AGENCY BANKING STRATEGY AND PERFORMANCE OF COMMERCIAL BANKS OF TIER THREE BANKS IN KENYA

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ABSTRACT

The performance of commercial banks in Kenya has increasingly been influenced by the adoption and utilization of agency banking, which plays a pivotal role in enhancing operational efficiency, customer engagement, and overall bank performance. This study investigates the influence of agency banking on the performance of tier-three commercial banks in Kenya, focusing specifically on the number of agents, agent network coverage, transaction volume through agents, and agent performance metrics. Grounded in Resource-Based Theory, the Technology Acceptance Model (TAM), Diffusion of Innovations Theory, Bank-Led Theory, and Agency Theory, the research examines how the adoption and integration of agency banking affect key performance indicators. A descriptive research design was used, targeting all 21 tier-three commercial banks in Nairobi City County, with a sample population of 2,123 employees across senior, middle, and operational management. Primary data was collected through structured questionnaires distributed to a purposive sample of 273 employees. Data analysis was conducted using descriptive, diagnostic, and inferential statistical methods with SPSS Version 26.0. The findings revealed that agency banking significantly and positively influenced the organizational performance of tier-three banks in Kenya. The study concludes that enhancing agency banking strategies can improve the operational efficiency of these banks. Recommendations include expanding agent networks, optimizing transaction volumes, and improving agent performance metrics to maximize the potential of agency banking and ensure long-term success.

Keywords: *Agency Banking Strategy, Performance,* Number of Agents, *Agent Network Coverage, Transaction Volume, & Agent Performance Metrics*

1.0 Introduction

Agency banking, a key component of alternative banking strategies, allows customers to access banking services through third-party agents instead of traditional bank branches (Nguyen & Ben Ali, 2021). This approach has been increasingly adopted worldwide due to its ability to offer convenience, flexibility, and accessibility to a broad range of customers, particularly in underserved and remote areas (Munyiri & Muthoni, 2022). Agency banking strategies are part of a larger trend of digital banking innovations, which also include mobile banking and e-banking. These methods have revolutionized the banking industry by reducing operational costs for banks and providing customers with faster, more accessible services (Kihoro, 2022).

Globally, agency banking has been widely adopted, especially in regions where access to traditional banking infrastructure is limited. In developed countries, agency banking has become an integral part of the banking experience, with retail agents providing a variety of services such as deposits, withdrawals, and bill payments (CBK, 2024). For example, in the United States and Europe, banks have partnered with retail outlets to extend their services, offering customers more convenient access to financial products (Nguyen & Ben Ali, 2021). In emerging markets, agency banking has gained significant traction, providing essential services in areas where traditional banking branches are scarce.

In Kenya, agency banking has been particularly successful, playing a pivotal role in increasing financial inclusion. By allowing customers in rural and low-income communities to access banking services without traveling long distances (Lyman, 2006), agency banking has helped millions of previously unbanked individuals. With more than 40,000 agents across the country, these agents typically located in retail shops or kiosks offer services such as cash withdrawals, deposits, and money transfers. This widespread adoption of agency banking in Kenya demonstrates its effectiveness in bridging the gap between formal financial services and underserved populations (Kihoro, 2022).

Agency banking has proven to be a vital strategy for tier-three banks in Kenya, which are often smaller and face significant challenges in terms of market reach and financial resources. As of 2024, tier-three banks have made significant strides in expanding their operations through agency banking, reaching customers in both urban and rural areas. Although these banks represent a smaller portion of the banking sector, agency banking has allowed them to remain competitive by offering affordable and convenient banking services to a larger customer base (CBK, 2024). Despite facing challenges such as limited technological infrastructure and high regulatory compliance costs, agency banking enables these banks to extend their services to communities that would otherwise remain underserved (Munyiri & Muthoni, 2022).

Bank performance is measured through various metrics, including shareholder returns, profitability, and customer satisfaction (Richard, 2010). Contemporary evaluations also consider non-financial factors such as customer loyalty and market share. Performance in the banking sector, particularly in the context of agency banking, can be evaluated through financial analysis, focusing on liquidity, solvency, and profitability, often using frameworks like CAMELS (King et al., 2006). Effective performance in agency banking also involves assessing the ability to meet set goals and targets efficiently, ensuring that banks leverage their agent networks to adapt to market conditions and customer expectations.

Tier-three banks in Kenya, categorized by asset size, market share, and capital adequacy, form a vital part of the financial sector. As of 2024, there are 24 tier-three banks, accounting for a modest share of the banking sector but showing substantial growth in assets and loans (CBK, 2024). Agency banking has played a significant role in this growth, allowing these smaller banks to reach broader customer bases, especially in underserved areas. Despite this progress, tier-three banks still face significant challenges, including competition from larger banks, high operational costs, and limited access to advanced technology. Some of these banks have reported financial losses due to these challenges, which include high customer acquisition costs, regulatory compliance expenses, and the logistical costs of maintaining extensive agent networks (Waweru, 2023).

Statement of the Problem

Commercial banks are vital to Kenya's economy, providing essential financial services to a broad range of consumers. However, challenges such as technological advancements, increased competition, and globalization have raised operational costs, affecting profitability (Kumar & Salimath, 2022). To address these issues, many banks have adopted agency banking strategies, which allow them to extend services through third-party agents, reducing costs and reaching underserved areas. Agency banking holds significant potential, particularly in remote regions, offering services such as deposits, withdrawals, and bill payments through local agents. However, challenges such as agent fraud, lack of adequate training, and limited infrastructure continue to undermine its effectiveness and may threaten its long-term viability (Munyiri & Muthoni, 2022).

While previous studies have highlighted the benefits of agency banking (Mbobua et al., 2013; Barasa & Mwirigi, 2019; Kandie, 2020), gaps remain regarding its impact on specific performance metrics within tier-three banks. Most research has focused on general adoption rates and customer satisfaction but has not explored how factors like agent numbers, network coverage, transaction volume, and agent performance specifically affect the performance of tier-three banks (Munyiri & Muthoni, 2022; Ochieng & Ndirangu, 2021; Gachoka, 2021; Muriuki, 2020; Omondi & Njoroge, 2021; Nyambura, 2022). This study aims to fill these gaps by evaluating how agency banking influences these performance metrics, with a focus on challenges such as agent management, operational efficiency, and fraud prevention within tier-three commercial banks in Kenya.

Objectives

This study sought to explore the influence of agency banking on the performance of commercial banks of Tier Three Banks in Kenya.

Hypothesis

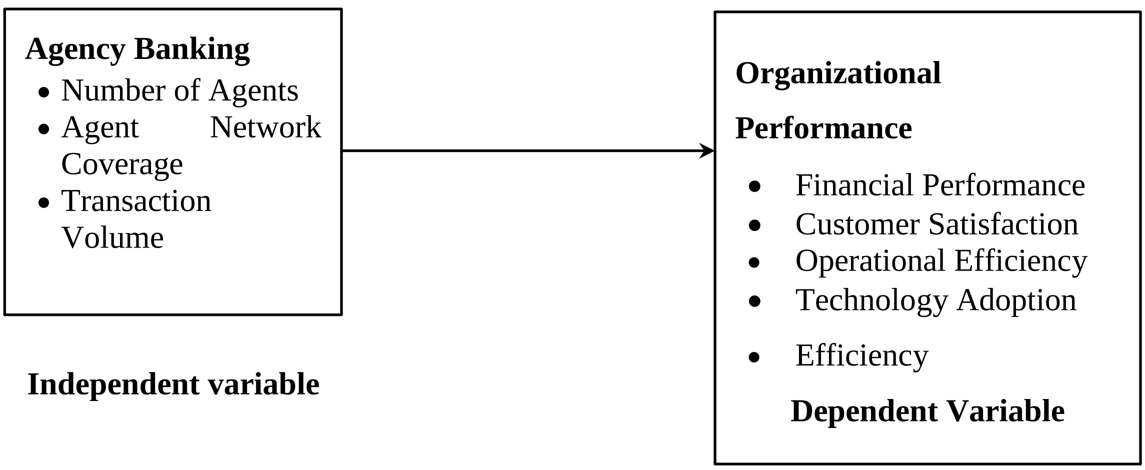
The agency banking strategy does not significantly impact the performance of commercial banks of Tier Three Banks In Kenya.

2.0 Literature Review

Existing studies emphasize the significant role of agency banking in enhancing financial inclusion, reducing operational costs, and expanding the reach of commercial banks, particularly in underserved areas. Studies by Porteous (2005) and Melzer (2006) highlight how agency banking helps banks reach remote populations and lower operational expenses by providing services through retail agents. Additionally, agency banking has been shown to improve accessibility to banking services in regions where traditional branches are not feasible, with studies by Barasa & Mwirigi (2019) and Kengere (2020) pointing to its positive impact on financial performance, such as increasing non-funded income and expanding market reach. However, these studies generally overlook the impact on specific operational performance metrics such as transaction volume, agent network coverage, and individual agent performance, especially in the context of tier-three banks.

Despite these insights, there is a notable gap in research regarding the comprehensive effects of agency banking on the operational performance of tier-three banks in Kenya. Studies such as Mbobua et al. (2013) and Kandie (2020) discuss obstacles like fraud, liquidity issues, and technology problems but do not explore how these challenges affect financial performance indicators like profitability or market share. Furthermore, studies like Ogetange (2020) and Ivatury & Lyman (2006) highlight the convenience and financial inclusion benefits of agency banking but lack focus on its impact on bank-specific metrics. Therefore, additional research is necessary to examine how factors such as agent performance, transaction volume, and network coverage contribute to the financial performance and sustainability of tier-three banks in Kenya.

Conceptual Framework



3.0 Methodology

The research employed a descriptive research design to examine the influence of agency banking strategies on the performance of tier-three commercial banks in Kenya. The sample size was 160 respondents, calculated using Yamane's formula for finite populations, with a total of 2,123 employees working across the 21 selected tier-three commercial banks in Kenya. Stratified sampling was used to ensure that the sample accurately represented employees from different levels of management (senior management, middle management, and operational staff). The sample size was allocated proportionally to each bank based on its representation within the overall population. The study selected 20 banks, ensuring a representative cross-section of the tier-three commercial banks in Kenya. Data was gathered using a structured questionnaire, designed to capture information on the influence of agency banking on the performance of tier-three commercial banks. A five-point Likert scale was used to measure responses, allowing for consistency and ease of analysis.

The collected data was analyzed using the Statistical Package for Social Sciences (SPSS), version 26. Descriptive statistics, including means, standard deviations, and frequencies, were used to summarize demographic information and key variables. Regression analysis was employed to assess the influence of agency banking strategies on the performance of tier-three commercial banks. The regression model used in this study was specified as follows:

$$Y = ß_0 + ß_1X_1 + \varepsilon$$

Where: Y = Organizational Performance; $ß_0$ = The intercept; $ß_1$= Coefficients for the variable agency banking strategy; X_1 = Agency banking strategy and ε = The error term.

4.0 Findings

This section presented the results of the Descriptive Analysis, Regression Analysis, and Model Summary.

Descriptive Analysis Results

The study aimed to evaluate the Agency Banking and its effect on Performance of Tier Three Banks in Kenya. The results are presented in Table 1.

Table1: Descriptive Results for Agency Banking Strategy

	M	STD
Number of Agents		
The bank has a sufficient number of agents to meet customer demand for banking services.	**4.06**	**1.08**
The growth in the number of agents has positively impacted the accessibility of banking services in underserved areas.	**3.39**	**1.12**
The bank's expansion of its agent network is effectively increasing its market penetration and customer reach.	**3.19**	**1.13**
Agent Network Coverage		
The bank's agent network covers a wide geographic area, ensuring accessibility to banking services in diverse locations.	**3.33**	**1.08**
Customers find it convenient to access banking services through the bank's extensive agent network.	**3.31**	**1.01**
The bank's agent network is effectively reaching rural and remote areas, thereby promoting financial inclusion.	**3.42**	**1.07**
Transaction Volume through Agents		
The volume of transactions processed through agency banking strategies reflects the bank's successful integration of agent services into its operations.	**3.22**	**1.08**
Customers trust the bank's agents for conducting various financial transactions, as evidenced by the high transaction volumes.	**3.10**	**1.12**
The increase in transaction volume through agents indicates growing customer adoption and satisfaction with agency banking services.	**3.08**	**1.25**
Agent Performance Metrics		
Customers are generally satisfied with the service quality provided by the bank's agents.	**3.42**	**1.01**

The average transaction processing time by the bank's agents meets or exceeds customer expectations.	**2.74**	**1.19**
Error rates in transactions processed through agency banking strategies are minimal, demonstrating the effectiveness of agent training and support.	**3.06**	**1.06**

Key: M = Mean**; STD =** Standard Deviation

The descriptive results for the agency banking strategy reveal a mix of agreement and disagreement across different aspects of the bank's operations. Regarding the number of agents, respondents generally agreed that the bank has a sufficient number of agents to meet customer demand for banking services, as reflected by a high mean score of 4.06. However, there was less agreement on whether the growth in the number of agents has positively impacted the accessibility of services in underserved areas, with a mean score of 3.39, suggesting some disagreement. Additionally, the effectiveness of the bank's agent network in increasing market penetration and customer reach received a lower mean score of 3.19, indicating a general sense of disagreement with the claim that the expansion of the network has been particularly effective in this regard.

When it comes to agent network coverage, respondents expressed mixed feelings. While a significant portion of respondents agreed that the bank's agent network spans a wide geographic area (mean = 3.33), ensuring accessibility to banking services, there was still some disagreement. The network's convenience for customers was similarly perceived with a mean score of 3.31, which indicates some hesitancy in agreeing that accessing banking services through the network is convenient. On a more positive note, respondents did agree that the bank's agent network is reaching rural and remote areas, which is contributing to financial inclusion, with a mean score of 3.42.

In terms of transaction volume, the results suggest that respondents were generally skeptical about the effectiveness of agency banking strategies in driving significant transaction volumes. With a mean of 3.22, respondents disagreed that the volume of transactions reflects a successful integration of agents into the bank's operations. There was also disagreement about whether customers trust agents enough to conduct transactions, as evidenced by lower transaction volumes (mean = 3.10). Furthermore, respondents were not fully convinced that an increase in transaction volume indicates growing customer adoption and satisfaction with agency banking services, with a mean of 3.08.

Regarding agent performance metrics, respondents showed a mixture of agreement and disagreement. The service quality provided by agents was considered satisfactory, with a mean score of 3.42, indicating general agreement. However, there were notable concerns regarding transaction processing times, which did not meet customer expectations, as reflected in a mean score of 2.74. Furthermore, respondents disagreed that error rates in transactions processed through agency banking strategies were minimal, with a mean score of 3.06, suggesting that there are still challenges in ensuring effective agent training and error management.

Other studies on agency banking have found similar results. For example, research by Donovan (2022) indicated that while agent banking networks significantly increase accessibility in underserved areas, the quality of service and customer satisfaction often varies, impacting the adoption of services. Additionally, studies by Ghosh and Vinod (2019) suggest that while transaction volume can increase, factors such as trust, convenience, and training remain key barriers to maximizing the full potential of agency banking networks.

Regression Analysis Results

The study hypothesis stated in the null form was as follows:

H_{01}: There is no significant relationship between agency banking strategy and organizational performance of tier three banks in Kenya.

To test this hypothesis, a simple regression model was employed, with agency banking strategy as the independent variable and organizational performance as the dependent variable. The goal was to determine whether agency banking strategy has a statistically significant influence on organizational performance in Kenyan tier three banks.

The hypothesis was tested by regressing agency banking strategy and organizational performance, following the equation:

$$Y = \beta_0 + \beta_1 ABS + \epsilon$$

Where: **ABS** represents agency banking strategy (independent variable) and **Y** represents organizational performance (dependent variable).

Model Summary

The regression analysis results show that the value of R is 0.715, and the R^2 is 0.511. This indicates that approximately 51.1% of the variation in organizational performance can be explained by agency banking strategy. The adjusted R^2 of 0.507 further strengthens this finding by accounting for the number of predictors in the model, thereby reinforcing the explanatory power of agency banking strategy.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.715	0.511	0.507	0.51446

The analysis of variance (ANOVA) results provide evidence of a statistically significant relationship between agency banking strategy and organizational performance. The calculated F-value is 147.092, and the p-value is 0.000, which is less than the 0.05 significance level. This indicates that the regression model is statistically significant, meaning that agency banking strategy significantly influences organizational performance.

Table 3: ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
1	38.931	1	38.931	147.092	0.000

Table 4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.960	.204		4.708	0.000
	Agency banking strategy	.697	.057	.715	12.128	0.000

The coefficients table shows the unstandardized and standardized coefficients for agency banking strategy. The derived regression equation is:

Y = 0.960 + 0.697**ABC**

Where: **Y** represents organizational performance; ***ABC*** represents agency banking strategy.

From these results, it is evident that when agency banking strategy is held constant, the performance of tier three banks in Kenya is 0.960. Each unit increase in agency banking strategy corresponds to a 0.697 unit increase in performance, with a statistically significant p-value of 0.000. This leads to the rejection of the null hypothesis and supports the alternative hypothesis, affirming that there is indeed a statistically significant relationship between agency banking strategy and organizational performance in Kenyan tier three banks.

5.0 Conclusions

The study concluded that the agency banking strategy significantly impacts the performance of tier-three commercial banks in Kenya. Key factors such as the number of agents, agent network coverage, transaction volume through agents, and agent performance metrics directly influence the banks' operational efficiency. A strong agent network and higher transaction volumes enable these banks to provide better customer service and improve financial performance. However, challenges such as limited agent coverage and occasional agent underperformance hinder optimal performance. Addressing these issues through strategic network expansion and performance monitoring will be critical to improving agency banking operations.

6.0 Recommendations

To improve agency banking performance for tier-three commercial banks in Kenya, several steps should be prioritized. First, increasing the number of agents in both urban and rural areas is essential to broaden service access, particularly in underserved regions. This will help expand the customer base and increase transaction volumes. Second, enhancing agent network coverage is vital. Banks should ensure agents are strategically located in high-traffic areas to maximize customer engagement and service accessibility. This will drive both usage and customer loyalty.

Third, banks must implement stronger agent performance monitoring systems. By tracking key metrics like transaction volumes and customer satisfaction, banks can identify areas for improvement and reward top-performing agents, ensuring consistent service quality.

Moreover, banks should invest in improving technological infrastructure to support agents. Reliable systems for transaction processing will minimize errors, ensure security, and enhance customer satisfaction. Finally, promoting financial literacy among both agents and customers is crucial. Regular training will ensure agents are well-equipped to provide quality services, while educating customers will drive usage and trust in agency banking. By focusing on these key areas, tier-three commercial banks can enhance their agency banking operations, improve performance, and contribute to greater financial inclusion.

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