THE EFFECTS OF AGENCY BANKING ON THE NON-FUNDED INCOME OF COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

This project is my original work and has not been presented for a degree or any other award in any other University.

Signature_____Date_____

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REG NO: D63/65048/2013

I confirm that this project was carried out by the candidate under my supervision as the University supervisor.

Signature_____Date_____

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DEDICATION

I dedicate this research project to the Almighty God for His grace, mercy and blessings that have seen me through.

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LIST OF ABBREVIATIONS AND ACRONYMS

ATM	Automated Teller Machine
BBIS	Branchless Banking Institutions
CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
CTF	Counter-Terrorism Financing
EBL	Equity Bank Limited
KBA	Kenya Bankers Association
KCB	Kenya Commercial Bank
KYC	Know-Your-Customer
MFI	Micro Finance Institution
MNO	Mobile Network Operations
NBA	Non-Bank Agent
NFSA	National Financial Access Survey
PCs	Personal Computer
PIN	Personal Identification Number
POS	Point of Sale
SPSS	Statistical Package for Social science

ABSTRACT

Agency banking in Kenya is part of the approach by the Central Bank of Kenya to promote innovation through mobile financial services and to address the delivery of channels costs (Central Bank of Kenya, 2010). Agency banking begun as early as 1999 in other countries like Brazil, Columbia, Pakistan, South Africa and Indonesia, it was introduced in Kenya in May 2010 when the Central Bank of Kenya published prudential guidelines for its operations. Since its inception a number of banks have embraced this model. Out of the 44 banks operating in the country 9 banks have rolled out agency banking services. The objective of the study was to analyze the effects of agency banking on the non-funded income for commercial banks in Kenya. The study employed a descriptive research design. This research made use of secondary data from selected period from 2011 to 2013 (3years).The population of the study was 9 Commercial Banks offering agency banking in Kenya. The study was quantitative in nature and the refined data was analyzed using inferential statistics. The statistics were generated with aid of computer software, statistical package for social sciences (SPSS, version 21).The findings were presented using tables. To analyze the relationship between agency banking and non-funded income for commercial banks in Kenya, a multiple regression model was used to establish whether a relationship exist between agency banking and non-funded income. The study used Non Funded income as dependent variable and value of fees and commissions income from agency banking, value of dividends and other income, value of fees and commissions from electronic, internet and mobile banking, debit cards and credit cards, value of foreign exchange income as independent variables both measured in Kshs. The study indicates that fees and commissions income from agency banking had a coefficient of 3.21 (p value less than 0.05); dividends and other income lead had a coefficient of 0.301 (p value less than 0.05); fees and commissions from electronic, internet and mobile banking debit and credit had a coefficient of 0.528 (p value less than 0.05), Foreign exchange income had a coefficient of 0.166 (p value less than 0.05).The regression analysis indicated that the independent variables can explain and predict non funded income of commercial banks in Kenya by 87%. The study also indicated that all the independent variables were significant in the model, as well the independent variables were found to be having significant positive relationship with non-funded income. The study concludes that agency banking has a positive impact on the non-funded income for commercial banks in Kenya. The study recommends the rest of the banks to adopt agency due to its positive impact on the non- funded income. Further, recommends that there is need to support agency banking by all players: the banks, government, and licensing bodies, especially local authorities; so as to reduce the high compliance costs in bureaucracy in registration. This will enhance financial inclusion.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The debate on capping interest rates in Kenya over a general a perception of unreasonable lending rates charged by commercial banks has raised several concerns. Loan-making banks tend to generate a higher share of their operating income from interest income, a state of affairs underlying two perspectives (Laeven and Levine, 2007). They add that on the one hand there is competitive pressure in the lending market for commercial banks given lending as their core activity. Banks, driven by the need to maximize profit, banks are likely to pay great attention to lending rates that they charge. However, lending rates are highly depended on interest rates guided by the central bank which exposes bank earnings to sensitivity on changes in such rates.

Generally, banks have two sources of income i.e. interest based income and non-funded income. It is believed that the problem is embedded in over-concentration on one type of income – interest income which is sensitive to changes in the CBR which is an exogenous factor for banks (Central Bank of Kenya, 2013). Kiweu (2012) indicated that for banks to avoid high volatility in reported profits, banks need to refocus and engage in non-funded activities. This has raised a more concern if Kenyan banks can reduce the effect of this over-concentration to ease the pressure on interest rates? Still, banks have continued spurring with an upward trend in profits. Perhaps, a more intriguing question is: Have banks shifted to other financial products(s) that boost their performance or can a shift to fee based income provide the answer? Should Kenyan banks move away from traditional intermediation role to remove a focus on the sensitive interest rates?

We have seen a lot of dynamics whereby the Kenya's banking industry is in the throes of a transformation caused by increasing globalization and deregulation. Financial innovations such as agency banking is taking place at an overwhelmingly fast pace in the global banking industry. Agency banking uses shared infrastructure to provide regular banking functions such deposits taking and withdrawals, loan disbursement and repayments, salary payments, pension payouts, funds transfer and issuance of mini statements. In addition, the agents helps the banks in reaching out to new customers through account opening, credit and debit card applications and cheque book request (Central Bank of Kenya, 2013). This model of banking can significantly reduce set-up and delivery costs, offering cash-in/cash-out operations only or a broader range of financial services to customers who usually feel more comfortable banking at their local merchants than at traditional bank branches (Lozano and Mandrile, 2009).

It is envisaged that the persistent good financial performance by banks may be a result of increased non-funded income, yet it is not clear to what extent has agency banking impacted this increased non-funded income. As demand to these questions keep increasing few researches have however been conducted in this regard. The ultimate findings of this research will therefore be invaluable in establishing if there is increased non-funded income and if it is a result of agency banking services by commercial banks in Kenya.

1.1.1 Agency Banking

Agency banking refers to bank partnerships with non-banks, typically retail commercial outlets, ranging from pharmacies, lottery kiosks, post offices, construction goods stores, and so forth, to provide financial services through their distribution outlets (Kumar, Nair,

Parsons & Urdapilleta, 2006). Kapoor (2010) views agency banking as a result of multiple factors; distribution strategy, cost effective model and a channel of innovation. Through agency networks, banks are able to reach new customers, to open new accounts, perform credit and debit card applications and cheque book requests (CGAP, 2006). Although many banks and non-financial institutions have discovered the advantages of agency banking and are increasingly employing many agents differs widely in scope, structure and operations across geographies.

Agency banking could be of benefit to the clients in the following ways; lower transaction cost by reducing the cost of delivering financial services, increased access to finance through longer opening hours, shorter lines than in branches, more accessible for illiterates and the very poor who might feel intimidated in branches, to the agency; increased sales from additional foot-traffic, differentiation from other businesses, additional revenue from commissions and incentives, finally to the financial institutions; increased customers base and market share, increased coverage with low-cost solutions in areas with potentially less number and volume of transactions, increased revenue from additional investments, interest and fee income, improved indirect branch productivity by reducing congestion (Ivantury and Timothy, 2006).

Agency banking begun as early as 1999 in other countries like Brazil, Columbia, Pakistan, South Africa and Indonesia, it was introduced in Kenya in May 2010 when the Central Bank of Kenya published prudential guidelines for its operations. Since its inception a number of banks have embraced this model. Out of the 44 banks operating in the country 10 banks have been licensed to operate agency business with more submitting

applications. The spread is clearly evidenced by the growing number of banks agents to small towns and even to the interior of villages around the country (CBK Annual Report, 2012).

1.1.2 Non-Funded Income

Repeated success by commercial banks in Kenya has raised public concern with the view that banking industry has experienced volatile interest rates margin and profitability. The view has been echoed by central bank, leading to the question whether there are possible viable alternative sources of income (CBK, 2007). Although the traditional revenue source of banks is interest income, and since the financial liberation era, bank have more intensively engaged in non-funded income generating activities. According to Mercieca *et al* (2007), non-funded Income is earned when banks provide a variety of services, such as trading of securities, assisting companies to issue new equity financing, securities commissions and wealth management, sale of land, building, and profit and loss on revaluation of assets.

According to DeYoung (2003), banks earn non-funded income in many ways; loan securitization loan origination, and loan servicing fees to offset the interest income that they lost with the disintermediation of consumer lending like mortgages and credit cards. Banks have also developed strategy of selling back-up lines of credit to firms that float commercial paper at a fee. These strategies aim at providing the customers with array of new and/or nontraditional fee-based products, selling increased amounts of an outcome existing fee based- products, pricing fee-based products more efficiently. These can be as a result of unbundling retail deposit products and improving the quality of fee-based

products and services so that they command higher prices (Evanoff and Ors, 2001; Keeton, 2000; and Whalen, 2001).

1.1.3 Agency Banking and Non-Funded Income

Early experiences indicate that banks with branchless banking through agencies can significantly reduce set-up and delivery costs, offering cash-in/cash-out operations only or a broader range of financial services to customers who usually feel more comfortable banking at their local merchants than at traditional bank branches (Lozano & Mandrile, 2009).Continued argument by analysts that markets with high competition, income diversification by banks help them reduce chances of financial distress thus reducing risks (Gamra and Plihon, 2011). Thus banks with greater fee-based services charge lower lending rates as they can retain profits from increased non-funded income (Pennaythur *et al*., 2012).

Bold (2011), argues that agent banking has led to reduced cost and enhanced efficiency in the financial sector with a possibility and availing financial services at much lower cost to consumers. It has also seen banks' expansion hence spread to far flung market pockets of bankable populations (Bold, 2011). Agent banking means commercial outlets like shops and supermarkets acting in some capacity on behalf of formal banks (Hogan, 1991). Therefore, agency banking has enabled bank customers to access the basic banking service such as; deposits, withdrawals, disbursement and repayment of loans, payment of bills, 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 applications, agency mobile phone banking services among others (CBK, 2010).

With agency banking it is cheaper to put up human resource expenses (Hogan, 1991). Banks do not incur cost of recruiting new employees given that the agent is the one who hires or carries out the transactions himself. There is savings on equipment like furniture and computers because the agents purchase the POS machines and mobile phones. In the agency model systems are installed in the mobile phones to allow the agents to transact and send the data to the central processing center where the information is captured and data reconciled (McKay, 2011). Banks bank save costs in terms of advertising and hiring sales personnel. Agents are paid on commission based on the number of transactions and accounts opened. This motivates them to work hard so that they can earn more.

1.1.4 Agency Banking in Kenya

Agency banking in Kenya is part of the approach by the Central Bank of Kenya to promote innovation through mobile financial services and to address the delivery of channels costs (Central Bank of Kenya, 2010).The onset of agency banking in Kenya is an aftermath of June 2009, when parliament gave approval for banking legislation to be amended. This was geared to enabling the use of agents, and the regulations for agent banking were published by the CBK in May 2010 (Guideline on Agent Banking - CBK/PG/15, 2010).

In Kenya, agency banking is probably best known for its M-PESA mobile phone-based payment services that started in 2007 way before any legislation related to agent banking, mobile payments. The publishing of the 2010 agent banking guidelines gave banks mandate to partner with non-bank based models. In March 2010, Safaricom and Equity Bank launched a full savings account. Equity Bank launched an M-PESA Equity account' marketing it as M-KESHO. Equity's M-KESHO customers can transact at any

of the more than 28,000 retail outlets that accept M-PESA (Making Finance Work for Africa, 2011). Other versions of agency banking model in Kenya include; Co-op KwaJirani by Co-operative Bank, KCB Mtaani for KCB Bank, Pesa Pap by Family Bank, Chase Popote for Chase Bank, Conso Maskani by Consolidated Bank, Diamond Trust Bank; Citibank and NIC Bank among others (Kiragu, 2012).

1.2 Research Problem

There is a repeated argument on combining income from different income earning activities results in rebalancing of income for commercial banks which may increase their returns and diversify risks (Gamra and Plihon, 2011). According to DeYoung and Rice (2003), at ceteris paribus, increased non-funded income by banks will not only improve banks' earnings but also change its' output mix, variable and fixed inputs as well financing structure. Another thought is that shifting the source of banks income from relatively volatile intermediation-based activities with its attendant credit and interest rates risks to relatively less volatile fee-based income with no such credit interest rate risks could reduce overall income volatility (Rogers, (1998). Consequently, commercial banks need to refocus and engage in non-funded activities which will help them avoid high volatility in reported profits. This way banks don't have to raise lending rates to earn more thus easing pressure on lending rates, assuming that there is scope for cross-subsidy amongst the two income sources (Kiweu, 2012).

Agency banking has enabled bank customers to access the basic banking service such as; deposits, withdrawals, disbursement and repayment of loans, payment of bills, 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

applications, agency mobile phone banking services among others (CBK, 2010).Continued argument by analysts that markets with high competition, income diversification by banks help them reduce chances of financial distress thus reducing risks (Gamra and Plihon, 2011). Thus banks with greater fee-based services such as agency banking charge lower lending rates (Pennaythur*et al*., 2012).

Musau (2003) analyzed the utilization of agency banking on performance of selected banks in Nairobi County, Kenya. The study revealed that agency security is a major contributor to performance of commercial banks in Kenya. The banks do understand application level security in agency banking. This corresponds with Collins (2010) since the study found that agency banking regulation and supervision was to a very great extent. Aduda, Kiragu and Ndwiga (2013) suggested a positive relationship between agency banking and financial performance in Kenyan banks due to increased profitability. However, Chiteli (2013) studied agent banking operations as a competitive strategy of commercial banks in Kisumu City and found that agents encounter challenges such as liquidity risk, operational risk, and credit risk. He therefore suggested that commercial banks should ensure they carry out in place mechanisms while planning and implementing agent banking operations as a competitive strategy that can mitigate these risks that are brought about by agent banking operations.

The presence of agency banking at commercial banks in Kenya has been widely documented and discussed in the industry press and regulatory publications (Gurbuz, Yanik and Ayturk (2013), but only a few academic studies have investigated the impact of increased agency banking on the non-funded income of commercial banks. It may be

well known that large banks and banks with specialized strategies like credit card banks and mortgage banks rely more heavily on non-funded income than do small banks with traditional business strategies. Still, there is little systematic understanding of why there seem to be sporadic growth in agency banking in by these very banks and how this model of agency banking is associated with increased non-funded income for commercial banks.

Although studies indicate that agency banking model has been very successful in propelling the performance of banks in Kenya including other developing countries like Colombia, Brazil, Peru and India, it remains implicit to what extent does agency banking contribute to financial performance through increased non-funded income. Surprisingly, little work has been done in these countries Kenya inclusive, particularly to analyze the effects of agency banking on the non-funded income of commercial banks perhaps as an attempt to explain the reason and impact of increased focus on agency banking and determine if this is one way of income diversification by commercial banks in Kenya. Aduda, Kiragu and Ndwiga (2013) while studying the relationship between agency banking and financial performance of commercial banks in Kenya, the findings showed that commercial banks in Kenya that had rolled up agency banking operations were more effective based on the number of agent signed by the commercial bank. However this study like other preceding and subsequent studies have not attempted to demonstrate on the effects of agency banking on non-funded income of commercial banks. This study therefore sought to fill the gap that has been left by previous studies by analyzing the effects of agency banking on the non-funded income of commercial banks in Kenya.

1.3 Research Objectives.

The objective of the study was to analyze the effects of agency banking on the non-funded income for commercial banks in Kenya.

1.4 Value of the Study

The findings of this study are beneficial towards enhancing the knowledge on agency banking that has attracted a sizeable number of researchers in the recent past. It also assists in confirming or giving any contrary evidence to the theoretical foundations of agency banking and non-funded income.

The study also assists policy makers in government to understand the connection between agency banking and non-funded income. This also informs the banks' management in reviewing and improving their competitive strategies and re-evaluating their business performance. It also serves as reference to the finding of the study to guide them in identifying the key challenges of agency banking and on how to improve its operations.

Those in the academic realm also find the study invaluable to them since it adds value to the existing body of knowledge on the banking sector. It provides them with more insight on relevant literature on agency banking and non-funded income. It also point out gaps for further research that serves as foundations for future research activity on agency banking and non-funded income for commercial banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the earlier studies related to agency banking and non-funded income by commercial banks in Kenya. It provides a summarization on findings from other researchers related to this study. The review covers both the theoretical and empirical reviews of the existing literature. The theoretical review helps in understanding of the current body of knowledge on the research topic while the empirical review help in understanding what other related studies have found and suggested.

2.2 Theoretical Review

Agency banking is the delivery of financial services outside conventional bank branches, using agents or other third-parties acting as an interface with customers the banks by use of system technologies (e.g. Card-reading POS, ATMs, Mobile phones). This is geared to deliver financial services to low income people at remote areas (State Bank of Pakistan, 2011). Theories of agency banking can be classified into three broad categories: bank-focused theory, bank-led and non-bank-led theory.

2.2.1 Bank –Led Theory

According to Lyman, Ivatury, and Stachen 2006), the bank –led theory a licensed financial institution that delivers financial services through a retail agent i.e. the bank develops the financial products and services but distributes them though a retail agent who on the other hand handles all or most customer interaction. In this theory the bank is the main provider of the financial services and customers maintain their accounts with the bank. Retail agents interact with the customer face-to-face and perform cash handling

functions, much as a branch-based teller would take deposits and process withdrawals (Owens, 2006).

In some countries, retail agents perform the role of 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. Regardless of the type of establishment, each retail agent is outfitted to communicate electronically with the bank for which it is working for. These retail outlets uses equipment such a mobile phone or an electronic point-of-sale (POS) terminal that reads cards. According to this theory, bank-led model offers a distinct alternative to conventional branch-based banking since customer conducts financial transactions at a whole range of retail agents instead of at bank branches or through bank employees (Lyman, Ivatury and Staschen, 2006). According to Tomaskova (2010) this model gives the potential to substantially increase the financial services spread by using a variety of delivery channels (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 the banks retail the role of customer relations.

Based on this theory, there are agent related risks following substantial outsourcing of customer contact to retail agents. Therefore, entrusting retail customer contact to the types of retail agents used in both the bank-led and nonbank-led models would seem riskier than when these same functions are carried out by bank tellers in a conventional bank branch. This is because the retail agents may operate in hard-to reach or dangerous areas and they lack physical security systems and lack of skilled personnel who can

handle a number of particular cases like cash handling with expertise (State Bank of Pakistan, 2011).

Many a times the banking regulation recognizes multiple categories of risk like credit risk, operational risk, legal risk, liquidity risk, and reputation risk that bank regulators and supervisors seek to mitigate. The bank lead theory is related to the study as it focus on how financial institution like bank deliver their financial services through a agency banking , where the bank develops financial products and services, but distributes them through bank agents who handle all or most customer interaction . For example; KCB of Kenya distributes it financial product through it KCB Mtaani agents where the agent 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.

2.2.2 Non-Bank-Led Theory

According to Kumar, etal(2006) under non-bank-led customers do not deal with a bank, nor do they maintain a bank account. Customers will therefore deal with a nonbank firm either a mobile network operator or prepaid card issuer and retail agents serve as the point of contact. Customers willexchange their cash for e-money stored in a virtual e-money account on the non-bank' server, which is not linked to a bank account in the individual's name. Non-bank-led is model has higher risk compared to the other theories as the regulatory environment in which these nonbanks operate might not give much importance to issues related to customer identification. This may lead to significant Anti-Money Laundering and Counter-Terrorism Financing (AML/CFT) risks. It is difficult to implement the aspect of Know Your Customer (KYC) to this segment. Moreover, the non-banks are not much regulated in areas of transparent documentation and record

keeping which is a prerequisite for a safe financial system. Regulators also have been found to lack experience in the realm. For these reasons, allowing non-bank-led model to operate is an unnecessarily a big leap and an unjustifiably risky proposition.

This model can become viable when regulators gain sufficient experience in mitigating agent related risks using bank led model and need to think about mitigating only e-money related risks (Kapoor, 2010). According to Hogan, B. (1991) to e-money risks are peculiar and to mitigate such risks, necessary changes in the existing regulations are required. This can start by bringing non-banks under financial regulatory net by giving these entities special status of some sort of quasi-bank/remittance agent etc. To be granted this status will be depended on meeting pre-specified standards of transparency, financial strength and liquidity. The entities are required to deposit their net e-banking surplus funds with scheduled banks meeting certain minimum rating criteria to avoid insolvency (State Bank of Pakistan, 2011). The Nonbank-led Theory is found relevant to the study as it explain how agent deals with customers on behalf of the bank.

2.2.3 Bank Focused Theory

The bank-focused theory is derived from the fact that traditional banks uses non-traditional low-cost delivery channels to provide banking services to its existing customers. These banks offer service ranging from use of automatic teller machines (ATMs) to internet banking or mobile phone banking to provide certain limited banking services to bank customers. This model is seen a modest way of conventional branch-based banking providing additional value to its customers. Despite the advantages experienced by banks in this model like more control and branding visibility this model has been found with accrued challenges (Kapoor, 2010).

The theory sees the customer's primary concerns as to do with the quality of experience, security of identity and transactions, reliability and accessibility of service and extent of personalization allowed. Banks therefore 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 (Kapoor, 2010).

2.3 Determinants of Non-Funded Income

The gravitating divergence of commercial banks to non-funded income is a result of three main factors; transformations by the sweeping deregulation, rapid technological advances in information flows, communications infrastructure, and financial markets and globalization. The powers gained from information and technology, deregulation and globalization of markets has made banks better educated, more inquisitive, sophisticated and deciding. The banking environment has changed tremendously thereby posing serious implications and challenges to the survival and profitability of banks (CGAP, 2003).

2.3.1 Transformations by the Sweeping Deregulation

Banks in an effort to respond to the deregulation that fostered competition between banks, nonbanks, and financial markets, Commercial banks have embraced the new technologies that have drastically altered their production and distribution strategies resulting to an increase in non-funded income. Although, other banks have continue using traditional banking strategies for which no-interest income remains relatively less significant, deregulation has removed a whole host of regulations stunting the industry's growth (DeYoung, 2003). He adds that the crucial amendment of Kenya's banking act in

2009, allowed banks to diversify into other financial services activities diverting away from the traditional intermediation role of banks. This led to a number of banks in a rush to seize the opportunities by taking advantage of this legislation to expand into non-traditional activities like; securities underwriting, insurance sales, and retail brokerage which fostered income from non-funded earning activities.

According to DeYoung, (2003), banks earn non-funded income in many ways; loan securitization loan origination, and loan servicing fees to offset the interest income that they lost with the disintermediation of consumer lending (e.g., mortgages, credit cards). Banks have also developed strategy of selling back-up lines of credit to firms that float commercial paper at a fee. These strategies aim at providing the customers with array of new and/or nontraditional fee-based products, selling increased amounts of an outcome existing fee based- products, pricing fee-based products more efficiently. These can be as a result of unbundling retail deposit products and improving the quality of fee-based products and services so that they command higher prices (Evanoff&Ors, 2001; Keeton, 2000; Whalen, 2001).

2.3.2 Rapid Technological Advances

Advances in information and communications technology that have revolutionized business in the world have enabled banks to increase their non-funded income. For example the introduction the Internet banking, Automatic Teller Machines (ATMs), new intermediation technologies such as; loan securitizations, credit scoring, and the introduction and expansion of financial instruments and now agency banking have immensely soared up growth in the banking sector (DeYoung, 2003).

Many of these new technologies have emphasized non-funded income while de-emphasizing interest income at banks. For example a bank can charge its customers a fee for carrying out their transactions at “convenience premium” through the ATMs, Mobile banking or over the internet. In addition to, greater access to commercial paper market that allowed large banks to earn fee income from providing back-up lines of credit that firms need to float commercial paper.

2.3.3 Globalization

Countries round the world are now part of the global village through integration of the country’s economy with other world class economies such as Singapore. Sometimes globalization has resulted to some mergers and acquisitions. According to Hawtrey (2003), the speed of globalization keep on quickening, banks will find themselves exposed to overseas and will have to succumb to world pricing benchmarks, more so in areas of fee-based activities like corporate finance and payments devices. Banks therefore, will need to device strategies that will shelve them for long term sustainability.

2.4 Empirical Studies

Bold (2011) in Brazil found that some countries restrict the location of agents, though such restrictions are sometimes eased when regulators recognize that the regulations create obstacles to financial inclusion. For example, due to concerns that agents could threaten bank branches, Brazilian regulation originally allowed agents only in municipalities that did not have bank branches. Also found that Indian regulators initially required agents to be located within 15 kilometers of a “base branch” of the appointing bank in rural areas, and within 5 kilometers in urban areas. This policy, intended to

ensure adequate bank supervision of its agents, limited the use of agents by banks with only a few branches.

Mwangi (2011) evaluating the role of agency banking in the performance of commercial banks in Kenya. This study was done on four banks offering agency banking services using questionnaires distributed to the banks' branch managers. The study established that infrastructure cost and security influence the performance of commercial banks attributable to agency banking to a very great extent. The study recommends that agency banking should be given attention on security measures including risk-based approach and banks should find better ways of screening their agents to ensure that the large cash transactions handling is effectively carried out on their behalf; secure operating systems capable of carried out real time transactions, generating an audit trail, and protecting data confidentiality and integrity.

Tarazi and Breloff (2011), revealed that regulations often impose some form of "fit and proper" requirements, mandating a form of agent due diligence that requires financial institutions to verify that would-be agents have good reputations, no criminal records, and no history of financial trouble or insolvency. While fit-and-proper criteria listed in regulation often are not problematic, providers and agents have occasionally argued that compliance with particular details can impose significant cost, particularly with respect to gathering documentation. Central banks regulations on agency banking hamper the growth of agency banking, these regulations slows down the penetration of the agency banking which negatively affect the performance of commercial banks. Central Bank has

stringent regulations on agency banking which slow down the growth of agency banking in Kenya thus affecting the performance of commercial banks in Kenya.

Kamau (2012) did a study on the relationship between agency banking and financial performance of the banks in Kenya. Through review of secondary data, the study found that the outlets for agency banking were 9,748 and increase from 8,809 in 2010 facilitating a total volume of 8.7 million transactions valued at Kshs 43.6 billion. By use of regression analysis, the study found a negative and weak correlation between number of agents, deposit and withdrawals transactions undertaken through agents and financial performance of banks as measured by return on equity.

Aduda, Kiragu, Ndwiga (2013) studied the relationship between agency banking and financial performance of commercial banks in Kenya. The objective for this study was to find out the relationship between agency banking and financial performance for those banks. This research used the descriptive design method using secondary data gathered from the commercial banks in Kenya that had adopted agency banking in Kenya The findings indicates that out of a total of 43 banks, 8 have rolled out the agency banking service. The findings further showed that yearly performance improved significantly from 2008 to 2011. This meant that agency banking is continuously improving leading to significance increased financial performance in those banks that have rolled up the service due to its convenience and efficiency in operation.

The findings showed that commercial banks that had rolled up agency banking operations were more effective based on the number of agent signed by the commercial bank. It further indicated that agency banking has positively and significantly influenced

performance of commercial banks. However, from the study there is need for further research to be undertaken which may include studies on the factors affecting the financial performance of the agent banks, 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 or financial inclusion and other related studies. The study also recommended development of a roadmap to agency banking development in Kenya, and further studies to be done on customer perception of agency banking so as to determine what affect banking agents' performance from the demand side.

Chiteli (2013) did study agent banking operations as a competitive strategy of commercial banks in Kisumu city. The objective of the study was to investigate agent banking operations as a competitive strategy for commercial banks in Kisumu city. Both primary and secondary data was used through questionnaires and a census. Descriptive research design was used. According to the study, The agents have also encountered challenges in providing banking services and the challenges include; liquidity risk, is whereby retail agents especially those that are relatively small, unsophisticated, and remote, may not have enough cash to meet customers' requests for withdrawals and may lack experience in the more complex liquidity management required for offering financial services. Operations to be effective as a competitive strategy for commercial banks strong internal control system should be put in place which should be flexible to be evaluated periodically. There should also be frequent updates of policies and procedures used in the industry by Kenya Bankers Association in consultation with the Central Bank of Kenya. Frequent audit should be carried out on the bank system and automation of all processes at least quarterly to determine any loopholes that should be sealed.

The study recommended that for agent banking operations to be effective as a competitive strategy for commercial banks strong internal control system should be put in place which should be flexible to be evaluated periodically. During the study, it was noted that more commercial banks country wide have embraced agent banking operations and various competitive strategies. It would be worthwhile to study agent banking operations as embraced by the other commercial banks not captured in this study as well as the other competitive strategies in use.

Watiri (2013) did as study on the adoption of agency banking by equity bank Kenya limited in its international business operations. The objective of this study was to determine the adoption of agency banking by equity bank in its international business operations. Data was collected using an interview guide and data collected both qualitative and quantitative form data. The study realized that agency banking is continuously improving and growing and as it grows, the level of financial inclusion is also growing. The study findings showed that increasing the area covered by agents outside the country has had the effects of increasing the reach. From the study agency banking has contributed to growth in financial inclusion. The study has also revealed that agent banking has improved the banks performance and also transformed the lives of customers and agents. Agency security is a major contributor to performance as per the study. The banks do understand application level security in agency banking in its business operations.

The study therefore recommends that there is need to support agency banking by all players: the banks, government, and licensing bodies, especially local authorities; so as to

reduce the high compliance costs in bureaucracy in registration. This will enhance financial inclusion. The study further recommends adoption of agency banking by all banks operating in the retail market and that agency banking be marketed more as it's an area with great growth potential as it uses the already established private enterprises and saves the bank huge capital outlays of opening a branch.

Wawira (2013) studied the contributions of agency banking on financial performance of commercial banks in Kenya .This study sought to establish the effect of central bank regulation on financial performance of commercial banks in Kenya, to determine the effect of low transaction cost through agency banking on financial performance of commercial banks in Kenya, to establish the effect of financial services accessibility by customers on financial performance of commercial banks in Kenya. The study targeted a population of 9 Commercial Banks offering agency banking with a sample of 36 respondents by use of questionnaires and analyzed by use descriptive statistical analysis.

In the study it was established that accessibility for financial services through agency banking affects the financial performance of commercial banks in Kenya to a great extent. Further, revealed that the adoption of agency banking in banking industry has shown a great momentum and across the world which has increased the accessibility of financial services. Many customers at remote areas can access financial services due to agency banking which has led to profitability of commercial banks and finally that there is great potential of using agency banking for provision of banking services to unbanked community Moreover, it established that agency banking has made it easier for commercial bank to reach out to many potential clients without investing so much in

opening branches hence it's a cost effective measure. It also increased the ease of expansion hence outreach to far flung market pockets of bankable populations.

Kiura (2014) studied role of technology in the implementation of agency banking in Kenya. General objective of this study was to assess the challenges facing the implementation of agency banking in Kenya. The study employed descriptive research design. The research design describes data and characteristics about the population or phenomena being studied. The target populations were the 44 commercial banks in Kenya by use of questionnaires to collect data from primary sources, while secondary data was collected from banks reports, research articles, and books, corporate strategic plans of the various banks, bulletins, and in-house newsletters. Qualitative data was analyzed using descriptive statistics while quantitative data was analyzed using inferential statistics.

According to the study, application of technology has ensured quick and effective services to the clients although the use of these technology systems has been associated with data and network security risks which make clients more susceptible for conducting financial transaction. The study indicated that it is not clear to consumers how they can protect themselves. However, banks can apply proper technology infrastructure backup, disaster recovery plan and technical security infrastructure in ensuring timely services availability to all clients. This study recommended that though all banks are using fully automated systems in rendering financial services in the country, they should ensure that those systems are of high and quality state ensuring that they are up to date.

2.5 Summary of Literature Review

The literature review found out the there are three theories that try to explain the concept of agency banking i.e. bank-led, bank focused and non-bank-led theories. All these theories seem to support the idea behind agency banking as a means to improve service delivery, response to competition and sustainability for banks. Both theories acknowledge that their risks associated with agency banking like credit risks, operational risk, legal risk, liquidity risk, and reputation risk. However none of the theories clearly illustrates how banks can mitigate the risks. Non-bank-led model for example has higher risks compared to the other theories. Proposed, mitigation measures are a subject to the regulatory environment in which these non-banks operate and might not give much importance to issues related to customer identification. Further, the theories do not demonstrate the effects of agency banking on the non-funded income of commercial banks in Kenya.

Empirical reviews indicate that studies have been done on the agency banking. Most of these studies are inclined to determine the relationship between agency banking and overall financial bank performance. The empirical studies have provided the information of agency banking on performance of organization. Studies reviewed showed that there a positive relationship between agency banking and general bank performance. Surprisingly, none of these studies or other recorded studies have studied on the effects of agency banking on non-funded income for commercial banks as a constituting component. This paper will therefore aim to close the research gap by establishing the effects of agency banking on the no-funded income of commercial banks in Kenya. This study will specifically test to explain the argument on the gravitating divergence of

commercial banks from interest based income to non-funded income. Further, then study will establish the relationship between agency banking and the non-funded income of commercial banks.

CHAPTER THREE

RESEARCH METHODOLOY

3.1 Introduction

This chapter presents the research methodology that was used while carrying out the research. It describes the research design, population, sample design, data collection instruments and procedures, and methods of data analysis.

3.2 Research Design

The study employed a descriptive research design. According to Cooper and Schindler (2003), a descriptive study is used to describe or define, often by creating a profile of a group of problems, people or events, through the collection of data and tabulation of the frequencies on research variables or their interaction. Descriptive research design is chosen because it enabled the researcher to generalize the findings to a large population. The descriptive research approach is deemed appropriate due to the fact that it allows analysis and relation of variables (Cooper and Schindler,2003), Also, this is a rigid design that provides enough provisions for protection against bias thus maximizing reliability (Kothari, 2008).

3.3 Population and Sample Design

A population is a well-defined set of people, elements, event, services, and group of things or households that are being investigated (Ngechu, 2004). The study was carried out at commercial banks in Kenya that offers agency banking services to their customers. Therefore, the target population of the study was 9 commercial banks currently actively offering agency banking in Kenya (Appendix II).

The study also adopted a purposeful sampling. A purposeful sampling allows a researcher to use cases that have the required information with respect to the objectives of the study (Mugenda and Mugenda, 2003). The study therefore target to obtain information from all the 9 banks to provide the information.

3.4 Data Collection

This research made use of secondary data. Depending on availability secondary data was obtained from the banks' annual reports. The selected period for the study is from 2011 to 2013 (3years). This period was suitable because agency banking guidelines were published by CBK in 2010.

A data collection form was used (Appendix II). The researcher sent an introduction letter to these commercial banks' financial managers stating the purpose of the study. In addition the research made use of telephone calls to respective respondents to further explain the purpose of the study and to make request for the required information. The researcher also reviewed the organization newsletters to where possible to obtain secondary data on agency banking operations in these banks. Secondary data in this was preferable due to its reliability and being free from errors.

3.5 Data Analysis

The study was quantitative in nature. The refined data was analyzed using inferential statistics. The study ensured that the data obtained is checked for completeness ready for analysis. A multiple regression analysis was used to determine the effects of agency banking (independent variable) on non-funded income (dependent variable). The

statistics were generated with aid of computer software, statistical package for social sciences (SPSS, version 21). The findings were presented using tables.

To analyze the relationship between agency banking and non-funded income for commercial banks in Kenya, a multiple regression model was used to establish whether a relationship exist between agency banking and non-funded income.

The estimated regression model used was as below;

$$Y = \beta_0 + \beta_1 X1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Whereby Y = Non-funded income calculated as the sum of commission fees, net trading profit/loss and other non-interest income, β_0= Constant, X_1= Value of fees and commissions income from agency banking measured in Kshs, X_2 = Value of dividends and other income X_3= Value of fees and commissions from electronic, internet and mobile banking, debit cards and credit cards measured in Kshs, X_4= Value of foreign exchange income measured in Kshs. while β_1, β_2, β_3,$\beta_4$and β_5 are coefficients of the independent variables and ε is the error term.

The study will use ANOVA to test the level of significant of the variables on the dependent variable at 95% level of significance.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the analysis of data, findings from the study and interpretation of the findings. Section 4.2 presents descriptive analysis; section 4.3 correlation analysis; Section 4.4 presents multiple regression analysis whereas section 4.5 presents chapter summary.

4.2 Response rate

The study sought to collect data on the effects of agency banking on the non-funded income for commercial banks in Kenya from 9 commercial banks in Kenya offering agency banking. The researcher managed to collect Data from all the 9 commercial banks which gave a response rate of 100%. The table below shows the response rate.

Table 4.1 Response Rate

Response	Frequency	Percent
Responded	9	100
Not responded	0	-
Total	**9**	**100**

4.3. Data Reliability and Validity

Data reliability and validity were key concern during data collection. Data reliability and validity was maintained by having respondents who were senior in the respective organizations. The researcher used discriminant validity to gauge the extent to which measures of the two constructs were comparatively distinctive from each other, and that

their correlation values were neither an absolute value of 0 or 1. Discriminant validity was deemed appropriate as it helps the researcher to assess the degree to which a concept and its indicators. The researcher also ensured that the values differ from another concept and its indicators also tracked the consistency of information provided and where the information was contradicting clarification was sought hence further improving the degree of accuracy. In addition, the data collection form used was simple and pretesting of the same was done before actual data collection.

4.4 Descriptive Statistics

The study sought to collect and analyze consolidated data from 9 commercial banks in Kenya that offers agency banking services to their customers. Secondary data obtained from reports published by the organization Newsletters. The dependent variable, Non-funded income calculated as the sum of commission fees, net trading profit/loss and other non-interest income with the independent variable being fees and commissions income from agency banking measured, dividends and other income, fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income . Table 4.3 below shows the mean and standard deviation of the amount in the variables.

Table 4.2: Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
Non-Funded Income (Kshs.)	444,296E3	12,552,000E3	4,316,267E3	0.4981	27
foreign exchange(Kshs.)	-	1,940,587E3	462,025E3	0.7348	27
dividend and other income (Kshs.)	88E3	8,590,320E3	1,524,943E3	0.4622	27
fees commission electronic, internet (Kshs.)	147,555E3	3,922,306E3	1,129,197E3	0.5171	27
fees and commission from agency (Kshs.)	75,140E3	3,338,231E3	1,044,283E3	0.7973	27

The Table above indicates that fees and commissions from electronic, internet and mobile banking, debit cards and credit cards has take the highest portion of non-funded income followed by fees and commission from agency then dividend and other income and finally foreign exchange.

4.5 Correlation Analysis

A partial correlation analysis using Karl Pearson correlation coefficient was performed. A negative coefficient indicated a negative relationship between the variables correlated; in which case an increase in one variable would result into a decrease in the other variable and vice versa. A positive coefficient on the other hand indicates a positive relationship in the variables; meaning that changes in the variables move together. An increase in one variable would therefore result into an increase in the other variable and vice versa.

The measures were constructed using summated scales from both the independent and dependent variables. As cited in Cooper and Schindler (2000) the correlation coefficient value *(r*) range from 0.10 to 0.29 is considered weak, from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong. However, according to Field (2005), correlation coefficient should not go beyond 0.8, to avoid multi-co linearity. Since the highest correlation coefficient is 0.618 which is less than 0.8, there is no multi-colinearity problem in this research. Table 4.3 shows the correlation analysis.

Table 4.3: Correlations

Pearson correlation	Foreign exchange	Dividend and other income	Fees commission electronic, interest	Fees and commission from agency	Non-Funded Income
Foreign exchange	1				
Dividend and other income	0.672	1			
Fees commission electronic, interest	0.593	0.326	1		
Fees and commission from agency	0.528	0.471	0.596	1	
Non-Funded Income	0.541	0.583	0.562	0.497	1

*Correlation is significant at the 0.05 level.

Results in table 4.2, on Pearson correlation coefficient revealed that foreign exchange has significant positive relationship with Dividend and other income ($r = 0.672$, $p< 0.05$), Fees commission electronic, interest ($r = 0.593$, $p < 0.05$), Fees and commission from agency ($r = 0.523$, $p< 0.05$) respectively, Non-Funded Income ($r = 0.541$, $p < 0.05$). Dividend and other income has a positive significant with Fees commission electronic, interest ($r = 0.326$, $p< 0.05$), fees and commission from agency ($r = 0.471$, $p< 0.05$), Non-Funded Income ($r = 0.583$, $p< 0.05$). Fees commission electronic, interest has a positive and significant relationship with Fees and commission from agency ($r = 0.596$, $p< 0.05$), Non-Funded Income ($r = 0.562$, $p< 0.05$). Whereas fees and commission from agency has significant positive relationship with Non-Funded Income ($r = 0.497$, $p< 0.05$).

4.6 Regression Analysis and Hypothesis Testing

A regression analysis between the dependent variable and the independent variables was carried out where fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income were the independent variable whereas non funded income was the dependent variable. Table 4.3 indicate that the r-squared for the model was 0.868, which indicates that the independent variables can be used to explain about 86% of the variation in non-funded income in commercial banks in Kenya.

Table 4.4: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.932[a]	0.868	0.861	0.32542

a. Predictors: (Constant), fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income.

Results in table 4.4 give the analysis of variances in the regression model. These results indicate that the model had an f-ratio of 1.830 which was significant at 0.000 level of significance. This result indicates that the overall regression model is statistically significant and is useful for prediction purposes at 5% significance level. This further indicates that the independent variables (fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income) used are statistically significant in predicting performance of non-funded income in commercial banks in Kenya.

Table 4.5 ANNOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	132410515	5	26482103	1.83203	.000[a]
	Residual	702421921	22	31928269.1		
	Total	**834832436**	**27**			

a. Predictors: (Constant), Dividends & Other Income, Foreign Exchange Trading Income, Fees and Commissions from agency banking, Fees Commissions from electronic,
b. b. Dependent Variable: Non-Funded Income

Results in table 4.6 below present the test of the statistical significance of the independent variables in the model and their coefficients.

The regression equation below has established that taking all factors into account (fees and commission income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income) constant at zero, this lead to negative Kenya shillings 127142 change in non-funded income since banks will incur more operational costs. The findings presented also shows that taking all other independent variables at zero, a shilling increase in fees and commissions income from agency banking lead to a shilling3.21 increase in non-funded income in commercial banks in Kenya; a shilling increase in Dividends and other income lead to a shilling 0.301 increase in non-funded income in commercial banks in Kenya; a unit increase in Fees and Commissions from electronic, internet and mobile banking debit and credit lead to a shilling 0.528 increase on the non-funded income in commercial banks in Kenya, whereas a shilling increase in Foreign Exchange Income lead to a shilling 0.166 increase on the non-funded income in commercial banks in Kenya.

This infers that Fees and commissions from electronic, internet and mobile banking, debit and credit contribute most to the non-funded income followed by Fees and commissions income from agency banking. At 5% level of significance and 95% level of confidence, Fees and commissions income from agency banking had a 0.0215 level of significance; Dividends and other income showed a 0.0214 level of significance, Fees and commissions from electronic, internet and mobile banking debit and credit showed a 0.0131 level of significance whereas Foreign exchange income showed 0.0246. This

indicates that Fees and commissions from electronic, internet and mobile banking debit and credit was the most significant.

Therefore multivariate regression equation becomes:

$Y = (127142) + 3.21\ X1 + 0.301X_2 + 0.528X_3 + 0.166X_4 + \varepsilon$

Table 4.6: Regression Coefficient

	Unstandardized Coefficients		**Standardized Coefficients**	**Sig.**
	B	**Std. Error**	**Beta**	
(Constant)	(127142)	5.187		.0061
Fees and commissions income -agency	.321	.385	.315	.0215
Dividends and other income	.301	.399	.272	.0214
Fees and commissions-electronic, internet, mobile	.528	.432	.362	.0131
Foreign exchange income	.166	.325	.112	.0246

a. Predictors: (Constant), fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income
b. Dependent Variable: non funded income

4.7 Discussion of Research Findings

The chapter carried out inferential analysis to analyze the effects of agency banking on the non-funded income for commercial banks in Kenya. Study results indicated that the independent variables (fees and commissions' income from agency banking; dividends

and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income) can explain and predict non funded income of commercial banks in Kenya by 92.54%. The chapter also indicated that all the independent variables were significant in the model, as well the independent variables were found to be having significant positive relationship with no- funded income. Results indicate that fees and commissions from electronic, internet and mobile banking, debit cards and credit cards had the highest effect on the non-funded income.

Advances in information and communications technology that have revolutionized business in the world have enabled banks to increase their non-funded income. For example the introduction the Internet banking, Automatic Teller Machines (ATMs), new intermediation technologies such as; loan securitizations, credit scoring, and the introduction and expansion of financial instruments and now agency banking have immensely soared up growth in the banking sector (DeYoung, 2003).

Many of these new technologies have emphasized non-funded income while de-emphasizing interest income at banks. For example a bank can charge its customers a fee for carrying out their transactions at “convenience premium” through the ATMs, Mobile banking or over the internet. In addition to, greater access to commercial paper market that allowed large banks to earn fee income from providing back-up lines of credit that firms need to float commercial paper.

DeYoung (2013) posited that the crucial amendment of Kenya’s banking act in 2009, allowed banks to diversify into other financial services activities diverting away from the traditional intermediation role of banks. This led to a number of banks in a rush to seize

the opportunities by taking advantage of this legislation to expand into non-traditional activities like; securities underwriting, insurance sales, and retail brokerage which fostered income from non-funded earning activities.

According to him banks earn non-funded income in many ways; loan securitization loan origination, and loan servicing fees to offset the interest income that they lost with the disintermediation of consumer lending (e.g., mortgages, credit cards). Banks have also developed strategy of selling back-up lines of credit to firms that float commercial paper at a fee. These strategies aim at providing the customers with array of new and/or nontraditional fee-based products, selling increased amounts of an outcome existing fee based- products, pricing fee-based products more efficiently. These can be as a result of unbundling retail deposit products and improving the quality of fee-based products and services so that they command higher prices.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

In this chapter, the researcher presents the summary, conclusions and the recommendations made from the study findings. In section 5.2, summary of findings are presented. Section 5.3 presents conclusions and recommendations made from the study findings while section 5.4 presents suggestion for further research. Section 5.5 presents limitations faced while carrying out the study.

5.2 Summary of Findings

The study results indicated that fees and commissions from electronic, internet and mobile banking, debit cards and credit cards has taken the highest portion of non-funded income followed by fees commission from agency banking then foreign exchange trading income and finally dividend and other incomes from the mean generated.

The correlation analysis conducted indicated that the variables in the study had positive and significant relationship between each other. The relationship between the variables was weak indicating that there was no multi-collinearity and therefore the variables data was ready for further analysis.

From the regression analysis carried the results of the study indicated that the independent variables (fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income) can explain and predict non funded income of commercial banks in Kenya by 87%. The study also indicated that all

the independent variables were significant in the model, as well the independent variables were found to be having significant positive relationship with non- funded income.

The study indicates that fees and commissions income from agency banking had a coefficient of 3.21(p value less than 0.05); dividends and other income lead had a coefficient of 0.301(p value less than 0.05); fees and commissions from electronic, internet and mobile banking debit and credit had a coefficient of 0.528 (p value less than 0.05), Foreign exchange income had a coefficient of 0.166 (p value less than 0.05).

5.3 Conclusion

The study concludes that agency banking has a positive impact on the non-funded income for commercial banks in Kenya. This was established from the fees and commissions income from agency banking; dividends and other income; fees and commissions from electronic, internet and mobile banking, debit cards and credit cards and foreign exchange income that proved a positive relation between each independent variable and the dependent variable (non-funded income).

Aduda, Kiragu, Ndwiga (2013) supports our study when they studied the relationship between agency banking and financial performance of commercial banks in Kenya. The objective for this study was to find out the relationship between agency banking and financial performance for those banks. This research used the descriptive design method using secondary data gathered from the commercial banks in Kenya that had adopted agency banking in Kenya The findings indicates that out of a total of 43 banks, 8 have rolled out the agency banking service. The findings further showed that yearly performance improved significantly from 2008 to 2011. This meant that agency banking

is continuously improving leading to significance increased financial performance in those banks that have rolled up the service due to its convenience and efficiency in operation. The findings showed that commercial banks that had rolled up agency banking operations were more effective based on the number of agent signed by the commercial bank. It further indicated that agency banking has positively and significantly influenced performance of commercial banks.

Similarly, Watiri (2013) on her study on the adoption of agency banking by equity bank Kenya limited in its international business operations. The objective of this study was to determine the adoption of agency banking by equity bank in its international business operations. Data was collected using an interview guide and data collected both qualitative and quantitative form data. The study realized that agency banking is continuously improving and growing and as it grows, the level of financial inclusion is also growing. The study findings showed that increasing the area covered by agents outside the country has had the effects of increasing the reach. From the study agency banking has contributed to growth in financial inclusion. The study has also revealed that agent banking has improved the banks performance and also transformed the lives of customers and agents. Agency security is a major contributor to performance as per the study. The banks do understand application level security in agency banking in its business operations.

5.4 Recommendations

The study recommends that since agency banking has a positive effect on non-funded income commercial banks should ensure that up-to-date technology is adopted in ensuring that there is enough security in carrying out agency banking for instance the debit and credit cards should be made in such a way that the client can't lose their money and no one can guess the ATM card pin number. The government should as well come up with policies that ensure that agency banking is carried out in through procedural manner to avoid cases where the bank losses money. As well the study recommends for the rest of the banks to adopt agency due to its positive impact on the non- funded income.

The study therefore recommends that there is need to support agency banking by all players: the banks, government, and licensing bodies, especially local authorities; so as to reduce the high compliance costs in bureaucracy in registration. This will enhance financial inclusion. The study further recommends adoption of agency banking by all banks operating in the retail market and that agency banking be marketed more as it is an area with great growth potential as it uses the already established private enterprises and saves the bank huge capital outlays of opening a branch.

5.5 Limitations of the Study

In carrying out this study the following limitations were faced: Some financial information could not be found in the published financial statement and therefore the respondent had to get the data direct from the financial managers of the banks; where the data was provided by financial managers in these commercial banks data was available on weekly basis, availability of the data on a quarterly or monthly basis would have provided more precision in the regression results.

There was limited information on agency banking since the model has been existing for less than five since its roll- out. The study borrowed largely from other countries such as Brazil and Latin America where the central bank of Kenya. Access to material from these countries majorly depended on published journals.

The target population was a bit limiting since the study used only those banks that have operationalized agency banking. There are nine banks out of the 43 Commercial banks in Kenya which have embraced agency banking. This study would be more informative if all banks had rolled out agency banking.

5.6 Suggestions for Further Research

The study recommends that a comparative study be conducted in other countries in East Africa where agency banking is done and determine the effect it has on the non-funded income of these commercial banks. This comparative study will help in generalization of findings on the effect of agency banking on the non-funded income.

The study also recommends that a different instrument of data collection in this case be used which could be a questionnaire or interviews to the financial managers in the

commercial banks. The different instrument will help the study to get in-depth data on agency banking and its effect on non-funded income.

Another study should be done where other variables are included in the study so that we can make observation on the model summary where we can see whether the predictability of the model can change. In our study the model could explain about 87%, another study should be carried with other variables to see their effect on the model and its ability to predict the effect of agency banking on non-funded income

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APPENDIX I:

LETTER OF INTRODUCTION

Dennis Moracha Kengere

University of Nairobi

School of business

P.O Box 25585-00100

Nairobi.

Dear Sir /Madam,

Re: RESEARCH ON THE EFFECTS OF AGENCY BANKING ON NON-FUNDED INCOME OF COMMERCIAL BANKS IN KENYA.

I am a postgraduate student at the University of Nairobi, Pursuing a Master Science in Finance. I am undertaking the above mentioned research project .I would be very grateful if you could provide the data requested for in the attached data collection form as honestly as possible.

The findings of the study will be availed to you upon request on completion of this research.

Thank you for your co-operation.

Yours faithfully,

Dennis Moracha Kengere

APPENDIX II:

LIST OF COMMERCIAL BANKS OFFERING AGENCY BANKING IN KENYA

1. Consolidated Bank of Kenya Ltd

2. Co-operative Bank of Kenya Ltd

3. Equity Bank Ltd

4. Chase Bank Kenya Ltd

5. Family Bank Ltd

6. Kenya Commercial Bank Ltd

7. Diamond Trust Bank Kenya Ltd

8. National Bank of Kenya

9. Post Bank

APPENDIX III:

DATA COLLECTION FORM:

Name of Commercial Bank:			
Particular	**2011**	**2012**	**2013**
Independent Variable			
Fees and Commissions from agency banking (Kshs.)			
Fees Commissions from electronic, internet and mobile banking, debit cards and credit cards (Kshs.)			
Foreign Exchange Trading Income (Kshs.)			
Dividends & Other Income (Kshs.)			
Dependent Variable			
Non-Funded Income (sum of commission fees, net trading profit/loss and other non-interest income) (Kshs.)			

APPENDIX IV:

DATA SHEET SUMMARY:

Year	Name of Bank	Fees and Commissions - agency banking	Fees Commissions -electronic, internet, etc.	Foreign Exchange Trading Income	Dividends & Other Income	Non-Funded Income
		Kshs. 'B'	Kshs. 'B'	Kshs. 'B'	Kshs. 'B'	Kshs. 'B'
2011	1	0.1223	0.1615	0.0505	0.1686	0.6230
	2	1.5144	2.1923	0.6212	1.1637	6.1694
	3	2.7028	0.6102	0.8210	7.8720	10.7270
	4	0.0914	0.2098	0.2841	0.0001	0.6338
	5	0.6345	0.5524	0.0306	0.0491	2.3544
	6	2.1300	3.9223	1.9406	0.8298	9.3076
	7	0.3342	0.4459	0.6560	0.1592	1.7071
	8	0.4646	0.6578	0.3100	0.2497	2.0216
	9	0.1054	0.2407	0.0776	0.1202	0.5990
2012	1	0.1058	0.2444	0.0554	0.1282	0.5910
	2	2.6059	3.3002	-	4.1788	10.1793
	3	2.6251	0.7236	0.6970	7.9540	10.4600
	4	0.1691	0.2313	0.3296	0.0068	0.9148
	5	0.8839	0.9710	0.0511	0.0403	3.2903
	6	1.9800	3.7680	1.6820	0.6514	8.6134
	7	0.3536	0.5421	0.8104	0.0684	1.8646
	8	0.5590	0.8032	0.2293	0.5381	2.3738
	9	0.2746	0.2825	0.0701	0.7877	1.2614
2013	1	0.0751	0.1476	0.0525	0.0229	0.4443
	2	3.1119	3.4952	-	5.0096	12.0001
	3	3.3382	0.9407	-	8.5903	12.5520
	4	0.1213	0.4294	0.7667	0.0074	1.0520
	5	0.4110	1.1631	0.0665	0.1241	1.8522

	6	2.1946	3.3141	1.6846	0.8945	9.2073
	7	0.4022	0.4446	0.7963	0.0777	1.9854
	8	0.5501	0.5465	0.3093	0.6537	2.3292
	9	0.3343	0.1477	0.0821	0.8271	1.4254