THE EFFECTS OF AGENCY BANKING ON THE FINANCIAL

PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than the University of Nairobi for Examination.

Signed…………………………..   Date…………………………

ODHIAMBO JARED WANGA

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This research project has been submitted for examination with my approval as the University of Nairobi Supervisor

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DEDICATION

This research project is dedicated to my Dear loving wife Cynthia, our children Phidel and Tracy, not forgetting my nephew Boaz for their constant support and encouragement throughout my studies. My parents and siblings for their wisdom and inspiration which has been my pillar in search for knowledge.

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LIST OF ABBREVIATIONS

ANOVA - Analysis of the variance

ATMs - Automatic teller machines

CAR - Capital adequacy ratio

CBK - Central Bank of Kenya

KYC - Know Your Customer

PBT- Profits before Tax

PCs - Personal computers

PEX - Palestine securities exchange

PIN - Personal identification number

POS - Point-of-sale

ROA - Return on Assets

ROE – Return on equity

SPSS - Statistical Package for Social Sciences

SSA - Sub-Saharan Africa

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ABSTRACT

The purpose of this study was to determine effects of agency banking on the financial performance of commercial banks in Kenya. The study was based on the following three theoretical foundations; agency theory, bank led theory and nonbank-led theory. This study adopted a descriptive research design. This study focused on all 43 commercial banks which are fully registered by CBK as at 31 December 2014. Secondary data was collected using desk review of published banks annual financial statements. The review covered a period spanning five years (2010 – 2014). The data considered was quantitative in nature. Data collection specifically entailed a review of the annual financial statements of each of the 43 banks during the period 2010 – 2014. The obtained data was analyzed using Microsoft Excel and the Statistical Package for Social Sciences (SPSS) and was presented in graphs, and tables to enable effective and efficient interpretation. It was established that all the measures of agency banking analysed (including asset Quality, capital adequacy, transaction commissions made through agents, and Point- of- sale banking) had a significant effects on financial performance of commercial banks in Kenya. The study concluded that introduction of banking agency in Kenya has brought tremendous improvements. The study also recommended that commercial banks should fully embrace agency banking through adoption of improved technology for information security to make it more reliable to the customers. This will increase volume of transactions which will lead to financial performance.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

A banking agent is a retail or postal 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. Banking agents can be pharmacies, supermarkets, convenience stores, lottery outlets, post offices, and many more. Banking agents are usually equipped with a combination of point-of-sale (POS) card reader, mobile phone, barcode scanner to scan bills for bill payment transactions, personal identification number (PIN) pads, and sometimes personal computers (PCs) that connect with the bank's server using a personal dial-up or other data connection. Clients that transact at the agent use a magstripe bank card or their mobile phone to access their bank account or e-wallet respectively. Identification of customers is normally done through a PIN, but could also involve biometrics. With regard to the transaction verification, authorization, and settlement platform, banking agents are similar to any other remote bank channel.

The point of sale (POS) is the time and place where a retail transaction is completed. It is the point at which a customer makes a payment to the merchant in exchange for goods or after provision of a service. At the point of sale, the merchant would prepare an invoice for the customer (which may be a cash register printout) or otherwise calculate the

amount owed by the customer and provide options for the customer to make payment. The twenty first century has been characterized by rapid growth and application of information technology, this entails innovative ways of doing things, with the key aim of cutting cost and improving productivity. The banking sector in Kenya as in most developing countries in the world leveraging on Technology to transform on its payment services, product development and delivery have embraced agency banking. A new concept that allows banks to engage third parties is in order to offer products and services on their behalf.

Agency Bank is a retail or postal outlet contracted by financial institution or mobile network operator to process client's transactions rather than a branch teller. It is the owner or an employee of the retail outlet who conducts the transaction and lets its client deposit, withdraw and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer. Banking agents can be pharmacies, super markets, conveniences stores, lottery outlets, post offices etc. (Ivatury & Layman, 2006). The Agency Banking model was rolled out in Kenya in May 2010, through the amendment of the Banking Act Chapter 488 Laws of Kenya by The Finance Act 2009, and publication of Central Bank of Kenya (CBK) Prudential Guideline (PG 15). The instruction of agent banking was intended to enable institutions to provide banking services cost effectively to customers. It is expected that the initiative will enhance financial access for those people who are currently unbanked or under banked (CBK, 2011).

1.1.1 Agency Banking

Agency banking refers to contracting of a retail or postal outlet by a financial institution or a mobile network operator to process bank clients' transactions. Banking agents help financial institutions to divert existing customers from crowded branches providing a "complementary", often more convenient channel. Other financial institutions, especially in developing markets, use agents to reach an "additional" client segment or geography. Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch. In such environments banking agents that piggy back on existing retail infrastructure – and lower set up and running cost - can play a vital role in offering many low-income people their first-time access to a range of financial services. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch. The trend of agent banking is evident in many nations all over the globe, such as in Australia where post offices are used as bank agents, France utilizing corner stores, Brazil making use of lottery outlets to provide financial services, Kenya pioneering the mobile financial services, Nigeria, South Africa and the Philippines (Siedek, 2008).

1.1.2 Financial Performance

Financial performance is a subjective measure of how well an organization can use assets from its primary mode of business and generate revenues (Karlyn, 2004). Financial performance is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to

measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales (Jayawardhera & Foley, 2000).

Profit is the ultimate goal of firm. To measure the profitability, there is variety of ratios used of which return on asset, return on equity and net interest margin are the major ones. Return on asset is a major ratio that indicates the profitability of a bank. It is a ratio of Income to its total asset (Khrawish, 2011). It measures the ability of an organization's management to generate income by utilizing company assets at their disposal. Net interest margin is a measure of the difference between the interest income generated by banks and the amount of interest paid out to their lenders, relative to the amount of their assets. It is usually expressed as a percentage of what the financial institution earns on loans in a specific time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). Return on equity is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. Return on equity is what the shareholders look in return for their investment.

1.1.3 Agency Banking and Financial Performance

Globally, retailers and post offices are increasingly utilized as important distribution channels for financial institutions. The points of service range from post offices in the Outback of Australia where clients from all banks can conduct their transactions, to rural France where the bank Credit Agricole uses corner stores to provide financial services, to

small lottery outlets in Brazil at which clients can receive their social payments and access their bank accounts (Kumar, 2006). In understanding agency, there are three parties to a transaction: the customer, the agent's employee who operates the POS (Point Of Sale) device and the bank. Each party should authenticate themselves before initiating any transaction, preferably with two factors of security hence; the customer and the authorized employee of the agent each have a personal card plus a secret PIN. To avoid fraudulent POS terminals, a bank could also announce a unique secret key to each of its clients through which the bank identifies itself to its clients before each transaction (Ivatury, 2008).

An agent network is fundamentally a technology play for a bank. It is similar to the millions of existing Visa, MasterCard and debit card merchants, except that in this case the card payments at retail stores would not only be for sale of goods but also for handing out and taking in cash on behalf of banks. (Ignacio, 2008). The introduction of agent banking is intended to enable institutions to provide banking services more cost effectively to customers. It is expected that this initiative will enhance financial access for those people who are currently unbanked or under banked. Agency banking requires commercial banks to rely to on the existing infrastructure in terms of supermarkets, credit unions, hotels and petrol stations reach out to customers. Based on the ongoing announcements of financial results by commercial banks, input of agency banking into the profits is minimal though the financial institutions are vowing to intensify recruitment of more third parties to assist in expanding their market share and foot print.

1.1.4 Commercial Banks in Kenya

The Central Bank of Kenya Regulates the Commercial Banks and Mortgage Finance Institutions in Kenya pursuant to the provisions of the Banking Act and the Regulations and Prudential Guidelines issued thereunder. They are the dominant players in the Kenyan Banking system and closer attention is paid to them while conducting off-site and on-site surveillance to ensure that they are in compliance with the laws and regulations. The Kenyan banking sector comprising of forty three banks registered total net assets of Ksh. 2.7 trillion as at 31st December 2013. There are twenty six local private commercial banks with Ksh. 1.7 trillion net assets accounting for 61.4% of the total assets. There are fourteen commercial banks owned by foreigners with Ksh. 900 billion and accounted for 34% of the total net assets. The remaining three are local public commercial banks with Ksh. 100 billion which is 4.6% of the sector's total assets. (CBK, 2013)

According to Obulutsa and Merriman (2014), commercial banks` performance in Kenya over the last decade has not been impressive. Several reforms have been implemented in the financial sector since 1990s aiming at increasing performance, stability, productivity, financial access and efficiency. However, bank profitability on average has been erratic. In the period 2008- 2013, increases in Profits before Tax (PBT) has been below 20% on average terms. In the year 2013 PBT of the Kenyan commercial banks increased by 16.6% as compared to the year 2012 when PBT increased by 20.6%. In the year 2009, PBT of the Kenyan banks increased by 12.9% as compared to the year 2008 when PBT increased by 13.4%.The year 2010 is the only year that PBT increased by around 52 percent. This trend is not impressive given that a lot of reforms have been done to

enhance performance of the banking sector. Also there has been a lot of changes in technology and several financial innovations have been developed in Kenya`s financial sector.

The main performance indicators used by CBK are assets, loans and advances, deposits and liabilities, capital and reserves, asset quality, profitability and liquidity of the banking sector. Similarly, the sector's capital adequacy, which is measured by the ratio of Total Capital to Total Risk Weighted Assets, decreased from 23% in December 2012 to 21% in December 2013 but was way above the statutory minimum of 12.0%. The banking sector is expected to maintain its growth momentum supported by the rollout of full file credit information sharing, regional integration initiatives, advances in information and communications technology and the introduction of the devolved governance system in Kenya. (CBK, 2013)

1.2 Research Problem

A major obstacle to financial inclusion is cost, not only cost, the cost incurred by banks in servicing low-value accounts and extending bank infrastructure to underserved, low-income areas, but also the cost incurred by poor customers (in terms of time and expense) in reaching bank branch (Tarazi & Beroff, 2011). The key to bridging the cost gap and improving bank profitability is achieving financial inclusion that requires innovative business models that dramatically reduce costs for everyone and thus pave way for profitable extension of financial services to the poor world.

The Kenyan business environment has changed and it has been characterized by stiff competition among the players and the banking industry is no exception. Competition

amongst the commercial banks as well as entry of mobile phone operators in the money transfer business has pushed banks towards becoming more innovative .The government of Kenya through the central Bank of Kenya embarked on Knowledge Exchange for Agent Banking models that could work for Kenya. It was in pursuant of vision 2030 that the financial services sector was identified as key in mobilizing funds to implement the visions 2030 flagship projects. According to 2009 national financial access survey, 32% 5 of Kenya's bankable populations are totally excluded from the financial services orbit (Njuguna, 2010).

Kamotho (2009), carried a study on mobile phone banking. The study covered the two main dominant mobile banking service providers- Safaricom and zain. It was observed that competition triggers innovation and creativity. Continuous innovation not only yield new products but rather promotes efficiency in the performance of activities. Hence lowering the transaction cost. Ndwiga (2013), studied effect of agency banking on financial performance of Commercial Banks in Kenya, The findings indicated that out of all the banks that have rolled up the service, Equity bank, Co-operative bank and Kenya Commercial Bank show significant performance index. The findings further showed that yearly performance improved significantly. This implies that agency banking is continuously improving leading to significant increased financial performance in those banks that have rolled up the service due to its convenience and efficiency in operation. The study revealed a positive strong effect between agency banking and financial performance.

Mwando (2013), contribution of agency banking on financial performance of commercial banks in Kenya, the study found that the move by the central bank to regulate agency

banking had a positive influence on the financial performance of commercial banks in Kenya. The study also found that low transaction cost through agency banking had a positive impact on the financial performance of commercial banks in Kenya. The study found that financial services accessibility by customers through baking agencies had a positive impact on financial performance of commercial banks in Kenya. The study found that increased market share had a positive effect on the financial performance of commercial banks with many banking institutions indicating that increased market share allowed a company to achieve greater scale in its operations which generally improved its profitability.

On the other hand Omondi and Maokomba (2014), studied the effects of alternative banking channels on profitability of commercial banks- case of the Co-operative bank of Kenya. The study found out that banks should try to make sure that ABCs' services are designed in the way that customers can easily use them; they are faster which will lead to high subscription rate for previously unbanked segment; banks must also use modern technology in their ABCs services as these will make them user friendly, faster and convenient; Customers should subscribe to ABCs services since they will save them time, money as well as enable them to perform several transactions at their comfort anywhere and at any time. From the above studies it is evident that little has been done on the effects of agency banking on the financial performance of commercial banks in Kenya; therefore this study seeks to answer the question; what are the effects of agency banking on the financial performance of commercial banks in Kenya?

1.3 Objective of the Study

The objective of the study was to determine effects of agency banking on the financial performance of commercial banks in Kenya

1.4 Value of the study

The government and other institutions involved in the country's policy formulation cannot overlook the banking sector as one of the major contributor to the country's ID. The findings from this study are of importance because they had the capacity of being used to formulate positive fiscal policies which are relevant and sensitive to the forces influencing the economic growth in Kenya. The study enable policy makers obtain knowledge of banking sector dynamics and the appropriate banking channels to be applied to enhance economic performance and therefore obtain guidance from this study in designing appropriate policies that regulate the banking sector in the country.

The research findings are very instrumental to various stakeholders in the banking sector in Kenya. For the government as the regulator through CBK who formulate and implement monetary policy and associations such as Kenya Bankers Association who endeavor to standardize management practices so as to ensure harmony in the industry will be able to take into account the impact of their capital decisions on the performance of the entire banking sector.

To the academicians the study contribute to the existing literature in the field of finance and growth of the country. It should also act as a stimulus for further research to refine and extend the present study especially in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature on the topic of effects of agency banking on the financial performance from previous studies. The chapter is organized as follows: Section 2.2 Theoretical Foundation, Section2.3 Determinants of financial performance, Section 2.4 Review of Empirical Studies and finally Section 2.5 Summary of Literature Review.

2.2 Theoretical Foundation

This section examines the various theories that are used to inform the study on the effects of agency banking on the financial performance. The study was based on the following three theoretical foundations; agency theory, bank led theory and nonbank-led theory.

2.2.1 Agency Theory

Agency theory emerged in the 1970s from the combined disciplines of economics and institutional theory by Stephen Ross and Barry Mitnick. Banking agents must fit within the distribution strategies of banks, alongside other channels, such as branches or automatic teller machines (ATMs). Commercial banks are big beneficiaries of the rapid growth of agency outlets, which have helped cut costs on expansion and staffing but it is important that the bank has a clear strategic rationale for each agent it sets up, to drive decision making, ensure appropriate agent setup and channel support, and permit subsequent performance evaluation against the original strategic intent (Siedek, 2008).

Banking agents help financial institutions to divert existing customers from crowded branches providing a "complementary", often more convenient channel. Other financial institutions, especially in developing markets, use agents to reach an "additional" client segment or geography. Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of setting up a fully-fledged branch the staffing costs related to that bank and other ancillary costs such as cleaning, security and maintaining an Internet connection.

In such environments banking agents that piggy back on existing retail infrastructure and lower set up and running cost, play a vital role in offering low-income people their first time access to a range of financial services. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch (Siedek, 2008).

Benefits of Agent Banking are among others bringing banking services closer to the customers for instance customers can apply for lines of credit, credit cards, loans and Mortgages through these agents hence, fewer visits are required to banks for doing banking transactions. Rikta (2007), mentioned that in Bangladesh, Customers had to visit on an average of 15 times to their lender for a single loan. Wendel and Williams (2001), mentioned that Agent businesses are more profitable and produce higher revenues, than commercial banks that use only branch networks. Banks can benefit from lower transaction costs as agent banking requires less paper work, less staffs and physical branches (Cheng, 2006).

The bank must address the challenges that are posed by having agency banking while at the same time taking advantage of all the benefits of having this channel of banking.

Agency Banking may eventually lead to financial inclusion in the countries where it has been adopted (Banker, 2011). Success in branchless banking ultimately depends on offering customers a service proposition that is superior to existing options. To date, branchless channels meet this standard only for some. Banking industry is broadly divided into two types of banks i.e. virtual banks and brick and mortar banks .CBK (2009), states that there are many technological and operational challenges in employing a successful agent banking strategy.

The theory assumes that technology should be in place to enable banks and their customers to interact remotely in a trusted way through existing local retail outlets. Agent banking requires a generally good infrastructure in terms of road network, communication and information technology. Considerations should be made for areas that are hard to reach due to a poor fixed infrastructure and poor transport system. Key issues to note are technology; competitive rates product innovation, brand image, Size of the company, location and convenience. The theory is important to the study because it allows the bank to address the challenges that are posed by having agency banking while at the same time taking advantage of all the benefits of having this channel of banking. The theory is positively affecting the study since most of the challenges are addressed by the agents not the banks. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch

2.2.2 Bank-led Theory

Bank-led Theory was developed by Cameron in 1972 during transformation of money-lenders into merchant banks during the origins of modern banking. In the most basic version of the bank-led theory of branchless banking, a licensed financial institution

(typically a bank) delivers financial services through a retail 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 & 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 (Owens, 2006).In some countries, retail agents also handle 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.

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 (Hogan, 1991). These retail agents may operate in hard-to reach or dangerous areas and they 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 (Lyman, Ivatury & Staschen, 2006). 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.

This theory assumes that 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

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, 2006). The bank lead theory is related to the study as it focus on how financial institution like bank deliver their financial services through a retail agent, where the bank develops financial products and services, but distributes them through retail agents who handle all or most customer interaction . For example; Family bank of Kenya distributes it financial product through it Pesa pap agent, 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. Bank-led theory is important to the study because it allows branchless banking, and licensed financial institution (typically a bank) to delivers financial services through a retail agent. The theory is positively affecting the study since the branchless banks will still make profits through the agents. The bank develops financial products and services, but distributes them through retail agents who handle all or most customer interaction

2.2.3 Nonbank-led Theory

Nonbank-led theory was developed by Kumar (2004) during his work on the effects of ownership structure on the firm performance for a panel of Indian corporate firms, from an agency perspective. In this theory customers do not deal with a bank, nor do they maintain a bank account. Instead, customers deal with a nonbank firm either a mobile network operator or prepaid card issuer and retail agents serve as the point of customer contact. Customers exchange their cash for e-money stored in a virtual e-money account on the nonbank's server, which is not linked to a bank account in the individual's name (Kumar, 2006). This model is riskier as the regulatory environment in which these nonbanks operate might not give much importance to issues related to customer identification, which may lead to significant anti-money laundering and counter-terrorism financing risks. Bringing in a culture of Know Your Customer (KYC) to this segment is a major challenge.

The theory assumes that the nonbanks are not much regulated in areas of transparent documentation and recordkeeping which is a prerequisite for a safe financial system. Regulators also lack experience in the realm. For these reasons, allowing nonbank-led model to operate is an unnecessarily big leap and an unjustifiably risky proposition. However, this model becomes viable after regulators have gained 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 (1991) to mitigate the e-money risks (which are peculiar to Nonbank-led model), necessary changes in the existing regulations are required. It starts

by bringing non-banks under financial regulatory net by giving these entities special status of some sort of quasi-bank/remittance agent etc. Grant of this status depends upon meeting pre-specified standards of transparency, financial strength and liquidity. There should be clear, well-defined limits on nature, type and volume of transactions that such entities can undertake. To avoid insolvency, these entities may be required to deposit their net e-banking surplus funds with scheduled banks meeting certain minimum rating criteria (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. This theory is used to determine the effects agency banking on expansion of commercial banks. The theory is positively affecting the study since it explains how agent deals with customers on behalf of the bank. Customers exchange their cash for e-money stored in a virtual e-money account on the nonbank's server, which is not linked to a bank account in the individual's name.

2.3 Determinants of financial performance

The determinants of bank performances can be classified into bank specific (internal) and macroeconomic (external) factors (Al-Tamimi, 2010). These are stochastic variables that determine the output. Internal factors are individual bank characteristics which affect the banks performance. These factors are basically influenced by internal decisions of management and the board. The external factors are sector-wide or country-wide factors which are beyond the control of the company and affect the profitability of banks.

2.3.1 Asset Quality

Asset quality is an evaluation of asset to measure the credit risk associated with it. It is related to the left-hand side of the bank balance sheet. The bank's asset is a bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size) related to the age of the bank (Athanasoglou, 2005). More often than not the loan of a bank is the major asset that generates the major share of the banks income. Loan is the major asset of commercial banks from which they generate income. The quality of loan portfolio determines the profitability of banks. The loan portfolio quality has a direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans (Dang, 2011). Thus, nonperforming loan ratios are the best proxies for asset quality. Different types of financial ratios used to study the performances of banks by different scholars. It is the major concern of all commercial banks to keep the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows that the good health of the portfolio a bank, the lower the ratio, the better the bank performance.

2.3.2 Capital Adequacy

Capital adequacy is the amount of capital a bank or other financial institution has to hold as required by its financial regulator. Capital is one of the bank specific factors that influence the level of bank profitability. Capital is the amount of own fund available to support the bank's business and act as a buffer in case of adverse situation (Athanasoglou, 2005). Banks capital creates liquidity for the bank due to the fact that deposits are most

fragile and prone to bank runs. Moreover, greater bank capital reduces the chance of distress (Diamond, 2000). However, it is not without drawbacks that it induce weak demand for liability, the cheapest sources of fund Capital adequacy is the level of capital required by the banks to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank's debtors. According to Dang (2011), the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. It has also a direct effect on the profitability of banks by determining its expansion to risky but profitable ventures or areas (Sangmi and Nazir, 2010).

2.3.3 Liquidity Management

Liquidity management describes the effort of investors or managers to reduce liquidity risk exposure. Liquidity is another factor that determines the level of bank performance. Liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors. According to Dang (2011) adequate level of liquidity is positively related with bank profitability. The most common financial ratios that reflect the liquidity position of a bank according to the above author are customer deposit to total asset and total loan to customer deposits. Other scholars use different financial ratio to measure liquidity. Ilhomovich (2009), used cash deposit ratio to measure the liquidity level of banks in Malaysia. However, the study conducted in China and Malaysia found that liquidity level of banks has no relationship with the performances of banks.

2.3.4 Management Efficiency

It is a level of performance that describes a process that uses the lowest amount of inputs to create the greatest amount of outputs. Efficiency relates to the use of all inputs in producing any given output, including personal time and energy. Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complexes subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for management quality. The performance of management is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency. The capability of the management to deploy its resources efficiently, income maximization, reducing operating costs can be measured by financial ratios. One of this ratios used to measure management quality is operating profit to income ratio (Sangmi & Nazir, 2010). The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. The other important ratio is that proxy management quality is expense to asset ratio. The ratio of operating expenses to total asset is expected to be negatively associated with profitability. Management quality in this regard, determines the level of operating expenses and in turn affects profitability (Athanasoglou, 2005).

Literature shows that performance within the banking sector is subject to various determinants; key among them being Asset quality, Capital adequacy, Liquidity management and Management efficiency. It emerges that these key determinants play a

vital role in profit maximization within various banking institutions around the world and also they pose managerial risks which needs to be mitigated.

2.4 Review of Empirical Studies

This section presents various studies that have been done on agency and point of sale banking and financial performance;

Veniard (2010),studied role of agency banking on economics in India; the study found that Agency banking does improve the economics of the institutions compared with branches, especially for high- transaction, low-balance accounts that are common among the poor user, low-balance accounts that are common among the poor users. Further finding is that Agent banking system are cheaper to operate than Branches, Costs are incurred only if transactions are realized, Agent transaction platforms benefit from additional transactional resources, Agent banking works best for low balance ,High transaction accounts.

De Young and Rice (2004), did a research on theoretical relation between commercial banks and agency banking in the U.S., the study revealed that the theoretical relation between commercial banks' non-interest proceeds, business strategies, market circumstance, technological transform and financial performance for U.S. Commercial banks between 1989 and 2001. They display that smartly managed commercial banks, degreed by means of a relative ROE degree, are much less engaged in non-interest revenue whilst large banks and banks that focal point more on agency banking are extra dependent on non-interest income. They also establish that trivial increases in non-

interest income produce superior, but more unstable profits, and a turn down in risk-adjusted profits.

Alkhatib (2012), studying the financial performance of Palestinian commercial banks listed on Palestine securities exchange (PEX) measured financial performance using three indicators; Internal–based performance measured by Return on Assets (ROA), Market based performance measured by Tobin's Q model (Price / Book value of Equity) and Economic–based performance measured by Economic Value add. The study employed the correlation and multiple regression analysis of annual time series data from 2005-2010 to capture the impact of bank size, credit risk, operational efficiency and asset management on financial performance measured by the three indicators, and to create a good-fit regression model to predict the future financial performance of these banks. The study rejected the hypothesis claiming that "there existed statistically insignificant impact of bank size, credit risk, operational efficiency and asset management on financial performance of Palestinian commercial banks".

A study Conducted by 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.

A study conducted by Ivatury and Mas (2008) on the number of agents banking in Brazil found that an extra 13 million unbanked people have been reached and more than 160,000 retail outlets turned into correspondents since 1999. These agents can be found in all municipalities in Brazil. Most agents are commercial establishments, such as

grocery stores, post offices, notaries and lottery outlets. More than 47,000 of these outlets are authorized to handle deposits and open accounts.

McKay (2011), conducted a research on the number of agent banking outlets and their effect on banking services in Mexico. Although by 2000, only 1,600 municipalities in Mexico 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. Mexico ̋s experience has offered valuable lessons for countries where banks can contract an agent. The Banks Act allows a bank to contract agents to receive on (the bank's) behalf from its clients any deposits, money due to it or applications for loans or advances, or to make payments to such clients on its behalf.

Tchouassi (2012) sought to find out whether mobile phones really work to extend banking services to the unbanked using empirical Lessons from Selected Sub-Saharan Africa Countries. This study sought to discuss how mobile phones could be used to extend banking services to the unbanked, poor and vulnerable population. The study noted that poor, vulnerable and low-income households in Sub-Saharan Africa (SSA) countries often lacked access to bank accounts and faced high costs for conducting basic financial transactions. The mobile phone presented a great opportunity for the provision of financial services to the unbanked. In addition to technological and economic innovation, policy and regulatory innovation was needed to make these services a reality.

Sangmi and Nazir (2010), did a study on the relationship between electronic banking and financial performance of commercial banks in Australia where he paid keen attention on the microfinance institutions in Sydney. However, the current study is focusing on commercial banks and not microfinance institutions. Sangmi and Nazir (2010), also

looked at the wider electronic banking whereas this study will only concentrate on agency banking.

Various local scholars have conducted research in areas of Agency Banking, Wairi (2011) in her study Factors influencing adoption of agency banking innovation among commercial banks in Kenya, her study revealed that the main factors influencing the adoption of agency banking among commercial banks in Kenya are Cost reduction, Enhancement of customer service and expanded presence by banks particular in remote areas. The study found out that the introduction of third party retail agents presents several risk factors with regard to the effective regulation and supervision of banks.

Wambugu (2011), in the study Factors influencing Adoption of Agency Banking by Commercial Bank in Kenya, found out that innovation were introduced in the period between 2006 and 2010.These included ATMs, Credit cards, women oriented banking, internet banking, youth oriented accounts, women oriented banking, children accounts, Shariah Compliant banks and now most recently introduced within the Kenyan banking sector Agency Banking.

In An evaluation of the role of Agency Banking in the performance of commercial banks in Kenya Mwangi (2013), concluded that some of the effects of regulations on the performance of commercial banks attributable to agency banking were influenced by board of directors and executive management, accountability and quality control. The study concluded that infrastructure cost and security influence the performance of commercial banks attributable to agency banking to a very great extent.

2.5 Summary of Literature Review

From the above theories, Bank-led theory is important to the study because it allows branchless banking, and licensed financial institution (typically a bank) to delivers financial services through a retail agent, agency theory allows the bank to address the challenges that are posed by having agency banking while at the same time taking advantage of all the benefits of having this channel of banking while nonbank-led theory explain how agent deals with customers on behalf of the bank. The theories have positive impact on the knowledge gap since they provide facts on agents and how they operate, this will lead a positive financial performance on commercial banks in Kenya

From the past international studies conducted, it has also come out clearly that performance of banks was greatly affected by security and infrastructure costs. Agency banking have come in and greatly reduced the costs of operations for commercial banks. Agent banking improves the bank's geographical coverage and competitiveness so that existing and potential customers can benefit from a greater level of convenience in accessing banking services. Small retail informal outlets are the most reliable credit issuers to many people and form the bulk of agency outlets that partner with the banks.

From the above local studies, most of them have focused on agency banking only and nothing has been done on the effects of agency banking on the financial performance of commercial banks in Kenya, hence the research gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that will be followed in accomplishing the study. Procedures and techniques that will be used in the collection, processing and analysis of data are discussed. This chapter is organized as follows; Section 3.2 sets to explain the research design, Section 3.3 presents population and sample, Section 3.4 explains data and data collection instruments, and finally section 3.5 presents the data analysis.

3.2 Research Design

This study adopted a descriptive research design. According to Schindler (2003), a descriptive research design is appropriate where the study seeks to describe the characteristics of certain groups, estimate the proportion of people who have certain characteristics and make predictions.

Mugenda and Mugenda (2003) describes descriptive research design as a systematic, empirical inquiry into which the researcher does not have a direct control of the independent variables as their manifestation has already occurred or because the independent variable cannot inherently be manipulated.

3.3 Population and Sample

Target population for in statistics is the specific population about which information is desired. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated.

This study focused on all 43 commercial banks which are fully registered by CBK as at 31 December 2014.

3.4 Data and Data Collection Instruments

Secondary data was collected using desk review of published banks annual financial statements. The review covered a period spanning five years (2010 – 2014). The data considered was quantitative in nature. Data collection specifically entailed a review of the annual financial statements of each of the 43 banks during the period 2010 – 2014. The objective was to obtain information that will help to determine effects of agency banking on the financial performance of commercial banks in Kenya

3.5 Data Analysis

The researcher collected data on financial performance. Freund (2001), underscores that the main objective of any statistical investigation is to determine relationships that make it feasible to predict one or more variables in terms of other variables. The obtained data was analyzed using Microsoft Excel and the Statistical Package for Social Sciences (SPSS) and was presented in graphs, and tables to enable effective and efficient interpretation. Using this data, the researcher conducted a correlation and regression

analysis to establish effects of agency and point of sale banking on the financial performance.

3.5.1 Conceptual Model

The study takes the form of a mathematical function

$$Y = f(X_1, X_2, X_3, X_4) \tag{1}$$

Where Y = financial performance (measured by Return on Equity (ROE) and Return on Assets (ROA).

X_I = is the Asset Quality (measured by nonperforming loan ratios)

X_2 = Capital Adequacy (measured by capital adequacy ratio (CAR))

X_3 = Agency banking (measured by number transaction made through agents)

X_4 = point- of- sale banking (measured by number transactions made through point- of-sale-merchants)

According to Dang (2011), major concern of most banks is to keep the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows that the good health of the portfolio a bank, the lower the ratio, the better the bank performance. it is not without drawbacks that it induce weak demand for liability, the cheapest sources of fund Capital adequacy is the level of capital required by the banks to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank's debtors. Ilhomovich (2009), noted that the most common financial ratios that reflect the liquidity position of a bank

according to the above author are customer deposit to total asset and total loan to customer deposits.

3.5.2 Analytical Model

The study applied the following regression model

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \mu \qquad (2)$$

Where Y = financial performance (measured by Return on Equity (ROE).

X_1 = is the Asset Quality (measured by nonperforming loan ratios)

X_2 = Capital Adequacy (measured by capital adequacy ratio (CAR))

X_3 = Agency banking (measured by transaction commissions made through agents)

X_4 = point- of- sale banking (measured by transactions made through point- of- sale)

$B_1 - \beta_4$ are the regression co-efficient or change introduced in Y by each independent variable

β_0 - is a regression constant

μ is the random error term accounting for all other variables that affect financial performance but not captured in the model.

The results are said to be statistically significant within the 0.05 level, which means that the significance value must be smaller than 0.05. The significance was determined by the t-value, which indicates how many standard error means the sample diverges from the tested value (Kothari, 2004). In addition, the Pearson Product Moment Correlation Coefficient was used to test the direction and magnitude of the relationship between the

dependent and independent variables at 95% confidence level. The model significance was tested using the analysis of the variance (ANOVA), t-tests, z-tests, F-tests and the chi-square at 95% confidence. Statistical inference techniques were used in making conclusions relating to the accuracy of the model.

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis and findings of the research. The objective of this study was to establish the effects of agency banking on the financial performance of commercial banks in Kenya for the period between 2010 -2014. The chapter is organized as follows; Section 4.2 Summary statistics, Section 4.3 Correlation, Section 4.4 Estimate or Empirical model, Section 4.5 Discussion of the findings and Section 4.6 Summary.

4.2 Summary Statistics

The study, solely adopted the use of secondary data sources. The information on financial performance was captured from Annual reports of the 43 Commercial Banks in Kenya as at December 2014. The study used descriptive statistics (involving mean and standard deviation), regression analysis and mean differences through t-tests to establish the effect of Agency banking on performance of Commercial banks in Kenya.

4.2.1 Asset Quality

Table 4.1: Descriptive Statistics on Asset Quality

Years	Total Loans	Non-Performing Loans	Asset Quality
2010	79,966	9,966	0.12463
2011	49,815	8,115	0.1629
2012	24,824	11,904	0.47954
2013	13,944	9,750	0.69923
2014	16,008	11,750	0.73401

Source: Researcher (2015)

From the results, the lowest net value for asset qualities was 0.12463 in 2010 while the highest was 0.73401 in 2014. the findings revealed that there have been a significant increase in asset quality during the five-year period.

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and other assets, as well as off-balance sheet transactions. The ability of management to identify and manage credit risk is also reflected here. The evaluation of asset quality should consider the adequacy of the Allowance for Loan and Lease Losses (ALLL) and weigh the exposure to counter-party, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered.
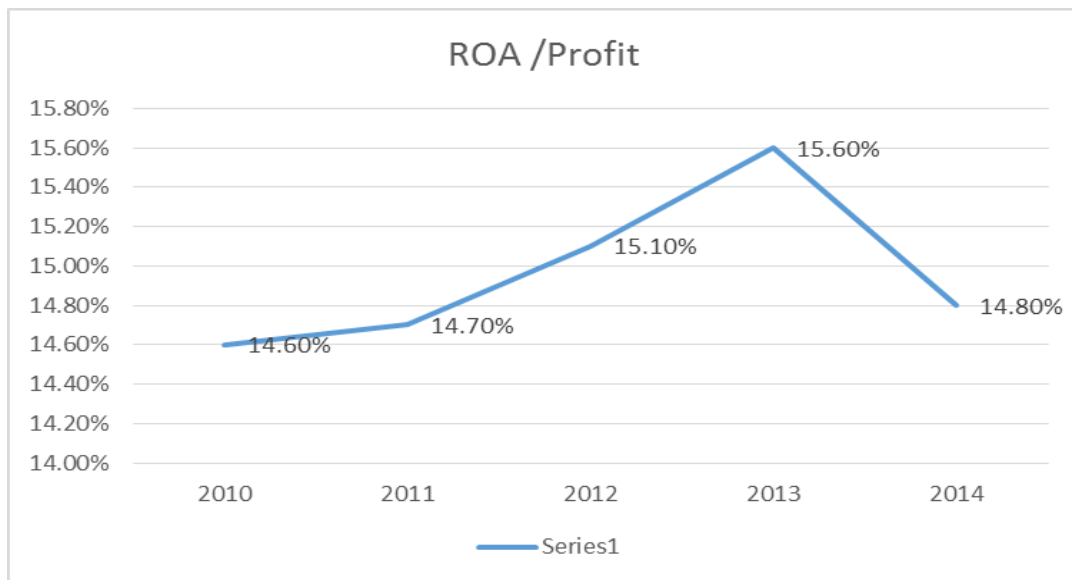
4.2.2 Capital Adequacy

Figure 4.1: Descriptive Statistics on Capital Adequacy

The commercial banks g system remained well capitalized during 2013 with the sector's

return on Assets and profit ratios standing at 15.6%. The capital adequacy was low 2010,

2011 2014 and 2012 (14.6%, 14.7% 14.8% and 15.1%) respectively.

Capital adequacy is the capital level required to maintain balance with the operational,

credit and market risks exposure of the financial institution in order to accommodate

potential losses and safeguard the debt holders of the financial institution. Bank

supervisors use the capital-risk asset ratio to measure the capital adequacy Karlyn (1984).

Capital adequacy focuses on the management ability to deal with marginal capital needs,

the nature of the composition of the balance sheet, the quality of capital and ability to

access sources of capital including capital markets, the volume of assets and capability of

acquiring loans (Uniform Financial Institutions Rating System, 1997).

4.2.3 Transaction commissions made through agents

Table 4.2: Descriptive Statistics on transaction commissions made through agents

Year	Mean	Std deviation
2010	10625.63	0.2522
2011	11276.57	0.1213
2012	14393.91	0.1712
2013	16743.46	0.1354
2014	18886.68	0.1423

Source: Researcher (2015)

The results on transaction commissions made through agents indicted that the year 2014

recorded the highest average number transaction commissions made through agents

18886.68 with the year 2012 recording the lowest mean value of transaction commissions

made through agents 10625.63. This implies that the transaction commissions made through agents has been increasing since 2010.

4.2.4 Point- of- sale banking

Table 4.3: Descriptive Statistics on point- of- sale banking

Year	Mean	Std deviation
2010	16,172.9	0.3376
2011	17363.76	0.2243
2012	29024.33	0.1554
2013	29307.65	0.2345
2014	58295.54	0.2167

Source: Researcher (2015)

The findings indicated that year 2014 recorded the highest average number of transactions made through point- of- sale (58295.54) while 2010 recorded the lowest number of transactions made through point- of- sale (16,172.9).

According to Bold, (2011) findings   the point of sale trends has been on increase and are directly related with organizational performance. Point of sale is often referred to as the point of service because it is not just a point of sale but also a point of return or customer order. Additionally, today POS software may include additional features to cater for different functionality, such as inventory management, CRM, financials, warehousing, etc. The point of sale for products and services is an important focus for marketers, because consumers tend to make purchasing decisions on very high-margin products or services at these strategic locations. Points of sale may be real, as in the case of a "brick and mortar" store, or virtual, as in the case of an electronic retailer that sells goods and services over the internet (Siedek, 2012).

4.3 Correlation

The Karl Pearson's product-moment correlation was used to analyse the association between the independent and the dependent variables. The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by *r*. The Pearson correlation coefficient, *r*, can take a range of values from +1 to -1.

A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association, that is, as the value of one variable increases so does the value of the other variable. A value less than 0 indicates a negative association, that is, as the value of one variable increases the value of the other variable decreases. Pearson's Correlation Coefficient was carried out and the results obtained are presented in table below.

Table 4.4: correlation

		Financial performance	Asset Quality	Capital Adequacy	transaction commissions made through agents	Point- of- sale banking
Financial performance commercial banks	Correlation Coefficient	1.000	.565	.592	.411	.558
	Sig. (2-tailed)	.	.006	.029	.024	.002
	N	43	43	43	43	43
Asset Quality	Correlation Coefficient	.565	1.000	.142	.037	001
	Sig. (2-tailed)	.006	.	.000	.003	.002
	N	43	43	43	43	43
Capital Adequacy	Correlation Coefficient	.592	.142	1.000	.046	.008
	Sig. (2-tailed)	.029	.002	.	.000	.000
	N	43	43	43	43	43
Transaction commissions made through agents	Correlation Coefficient	.411	.037	.046	1.000	.124
	Sig. (2-tailed)	.024	.000	.001	.	.002
	N	43	43	43	43	43
Point- of- sale banking	Correlation Coefficient	.558	001	.018	.124	1.000
	Sig. (2-tailed)	.002	.001	.003	.000	.
	N	43	43	43	43	43

Source: Researcher (2015)

On the correlation of the study variable, the researcher conducted a Pearson moment correlation. From the finding in the table above, the study found that there was strong correlation coefficient between bank financial performance and Asset Quality as shown by correlation factor of 0.565, this strong relationship was found to be statistically significant as the significant value was 0.006 which is less than 0.05, the study also found strong positive correlation between bank financial performance and Capital Adequacy as shown by correlation coefficient of 0.592, this too was also found to be significant at 0.029 level. The study also found strong positive correlation between bank financial performance and transaction commissions made through agents as shown by correlation coefficient of 0.411 at 0.024 level of confidence. There was a strong positive correlation between bank financial performance and Point- of- sale banking as shown by correlation coefficient of 0.558 at 0.002 level of confidence

4.4 Estimated or Empirical Model

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions. The model summary are presented in the table below

Table 4.5: **Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.918[a]	.842	.817	.0193

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 above table the value of adjusted R squared was 0.817 indication that there was variation

of 81.7 percent on financial performance of commercial banks due to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking at 95 percent confidence interval. This shows that 81.7 percent changes in financial performance of commercial banks could be accounted to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking. 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 0.918.

The study further tested the significance of the model by use of ANOVA technique. The findings are tabulated in table below.

Table 4.6: Summary of One-Way ANOVA results

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	71.9	4	17.975	9.679	.000[b]
1	Residual	72.288	39	1.8535		
	Total	144.188	43			

Critical value = 2.44

Source: Researcher (2015)

From the ANOVA statics, the study established the regression model had a significance level of .000 which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The calculated value was greater than the critical value (9.679>2.44) an indication Asset Quality, Capital Adequacy, transaction commissions made through agents, and Point- of-

sale banking all have a significant effects on financial performance of commercial banks in Kenya. The significance value was less than 0.05 indicating that the model was significant.

In addition, the study used the coefficient table to determine the study model. The findings are presented in the table below.

Table 4.7: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.489	.142		3.442	.000
	Asset quality	.179	.219	.199	3.81	.024
	Capital Adequacy	.247	.109	.051	2.266	.004
	Transaction commissions made through agents	.120	.219	.138	2.546	.001
	Point- of- sale banking	.216	.084	.114	2.401	.011

From the regression model obtained above, a unit change in Asset quality for year would lead to an increase in financial performance of commercial banks in Kenya by a factor of by a factor of 0.179, a unit change in Capital Adequacy would lead to an increase in financial performance of commercial banks in Kenya by a factor of by a factor of 0.247, a unit increase in Transaction commissions made through agents, while holding other factors at constant would cause an increase in financial performance of commercial banks in Kenya by a factor of 0.120, a unit increase in Point- of- sale banking, while holding other factors at constant would cause an increase in financial performance of commercial banks in Kenya by a factor of 0.216

The findings above conform to findings by Dawood (2014) that number of transactions made through bank agents is directly related financial performance. The findings concur with Tianwei & Paul, (2003) who found out that financial innovations are positive related with Banks financial performance.

The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and $\alpha=0.05$. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. All the predictor variables were significant in the model as their probability values were less than $\alpha=0.05$.

4.5 Discussion of the Findings

From the findings 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 above table the value of adjusted R squared was 0.817 indication that there was variation of 81.7 percent on financial performance of commercial banks due to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking at 95 percent confidence interval. This shows that 81.7 percent changes in financial performance of commercial banks could be accounted to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking. 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 0.918.

From the ANOVA statics, the study established the regression model had a significance level of .000 which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The calculated value was greater than the critical value (9.679>2.44) an indication Asset Quality, Capital Adequacy, transaction commissions made through agents, and Point- of-sale banking all have a significant effects on financial performance of commercial banks in Kenya. The significance value was less than 0.05 indicating that the model was significant.

These findings concur with findings by Mwangi (2011) who evaluated the role of agency banking in the performance of commercial banks in Kenya. The study was done on four banks offering agency banking services using questionnaires distributed to the banks' branch managers. The study established that number of transactions made on point of sale influence the performance of commercial banks attributable to agency banking to a very great extent. However, the current results also concur with findings by Kamau (2012) who studied the relationship between agency banking and financial performance of the banks in Kenya. Through review of secondary data, the study found that agency banking outlets were 9,748 active agents in 2011 from 8,809 in 2010 facilitating a total volume of 8.7 million transactions valued at KSh 43.6 billion. Using regression analysis, the study positive but weak correlation between number of agents, deposit and withdrawals transactions undertaken through agents and financial performance of banks as measured by return on equity by December 2011.

Additionally the findings support Kithuka (2012) who did a study on "factors influencing growth of agency banking in Kenya". The study sampled 100 Equity Bank agencies

doing bank focused, bank led and non-bank led transactions in Kwale County. The study established that convenience of the money transfer technology plus its accessibility, cost, support and security influence the use of agency banking. The findings further revealed that the relationship could not be conclusively determined due to the low number of banks that have implemented it and impact may become clearer once all banks adopt agency banking

4.6 Summary

This chapter presented analysis and findings of the research. The objective of this study was to establish the effects of agency banking on the financial performance of commercial banks in Kenya for the period between 2010 -2014. It was established that all the measures of agency banking analysed (including asset Quality, capital adequacy, transaction commissions made through agents, and Point- of- sale banking) have a significant effects on financial performance of commercial banks in Kenya.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the study findings, conclusion and recommendations. The objective of this study was to establish the effect of agency banking on the financial performance of commercial banks in Kenya. The Chapter is organized as follows Section 5.2 Summary of the findings, Section 5.3 Conclusions, Section 5.4 Recommendations and Section 5.5 the Limitations of the Study.

5.2 Summary of the Study

Based on the findings, the lowest net value for asset qualities was 0.12463 in 2010 while the highest was 0.73401 in 2014. The findings also revealed that there have been a significant increase in asset quality during the five-year period. The commercial banks system remained well capitalized during 2013 with the sector's return on Assets and profit ratios standing at 15.6%. The capital adequacy was low 2010, 2011 2014 and 2012 (14.6%, 14.7% 14.8% and 15.1%) respectively. The results on transaction commissions made through agents indicted that the year 2014 recorded the highest average number transaction commissions made through agents 18886.68 with the year 2012 recording the lowest mean value of transaction commissions made through agents 10625.63. This implies that the transaction commissions made through agents has been increasing since 2010. The findings indicated that year 2014 recorded the highest average number of transactions made through point- of- sale (58295.54) while 2010 recorded the lowest number of transactions made through point- of- sale (16,172.9).

From the findings in the above table the value of adjusted R squared was 0.817 indication that there was variation of 81.7 percent on financial performance of commercial banks due to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking at 95 percent confidence interval. This shows that 81.7 percent changes in financial performance of commercial banks could be accounted to changes in Asset Quality, Capital Adequacy, Agency banking, and Point- of- sale banking. R-value 0.918 from the findings implied that there was a strong positive relationship between the study variables. From the ANOVA statics, the study established the regression model had a significance level of .000 which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The calculated value was greater than the critical value (9.679>2.44) an indication Asset Quality, Capital Adequacy, transaction commissions made through agents, and Point- of- sale banking all have a significant effects on financial performance of commercial banks in Kenya. The significance value was less than 0.05 indicating that the model was significant.

5.3 Conclusions

Based on since 2010 regulation by the Central Bank of Kenya, introduction of banking agency in Kenya has brought tremendous improvements. Introduction of this innovative channel has helped to bring access to financial services much closer to the customers. However, agency banking has experienced tremendous growth and complexity of the transactions been handled. The revolution of information technology has influenced almost every facet of life, among them is the banking sector. Technological advancement has not only affected the way of living but has had an effect on the way people do their

banking. The Kenya Bureau of Statistic Report (2011) indicates that more than 7 million adult rural Kenyans are either under-banked or unbanked. This is partly because of the high cost of maintaining the bank branches and the low nature of business transactions in rural Kenya a situation which makes opening of new branches in the rural areas a less productive venture. Technology has therefore created greater opportunities to service providers to offer great flexibility to the customers. Agent banking involves a number of technologies in order for the financial institutions to keep track of the transactions done by the retail outlet. The study further concludes that that financial services accessibility by customers through baking agencies had a positive impact on financial performance of commercial banks in Kenya and therefore are of great importance.

5.4 Recommendations

Based on the finding the study made recommendations to the government and the policy makers. The study further gave recommendation for further research

5.4.1 Government and policy makers

The study recommends that policy makes and the government should ensure that regulations are efficient to enable more banks to embrace agency banking service. The study also recommends that commercial banks should fully embrace agency banking through adoption of improved technology for information security to make it more reliable to the customers. This will increase volume of transactions which will lead to financial performance.

Based on the findings and conclusions presented above, the study recommends that banks should increase the commission given to their agent operator for motivation

purposes so as to increase their performance. In addition, banks should educate and regulate their agents on issuing of loan to reduce the increasing number of defaulters and enhance customer confidence in agents. The study recommends that customers should be enlightened on the operation of agency banking in order to enhance their confidentiality.

5.4.2 Recommendations for further research

The current study established effect of agency banking on the financial performance of commercial banks in Kenya. The study recommended that there is need for further research to be undertaken which may include studies on customer perception of agency banking so as to determine what affect banking agents' performance from the demand side. Moreover, studies can be done on the economic impact of agency banking model performance in Kenya.

5.5 Limitations of the Study

The study was limited to establishing the effect of agency banking on the financial performance of commercial banks in Kenya. The study was limited to 43 commercial in Kenya, the study was limited to five year period from year 2010 to year 2014. The study was limited to secondary data, which was collected from financial annual reports of all the respective banks from the NSE and in the CBK website.

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APPENDICES

Appendix I: List of Commercial Banks in Kenya

Classification	Description	Commercial Banks
Tier I	Comprises of banks with a balance sheet of more than Kenya Shillings 40 billion	1. Citibank 2. Equity Bank 3. Standard Chartered Bank 4. Barclays Bank of Kenya 5. NIC Bank 6. Kenya Commercial Bank 7. National Bank of Kenya 8. Diamond Trust Bank 9. Co-operative Bank of Kenya 10. CFC Stanbic Bank
Tier II	Comprises of banks with a balance sheet of less than Kenya Shillings 40 billion but more than Kenya Shillings 10 billion	11. I&M Bank 12. Bank of India 13. Bank of Baroda 14. Family Bank 15. Prime Bank

		16. Commercial Bank of Africa
		17. Bank of Africa
		18. Consolidated Bank
		19. Chase Bank
		20. Fina Bank
		21. Eco-Bank
		22. HFCK
Tier III	Comprises of banks with a balance sheet of less than Kenya Shillings 10 billion	23. Habib A.G. Zurich
		24. Victoria Commercial Bank
		25. Credit Bank
		26. Habib Bank (K) Ltd
		27. Oriental Commercial Bank
		28. K-Rep Bank
		29. ABC Bank
		30. Development Bank of Kenya
		31. Middle East Bank
		32. Equatorial Commercial Bank
		33. Trans-National Bank

34. Dubai Bank

35. Fidelity Commercial Bank

36. City Finance Bank

37. Paramount Universal Bank

38. Giro Commercial Bank

39. Imperial Bank

40. Guardian Bank

41. Southern Credit Bank

42. Gulf African Bank

43. First Community Bank

Source: The Banking Survey by CBK 2014, pp. 191