically employed in assessing the closeness in which the data is fitted to the line of fit. It is called the coefficient of multiple determination for multiple regression. The progression in the financial performance of the Kenyan Commercial Banks may possibly be attributed to the consolidated impact of the predictor variables which was 33%.

Table 4.7 Summary of One-Way ANOVA

ANOVA					
	<i>Df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	6	0.00056	0.000022	3.980	0.033
Residual	84	0.00022	0.000016		
Total	90	0.00078			

ANOVA was used to establish the significance of the regression Model from which 0.033 probability value was determined. This suggests that the regression relationship was highly substantial in foretelling the manner in which financial performance is affected by agency banking. The F calculated at 5% level of significance was 3.980. Because F determined is higher than the F critical it signifies that the whole model was significant.

Table 4.8 Regression Coefficients Results

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Sig 0.05</i>
Intercept	0.223	0.107	5.817	0.04	0.0397
Number of agents	0.227	0.097	0.763	0.03	-0.027
Cash deposited by agents	0.237	0.687	0.223	0.02	1.56
Cash withdrawn using bank agents	0.324	0.102	0.768	0.035	-0.265
Number of new accounts opened	0.312	0.692	0.228	0.025	-0.0655
Bank size	0.2882	0.668	0.204	0.0012	-0.05788

The equation of the regression is as shown below;

$$Y = 0.223 + 0.227X^1 + 0.237X^2 + 0.324X^3 + 0.312X^4 + 0.2882X^5 + e$$

This regression equation has determined that with every other factor held constant (no of agency banking) financial performance would be 0.223. Holding other factors constants (zero), the results shows that a unit rise in registered agents would result in a rise in ROA by 0.227. A unit increase in the amount of cash deposited using bank agents would result in a rise in ROA by 0.237. A unit increase in the amount of cash withdrawn using bank agents would result in a rise in ROA by 0.324. A unit increase in the number of new accounts opened using bank agents would result in a rise in ROA by 0.312. A unit increase in bank size would result in a rise in ROA by 0.2882. This therefore implies that increase in agency banking enhances the financial performance of the Kenyan Commercial Banks and therefore, we conclude that commercial banks should adopt agency banking to improve financial performance because it results to an increase of the overall ROA.

4.5 Interpretation of the Findings

The studied independent variables describe a significant 33% of the improvement in financial performance of as denoted by adjusted R^2 (0.33). Hence this implies that the independent variables contribute 33% of improvement in financial performance while other aspects as well as random variations not explored in this study contribute 77% of the financial performance.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the study and makes conclusions, and recommendations of the research. The section summarizes the major findings; it draws the conclusions and notes the recommendations from the findings of the study. It further outlines the shortcomings of the research and gives references for other research done.

5.2 Summary of the Findings

The researcher targeted at establishing how financial performance is affected by agency banking in Kenyan Commercial Banks. The study evaluated the effects of changes in the number of registered agents, the amounts deposited and withdrawn using bank agent as well the number of new accounts opened by the said agents as an indicator of agency banking and correlated the changes with the changes on ROA. The analysis on the aggregate summary the average annual growth rate in the number of agents, return on assets, the rate of growth in the amount of cash deposited and withdrawn using bank agents as well as the growth rate in the number of new accounts opened annually by the bank agents for the Kenyan Commercial Banks for the 5-year period.

The study was a comparative study that compared the indicators for changes in agency banking with that of financial performance. A trend analysis of the growth rate of agency banking and financial performance indicators was undertaken to establish the change in financial performance and correlated with the changes in agency banking as measured in terms of changes in number of

agents, amount of money deposited and withdrawn using the agents and growth in number of new accounts opened by the bank agents for Commercial Banks in comparison with the changes inROA for Commercial Banks in Kenya.

A comparison of the mean and annual growth rates financial performance in comparison with the rate of growth in the amount of cash deposited and withdrawn using bank agents for Kenyan Commercial Banks was undertaken to determine the change in financial performance. The study findings indicate agency banking has significantly enhanced banks financial performance in kenya.

5.3 Conclusions

Chi-square test was employed in evaluation of the degree and nature of association between agency banking and financial performance. The regression and the chi-square test found that the variables under the model are key in determining the direction of the financial performance of Kenyan Banks. The findings indicate that their progression in agency banking positively enhances finance performance.

5.4 Recommendations of The Study

The research suggests that organizations ought to ensure that they continually invest and explore other ways of enhancing agency banking for purposes of seeking competitive advantages that result in efficiency, reduction of unearning assets and thus better asset utilization. This is because existing literature indicate that firms should seek to acquire strategic partnerships such as those with banking agents for purposes of increasing efficiency

This is because strategic partnerships that an organization establishes have a substantial effect on its performance. Strategic partnerships for an organization is an aspect that can enable an organization to survive in Kenya's highly competitive banking sector that has recently witnessed

diminishing returns due to fiscal policy adjustments, informed customer choices leading to greater desire for sustainable cost control practices. The use of agency has been argued to be one of those key strategies that have enhanced competitiveness of the financial institutions.

Management in Kenya banking industry is encountering change because of changes in customer needs, conduct, information, and aggressive development due to globalization, liberalization and other technological changes. The banking sector is experiencing quick as well as major changes because of the all-inescapable impact of Information Technology (IT) and amazing improvements in the innovation in areas of communications and information systems. such systems have fundamentally changed the conventional methods for banking and enabled banks to save on resources and enhance efficiencies. Commercial banks should utilize the latest innovations to furnish their clients with better services that fit to their necessities.

Managing banking is no more a business identified with just cash exchanges it is presently seen as business identified with data on budgetary exchanges. Advanced CRM programming has allowed eminence administration attainable as well as productive. CRM is additionally reforming the business sector. Through giving itemized client narratives, coordinated administration, and estimating data, these apparatuses enable the sales representative to be consultative and to include more an incentive than previously. Innovative adjustments are therefore necessary bank's data framework ventures and activities with its business methodology.

Such services by financial institutions result in time saving enhanced storage capacity, money saving, enhanced data accuracy, as well as safeguarding data security. Consumer e-banking should also be enhanced to enable provision of twenty-four hours banking services as well as enhanced productivity, convenient as well as swift banking, reduced cost banking, virtual banking among

others. Transformation has been seen in the service delivery to clients as a result technological transformation.

5.5 Limitations of The Study

It was difficult to access secondary data due to strict confidentiality exhibited by most organizations. The annual financial statements are also prepared under the fundamental assumptions and concepts which are subjective and therefore not be consistently applied particularly in terms of provisions and estimates. Another limitation is the fact that financial statements are a reaffirmation of the previous year's performance hence misstatements of the material of the performance of the firm can lead to adjustment of the previous year's and this may not be revealed to the public. This means that the depicted pattern may have an effect on the correlation created.

Since it was a census survey research using secondary data; data collection was extremely tedious and time consuming. The time period for the conduction of the research was limited thereby a broad research could not be conducted. The study, however, minimized these by conducting in-depth analysis that significantly covers the shortcomings of the study. Additionally, it was tedious gathering data as well as evaluation since it was relatively raw. Also, data presentation in the various organizations was diverse thereby difficulty in computation.

5.6 Recommended Areas of Further Research

The fact that this study limited itself to agency banking in Commercial Banks in Kenya; I suggest that comparative study should be undertaken in other financial institutions such as deposit taking Savings and Co-operatives to establish the implications of the information technology and other strategic partnerships on operational efficiencies and financial performance of such institutions. Other studies that attempt to predict the strategic direction and future competitiveness in Kenya's

banking sector should be undertaken in order to inform investor strategic investment decisions. This is because of the dynamics of close linkages (thin line) between telecommunication and banking industry makes one wonder about the future dynamics of the industry.

Other studies that seek to establish strategic practices that lead to better organizational performance in Kenya's banking industry should be undertaken Other studies on the effect of fiscal policy adjustments of on the performance of the Kenyan Commercial Banks. Given the turbulent nature of the business environment, for example technology, risks and uncertainties, it was appropriate to mirror this research after a period of ten years and examine the influence of agency banking on performance.

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APPENDICES

APPENDIX I: LIST OF COMMERCIAL BANKS IN KENYA

1. KCB Bank Kenya Ltd
2. Co - operative Bank of Kenya Ltd
3. Equity Bank Kenya Ltd
4. Barclays Bank of Kenya Ltd
5. Standard Chartered Bank (K) Ltd
6. Commercial Bank of Africa Ltd
7. Diamond Trust Bank (K) Ltd
8. Stanbic Bank Kenya Ltd
9. NIC Bank PLC
10. I & M Bank Ltd
11. National Bank of Kenya Ltd
12. Chase Bank Ltd**
13. Citibank N.A. Kenya
14. Family Bank Ltd
15. Bank of Baroda Ltd
16. Bank of Africa Kenya Ltd
17. Prime Bank Ltd
18. HFC Ltd
19. Ecobank Kenya Ltd
20. Bank of India
21. Imperial Bank Ltd**
22. Guaranty Trust Bank (Kenya) Ltd
23. Gulf African Bank Ltd
24. African Banking Corporation Ltd
25. Victoria Commercial Bank Ltd
26. Mayfair Bank Ltd
27. Sidian Bank Ltd
28. SBM Bank (Kenya) Ltd
29. Development Bank of Kenya Ltd
30. Jamii Bora Bank Ltd
31. Spire Bank Ltd
32. First Community Bank Ltd
33. DIB Bank Kenya Ltd
34. Guardian Bank Ltd
35. Consolidated Bank of Kenya Ltd
36. Habib Bank A.G. Zurich
37. Transnational Bank Ltd
38. Paramount Bank Ltd
39. M-Oriental Commercial Bank Ltd
40. Credit Bank Ltd
41. Middle East Bank (K) Ltd
42. UBA Kenya Bank Ltd
43. Charterhouse Bank Ltd*

*Banks under statutory management

**Banks in receivership

Source: Banks Published Financial Statements (December 2017)