

## **CHALLENGES FACING GROWTH OF AGENCY BANKING IN KENYA: A CASE OF KISII COUNTY**

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### **Abstract**

Kenya legitimized agency banking act 2009 to enable Central Bank of Kenya to license banking agents for commercial banks. However, even with current 45,500 agents offering financial services, the penetration rate is still a challenge, for many banks have not embraced the model.

In this line, the current study sought to establish the challenges facing growth of agency banking in Kenya. The study sought to establish the effect of technological requirements, customer's attitudes, customer information confidentiality and insecurity on agency banking in Kenya. The study is hinged on the agency theory, diffusion of innovations theory and stewardship theory. The study used a descriptive research design. A sample was drawn from the target of 310 agency banks in Kisii County. The Fisher formula was used to arrive at a sample size of 96. Data was collected through a questionnaire. The study recommends that agency bankers should aim to improve the technology under which agency banking operates since it leads to an improvement in growth of agency banking in Kenya. Agency bankers should not change their system frequently. They should also adopted modern technology in their operations. The study also concludes that agency bankers should enhance customer information confidentiality because it leads to an improvement in growth of agency banking in Kenya. The agency bankers should enhance customer information security system, their integrity in keeping secrets, adoption of a risk-based approach for combating money laundering and terrorist financing as well as value customer data privacy. The study also recommends that agency bankers should aim to change the customer's attitudes and perception towards agency banking by diversifying the products and creating awareness in the new products, coming up with products which are easy to use, available and tailor made.

**Key words: Agency banking, Technological requirements, Customers attitudes, Insecurity, Customer information confidentiality**

### **Background to the Study**

According to Safaricom (2011), financial inclusion is a big challenge in Kenya. Among other efforts to improve financial inclusion and access to financial services is the use of agency banks. There are more than 45,500 agents offering financial services on behalf of licensed financial institutions. Agency banking is the provision of banking services by a third party agency to customers on behalf

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of licensed prudently regulated financial institutions such as commercial banks. The impact of these developments on financial inclusion, however, appears so far to have been less significant than has been claimed by some observers (Gichana, 2013).

Agency banking started in Australia where post offices were used as bank agents. In France, corner stores were being used as agency banking; Brazil used lottery outlets as agency banking to provide financial services. In Africa agency banking started in Nigeria and South Africa where mobile financial services were used. In Kenya agency banking started from mobile financial services such as KCB mtaani, Equity agents and Pesa pap (Irungu, 2010).

In recent years, agency banking has been adopted and implemented with varying degrees of success by a number of developing countries, particularly in Latin America. Brazil is often recognized as a global pioneer in this area since it was an early adopter of the model and over the years has developed a mature network of agency banks covering more than 99% of the country's municipalities. Other countries in Latin America have followed suit, including Mexico (2009), Peru (2005), Colombia (2006), Ecuador (2008), Venezuela (2009), Argentina (2010), and Bolivia (2006) (Agalla, 2014). Other countries around the world have also utilized the agency banking model to expand financial services, including Pakistan, Philippines, Kenya, South Africa, Uganda, and India. The regulation, design, and growth of agency banking vary across countries.

In Brazil in 2008, agents transacted 75% of the volume (agents made 1.6 billion transactions) and 70% of the value (agents transacted a total of US \$ 105 billion) of total bill payments (Banco in CGAP, 2010). Again in Brazil, rural agents transact more deposits and withdrawals as a percentage of total transactions (38%) than their urban counterparts (8%) (CGAP, 2010). In Colombia from August 2010 to July 2011, collections of utility bill payments through agency banking made up the majority of transactions averaging \$1.8 million in July 2011, followed by mandatory payments, such as loan repayment and official government payments, such as tax accounting for over \$ 800,000 in July 2011 (EFInA, 2011).

Agency banking is a comparatively newer phenomenon in Africa when compared to traditional banking or even mobile money services but its rapid growth in some areas is making it a strong contender. In Kenya for example, agency banking was launched in 2011 and by March 2013, 11 commercial banks had contracted 18,082 active agents and were facilitating over 48.4 million transactions valued at \$3 billion according to a report from the Central Bank of Kenya (Calleo Solutions, 2014). In Tanzania agency banking was only regulated in March 2013 but they are hoping for similar growth in the region. Similarly in Nigeria the central bank released guidelines for agency banking in February 2013. The Bank of Ghana on the other hand was comparatively early to recognize the potential for branchless banking and issued guidelines in 2008 to support its development. But a difficult regulatory relationship between the telecoms and banks has inhibited it being used to its full potential (Calleo Solutions, 2014).

According to the Central Bank of Kenya (2014), despite the opportunities brought about by agency banking for both the customers and commercial banks by December 2014, 16 commercial banks and 3 microfinance banks had contracted 35,789 and 58 agents respectively across the country with a concentration of 90% of the agents in 3 banks; Equity Bank with 13,767 agents, Kenya Commercial Bank with 9,687 and Cooperative Bank with 8,765. Problems associated with agency banking range from inability to transact huge transactions, transaction limits and insecurity. Many people find that agents lack capacity to handle large transactions of cash and under-spend on security measures, thus, negating potential clients' confidence in them. (Kiragu,

2011). Many people still prefer to queue in commercial banks banking halls despite the fact that many outlets of agency banking being opened in the country. This formed a key point which led the current study to investigate the challenges facing growth of agency banking in Kenya.

### **Statement of the Problem**

The World Bank estimates that in many countries, over half of the population, “the unbanked”, has never had a bank account. The poor tend to be terrified of banks, since they are often humiliated or ignored when they try to enter them (World Bank, 2006). In an effort to expand financial access to low income households on fair and equitable terms, the Kenyan parliament reviewed the banking act 2009 to enable the central bank of Kenya to license banking agents to deliver financial services on behalf of banks (CBK, 2011). However according to Safaricom (2011), financial inclusion was a big challenge in Kenya; only 22.6% of the adult population had a bank account even with more than 45,500 agents offering financial services.

According to CBK (2010), despite the quite essence of the recent agency banking growth in Kenya, the results to an extent have been a failure. Many banks have not embraced the model with only 4 banks (9% penetration among banks) (Equity, Co-operative, post bank and Kenya commercial bank (KCB) out of the possible 44 having adopted the idea by June of 2011 leading to low accessibility of their banking services by the customers and low coverage in the country (Okuthe, 2010).

In spite of the success of agency banking globally and good performance of Commercial banks in Kenya, there are a number of challenges facing the agency banking. For starters many of the banks that have embarked on agency banking roll-out have found that agents lack the capacity to handle large transactions of cash and that they are not spending enough on security measures leading to poor performance of agency banking (Musau, 2013). In addition, agency banking has received a blow as many of the available outlets (agents) have already been snagged by mobile phone companies, who have relied on their agents to fast-track uptake of mobile money solutions such as M-Pesa, YuCash, Orange Money and Airtel Money (Kiragu, 2011).

A review of existing literature shows that even though agency banking has received considerable attention, only a few studies had been conducted to show the challenges facing agency banking in the country. Therefore, there was a need to conduct an in depth study to highlight the challenges that faced the growth of agency banking in this country. This was in an attempt to provide rigor in the results and enable for comparison of previous study findings.

### **Main Objective of the study**

The main purpose of the study was to investigate the challenges facing growth of agency banking in Kenya

### **Specific objectives of the study**

The specific objectives of the studies are to:

- i. Establish the effect of technological requirements on agency banking in Kenya
- ii. Determine the effect of customer’s attitudes towards use on agency banking in Kenya
- iii. Assess the effect of customer information confidentiality on agency banking in Kenya
- iv. Investigate the effect of insecurity on agency banking in Kenya

### **Theoretical Literature review**

Cost saving and accessibility of financial services are the main forces driving banks to embrace

agency banking in their operations. Banking agent is retail or postal outlet contracted by a financial institution or a mobile network operator to process client's transactions. Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transactions and lets clients to deposit, withdraw and transfer funds, pay their bills, inquire about an accounts balance or release government benefits or direct deposit from their employer (Pickens, 2009).

Banking agents can be pharmacies, supermarkets, convenient stores, lottery outlets, post office and many more. Globally, these retailers and post offices are increasingly utilized as important distribution channels for financial institutions. The points of service range from post office 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 (AF1,2010).

Brazil is a pioneer in agent banking. Since 1999, more than 100,000 retail outlets have been turned into bank agents, reaching 13 million extra unbanked people. In Brazil, bill payments and the payments of government benefits to individuals comprised 78% of the 1.53 billion transactions conducted at the country's more than 95,000 agents in 2006 (CGAP 2006).

In Russia, more than 100,000 automated payment terminals have sprung up in the larger cities in the recent year. One provider, cyber plat, claims to have processed 1.2 billion transactions worth US Dollars 4.7 billion through the first three quarter of 2007. Via its 70,000 cash acceptance points, mostly for prepaid airtime, television, internet and other utilities (CGAP) (Ivantury and Pickens, 2006).

So far in Kenya, CBK data shows 8,809 agency outlets were opened in 2010, most of which are being operated by Equity and cooperative bank. KCB hoped to open about 2,5000 agency branches by 2012, while post bank hoped to open 500 agency branches by 2012. As at June 30, 2015, Central Bank of Kenya had authorized 17 commercial banks to offer banking services through third parties (agents) (Central Bank of Kenya, 2015).

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 (Ivantury and Pickens, 2006).

In Kenya, 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).

The study was hinged on three theories which are the agency theory, diffusion of innovation theory and stewardship theory.

### **Agency Theory**

This theory posits that the firm consists of a contract between the owners of economic resources – the principles and managers- the agents who are charged with using and controlling those resources. Agency theory highlights on problems encountered by investors who cannot avoid the

services of agents in managing their businesses. In agency banking, the agent act on behalf of the bank.

### **Diffusion of Innovations Theory**

Rogers (1995) identified five characteristics that determine the rate of adoption of the innovation: the relative advantage, compatibility, complexity, trialability and observability.

Innovativeness is described as the “degree to which an individual or other unit of adoption is relatively earlier in adopting new ideas than the other members of a system” (Rogers, 2003).

### **Stewardship Theory**

Stewardship theorist assumes a strong relationship between the success of the organization and the principal's satisfaction (Slyke, 2007). In light of agency problems, this study views the banking agents as stewards whose interests are aligned with the interests of the banks and banks objectives are held above personal objectives (Walsh & Seward 1990) or distorted perceptions (Hodgson, 2004). However, as Karra et al., (2006) points out, stewardship behaviors in some agents may alter into agency behaviors overtime, and complacency might set in (Fama & Jensen, 1983). As a result, role conflict may increase between the banks and the banking agents.

### **Empirical Literature review**

#### **Technological Requirements**

Technology involves application of knowledge, tools and skills to solve problems and extend human capacity (Mberia, 2009).

Growth of agency banking was significantly affected by technological factors, such as network failure, poor infrastructure hence banks ought to come up with strategies that to address the above concerns.

#### **Customer Attitudes**

According to Katz (1960) and Grewal, Mehta and Kardes (2000) attitudes serve four key functions for individuals: knowledge function, value-expressive function, utilitarian function and ego-defensive function.

Mamwa (2014) explored the consumer attitude toward agency banking by customers of commercial banks that offer agency banking in Machakos Township, Kenya.

#### **Customer Information Confidentiality**

Vutsengwa and Ngugi (2013) conducted an assessment of the challenges facing commercial banks in sustainability of agency banking in Kenya. The study emphasizes that banks should embrace a good information security system for convenience, confidentiality, integrity, and availability, by doing this the value of the information will be sustained.

#### **Insecurity**

According to Mas (2009) based on his work on the economics of branchless banking, some agents disclosed customer information to third parties without their knowledge that the bank owes its customers the duty of confidentiality and a breach of this duty led to customer taking legal actions against the bank.

Agent banking's security and trustworthiness was termed as one of the most important factors within every target customer segment when deciding on the use of a banking service delivery channel.

### **RESEARCH METHODOLOGY**

The study employed a descriptive study design. The population of study consisted of Agent Bank employees in Kisii County. A sample was drawn from the target of 310 agency banks in Kisii County. The study adopted a stratified random sampling technique to come up with the required sample. To get the size of each stratum, proportional allocation was used. To determine the sample size, the global formula for sample size is determined by Cochran's formula as quoted in Mugenda and Mugenda (2003):

$$n = Z^2 * p * (1-p) / d^2$$

The substituted values in determining the sample size for a large population are as follows.

$$n = \frac{(1.96)^2(0.5)(0.5)}{(0.1)^2} = 96$$

In this study, the total population was 310. Therefore the sample size was:  $n_s = 96 / (1 + 96/310) = 73$ . This makes 23.5% of the target population. The main data collection instrument was a questionnaire consisting of structured questions. The quantitative data collected was analyzed by calculating response rate with descriptive statistics such as mean, median, and standard deviation. Inferential data analysis was carried out by the use of correlation and regression analysis to determine the strength and the direction of the relationship between the dependent variable and the independent variables. The Pearson correlation tested the strength of the association while the regression analysis established the form of relationship between the independent and dependent variable.

The regression took the following form:

$$Y = \beta_0 + \beta_1 \chi_1 + \beta_2 \chi_2 + \beta_3 \chi_3 + \beta_4 \chi_4 + \epsilon$$

Where: Y = Growth of agency banking,  $\chi_1$  = Technological requirements,  $\chi_2$  = Customer's attitudes,  $\chi_3$  = Customer information confidentiality,  $\chi_4$  = Insecurity,  $\beta_0$  = the constant,  $\beta_{1-n}$  = the regression coefficient or change included in Y by each  $\chi$  and  $\epsilon$  = error term..

## **RESULTS**

### **4.10 Inferential analysis**

The study conducted inferential analysis to establish the association and relationship between the study variables. Both Pearson correlation and ordinary least square regression analysis were conducted.

#### **Correlation analysis**

Correlation analysis was conducted to establish the association between the study variables. The results are as presented in Table 4.9.

**Table 7 Correlation analysis**

		Technological requirements	Customer attitudes	Customer information confidentiality	Insecurity	Growth
Technological requirements	Pearson Correlation	1				
	Sig. (2-tailed)					
Customer attitudes	Pearson Correlation	0.529	1			
	Sig. (2-tailed)	0.000				
Customer information confidentiality	Pearson Correlation	-0.055	-0.119	1		
	Sig. (2-tailed)	0.652	0.328			
Insecurity	Pearson Correlation	-0.316	-0.46	0.041	1	
	Sig. (2-tailed)	0.008	0.000	0.739		
Growth	Pearson Correlation	0.373	0.323	0.330	-0.080	1
	Sig. (2-tailed)	0.001	0.006	0.005	0.510	

\*\* Correlation is significant at the 0.01 level (2-tailed).

The findings of the study indicates that technological requirements was positively and significantly associated with growth of agency banking in Kenya ( $R=0.373$ ,  $P$ - Value= 0.001). This implied that an improvement in technological requirements was positively associated with an improvement in growth of agency banking.

The findings also indicate that customer attitudes and growth of agency banking were positively and significantly associated ( $R=0.323$ ,  $P$ - Value= 0.006). This implies that an improvement in the customer's attitudes regarding agency banking leads to an improvement in adoption and growth of agency banking in Kenya.

The study findings also indicated that customer information confidentiality was positively and significantly associated with growth of agency banking in Kenya ( $R=0.330$ ,  $P$ - Value= 0.005). This implies that the more the agents bank operators hold customer information confidential, the more the growth of agency banking in Kenya succeeds.

Regarding, insecurity, the findings indicated that insecurity was negatively but insignificantly associated with growth of agency banking in Kenya ( $R= -0.080$ ,  $P$ - Value= 0.510).

### Regression analysis

The general objective of the study was to investigate the challenges facing growth of agency banking in Kenya. The study used an ordinary least square regression model to achieve this. The

results for the model summary are presented in Table 8 below.

**Table 8: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.617a	0.38	0.342	0.433752

The study findings in Table 8 indicate that the four variables (technological requirements, customer's attitudes, customer information confidentiality and insecurity) jointly explain 38% of the changes in growth of agency banking in Kenya as indicated by an R square of 0.38. Furthermore, the findings indicated in Table 9 indicates that the F statistic was significant at 5% level of significance ( $F=9.974$ ,  $p=0.000$ ) implying that the model fit well. The results for model coefficients are as presented in Table 10.

**Table 9: Model Fitness**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.506	4	1.876	9.974	.000b
	Residual	12.229	65	0.188		
	Total	19.735	69			

Regression of coefficients results in Table 10 shows that technological requirements and growth of agency banking in Kenya are positively and significantly related ( $B=0.203$ ,  $p=0.010$ ) implying that an improvement in the technology leads to an improvement in growth of agency banking in Kenya. The results further indicate that customer attitudes and growth of agency banking in Kenya are positively and significantly related ( $B=0.188$ ,  $p=0.006$ ). These results imply that an improvement in the customer's attitudes towards agency banking leads to an improvement in growth of agency banking in Kenya.

The findings further revealed that customer information confidentiality and growth of agency banking in Kenya are positively and significantly related ( $B=0.241$ ,  $p=0.000$ ) while insecurity and growth of agency banking in Kenya are negatively and significantly related ( $B=-0.194$ ,  $p=0.003$ ). This shows that an improvement in customer information confidentiality leads to an improvement in growth of agency banking in Kenya while an increase in insecurity leads to a decrease in growth of the agency banking in Kenya.

**Table 10: Model Coefficients**

Indicator	B	Std. Error	t	Sig.
(Constant)	1.261	0.510	2.475	0.016
Technological requirements	0.203	0.076	2.671	0.010
Customer attitudes	0.188	0.066	2.861	0.006
Customer information confidentiality	0.241	0.063	3.820	0.000
Insecurity	-0.194	0.066	-2.959	0.004

### Conclusion

The study concludes that technological requirements, customer attitudes and customer information confidentiality are positively and significantly associated with growth of agency banking in Kenya implying that an improvement in any of these factors is associated with an



improvement in growth of agency banking. Regarding, insecurity, the study concludes that insecurity is negatively but insignificantly associated with growth of agency banking in Kenya.

The study further concludes that technological requirements and growth of agency banking in Kenya are positively and significantly related implying that an improvement in the technology leads to an improvement in growth of agency banking model in Kenya. Furthermore, the study concludes that customer attitudes and growth of agency banking model in Kenya are positively and significantly related implying that an improvement in the customers attitudes towards agency banking leads to an improvement in growth of agency banking in Kenya.

The findings also led to the conclusion that customer information confidentiality and growth of agency banking in Kenya are positively and significantly related while insecurity and growth of agency banking in Kenya are negatively and significantly related indicating that an improvement in customer information confidentiality leads to an improvement in growth of agency banking in Kenya while an increase in insecurity leads to a decrease in growth of the agency banking in Kenya.

### **Recommendations**

The study recommends that agency bankers should aim to improve the technology under which agency banking operates since it leads to an improvement in growth of agency banking in Kenya. Agency bankers should not change their system frequently. They should also adopted modern technology in their operations. The study also concludes that agency bankers should enhance customer information confidentiality because it leads to an improvement in growth of agency banking in Kenya. The agency bankers should enhance customer information security system, their integrity in keeping secrets, adoption of a risk-based approach for combating money laundering and terrorist financing as well as value customer data privacy. The study also recommends that agency bankers should aim to change the customer's attitudes and perception towards agency banking by diversifying the products and creating awareness in the new products, coming up with products which are easy to use, available and tailor made.

### **Areas of further studies**

The study recommends that other studies can be conducted on the same topic but in a different context other than Kisii County. This would enable for comparison of findings to reach more in-depth conclusions. Furthermore, the study findings indicated that the four variables (technological requirements, customer's attitudes, customer information confidentiality and insecurity) jointly explain 38% of the changes in growth of agency banking in Kenya. This implies that the remaining 62% is explained by other factors not determined by the model used in the current study. A similar study can be conducted to establish other factors affecting growth of agency banking other than technological requirements, customer's attitudes, customer information confidentiality and insecurity.

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