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The Role of Agency Banking in Enhancing Financial Sector Deepening in Emerging Markets: Lessons from the Kenyan Experience

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Abstract
Agency banking has increasingly gained importance in developing countries over the last decade. However the extent to which agency banking can be used as a tool to deepen the financial sector remains largely unknown. Also, the true benefits of the agency banking model to customers, the banks and the bank agents also remains largely unstudied. This study sought to analyze these benefits and provide some insights into the actual performance of agency banking with regard to enhancing access to banking services by the unbanked. The study was conducted among 40 registered outlets with a respondent sample of 400 people. Systematic sampling technique was used to pick the respondents who were requested to fill structured questionnaires. The study incorporated descriptive data analysis tools and the likert scale to determine the weight of the factors. The study concluded that agency banking has played a pivotal role in enhancing the penetration of banking services in unbanked markets. Besides, agency banking also enhances the access of the full range of banking products within a less than formal setting. The study concludes that the agency banking model has not only helped to demystify banking among low income populations but it has also placed beneficiaries on sure path towards become financially secure. The study also found that banking agents also double up as the backbone of electronic money banking since they perform transactions over a bank device, to enable clients to convert cash into electronic money and vice versa. This is an important role in enhancing financial sector deepening.
Keywords: Agency Banking, Financial sector deepening, Market segmentation.

1.0 Introduction

Agency banking has become an important avenue for growing access to banking services in technologically upward developing economies. In Kenya, for example, banking technology and other related technologies have grown rapidly in the last decade. At the center of these technologies are money transfer technologies that have given rise to innovative products like Mpesa which is a mobile phone-based savings and money transfer product operated by Safaricom, one of Kenya’s premier telecommunications firm.

The rapid growth in ICT that is being experienced in developing economies, especially in Africa, has triggered new innovations in all sectors, one of which is agency banking. Agency banking is the process of using an agent to deliver banking products to peripheral customers. According to the Central Bank of Kenya (2010), an agent is an entity that has been contracted by an institution and approved by the Central Bank of Kenya (CBK) to provide the services of the institution (a bank) on behalf of the institution. The types of entities which can act as agents in Kenya are limited liability partnerships, sole proprietorships, partnerships, societies, cooperative societies, state corporations, trusts, public entities and any other entity which the CBK may prescribe.

In Kenya, the CBK bars faith-based organizations, not-for-profit organizations, Non-Governmental Organizations (NGOs), educational institutions, and Forex bureaus from acting as agents. Individuals are also not expressly permitted to be agents but are often approved as informal sole proprietorships. For an agent to be registered, it must have been operating as a business for at least 18 months and not been classified as a deficient, doubtful, or non-performing borrower during the period. The principal institution must assess the moral, business, and professional suitability of an agent before such agent is registered (CBK, 2010).

According to Kitaka (2001) Banking agents help financial institutions to divert existing entrepreneurs from crowded branches providing a “complementary”, often more convenient channel of accessing bank services. Financial institutions, in developing markets, reach an “additional” client segment or geography. Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch.

In such environments banking agents that piggy back on existing retail infrastructure and lower set up and running cost can play a vital role in offering many low income people their first time access to a range of financial services. Also, low income clients often feel more comfortable banking at their local store than walking into a branch (Adiera, 1995)

2.0 Purpose of the study

In Kenya, over 30,000 outlets are currently enrolled as bank agents. This has allowed bank branches to deal with smaller pools of high net-worth clients from whom they can pick the cash-rich operations they need to roll out the agency banking model. Some banks, like Co-operative, have opted to partner with cash-rich Savings and Credit Cooperative Societies in order to roll out their products effectively. However, owing to the short period within which the agency banking model has existed, the extent to which the model can benefit banks, their clients and the economy remains largely unstudied. This necessitated the researchers to conduct this study to analyze the role of agency banking in enhancing financial sector deepening into unbanked emerging markets.

3.0 Methodology and Research Design

The study was largely of a qualitative exploratory nature. It targeted the coastal city of Mombasa, Kenya and its environs. From a fairly harmonious population of 20,000 entrepreneurs, the researcher targeted 40 banking agent subscribers all across the four agent banks namely Co-op Kwa jirani, Equity mashinani, KCB Mtaani and Post Bank; Benki mashinani.
The respondent sample consisted of 400 respondents. These respondents were selected from lists submitted by the authorized dealers in the region. The study employed systematic sampling method whereby every 1st, 3rd, 6th, 9th… etc. client entering the outlet was asked to complete a questionnaire.
Whereas the primary instrument of data collection was a questionnaire, secondary data was obtained from the annual prospectus of the four banks, news lines, bank agent records, bank pamphlets, and research findings from similar studies obtained from libraries, newspapers and other publications.

4.0 Agency Banking in Kenya

4.1 Current Situation of Agency banking in Kenya

According to Kitaka (2001) the agency banking model, a model that through which banks allow commercial outlets to act in some capacity on behalf of formal banks was launched to a somewhat lukewarm reception by a handful of banks. He argues that the model has suffered some teething problems which have sent some banks back to the drawing board. For instance, banks are facing problems converting agent outlets into outsourced banks. The banking agency selection criteria have also shown some weaknesses, and many banks are now re-organizing their agents in order to meet rising demand. Keen to take advantage of the cost saving and accessibility brought about by the agency banking model, a number of Kenyan financial institutions have embarked on an aggressive entry into the segment. But many are finding that agents lack capacity to handle large transactions of cash and under-spend on account of security fears.

So far, Equity Bank (Equity Mashinani), Post bank (Benki Yangu), Cooperative Bank (Co-op kwa jirani) and Kenya Commercial Bank (KCB Mtaani) have launched forays into the segment. The challenge for many however, has been to identify agencies that are able to provide adequate cash to entrepreneurs. Recent data from the Central Bank of Kenya (CBK) reveals that the regulator has licensed over 10,000 establishments to act as agent banks, with Equity claiming to have outsourced some of its operations to 5,000 active outlets.

Central Bank of Kenya data shows 8,809 agency outlets were opened in 2010, most of which are being operated by Equity and Co-operative banks. Kenya Commercial Bank hopes to open about 2,500 agency branches this year, while Post bank hopes to open 500. But identifying the agents who are capable of handling cash transactions efficiently has been a challenge for the institutions, with entrepreneurs reporting that cash is often scarce even as rising fears of security abound.

4.2. The role of Agency Banking in Economic Growth

4.2.1 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.

4.2.2 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 Kitaka (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.

4.2.3 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 approaches 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.

4.3 Agency Banking as a Tool for Financial Sector Deepening

4.3.1 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.

4.3.2 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.

4.3.3 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.

5.0 Findings

5.1 General Findings

Data was collected from four hundred (400) respondents from the agent banks in Mombasa. Of the 400 respondents sampled, 370 responded, a reasonably high response rate of 92.5 percent the collected data was then summarized coded and analysis made. Descriptive statistics e.g. percentages, graphs and cross tabulations were used to describe, analyze and present the study findings.

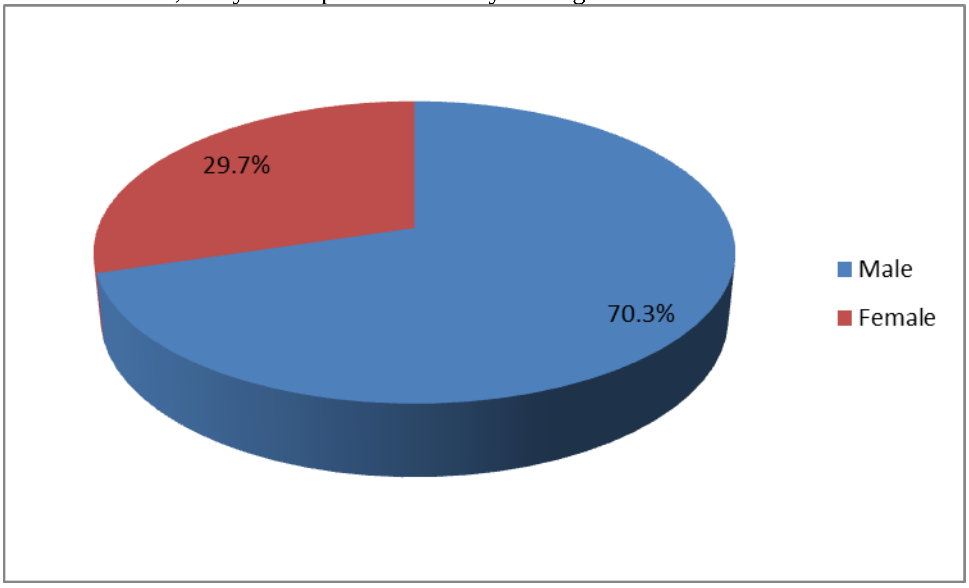

Figure 1: Gender

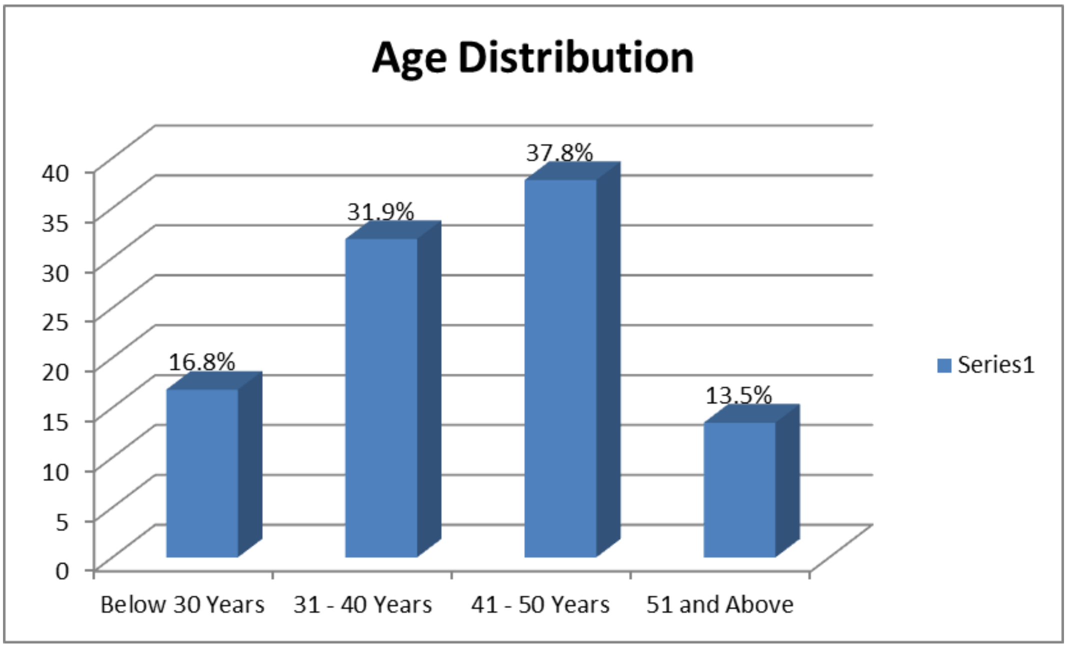

Figure 2: Age Distribution

Figure 1 indicates that 260 (70.3) of the respondents are male while 110 (29.7) are females while according to figure, 62 (16.7%) respondents were aged below 30 years, 118 (31.8%) were aged between 31 and 40 years, 140 (37.9%) respondents were aged between 41 and 50 years, and 50 (13.6) were aged above 50 years. This implies that most of the services are offered by male entrepreneurs. It also shows that majority of the work force are middle aged. These are young and energetic people who work in their respective businesses.

5.2 Impact of Agent Banking on the Entrepreneurs in Mombasa

To attain this objective, the researcher considered the benefits of agent banks. The study brought out benefits that were two-fold: to the banks themselves and to the customers.

Some of the notable benefits to the bank were:

1. Increased sales from additional foot-traffic
2. Lower transaction cost
3. Ease of expansion
4. Lower expansion costs and improved efficiency

The benefits that accrued to the clients included:

1. Lower costs of service
2. Decentralization of banking services which brought the bank to the customer's doorstep
3. Lumping of bank services with shop items which created a one-stop shop for banking and retail purchasing by the client
4. Access to longer banking hours
5. Shorter banking time periods owing to reduced queues at the 'bank'
6. Easier access to the bank by the less literate and the very poor customers who would otherwise feel intimidated in branches.

The following table indicates the impact of agent banking on entrepreneurs in Mombasa Town on selected parameters:

Level of impact	**N**	**Mean**	**Interpretation**
Lower transaction cost	370	4.0610	High
Service closer to the entrepreneur	370	4.7195	Very high
Longer opening hours	370	3.9756	High
Short lines than the branches	370	3.3415	Moderate
Grand mean	**4.0244**		**High**

Table 2 indicates that, the impact of agent banking on entrepreneurs in Mombasa had a grand mean of 4.0244 which is indicative of a high impact.

5.3 Challenges of Managing Agency Banking

The study identified a number of challenges that the banks need to address to maintain the Banker- Customer relationship and avoid losing customers. The customer who is served by the agent remains the responsibility of the banks hence the need to protect the reputation of the bank. Some of the challenges that need to be addressed in this regard are:

1. Confidentiality – Every year Banks ensure that their staff members sign secrecy forms and maintain confidentiality for all customer information. This does not happen in many cases at the Agent level since the employees of the agents are not bank staff. This needs to be resolved
2. Security – Most of these agencies are in areas that are what would be considered 'high Risk'. The Bank needs to audit the security measures being taken by the agencies to ensure safety of the customer and the agent
3. Customer service to the bank customer – Service is a huge challenge for the banks as they need to train and retrain the agents so as to maintain high levels of customer service
4. Issues of Fraud – The agency staff will be a target by fraudsters as they are aware that they will not be able to easily identify fraudulent transactions, especially in the case of identification of documents for originality

The study also found that customers also experience some challenges such as network failures, in which case if the provider's ICT system is slow or down then they are not able to conduct their bank. It was also noted that although they offer convenience for small scale traders the agents need to earn commissions from the sale proceeds or business undertakings, which predisposes clients to some charges, albeit low, that they would otherwise not pay in the main banking hall.

In addition, the agents face security risks which limit the amount that a customer is able to transact at any one given time. It should be noted that some of the agents operate in very insecure neighborhoods.

6.0 Conclusions

The aim of this research paper was to investigate the role of agency banking in enhancing financial sector deepening into unbanked markets in Kenya. In order to achieve this, the paper delved into general as well as specific issues surrounding Kenya's financial sector, the evolution of agency banking, the role of agency banking in economic growth, agency banking as a tool for financial sector deepening and challenges of managing agency banking.

The study concludes that in as much as agency banking has played and continues to play a key role in enhancing financial deepening and inclusion in the countries where it has been adopted, the model is still bedeviled with some challenges which if not handled could reverse the gains made. Banks must, therefore, address the challenges that are posed by agency banking in order to maximize on the benefits of having this channel of banking. There is need to pay special attention, especially, to the quality of services rendered by agents in order not to undersell the mother bank.

The model is also useful to banks that wish to enhance their competitiveness. It has proved useful in not only expanding the client base of banks but also in enhancing the range of service absorption per client. The model has significant cost and financial benefits as well. This is because the costs by the agents are not passed to the bank. It also enhances positive brand perception by more clients especially if the mother bank is in control of the quality of services offered by the agent. However this has been a difficult intervention to implement.

Moving forward, it will be useful for banks in Kenya to establish forums where banking issues are discussed. Such forums would bring together key stakeholders, besides the banks and their agents. As at now, those forums are lacking. Central Banks are currently playing the critical role of channeling information to and from banks regarding agency banking but this is still not adequate. The forums proposed here will enhance discourse among stakeholders and supplement the Central Bank channels of communication thereby leading to higher level product innovation.

It is also recommended that commercial Banks establish training centers where employees working in agent banks and the agent-entrepreneurs can be trained to improve their performances. The study is of the opinion that this type of training, though happening, is grossly inadequate.

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