

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

**BY**

**DAVID BELITA KAMBUA**

**D61/64370/2013**

**RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT  
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE  
OF MASTER OF BUSINESS ADMINISTRATION OF THE  
UNIVERSITY OF NAIROBI**

**NOVEMBER 2015**

## **DECLARATION**

I, the undersigned, declare that this research proposal is my original work and that it has not been presented in any other university or institution for academic credit.

SIGNED DATE

.....

DAVID BELITA KAMBUA

D61/64370/2013

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

Dr. Cyrus Iraya

Senior Lecturer, Department of Finance & Accounting

SIGNED DATE

.....

## **ACKNOWLEDGEMENT**

I thank The Almighty God for giving me the strength, good health and wisdom without which I would not have made it this far. I am indebted to Dr. Cyrus Mwangi Iraya for having guided and supervised my research work. His contribution and encouragement during the entire research period made it possible for me to accomplish this task. My sincere gratitude to my friends, colleagues, relatives for their continued support & encouragement.

My entire family for their moral support and being a pillar through this journey.

May God bless you all.

## **DEDICATION**

I dedicate this work to my dear husband (Samuel Mutuku) especially for his sacrifices he endured for me to complete this project. His Love, support, concern, care, encouragement and enthusiasm has driven me to attain this goal.

## **ABSTRACT**

In a growing number of countries, banks are finding new ways to make money delivering financial services to "unbanked" people. Rather than using bank branches and their own field officers, they offer banking and payment services through retail outlets, including grocery stores, pharmacies, seed and fertilizer retailers and gas stations among others. The study sought to establish the effect of agency banking on financial performance of commercial banks in Kenya. This study adopted descriptive research design. The population for this study was 16 commercial banks that have embraced agency banking. The study used secondary data and was collected from previously collected data, general business publications, reports from and by financial institutions and CBK banks supervision reports. Annual reports of the banks were analyzed for the period between 2012 and 2014, which is the study period of 3 years. The study used both quantitative and qualitative techniques to analyse data from the questionnaire. The quantitative data collected was analyzed by using Statistical Package for Social Sciences (SPSS version 22) and presented through percentages, means, standard deviations and frequencies. Multiple linear regression models were used in measuring each variable and this model. The study concluded that increase in the number of agents of commercial banks lead to an increase in the financial performance of commercial banks hence there is a positive relationship between number of agents and financial performance. The study also concludes that there is a positive relationship between cash deposits, volume of deposits, volume of withdraws and financial performance. The study also concludes that bank size has a positive relationship with financial performance of commercial banks; this is because as the number of agents increases the size of the assets increase hence financial performance. The study recommended that; commercial banks should be encouraged to embrace agency banking through adoption of improved technology; this will increase volume of transactions and bank size which will lead to financial performance. Security enhances accessibility and operation of agents' banks; the government of Kenya should thus improve security to enhance operation of the agents' bank. This will enable commercial banks in Kenya increase the number of agents. This can be done by reducing the requirements of becoming a bank agent. Commercial banks in Kenya should improve customers' perception by making more advertisements and also increase promotion activities of agent's banking. By doing this the number of transactions made by customers will increase. This in turn helps the customers to save more and hence the amount the bank can loan increases. This helps to improve the financial performance of commercial banks. The government should support the program of operation of agency banking. This can be done by reducing the high compliance costs, bureaucracy in registration and high cost of taxation. This will increase the number of transaction by the banks hence profitability.

## TABLE OF CONTENTS

<b>DECLARATION.....</b>	<b>i</b>
<b>ACKNOWLEDGEMENT.....</b>	<b>ii</b>
<b>DEDICATION.....</b>	<b>iii</b>
<b>ABSTRACT.....</b>	<b>iv</b>
<b>TABLE OF CONTENTS .....</b>	<b>v</b>
<b>LIST OF TABLES .....</b>	<b>viii</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>ix</b>
<b>CHAPTER ONE: INTRODUCTION.....</b>	<b>1</b>
<b>1.1Background of the Study.....</b>	<b>1</b>
1.1.1 Agency Banking.....	3
1.1.2 Financial Performance.....	4
1.1.3 Agency Banking & Financial Performance .....	6
1.1.4 Commercial Banks in Kenya.....	7
<b>1.2 Research Problem .....</b>	<b>8</b>
<b>1.3 Research Objective .....</b>	<b>10</b>
1.3.1 Specific Objectives of the Study .....	10
<b>1.4 Value of the Study.....</b>	<b>11</b>
<b>CHAPTER TWO: LITERATURE REVIEW.....</b>	<b>12</b>
<b>2.1 Introduction.....</b>	<b>12</b>
<b>2.2 Theoretical Review.....</b>	<b>12</b>

2.2.1 Intermediation Theory .....	12
2.2.2 Bank-Focused Theory .....	14
2.2.3 Bank-Led Theory .....	14
2.2.4 Agency Theory.....	17
<b>2.3 Determinants of Financial Performance of Commercial Banks.....</b>	<b>17</b>
2.3.1 Capital Adequacy .....	18
2.3.2 Agency Banking.....	18
2.3.3 Bank Size.....	19
<b>2.4 Empirical Review .....</b>	<b>19</b>
<b>2.4 Summary of the Review.....</b>	<b>23</b>
<b>CHAPTER THREE: RESEARCH METHODOLOGY .....</b>	<b>25</b>
<b>3.1 Introduction.....</b>	<b>25</b>
<b>3.2 Research Design .....</b>	<b>25</b>
<b>3.3 Target Population .....</b>	<b>25</b>
<b>3.4 Data Collection .....</b>	<b>25</b>
<b>3.5 Data Analysis.....</b>	<b>26</b>
3.5.1 Test of Significance of the Model .....	27
<b>CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION .....</b>	<b>28</b>
<b>4.1 Introduction.....</b>	<b>28</b>
<b>4.2 Descriptive Statistics.....</b>	<b>28</b>
<b>4.3 Correlation.....</b>	<b>29</b>

<b>4.4 Regression Analysis .....</b>	<b>30</b>
<b>4.5 Discussions of Findings.....</b>	<b>33</b>
<b>CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS .....</b>	<b>35</b>
<b>5.1 Introduction.....</b>	<b>35</b>
<b>5.2 Summary.....</b>	<b>35</b>
<b>5.3 Conclusions.....</b>	<b>37</b>
<b>5.4 Policy Recommendations.....</b>	<b>38</b>
<b>5.5 Limitations of the Study .....</b>	<b>39</b>
<b>5.6 Suggestions for Further Study .....</b>	<b>39</b>
<b>REFERENCES.....</b>	<b>40</b>
<b>APPENDICES .....</b>	<b>44</b>
Appendix 1: List of Commercial Banks operating Agency Banking in Kenya as at Dec 2014.....	44
Appendix II: Number of Transactions .....	45
Appendix III: Type & Values of transactions undertaken through agent banking .....	46
Appendix IV: Return on Asset (ROA) for years-2012, 2013, 2014 .....	47
Appendix V: Bank sizes as at 2012, 2013, 2014.....	48



## LIST OF TABLES

Table 4.1: Descriptive Statistics .....	28
Table 4.2: Correlation .....	29
Table 4.3: Model Summary .....	30
Table 4.4: ANOVA.....	31
Table 4.5: Regression Model .....	32

## **LIST OF ABBREVIATIONS**

<b>AML</b>	Anti-Money Laundering
<b>ATM</b>	Automatic Teller Machine
<b>CBK</b>	Central Bank of Kenya
<b>CFT</b>	Counter-Terrorism Financing
<b>CGAP</b>	Consultative Group to Assist the Poor
<b>KCB</b>	Kenya Commercial Bank
<b>MFI</b>	Micro Finance Institution
<b>POS</b>	Point of Sale
<b>ROA</b>	Return on Assets
<b>SMS</b>	Short Message Service
<b>SPSS</b>	Statistical package for Social and statistical Scientist

# **CHAPTER ONE: INTRODUCTION**

## **1.1 Background of the Study**

Every facet of life has been influenced by the increased developments in information technology. One of those sectors majorly affected is banking sector. Operations of many banks have been redefined with introduction of electronic banking with many benefits being realized like flexibility in customers' service and low cost of banking. This far, banks have been able to develop branchless banking such as ATM and agency banking. An agency bank is a company/organization that acts in some capacity on behalf of another bank, it, thus, cannot accept deposits or extend loans in its own name; it acts as agent for the parent bank. Agency banking refers to a retail outlet contracted by a financial institution or a mobile network operator to process clients' transactions. Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction and lets clients deposit, withdraw, and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer (CBK, 2014). Financial performance is the degree in which financial objectives are being accomplished in an organization. In other words; it's the measurement of how an organization's operations and policies are faring in monetary terms. This portrays the firm's financial stability over a given period whether across the firm or in comparison with other industries doing similar activity.

Globally, these retailers and post offices are increasingly utilized as important distribution channels for financial institutions. Agency banking was first developed in Brazil in 1999. Although by 2000, only 1,600 municipalities in Brazil had bank branches, by 2010, some 170,000 agents cover all of the 5,500 municipalities, and nearly 12 million accounts have been opened at agents over three years (Kumar, Nair, Persons & Urdapilleta, 2006). In United States, agency banking is a form of organization commonly used by foreign banks to enter the US market. Using an agency bank allows a foreign bank to engage in financial activity on US soil. People in the United States who want to do business with the parent bank can do so through the agent, with representatives at the agency bank taking care of issues like currency exchange, transfers of funds, and deposits among others. In Africa, the finance sector has a pivotal role to play in economic development. Across the continent a number of banks are championing sustainability and reengineering their operations to integrate agency banking models. However, in Africa, agency banking is a new concept, with the model/concept being highly implemented in Kenya and South Africa. In South Africa, the first agency banking was implemented in 2005 (Mwangi, 2011).

In Kenya, the banking Act, Central Bank of Kenya Act and the companies Act govern the operations of banking sector. Agency banking model has gained traction for both commercial and microfinance banks. The liberalization of banks in Kenya was effected back in 1995 where all exchange controls were lifted. Central Bank of Kenya is the regulating authority with 45 banking institutions whereby 44 are commercial banks and 1 is a mortgage finance company. Apart from that, there are 8 representative offices of

foreign banks,9 microfinance banks,2 credit reference bureaus The locally owned banking institutions are 30 while foreign owned are 14. By December 2014, 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents respectively across the country. By the end of Dec 2013 there were 13 commercial banks and no micro finance banks. This has improved by 52.4% in the number of approved agents. (CBK, 2014)

### **1.1.1 Agency Banking**

Agency banking refers to a partnership with non –banks, typically retail commercial outlets ranging from lottery kiosks, pharmacies, post office, construction good stores and so forth, to provide distribution outlets for financial services (Kumar et al; 2006). Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction and lets clients deposit, withdraw, and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer (CBK, 2014). Agency banking model requires commercial banks to rely on the existing infrastructure in terms of supermarkets, credit unions, hotels and petrol stations to reach out to customers. Agents can be limited liability companies, cooperative societies, parastatals, trusts, partnerships or individuals. Any entity which is faith-based or not-for-profit, a non-governmental organization, an educational institution, forex bureau or any other entity which, under any applicable law is not allowed to carry on profit-making business shall not engage in agent banking business. Agents are selected based on their network, services to be provided, anti-money laundering procedure, strategy and financial projections envisioned from agency business (Mwangi, 2011).

Agency banking was first developed in Brazil. Brazil was an early adopter of the model and agency banking has greatly matured over the years covering more than 99% of the countries municipalities. Other countries like Peru, Colombia, Mexico, Pakistan, and the Philippines also started experiencing with banking agent networks. Other countries around the world have also utilized the agent banking model to expand financial services, including Kenya and South Africa. It has enhanced performance greatly in the continent. Agent banks also help increase savings. Agents can be savings advocates, with key functions designed to be played by agents. Everybody needs a safe place to save, and costs can be reduced for agent banks by leveraging on the existing infrastructure, and minimizing credit risks to makes it safe (CGAP, 2010).

With real-time authorization of transactions structures, the banks check whether there are enough funds in the agent's account or the client's account before authorizing a cash transaction. Banking agents, thus, enforce liquidity management structures to ensure they have enough money for daily transactions. At best, banks generate automatic receipts from a printer integrated into the POS terminal, or as a storable text message sent to the customer's mobile phone, in the bank's name - since it represents a claim against a bank transaction. A complaints and claims structure is also necessary for customers who believe the process has not worked fairly for them and that requires records (Lozano & Mandrile, 2010).

### **1.1.2 Financial Performance**

Financial performance is the degree in which financial objectives are being accomplished in an organization. In other words; it's the measurement of how an organization's

operations and policies are faring in monetary terms. This portrays the firm's financial stability over a given period whether across the firm or in comparison with other industries doing similar activity. The reform agenda of Central bank of Kenya is to make Kenyan commercial banks achieve targets of vision 2030 where over 70% of Kenyans will be able to access formal financial services. By December 2014, 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents respectively across the country. By the end of Dec 2013 there were 13 commercial banks and no micro finance banks. This has improved by 52.4% in the number of approved agents. (CBK, 2014). Since the time of great depression in the 1940's scholars have been having great interest to study and research on financial performance analysis of commercial banks. Financial performance can be measured through the following avenues which are accredited by the Central Bank: -the Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity. Various studies have shown that high total capital, credits and deposits resulting from the operations of a bank doesn't necessarily show that the bank is profitable. How the assets of the bank are managed and the operational efficiency influences financial performance (Tarawneh, 2006)? Commercial banks operate with a main goal of making profits. From this study, I endeavor to bring out how agency banking affects financial performance of commercial banks. This is through their profitability. Profitability can be measured through various ratios which include Return on Asset, Return on Equity, Net profit margin etc. (Alexandra, 2008).

### **1.1.3 Agency Banking & Financial Performance**

According to the Fin-Access National Survey (2009), banks have billions at their disposal yet most of this goes to big corporate organizations and high net worth clients. A recent World Bank survey into Kenya's financial sector vindicates this survey, shows that access to formal financial services has increased from 26% of Kenyan bankable population in 2006 to 67% in 2013.

In a growing number of countries, banks are finding new ways to make money delivering financial services to "unbanked" people. Rather than using bank branches and their own field officers, they offer banking and payment services through retail outlets, including grocery stores, pharmacies, seed and fertilizer retailers and gas stations among others. For poor people, "Agency Banking" through retail agents may be far more convenient and efficient than going to a bank branch (Lyman, Ivatury and Staschen, 2006). To enhance financial inclusion (market access), Banking Act of Kenya was amended in 2010 to pave way for agency banking.

Despite the opportunities brought about by agency banking for both the customers and commercial banks by December 2014, 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents respectively across the country with a concentration of 90% of the agents in 3 banks; Equity Bank with 13,767 agents, Kenya Commercial Bank with 9,687 and Cooperative Bank with 8,765 (CBK, 2014). However, many are finding that agents lack capacity to handle large transactions of cash and under-spend on security measures, thus, negating potential clients' confidence in them. Besides this, agency banking has received a blow as many of the available outlets (agents) have



already been snagged by mobile phone companies, who have relied on their agents to fast-track uptake of mobile money solutions such as M-Pesa, YuCash, Orange Money and Airtel Money (Kiragu, 2011).

#### **1.1.4 Commercial Banks in Kenya**

In Kenya, the banking Act, Central Bank of Kenya Act and the companies Act govern the operations of banking sector. The liberalization of banks in Kenya was effected back in 1995 where all exchange controls were lifted. Central Bank of Kenya is the regulating authority with 44 banking institutions whereby 43 are commercial banks and 1 is a mortgage finance company. Apart from that, there are also 8 representative offices of foreign banks, 9 microfinance banks, 2 credit reference bureau, 13 money remittance providers and 87 foreign exchange bureaus. Out of the 44 banking institutions, 30 were locally owned banks. We have 16 commercial banks having the facility of agency banking. These are: -Equity bank, Kenya Commercial Bank, Co-operative Bank, Chase bank, Post bank, Family bank, Consolidated Bank, Standard Chartered Bank, I &M, African Banking Corporation, Barclays Bank of Kenya, Citi Bank, Commercial Bank of Africa, Eco bank, Diamond Trust Bank, and NIC Bank (CBK,2014)). On- site surveillance and off-site surveillance is done by Central Bank of Kenya as a way of regulating commercial banks in Kenya. This calls for inspection of institutions business records to ascertain whether they comply with the regulations.

Agent banking was adopted in the banking industry to enhance financial inclusion. Financial inclusion is the delivery of formal financial services in a reliable, convenient, affordable, continuous, and flexible manner to those without access to financial services

(CBK, 2014). The unbanked population includes individuals, households, small and medium sized entrepreneurs etc. With ease of access to financial services, the poor and marginalized people can build strong financial standing and even grow their investments. Agency banking in commercial banks has promoted economic growth and overall social well-being of a larger population. Domestic resources have been easily mobilized leading to efficient allocation of resources in societies in Kenya.

Regulatory and supervisory reforms and initiatives have made the banking sector to continually grow in terms of efficiency, inclusiveness and stability. The Government effort is to have a vibrant and competitive financial sector by 2030. Through agency banking, banks have explored more and convenient cost effective ways of reaching the unbanked population. Through Agency banking, banks have recorded enhanced performance during the year ended December 2014. The sector recorded a 12.2 per cent growth in pre-tax profits during the year. Both the total net assets and total deposits held by commercial banks recorded growth rates of 18.4 per cent (CBK, 2014).

## **1.2 Research Problem**

For the majority of Kenya's population that live in rural areas, access to banking services has been almost non-existent until the arrival of agency banking, however, this has been revised with the institutionalizing an infrastructure based on a model first pioneered in Brazil; agency banking. Agency banking has led to low cost of infrastructure and larger Access to formal financial services whereby it has increased from 26% of Kenyan bankable population in 2006 to 67% in 2013. This owes to low incomes and high cost of

banking, low profitability in serving the unbanked in the existing banking environment, remote and sparsely populated areas with poor infrastructure, lack of awareness, social exclusion and low literacy levels, distance from bank branch, branch timings, lengthy documentation and procedures. Any stable and efficient agency banking system depends on technology that enables banks and customers to interact remotely. The introduction of agency banking has resulted to an immense growth of banks (CBK, 2014)

However, in Kenya, high proportion of population is excluded from access to financial sector with the situation being grave in rural areas where banks branches are almost non-existent (Government of Kenya, 2005 and Fin Access National Survey, 2009). Considerable efforts have been made to address this problem that impacts directly on the livelihoods of poor people as well as economic growth. One of these efforts, was the legislation of agency banking model introduced in 2010 to expand access to financial services, especially in remote areas where it has been expensive for banks to maintain a presence, owing to smaller volumes (Beck et al, 2010). In Kenya, 16 commercial banks and 3 microfinance banks have engaged in Agency banking. Agency banking has come up with benefits which include reduction in cost, enhanced efficiency in the financial sector by availing financial services at much lower cost to consumers and increasing the ease of banks' expansion hence outreach to remote areas (Mwangi, 2011). Thus, agency banking can act as a great channel for financial deepening.

While numerous studies have been conducted on branchless banking, very few have focused on agency banking. Lozano and Mandrile (2010) studied agent model for

branchless banking in Colombia and developed a model whereby MFIs act as agents of branchless banking services, creating a new microfinance value chain through a process of scale and inclusion, and enable the poor to access a wider array of banking services. Various local studies have been done on Agency banking. Wabwoba (2012) looked at the challenges facing equity agency banking using Pokot County s his case study. The study found out that failure in mobile network was a major threat to adoption of agency banking. Kithuka (2012) studied the factors influencing growth of agency banking in Kenya. 100 Equity bank agencies were sampled and it was found out that money transfer technology has eased agency banking. However, these studies were conducted on at most 9 banks that had implemented agency banking and as such the findings might be outdated and false reflection of the current state since 16 banks have implemented agency banking. Also, Agency banking has experienced low adoption with no scientific study having been done on Agency banking in Kenya. This study seeks to assess agency banking model as one of the financial innovation in Kenya that can contribute to banks financial performance.

### **1.3 Research Objective**

The objective of this study was to establish the effect of agency banking on financial performance of commercial banks in Kenya.

#### **1.3.1 Specific Objectives of the Study**

- i. To determine the change in customer base since initiation of agency banking
- ii. To establish the acceptance level of agency banking in the market
- iii. To determine the change in profitability resulting from agency banking adoption

#### **1.4 Value of the Study**

The research findings of this study will be beneficial to a variety of people. First, current bank agents and prospective or potential agents can use the study to educate themselves on the many avenues and platforms of developing agency banking as a competitive advantage strategy. Second, the findings of this study can be used by commercial banks and MFIs to improve or expand services in a way geared to economic empowerment to all stakeholders. Thus Agency banking is one of such avenues of expanding their service access networks cheaply. For the commercial banks who have not embraced agency banking can use this study as a gateway to embracing the technology. Also the policy makers and executives in the commercial banks in Kenya can use agency banking as a product in making strategic decisions.

The study will also important to the public as it by explores various agency banking models in Kenya; the findings would contribute towards the strengthening the agency banking business. This would promote customer loyalty and widen financial services as more Kenyans would access banking services.

Central Bank and other regulatory bodies will benefit from this study in that issues that will come out of this study and will need to be regulated will be exposed. New revenue generating channels will be opened through increased tax bases from agents operating on behalf of banks. To enhance financial inclusion through agency banking, more rules and regulations will be adjusted in the existing business environment.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The chapter reviews literature from past studies, internet, text books and published articles. An empirical review of past studies has been done to guide the research gaps in this study. Agent-assisted banking is relatively new.

### **2.2 Theoretical Review**

Agency banking represents a new distribution channel that allows financial institutions and other commercial actors to offer financial services outside traditional bank premises. A wide spectrum of Agency banking models is evolving (State Bank of Pakistan, 2011) and is set to define the banking industry in this century.

#### **2.2.1 Intermediation Theory**

The theory regarding financial intermediation was developed starting with the 60's, the starting point being the work of Gurley and Shaw (1960). Economic role of financial intermediaries which include Investment banks, insurance, commercial banks and agency banking, build on the economics of imperfect information that began to emerge during the 1970s with the seminal contributions of Akerlof (1970), Spence (1973) and Rothschild and Stiglitz (1976). Financial intermediaries exist because they can reduce information and transaction costs that arise from an information asymmetry between borrowers and lenders. Financial intermediaries thus assist the efficient functioning of markets, and any factors that affect the amount of credit channeled through financial intermediaries can have significant macroeconomic effects.

There are two strands in the literature that formally explain the existence of financial intermediaries. The first strand emphasizes financial intermediaries' provision of liquidity. The second strand focuses on financial intermediaries' ability to transform the risk characteristics of assets. In both cases, financial intermediation can reduce the cost of channeling funds between borrowers and lenders, leading to a more efficient allocation of resources.

Diamond and Dybvig (1983) analyze the provision of liquidity (the transformation of illiquid assets into liquid liabilities) by banks. In Diamond and Dybvig's model, investors (depositors) are risk conscious and uncertain about the timing of their future consumption needs. Without an intermediary, all investors are locked into non-liquid long-term investments that yield high payoffs only to those who consume late. Those who must consume early receive low payoffs because early consumption requires premature liquidation of long-term investments. Banks can improve on a competitive market by providing better risk sharing among agents who need to consume at different and random periods. An intermediary promising investors a higher payoff for early consumption and a lower payoff for late consumption relative to the non-intermediated case enhances risk sharing and welfare.

Agency banking is about bringing technology innovation to the front end of the bank, as financial intermediary. While this ought to divert much of the transactional volume that is now channeled through bank branches, it does not make bank branches obsolete rather provides synergies that all parties benefit from. Theories of agency banking can be

classified into three broad categories: Bank Focused theory, Bank-Led and Nonbank-Led theories.

### **2.2.2 Bank-Focused Theory**

The bank-focused theory arises when a traditional bank uses non-traditional low-cost delivery channels to provide financial services to its existing customers. Examples vary from the use of automatic teller machines (ATMs) to internet banking or mobile phone banking to provide certain limited banking services to clients. This model is additive in nature and may be seen as a modest extension of conventional branch-based banking.

Though the bank-focused model offers advantages such as more control and brand visibility to the financial institutions concerned, it is not free of challenges. The clients' primary concerns regard to the quality of experience, security of identity and transactions, reliability and accessibility of service and the extent of personalization allowed. Banks address these issues by providing a branchless banking service with an easy to use interface, made secure with the help of multi-factor authentication and other technology, capable of running uninterrupted 365 days a year (Mas, 2009).

### **2.2.3 Bank-Led Theory**

In the most basic version of the bank-led theory of branchless banking, a licensed financial institution - a bank, delivers financial services through an agent. That is, the bank develops financial products and services, but distributes them through retail agents who handle all or most customer interaction (Lyman, Ivatury and Staschen, 2006). The bank is the ultimate provider of financial services and is the institution in which customers maintain accounts. Retail agents have face-to-face interaction with customers



and perform cash-in/cash-out functions, much as a branch-based teller would take deposits and process withdrawals.

This has been expanded recently to include retail agents handling all account opening procedures and, in some cases, even identify and service loan customers. Virtually any outlet that handles cash and is located near customers could potentially serve as a retail agent. Whatever the establishment, each retail agent is outfitted to communicate electronically with the bank for which it is working. The equipment may be a mobile phone or an electronic point-of-sale (POS) terminal that reads cards.

Bank-led model offers a distinct alternative to conventional branch-based banking in that customer conducts financial transactions at a whole range of retail agents instead of at bank branches or through bank employees (Lyman et al; 2006). This model promises the potential to substantially increase the financial services outreach by using a different delivery channel (retailers/ mobile phones), a different trade partner (Chain Store) having experience and target market distinct from traditional banks, and may be significantly cheaper than the bank based alternatives. In this model customer account relationship rests with the bank (Tomášková, 2010).

In bank-led model the technological/physical infrastructure of a retailer is used to provide some basic banking services like balance enquiry, account to account fund transfer, payments for goods/services at merchant outlets using bank account (through ATM/ Debit card / Phone SMS etc). Most of these services are already being provided by banks and are covered under existing regulations; hence, the model poses no specific regulatory

issues. Besides, it lowers the cost of delivery to banks, including costs of building and maintaining a delivery channel and to customers of accessing services (Lyman, Pickens and Porteous, 2008). In Brazil, private and state-owned banks deliver financial services through retail agents including small supermarkets and pharmacies, post offices, and lottery kiosks (Kumar et al; 2006).

Agents Related Risks arise from substantial outsourcing of customer contact to retail agents. From a typical banking regulator's perspective, entrusting retail customer contact to the types of retail agents used in both the bank-led and nonbank-led models would seem riskier than these same functions in the hands of bank tellers in a conventional bank branch. These retail agents may operate in hard-to reach or dangerous areas and lack physical security systems and specially trained personnel. The lack of expert training may seem a particular problem if retail agents' functions range beyond the cash-in/cash-out transactions of typical bank tellers to include a role in credit decisions (State Bank of Pakistan, 2011).

Banking regulation typically recognizes multiple categories of risk that bank regulators and supervisors seek to mitigate. Five of these risk categories credit risk, operational risk, legal risk, liquidity risk, and reputation risk take on special importance when customers use retail agents rather than bank branches to access banking services. The use of retail agents also potentially raises special concerns regarding consumer protection and compliance with rules for combating money laundering and financing of terrorism (Kumar, et al; 2006).

#### **2.2.4 Agency Theory**

During the 1960's and early 1970's economists explored risk sharing among individuals or groups. Agency theory broadened this risk sharing idea. Agency theory is directed at the ubiquitous agency relationship in which one party (The Principal) delegates work to the other party (the Agent) who performs the work. Agency theory is a theory that shows the contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources (Lambert, 2002). Jensen and Meckling (1976) were the first scholars to explicitly model the theory of agency.

Agency theory is based on the premise that agents are more informative than the principals. This information asymmetry affects the ability of the principal to effectively monitor their wealth and this is where the agents came in hand to help. It also assumes that principals and agents act rationally (Brigham & Gapenski, 1993). In the simplest agency models, the organization is reduced to these two contracting characters: the principal and the agent. The principal's roles are to supply capital, to bear risk, and to construct incentives, while the role of the agent are to make decisions on the principal's behalf and to also bear risk (Lambert, 2002). Banking surplus funds with scheduled banks meeting certain minimum rating criteria (State Bank of Pakistan, 2011).

#### **2.3 Determinants of Financial Performance of Commercial Banks**

In resource allocation in a country, commercial banks help a lot. In researches, a lot of studies have focused on the financial performance of these commercial banks. Their performance can be affected by various factors which can be categorized in to: external

and internal factors (Al-Tamini, 2010) the internal factors are bank specific which affect the performance of the bank while external factors are sector wide which are beyond the companies control since it affects all sectors profitability. The internal factors differ from bank to bank and the bank at hand can manipulate them to their success. These include capital size, management efficiency, agency banking. On the other hand, the external factors include: inflation rate and political instability among others.

### **2.3.1 Capital Adequacy**

Banks profitability is highly affected by size of capital. According to Khrawish (2011) capital refers to the available funds the bank uses to support its business and it will serve as a buffer in times of adverse financial situation. When a bank has large size of capital, its liquidity position is good and it's capable to operate all through even in times of distress (Diamond, 2000). This in turns leads to higher profitability levels. The CBK Prudential Guideline on Capital Adequacy requires each bank to have a minimum capital adequacy of a ratio of core capital of 8% (CBK, 2014).

### **2.3.2 Agency Banking**

In a growing number of countries, banks are finding new ways to make money delivering financial services to "unbanked" people. Rather than using bank branches and their own field officers, they offer banking and payment services through retail outlets, including grocery stores, pharmacies, seed and fertilizer retailers and gas stations among others. For poor people, "branchless banking" through retail agents may be far more convenient and efficient than going to a bank branch (Lyman, Ivatury and Staschen, 2006). To enhance financial inclusion (market access), Banking Act of Kenya was amended in 2010 to pave

way for agency banking. This has led to increased profitability of banks. Increased number of transactions facilitated by bank agents largely attribute to increases in transactions relating to payment of bills, mini statement requests, cash withdrawals and cash deposits which in turn improves profitability of commercial banks (CBK, 2014)

### **2.3.3 Bank Size**

Banks have relentlessly increased in their sizes over the years. In terms of their national economies, most financial institutions have become very large. If the absolute size of a bank increases, its rate of return on asset as well as bank risk increases. The systematic size, i.e. size relative to the national economy has no effect. The absolute size of a bank is defined as a tradeoff between the bank risk and its return. Larger banks have a larger share of their income in terms of non-interest income (Huizinga, 2012). The market share will give the bank size. This comprises of net asset deposits, capital, number of loan accounts and number of deposits.

### **2.4 Empirical Review**

Kandie (2013) sought to establish the effect of agency banking on financial inclusion in Kenya. The study adopted was a cross sectional survey approach in research design. The population consisted of six commercial banks with agency banking services in Kenya. She used secondary data with inferential statistics techniques being used to make a prediction about the dependent variable. The findings showed strong positive relationship between financial inclusion and agency banking.

Watiri (2013) sought to establish the contribution of agency banking in financial performance of commercial banks in Kenya. The study adopted a descriptive survey. It found out that low transaction cost through agency banking had a positive impact on the financial performance of Kenyan commercial banks. By this time, only 9 banks had adopted agency banking and by Dec 2014, 16 banks have adopted the model. This gives more accurate results than Watiris. Also, Watiri's study didn't consider the financial performance before adoption of agency banking but my study will be a comparative study showing the financial performance before and after adoption of agency banking in Kenya commercial banks.

CGAP (2010) conducted survey of Russia on regulation of branchless banking. The survey was done using empirical analysis of relevant legal and policy changes through the end of 2009. The findings indicate that more than 100,000 automated payment terminals have sprung up in the larger cities in recent years. One provider, Cyber Plat, claims to have processed 1.2 billion transactions worth US\$4.7 billion through the first three quarters of 2007 via its 70,000 "cash acceptance" points, mostly for prepaid airtime, television, Internet, and other utilities (CGAP).

Lozano and Mandrile (2010) studied agent model for branchless banking in Colombia. It examined traditional banking sector's interest in branchless banking and identifies available platforms for implementation of banking agent networks and empirically highlighted benefits of branchless banking for Colombian MFIs, and gives an overview of the current network of NBCs in the country. The findings presented a new model

where MFIs act as agents of branchless banking services. Implementation of the model would create a new microfinance value chain through a process of scale and inclusion, and enable the poor to access a wider array of banking services. Recommendations included: clear rules of representation to mitigate confusion of clients on roles of banks; synergy among all players for achievement of integrated branchless banking solution; and, expansion of infrastructure and technology to support the model.

Modupe (2010) examined the dynamic of financial innovation in the banking industry in the Nigeria, and found that a distinction between product innovation and process innovation is necessary as much as the adoption of each type of innovation has its own characteristics and has a different impact on banking performance. They argue that product innovations have a market focus and are effectiveness driven, while process innovations have an internal focus and are efficiency driven. In fact, product innovations are introduced to satisfy an external user or market need, while process innovations are defined as new elements introduced into the firm's production or into the services it provides. The latter are essentially introduced by the firm with a view towards improving its efficiency.

Wambari (2009) sought to establish the importance of mobile banking in the day to- day running of small businesses in Kenya. The study used a random sample of 20 firms and selected senior personnel (owners, managers or supervisors) to whom semi-structured questionnaires were administered. The study established that in urban areas over 73 % of

mobile phone usage is for business purposes while over 70 % of mobile phone usage in the rural areas is for social communication.

Laukkanen (2007) conducted a survey of mobile banking in developing countries with specific reference to secure framework for delivery of SMS-banking services. Using secondary data, the study established that the potential for SMS mobile banking services is high in countries where internet infrastructure hinders the access to electronic banking services. However, most developing countries particularly in Africa internet connectivity and bandwidth are low and the population is not urbanized and averagely poor hence internet banking services not viable in most parts of the continent. The study concluded that internet banking will remain the most attractive service for developed countries whereas SMS banking will gain more in-roads in developing countries.

Consultative Group to Assist the Poor (CGAP) (2006) conducted a survey on in branchless banking in Pernambuco, Brazil. It was found that bill payments and the payments of government benefits to individuals comprised 78 percent of the 1.53 billion transactions conducted at the country's more than 95,000 agents in 2006.6 CGAP research in Brazil found that, of the 750 people who responded to a survey in Pernambuco State, 90 percent reported using banking agents to pay utility and other bills, only 5 percent reported opening a bank account at the agent, and less than 5 percent said they had made a cash deposit into their bank account at an agent. Indeed, 87 percent of those who had opened an account stated that they had done so just to receive w Kumar, Nair, Parsons and Urdapilleta (2006) explored the extent to which formal, regulated



financial institutions such as banks have been able to partner with correspondents, commercial entities whose primary objective and business is other than the provision of financial services in Brazil. The findings indicate that Brazil has created an unusually favorable environment for correspondent banking. It was further established that costs and regulatory regimes affect the details of profitability or differential advantage of correspondent banking compared to branch banking. It was established that branchless banking allows banks to gain proximity to small and perhaps higher risk clients through a format that is friendly to this population segment, but with significantly reduced startup investments and ongoing costs. Economies of scale allow this despite low balances and profit margins from business with these clients' welfare or salary payments.

From all those studies reviewed, it's evident that agency banking has brought more advantages like cost saving and accessibility to financial services, with Kenyan financial institutions regaining more aggressive entry into this segment. However, documentation of how this agency banking model is lacking in Kenyan banks. The gap this study seeks to fill is therefore to evaluate the effect of agency banking in the performance of commercial banks in Kenya. The earlier studies also have been done on fewer banks which had adopted agency banking leading to generalized results. This study will get data from 16 banks currently doing agency banking resulting to more accurate results.

#### **2.4 Summary of the Review**

This section highlights findings that have emerged as a result of the empirical and theoretical work on effect of agency banking on financial performance of Kenyan

commercial banks. The few studies which have been done focusing on bank based models showed that customers have direct contractual relationship with regulated financial institutions through transaction accounts, savings accounts, loans, or combinations thereof. There are three theories discussed which include Intermediation theory, Non –bank led theory and Bank led theory. All these theories agree that agency banking has led to improved financial performance in financial institutions.

Innovation of new products has majorly been brought have by growth in technology. This technology has spurred large growth of banking industry. From the past studies done, performance of financial institutions has been affected by infrastructure and security. Operation costs for commercial banks have gradually reduced as a result of adoption of agency banking models. With agency banking, larger geographical places can access financial help thus increased competition, competition has led to better services.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

The chapter outlined the research design that was suitable for the study, the target population, the research sample, data collection and data analysis techniques that was applied.

### **3.2 Research Design**

This study employed descriptive research design. Descriptive research involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data collection. Descriptive research goal is to describe the data and characteristics of the study. It is an accurate research design and is one of the best methods for collecting information that demonstrates relationships.

### **3.3 Target Population**

The target population for this study was all commercial banks in Kenya that has adopted agency banking. There are 16 commercial banks having the facility of agency banking as shown in Appendix 1.

### **3.4 Data Collection**

This section sets out how data for the study was collected. Secondary data was used for this study since it was easily available, cheaper and for this case very accurate. Secondary data is the data that already has been collected e.g. from journals, published printed sources, books etc. (Kelly, 2005) The CBK guideline on agent banking requires that all

banks offering agency banking must furnish The Central Bank of Kenya with data and other information on agency operations, Including the number of transactions from the agents of each bank, money flowing from each agent, incidents of fraud, theft or robbery, Customer complaints and remedial measures taken to address customer complaints. Failure to submit this data accurately and on time not later than the tenth day of the following month attracts administrative sanctions.

Each bank Annual reports was used to extract the financial performance indicators while the supervisory reports from CBK was used to show the number of agents registered and the total value of transactions done though agents. These reports are for three-year period from year 2012-2014

### **3.5 Data Analysis**

Multiple linear regression was used as the mode of analyzing the data collected so as to establish whether there is any relationship between agency banking and financial performance of commercial banks in Kenya. The algebraic expression of the analytic model applied was as below;

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

Where; Y=Financial performance measure which will be measured by Return on Asset (ROA). The following is the components of model according to Kiragu (2012)

$\alpha$  =Regression constant,

$\beta_1$  to  $\beta_4$  =Regression coefficients,

$X_1$ =Log of Number of Agents,

$X_2$ = Log of Cash deposits transactions by agents,

$X_3$ = Log of Volume of cash withdrawals transactions done by agents,

$X_4$ = Log of the bank size (Control variable)

$\epsilon$ = coefficient of error

### **3.5.1 Test of Significance of the Model**

In case of multiple linear regressions, test for significance was carried out using Analysis of Variance (ANOVA). The test confirms whether any linear statistical relationship exists between a dependent variable and the predictor variable.

The statements for the hypotheses are:  $H_0: \beta_1 = \beta_2 = \beta_3 = \dots \beta_k = 0$

$H_1: \beta_j \neq 0$  for at least one  $j$ . These inferential tests will be conducted at 95% confidence.

Hypothesis Tests will be used to give confidence on the model an assumption is that the error term  $\epsilon$ , is normally and independently distributed with a mean of zero and variance of the square of the standard deviation.

## CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

### 4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The objective of the study was to establish the effect of agency banking on financial performance of commercial banks in Kenya among 16 commercial banks in Kenya for a period of 3 years from the year 2012 to 2014. The data was gathered exclusively from the secondary source records at Central Bank of Kenya and commercial banks audited financial report.

### 4.2 Descriptive Statistics

In section 4.2 the study presents the research finding on the descriptive statistic in the data collected.

**Table 4.1: Descriptive Statistics**

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
ROA	48	-4.8	10.4	3.8719	2.90117
Number of Agents	48	4.86	8.81	6.9904	1.02236
Cash Deposits	48	20.59	24.39	22.6437	1.01242
Cash Withdrawals	48	19.82	23.58	21.8767	0.99862
Bank Size	48	0.41	13.54	4.7431	3.6135

Financial performance measure Return on Assets (ROA), number of banks agents, cash deposits, cash withdrawals and bank size were used for the study. Their mean,

maximum, minimum and standard deviation was taken in to account. From the findings, the study found that there was mean of 3.8719 for return on assets, 6.9904 for number of agents, 22.6437 for cash deposits, 21.8767 for cash withdraws and 4.7431 for bank size. On return on assets had 2.90117, number of agents 1.02236, cash deposits 1.01242, cash withdraws 0.99862 while bank size had 3.6135. Bank size had the highest standard deviation hence the highest variation from the mean.

### 4.3 Correlation

**Table 4.2: Correlation**

		ROA
ROA	Pearson Correlation	1
	Sig. (2-tailed)	
	N	48
Number of Agents	Pearson Correlation	.657**
Cash Deposits	Pearson Correlation	.665**
	Sig. (2-tailed)	.001
	N	48
Cash Withdrawals	Pearson Correlation	.677**
	Sig. (2-tailed)	.000
	N	48
Bank Size	Pearson Correlation	.620**
	Sig. (2-tailed)	.000
	N	48

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

On the correlation of the study variables, the researcher conducted a Pearson correlation. From the findings on the correlation analysis between Return on assets and various derivatives, the study found that there was a strong positive correlation coefficient between return on assets and number of agents as shown by correlation factor of 0.657. The study also found a positive correlation between ROA and cash deposits as shown by correlation coefficient of 0.665. The study also found a positive correlation between ROA and cash withdrawals as shown by correlation coefficient of 0.677. Finally, there was a positive correlation between ROA and bank size as shown by a correlation coefficient of 0.620. Hence all the derivatives had a position relationship with return on assets as a measure of financial performance. There was also significant relationship between the variables as the correlation of the variables was significant at 0.01 significant level.

#### 4.4 Regression Analysis

In this section the study presents the research findings on the relationship between various independent variables on the regression model and financial performance.

**Table 4.3: Model Summary**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.744 <sup>a</sup>	0.553	0.512	2.02759

a. Predictors: (Constant), bank size, number of agents, cash withdrawals, cash deposits



From the table above, R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by R 0.744 at 5% significance level. The Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the table above the value of adjusted R squared was 0.512 an indication that there was variation of 51% on return on assets due to changes in bank size, number of agents, cash withdrawals and cash deposits at 95% confidence interval. This is an indication that 51% of the changes in return on assets could be accounted for by the independent variables.

**Table 4.4: ANOVA**

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	218.812	4	54.703	13.306	.001 <sup>b</sup>
	Residual	176.778	43	4.111		
	Total	395.59	47			

a. Dependent Variable: ROA

b. Predictors: (Constant), bank size, number of agents, cash withdrawals, cash deposits

From the table above, the processed data, which is the population parameters, had a significance level of 0.1% which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance (p-value) is less than 5%. The F

critical at 5% level of significance, 4 d.f, 43 d.f was 2.58, while F computed was 13.306, since F calculated is greater than the F critical (value = 2.58), this shows that the overall model was significant.

**Table 4.5: Regression Model**

Coefficients <sup>a</sup>

	Unstandardized		Standardized	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.026	.412		4.917	.012
Number of agents	4.341	1.218	4.423	3.564	.021
Cash deposits	1.493	.476	1.211	3.137	.034
Cash withdrawals	2.861	.697	3.327	4.105	.018
Size	0.776	.228	0.908	3.404	.026

a. Dependent Variable: ROA

$$Y = 2.026 + 4.341 X_1 + 1.493 X_2 + 2.861 X_3 + 0.776 X_4$$

From the regression equation above it was found that holding number of agents, cash deposits, cash withdraws and bank size to a constant zero, return on assets would be 2.026. A unit increase in number of agents would lead to increase on return on assets by 4.341 units. A unit increase in cash deposits would lead to increase in return on assets by 1.493 units, a unit increase in cash withdrawals would lead to increase in return on assets by 2.861 units and a unit increase in bank size would lead to increase on return on assets by 0.776 units. Overall number of agents had the greatest effect on return on assets.

At 5% level of significance and 95% level of confidence, cash withdrawals had a 0.018 level of significance; number of agents had a 0.021 level of significance, bank size had a 0.026 level of significance while cash deposits had a 0.034 level of significance. All the variables were significant ( $p < 0.05$ ).

#### **4.5 Discussions of Findings**

From the findings the study revealed that there was a strong positive correlation coefficient between financial performance through return on assets and number of agents. The findings agreed with the findings by Watiri (2013) who sought to establish the contribution of agency banking in financial performance of commercial banks in Kenya and found out that low transaction cost through agency banking had a positive impact on the financial performance of Kenyan commercial banks. The findings of this study also agree with the finding of Aduda, (2013) in his study that found out that agency banking is continuously improving and growing and as it grows, the level of financial inclusion is also growing proportionately hence increasing profitability. The study further revealed that increasing the area covered by agents within the country has had the effect of increasing the reach of the financial services to the people thus raising the levels of financial because a certain cliché of the population would not visit the bank branches for various reasons.

The findings also agreed with Podpiera (2008) argue that agent banking does improve the economics for these institutions compared with branches, especially for high-transaction, low-balance accounts that are common among poor users. The findings differed with the

finding of Pickens, (2010) who stated that agency banks have not contributed much to banks' revenue growth owing to customers' skepticism about its transactional security.

The findings also revealed a strong positive correlation coefficient between number of agents, cash deposits, cash withdraws and financial performance through return on assets. This is because agency banking lead to increased number of transactions facilitated by bank agents largely attribute to increases in transactions relating to payment of bills, mini statement requests, cash withdrawals and cash deposits which in turn improves profitability of commercial banks (CBK, 2014).

The findings also revealed a strong positive correlation coefficient between bank size and financial performance through return on assets. The findings were concurrent with the findings by Diamond (2000) that when a bank has large size of capital, its liquidity position is good and it's capable to operate all through even in times of distress which in turns leads to higher profitability levels. The findings finally revealed that all the variables had a positive correlation with return on assets and a unit increase in each variable would lead to increase in return on assets as shown by the above studies.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

From the analysis and data collected, the following discussions, conclusion and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to establish the effect of agency banking on financial performance of commercial banks in Kenya.

### **5.2 Summary**

On descriptive statistics the study found out that there was mean of 3.8719 for return on assets, 6.9904 for number of agents, 22.6437 for cash deposits, 21.8767 for cash withdraws and 4.7431 for bank size. On return on assets had 2.90117, number of agents 1.02236, cash deposits 1.01242, cash withdraws 0.99862 while bank size had 3.6135. Bank size had the highest standard deviation hence the highest variation from the mean.

On correlation, the study found that there was a strong positive correlation coefficient between return on assets and number of agents represented by correlation factor of 0.657. The study also found a positive correlation between ROA and cash deposits represented by correlation coefficient of 0.665. The study also found a positive correlation between ROA and cash withdrawals represented by correlation coefficient of 0.677. Finally, there was a positive correlation between ROA and bank size represented by a correlation coefficient of 0.620. Hence all the derivatives had a positive relationship with return on assets as a measure of financial performance. There was also significant relationship

between the variables as the correlation of the variables was significant at 0.01 significant level.

There was a strong positive relationship between the study variables represented by R 0.744 at 5% significance level. R squared was 0.512 an indication that there was variation of 51% on return on assets due to changes in bank size, number of agents, cash withdrawals and cash deposits at 95% confidence interval. This is an indication that 51% of the changes in return on assets could be accounted for by the independent variables. The variables had a significance level of 0.1% which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance (p-value) is less than 5%. The F critical at 5% level of significance, 4 d.f, 43 d.f was 2.58, while F computed was 13.306, since F calculated is greater than the F critical (value = 2.58), this shows that the overall model was significant.

From the regression equation it was found that holding number of agents, cash deposits, cash withdraws and bank size to a constant zero, return on assets would be 2.026. A unit increase in number of agents would lead to increase on return on assets by 4.341 units. A unit increase in cash deposits would lead to increase in return on assets by 1.493 units, a unit increase in cash withdrawals would lead to increase in return on assets by 2.861 units and a unit increase in bank size would lead to increase on return on assets by 0.776 units. Overall number of agents had the greatest effect on return on assets. At 5% level of significance and 95% level of confidence, cash withdrawals had a 0.018 level of significance; number of agents had a 0.021 level of significance, bank size had a 0.026

level of significance while cash deposits had a 0.034 level of significance. All the variables were significant ( $p < 0.05$ ).

### **5.3 Conclusions**

The study concludes that increase in the number of agents of commercial banks lead to an increase in the financial performance of commercial banks hence there is a positive relationship between number of agents and financial performance. This is because as agency banking grows, the level of financial inclusion is also growing proportionately hence increasing profitability. The study also concludes that there is a positive relationship between cash deposits, volume of deposits, volume of withdraws and financial performance, this is because as the number of agents through agency banking grows there is increased number of transactions facilitated by bank agents. This is largely attribute to increases in transactions relating to payment of bills, mini statement requests, cash withdrawals and cash deposits which in turn improves profitability of commercial banks.

The study also concludes that bank size has a positive relationship with financial performance of commercial banks; this is because as the number of agents increases the size of the assets increase hence financial performance. This is because bank size is attributed to capital and when a bank has large size of capital, its liquidity position is good and it's capable to operate all through even in times of distress, this in turn improves profitability. Banks have relentlessly increased in their sizes over the years and if the absolute size of a bank increases, its rate of return on asset increase as well as

bank risk increases.

#### **5.4 Policy Recommendations**

The study sought to determine the effect of agency banking on financial performance of commercial banks in Kenya. The study recommends that; commercial banks should be encouraged to embrace agency banking through adoption of improved technology. This will increase volume of transactions and bank size which will lead to financial performance.

Security enhances accessibility and operation of agents' banks; the government of Kenya should thus improve security to enhance operation of the agents' bank. This will enable commercial banks in Kenya increase the number of agents. This can be done by reducing the requirements of becoming a bank agent.

Commercial banks in Kenya should improve customers' perception by making more advertisements and also increase promotion activities of agent's banking. By doing this the number of transactions made by customers will increase. This in turn helps the customers to save more and hence the amount the bank can loan increases. This helps to improve the financial performance of commercial banks.

The government should support the program of operation of agency banking. This can be done by reducing the high compliance costs, bureaucracy in registration and high cost of taxation. This will increase the number of transaction by the banks hence profitability.



### **5.5 Limitations of the Study**

This study was not without limitations. In attaining its objective, the study was limited to 16 commercial banks that have embraced agency banking over a 3 years' period starting from year 2012 to year 2014. This is because only those 16 commercial banks have embraced agency banking and most of them stated operating agency banking in the year 2012. The study was limited to secondary data collected from the banks financial reports and Central banks of Kenya. While the data was verifiable since it came from the CBK and banks publications, it nonetheless could still be prone to shortcomings. Secondary data may also be unreliable as it may be intended for other purposes.

### **5.6 Suggestions for Further Study**

This study sought to establish the effect of agency banking on financial performance of commercial banks in Kenya. A study can be done on the challenges facing the adoption of agency banking by commercial banks in Kenya so as to find the reasons behind low number of operation of agency banks compared to the number of commercial banks operating in the country.

A study can also be done on the factors affecting the financial performance of the agent banks; this will enable the commercial banks embrace agency banking through adoption of technology thus enhancing financial performance of commercial banks.

A study can also be done on the role of the government or regulatory framework in supporting the adoption of agency banking and the impact of agency banking to the financial sector deepening and financial inclusion.

## REFERENCES

- Alexandru, C., Genu, G., & Romanescu, M.L. (2008). The Assessment of Banking Performances-Indicators of Performance in Bank Area. MPRA Paper No. 11600.
- Anyasi, F.I. and Otubu, P.A. (2009), Mobile Phone Technology in Banking System: Its Economic Effect. *Research Journal of Information Technology 1(1): 1-5*.
- Beck, Thorsten; Cull, Robert; Fuchs, Michael; Getenga, Jared; Gatere, Peter; Randa, John; Trandafir, Mircea. (2010). *Banking Sector Stability, Efficiency, and Outreach in Kenya*.
- Bringham, E. and Gapenski, L. (1993). *Intermediate Financial management 4th Edition* Orlando; The Dryden press
- Burgess, R., & Rohini, P. (2004). Can Rural Banks reduce Poverty? Evidence from the Indian Social Banking Experiment. *American Economic review Journal, 45,345-360*.
- Central Bank of Kenya (2010), *Agent Banking Knowledge Exchange*. Nairobi, Kenya.  
Retrieved from <http://www.afilobal.org/sites/>
- Central Bank of Kenya (2010), *Guideline on Agent Banking - CBK/PG/15*, Nairobi.
- Central Bank of Kenya (2012), *Annual Report CBK/PG/48*, Nairobi
- Central Bank of Kenya (2014), *Annual Report CBK/PG/48*, Nairobi.

- CGAP.2010. Understanding Branchless Banking Business Models International Experiences. *Focus Note No. 43* Washington D.C.
- Diamond, D.W. (1984). Financial intermediation and delegated monitoring. *Review of Economic Studies* 51, 393-414
- FSD Kenya. (2009), The Performance and Impact of M-PESA: Preliminary Evidence From a Household Survey. *Mobile Money Summit*.
- Freedman, D. A. (2005). *Statistical Models: Theory and Practice*, Cambridge University
- Gurley, G., & Shaw, S. (1960) "Money in a theory of finance", Brookings
- Harry Huizinga (2012) Evidence on performance, strategy and market discipline
- Ivatury, G., & Lyman, T. (2006). *Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation*. Washington D.C: CGAP Focus Note No. 38.: October
- Kandie, C. (2013) Impact of Agency banking on financial inclusion in Kenya. *MBA Thesis, University of Nairobi*
- Kiragu, P. (2011). The Extent of Implementation of Agency Banking Among Commercial Banks in Kenya. MBA Project, University of Nairobi

- Kithuka, B.K. (2012). Factors influencing growth of agency banking in Kenya: the case of Equity bank, Kwale County, Kenya. *MA Thesis*, University of Nairobi.
- Khrawish, H.A. (2011) Determinants of Commercial Banks Performance: Evidence from Jordan. *International Research Journal of Finance and Economics*, Zarqa University, 5(5), 19-45.
- Kumar, A., Nair, A., Parsons, A., & Urdapilleta, E. (2006). Expanding Bank Outreach through Retail Partnerships: Correspondent Banking in Brazil World Bank Working Paper No. 85. The World Bank: Washington DC. 2006
- Laukkanen, T., (2007). Internet vs. mobile banking: comparing customer value perceptions. *Business Process*
- Lyman, M., Timothy, A., Ivatury, G. and Stefan, S. (2006). Use of Agents in Branchless Banking for the Poor; Rewards, Risks, and Regulation. *Focus Note* 38. *Washington, D.C.*
- Lozano, D.M., & Mandrile, M. (2010). A New Agent Model for Branchless Banking in Colombia. International Development Law Organization.
- Mas, I. (2009). *The Economics of Branchless Banking: Innovations*. Boston, MA: MIT Press
- Modupe, L. (2010), Enhancing Financial innovation and Access. *Agent Banking*

*Innovation Forum Nigeria.*

- Mwangi, R.W. (2011). An Evaluation of the Role of Agency Banking in the Performance of Commercial Banks in Kenya. *MBA Thesis, Kenyatta University*
- Tarawneh, M. (2006). A comparison of financial performance in the banking sector: Some Evidence from Omani Commercial Banks. *International Research Journal of Finance and Economics (3): 1-5, 2006.*
- Wabwoba, T.B (2012) Challenges facing equity agency banking; a case of Pokot County, Kenya. *MBA thesis, University of Nairobi*
- Wambari, K. (2009) Importance of Mobile banking in Small and Medium sized business in Kenya. *MBA Thesis, University of Nairobi*
- Watiri, T.A (2013) The impact of agency banking on financial performance of Kenyan commercial banks, *MBA project, University of Nairobi*
- Wen, W. (2010) Ownership Structure and Banking Performance: New Evidence in China. *Universitat Autònoma de Barcelona Departament D'economia de L'empresa,*

## APPENDICES

### **Appendix 1: List of Commercial Banks operating Agency Banking in Kenya as at Dec 2014**

- 1) Kenya Commercial Bank Ltd.
- 2) Co-operative Bank of Kenya Ltd
- 3) Chase Bank (K) Ltd.
- 4) Diamond Trust Bank Kenya Ltd
- 5) Equity Bank Ltd.
- 6) Family Bank Ltd.
- 7) NIC Bank Ltd
- 8) Bank of Africa (K)
- 9) Citi Bank Ltd
- 10) Consolidated Bank
- 11) Standard Chartered Bank
- 12) I & M
- 13) African Banking Corporation
- 14) Barclay Bank of Kenya
- 15) Citi Bank
- 16) Eco bank

**SOURCE: Bank supervision Report 2014**

## Appendix II: Number of Transactions

Type of Transaction	No. of Transactions		
	Year 2012	Year 2013	Year 2014
Cash Deposits	12,554,299.00	18,531,811	25,967,462
Cash Withdrawals	11,862,412.00	16,981,903	24,900,283
Payment of bills	142,046.00	113,429	268,115
Transfer of funds	944.00	3,292	1753
Account balance enquiries	4,770,829.00	5,771,490	6,388,489
Mini Statement requests	43,376.00	30,776	57,327
Account opening forms collections	176,218.00	158,781	119,743
Totals	29,550,124	41,591,482	57,703,172
No. of Active agents	16,333	23,477	35,789

Source CBK Supervisory bank reports 2012, 2013 2014

**Appendix III: Type & Values of transactions undertaken through agent banking**

Type of transaction	Value of the transaction "Millions"		
	Year 2012	Year 2013	Year 2014
Cash Deposits	101,170.60	160,789.90	236,145.75
Cash Withdrawals	49,609.5	73,893.5	104,999.73
Payment of bills	238.7	251.2	3,461.60
Payment of retirement social benefits	1,064.4	1,253.9	1,164.37
Transfer of funds	14.2	27.1	28.47
Totals	152,097.4	236,215.6	345,699.77

**Source CBK Supervisory bank reports 2012, 2013 2014**



**Appendix IV: Return on Asset (ROA) for years-2012, 2013, 2014**

Bank	Year 2012(%)	Year 2013(%)	Year 2014(%)
Equity	7.4	7.7	7.26
Kenya Commercial Bank	5.2	5.5	5.93
Barclays Bank of Kenya	7.0	5.8	5.44
Standard Chartered Bank	5.9	6.0	6.42
Co-operative Bank	4.8	4.7	4.43
Citi Bank	10.4	7.0	5.22
I&M Bank	5.2	5.5	5.64
Diamond Trust Bank	4.9	4.9	4.47
NIC Bank	4.2	4.6	4.44
Commercial Bank of Africa	4.0	3.6	2.57
Chase Bank	2.7	2.9	3.08
Family Bank	2.7	4.0	4.24
Consolidated Bank	1.0	-0.8	-1.82
African Banking Corporation(ABC)	2.9	2.9	1.49
Bank of Africa(K)	1.3	2.0	.33
Eco bank(K)	-4.8	-3.3	-1.09
Totals	64.8	63.0	59.14

**Source CBK Reports years 2012, 2013, 2014**

**Appendix V: Bank sizes as at 2012, 2013, 2014**

<b>Bank</b>	<b>Bank size (%) 2012</b>	<b>Bank size (%) 2013</b>	<b>Bank size (%) 2014</b>
Equity	10.06	9.79	8.70
Kenya Commercial Bank	13.54	12.83	12.69
Barclays Bank of Kenya	8.08	7.65	7.29
Standard Chartered Bank	8.29	8.09	8.91
Co-operative bank of Kenya	8.74	8.61	8.74
Citi bank	3.42	2.83	2.76
I&M	4.08	4.19	4.10
Diamond Trust Bank(K)	4.10	4.26	4.63
NIC Bank (K)	4.32	4.17	4.24
Commercial Bank of Africa	4.08	4.40	5.12
Chase Bank	1.87	2.40	2.98
Family Bank	1.42	1.62	2.06
Consolidated Bank	0.66	0.41	0.41
African Banking Corporation(ABC	0.76	0.70	0.63
Bank of Africa(K)	1.83	1.77	1.77
Eco bank (K)	1.06	1.15	1.46
Totals	76.31	74.87	76.49

**Source CBK Reports years 2012, 2013, 2014**