International Journal of Innovative Research and Advanced Studies (IJIRAS)
Volume 8 Issue 2, February 2021

ISSN: 2394-4404

Adoption Of Agency Banking And Operational Cost Of The Commercial Banks In Kenya

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***Abstract:** The adoption of financial innovation by commercial banks has been a strategic move aimed at expanding the market share of most commercial banks. The adoption of electronic service delivery by most commercial banks has assisted banks to render effective services to its consumers and businesses. Despite most of the studies on agency banking adoption indicating that the aim is to reduce the cost of operation, there remains a gap on studies seeking to establish whether agency banking has had a statistically significant effects on operating costs of the bank such as cost of labor, rental charges, cost of depreciation charge on plant and equipment, cost of utilities and marketing costs hence the motivation for this research. This study sought to assess the relationship between availability of financial services and operational costs by commercial banks in Kenya, The study adopted the cross sectional design in analyzing data from various commercial banks over a period of time. The target population of the study constituted all the 11 commercial banks that have adopted agency banking by 2014 since its authorization in the 2010. All the 11 banks were considered for the study indicating that a census was appropriate. A research window of four years before and after the adoption and 4 years after the adoption was considered. The data collection was done using a secondary data capture tool where various costs were extracted from the financial statements of the 11 banks between 2006 and 2014. The data for the period before and the period after the adoption of agency was captured and analyzed. The results were analyzed using descriptive statistics of mean and standard deviations and inferential statics of correlation, simple and multiple regression and t- test to test the significance of the change. The results indicated that operating costs reduced for those banks that had adopted agency banking since the mean difference before adoption was much more than the difference after the adoption. This was attributed to the fact that financial services were readily available to the customers. The results have also showed that the mean difference measured by the t statistic indicate that availability of financial services significantly contributed to the reduction in the operational costs among the commercial banks that had adopted agency banking in Kenya. The results further indicated that the mean difference between availability and operating costs of commercial banks was statistically significance. The study concluded that agency banking adoption has had a very significant effect on the reduction of operational costs by making services available to their customers. The study recommends that commercial banks needs to expand their services offered by agencies in order to reduce the cost incurred at the branch and make their financial services available to most of the unbanked customers. The results are expected to benefit the management of the commercial banks, the customers, and other stakeholders in the sector as it provided an insight to the agency banking in relation to operational costs. In the course of this research, ethical considerations were followed.*

***Keywords:** Adoption, Agency Banking, Availability, Financial Innovation and Operational Costs*

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I. INTRODUCTION

A. BACKGROUND OF THE STUDY

Globally the adoption of agency banking has been enabled due to network coverage in almost all area including the rural remote areas (Cetorelliand Goldberg, 2012). The number of people who now operate a bank account has grown to over 400 million globally. However, they are able to transact at any point by depositing, sending and withdrawing money because of agency banking. Kumar et al, (2016) has noted that agency banking also referred to as branchless banking has been

noted to have an influence in the performance of the banking industry. Through agency banking, banks have indicated that there has been fall in set-up and delivering costs and improved services, which brought much convenience and comfort to banking at the local agents than at traditional bank branches.

According to Ignacio et al, (2016) Brazil for instance, agency banking arrangements form the largest part of retail commercial outlets. In the USA agency banking has enhanced delivery of service and opened avenues for new clients to be reached. Although the agency banking mode aimed at meeting the banking needs of the poor segment of the population it has been noted that the mode serves all sorts of people in the society (CGAP, 2010). The objective of agency banking is far from being achieved given that in most countries in developing economies such as Peru. In countries such as Peru most agencies for the banking sector are concentrated in the urban areas, this indicates that the objective of agency banking could be far from being achieved as most of the targeted groups in the rural and the poor class are still not covered (Neil and Leishman, 2010).

Agency banking is a financial development where the bank gets a retail outlet whether a small market enterprise or corporate or mobile network operator to carry out bank client's transactions (Calleo, 2014). As indicated by Sahut (2011) agency banking can be portrayed as systems that facilitate bank customers to access accounts and to conduct transactions such as cash deposit, cash withdrawal, electronic fund transfers, and payment of bills, account balance enquiry and loan referrals. The agents who are contracted operate in most convenient places such as supermarkets, retails shops and convenience stores (Sahut, 2011). Morawczynski and Mark, (2009) indicated that the contribution of agency banking to development on developing countries cannot be ignored.

As per the CBK (2017) report there are 40 commercial banks in Kenya ,comprising of 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 73 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus. In Kenya, financial inclusion has kept on rising, with the percentage of the residents living within 3 kilometers of a financial services access point growing to 77.0% in 2017 from 59.0% in 2013. 13 counties out of 47 recorded a decrease in the number of physical bank branches as per the CBK (2017) report.

Addressing the critical concern of reaching the desired goals and objectives of the firm. It entails addressing the specific questions of how, who, where and when. Strategic implementation focuses on the whole organization. Many authors recognize that strategy implementation is an area of challenge to many organizations.

According to Hourani (2017) citing Miller and Dess, (1996) strategy implementation includes wide range of efforts and activities and are best focused on the following organizational domain namely; the structure of the firm, the leadership, resource allocation, organizational culture and organizational communication to understand and measure the strategic implementation practices. These aspects are central determinants of strategy implementation with consequent effect on the performance.

B. STATEMENT OF THE PROBLEM

It is essential to note that since the 2008 global financial crisis, the performance of banks has been so much affected and the reason for this trend is the cost of operations which have so far remained high. In Europe and USA which are considered developed economies, their return on equity and assets has remained very low since the financial crisis. Banks need to devise ways through which that trend can be changed. Among strategies that have been suggested by previous researchers is the digitization of operations through automation and adoption of technology. Banks have adopted technology on various fronts such as product development, services, and processes over the past decade with the aim of enhancing operating costs reduction. Although adoption of new technologies has aimed at assisting banks to shade off most of their costs including service delivery at branches, staff, high risks in operations and compliance employees. Yet, banks in the US and the European Union saw costs rise by 8% averagely from 2010 through 2016. Prior to the adoption of technologies like ATMS and mobile banking, funds withdrawals, accounts enquiries and funds transfers between accounts needed face to face interactions between bank staff and clients, a process which was slow and subject to costly human errors and large labour costs.

There have been a number of studies conducted in Kenya about agency banking adoption for instance, Kimonge (2017), Njagi (2013), Emoru (2012) and Wabwoba (2012). The common theme about these studies is that there is a relationship between adoption of agency banking and performance of commercial banks in Kenya. Similarly, Aluoch, Odondo and Ndede (2018) established that agency banking is key in influencing the financial performance of commercial banks in Kisumu city, Kenya. Additionally, Belita (2013),Ndirangu (2013) and Ngari and Muiruri (2014) in the context of Kenya reported that agency banks significantly influences financial performance of commercial banks. However, despite the introduction of agency banking, it is not clear how agency banking has affected the operational costs of commercial banks since its adoption. Therefore, there is need for a study to evaluate the effect adoption of agency banking has had on the bank's operation costs.

C. OBJECTIVE OF THE STUDY

The general objective of this study was to evaluate the relationship between the adoption of agency banking and operational costs of commercial banks in Kenya. Specific objective for this study included:

- ✓ To assess the relationship between availability of financial services and operational costs of commercial banks in Kenya.

D. RESEARCH QUESTION

This study sought empirical evidence to answer the following question:

- ✓ To evaluate the adoption of agency banking and the operation costs of commercial banks in Kenya.

ISSN: 2394-4404

II. LITERATURE REVIEW

A. THEORETICAL REVIEW

This study was underpinned by the following theories; the agency theory, bank led theory and nonbank-led theory.

a. AGENCY THEORY

Previous studies that have considered agency theory have indicated that the theory emerged in the 1970s combining the economic and institutional theory by Stephen Ross and Barry Mitnick. The proponent of this theory was Jensen and Meckling in the year 1976. The theory helped to expound on the relationship between a principle and an agent with very specific duties and responsibilities. The theory explains that commercial banks that are the principles have a responsibility and duty towards their agents who are assigned by the bank to carry out certain services on its behalf.

In this study the commercial banks were the main beneficiaries of this relationship as it has led to increase in agency outlets, which have ensured reduced costs on expansion and staffing (Siedek, 2008). The relationship between the agent and the principle which is contractual in nature can either increase or reduce the costs involved. In such environment banking agents rely mainly on the existing retail infrastructure and hence have a lower set up and running cost. According to Wendel and Williams (2001), agent businesses have offered better profitability to commercial banks by enhancing financial inclusion. The agency contract has contributed to lowering the transactions costs as agent banking requires less paper work, less staff and no physical branches (Cheng, 2006). The theory assumes that technology is available and that most of the unbanked population are willing to take the initiative of transacting through the agency. The theory allows the banks to critically assess the relationship between the agency and the commercial bank and the customers. The theory indicates that agency has the potential of solving the cost issue for the commercial banks however the theory basically highlights the relationship between the principle and the agent with little emphasis on other aspects of banking

b. BANK LEAD- THEORY

This theory gave a more elaborate view of the agency theory by considering not only the bank and the agent but also taking into consideration an understanding of the customers who make this relationship effective. The theory was first developed and used in Cameron in 1972 during the period of transformation of the money-lenders into merchant banks. The theory was much used during the introduction of branchless financial institutions which are offering banking services through third parties called the agents. Bank (Lyman,Ivatury & Staschen, 2006). Through his theory the bank retains the autonomy of service provision and it deals directly with the issues of the customers but through an agent. All the customers who wish to own an account must register through the bank though they carry out most of the transactions at the agent. With this arrangement the theory indicates than the bank still has autonomy over the customer even though the customer might not visit the branch. The main limitation of this theory is the main bank still has autonomy and control of what the agent can offer to the customers. However, most of the control is still done at the main branch, meaning that the level of restrictions is very high.

c. DIFFUSION OF INNOVATION THEORY

The third theory is the diffusion of innovation theory that was put across by Rogers (2003). According to Rodgers the innovations that have taken place in the financial sector have brought enormous changes in the banking services which are offered to the customers. These innovations have also made the financial services more accessible and available to customers. Diffusion of innovations theory is expected to bring about five key benefits to both the banks and the customers; relative advantage, complexity, compatibility, triangulability, and observability. In this regard it is noted that an innovation has to be tested before adoption in order to minimize the un-certainty and increase the likelihood of the adoption to be successful (Rogers, 2003). Since agency banking is an innovation that has brought changes to the banking sector, then understanding the innovation theory was relevant to this study. The banks have tried their best to popularize the adoption of agency and hence convinced the consumers of their services to adopt the innovation as a way of saving costs.

B. EMPIRICAL LITERATURE REVIEW

This section sought to review literature on what others have done in relation to the study topic.

a. FINANCIAL AVAILABILITY OF BANKING SERVICES

According to Sanford (2013), individuals who use agent banks are most likely to be poor, less educated, employed in the informal sector, female and people residing in small towns or settlements that are not easily reachable. This may bring about a more comprehensive financial system. According to Beck et al. (2006), it does not just own an account that is important but the extent of usage and the level of activity on the account is what counts. For any innovation to be considered successful there is need to see the level of loan penetration, loan income ratio, demographic deposit penetration, deposit-income ratio, deposit-GDP ratio and cash deposit ratio increase (Beck et al., 2013).

Amatus and Alireza (2015) empirically analyzed the impact of financial inclusion on bank stability in sub-Saharan Africa. The study hypothesized bank Z-score as a measure of stability. Financial inclusion was measured by the usage dimension of total outstanding deposits and loans, while GDP per capita and inflation were control variables. From the results, bank usage had a negative effect on stability of banks. Greater GDP per capita was found to improve stability while inflation, had an adverse effect on bank stability. The study employed only one measure of stability, namely insolvency risk. The current study included credit and liquidity risk when testing stability. Ghassan and Fachin (2014) carried out an

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analysis on financial stability of Islamic banks in Saudi Arabia by utilizing a time series model. The current study included credit risk and liquidity risk to enrich the multidimensional measure of stability.

According to Belita (2013), the impact of Agency Banking on financial performance of commercial banks in Kenya, indicates that there is a positive relationship between the volume of deposits, cash deposits and volume of withdrawals and financial performance of commercial banks in Kenya. The performance of the commercial banks was highly influenced by the agency banking. The study used descriptive design where 16 commercial banks participated in the study. The study concluded that there is a positive link between the increase in the number of banking agents and the financial performance of banks. Despite the positive results the study did not consider how agency banking influences the operating costs hence need for further investigation of the same.

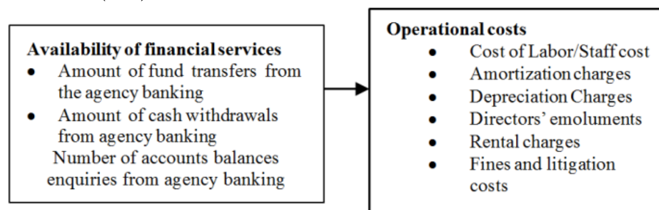
Monica (2015) sought to establish the outcome of Agency Banking on the financial performance of commercial banks in Kenya. Using a sample of 17 commercial banks and a descriptive research design, the study established that there was a solid positive connection between return on assets of commercial banks and the volume of transactions just as the size of the bank. The study concluded that a rise in the number of agents of commercial banks causes an increased financial performance, implying that there is a positive correlation between the agent outlets and financial performance of banks.

Ndirangu (2011) sought to assess the effect of Agency Banking on the financial performance of commercial banks in Kenya. The study focused on the number of agents and deposits, withdrawals undertaken through the agents and loan repayment transactions as independent variables, while performance was measured using ROE Using a census, the study established that there was a positive correlation between the number of agents, the level of transactions effected and financial performance of the commercial banks using the return on equity. The other aspects studied did not have a significant effect on banks financial performance. This implies that there were other factors that might be contributing to the performance of the banks that conduct agency banking.

Clara and Melinda (2010) conducted a study in Kenya to assess the effect of agency banking on performance of commercial banks in Kenya. In their study they focused on assessing the effect of the value of their financial service and service accessibility on the banks performance. The study established that the operations of most commercial banks changed with the adoption of agency banking due to the convenience of transacting. This demonstrates that agent banking has an impact on financial deepening since the number of agents has a direct effect on the number of customers (Cohen, Danielle and Julie, 2008). This study did not consider whether agency banking has improved the ease of access of banking services in the financial sector despite all these advantages hence the need for this study.

C. CONCEPTUAL FRAMEWORK

It assists the researcher to see the proposed relationship between the variables easily and quickly. The conceptual framework gives the explanation about the relationship between independent and dependent variables. The dependent variable was concetiaualissed as the operational costs. Figure 2.1 shows how the conceptual framework for this study. Operational cost is considered as a dependent variable (DV) whereas adoption of agency banking is taken as independent variable (I.V).



Source: Author, 2020

Figure 1: Conceptual Framework

III. RESEARCH METHODOLOGY

A. RESEARCH DESIGN

Mixed methodology was adopted in this study where it used cross sectional design and Event study design to ascertain the connection between the adoption of agency banking and operational costs of commercial banks in Kenya. Since the study compared two periods, that is before and after the adoption the cross sectional design was adopted to test the correlation between the means and also to run the regression analysis.

B. EMPERICAL MODEL

Empirical model used in the study to test the relationship between the adoption of agency banking and operational costs of commercial banks in Kenya was presented as shown below;$=\beta o+ \beta 1\ X1+\beta 2X2+ \beta 3X3+\varepsilon$

Where; Y = Operational cost

$X1$= Availability of financial services

$X2$ = Financial inclusion

$X3$= Accessibility to financial services

βo= Constant

$\beta 1$,2,$\beta 3$ and $\beta 4$ = Regression coefficients

ε = Error term

C. TARGET POPULATION OF THE STUDY

The study utilized quantitative secondary data. All the 11commercial banks that have not just adopted agency banking but have active agency operating countrywide were the target population of the study. According to the CBK (2017) report 14 banks had adopted agency banking by 2014 but three of them do not have active agencies in the market hence they were not considered for the study

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D. RESULT ANALYSIS AND PRESENTATIONS

Regression Analysis

Model	R	R Square	Adjusted R Square	R Square Change	F Change	df1	df2	Sig. F Change
				Change Statistics				
1	.676[a]	.457	.224	.457	1.961	3	7	.209

Table 1.1: Model Summary

From the regression summary model table 1.1 the results indicate that there is a strong correlation between availability of financial services and the operational costs for the eleven selected banks. However, the results show that the relationship is not statistically significant given that the R = 0.676 and the p value > 0.05. The results further show that 45.7% change in the operational costs of commercial banks is attributed to a unit change in the banks transactions because of available (R squared = 0.457). Although the model is not statistically significant, because p > 0.05 but the results are a good indicator of understanding the effect of adoption of agency banking on the operational costs of commercial banks.

Further analysis of the results was done using the analysis of variance. The results are presented in Table 1.2.

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-3444.268	2577.241		-1.336	.223
	Availability	-.146	.152	-.683	-.959	.369

Table 1.2: Coefficients

The results in table 1.2 show that the independent variable (availability) as given by the beta coefficient value ($-\beta_1=0.146$) shows a negative indicating that there is an inverse relationship between the variables. The results also show that the effect of availability of financial services on operations cost is not statistically significant and it’s therefore just by chance since the t statistic (t= - 0.959) is more than - 2 but less than +2. This falls in the rejection region indicating that though there is a relationship between the variables but it is not significant. The results are modeled as shown below.

$Y=\beta_0+\beta 1X_1+\varepsilon$... (i)

$Y= -3444.3 -.146X_1 + 2577.2$ .... (i)

$Y = -867.1 -0.146 X_1$

The results show that the model can be used to assess the effect of agency banking adoption on the operational costs of the bank however the level of significance is not statistically convincing as the situation can change either for the better or for the worse given other intervening variables. This supports the findings of Cetorelli& Goldberg, (2012) who indicated that close to 400 million people globally do not have a bank account but access financial services from other means services but they transact through agency banking. It was also established that branchless banking through agency banking has significantly reduced set-up and delivery costs agency. The findings also concur with those established by Chaia et al (2010) who reported that the adoption of agency banking by commercial banks has provided a basis for offering financial services in emerging markets because of its costs effectiveness to both the customer and the financial institution. This means that adoption of agency banking has significantly enhanced availability of financial services, hence affected the operation costs of the commercial banks.

E. SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

a. SUMMARY OF THE FINDINGS

Availability of financial services was measured by the number of fund transfers from the agency; number of cash withdrawals from agency and number of accounts balances enquiries from agency banking. The study hypothesized that there is no significant mean difference between availability of financial services of commercial banks before and after the adoption of agency banking. The findings revealed that the number of fund transfer, number of cash withdrawals and number of accounts opened before adoption of agency bank were much lower for all the commercial banks compared to the number of transactions after the adoption of agency banking. The results further established that the mean difference for all the indicators of availability of financial services were statistically significant. This implies that operating costs of commercial banks have gone down due to adoption of agency banking which has influenced available of financial service to the customers. The customers are finding it easier and convenient to transfer funds, withdraw money from their accounts at any place within their reach. This has reduced the number of staff at the bank hall making service delivery cheaper for the bank. Most of the routine services are now available at the agent hence easing the congestion at the bank and reducing the actual operational cost at for the commercial bank.

b. CONCLUSIONS

Based on the results presented the study established that adoption of agency banking is growing and will continue to grow in the near future to enhance the operations of the commercial banks. The study concludes that adoption of agency banking has had an effect on the availability of financial services to those customers and users who had been cut off from the banking services through the mainstream service provision channels. With increased availability of financial services customers are able to increase their level of transactions including; deposits, withdrawals and funds transfer which has had a significant effect on the operational costs of the banks.

c. RECOMMENDATIONS

Theoretical Recommendations

Based on the results presented, this study contributes to the theoretical knowledge in the sense that the study has used cross sectional design where different banks have been considered instead of the case study design that is common. The study has also added rich theoretical understanding of how adoption of a new model brings a clear comparison of results before and after the adoption. The use of the paired t test analysis is not very common in research where previous studies have been seen

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only to give the regression values. By testing the mean differences between the years was a good theoretical add for further researchers who need to fill gaps in the exiting study literature.

Policy Recommendations

From the findings and conclusions presented in this study the, following policy recommendations are drawn; since the adoption of agency banking in the year 2010, the agents have been allowed to offer only limited services involving withdrawals, deposits payment of bills checking of account balances among other routine procedures. This has forces many customers to still go to the banking hall to get certain services which makes the procedure very expensive for the customers. The model will be more comprehensive to use when the banks and their regulators allow the agents to perform core activities including loan vetting and cheque processing. This will make it possible to enhance financial inclusion and make the entire process available and accessible to as many customers as possible regardless of their financial standing and their proximity to the urban areas where most of the bank's branches are.

Areas For Further Study

Areas that need further consideration are the use of panel data to clearly bring out the change and assess the longitudinal effects on the dependent variable. Consideration of the various challenges facing the agents and the banks in rolling out the mode fully needs to be given consideration in future research.

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