FACTORS INFLUENCING THE ADOPTION OF AGENT BANKING INNOVATION AMONG COMMERCIAL BANKS IN KENYA

BY

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Declaration

This management research project is my original work and to the best of my knowledge has not been submitted for examination to any university or college for the award of any other degree, diploma or certificate.

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

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Dedication

This project is dedicated to Joash, for always being there in offering support and encouragement, to Linda and Austin, my constant source of inspiration, and to my parents for believing in me.

Abstract

This study sought to determine the factors that influence agent banking adoption among commercial banks in Kenya.

This was a descriptive study aimed at determining the factors affecting adoption of agent banking amongst commercial banks in Kenya. A census survey design was employed by use of questionnaires sent out to the respondents. The study population comprised of all the 43 commercial banks in Kenya as at the time of study. The data collected was analyzed using descriptive statistics.

The findings of the study revealed that the main factors influencing the adoption of agent banking among commercial banks in Kenya are, (i) Cost reduction (ii) Enhancement of customer service (iii) Expanded presence by banks particularly in remote areas. The most important factor was cost reduction in the provision of banking services. Another key factor was the prospect of customer service enhancement owing to a greater level of convenience that comes with the presence of retail agent outlets.

This study found that the introduction of third party retail agents presents several risk factors with regard to effective regulation and supervision of banks, and therefore recommends that the regulator closely monitors the banking sector and strictly enforces compliance with the agent banking guidelines, while the banks continuously ensure careful vetting of agents.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The Kenya Finance Act (2010) amended the Banking Act to allow commercial banks contract third party retail agents to provide financial services on their behalf. This research intends to establish the factors that influence the adoption of agent banking innovation among commercial banks in Kenya. This chapter introduces the concept of agent banking innovation and gives an overview of the banking sector in Kenya.

1.1.1 The Concept of Agent Banking

Over the past 30 years, microfinance has evolved significantly and has achieved varied success in different parts of the world. Microfinance is defined as ‘the provision of financial services, primarily but not exclusively savings and credit, to poor households that do not have access to formal financial institutions (Ledgerwood & White, 2006). It came into prominence in the 1980s with the emergence of the Grameen Bank.

With the evolution of microfinance, there has been a gradual paradigm shift in the way it is practiced. Traditionally, microfinance focused on providing small loans (microcredit) to the poor to help them engage in productive activities. With time, it was demonstrated that a much broader range of financial services (microfinance), including savings, money transfers, and micro-insurance, were necessary in helping the poor build their assets, increase their income and reduce their vulnerability to risks (World Bank, 2006). In recent years, the core vision of microfinance pioneers, to help the poor help themselves, has broadened to the concept of inclusive finance (Rhyne, 2007). The United Nations defines an inclusive financial sector as a ‘financial sector that offers a range of financial services to the entire active population of a country’. It is characterized by competition among financial service providers, a diverse range of financial service providers, sustainability with respect to the permanence of access to financial services, and legal and regulatory environments that ensure the integrity of the financial sector and access to financial services (United Nations, 2007). The vision of the Consultative Group to Assist the Poor (CGAP) regarding inclusive finance is to have a world in which poor people everywhere enjoy permanent access to a range of financial services delivered by different financial services providers through a variety of convenient delivery channels (Helms, 2006).

One of the emergent alternative delivery channels, agent banking, is fast gaining momentum in many countries in Latin America (Brazil, Columbia and Peru), Asia (India) and South Africa. Agent banking, which leverages heavily on ICT, is a component of branchless banking that allows financial institutions to offer financial services outside the traditional brick and mortar bank premises (Mas, 2008; Mas and Siedek, 2008). It allows customers conduct a limited range of financial transactions at third party retail outlets including post offices, supermarkets, general and grocery stores, pharmacies, and gas stations, among others, located in remote areas. These retail agents are mandated to manage transactions (deposits, payments and cash withdrawals) on behalf of the financial institution and are remunerated on a fee-for-service basis They are linked to the institution's servers using a telephone line, cable or satellite link and use equipment as Point of Sale (POS) device and barcode readers.

Agent banking improves the bank's geographical coverage and competitiveness so that existing and potential customers can benefit from a greater level of convenience in accessing banking services. This convenience is offered through agents of the bank and when combined with new services can expand the bank's target beyond the traditional markets. The introduction of agency banking is meant to expand access to financial services, especially in rural areas where it has been expensive for banks to maintain a presence, owing to the smaller volumes. Banks tap in to the network of SACCOS and micro-finance institutions to access their front office services while guaranteeing customers' deposits.

Although agent banking is fast growing and gaining strong roots in Latin America, Asia and South Africa, it remains untapped in most of Africa. To keep up with international trends regarding the use of agent banking to enhance financial inclusion, the Finance Act (2010) amended the Banking Act to facilitate use of third parties by banks to provide banking services. The Central Bank of Kenya amended the Banking Regulations and issued Agent Banking Regulations (2010) to allow commercial banks contract third party retail agents to provide financial services on their behalf. This decision was also driven by Kenya's, blue print for economic development, Vision 2030, to extend access to financial services for all adult Kenyans by the year 2030.

1.1.2 Adoption of Innovations

An innovation is an idea, behavior, or object that is perceived as new by its audience. Any innovation goes through several stages before it becomes adopted. The process by which a new idea or a new product is acquired is known as adoption. Kibera & Waruingi (1998) discussed five stages consumers go through before they adopt or reject a new product and these are awareness, interest, evaluation, trial and adoption. Diffusion of innovations seeks to explain how innovations are adopted in a population. It offers three valuable insights in the process of social change namely the qualities that make an innovation spread successfully, the importance of peer to peer conversations and peer networks, and it gives an understanding of the needs of different user segments.

Scholars have recognized five qualities that determine the success rate of adopting an innovation. Some innovations are taken up very fast while others take a long time to gain acceptance. Rogers (2003) states that there are five attributes upon which an innovation is judged, and the first quality is relative advantage, which refers to the degree to which an innovation is perceived as better than the idea it supersedes by a particular group of users, measured in terms that matter to those users, for example economic advantage, social prestige, convenience, or satisfaction. The greater the perceived relative advantage of an innovation, the more rapid its rate of adoption is likely to be. The second attribute is compatibility with existing values and practices and this refers to the degree to which an innovation is perceived as being consistent with the values, past experiences, and needs of potential adopters. An idea that is incompatible with their values, norms or practices will not be adopted as rapidly as an innovation that is compatible. Simplicity and ease of use is the third attribute and it is the degree to which an innovation is perceived as difficult to understand and use. New ideas that are simple to understand are adopted more rapidly than innovations that require the adopter to develop new skills and understandings. Triability is the fourth attribute and it refers to the degree to which an innovation can be experimented with on a limited basis. An innovation that can be tried represents less uncertainty to the individual who is considering it. The fifth quality is observable results. The easier it is for individuals to see the results of an innovation, the more likely they are to adopt it. Visible results lower uncertainty and also stimulate peer discussion of a new idea. According to Rodgers (2003) these five qualities determine between forty nine to eighty seven per cent of the variation in the adoption of new products.

Wejnert (2002) states that although impersonal marketing methods like advertising and media stories may spread information about new innovations, peer to peer conversations and networks are important because adoption of new products or behaviors involves the management of risk and uncertainty. People we know that have successfully adopted the innovations themselves can give us credible reassurances that our attempts to change will not result in embarrassment, humiliation, financial loss or wasted time. Diffusion researchers believe that a population can be broken down into five different user segments based on their propensity to adopt a specific innovation namely innovators, early adopters, early majorities, late majorities and laggards. Each group has its own personality as far as its attitude towards a particular innovation goes.

1.1.3 The Banking Sector in Kenya

As at end of June 30 2009, the Kenyan banking sector comprised of 43 commercial banks, 2 mortgage finance companies and 123 foreign exchange bureaus. The sector witnessed an increase in the branch network from 772 branches in June 2008 to 930 in June 2009 representing a growth of 20.5 per cent. One deposit taking micro finance institution, namely Faulu Kenya, was issued with a license to allow it to take deposits from the public during the year 2008/2009. Branches are being opened in rural areas and this is a manifestation that the banks are now moving downstream. This move coupled with the new products banks have been launching, is expected to improve access to financial services. The Central Bank of Kenya approved 29 business names for applicants seeking to operate deposit taking micro finance institutions which is the first stage in the licensing process. This is according to CBK annual reports. Out of the 45 institutions, 34 are locally owned. The foreign banks comprised of 6 locally incorporated and 5 branches of foreign incorporate institutions.

CBK (2009) reports that local banks dominate the Kenyan banking sector in terms of numbers, but only account for 48.2% of the sector's total assets, closely followed by the foreign owned banks with 43% of the sectors assets. The Kenyan banking sector has continued to record impressive growth in the last few years. The banking sector's pre-tax profits grew by 30 percent from Kes. 12.6 billion as at June 2006 to Kes. 16.3 billion as at June 2007. The banking sector performance indicators improved with a decline in the stock of non-performing loans and enhancement of capital adequacy ratios attributed mainly to fresh capital injections and retention of profits over the period. The total assets of the banking sector rose by 15.0 per cent from Kes. 1,099.1 billion in June 2008 to Kes. 1,263.5 billion as at June 2009. The major components of assets were net advances, government securities and placements accounting for 53 percent, 22 percent and 10 percent respectively. In the same period, deposits expanded by 9.5 percent from 871.5 billion to 953.7 billion in June 2009.

The Kenyan banking industry has been expanding branch networking amid the introduction of branchless banking system, which include the use of EFTs, ATM cards, SMS banking etc. CBK (2009) clearly indicates that, branch network has been slowly expanding since 2002. By the end of June 2009, Kenya had a total branch network of 930, as compared to 486 branches in the period ended June 2007. Further it is indicated that Nairobi province has a large number of branch network while North Eastern province has never added any branch since the year 2000. It has maintained 4 branches in the whole province. This indicates that many Kenyan are left un-banked throughout the country's eight provinces, as banks have customer bases concentrating in major cities.

The Micro Finance Act and operational regulations came into force in 2008 in a bid to enhance efficiency and promote a broader and deeper access to financial services and products particularly to the poor, low income households and micro and small scale enterprises. Central Bank of Kenya has commenced licensing of deposit taking micro – finance institutions. Despite the growth in number of branches even in rural areas, there is widespread consensus that there is constrained access to financial services and products to majority of Kenyans. According to FinAccess Survey (2009), 22.6 percent of the adult population had access to formal financial services through banks as compared with 18.9 percent in 2006. An additional 17.9 percent of adult Kenyans were served by other formal institutions, namely, micro finance institutions and SACCO societies compared with 7.5 per cent in 2006. The dynamism of the banking sector is expected to continue as banks seek new opportunities in the face of an anticipated subdued risk appetite. According to the CBK annual report 2009, banks are however expected to explore new opportunities locally and regionally to maintain growth momentum. Rapid rise of alternative channels of banking which include agent banking and electronic banking products through mobile phones and personal computers is expected.

The banking industry has also over years continued to introduce a wide range of new products, prompted by increased competition, embracing ICT and enhanced customer needs. As a marketing strategy, the new products offered in this segment of market, continue to assume local development brand names to suit the domestic environment and targeting the larger segment of local customer base. All the above clearly indicate that, Kenya's banking industry has great developments like any other banking market in the world.

1.2 Statement of the Problem

Despite the rapid growth and broadening of microfinance and the financial sector at large, in the past few years, it is estimated that over three billion people globally still lack access to a broad range of financial products and services on a sustainable basis. The situation is particularly dire in sub-Saharan Africa, where over 90% of the population are excluded from access to financial services from the formal financial system (United Nations, 2007). Agent banking is a new concept for commercial banks in Kenya and hence the study of innovation adoption.

Although agent banking is gaining a lot of interest from the banking industry, it has not received a lot of attention from scholars. There are limited studies that have been done to highlight the factors that influence agent banking adoption among commercial banks. For instance, Mitchell (1995) established that extensive use of emergent banking delivery channels have made banking services convenient to bank customers. Kumar et al. (2006) explored expansion of the bank outreach through correspondent banking in Brazil. Similarly, Hernandez-Coss (2009), explored the impact of introducing banking agents in Mexico. Despite these studies having been conducted in developing countries, the findings may not be applicable in Kenya owing to certain environmental differences. A good number of studies have been done on various aspects in the banking sector in Kenya. Examples of these studies include Ali (2008), Otunya (2006), Kisia (2006), Kisingu (2007), and Kinuthia (2008). Ali (2008), determined the strategic issue management practiced by commercial banks in Kenya, whereas Otunya (2006), surveyed consumer adoption of mobile phone banking in Kenya, and Kisia (2006) determined factors affecting provision of services by commercial banks in Kenya to international business. Given the novelty of agent banking in Kenya, there has been no research study in this topic, yet as at December 2010, Central Bank of Kenya had approved over eight thousand (8,000) applications for retail agents by various commercial banks (Central Bank of Kenya, 2010).

Therefore, this research study seeks to determine the factors influencing the adoption of agent banking among commercial banks in Kenya. This study will be guided by the following question:

What factors influence adoption of agent banking among commercial banks in Kenya?

1.3 Research Objective

To determine the factors that influence the adoption of agent banking among commercial banks in Kenya.

1.4 Significance of the Study

Firstly, the study will assist commercial banks in Kenya identify and monitor the factors influencing agent banking adoption. Those factors relating to institution's ability to provide the conditions conducive to the introduction and acceptance of innovations could be used to map out an institutional framework for adoption. The research findings will help in monitoring development and growth of agent banking. Secondly, the research will help suggest possible solutions and strategies to the problems in agent banking. Thirdly, the study will contribute to the body of knowledge and to adding information on the banking industry.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the concept of adoption of innovation, the global development of agent banking, and briefly discusses the agent banking model and the success factors of agent banking adoption.

2.2 Innovation

Denning (2004) describes innovation as a transformation of practice in a community. This statement carries with it the concept that a successful innovation is one that is taken up by a community with an accompanying adjustment to expected work methods and / or practices. There is an important distinction between the meaning of "invention" and "innovation". Carayannis, Alexander, & Mason (2006), state that invention is the development of a new idea that has useful application. Innovation is a more complex term, referring to how an invention is brought into commercial usage."

The factors that affect the spread of innovation are described in several well-known theories. Perry (2006) affirms that scholars in the diffusion theory field, define diffusion as the process through which some innovation is communicated within a social system. He introduces the idea that time is an important factor in the rate of diffusion. He also stresses the role of individuals and their social influence in the diffusion process. An upsurge of research into diffusion in the late 1960s included practical studies looking at commercial products. These focused on innovations in business settings and were destined to provide insights into improving marketing as well as describing product dissemination. Scholars, like Rogers, who study communication, have concentrated on more theoretical approaches. Rogers' theory can be divided into three main components namely, the innovation decision process, the characteristics of an innovation, and adopter characteristics.

The innovation decision process categorizes the steps an individual takes from awareness of an innovation through to the formulation of an attitude to the innovation, on to the decision as to whether to implement and finally confirmation of this approach. These five categories are knowledge, persuasion, decision implementation and confirmation. Perry (2006) states that different innovations have different probabilities of adoption and hence different adoption rates. Therefore, the characteristics of an innovation have an impact on the likelihood of acceptance and adoption, and also on the rate at which this process develops. These innovation characteristics have been classified into five criteria namely, compatibility, complexity, observability, relative advantage, and triability. Rogers (2003) has defined socio-economic characteristics of early adopters under three headings which are socio-economic, personality values and communication of behavior. The degree of interpersonal influence an early adopter possesses within the innovation decision process will affect the dissemination of the innovation to others. Three issues are identified, which are information flow, opinion leadership and diffusion networks. At different stages in the diffusion of the innovation, individuals may be either leaders or followers. Leaders have the ability to exert a positive influence over their contacts and to encourage use of an innovation. Rogers also defines five adopter categories which are innovators, early adopters, early majority, late majority and laggards.

Ankem (2004) describes Marcus‘s theoretical model of adopting that has been derived from the diffusion of innovation theory as the social learning theory. Marcus’s model highlights the importance of innovation behavior and the phenomenon of others modeling themselves on this. Communication channels are a vital component in spreading this modeling behavior to other potential adopters. Ankem explains how the model sets out a range of influential factors in the take-up of innovations including, associated costs, availability of necessary resources, and, the value of the innovation. This illustrates the need to bring together a mix of personal and institutional factors for optimal take-up of innovations. Those factors relating to institutions ability to provide the conditions conducive to the introduction and acceptance of innovations could be used to map out an institutional framework for adoption.

2.3 Global Development of Agent Banking

The banking industry is constantly responding to changes in customer preferences and needs; increasing competition from non-banks, changes in demographic and social trends, information technology advances, channel strategies, and government deregulations of the financial service sector (Byers & Lederer, 2001). Success or failure of many retail banks is dependent upon the capabilities of management to anticipate and react to such changes in the financial market place. In the search for sustainable competitive advantages in the competitive and technological financial service industry, banks have recognized the importance to differentiate themselves from other financial institutions through distributions channels. This has resulted in banks developing, and utilizing new alternative distribution channels to reach their customers (Daniel, 1999; Thornton & White, 2001).

A survey carried out by the World Bank in 2008, established that 80 percent of the Kenyan population did not operate a bank account, compared to 30 percent in South Africa, 60 percent in Swaziland, 90 percent in Uganda and 92 percent in Malawi (World Bank, 2008). Another World Bank report of 2009 revealed that on average only about 26 percent of people around the world had access to formal financial services. Out of these, only 20 percent of the population in Sub-Saharan Africa; 30 percent in Europe and Central Asia; 35 percent in Latin America; 32 percent in the Middle East and North Africa; and 25 percent in South Asia had accounts in formal financial institutions (World Bank, 2009).

The limited access to financial services is attributed to three main challenges: limited scale (outreach), depth and the high cost of providing financial services. Essentially, the provision of financial services to many more people, especially in the depth of rural areas, using traditional branch networks entails high costs (Helms, 2006). In an attempt to overcome these challenges, financial service providers in a growing number of countries are finding innovative ways of delivering financial services. The use of ICT is indeed providing a means to increasing scale and depth, while reducing costs in the provision of financial services. Studies suggest that technology plays a significant role in improving financial access by taking financial services in a sustainable way to under-served and un-served areas (Stegman et al., 2005, Claessens, 2006, and UNDP, 2007). Studies also reveal that technologies such as ATMs, mobile phones and points-of-sale (POS) devices are increasingly being used to reduce costs and increase access for low-income clients (Ivatury, 2006). These technologies are providing alternative delivery channels for the delivery of financial services.

Available literature puts forward a case that the use of retail agents is opening up new windows of opportunities for financial service providers to reach out to more people, especially in remote, rural areas, while bringing down costs of operation. For example, in Peru the cost of setting up a bank branch is about $200,000, while an agent costs just $5,000. Literature also points to the fact that agent banking is a more convenient and efficient way of extending financial services to the poor, unbanked and marginalised communities (Lyman, Ivatury & Staschen, 2006). For example, in 2001, agent banking (also referred to as correspondent banking) was introduced in Brazil. In a short span of 9 years, this alternative delivery channel has radically transformed access to financial services in the Latin American country. Today there are over 95,000 agents including supermarkets, lottery kiosks, pharmacies and post offices allowed to provide services such as account opening, deposits, withdrawals and bill payments on behalf of commercial banks. Over 13 million new savings accounts have been opened. Given the success of Brazil’s agent banking model, together with other models around the world, other developing economies are looking into ways of developing innovative channels and proportionate regulations to enhance access to financial services for the poor through alternative channels like agent banking.

Despite these impressive gains, there are still many more poor individuals and households that remain without access to formal financial services (Accion, 2009). According to the World Bank, over 3 billion people, representing 45% of the world's population, are still submerged in poverty, living on less than 2 dollars a day, and locked outside the formal financial system. As a result, they have little or no access to formal financial services that can help them increase their incomes and improve their lives (World Bank, 2009).

2.4 The Agent Banking Model

Agent banking, also known as correspondent banking, is a model for delivering financial services whereby a bank partners with a retail agent or correspondent in order to extend financial services to locations for which bank branches would be uneconomical. It is a delivery channel that holds high potential for closing the delivery gap. Agent banking is a branchless banking model that allows financial institutions to use third party retail agents and leverage on ICT to provide financial services outside the traditional brick and mortar bank premises. It is opening up new windows of opportunity for financial institutions to reach out to more people, especially in remote, rural areas, while bringing down costs of operation (Mas, 2008; Mas & Siedek, 2008). Banking agents can be post offices, shops, Saccos, pharmacies, microfinance institutions, retail outlets, supermarkets, petrol stations and internet/communication centres.

CBK (2010) stipulates that the banking services that agents may provide as may be agreed between it and institution include cash deposit and withdrawal, cash disbursement and cash repayment of loans, cash payment of bills, cash payment of retirement and social benefits, transfer of funds, balance enquiry, generation and issuance of mini bank statements, collection of documents in relation to account opening, loan application, credit and debit card application, collection of debit and credit cards, agent mobile phone banking services, cheque book request and collection, collection of bank mail or any other activity as central bank may prescribe. There are certain activities against which a banking agent is prohibited and these include transacting during communication failure, failure to issue receipt or acknowledgement, charging any fees, ceasing or diminishing of initial commercial activity, guaranteeing customers, offering banking services on own account, continuing banking business in existence of a criminal record or disciplinary case, offering services not included in the contract, opening accounts, carrying out loan appraisal and approvals, cheque deposit encashment, foreign exchange transactions, agents being run by a bank’s employee or associate.

Agent banking presents various benefits for the banks, for the customers, for the agents and for the country in which it is practiced. First and foremost, agent banking allows financial institutions to establish physical presence in rural areas, remote areas or low population density where the cost of opening a branch may not make business sense. Secondly, it allows customers to access financial services in a more familiar way than in a branch as the unbanked are not familiar with the procedures of a traditional bank branch. Thirdly, it increases the sales from customers seeking banking services while increasing the income source for the agents through the commissions or fees they get from banks. Last but not least, agent banking contributes to a more efficient and inclusive financial system by extending financial services to a wider population (Mas & Siediek, 2008).

2.5 Success Factors in Agent Banking Adoption

CBK (2009) states that there are many technological and operational challenges in employing a successful agent banking strategy. Technology should be in place to enable banks and their customers to interact remotely in a trusted way through existing local retail outlets. Agent banking requires a generally good infrastructure in terms of road network, communication and information technology. Considerations should be made for areas that are hard to reach due to a poor fixed infrastructure and poor transport system.

There are various risk implications of use of agents by banks. Entrusting retail customer contact to the agents is riskier than these same functions in the hands of bank tellers in a conventional bank branch. Special attention should be paid to credit risk, operational risk, liquidity risk and reputation risk. The use of retail agents potentially raises special concerns regarding consumer protection and compliance with rules for combating money laundering and financing of terrorism which deserves the institution's attention. The time lag between collection from customers and depositing the same to the bank by the retail agents generates credit risk. There are chances of customer or retail agents committing fraud, loss of bank's equipment or other property from a retail agent's premises, data leaks or data loss from hacker attacks, inadequate physical or electronic security or poor back up systems. All these factors lead to operational risk.

Retail agents that are relatively small, unsophisticated and remote may not have enough cash to meet customer's requests for withdrawals and may lack experience in the more complex liquidity management required for offering financial services. When retail agents underperform or are robbed, the bank's image may suffer causing reputational risk which may also be caused by operational risks such as loss of customer records or leakage of confidential customer data, as can liquidity shortfalls in the retail agents' cash drawer. Banks bear the risks that customers are improperly identified and that they use the retail agent to launder money or channel funding to terrorists, with or without the agent's knowledge or complicity. There is need to consider all of the above risks and extend the risk management program to cover the same. Proper assessment of agent's credit worthiness and proper limit structure for agents' various activities commensurate with this assessment should be in place. Proper dispute resolution mechanisms should be in place as should proper communication of its complaints redressed set up to the customers. (The State Bank of Pakistan, 2007).

Appropriate customer protection against risks of fraud, loss of privacy, and loss of service is needed for establishing trust among consumers as trust and customer confidence is the single most necessary ingredient for growth of any branchless banking model. As it deals with a large number of first time customers with low financial literacy level, agent banking requires that adequate measures for customer protection, awareness and dispute resolution are in place.

The competition amongst commercial banks to offer banking services to the population has increased greatly, thus increasing efficiency and access. Early movers are able to partner exclusively with businesses that have the largest number of local retail outlets thereby patching together a sizable agent network relatively quickly. Ivatury and Mas, (2006) stated that a bank that is first to introduce banking services in a given geographical area is likely to capture the greatest market share among the local population.

Demographic factors for instance age, gender, income and education levels impact on the ability of customers to use their credit cards, debit cards and PIN security systems. Education plays a significant role towards technology use (Ivatury and Mas, 2008).

The success of agent banking is also based on the ease of banking by the agent. In Brazil for example, the available technological network allows any agent to deposit cash received in any bank to be transferred to his own bank at no fee. It is therefore not necessary for an agent of one bank to travel long distances to deposit cash in his own bank branch. Availability of agent channels is vital in ensuring a wide reach by the bank through its retail agents especially in rural areas. Urban areas have numerous delivery channels for example shops, supermarkets and pharmacies. (Kumar, Nair, Parsons and Urdapilleta, 2006)

Physical security can pose a challenge with regard to security of cash and even the people managing and working with agents. The specific security challenges are robbery, theft and fraud. Distance to the nearest bank branch may be a challenge particularly in the rural areas. In Brazil for instance, some commercial banks have accounts with other banks with branches near the location of their agents to enable their agents bank their cash. This has solved the problem of distance. In Columbia however, an agent has to travel to his own branch to deposit cash received.

While developing an agent channel for a bank presents a range of technological and operational challenges that may be new for a bank, the main challenge is strategic; understanding specifically how this new channel fits within its customer segmentation, service proposition, and branding objectives. The challenge is particularly important for banks pursuing agents as a way to offer banking services to those previously with no bank accounts. Banks will need to tackle basic financial education barriers to these potential customers, develop appropriate product that target their needs and economic means, find efficient ways to reach them with effective marketing messages and put in place a mechanism for checking customer identities as many of them may not have any form of formal education.

Mas and Siediek (2008) are of the view that a bank without a large network of branches faces a challenge of failure to bank with another bank due to associated charges. Ultimately, scale and ubiquity are best achieved by tapping into shared or interoperable networks of agents that serve multiple banks; much like a POS enabled store today can accept cards from Visa or MasterCard issued by any bank in their respective associations. Ivatury and Mas (2008) describe a system whereby the agent has a contract with at least one bank but may service customers of other banks with which it does not have a direct contract as long as the agent transactions for these other issuing banks are governed by the contract between the agent and its own acquiring bank and a separate agreement between the issuing bank and acquiring banks.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research methodology that will be used for the study and describes the research design, the study population, the data collection methods and data analysis method.

3.2 Research Design

This was a descriptive study aimed at determining the factors affecting adoption of agent banking amongst commercial banks in Kenya. Descriptive statistics describe the main features of a collection of data quantitatively, and provide simple summaries about the sample and the measures (Mann, 1995). The goal of a descriptive study is to offer a profile or to describe relevant aspects of the phenomena of interest from an individual, organization or industry perspective. A census survey design was employed by use of a questionnaire sent out to the respondents. Ali (2008) successfully used this design in a study of commercial banks.

3.3 Study Population

The target study population comprised of all the 43 commercial banks in Kenya as per the CBK 2009 annual report. With a population of only 43 banks, a census study was undertaken, given the small size of the population.

3.4 Data Collection Method

The study used primary data collected through questionnaires with open and closed ended questions. The closed ended questions used Likert scale of 1 to 5. Part 1 mainly consisted of general information about the banks and the respondents, while part 2 covered factors influencing the adoption of agent banking. The questionnaires were dropped and picked later. The target respondents were senior management in charge of retail banking channels in each of the commercial banks, and with 1 respondent per bank.

3.5 Data Analysis Method

Descriptive statistics were used to analyze the research data. Descriptive statistics describe the main features of a collection of data quantitatively using frequency tables, percentages, arithmetic mean and standard deviation. The arithmetic mean is a measure of central tendency which may be used to represent data in an entire population. Standard deviation is a widely used measure of variability in statistics and probability theory. It shows how much variation there is from the mean. A low standard deviation indicates that the data points tend to be very close to the mean, whereas high standard deviation indicates that the data are spread out over a large range of values.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis and findings of the study based on the interpretation of the data collected. The researcher received thirty (30) responses from a total of forty three (43) questionnaires distributed, which represents 70% response rate, thus enabling meaningful data analysis.

4.2 Respondents' Profiles

This section shows the demographic details of the respondents. The respondents were asked to indicate their position in the bank. The results are shown in Table 4.1.

Table 4. 1 Position of Respondents

Position	Frequency	Percentage
Top Management	12	40
Middle Management	15	50
Lower Management	3	10
Total	30	100

Source: Research data

Table 4.1 shows that 40% of the respondents were in top management positions, 50% in middle management, and only 10% in lower management. This portrays the fact that agent banking had not yet been operationalized and that the necessary operational framework and infrastructure were being established.

The respondents were asked to indicate their length of service in the bank. The results are shown in Table 4.2.

Table 4. 2 Respondents' length of service in the bank

Number of years	Frequency	Percentage
0 - 5	14	47
6 -10	12	40
11- 20	4	13
Over 20	0	-
Total	30	100

Source: Research data

As shown in Table 4.2, 87% of respondents had served for up to 10 years in their respective banks, possibly implying high turnover and /or early retirement.

The respondents were asked to indicate the length of service in their current positions. All the respondents had served in their current positions for less than 5 years, which may imply job rotation, upward career mobility, and the creation of posts arising from the introduction of agent banking.

4.3 Banks' Profiles

The respondents were asked to indicate the number branches their respective banks' have in Kenya. The results are shown in Table 4.3.

Table 4. 3 Branch network

Number of branches	Frequency	Percentage
1-10	12	40
11-30	11	37
31-50	3	10
51-100	1	3
Over 100	3	10
Total	30	100

Source: Research data

As shown in Table 4.3, 77% of the respondent banks had a total of 30 or less branches, while only 13% had a branch network of more than 50 branches. This shows that only a few market players own the majority of banking outlets which may imply that the costs of setting up a branch are prohibitive.

The respondents were asked to indicate how many years the banks have been in operation. The results are shown in Table 4.4.

Table 4. 4 Bank's years of operation since establishment

Number of years	Frequency	Percentage
0-10	3	10
11-20	7	23
21-30	8	27
Over 30	12	40
Total	30	100

Source: Research data

As shown in Table 4.4, 67% of the respondent banks have been in operation for over 20 years, and 33% for less than 20 years, with only 10% having been set up in the last 10 years. This could imply a slow growth in the number of players possibly due to high barriers to entry.

The respondents were asked to indicate the number of employees in the bank. The results are shown in Table 4.5.

Table 4. 5 Number of employees

Number of employees	Frequency	Percentage
Up to 200	6	20
201 – 500	10	33
501 – 1000	6	20
1001 – 2000	3	10
Above 2000	5	17
Total	30	100

Source: Research data

As shown in Table 4.5, 53% of the respondent banks had less than 500 employees, while 27% had over 1000 employees. This reflects the market dominance by a few banks.

4.4 Banks' Likelihood of Agent Banking Adoption

The respondents were asked to state to what extent their respective banks consider adopting agent banking.   The results are shown in Table 4.6.

Table 4. 6   Banks' likelihood of agent banking adoption

	Score	Frequency	Mean	Standard Deviation
Not applicable	1	3	3.70	1.19
To a limited extent	2	0		
To a moderate extent	3	9		
To a great extent	4	9		
To a very great extent	5	9		
Total respondents		30		

Source: Research data

The likert scale gave 5 levels. "Not applicable" is the first level and it represents banks which are not considering having retail agents. The next level is "to a limited extent" representing banks which are considering having only very few agents. The third level is "to a moderate extent" and represents banks that are considering having a good number of retail agents. The fourth level "to a great extent" represents banks that are considering recruiting a large number of agents. The fifth level "to a very great extent" represents banks which are considering having a very wide coverage of retail agents and have already embarked on recruitment of agents.

As shown in Table 4.6, the mean score of 3.7 and the standard deviation of 1.19 indicate a high inclination towards the adoption of agent banking by most respondent banks.

4.5 Factors Affecting Agent Banking Adoption

The respondents were asked to indicate the factors that affect the adoption of agent banking. The factors are grouped as "general" and "specific" factors. The results of the general factors are given in Table 4.7.

Table 4. 7 General factors affecting agent banking adoption

Factor	Frequency	Percentage	Rank
Cost reduction	24	80	1
Enhancement of customer service	21	70	2
Market outreach	17	57	3
Technology	15	50	4
Competition	10	33	5

Source: Research data

As shown in Table 4.7, among all the factors cited as influencing the adoption of agent banking by the respondents, the drive to reduce costs reduction ranked highest. As agent banking does not require the traditional brick and mortar branches, it will save banks the cost of putting up branches. Pursuit of customer service enhancement ranked second.

Agent banking creates convenience for customers through availability of agent outlets offering banking services. The opportunity to expand market outreach ranked third. Agent banking will expand the market outreach by banks through the presence of banking agents in places that could otherwise not be accessed by banks, thus reaching new customers. Availability of appropriate ICT infrastructure is vital for the success of provision of banking services by agents and ranked fourth. Competition ranked fifth among the factors cited as influencing agent banking adoption.

The respondents were asked to indicate the extent to which they agree with each of the factors listed as influencing adoption of agent banking. The results are shown in Table 4.8.

Table 4. 8 Specific factors affecting agent banking adoption

	SD	D	N	A	SA	Mean	Rank	Std. Dev..
Factor	1	2	3	4	5			
Agency banking will enhance access to the bank's services by both existing and new customers	0	0	0	12	18	4.6	1	0.49
Managing credit risk, operational risk, liquidity risk and reputation risk greatly influences AB adoption.	0	3	0	9	18	4.4	2	0.89
Availability of appropriate agency channels influences AB adoption	0	0	0	24	6	4.2	3	0.90
The level of development of ICT infrastructure and the road network significantly impacts AB adoption.	0	0	6	15	9	4.1	4	1.11
Agency banking services are compatible with the bank's existing service offerings.	0	3	3	15	9	4.0	5	0.70
Competition influences the adoption of agency banking	0	3	3	15	9	4.0	5	0.92
Proximity and accessibility to a bank branch by the retail agents impacts AB success	3	0	3	12	12	4.0	5	0.80
Existence of regulatory guidelines on agency banking positively supports AB adoption	0	0	6	18	6	4.0	5	0.89
Education level of agents and customers has a direct impact on agency banking success	0	0	9	18	3	3.8	9	0.40
Agency banking is easy to understand and use	0	3	9	12	6	3.7	10	1.18
Availability of physical security has an impact on provision of AB services.	0	0	18	6	6	3.6	11	0.63
Agency banking should initially be experimented on a limited basis before extending it further	0	9	6	9	6	3.4	12	0.60
Collaboration with other banks on various aspects e.g. receiving agents deposits on behalf of other banks, has an impact on provision of AB services	3	9	3	9	6	3.2	13	1.33

Source: Research data

As shown in Table 4.8, the responses were scored on a scale of 1 – 5, with 1 representing the respondents' strong disagreement and 5 representing strong agreement with each of the factors. The prospect that agent banking will enhance access to banks' services, by both existing and new customers, ranked highest with a mean score of 4.6. Existing and potential customers can benefit from a greater level of convenience in accessing banking services through greater geographical coverage and extended working hours offered by banks' agents. Customers will also benefit from reduced cost of accessing financial services since agent banking is leveraged on ICT. Agent banking also allows customers to access financial services in a more familiar way than in a branch as they are unfamiliar with traditional bank procedures.

The second factor was risk management with a mean score of 4.4. The use of retail agents presents increased credit, operational, liquidity and reputational risk to banks. The time lag between collection of deposits from customers and remitting it to banks generates credit risk. Inadequate physical or electronic security, frauds and errors lead to operational risk. Agents may not have enough cash to meet withdrawal demands, hence liquidity risk. If retail agents underperform, the bank's image suffers hence reputational risk.

The third factor was availability of appropriate agent channels with a mean score of 4.2. Availability of agent channels is vital in ensuring a wide reach by banks particularly in rural areas as there are fewer delivery channels compared to urban areas. The fourth factor was ICT infrastructure and road network. Agent banking requires a generally good infrastructure in terms of road network, communication and information technology.

Ranked fifth were four factors that influence the adoption of agent banking, which all had a mean score of 4.0. These factors were: compatibility of agency banking services with the bank's existing service offerings, competition, proximity and accessibility to a bank branch by the retail agents, and existence of regulatory guidelines on agency banking.

The education level of agents and customers, the ease of understanding and using agent banking model and the availability of physical security ranked ninth, tenth and eleventh, respectively. The twelfth ranked factor was the need for agency banking to be initially experimented on a limited basis before extending it further, while ranking last was the need for collaboration with other banks on various aspects e.g. receiving agents' deposits on behalf of other banks.

Out of the 13 factors, 10 had a standard deviation of less than 1, indicating a general consensus by respondents on the factors influencing adoption of agent banking. Three factors namely, collaboration with other banks, simplicity of agent banking and level of information technology infrastructure, had a standard deviation greater than 1 indicating varied opinions on their influence on agent banking adoption.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary, conclusion and recommendations of the research study. The recommendations are presented in two tiers, one being recommendations with policy implications while the other being recommendations for further research.

5.2 Summary

The objective of this research study was to determine the factors that influence the adoption of agent banking in Kenya. The study found out that the general factors influencing the adoption of agent banking were cost reduction in provision of banking services, followed by enhancement of customer service, market outreach, technology and competition. Chief among the specific factors were risk management, availability of appropriate retail channels, and availability of appropriate information and communication technology infrastructure.

There were significantly divergent views as regards the impact of collaboration with other banks in provision of various agent banking services for example receiving agents deposits on behalf of other banks. Sharp differences were also noted as to whether agent banking should be experimented on a limited basis before roll out.

There was a clear indication that the banking sector is enthusiastic about agent banking, particularly given the Safaricom M-Pesa success in Kenya and the opportunity to reach the un-banked and under-banked population in otherwise remote areas.

5.3 Conclusion

The findings of the study reveal that the banking sector is eager to embrace agent banking as an alternative service delivery channel. Agent banking presents opportunity for rapid expansion at minimal cost by leveraging on the existing investment of the retail agents through information and communication technology. The study shows that the main factors that influence agent banking adoption among commercial banks in Kenya are the prospects of cost reduction, and customer service enhancement.

5.4 Recommendations

5.4.1 Recommendations with Policy Implications

This study found that the introduction of third party retail agents presents several risk factors with regard to effective regulation and supervision of banks, which include operational risks, money laundering, credit risk and reputational risk. It is therefore recommended that, the regulator closely monitors the banking sector and strictly enforces compliance with the agent banking guidelines, while the banks continuously ensure careful vetting of agents.

5.4.2 Suggestions for Further Research

This study determined the factors that influence agent banking adoption among commercial banks in Kenya. However, it did not establish the impact of agent banking with regard to financial access by the un-banked population. Therefore, future research studies could be conducted to gauge the extent of financial inclusion through agent banking in Kenya.

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APPENDICES

Appendix I: List of Banks

1. Africa Banking Corporation Ltd
2. Bank of Africa Ltd
3. Bank of Baroda Ltd
4. Bank of India
5. Barclays Bank of Kenya
6. CFC Stabic Bank Ltd
7. Chase Bank Ltd
8. Citibank N.A. Kenya
9. City Finance Bank
10. Commercial Bank of Africa Ltd
11. Consolidated Bank of Kenya Ltd
12. Co-operative Bank of Kenya
13. Credit Bank Ltd
14. Development Bank of Kenya Ltd
15. Diamond Trust Bank Ltd.
16. Dubai Bank Ltd.
17. Ecobank Ltd
18. Equitorial Commercial Bank Ltd
19. Equity Bank Ltd
20. Family Bank Ltd
21. Fidelity Commercial Bank Ltd
22. Fina Bank Ltd
23. First Community Bank Ltd
24. Giro Bank Ltd
25. Guardian Bank
26. Gulf African Bank Ltd
27. Habib AG Zurich
28. Habib Bank Ltd
29. I & M Bank Ltd
30. Imperial Bank Ltd
31. Kenya Commercial Bank Ltd
32. K-Rep Ltd
33. Middle East Bank Ltd
34. National Bank of Kenya Ltd
35. NIC Bank Ltd
36. Oriental Commercial Bank
37. Paramount Universal Bank
38. Prime Bank Ltd
39. Southern Credit Banking Corporation Ltd
40. Standard Chartered Bank Ltd
41. Trans-National Bank Ltd
42. UBA Kenya Bank Ltd
43. Victoria Commercial Bank Ltd

Source: CBK Annual Report 2009

Appendix II: Cover Letter

Daisy Kanini Wairi
C/O University of Nairobi
NAIROBI

15th September 2010

TO WHOM IT MAY CONCERN

Dear respondent

REQUEST FOR RESEARCH DATA ON FACTORS INFLUENCING ADOPTION OF AGENT BANKING AMONG COMMERCIAL BANKS IN KENYA

I am a post graduate student in the School of Business at the University of Nairobi. I am undertaking a survey on the Factors Influencing the Adoption of Agent Banking among Commercial Banks in Kenya, in partial fulfillment of the requirement for the award of a Master of Business Administration (MBA) degree.

I therefore request for your kind assistance in completing the attached questionnaire to the best of your knowledge. The information you give will be treated with strict confidence and is solely for academic purposes. Even where a name is given, it will not under any circumstances appear in the final report. A copy of the final report will be availed to you upon request.

Your assistance and co-operation will be highly appreciated.

Thank you.

Daisy Kanini Wairi

Appendix III: Questionnaire

Part 1

1. What is the name of your bank ………………………………………..

2. How many branches does your bank have in Kenya? ....

3. How old is your bank?

   0 -10 Years ( )

   11 – 20 Years ( )

   21 – 30 Years ( )

   Above 30 years ( )

4. How many employees does your bank have?

   …………………………………………..

5. What is your position in the bank?

   Top management ( )

   Middle management ( )

   Lower management ( )

6. How long have you worked in the bank?

   ………………………………………………..

7. How long have you worked in the current position?

   ……………………………………..

8. To what extent do you consider adopting agency banking?

   Not applicable ( )

   To a limited extent ( )

   To a moderate extent ( )

   To a great extent ( )

   To a very great extent ( )

9. Kindly state the main factors that affect the adoption of agent banking.

Part 2

10. Kindly indicate the extent to which you agree with each of the following statements as regards the adoption of agent banking by your bank.

Factor	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
Agency banking will enhance access to the bank's services by both existing and new customers					
Agency banking services are compatible with the bank's existing service offerings.					
Agency banking is easy to understand and use					
Agency banking should initially be experimented on a limited basis before extending it further					
The level of development of ICT infrastructure and the road network significantly impacts AB adoption.					
Managing credit risk, operational risk, liquidity risk and reputation risk greatly influences AB adoption.					
Availability of physical Security has an impact provision of AB services					
Competition influences the adoption of agency banking					
Availability of appropriate agency channels influences AB adoption					
Proximity and accessibility to a bank branch by the retail agents impacts AB success					
Existence of regulatory guidelines on agency banking positively supports AB adoption					
Education level of agents and customers has a direct impact on agency banking success					
Collaboration with other banks on various aspects e.g. receiving agents deposits on behalf of other banks, has an impact on provision of AB services					

11. Kindly give any other comments you may have about agent banking

____

____

____

____

Your participation and assistance is highly appreciated!