AGENCY BANKING AND NON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA: EVIDENCE FROM BANK AGENTS IN NAKURU CENTRAL BUSINESS DISTRICT

MWANGI ELIZABETH WAITHERA

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DECLARATION

This project is my original work and has not been presented for a degree in any other University or institution of higher learning and this is to the best of my knowledge.

Signature …… Date ……

Mwangi Elizabeth Waithera
GMB/NE/0407/05/13

Recommendation

Signature……Date……

Dr Stella Muhanji

Senior Lecturer
School of Business
Kabarak University

DEDICATION

This research project is dedicated to my husband, children and to my parents.

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ABSTRACT

The purpose of this study was to investigate agency banking and its effect on non-financial performance of Commercial Banks in Kenya. More specifically, the study sought to establish the extent to which system security, float, agent staff retention and support by banks aspects affect non-financial performance of Commercial Banks in Nakuru CBD. To achieve the objectives of the study, a descriptive research design was adopted where all 136 agents drawn from various commercial banks within town district were targeted for study. The study relied solely on primary data which was collected using structured questionnaires containing mainly closed ended questions for ease of analysis. Data analysis was done using descriptive and inferential statistics with an aid of a computer software SPSS. The study findings indicated that system security, float amount, agent staff retention and support by banks all have an insignificant effect on non-financial performance of Commercial Banks. However, length of service was the only one variable that turned out to be significant. From the findings it can be concluded that agency banking is still new hence the results are not conclusive enough. This study recommends that attention be given to integration of system security challenges and float limits factors to agency banking effectiveness which requires prompt and quick response by commercial banks whenever such challenges occur. There is also need to empower agents with proper skills through training, plus of course ensuring that there exist sound organizational structures, culture, systems, and processes among banks that are supportive of their optimal performance. Finally, the research recommends further studies be done on other non financial aspects other than number of new accounts opened and level of deposits.

Keywords: *Agency Banking, Agents, Commercial Banks, Non-financial Performance.*

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LIST OF ABBREVIATIONS/ACRONYMS

ATM: Automated Teller Machine

BBIS: Branchless Banking Institutions

CBK: Central Bank of Kenya

CGAP: Consultative Group to Assist the Poor

EBL: Equity Bank Limited

KBA: Kenya Bankers Association

MNO: Mobile Network Operations

NFSA: National Financial Access Survey

PCs: Personal Computer

POS: Point of sale

SPSS: Statistical package for Social science

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The Kenya Banking sector has demonstrated a solid growth over the past few years. The industry continues to offer significant profit opportunities for the major participants. Kenya has attracted worldwide acclaim by expanding financial services to millions of poor households via mobile phones (Standage, 2009). In order to gain a competitive edge some commercial banks have adopted agency banking as a diversification tool.

Diversification is a company strategy wherein a company tries to increase profitability through increased sales volume from new products and new markets. In layman's term, diversification means venturing out into new business, new products or new markets to increase profits. It is a form of growth strategy involving a significant increase in the performance objectives beyond past performance records (Amit & Livnat, 1988). Diversification allows a company to venture out into new lines of business that are different from the present operations. Companies employ different diversification strategies to expand firms' operations by adding markets, products, services, or stages of production to the existing business. Diversification in the form of growth strategy is viewed by many investors as "bigger the better". Higher sales volume is seen as a measure of performance irrespective of the profit margins, increase in sales is always welcomed. People often assume that if the sales increase, profits will follow suit.

The Kenya Banking sector has experienced three main developments in the distribution strategies of banks favoured by the adoption of the new technologies. First, branches are being redesigned in terms of location and services offered to clients in order to make them more cost-efficient and to integrate them with the new distribution channels used by banks. Second, electronic channels are growing rapidly, and these channels are used not only for providing information and transaction services, but also for the promotion and sale of banking products. Third, banks are gradually increasing their cooperation with third parties, such as retailers, financial companies and financial agents/services groups. All these developments have led to an

increased focus of banks on selling products, with possible consequences on banks' traditional information-intensive intermediation activity.

Though banks continue to invest in rolling out brick and mortar branches that are complimented by various delivery channels, the challenge of access to formal financial services remains a big impediment to financial performance. Customers (especially in remote areas) are forced to travel long distances and spend huge amounts on transport in order to access a branch. In addition valuable time is spent commuting to and fro that could have been spent more productively. To curb these challenges, the central bank of Kenya released a legislation that allows commercial banks to contract third party retail networks as agents (Aduda, Kiragu, & Ndwiga, 2013). In Kenya, agency banking is governed by the Prudential Guideline on Agent Banking issued by the Central Bank of Kenya (CBK) and which became operational on 1st May 2010. In February 2011, the Central Bank of Kenya released regulations allowing banks to offer services through third party agents approved by the CBK (Central Bank of Kenya, 2014).

1.2 Agency Banking

Agency banking refers to bank partnerships with non-banks, typically retail commercial outlets, ranging from lottery kiosks, pharmacies, post offices, construction goods stores, and so forth, to provide distribution outlets for financial services (Kumar, Nair, Parsons, & Urdapilleta, 2006). The agent retail outlet is contracted by a financial institution to process client' transactions thus rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction. (Central Bank of Kenya, 2010).

Agent means an entity that has been contracted by an institution and approved by the Central Bank to provide the services of the institution on behalf of the institution (Central Bank of Kenya, 2012). Agents provide a range of banking services which include: cash deposit and cash withdrawal, cash disbursement and cash repayment of loans, cash payment of bills, cash payment of retirement and social benefits, cash payment of salaries, transfer of funds, balance enquiry, generation and issuance of mini bank statements, collection of documents in relation to account opening, loan application, credit and debit card application (Central Bank of Kenya, 2012). Other services include collection of debit and credit cards, agent mobile phone banking services, cheque-book request, cheque-book collection by customers and collection of bank

mail/correspondence for customers. Retail agents use existing distribution channels, and connect the provider with the client through the internet, POS devices, mobile phones, and electronic cards.

In addition, agency banking allows banks to reach new customers who can open new accounts, perform credit and debit card applications and cheque book requests (CGAP, 2006). Agency banking has enabled bank customers to access the basic banking services, within the comfort of their neighbor-hood. The convenience of access to banking services and the extended hours that the agencies work has been the most attractive features to the customer (Ivatury & Lyman, 2006).

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 and/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 (Jacob, 2005).

Local regulation determines if financial institutions are allowed to work through retail outlets. This include: what kind of, if any, financial institutions are permitted to contract banking agents, what products can be offered at the retail outlets, how financial institutions have to handle cash transport, Know Your Customer requirements, consumer protection, and other operational areas (Mas & Siedek, 2008)

1.2.1 Global Status of Agency banking

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 (Ivatury &

Lyman, 2006). However, agency banking (known as correspondence banking) can be traced to Brazil in 1999 exponentially growing from 1,600 agents in 2000 to 170,000 agents in 2010 (McKay, 2011).In United States, agency banking model is used by foreign banks to enter the market.

With more than 400,000 agents as of December 2013, Brazil had one of the largest agent networks in the world. Brazil has largely overcome the distance barrier to financial access, and a majority of Brazilians - 67% of the population now pay at least one bill at an agent. However, only a small proportion of the population use this channel for opening or transacting through a bank account, or for accessing credit: only 12% of banked respondents usually withdraw from their bank account at an agent, 9% usually deposit at an agent, only 6% have accessed a loan through an agent, and 4% have opened an account through this channel. However, we do find evidence that those using agents are poorer, less educated, more likely to work in the informal sector, and to be women than those using other channels. Thus, while only a minority of Brazilians is using agents for financial services other than bill pay, these individuals' exhibit characteristics of traditionally underserved populations, suggesting that agents have made a difference for financial inclusion in Brazil. Nonetheless, the 79% of unbanked households that regularly visit an agent represent a missed opportunity to offer financial services to unbanked Brazilians through this channel (Sanford, 2014).

In Africa there is a saying that 'cash is king' and while there have been many initiatives towards financial inclusion and electronic payments, it is as true now as it ever was (Iveri Payment Technologies, 2014). Agency banking was first implemented in South Africa in 2005 after amendment of Bank Act giving banks green light to contract nonbank third parties to collect deposits, money due to the bank or applications for loans or advances, or to make payments to such clients on banks' behalf (Bold, 2011). In Ghana, agency banking was introduced in 2008 allowing for bank-based model of branchless banking using nonbank retail agents (McKay, 2011).

According to a study published by the World Bank (2014), in Africa less than a quarter of all adults make use of bank accounts or other financial products from a formal financial institution and 90 percent of all consumer payments are conducted with cash. However, with over 1 billion

people spread across 56 countries it is difficult to make any statements that will apply uniformly. Within the continent, there is a large variation in account ownership: in Sub Saharan Africa 24% of adults have an account at a formal financial institution, though this ranges from 51% in Southern Africa to 11% in Central Africa In the Democratic Republic of Congo and Central African Republic, more than 95% of adults are unbanked (for example do not have an account at a formal financial institution). In North Africa 20% of adults have an account at a formal financial institution ranging from 39% in Morocco to 10% in Egypt (Demirguc, Asli, & Leora, 2012). The main reasons for this large unbanked population in Africa is geographical inaccessibility and poor infrastructure, with many of the unbanked living in remote rural areas. This, combined with the high cost of banking services and a lack of financial education and understanding, creates very high barriers to banking for poor rural populations (Iveri Payment Technologies, 2014).

In Kenya, the use of the agency banking model by banks has continued to improve access of banking services since its launch in 2010. By December 2014, 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents, respectively, spread across the country. This was a marked improvement from 13 commercial banks (and no microfinance banks) with a total of 23,477 agents by the end of December 2013[1]. In addition, the number of approved agents increased by 7,144 to 23,477 as at the end of December 2013. This represents a 52.2 % increase in the number of licensed agents, albeit the concentration of 90% of the agents in 3 large banks[2]. The number of transactions increased by 37.9 % from 42,055,854 transactions recorded in 2013 to 57,995,472 transactions in 2014 as shown in Table 1.1 (Central Bank of Kenya, 2014).

[1]Banks offering agency banking are: Equity Bank; Co-operative Bank (Co-op Kwa Jirani); KCB Bank; Equitorila Commercial Bank; I& M; Jamii Bora; Post Bank; Family Bank (Pesa Pap); Chase Bank (Chase Popote); Consolidated Bank (Conso Maskani); Diamond Trust Bank; Citibank and NIC Bank (Kiragu, 2012).
[2] Kenya Commercial Bank, Equity Bank and Co-operative Bank of Kenya.

Table 1.1: ***Type and Number of transactions undertaken through Agent Banking - December 2014***

Type of Transaction	**Number of Transactions**			
	Year 2013	**Year 2014**	**% Change**	**Cumulative (2010-2014)**
Account balance enquiries	5,771,490	6,388,489	10.7%	18,127,972
Cash Deposits	18,531,811	25,967,462	40.1%	60,629,074
Cash Withdrawals	16,981,903	24,900,283	46.6%	56,705,290
Collection of account opening application forms	158,781	119,743	-24.6%	1,433,271
Collection of debit and credit card application forms	57,245	6,093	-89.4%	115,550
Collection of debit and credit cards	19,673	6,730	-65.8%	57,724
Collection of loan application forms	-	398	100.0%	398
Mini-statement requests	30,776	57,327	86.3%	137,892
Payment of Bills	113,429	268,115	-136.4%	566,988
Payment of Retirement and Social Benefits	387,454	279,079	-28.0%	969,988
Transfer of Funds	3,292	1,753	-46.7%	5,994
Total	**42,055,854**	**57,995,472**	37.9%	**138,750,141**
Number of Agents	23,477	35,847	52.7%	

Source: CBK, 2014

The number of transactions conducted by bank agents rose by 38 per cent in 2014 underscoring the growing confidence in the banking concept introduced four years ago. According to the Central Bank of Kenya 35,789 agents contracted by 13 commercial banks conducted 58.2 million transactions in 2014 compared to 42 million deals in 2013. The value of the transactions was Sh320 billion up from Sh236.2 billion in 2013. More data from CBK revealed that the agents handled over Sh99 billion in the three months between September and December 2014 indicating they are now handling more than a billion shillings daily (Ngigi, 2015).

Despite the growth in agency banking, there are a number of challenges that have been identified by banks such as lack of capacity by agents to handle large transactions of cash and minimal expenditure on security measures. It is against this background that the researcher will conduct a study on how system security, float amount, agent staff retention and support by commercial banks affect the operational performance of the banks in Kenya.

1.3 Statement of the Problem

Offering of selected banking services through third parties appointed by the banks is expected to be one of the solutions to reaching sections of the disadvantaged in society providing them with

affordable financial services and access to credit (Beck, 2008). With a wider distribution of agents and their availability in nearly all towns and shopping centers as opposed to the limited traditional branch network, it is expected access to financial services should become more enhanced. Due to the huge savings made by reaching people without the expense of having to build branches, employ staff and incur the various other expenses of running a branch, it follows that financial services at these points should be offered at slightly lower prices and in addition benefits those who are geographically disadvantaged by availing the services closer to them. To the banking industry besides the cost savings, banks have penetrated and reached people they would never have reached particularly in the very remote areas (Kimenya, 2002).

According to Ignacio (2009), reaching the unbanked people and areas has been a major challenge. Occasioned by harsh climatic conditions, rough terrain, rural and poor regions are the worst hit (Kimenya, 2002). Very few financial institutions have the will to go into these areas especially bearing in mind that the places with such harsh conditions also attract fewer people thus the population densities there are very low, Financial institutions are not willing to spend large amounts of resources building branches which will not serve adequate numbers for them to break even profit wise. With this in mind banks have since adopted agency banking and entrusted them with some services as their agents thereby rendering themselves principals. An agent is expected to carry out the duties assigned to him/her by his/her principal. Banks are just like other businesses but their product just happens to be money. Other businesses sell services; banks sell money in the form of loans, certificate of Deposits (CDs) and other financial products. They make money on the interest they charge on loans because that interest is higher than the interest they pay on depositors' accounts. To achieve this banks have entrusted agents with some duties such as opening of new accounts which will in turn increase their market share and deposit taking. It is therefore evident that banks depend on agency banking to improve on their market share as well as increasing their deposit volumes.

Despite the relevance of agents to the banking sector, research into the field remains scanty. Kamau, (2012), undertook a study on the relationship between agency banking and financial performance of banks in Kenya and established negative and weak correlation between the two. Mwangi, (2011) sought to establish role of agency banking in the performance of commercial banks in Kenya and established that cost effectiveness (infrastructure, human resource and

security cost) associated with agency banks positively influence banks financial performance. Kithuka (2012), studied factors influencing growth of agency banking in Kenya and established that convenience of its technology, accessibility and cost has influenced its use.

To bridge the existing knowledge gap it is worth carrying out a study to find out whether commercial banks have achieved their financial goals by embracing agency banking.

1.4 Objectives of the Study

1.4.1 General Objective of the Study

The general objective of the study was to investigate the relationship between agency banking and non- financial performance of commercial banks in Kenya

1.4.2 Specific Objectives

The study sort to address the following specific objectives

i) To establish if system security at the agent location affect the non financial performance of commercial banks in Kenya

ii) To determine if float amount affect the non financial performance of commercial banks in Kenya

iii) To establish the effect of agent staff retention on non financial performance of commercial banks in Kenya

iv) To evaluate whether support by commercial banks affects the non financial performance of commercial banks in Kenya

1.5 Research Hypotheses

H_{o1}: System security aspects at agent location have no significant effect on non financial performance of commercial banks in Kenya.

H_{o2}: Amount float has no significant effect on non financial performance of commercial banks in Kenya.

H_{o3}: Agent staff retention has no significant effect on non-financial performance of commercial banks in Kenya.

H_{04}: Support by banks has no significant effect on non-financial performance of commercial banks in Kenya.

1.6 Scope of the study.

All Commercial Banks offering Agency banking in Nakuru County was included in the study. With nine out of the thirteen Banks licensed to carry out agency banking situated in the CBD it was prudent to carry out this study within Town District as it was assumed that proper representation will be achieved.

1.7 Justification of the Study

Many financial institutions in Kenya (Equity bank, Post bank, KCB and Cooperative bank) have turned to branchless banking methods such as agency banking in their efforts to increase their competitive advantage over their rivals. Agency banking in Kenya is in the early stages as it has been there since 2010 and with a limited number of provides that are operational. Despite the fact that agency banking is in existence, the service has not yet been exploited fully and this demands attention. This therefore justifies the relevance of this study in providing guidance in agency banking

1.8 Limitations and Delimitations of the Study

The respondents approached were reluctant at first to give information fearing that the information sought might be used to intimidate them. The researcher sought to explain the purpose of the study and eliminate the fears. A letter of introduction from the university was also used to assure them that information provided will be strictly used for academic purposes.

1.8 Significance of the study.

The research study findings will contribute to better understanding of the effect of agency banking on the non-financial performance of commercial banks .More specifically; the study will benefit the following stakeholders

Commercial banks

This study will inform Kenyan Commercial banks on the actual contribution of agency banking to their performance and/or non performance with a view of sustaining the gains thus made and addressing any weaknesses that may be observed. The banks will also be able to lobby for appropriate policy formulation and strategies that will fully exploit agency banking opportunities that are feasible in Kenya. The information gathered would encourage financial institutions to

use agents in the provision of banking services so as to reduce the cost of financial services and to foster financial inclusion, reach and depth.

The Government

The study will inform the central bank of Kenya on the areas in the guidelines that require to be reviewed. In addition the central bank of Kenya bank supervisors were informed on areas of focus during the audit based on the risks. It will also increase financial outreach and to promote financial inclusion to the unbanked and under banked population. Hence, helping the Government to move towards achieving the financial pillar, one of the vision 2030 pillars

Researchers

Other researchers and academicians can use the result of the study for training and further research, as the study will lay platform on which research on the topic can be undertaken.

1.9 Operational Definition of Terms

Agency banking: The Provision of banking services by a third – party agency to customers on behalf of a licensed, prudentially - regulated financial institution, such as a bank or other deposit taking (Kumar, Nair, Parsons, & Urdapilleta, 2006).

Bank Agent: refers to any third party acting on behalf of a bank (or other principal), whether pursuant to an agency agreement, service agreement, or other similar arrangement (Lauer, Dias, & Tarazi, 2011).

Commercial Bank: is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans (Jadhav, 2011).

Financial Inclusion- is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. It can also be referred to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products (Bhaskar, 2013).

Non-Financial Performance- A nonfinancial performance measure expresses performance in a measure other than money. Non financial measures are often linked to either the inputs or outputs of an activity or process. A process is a sequence of activities for performing a task

(Agarwal, 2006). In this study volume of deposits and number of new customer accounts opened will be used as measures for non financial performance of commercial banks.

Float- This is the cash at hand and bank balances set aside by the agent for agent banking operations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical and empirical literature review and the conceptual framework of the study

2.2 Theoretical Review

2.2.1 Agency Theory

Agency theory analyzes the relationships between a business firm's owners and its managers who, under law, are agents for the owners (Jensen & Meckling, 1976). The key issues in agency theory center upon whether adequate market mechanisms exist that compel managers to act in ways that maximize the utility of a firm's owners where ownership and control are separated. Under the terms of agency theory, a principal (P) passes on authority to an agent (A) to conduct transactions and make decisions on behalf of the principal in an effort to maximize P's utility preferences. Agency problems can arise if: P and A have different goals; P and A have disparate skills in evaluating A's performance; P and A possess different sets of information relevant to the managerial decisions A must make as a representative of P; or P and A have different degrees of risk aversion. At the core of agency problems is the fact that principals may not be able to monitor agents, either perfectly or costless, as to the agent's actions or the information behind those actions. Agency problems emerge because contracts between principals and their agents are neither costless written nor costless enforced. Managers, as agents of a firm's shareholders, may not devote their best efforts toward managing the firm unless those efforts are consonant with maximizing their own welfare. In the commercial banking industry, ownership is becoming increasingly diversified among individual and institutional shareholders, and the dominance of individual stockholders in the industry appears, on the whole, to be decreasing. These trends may exacerbate "agency problems" in the banking industry if these problems truly exist.

In commercial banking, agency problems may arise from three principal sources: partial ownership of a banking firm by individuals who are both owners and managers and who, therefore, may behave differently than utility-maximizing owners alone; the presence of government-sponsored deposit insurance programs that do not differentially price insurance

coverage to reflect the risk exposure of each banking firm and that can elect to delay recognition of a bankruptcy, creating a moral hazard because management and stockholders can pursue high-risk investments in an attempt to transfer wealth from depositers to shareholders; and, the existence of informational asymmetry where owners and managers do not share the same information.

Williamson, (1981) argues that a utility-maximizing manager may be prone to expense-preference behavior that results in operating expenses and capital outlays carried beyond the profit-maximizing level. However, limits on managerial discretion exist that may force long-run conformity to owners' interests, including labor market constraints (such as the job mobility of existing management, as noted by Fama (1970) and capital market constraints (such as the threat of corporate takeovers). Agent banks are retail establishments contracted by the banks and authorized by the central banks to render services for banks. They use technology and business arrangements with retailers, such as supermarkets, grocery stores, drugstores, gas stations, the postal company, and the lottery outlet chain.

Agency banking offer services including savings deposits, credit withdrawals, bill payments, new account openings, money transfers, insurance, and government benefits including pension receipts to provide access to financial services people active in informal economy. However, the new channel represented by agency banking is expanding significantly, in their many ways of composition with the retailers, lottery outlets, post office agencies, register offices, retail store chains, etc. They are truly extensions of banking services installed in their partners' infrastructure

2.2.2 Bank-led Theory

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 (Ivatury & Lyman, 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.

Bank-led model offers a distinct alternative to conventional branch-based banking in that customer conducts financial transactions at a whole range of retail agents instead of at bank branches or through bank employees (Ivatury & Lyman, 2006).

This model promises the potential to substantially increase the financial services outreach by using a different delivery channel (retailers/ mobile phones), a different trade partner (Chain Store) having experience and target market distinct from traditional banks, and may be significantly cheaper than the bank based alternatives. In this model customer account relationship rests with the bank (Tomaškova, 2010).

Agents related risks arise from substantial outsourcing of customer contact to retail agents. From a typical banking regulator's perspective, entrusting retail customer contact to the types of retail agents used in both the bank-led and nonbank-led models would seem riskier than these same functions in the hands of bank tellers in a conventional bank branch. These retail agents may operate in hard-to reach or dangerous areas and 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 (State Bank of Pakistan, 2011). Banking regulation typically recognizes multiple categories of risk that bank regulators and supervisors seek to mitigate. Five of these risk categories credit risk, operational risk, legal risk, liquidity risk, and reputation risk-take on special importance when customers use retail agents rather than bank branches to access banking services. The use of retail agents also potentially raises special concerns regarding consumer protection and compliance with rules for combating money laundering and financing of terrorism (Kumar, et al. 2006).

The bank lead theory is related to the study as it focuses on how financial institutions 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 its financial product through its Pesa Pap agent, where the agent has face-to-face interaction with customers and perform cash-in/cash-out functions, much as a branch-based teller would take deposits and process withdrawals.

2.2.3 Nonbank-led Theory

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, et al. 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 (AML/CFT) risks. Bringing in a culture of Know Your Customer (KYC) to this segment is a major challenge. Further the nonbanks are not much regulated in areas of transparent documentation and record keeping 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.

2.2.4 Theories of Financial Inclusion

Financial inclusion is the core of the Central Bank of Kenya's reform agenda to support Kenya's development blue print, vision 2030. Financial inclusion is defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at affordable costs. (Rangarajan's committee)

Financial inclusion is defined as "the policy goal of reaching all financially excluded households with a full range of responsibly delivered, affordably priced and reasonably convenient formal financial services." (Chriten, 2011)

Evidence shows that financial inclusion is key to reducing the economic vulnerability of households, promoting economic growth, alleviating poverty and improving the quality of peoples' lives. Financial inclusion is a process that ensures ease of access and ability to use formal financial system by all members of an economy. Due to the high connectedness between financial and social exclusion, an inclusive financial system have been identified to transcend individual gains to enhance societal benefits. It's attributes of enhancing appropriate financial decision-making and capability of financial users are expected to complement the investment redistribution role of financial service providers. Thus, an all inclusive financial system enhances efficiency and welfare by establishing a 'functional' equilibrium between the financial and real sectors of an economy.

In a wider context, financial inclusion contributes to economic growth through value creation of small entrepreneurship and businesses, positive spillovers, improvements in human development indicators (health, nutrition, and education), reduction in inequality and poverty (Chriten, 2011). The key theories of financial inclusion include:

2.2.4.1Business Correspondent/Business Facilitator Model (BC/BF)

BC/BF model practiced by banks is a relatively new concept that has successfully been practiced in India. Banks increase their reach by engaging local 'correspondents' and 'facilitators' to offer

their services. Facilitators are individuals while correspondents may be individuals or institutions. They help the bank reach more people in areas where bank branches do not exist or by easing traffic at existing branches. This channel is also meant to distribute product information. But these advantages come with costs. Banks have to realize that, for the model to succeed, the BC's /BF's have to be compensated adequately so that they too see this as a business opportunity. Further, client fears and misconception about this channel should be addressed. Banks will have to increase trust, provide enough incentives and use technology for adequate reporting.

A policy oriented approach can be to let the corporate houses and non-banking financial companies which want banking licenses instead. Thus banks can continue to be responsible for KYC/AML and other norms to cover the risks to the system and BCs will have balance sheets large enough to plan sufficiently large technological investments.

2.2.5 Intermediation Theory

In the traditional Arrow Debreu model of resource allocation, and households interact through markets and financial intermediaries play no role. When markets are perfect and complete, the allocation of resources is Pareto client and there is no scope for intermediaries to improve welfare. Moreover, the Modigliani Miller theorem applied in this context asserts that financial structure does not matter: households can construct portfolios which offset any position taken by an intermediary and intermediation cannot create value (Fama, 1980 and McDonald, 2011).

A traditional criticism of this standard market-based theory is that a large number of securities are needed for it to hold except in special cases. However, the development of continuous time techniques for option pricing models and the extension of these ideas to general equilibrium theory have negated this. Dynamic trading strategies allow markets to be effectively complete even though a limited number of securities exist. Such an extreme view that financial markets allow an efficient allocation and intermediaries have no role to play is clearly at odds with what is observed in practice.

Historically, banks and insurance companies have played a central role. This appears to be true in virtually all economies except emerging economies which are at a very early stage. Even here, however, the development of intermediaries tends to lead the development of financial markets themselves (McKinnon, 1973). In short, banks have existed since ancient times, taking deposits

from households and making loans to economic agents requiring capital. Insurance, and in particular marine insurance, also has a very long history. In contrast, financial markets have only been important recently, and then only in a few countries, primarily the UK and the US. Even there, banks and insurance companies have played a major role in the transformation of savings from the household sector into investments in real assets. Roles played by these intermediaries in the financial sector is found in the many and varied models in the area known as intermediation theory.

These theories of intermediation have been built on the models of resource allocation based on perfect and complete markets by suggesting that it is frictions such as transaction costs and asymmetric information that are important in understanding intermediation. Gurley and Shaw (1960) and many subsequent authors have stressed the role of transaction costs. For example, fixed costs of asset evaluation mean that intermediaries have an advantage over individuals because they allow such costs to be shared. Similarly, trading costs mean that intermediaries can more easily be diversified than individuals.

Looking for frictions that relate more to investors' information sets, numerous authors have stressed the role of asymmetric information as an alternative rationalization for the importance of intermediaries. One of the earliest and most cited papers, Leland and Pyle (1977), suggests that an intermediary can signal its informed status by investing its wealth in assets about which it has special knowledge. In another important paper, Diamond (1984) has argued that intermediaries overcome asymmetric information problems by acting as ``delegated monitors." Bhattacharya and Thakor (1993) have provided an excellent survey of the current state of the literature on banking, building on an earlier review of the banking literature. The traditional views of the roles and functions performed by intermediaries with the evolution of these institutions over the last few decades. It is an attempt to confront the literature with a view of the practice to see if the literature adequately addresses the reasons that these institutions exist in the financial markets, and how they perform value added activity.

To understand how physical coverage translates into improved usage and how particular banking models can impact financial intermediation and financial performance, by extension, it is important to consider the issue of the non-exclusivity of agents. Non-exclusivity improves outreach by allowing agents to represent more than one financial institution, in effect allowing them to serve more customers. Non exclusivity of agents is especially important in rural areas

where bank branch coverage is minimal and qualified agents are also scarce. In rural areas, an agent will often be the only banking outlet available to the local population. It is critical that these agents are allowed to serve as much of the local population as possible, which would mean representing multiple financial institutions, from mainstream commercial banks to state-run development banks that cater to the needs of low-income populations.

2.3 Operation of Agents

Banking agents are usually equipped with a combination of POS card reader mobile phone, bar code scanner to scan bills for bill payment transactions, personal identification Number (PIN) that connects with banks server using a personal dial up or other data connection. Clients that transact at the agents use magnetic stripe bank card or their mobile phone to access their bank account or e-wallet respectively. Identification of customer is normally done through a personal identification number (PIN) but could also provide biometrics with regard to the transaction verification, authorization and settlement platform, baking agents are similar to any other remote bank channel (Ivatury & Layman, 2006).

Local regulation will determine if financial institutions will be allowed to work through retail outlets. Regulators generally determine what kind of, if any financial institutions are permitted to contract banking agents, what products can be offered at the retail outlets, how financial institutions have to handle cash transport, know your customer (KYC) requirements, consumer protection and other operational areas.

Agency banking transaction for the client has no difference in accessing his/her bank account at the agent or in a branch or at a difference in accessing agent or in a branch or at an ATM. However, besides signing a contract with the financial institution it will be working for, the banking agent has to open a bank account at the same. In addition the store has to deposit a certain amount of cash into that account which will serve as the banking agent “working capital’

In many cases, rather than asking the agents to come up with the cash deposit, the financial institution will extend the store credit line. The size of the credit line is normally not standardized, but adopted individually to each agent depending on its size, the extended volume of transactions and how long the agent has been working with the

bank.

This is how credit will be used during the transaction:

· Client withdraws money (“cash-out” transaction). Agents Account is credited in same amount.
· Client deposits money (“cash-in’ transaction): Agent Account is debited in same amount.

In case the agents credit line has reached its limit and the agent bank account does not have sufficient funds, to cover the received funds, POS will block and can only be deblocked if the funds have been deposited in the next bank account.

The transaction process for banking services using a bank card is:

(a) An existing bank client presents his card at the agent and requests for specific transaction and the amount withdrawn deposited and transferred

(b) The Agent selects the type of transactional and POS device or personal computer, enter the amount stripes the clients card through the device, and lets the client enter the PIN.

(c) A General packet radio service (GPRS), dial up, or satellite communication connects with the banks sever to authorize the transaction.

(d) Once the transaction has been authorized the device prints the clients receipt.

2.4 Commercial Banks

Banks means a company which carries on, or proposes to carry on, banking business in Kenya and includes the Co-operative Bank of Kenya Limited but does not include the Central Bank (Government of Kenya, 1991).

According to the Banking Act Cap 488, Laws of Kenya, “Banking Business” means:

(a) The accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice

(b) The accepting from members of public of money on current account an payment on and acceptance of cheques; and

(c) The employing of money held on deposit or on current account, or any part of the money, by lending investment or in any other manner for the account and at the risk of the person so empowering the money. (Government of Kenya, 1991)

Currently there are 44 licensed commercial banks in Kenya. Commercial banks account for much of the total deposit in the country. The banks that dominate the commercial banking sector in Kenya are: Barclays Bank of Kenya Ltd, Kenya Commercial Bank, Standard Chartered Bank, Equity bank Ltd, National Bank of Kenya and Cooperative Bank of Kenya Ltd. They have also opened many branches in most areas of the country. These banks engage in the general banking system although some smaller banks tend to be rather specialized in domestic trade and others in import and export finance facilities offered by Kenya Commercial Banks (www.centralbank.go.ke).

According to Kumar (2003) facilities offered by Kenya Commercial Banks include: Money telegraphic transfer by mail, Standing order payments, Foreign exchange transactions services, Issue of traveler's cheques, discounting of bills of exchange and promissory notes, providing documentary credit to overseas trade, providing credit status information to customers, Offering share brokerage services i.e. buying and selling of shares and stock on behalf of their customers, operation of safe deposits, operation of trust departments, dealing with confidential share purchases, offering business advisory services, acceptance of various deposits like fixed and regular deposits and providing loans and advances. All mainstream banks have introduced Mobile phone banking services in an effort to reach more customers at a relatively lower cost.

2.5 The role of Agency Banking in Economic Growth

2.5.1 The Economics of Micro-Accounts

When financial agent banks do not have branches that are close to the customer, the customer is less likely to use and transact with their service. However, the emergence of new delivery models as a way to bank has played a key role to drastically change the economics of banking by the poor. By using retail points as agents banking providers can offer banking services in a commercially viable way since they are able to reduce fixed costs and encourage entrepreneurs to use the service more often and in the process provide access to additional revenue sources.

According to Podpiera (2008) agency banking does improve the economics for these institutions compared with branches, especially for high-transaction, low-balance accounts that are common

among poor users. This view is supported by many other writers and researchers. This study focused on the following types of agent banking delivery channels as adopted from Kithaka (2001):

1. POS-enabled bank agent- this is an agent managed by a bank that uses a payment card to identify entrepreneurs.
2. Banking agent-enabled agent- this is an agent that is often managed by a telecom, uses a cell phone to identify entrepreneurs, and provides store-of-value accounts called bank wallets that are backed by bank deposits. Entrepreneurs can use bank wallets to send, receive, and store electronic monetary value. For this study, we consider these as a store of value that provides an avenue for savings
3. Bank-provided account linked to a bank wallet- This is a bank account that is linked to a bank wallet. The bank does not manage the agent and pays a fee to the telecom for deposits and withdrawals.

Kithaka, (2001) indicates that in most agency banking models, the cost and revenue estimation is done on a per account basis for transactional accounts, commitment savings accounts, reverse commitment accounts, and time deposits. It focuses on the costs and revenues incurred by the financial agent bank associated with account opening, financial margin, and transactions for low-cost accounts. The revenue assumptions are based on a view that financial agent banks can and should charge for withdrawals and transfers through agent channels. Although some institutions in the sample do not transfer these charges, this can be counterproductive when reaching new low-income markets where entrepreneurs have a higher willingness to pay for nearby transaction services and where the financial margin earned on lower-balance accounts was insufficient to cover the cost of maintaining that account. As such, clients are likely to transact more with greater proximity to agents.

2.5.2 Agent Banking Systems versus Bank Branches

Gardner (2000) contends that agent banking systems are up to three times cheaper to operate than branches for two reasons. First, agent banking minimizes fixed costs by leveraging existing retail outlets and reducing the need for financial agent banks to invest in their own infrastructure. Although agent banking incurs higher variable costs from commissions to agents and communications, fixed costs per transaction for branches are significantly higher. This argument

is further supported by Kithaka (2001) who argues that setting up an agent costs 2 to 4 percent of the cost of a branch cashier. So even when functioning at maximum capacity, a branch cashier incurs more than 78 cents in fixed costs per transaction, compared to just 11 cents for a POS enabled agent and 4 cents or less for a bank-enabled agent or bank wallet. Second, acquisition costs are lower for bank-enabled agents and bank wallets. By using banking agents instead of payment cards, bank wallets and bank accounts linked to a bank wallet are able to acquire entrepreneurs at less than 70 percent of the cost of a branch or POS-enabled agent. He further argues that in some countries, bank wallets may benefit from lower-cost Know Your Customer (KYC) requirements, such as the elimination of requirements to provide photographs and photocopies of documents.

In many developing countries, banks have expanded their network through trusted local "agents" or "correspondents" to offer their services. The sector has witnessed a rapid growth in the last ten years. For instance, whereas previously many banks focused on traditional banking, agents in a number of countries are now authorized to offer a many of the traditional products offered by banks. Banks have, therefore, moved up the ladder of product range to offer more sophisticated banking products such as bank supported insurance and asset financing products.

2.5.3 Cost of Banking

Agency banking represents a significant opportunity to reduce transaction costs such as travel for clients by bringing financial services to hard-to-reach and geographically dispersed areas. This is especially true in Africa where some areas are sparsely populated leaving long distances between the customer and the bank. Moreover, in these areas overall literacy levels are fairly low. Also, banks and other financial institutions often do not have sufficient incentive or capacity to establish formal branches in these areas. Obviously, the set-up of agent banks is less costly and more flexible than for traditional bank branches since it reduces the need to invest in staff and physical infrastructure. These views are supported by Kithaka (2001) and Kasekende (2008) among other researchers.

In countries where agency models have been successfully implemented, regulators and supervisors have tried to address the potential risks of using a large number of agents to deliver financial services by adopting risk-based to supervision where agents are supervised indirectly and banks must assume full responsibility for their agents. This has been done with varying

success rates. Kasekende (2008) argues that regulation enabling agent banking allows for sufficient business incentives for both agents and financial institutions to increase outreach by delivering financial services through a network of agents. Many of these initiatives not only enhance the value of the model but they reduce the overall cost of banking for the low-end bank client.

2.6 Agency Banking as a Tool for Financial Inclusion

2.6.1 Increased Number of Branches

Central banks play a key regulatory role in any financial market. They have been at the center of the growth of Agency banking in developing countries. In Kenya, the Central Bank of Kenya has played a pivotal role in enhancing penetration of the agency banking model. In 2009 for instance, the CBK commenced measures to open up banking channels to non-bank agents. An amendment to the Banking Act allowed banks to start using agents to deliver financial services. It was then argued that using small shops, petrol stations, pharmacies and other retail outlets as agents could have a dramatic impact on improving access to financial services, especially in rural areas. This resulted into mushrooming of many agency banks in the country (Baron 2002). This decision has been widely praised as having resulted in the deepening of the financial sector and raising overall levels of financial literacy in the country.

2.6.2 Enhanced Accessibility to Banking Services

According to Berger (1998), agent banks offer similar services as a real bank. This ranges from cash deposits and withdrawals, disbursement and repayment of loans, payment of salaries, pension, transfer of funds, and issuance of mini-bank statements, among others. Berger further argues that, the agent also facilitates new account opening, credit and debit card application, cheque book request, hence eliminating the need for the commercial bank to have branches all over. This is being replicated across the country, especially in rural areas. The Kenyan situation remains an important case study in this regard. In Kenya, the Central Bank has already licensed four banks to carry out agent banking business and approved 8,809 agents. Many others are expected to be licensed in due course. This is expected to deeply boost penetration of low cost banking services in the country.

2.6.3 Wider Market Coverage and Customer Loyalty

Perhaps the greatest benefit of agency banking in Kenya has been taking banking services to areas that hitherto would have remained unbanked for a long time. These are areas that most banks always shunned because of economic factors. Taking the bank to the community has not only widened and deepened the financial market but it has also enhanced customer loyalty to respective banks. This has continued to create committed entrepreneur-clients.

According to Christopher (2002) the process of loyalty building can be seen in the form of a ladder in which the customer has to be converted into a client then into a supporter, an advocate and ultimately to a partner. Finding loyal entrepreneurs requires targeting those segments to which the bank can deliver superior value. The economic benefits of customer loyalty often explain why one bank is more profitable than its competitors. Therefore, building a highly loyal customer base cannot be done as an add-on; it must be integral to a bank's basic business strategy. The agency banking model has played this role in a great way.

According to Cohen (2002) the ongoing global expansion of a high-tech telecommunications infrastructure, coupled with the increased availability of advanced information technology services, is having an impact on almost every emerging industry. Emerging industries are newly formed or reformed industries that have been created by technological innovations, shifts in relative cost relationships, emergence of new consumer needs or other economic and sociological changes that evaluate a new product or service to the level of a potentially viable business opportunity. The agency banking model is expected to continue playing a catalytic role in expanding the reach of banks within a rapidly changing technological environment.

2.7 Empirical Review

2.7.1 Support by commercial banks

One key determinant for agency success, according to Equity Bank, has been the bank's strategy to rollout and manage agents through its branches instead of using a third party agent network management company. Thus, every activity necessary for agent management: recruitment; training; branding; marketing; liquidity management; operations support and monitoring is run through the bank's branches with high level support from the head office and a centralized contact centre (Venkata & Priyank, 2013).

So as to reach millions of people across the country, the bank has created a separate agency banking department which reports directly to Director of Operations. At the head office, the agency banking team is divided into six pillars - business development; distribution; operations; training; customer experience; and quality assurance. At the branch level, a dedicated Agency Supervisor (AS) is recruited specifically to take care of the agency business. The AS reports to the Branch Manager as well as to the agency banking team at head office. The AS is the prime owner of agents, and hence bank has been working hard to optimize the supervisor-agents ratio to not more than 1:40 per branch. If there are more than 40 agents under a branch, the bank recruits additional supervisors to take better care of the agents (Venkata & Priyank, 2013).In addition Equity Bank pays good commissions to agents for withdrawals and deposits. As is common practice, while customers are not charged for deposit transactions, the bank still pays the agents for deposits to motivate them to enable these transactions (Venkata & Priyank, 2013).

2.7.2 Agency Staff Retention

Employee retention is defined as the existence of an ongoing employment relationship (Huang & Chuang, 2006). The retention of employees has become a leading challenge faced by many organisations worldwide. Consequences such as the high cost of recruitment and selection, the possible loss of productivity during the adjustment period, the probable loss of business opportunities, poor customer rapports as well as the hidden cost of lost productivity have drawn organisations attention to the magnitude of retention (Chew & Chan, 2008). Luna-Arocas and Camps (2008), believe that maintaining a stable workforce is one of the key sources of sustainable competitive advantage for organisations. In addition, these authors indicate that retaining employees is cheaper than recruiting replacements. Retention management refers to the collection of human resources (HR) practices developed to reduce voluntary turnover rates (De Vos & Meganick, 2009). With retention management, certain organisational incentives and HR strategies are implemented that are effective in reducing voluntary employee turnover. However these incentives and strategies will only be successful if they are consistent with what employees value (De Vos & Meganick, 2009). Examples of incentives or strategies implemented to create more positive organisational climates for the purpose of retaining valuable employees include equitable remuneration that reflects performance, sufficiently challenging and interesting work, as well as opportunities for training and career development (Chew & Chan, 2008).

2.7.3 Float

This is the cash at hand and bank balances set aside by the agent for agent banking operations. According to CGAP (2015), the top concerns among agents are low remuneration, liquidity management and network availability. The operation of the agency is such that a customer deposit at the agent means customer giving cash to the agent and is accounted by the bank by debiting the agent account at bank and crediting the customer‘s account at the bank . It is therefore not possible for an agent to receive a deposit unless the agent has sufficient credit in the bank. A customer withdrawal at the agent means the agent gives cash to the customer and the bank accounts by debiting the customer‘s bank account and crediting the agent‘s account at the bank. An agent then can only pay out a withdrawal if they have cash in their till at the shop. This means the agent has to have both cash in the bank and cash in till. This is a key challenge to banks as most agents are not able to balance the cash holding or have inadequate capital. For some reason banks have not been able to convince some businesses like large retail chains which could be ideal for agency banking. Some of the reasons given are the inability of the banks to provide reconciliation mechanism which has led to the chains loosing cash. The situation of float is even worse for remote agents who have to travel to the banks to replenish their deposits when balances run low. Erratic nature of finance services daily cash limits are also to be considered as part of anti-money laundering initiative by CBK, agents cannot transact above certain limit. Hitting this limit means the agent can only close for the day unless they have applied for higher limits. In Brazil many agents complain about downtime –POS — “frozen” by bank once cash limit reached, pending deposit of cash at branch, but often with a lag until POS is unfrozen (Rosenberg, 2010).

The challenges of handling cash transactions efficiently for agency banks might be influenced by the more than 30,000 mobile money outlets currently operating across the country. This huge network has resulted in a smaller pool of cash-flush businesses from which banks can draw, in order to roll out the agency banking model. The Kenyan government has been advocating an increase in partnerships between the banks mobile network operators and this hurdle might just be the impetus needed to drive further cooperation and partnerships between the banks and the mobile network operators (Technology Banker 2011).

2.7.4 Security

Lyman and Stschem (2006) indicate that protecting client funds is priority for many financial regulators, as loss of funds can have serious consequences for customers, as well as for public confidence in financial systems. Banks are usually required to comply with prudential rules created to ensure systematic stability and depositor protection. Bank deposits also are covered by insurance in many jurisdictions. In addition, governments may provide an implicit guarantee to bank depositors, especially when banks are systematically important. However, in emerging branchless banking models, nonbanks may collect funds in exchange for electronically stored value, without being subject to the full range of prudential rules imposed on banks. Also, there may be models where even if client funds sit in a bank account, they receive a different regulatory treatment than those applicable to bank deposits.

Countries with the most prominent branchless banking models have taken varied approaches to handling and protecting client's funds. In the Philippines, smart money accounts balances are deposited in the clients name in a commercial bank but are considered accounts payable on the bank's books rather than deposits. Hence, although it is a bank based model, it has different regulatory treatment as to bank deposits. In Russia, web based stored value services do not currently follow any regulatory standard for safeguarding client funds. Funds collected by M-pesa, which customers increasingly use as a short-term savings mechanism(Collins 2010), are deposited in pooled trust accounts at the several commercial banks, for the benefit of the customers no system is in place for customers to claim trust assets (e g in the event of insolvency). In Kenya policy and regulation have been used extensively to support the development of a diverse range of delivery channels. In 2006, the CBK and CCK and the Ministry of Finance supported the rollout of safaricom's mobile phone base money transfer product M-pesa, through Safaricom as the implementing agency and not a commercial bank. In 2009 the finance Act was amended to facilitate use of third parties by banks to provide banking services. Central bank's Agent banking guidelines (CBKK/PG/15) issued in 2010(central bank website) to regulate agency banking.

One shortcoming of most of today's branchless banking system is that they provide security at the network layer only and do not implement any application –layer cryptography. For example,

M-pesa, which is the pioneer of the branchless banking concept and serves over 50% of Kenya's adult population, uses a custom-made SIM Tool Kit (STK) program to protect transaction messages exchanged between client phones and the server, Not much is publicly known about M-Pesa's security algorithm but recent attacks on the system reveal that it does not guarantee end-to-end security to customers. Other key players like G-cash in the Philippines rely directly on GSM's default security services to protect client information but these services are known to offer very weak security guarantees; in, it is argued that vulnerabilities in GSM's security suite could be used to deliver subvert G-cash transactions. Indeed, the question of what application-level security means in the context of branchless banking does not seem to be well-understood yet, neither in the academic literature nor in practice (Collins, 2010). An important shortcoming typical of informal financial services is lack of reliability and continuity in the long run. Formal providers have clear incentives to offer more reliable and safer services. Technology-enabled mechanisms may help achieve that goal. Evidence from the four country studies suggests that technical failures (e.g., equipment malfunctioning and other errors occurring during a transaction) are not a major issue in branchless banking. Similarly, research on consumer experience in Brazil shows that less than 5 percent of users have made a mistake and paid the wrong bill at an agent, sent money to the wrong account, or noticed that a payment or a deposit was never processed or received (Collins 2010).

Less than 0.1 percent of M-pesa clients in Kenya report having lost money when sending money it to someone else, and most customers say they believe their money is safe with M-pesa (Collins 2010). Lack of cash at cash points does not appear to be a widespread problem at this time, according to our in-country studies. Moreover, it appears that low-income clients may be willing to tolerate occasional liquidity shortfalls in exchange for continuity of service in the long run and the convenience of an extensive network. Physical security is another common concern of regulators. In Brazil, for example, agents must deposit the cash received from clients in a bank branch no more than every other business day. This is intended to limit cash accumulation that can lead to robbery by third parties or even by the agent itself.

The Mexican regulator, by requiring every agent transaction to be made against the agent's account at the contracting bank, does not reduce the risk of third- party robbery but eliminates the risk of agents misappropriating the accumulated cash, since the cash is in fact the agent's

own. The simplest measure to reduce cash accumulation and its related risks may be requiring providers to set daily and monthly transaction limits for each agent and client. Regulators should avoid setting physical security standards similar to those imposed on bank branches, however, since this could have severe consequences for the viability of the service and hence access (Stephens & Kevin, 1998). Continuity in the long run is highly valued by financial services users. Threats to continuity can arise from problems with the business models that reduce customer confidence (e.g., inadequate technological platforms) and from forces outside the scope of financial regulators In Brazil, for example, labour unions are using the courts to demand pay equality with bank employees for agents.

A draft law intends to subject agents to the same physical security requirements applicable to bank branches. In addition, the Brazilian sanitary agency proposed the prohibition of pharmacies (one of the most important types of agents in the country) from signing agent agreements. If successful, these measures could seriously undermine the business that use agents and leave millions of customers without a convenient channel to conduct financial transactions (Ignacio,2008).

Equity banks agents across east Africa use the bank servers to serve customers. The challenge comes in when the bank servers are down even agents cannot serve customers. The bank should build agents their own systems and serves so that when there is an issue with the systems the agents can continue serving customers. Mobile phone network failures posted a major challenge to agency banking in the region. From the findings 50% of clients are affected by this problem (100%) of agents asked admitted that it was a major problem. Liquidity related problems was also seen as a major problem affecting agency banking with each agent losing at least 4 clients per week due to the problem. Lack of startup capital has also locked up many potential agents from being recruited (McKay, 2011).

2.8 Conceptual framework

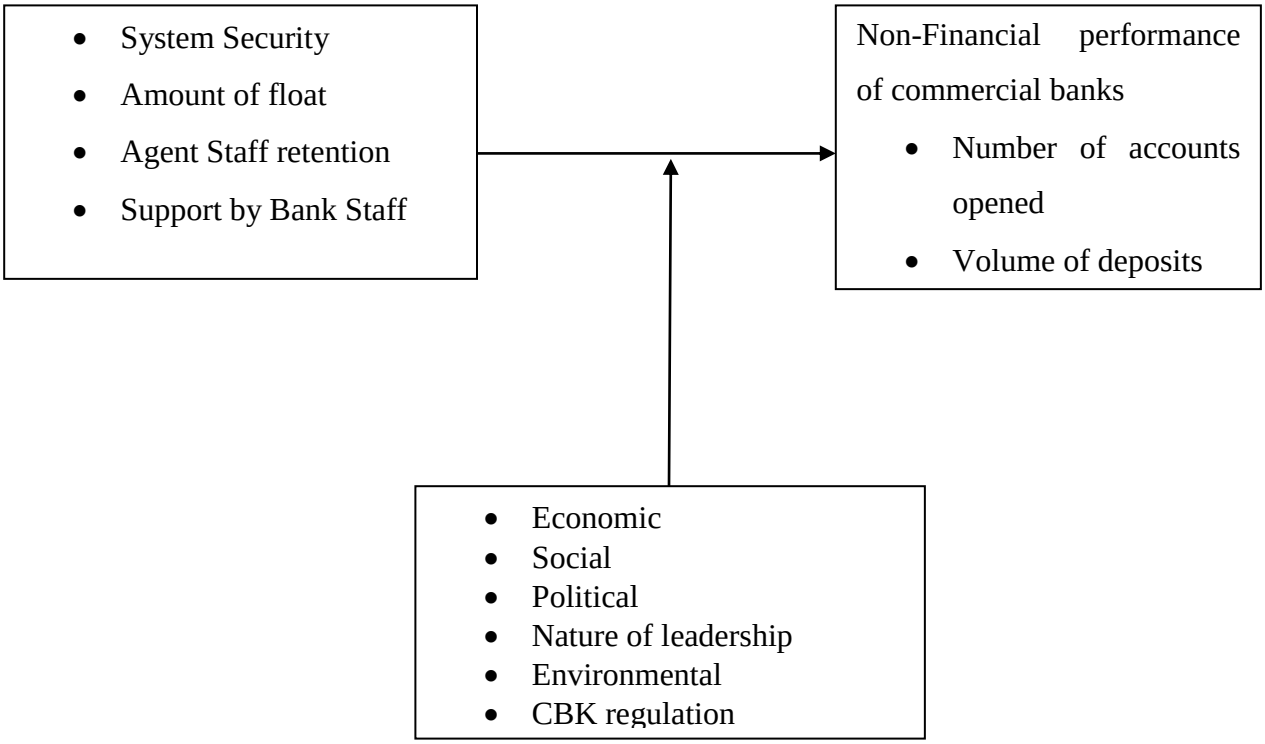
According to Orodho, (2009) a conceptual framework is a model of presentation where the relationship between variables in the study is represented diagrammatically. Independent variables are factors that mitigate agency banking and include; system security, float amount,

agent staff retention and support by bank staff. All these factors affect non financial performance whose measures are volume of deposits and number of new customer accounts opened.

Volume of deposit will be measured by amount of cash flows (withdrawals against cash deposits) that the agency receives from the customers. Customer base will be measured by number of new customers that register for agency banking and also by the number of customers that have embraced agency banking services without necessarily going to the bank. This will spell out the presence or lack of security, transparency and accountability in the agency system.

The study will also underscore the contribution of intervening variables such as socio-economic and political systems which may be beyond the control of the management of commercial banks.

Independent Variables **Dependent Variables**



Intervening Variables

Fig 1: Conceptual Framework

Source: **Author (2015)**

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

A research design is the plan, structure of investigation conceived to obtain answers to research questions that includes an outline of the research work from hypothesis, methods and procedures for collecting and analyzing data and presenting the results in a form that can be understood by all (Mugenda & Mugenda,1999). This research problem was studied through the use of a descriptive research design. A descriptive study is concerned with finding out the what, where and how of a phenomenon (Cooper & Schindler, 2001).

3.2 Target Population

Table 3.1 Target Population

Bank	**Number**	**Percentage**
First Community Bank Ltd	2	1.47
Co-operative Bank of Kenya Ltd	30	22.06
Equity Bank Ltd	67	49.26
Chase Bank Kenya Ltd	1	0.74
Family Bank Ltd	11	8.09
Kenya Commercial Bank Ltd	18	13.24
Diamond Trust Bank Kenya Ltd	2	1.47
National Bank of Kenya	4	2.94
Post Bank	1	0.74
Total	**136**	**100**

Source: Field Data, 2015

Target population is defined as all the members of real or hypothetical set of people, events, or objects to which a researcher wishes to generalize the results of the study (Kothari, 2004).The

target population of the study was 136 agents drawn from 9 Commercial Banks offering agency banking in Nakuru CBD as shown in table 3.1 above.

3.3 Sample Population

The study utilized census. Thus all the 136 respondents in the target population were involved in the study. When the population is small there is no reason for sampling if time and resources allow and this increases reliability (Mugenda,2003).

3.4 Construction of Research instruments

The study utilized primary data. The data was collected by use of questionnaires. The questionnaires were divided into 5 Sections. Section A covered the respondent's profile, Section B covered system security, Section C covered float amount, section D covered agent staff turnover and section E covered support by commercial banks.

3.5 Piloting of research instruments

The researcher carried out a pilot study to appraise the interview schedule soundness of the items and to estimate time required to answer the items. The pilot study covered some of the 6 agents who were not included in the target population. The results of the pilot study were discussed with the respondents and the required adjustments made.

3.6 Testing for validity & Reliability

3.6.1 Reliability Test for Data Collection Instrument

The reliability of instruments measure the consistency of instruments, Best and Khan, (2003) considers the reliability of the instruments to be the degree of consistency that the instruments or procedure demonstrates. What it measures it does so consistently. The cronbach's alpha reliability coefficient of four independent variables was obtained. In general, reliabilities less that 0.60 are considered poor, those in the 0.7 range are acceptable and those over 0.8 are good (Sekaran, 2003)

3.6.2 Validity Test for Data Collection Instrument

Validity is the degree to which a test measures what it purports to measure. Mugenda and Mugenda (1999), defines validity as the accuracy and meaning fullness of the inferences which

are based on the research results. It is the degree to which results obtained from the analysis of the data actually represents the phenomena under study. To enhance validity the researcher consulted the supervisor for verification and appraisal of the instruments.

3.7 Data collection Methods and Procedures

According to Mugenda and Mugenda (1999) questionnaires give a detailed answer to complex problems. Additionally, questionnaires are also a popular method for data collection in deduction because of the relative ease and cost-effectiveness with which they are constructed and administered. Questionnaires give a relatively objective data and therefore, are most effective. In this study, Questionnaire was used as the main instrument of data collection from the agents .Self administered questionnaires with closed and Open ended questions that was developed in line with the objectives of the study was used to enable respondents provide responses related to variables of study. The questionnaires were collected after one week for analysis.

3.8 Ethical Considerations

There are a number of ethical considerations to be kept in mind during the research process. First and foremost is that some of the information that this study sought to have and analyze might be considered private by the commercial banks. The respondents might give confidential and sensitive information that that should not get to the hands of the public. Our first consideration was therefore to ensure confidentiality and protect the anonymity of our respondents. All communication with respondents and any information given for the purpose of the study was treated with the strictest confidence. All the respondents to the study were coded to protect their anonymity. The research accompanied her with an explanatory letter that assured the respondent of the confidentiality of their response. Participation in the study was entirely voluntary and correspondence with the respondent contained a clear narrative describing the purpose of the study as well as a guarantee that the information provided will only be used for the purposes stated.

3.9 Data analysis techniques and Procedures

The collected data was thoroughly examined and checked for completeness and comprehensibility. The data was then summarized and analyzed to generate descriptive statistics and inferential statistics. Data was presented using percentages and frequency tables. This ensures that the gathered information is clearly understood and interpreted.

Various attributes for system security, amount of float, agent staff retention and support by commercial banks were used to explain the relationships. Factor analysis was carried out to extract factors for each variable. The study only used questions with factor loadings greater than 0.5 for regression analysis. This is because it has generally been argued that high factor loadings indicate that the variables are best choice representative of the corresponding factor. Thereafter, correlation and regression analysis were carried out.

Correlation was used to portray the relationship between non financial performance and system security, amount of float, agent staff retention and support by commercial banks.

Regression analysis was sued to determine the effect of agency banking on non financial performance of commercial banks. The regression equation estimated is:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Whereby Y= Non-financial Performance, X_1 = system security, X_2 = float, X_3 = agent staff retention, X_4 =support by commercial banks X_5 =length of service, while $\beta_0, \beta_1, \beta_2, \beta_3$, $\beta_{4,}$and β_5 are coefficients to be estimated and ε is the error term.

Length of service was included in the regression analysis as a control variable. This was aimed at controlling any specification errors.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATIONS AND DISCUSSIONS

4.1 Introduction

This chapter comprises of a presentation of data results and their interpretation. The presentation in this chapter shows the results as tested according to the objectives of the study. The chapter begins with the demographic characteristics of the respondents such as age, educational level, tenure and gender which are all presented using cross tabulations. Descriptive statistics for the items in the instrument are also presented using means for each item to define the relative opinion of the respondents for that particular item. The results from the correlations and the regression analysis results are presented.

4.1.1 Response Rate

Table 4.1 shows the response rate of the respondents

No. of questionnaires Returned	No. of respondents targeted	Response Rate (%)
113	136	83

Source: Research Data, 2015.

A total of 136 questionnaires were administered directly by the interviewer. Among the administered questionnaires, only 113 were returned resulting in a response rate of 83%, which is an acceptable proportion.

4.2 General Characteristic of the Respondents

Cross tabulations and frequency distributions were used to indicate variations of respondents based on age, gender, tenure and length of service. Descriptive statistics aided the study in illustrating the characteristics of the respondents and nature of the data in line with the study objectives.

4.2.1 Gender by age of the Respondents

Data on gender and age is presented in Table 4.2

Table 4.2 Gender by age of the Respondents

Gender		Age					Total
		Below 20 years	21-29	30-39	40-49	50 years and above	
Male	Frequency	0	7	15	13	9	**44**
	Percentage (%)	0.0	15.9	34.1	29.5	20.5	**100**
Female	Frequency	4	37	19	7	3	**70**
	Percentage (%)	5.7	52.9	27.1	10.0	4.3	**100**
Total	**Frequency**	**4**	**44**	**34**	**20**	**12**	**114**
	Percentage (%)	**3.5**	**38.6**	**29.8**	**17.5**	**10.5**	**100**

Source: Research data, 2015

The results in Table 4.2 show that, majority of the respondents 73% (4%+39%+30%) were aged below 40 years, meaning that the youth have mainly ventured into agency banking compared to the middle aged persons (Above 40 years). This interesting finding may be due the fact that the level of unemployment among the youth especially in Kenya is rocket high at about 60% thus rendering the unemployed to be more innovative in creating jobs. Additionally, the initial capital outlay required to start up agency banking is quite low compared to other business ventures that demand significantly high capital for a start. In respect to gender, 62% of the total respondents were female, while the rest 38% were male, implicating that the agency banking sector is mainly dominated by the female gender.

4.2.2 Marital Status of the Respondents

The result in respect to the respondents' marital status is presented in Table 4.3

Table 4.3 Marital Status by Age of the respondents

Marital Status		Age					Total
		Below 20 years	21-29	30-39	40-49	50 years and above	
Single	Frequency	3	31	5	0	0	**39**
	Percentage (%)	7.7	79.5	12.8	0.0	0.0	**100**
Married	Frequency	0	10	27	15	10	**62**
	Percentage (%)	0.0	16.1	43.5	24.2	16.1	**100**
Separated	Frequency	1	3	0	1	1	**6**
	Percentage (%)	16.7	50.0	0.0	16.7	16.7	**100**
Divorced	Frequency	0	0	1	1	0	**2**
	Percentage (%)	0.0	0.0	50.0	50.0	0.0	**100**
Widowed	Frequency	0	0	0	3	1	**4**
	Percentage (%)	0.0	0.0	0.0	75.0	25.0	**100**
Widow	Frequency	0	0	1	0	0	**1**
	Percentage (%)	0.0	0.0	100.0	0.0	0.0	**100**
Total	**Frequency**	**4**	**44**	**34**	**20**	**12**	**114**
	Percentage (%)	**3.5**	**38.6**	**29.8**	**17.5**	**10.5**	**100**

Source: Research data, 2015

According to the findings, majority of the respondents are either married or single 89% and the rest 11% are separated, widowed or divorced. More, specifically majority of the agents are married 55%, meaning that many venture into agency banking to cater for their families. Among the married majority 59% (16%+46%) are aged below 40 years with the rest 30% aged above 40 years.

4.2.3 Age by Level of Education of the Respondents

Table 4.4 presents results by age and education level of the respondents.

Table 4.4: Age by Level of education of the respondents

Level of Education		Age					Total
		Below 20 years	21-29	30-39	40-49	50 years and above	
No School	Frequency	0	0	0	0	1	**1**
	Percentage (%)	0.0	0.0	0.0	0.0	100.0	**100**
Primary	Frequency	1	0	1	1	0	**3**
	Percentage (%)	33.3	0.0	33.3	33.3	0.0	**100**
Secondary	Frequency	3	11	6	10	4	**34**
	Percentage (%)	8.8	32.4	17.6	29.4	11.8	**100**
College	Frequency	0	28	18	5	5	**56**
	Percentage (%)	0.0	50.0	32.1	8.9	8.9	**100**
University	Frequency	0	5	8	3	2	**18**
	Percentage (%)	0.0	27.8	44.4	16.7	11.1	**100**
Others	Frequency	0	0	1	1	0	**2**
	Percentage (%)	0.0	0.0	50.0	50.0	0.0	**100**
Total	**Frequency**	**4**	**44**	**34**	**20**	**12**	**114**
	Percentage (%)	**3.5**	**38.6**	**29.8**	**17.5**	**10.5**	**100**

Source: Research data, 2015

According to the results in Table 4.4, majority (83%) of those acting as agents have at least attained college education as their highest level of education, the rest 17% hold university degrees. This means that for one to be agent he/she must at least be able to record transactions and understanding some basic arithmetic involved in the business. Interestingly, 61% of the agents aged below 40 years are more educated compared to their pears aged above 40 years. This means that in recent times more emphasis has been placed on education than it was before when one could easily land a decent job with just secondary education.

4.2.4 Age by Length of Service of the Respondents

Table 4.5 presents results for age and length of service of the respondents**.**

Table 4.5: Age by Length of Service of the Respondents

Age		Below 1 Year	1-2 years	2-3 years	3-4 years	Over 4years	Total
Below 20 years	Frequency	4	0	0	0	0	**4**
	Percentage (%)	100.0	0.0	0.0	0.0	0.0	**100**
21-29	Frequency	9	20	9	4	1	**44**
	Percentage (%)	20.5	45.5	20.5	9.1	2.3	**100**
30-39	Frequency	10	7	10	2	5	**34**
	Percentage (%)	29.4	20.6	29.4	5.9	14.7	**100**
40-49	Frequency	4	7	7	1	1	**20**
	Percentage (%)	20.0	35.0	35.0	5.0	5.0	**100**
50 years and above	Frequency	4	3	2	1	2	**12**
	Percentage (%)	33.3	25.0	16.7	8.3	16.7	**100**
Total	**Frequency**	**31**	**37**	**28**	**8**	**9**	**114**
	Percentage (%)	**27.2**	**32.5**	**24.6**	**7.0**	**7.9**	**100**

Source: Research data, 2015

According to Table 4.5, 45.5% of the agents in the aged between 21-29 years had rendered agency service for the past two years with the least, at 2.3%, having offered these services for over 4 years. For those in age group of 40-49 years majority indicated that they have been acting as agents for various commercial banks for over one year with 35% of them having been in the business between 1-2 years and 3-4 years, respectively. Those above 50 years recorded the highest duration of service rendering as agents with 16.7 % among these having being agents for over 4 years. Note that agency banking began in 2010 and hence they have been agents since its inception. From the findings majority of the respondents had offered agency services for less than two years with majority of them falling in between 1-2 years.

4.3 System Security Aspects

Agents were asked to indicate their security system challenges and how they affect performance of agency banking. Specifically, questions revolved around the effects of system challenges on deposits, customer experience and support provided by commercial banks in case of downtimes. The results are presented in Table 4.6

Table 4.6: System Security Aspects

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	X^2	P-Value
I do experience system security challenges a lot of times	8(7.0)	47(41.2)	10(8.8)	35(30.7)	14(12.3)	52.404	0.0001
Lapses in the system security affects my operations as an agent	17(14.9)	66(57.9)	8(7.0)	19(16.7)	3(2.6)	111.735	0.0001
Lack of security in the system leads to a feeling of insecurity among customers	15(13.2)	48(42.1)	21(18.4)	23(20.2)	7(6.1)	41.614	0.0001
System insecurity leads to reduced number of deposits	12(10.5)	64(56.1)	13(11.4)	19(16.7)	6(5.3)	96.789	0.0001
Whenever there are lapses in the system commercial banks are always quick enough in addressing such issues	22(19.3)	51(44.7)	13(11.4)	20(17.5)	8(7.0)	49.070	0.0001

Source: Research data, 2015

From the results, system security turned out to be the highest challenge faced by bank agents with 57.9% of the respondents agreeing that lapses in the system affected operations in the agency. This means that operations in the agency are bound to stall whenever upgrades are made by respective commercial banks. Decrease in amount of deposits was attributed to system insecurity with (56.1%) of the respondents having agreed to this. The findings also indicate that whenever there are lapses in the system commercial banks are always quick enough in addressing such issues, with 51(44.7%) of the respondents being in agreement. In consideration

of the above outcomes, there is high likelihood that that system insecurity spur a major challenge to commercial banks agents a lot of times. These findings agree with Mckay (2011) who noted that mobile phone network failures posed a major challenge to agency banking in the region. From the findings 50% of clients are affected by this problem with 100% of agents admitting that it was a major problem. It was also reported that Equity bank agents across East Africa use the bank servers to serve customers. When the bank servers are down, agents cannot serve customers. As pointed out by McKay (2011), it is important that banks should build agents their own systems and servers so that when there are challenges with the system, agents can continue serving customers.

4.3.1 Agent Float

Agents were asked to indicate their level of agreement on the float amount and how it affects performance of agency banking. Specifically, questions revolved around the amount of float and the challenges they face in maintaining the float. The results are presented in Table 4.7.

Table 4.7: Agency Float Aspects

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	X^2	P-value
Maintaining adequate floats Amount is Always a major Challenge	14(12.3)	57(50.0)	3(2.6)	24(21.1)	15(13.2)	110.000	0.000
Fluactions in float amount affects agency operations	11(9.6)	63(55.3)	13(11.4)	16(14.0)	11(9.6)	89.333	0.000
Lack of float cash at the agency leads to frustration among customers	28(24.6)	63(55.3)	10(8.8)	7(6.1)	6(5.3)	102.579	0.000
Commercial banks extend financial assistance to agents to expand and improve its services	12(10.5)	36(31.6)	19(16.7)	27(23.7)	20(17.5)	14.509	0.006
It is difficult to run a cash heavy operation at the agency level	12(10.5)	27(23.7)	20(17.5)	42(36.8)	13(11.4)	26.614	0.000

Source: Research data, 2015

The findings indicate that at least all agents have experienced float challenges at a point in time. For instance, 50% of the respondents agreed that maintaining adequate float amount is always a major challenge and that it affects agency operations. On whether lack of float cash at the agency lead to any form of frustration among customers, 55.3% of the respondents were in agreement; at the same time 31.6% agreed that commercial banks provided financial assistance to agents to expand and improve its services. However, they were in disagreement with the notion that

running cash heavy operation the agency level was difficult (36.8%), meaning that they can carry out any transaction without difficulty.

From the findings more credence is given to the view of Mckay (2011) that liquidity related problems is seen as a major problem affecting agency banking with each agent losing at least 4 clients per week due to the problem. These findings are also in line with those of CGAP (2015) where liquidity management is viewed as the top concern among agents hence cited as a key challenge to banks as most agents are not able to balance the cash holding or have inadequate capital.

4.3.2 Agent Staff Retention

Respondents were asked to indicate their level of agreement on agent staff retention and how it affects performance of agency banking. Precisely, questions revolved around the incentives offered to agents to ensure retention and the threats they present to the agency whenever they is change of personnel. The results are presented in Table 4.8.

Table 4.8 shows that agents agree (56.1%) that low commission earned is a major reason why agents quit. They also agree (50%) that resignation of an agent affects operations at the agency. Asked whether they offered incentives such as leave and bonus so as to ensure long term retention of an agent, majority of the respondents (40.4%) indicated that they do grant staff agents paid leave and bonuses for good performance. Similarly, 38.6% of the respondents agreed that constant change of personnel at the agency always brought about a feeling of insecurity among day to day customers. Further still, 41.2% agreed to the fact that poor staff retention lead to loss of customers.

Consequently, of the five items examined, low commission earned is viewed to a great extent as the main reason why agents quit or cease to offer agency services. Findings by CGAP (2011) indicate that low remuneration is a major concern to agents. However, Chew & Chan (2008) cited equitable remuneration that reflects performance and opportunities for training and career development as examples of incentives or strategies to implement so as to create more positive organisational climates for the purpose of retaining valuable employees. Luna-Arocas and Camps (2008) also believe that maintaining a stable workforce is one of the key sources of sustainable competitive advantage for organisations.

Table 4.8: Retention Aspects

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	X^2	P-value
Low commission earned is a major reason why agents quit	32(28.1)	64(56.1)	9(7.9)	6(5.3)	3(2.6)	116.088	0.000
Resignation of an agent affects operations at the agency	8(7.0)	57(50.0)	16(14.0)	22(19.3)	11(9.6)	69.070	0.000
I always offer incentives (such as bonuses, leave) to ensure long term retention of an agent staff	2(1.8)	46(40.4)	14(12.3)	34(29.8)	17(14.9)	53.416	0.000
Constant change of personnel serving customers bring about a feeling of insecurity among customers	15(13.2)	44(38.6)	23(20.2)	25(21.9)	7(6.1)	33.544	0.000
Poor staff retention leads to loss of customers	20(17.5)	47(41.2)	18(15.8)	24(21.1)	5(4.4)	41.000	0.000

Source: Research data, 2015

4.3.3 Support by Commercial Banks

Table 4.9 indicates results of how agents view support by commercial banks and how it impacts on the performance of agency banking.

Table 4.9: Support by Commercial Banks Aspects

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mode	P-value
Commercial banks are always quick in replenishing stationery used in agency banking i.e Machine rolls, transaction e.t.c	33(28.9)	58(50.9)	9(7.9)	9(7.9)	5(4.4)	116.088	0.000
Banks are doing their best in promoting and advertising the agency banking system in the country	41(36.0)	59(51.8)	6(5.3)	6(5.3)	1(0.9)	69.070	0.000
Commercial bank staff often visits to inquire on the agency operations	17(14.9)	77(67.5)	8(7.0)	7(6.1)	4(3.5)	53.416	0.000
Commercial banks are very effective in terms of time taken to replace or repair faulty POS (Point of Sale) machine/phone at the agency	13(11.4)	46(40.4)	20(17.5)	23(20.2)	11(9.6)	33.544	0.000
There has been a considerable empowerment to the agency by commercial banks through training and motivation	13(11.4)	68(59.6)	14(12.3)	12(10.5)	7(6.1)	41.000	0.000

Source: Research data, 2015

From Table 4.9, majority of the respondents (50.9%) agreed that commercial banks are always quick in replenishing stationery used in agency banking such as machine rolls and transaction record books. This means that the respondents had not been compelled to wait for longer periods whenever there is depletion of agency related materials. On the same note 51.8% of the respondents agreed that the commercial banks are doing their best in terms of promoting and advertising the agency banking system in the country. In addition, 67.5% of the respondents agreed that commercial bank staff often visits to inquire on the agency operations; similarly, 40.4% agreed that commercial banks are very effective in terms of time taken to replace or repair faulty POS (Point of Sale) machine/phone at the agency. Lastly, 59.6% of the respondents agreed to the fact that there has been a considerable empowerment to the agency by commercial banks through training and motivation of agents. These findings gave more credence to the view of Venkata and Priyank (2013), that agent management activities such as recruitment, training, branding, marketing, liquidity management, operations support and, monitoring should be run through the bank's branches together with high level support from the head office and a centralized contact center.

4.4 Inferential Statistics

Correlation and poison regression analysis results are presented in this section to evaluate the relationship between agency banking and non-financial performance.

Before carrying out correlation and regression analysis, factor analysis was carried out to extract 4 factors namely, system security, float amount, agency staff retention and support by commercial banks. Factor analysis was employed to unearth underlying factors that illustrate relationships among sets of related items. It is a preferred tool because of its ability to identify small number factors that are linked critically to the domain of interest and grouping similar structures together.

The factors for this study were labeled as system security, float amount, agency staff retention and support by commercial banks. They were generated from a set of questions that illustrated stability in response. System security was loaded onto by 3 questions touching on, system security lapses and its effect on operations, feeling of insecurity among customer because of system insecurity and reduction in number of deposits as a result of system insecurity.

Amount of float was loaded onto by 2 questions touching on challenges being faced by agents in maintaining adequate float amount and effects of float fluctuations on agency operations. Similarly, agent staff retention was loaded onto by 2 questions touching on the effects of staff resignation on agency operations and a feeling of insecurity among customer being brought about by constant change of personnel serving customers. Lastly, support by commercial banks was loaded onto by only 1 question touching on considerable empowerment to the agency by commercial banks through training and motivation.

Table 4.10: Factor loadings

Variables	Statement in questionnaire	Factor loadings
System security	Lapses in the system security affects my operations as an agent	0.5023
α =0.6029	Lack of security in the system leads to a feeling of insecurity among customers	0.6563
	System insecurity leads to reduced number of deposits	0.6502
Amount of float	Maintaining adequate float amount is always a major challenge	0.6624
α = 0.6991	Fluctuations in float amount affects agency operations	0.7358
Agent staff retention	Resignation of an agent affects operations at the agency	0.5250
α = 0.5370	Constant change of personnel serving customers brings about a feeling of insecurity among customers	0.5490
Support by commercial Banks	There has been a considerable empowerment to the agency by commercial banks through training and motivation	0.5546
α = 0.5546		

α- represents Cronbach's alpha, which is the average of the average of the factor loadings in each category.

This resulted in α =0.6029, α = 0.6991, α = 0.5370 and α = 0.5546 for system security, amount of float, agency staff retention and support by commercial banks respectively. The results indicate that all variables of interest elicited reliability which fell below the Cronbach's cut off test of 0.7. Nunnally (1978) offered a rule of thumb of 0.7 as the acceptable reliable coefficient but also argues that lower thresholds are sometimes used. This is consistent with the Hatcher (1994) argument that a construct is hypothetical variable that is being measured and that the Cronbach's alpha is an index of reliability associated with the variation accounted for by the true score of the underlying construct.

After identifying the factors, correlation and regression analysis were carried out.

4.4.1 Correlation Analysis

Correlation analysis was carried out to determine the relationships, direction and strengths between the dependant variable; non-financial performance; and independent variables namely; system security, amount of float, agent staff retention and support by commercial banks.

From the correlation results, there was a weak insignificant correlation between the non-financial performance measures (number of accounts opened and deposits levels) and agency banking, since the variables of interest; system security, amount of float, agent staff retention and support by commercial banks all turned out to be insignificant. These findings are further manifested by the regression results.

However, significant positive correlations were found to exist between deposits levels and the length of service ($r=0.3103$, $p=0.000$), signifying that lengthy service was associated with high levels of deposits. Better still, there existed a more strong positive significant correlation between deposits levels and number of accounts opened ($r=0.7985$, $p=0.000$), indicating that by opening more new accounts the level of deposits increases proportionately

Table 4.10 below shows the correlation matrix between agency banking variables and non financial performance. The values in parenthesis represent the p-values.

Table 4.11: Summary of Correlations

	Length	Security	Float	Retention	Support	Deposits	Accounts
Length	1.0000						
Security	0.0581	1.0000					
	(0.5427)						
Float	-0.1533	0.0587	1.0000				
	(0.1050)	(0.5388)					
Retention	0.0217	0.1312	0.1408	1.0000			
	(0.8202)	(0.1698)	(0.1386)				
Support	-0.1251	-0.0688	0.1944*	0.1785	1.0000		
	(0.1927)	(0.4774)	(0.0419)	(0.0633)			
Deposits	0.3103*	-0.0610	0.0191	-0.1206	-0.0313	1.0000	
	(0.0008)	(0.5230)	(0.8410)	(0.2052)	(0.7451)		
Accounts	0.2233*	-0.0359	0.0328	0.0243	0.0440	0.7985*	1.0000
	(0.0175)	(0.7073)	(0.7300)	(0.7993)	(0.6481)	(0.0000)	

The values in parenthesis are the z-values and the level of significance at 1%, 5% and 10% are denoted by ***,** and * respectively.

Source: Research Data, 2015

4.4.2 Regression Analysis

To determine the effect of agency banking on non-financial performance, the independent variables were regressed against accounts and deposits. Poisson regression model was estimated because the dependent variable was categorical. However, length of service was introduced as a control variable and analysis done because of the possibility of specification error. This ensured that a few important variables were left out of the estimation which affects the non financial performance.

Model 1 is regression with accounts as the dependent variable. Model 2 is regression with deposits as the dependent variable while Models 3 and 4 are regression with accounts and deposits as dependent variables but with inclusion of control variables. **L**ength of service was introduced in models 3 and 4 because of the possibility of specification error. These results are presented in Table 4.11.

Table 4.12: Regression results

Variables	Model 1	Model 2	Model 3	Model 4
Constant	1.308	1.328	1.237	.0318
	(26.13)***	(26.78)***	(2.64)**	(0.69)
System security	-0.029	-0.042	-0.050	-0.080
	(-0.43)	(-0.64)	(-0.75)	(-1.21)
Amount of float	0.027	0.028	0.026	0.036
	(0.43)	(0.45)	(0.40)	(0.57)
Agency staff retention	0.016	-0.081	0.029	-0.073
	(0.22)	(-1.10)	(0.40)	(-1.00)
Support by Commercial	0.022	-0.015	0.047	0.044
Banks	(0.29)	(-0.20)	(0.62)	(0.58)
Gender	-	-	-0.028	0.247*
			(-0.22)	(1.95)
Length of Service	-	-	0.089**	0.135***
			(2.16)	(3.43)
Pseudo R^2	0.0014	0.0046	0.0213	0.0446
No. of observations	108	108	108	108

The values in parenthesis are the z-values and the level of significance at1%, 5% and 10% are denoted by ***, ** and *, respectively.

Source: Research data, 2015.

For all the models, the variables of interest turned out to be statistically insignificant although they have the expected signs. Amount of float, support by banks and agency staff retention positively affect non-financial performance of commercial banks. On the other hand, system security has a negative effect on non-financial performance. When, control variables were introduced in the regression analysis, length of service and gender effects turned out to be statistically significant.

Insignificance of the variable of interest can be attributed to the fact that agency banking is still a new idea in the country hence the results cannot be supported enough.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This chapter presents the discussion, conclusions, and recommendations arising out of the research findings in chapter four and suggests areas for further study. The study has generated several findings of which are in line with existing literature and previous research findings..

5.2 Summary of Findings

The overall objective of this study was to investigate the effect of agency banking on the non-financial performance of commercial banks in Nakuru Town. More specifically, the study sought to establish if system security, float amount, staff retention and support by banks affect non-financial performance of Commercial Banks in Nakuru Town.

From the findings majority of the respondents agreed that system security, amount of float, agency staff retention and support by commercial banks affected the amount of deposits and account opening at the agency level. More specifically, security system lapses were attributed to the reduced number of deposits made since it crippled agency operation to a large extent. Inadequacy of float amount was also cited as major reason for customer dissatisfaction and frustration for relaying on agency banking for financial services. Interestingly, low commission earned was indicated as a major reason why agents quit or cease to offer agency services. The fact that commercial banks employees often visit the agents to inquire on operations is a fair indication that agents receive support from commercial banks.

Regression analysis results showed insignificant relationship between the independent and dependent variables. However, there was a significant relationship between length of service and gender and non-financial performance.

5.3 Conclusions

Based on the descriptive analysis system security lapses, inadequacy of float amount, low commission offered to agents and constant support by commercial banks were cited as the main influences of agency banking performance. It is evident therefore that without proper consideration of the above aspects the performance of agency banking will not be at its optimal

level. Regression analysis confirmed insignificant relationship with the variables of interest. However, length of service and gender which were control variables indicated a significant relationship. Since the agency banking is still a new idea in the country, insignificance of the regression results can be attributed to such.

5.4 Recommendations

As a result of the research findings, it is recommended that maintaining a sound security system at the agency level may yield a more confident clientele, increased customer base and deposit levels. Banks should therefore develop separate security systems for agents that whenever lapses occur or system upgrades are carried out at the bank agents can continue with their operations smoothly. Additionally, prompt and quick response by commercial banks is needed whenever such challenges occur. Fair and equitable incentive packages should also be offered to agents in terms of commissions earned and bonuses for good performance. This will bring about a feeling of satisfaction and commitment on a more permanent basis per se and creativity boost thus helping the organization achieve its objectives in an integrated manner. There is also need to empower agents with proper skills through training, and ensuring that there exist sound organizational structures, culture, systems, and processes within banks that are supportive of their optimal performance. The agents also need to be engaged with ownership of the commercial banks through right issue and shares thereby ensuring ideological subscription into the mission and vision of respective banks.

5.5 Recommendation for Further Research

Since the study could not evaluate all possible factors that contribute to non financial performance of commercial banks through agency banking, further research is recommended. More needs to be done on this area on other non-financial aspects of agency banking other than level of deposits and number of accounts opened.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

Waithera Elizabeth Mwangi,
Kabarak University,
P.O Box Private Bag,
Kabarak.

Dear sir /madam,

Re: RESEARCH ON EFFECT OF AGENCY BANKING ON OPERATIONAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

I am a postgraduate student at Kabarak University, Pursuing a Master Degree in Business Administration (MBA).I am undertaking the above mentioned research project .I would be very grateful if you could answer the questions in the interview guide as honestly as possible. The findings of the study will be availed to you upon request on completion of this research. Thank you for your co-operation.

Yours faithfully,
Waithera Elizabeth Mwangi

APPENDIX II: QUESTIONNAIRE

SECTION A: SOCIO-DEMOGRAPHIC DATA OF THE RESPONDENT

1. Name of the Agency…….
2. Gender

   [ ] Male

   [ ] Female

3. Age

   [ ] Below 20years
   [ ] 21-29 years
   [ ] 30-39 years
   [ ] 40-49 years
   [ ] 50 years and above

4. Marital Status

   [ ] Single
   [ ] Married
   [ ] Separated
   [ ] Divorced
   [ ] Widowed
   [ ] Widow

5. Level of education

   [ ] No school
   [ ] Primary
   [ ] Secondary
   [ ] College
   [ ] University
   [ ] Other specify.....

6. How long have you been an agent?

   [ ] Below 1 year
   [ ] 1-2 years
   [ ] 2-3years
   [ ] 3-4 years
   [ ] Over 4years

SECTION B: QUESTIONS

Kindly rate your levels of agreement or disagreement with the statements in the tables below using the scale given: SA=Strongly Agree (1)

A=Agree (2)

N=Not Sure (3)

D=Disagree (4)

SD=Strongly Disagree (5)

Kindly place a tick (√) against the suggested opinion to show your level of agreement or disagreement with it in the that appropriate box in the table

PART A: SYSTEM SECURITY AND OPERATIONAL PERFORMANCE

Item	**System Security and Operational Performance**	SA	A	N	D	SD
i.	I do experience system security challenges a lot of times					
ii.	Lapses in the system security affects my operations as an agent					
iii.	Lack of security in the system leads to a feeling of insecurity among customers					
iv.	System insecurity leads to reduced number of deposits					
v.	Whenever there are lapses in the system commercial banks are always quick enough in addressing such issues					

PART B: AGENT FLOAT AND OPERATIONAL PERFORMANCE OF COMMERCIAL BANKS

Item	Float Amount	SA	A	N	D	SD
i.	Maintaining adequate float amount is always a major challenge					
ii.	Fluctuations in float amount affects agency operations					
iii.	Lack of float cash at the agency leads to frustration among customers					
iv.	Commercial banks extend financial assistance to agents to expand and improve its services					
v.	It is difficult to run a cash heavy operation at the agency level					

PART C: AGENT STAFF RETENTION AND OPERATIONAL PERFORMANCE

Item	Agent Staff Retention	SA	A	N	D	SD
i.	Low commission earned is major reason why agents quit					
ii.	Resignation of an agent affects operations at the agency					
iii.	I always offer incentives (such as bonuses, leave) to ensure long term retention of an agent staff					
iv.	Constant change of personnel serving customers brings about a feeling of insecurity among customers					
v.	Poor staff retention leads to loss of customers					

PART D: SUPPORT BY COMMERCIAL BANKS

Item	Support by Commercial Banks	SA	A	N	D	SD
i.	Commercial banks are always quick in replenishing stationery used in agency banking i.e Machine rolls, Transaction registers e.t.c					
ii.	Banks are doing their best in promoting and advertising the agency banking system in the country					
iii.	Commercial bank staff often visits to inquire on the agency operations					
iv.	Commercial banks are very effective in terms of time taken to replace or repair faulty POS (Point of Sale) machine/phone at the agency					
v.	There has been a considerable empowerment to the agency by commercial banks through training and motivation					

PART E: NON-FINANCIAL PERFORMANCE

Item	Non-financial Performance	SA	A	N	D	SD
i.	More deposits are done at the agent outlet than withdrawals					
ii.	Agents contribute to acquisition of new customers by commercial banks					

THANK YOU VERY MUCH FOR YOUR PATIENCE AND RESPONSES

APPENDIX V: COMMERCIAL BANKS IN KENYA OFFERING AGENCY BANKING

1. Chase Bank Kenya Ltd
2. Consolidated Bank of Kenya Ltd
3. Co-operative Bank of Kenya Ltd
4. Diamond Trust Bank Kenya Ltd
5. Equity Bank Ltd
6. Family Bank Ltd
7. First Community Banks
8. Kenya Commercial Bank Ltd
9. National Bank of Kenya
10. Post Bank
11. NIC Bank

Source: www.cbk.ac.ke

APPENDIX VI: LIST OF LICENCED COMMERCIAL BANKS IN KENYA

1. African Banking Corporation ltd
2. Bank of Africa k Ltd
3. Bank of Baroda Kenya
4. Bank of India Ltd
5. Barclays Bank of K Ltd
6. CFC-Stanbic Bank Ltd
7. Charterhouse Bank Ltd
8. Chase Bank Kenya Ltd
9. Citibank N.A.
10. City Finance Bank Ltd
11. Commercial Bank of Africa ltd
12. Consolidated bank
13. Co-operative Bank of Kenya
14. Credit Bank Ltd
15. Credit Finance C Bank Ltd
16. Development Bank of K
17. Diamond Trust Bank
18. Dubai Bank Ltd
19. Ecobank Kenya Ltd
20. Equatorial Commercial Bank ltd
21. Equity Bank
22. Family Finance Bank
23. Fidelity Ccommercial Bank Ltd
24. FINA Bank ltd
25. First community Bank Limited
26. Giro Commercial Bank
27. Gurdian Bank Ltd
28. Gulf African Bank Limited
29. Habib Bank A.G Zurich
30. Habib Bank Ltd

31. Imperial Bank ltd
32. Investments and Mortgages
33. Jamii Bora Bank Limited.
34. KCB Ltd
35. K-Rep Bank ltd
36. Middle East Bank
37. National Bank of Kenya
38. National Industrial Credit Bank ltd
39. Oriental Commercial Bank Ltd
40. Paramount Universal Bank Ltd
41. Prime Bank ltd
42. South Credit Banking Corporation
43. Standard Chartered Bank of Kenya
44. Trans-National Bank
45. UBA Kenya Bank Limited
46. Victoria Commercial Bank Ltd

Source: www.centralbank.go.ke