

Agency banking as an Alternative Banking Services Delivery Channel and Financial Performance of Commercial Banks in Kenya

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How to cite this article: Mwangi, T. N., & Kalui, F. (2022). Agency banking as an Alternative Banking Services Delivery Channel and Financial Performance of Commercial Banks in Kenya. *Journal of Finance and Accounting*, 2(2), 1-10.

Abstract

This study set out to investigate the effect of agency banking as an alternative banking service delivery channel on the financial performance of commercial banks in Kenya. The study was anchored on modern portfolio theory and employed a causal research design. Census method of sampling was employed, where all the 40 commercial banks operating as of December 2018 formed the study units. Both primary and secondary data were used. Data was analysed using descriptive and regression analysis. The study findings showed that agency banking had a positive and significant effect on financial performance of commercial banks. The study concluded that agency banking contributes significantly to positive change in financial performance of commercial banks in Kenya. The study, therefore, recommends that the management of commercial banks should consider embracing the agency banking model and increasing the use of agents that rely on the existing infrastructure such as supermarkets, credit unions, hotels, and petrol stations to reach out to more customers.

Keywords: *Agency banking, alternative banking services delivery channel, financial performance, commercial banks*

1.0 Introduction

Commercial banks are the foundation of the payment system in many economies by playing an intermediary role between savers and borrowers. They further enhance the financial system by ensuring that financial institutions are stable and can effectively facilitate financial intermediation. Commercial banks differ markedly in their sources of revenue. Some focus on business lending, others on household lending, while some focus on fee-earning activities.

Increasingly, in recent years, the financial services industry has experienced drastic changes due to the liberation and deregulation of the financial sector, advances in information technology infrastructure, and the growing consumer demands for better product and service pricing. All these factors have resulted in greater competition among banks and other financial institutions. The stiff competition in the banking industry has made banks unable to meet the return of equities (ROE) demanded by shareholders based on net interest income alone. Commercial banks, therefore, have been forced to diversify their income sources from traditional intermediation income-generating activities to non-intermediation income-generating activities such as fee income, service charges, and other technological non-traditional sources.

In Kenya financial liberalisation of the early 1990s opened the banking industry to several players leading to stiff competition and weakening the financial performance leading to the collapse of some banks. In response, commercial banks changed their income sources activities by diversifying as a possible way to improve their performance.

Kenyan commercial banks have exponentially embraced the use of information and communication technologies in their service provision. They have invested huge amounts of money in implementing self and virtual banking services to improve the quality of customer service such as through the use of the internet and mobile banking.

As of 31st December 2017, there were 40 operational registered commercial banks in Kenya including 15 multinational banks with 31.7% of the total net assets, 25 banks that are locally owned with 78.3% of total net assets, and 3 banks that had a majority government shareholding. In addition, there was 1 mortgage finance company, 73 foreign exchange bureaus, 13 microfinance banks, and 19 money remittance providers. The total net assets in the banking sector stood at Kshs. 4 trillion as of 31st December 2017 (CBK, 2017).

1.1 Problem Statement

Commercial banks serve as financial intermediaries which are the link between customers and banking services. The banking sector is critical to the economy of Kenya and other global nations. The banking industry has in the recent past been facing challenges brought about by increased competition, increased cost of doing business, changing cultural trends, technological advancements, increased regulations, and rapid globalization trends. For instance, Loonam and O'Loughlin (2008) study found that increased cost of operations and reduced earnings had impacted commercial banks thus affecting their profitability. The culmination of these challenges has forced many commercial banks to create new competitive service offerings, rationalize business lines, and seek sustainable improvements in operational efficiencies to maintain profitability. Commercial banks, therefore, must be structured for agility to cope with local and global banking customer service dynamics. Commercial banks being profit-oriented institutions have therefore embraced innovative alternative banking service delivery channels to lower their operational costs, improve their customer service, and increase their financial performance.

Alternative banking service delivery channels adopted by commercial banks have, however, faced various challenges which bring concerns about their impact on commercial banks' profitability. For instance, Maungu (2015) study noted that some of the barriers faced by delivery channels include; a lack of customer confidence, security concerns, system failures, cases of transaction errors, and network failures. The study also, noted that despite the existence of alternative banking services delivery channels, some bank halls continued to be congested.

Previous international studies undertaken on banking service delivery channels include Chen and Hitt (2002) which showed that customer retention in the online brokerage industry can be influenced by the design of self-service systems and other product design choices. Balasubramanian and Peterson (2010) study established that service delivery channels contribute to the aggregated firm's sales growth, improved customer satisfaction, cost reduction, and increased means of linking the firm products to the market, thus improving productivity. To the best of the researcher's knowledge, many studies on alternative banking services delivery channels such as agency banking have been done in Europe and Asian countries and very few have been done locally. This study, therefore, sought to fill this knowledge gap by evaluating the effect of agency banking as an alternative banking services delivery channel on financial performance of commercial banks in Kenya.

1.2 Research Hypothesis

Ho: There is no significant effect of agency banking on financial performance of commercial banks in Kenya.

2.0 Theoretical Review

This study hinged on the modern portfolio theory (MPT). MPT is a normative theory in that it hypothesizes how investors should behave rather than how investors behave. It originated with Markowitz (1952) proposition that there is a trade-off between risk and return, correlations in returns of different assets, portfolio selection, and investment optimization. In its simplest form, MPT provides a framework to construct and select portfolios based on the expected performance of the investments and the risk appetite of the investor. The theory is a mathematical formulation of the theory of diversification, intending to select a collection of assets that have collectively lesser risk than any individual asset. The theory suggests that diversification reduces firm risk, due to the imperfect correlation among different assets.

MPT shows that an investor can construct a portfolio of multiple assets that will maximize returns for a given level of risk. Likewise, given the desired level of expected return, an investor can construct a portfolio with the lowest possible risk. Based on statistical measures such as variance and correlation, an individual investment's return is less important than how the investment behaves in the context of the entire portfolio. Markowitz & Adesota (1995) identify factors that determine the efficiency of portfolio selection as the expected future return of each candidate's security, the expected risk of each candidate's security, and lastly the extent to which each security's risk correlated with every other security.

Applied to the banking system, MPT has indeed led to numerous innovations leading to functionally diversified banks having a comparative advantage in terms of long-term performance/risk profile compared to specialised competitors (Baele, De Jonghe, & Vennet, 2007). Diversified commercial banks can reduce operational costs by consolidating back-office operations such as custody, escrow, trust services, settlement services, research, and advisory functions, and eliminating redundant costs, such as closing overlapping branches. Thus, the banks diversify by shifting their reliance on traditional methods of revenue generation to business activities that generate fee revenue, trading revenue, and other types of non-interest revenues. It has also been argued that combining different types of income-earning activities – non-interest and interest-earning assets – results in the rebalancing of income away from interest income and may increase return and diversify risk (Gamra & Plihon, 2011).

Regarding the current study, the MPT has been used to underscore the fact that a heavy reliance of a bank on interest-based income as the main source of revenue increases the exposure of the bank due to a higher concentration of bank products or services to a limited range of customer segments. Consequently, multiple sources channels, supported by the adoption of innovations can remarkably increase the bank's profitability and survival chances in an increasingly competitive banking environment (Khanna & Gupta, 2015). Further, various factors such as increased competition, technological changes, and increased instability in the financial system due to globalization, have enabled the banks to increase their portion of income derived from non-intermediation activities. It is imperative to understand how different channels introduced in the Kenyan banking sector in the recent past have influenced the financial performance of commercial banks. This study particularly focused on agency banking.

2.1 Empirical Review

Kamau (2012) studied the relationship between agency banking and financial performance of banks in Kenya. Through the review of secondary data, the study revealed 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 43.6 billion. Using regression analysis, the study gave a negative and weak correlation between the number of agents, deposits, and withdrawal transactions undertaken through agents and financial performance of banks as measured by return on equity.

Mwangi (2013) study's objective was to evaluate the role played by agency banking in the good or bad performances of commercial banks in Kenya. its specific objectives were; to evaluate the impact of liquidity on the commercial banks' performance attributable to agency banking, to establish the impact of cost on the commercial banks' performance attributable to agency banking, and to assess the effects of security on commercial banks' performances attributable to agency banking. A descriptive research design was used for the study. The study targeted four banks offering agency banking services in Kenya. The study population was forty branch managers of the selected banks. Inferential statistics were also taken into consideration. Using regression analysis to make conclusions, the study concluded that infrastructure security and cost influence the performance of commercial banks attributable to agency banking to a very great extent.

Murugi (2013) looked at the effects of agency banking on financial performance of banks in Kenya. Annual reports on individual banks' financial performance were used to extract financial performance indicators. CBK's annual report and supervisory reports were also used to establish the number of agents registered and the total transactional value conducted through the agents. The variables of interest were: the cash withdrawal and deposit transactions done through agents; the number of active agents; return on assets (ROA) to measure profitability; cost-to-income ratio (to measure cost efficiency in using agency banks); and, staff cost to revenue ratio to measure the reduction of human resource cost due to agency banking. The data was collected for the three-year from 2010 to 2012. The findings indicated that out of all the banks that had rolled up the service, Equity Bank, Co-operative Bank, and Kenya Commercial Bank showed significant performance indexes. The findings further showed that yearly performance improved significantly. This implies that agency banking was continuously improving leading to significantly increased financial performance in those banks that had rolled up the service due to its convenience and efficiency in operation. The study also revealed a strong positive effect between agency banking and financial performance.

Another study was done by Ogetange (2014) whose main objective was to evaluate the extent to which the agency banking model contributed to the financial performance of the commercial banks in Kenya. Performance measures adopted were; return on equity (ROE) and return on assets. The study revealed that agency banking has a significant positive effect on the ROE of Kenyan commercial banks. Regression statistical analysis of the data collected revealed that there is a significant level of relationship between the agency banking variables and the rate of return on Assets (ROA). This implies that efficiency was continuously improving leading to significantly increased financial performance in those banks that had rolled up the service due to its convenience and efficiency in operation.

A study by Orgamo (2015) on the effects of agency banking sought to investigate the effect agency banking had on the financial performance of Kenyan commercial banks in 2014. Chase bank was used as a case study. The study also sought to establish the effect of accessibility of banking services, low cost of service, and increased customer transactions through agency

banking. The relationship between the dependent and the independent variables was determined using multiple regression analysis. The relationships in the study were positive and significant. The relationship between the accessibility of banking services and financial performance of Chase Bank had a coefficient of 1.251 and a p-value of 0.000. In addition, the relationship between the low cost of service and financial performance of Chase Bank had a coefficient of 0.800 and a p-value of 0.000. Further, the relationship between customers and the financial performance of Chase Bank had a coefficient of 0.311 and a p-value of 0.008. The study found that banking using the agency model excels in service quality and delivery. Also, agency banking has low infrastructural costs and hence cost reduction. Efficiency and convenience in operation in agency banking had also increased the bank's customers' transactions. The study concluded that there was a positive and significant relationship between the accessibility of banking services, low cost of service, and customer transactions as a result of agency banking and the financial performance of Chase Bank.

King'ang'ai et al. (2016) investigated the impact that banking through agents had on performance of banks financially in East Africa's Rwandan nation using a sample of the four Rwandese commercial banks in operation as of 31st December 2015. The study findings revealed that regulating agency banking, low transaction cost through agency banking, access to services related to banking by customers through the bank agents, and growth in the overall market positively impact the performance of banks financially in the country. The results of the multiple linear regression model established a positive significant association between agency banking impact and the performance of commercial banking institutions in Rwanda.

2.2 Conceptual Framework

The conceptual framework for this study depicted in Figure 1 below shows the relationship of agency banking as an alternative banking service delivery channel to the financial performance of all registered commercial banks in Kenya. It conceptualizes agency banking as an independent variable and financial performance of commercial banks as a dependent variable. The study assumed a linear relationship between dependent and independent variables.

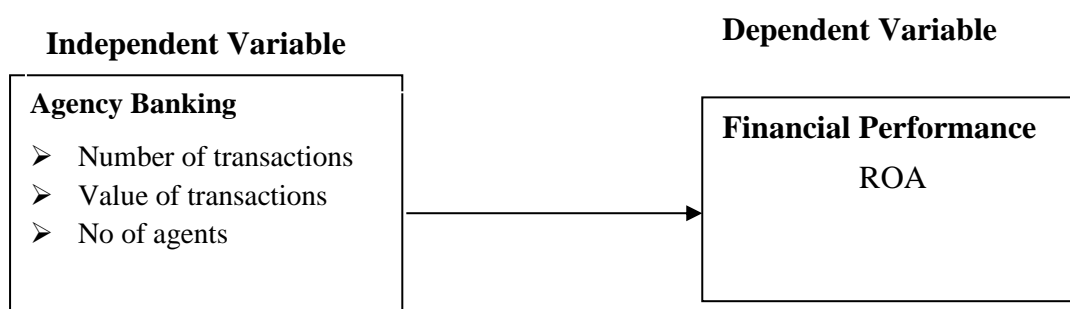


Figure 1: Conceptual Framework

3.0 Methodology

The research employed a causal research design. Census method of sampling was employed, where all the 40 commercial banks operating as of December 2018 formed the study units. Both primary and secondary data were used. Primary data was collected using closed and open-ended questionnaires while secondary data was obtained from the CBK reports and audited annual financial reports of the commercial banks. Descriptive and inference statistics were used to analyse the data with help of Statistical Package for Social Sciences (SPSS) Version 23 programme. Data was presented in form of tables, mean and standard deviation. Linear

regression analysis was performed to determine the effect of agency banking on financial performance of commercial banks.

4.0 Results and Discussion

4.1 Descriptive Statistics for Agency Banking

In this section, the study presents the findings on respondents' level of agreement or disagreement with various statements relating to agency banking. Respondents' responses were based on 5-point Likert scale questions where: 1. strongly Disagree 2. Disagree 3. Neutral 4. Agree 5. Strongly agree. Results were interpreted using means and standard deviations where a mean value of 1-1.4 was strongly disagreed, 1.5-2.4 disagree, 2.5-3.4 neutral, 3.5-4.4 agree and 4.5-5 strongly agree. The results are presented in Table 1.

Table 1: Agency Banking

| Statement | N | Min. | Max. | Mean | Std. Dev. |
|--|----|------|------|-------------|-------------|
| The increase in the number of agency banking transactions increases the bank's revenues. | 37 | 1.00 | 5.00 | 3.9574 | .62070 |
| There has been continuous growth in the bank's agency banking transactions in the last five years. | 37 | 1.00 | 5.00 | 3.7553 | .71371 |
| The Value of agency banking transactions affects a bank's revenues. | 37 | 1.00 | 5.00 | 3.7979 | .74169 |
| There has been continuous growth in the value of agency banking transactions in the last five years. | 37 | 1.00 | 5.00 | 3.7128 | .71275 |
| The increase in the number of agency banking agents increases the bank's revenues. | 37 | 1.00 | 5.00 | 3.8511 | .60388 |
| There has been continuous growth in the number of agency banking agents in the last five years. | 37 | 1.00 | 5.00 | 3.8298 | .63311 |
| Aggregate | | | | 3.82 | 0.67 |

From the findings shown in table 1, the respondents agreed that the increase in the number of agency banking transactions increases the bank's revenues as shown by a mean of 3.9574; the increase in the number of agency banking agents increases the bank's revenues as shown by a mean of 3.8511; there has been continuous growth in the number of agency banking agents in the last five years as shown by a mean of 3.8298; the value of agency banking transactions affects bank's revenues as shown by a mean of 3.7979; there has been continuous growth in the bank's agency banking transactions in the last five years as shown by a mean of 3.7553 and there has been continuous growth in the value of agency banking transactions in the last five years as shown by a mean of 3.7128. These findings agree with the findings of King'ang'ai and Kigabo (2016) whose study on the effect of agency banking on financial performance of commercial banks in Rwanda found that financial services accessibility, increased market share, and low transaction costs enhance financial performance of commercial banks in Rwanda.

4.2 Descriptive Statistics for Financial Performance

The researcher measured financial performance of the banks using Return on Assets, Return on Equity, and Profit before Tax. Data was collected from the financial statements of all 40 commercial banks from 2013 to 2017. The findings are presented in the subsections below.

Return on Assets

Table 2 below presents the summary of the ROA of commercial banks in Kenya between the years 2013 and 2017. Commercial banks in Kenya were 37 between 2013 and 2016 and in 2017 they increased to 40.

Table 2: Return on Assets

| Year | N | Min. | Max. | Mean | Std. Dev. |
|------------------|----|--------|------|-------------|-------------|
| 2013 | 37 | -7.5 | 7.7 | 2.8307 | 0.4629 |
| 2014 | 37 | -6.97 | 7.26 | 2.5668 | 0.4707 |
| 2015 | 37 | -4.53 | 6.56 | 2.2000 | 0.4313 |
| 2016 | 37 | -7.01 | 6 | 1.8405 | 0.5048 |
| 2017 | 40 | -32.15 | 6.49 | 0.0862 | 1.0304 |
| Aggregate | | | | 1.90 | 0.58 |

The financial performance of commercial banks was assessed using ROA where the study computed the average ROA for each commercial bank over five years and fitted a graph to show the trend in performance. Figure 2 presents the findings.

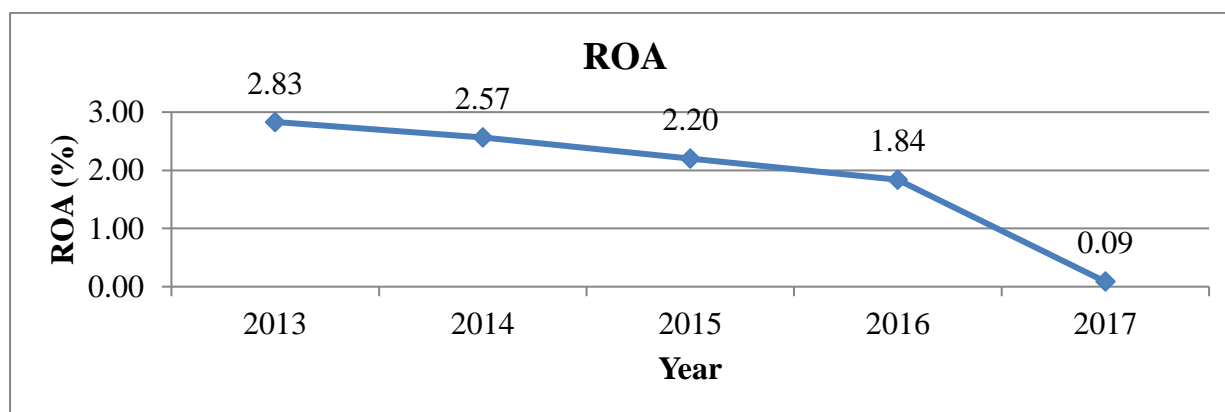


Figure 2: Financial Performance Measured Using Return on Assets

From the findings, ROA has recorded a decreasing trend from 2013 to 2017. Between 2013 and 2017, there was a steady decline in ROA. The findings show that between 2017 and 2018 there was a drastic decline in ROA. These findings, therefore, suggest that the financial performance of commercial banks in Kenya between the years 2014 and 2018 decreased. This suggests that commercial banks in Kenya are not efficient in utilizing their resources to generate income. It further indicates that the management of commercial banks is not efficient in generating a net income from all the resources of the institution. The findings agree with Wen (2010) who stated that a higher ROA shows that the company is more efficient in using its resources. The study changed the dependent variable ROA scale to ordinal by ranking these

findings. This enables the researcher to carry out simple and multiple regression to test the effect of each and combined independent(s) dependent variable (ROA).

For the purpose of inferential data analysis secondary data on return on asset (ROA) was converted into five Likert scale form such that less than 1% = 1, 1%-2% = 2, 2- 4% = 3, 4%-6% =4 and over 6% =5. After the dependent variable was changed to the Likert scale like the independent variables, they were transformed into composite variables to facilitate the computation of regression analysis.

4.3 Regression Analysis

Regression analysis is a set of statistical methods used for the estimation of the relationship between a dependent variable and one or more independent variables. It is utilised to assess the strength of the relationship between variables and for modeling the future relationship between them. For this study, a simple regression analysis was conducted. The decision on whether to reject or accept the null hypothesis was based on 0.05. The statistical analysis and interpretation are as presented below.

The study regressed agency banking on financial performance of commercial banks in Kenya to test the null hypothesis of the study which was: There is no significant effect of agency banking on financial performance of commercial banks in Kenya. Regression analysis findings were presented in three tables discussed hereunder.

Table 3: Model Summary of Agency Banking on Financial Performance

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .814 ^a | .663 | .657 | .28851 |

a. Predictors: (Constant), Agency banking

From the findings, the value of adjusted R^2 is 0.657 which suggests that changes in agency banking can explain a 65.7% variation in financial performance of commercial banks in Kenya. The remaining 34.3% suggest that there are other factors other than agency banking that can be attributed to variations in financial performance of commercial banks in Kenya. The findings also established that there was a strong positive correlation between agency banking and financial performance of commercial banks in Kenya as indicated by a correlation coefficient (R) value of 0.814.

Table 4: Analysis of Variance of Agency Banking on Financial Performance

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|-------|--------------|----------------|-----------|-------------|-------|-------------------|
| 1 | Regression | 0.777 | 1 | 0.777 | 9.358 | .007 ^b |
| 1 | Residual | 7.636 | 35 | 0.083 | | |
| | Total | 8.413 | 36 | | | |

a. Dependent Variable: Financial performance (ROA)

b. Predictors: (Constant), Agency banking

From the findings, the p-value obtained (0.007) was less than the selected level of significance, an indication that the model was significant.

The findings further showed that the f-calculated value (9.358) was greater than the f-critical value (3.945) which is an indication that agency banking is significant in predicting financial performance of commercial banks in Kenya.

Table 5: Beta Coefficients of Agency Banking on Financial Performance

| Model | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|----------------|-----------------------------|------------|---------------------------|-------|-------|
| | B | Std. Error | Beta | | |
| 1 (Constant) | 0.822 | 0.095 | | 8.653 | 0.000 |
| Agency banking | 0.311 | 0.068 | 0.298 | 4.574 | 0.007 |

a. Dependent Variable: Financial performance (ROA)

From the findings in table 5 above the following regression equation was fitted;

$$Y = 0.822 + 0.311X$$

From the above regression equation, it is evident that by holding agency banking to a constant zero, financial performance of commercial banks in Kenya will be at a constant value of 0.822. The findings further show that increasing agency banking by a single unit will lead to an increase in financial performance of commercial banks in Kenya by 0.311.

Based on the results of Coefficient table 5 results showed that agency banking had a p-value of 0.007 which is less than the 0.05 level of significance of the study ($P < 0.05$) implying a statistically significant relationship between agency banking and commercial banks in Kenya financial performance.

The null hypothesis which states that agency banking has no significant effect on financial performance of commercial banks in Kenya was rejected because ($p < 0.05$)

5.0 Conclusion

The study concluded that agency banking positively influences financial performance of commercial banks. These conclusions are in line with the existing literature which shows how the profitability of many banking institutions improved after the adoption of agency banking. It was noted that the findings of this study are in line with those of other scholars which implies that the findings can be generalized in other studies.

6.0 Recommendations

The study established that agency banking has a significant influence on financial performance of commercial banks in Kenya. The study, therefore, recommends that the management of commercial banks should consider embracing the agency banking model and increase the use of agents that rely on the existing infrastructure such as supermarkets, credit unions, hotels, and petrol stations to reach out to more customers.

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