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Effect of Reduced Overall Costs by Agency Banking in the Financial Inclusion of Small and Medium Enterprises in Kenya

Lucy Margaret Andeso[1], Dr. Assumpta Kagiri[2]

College of Human Resource Development, Jomo Kenyatta University of Agriculture and Technology

Abstract: **The current study sought to assess the effect of reduced overall costs by agency banking in the financial inclusion of small and medium enterprises in Kenya. The study was guided by four theories: Theory of Financial Intermediation; Transaction Cost Theory; Agency theory and the Theory of Financial Inclusion. The study employed a descriptive research design. The target population of the study were the SME'S operating within the Nairobi North Tax District and are legally registered by KRA as taxpayers on the category of SMEs. Nairobi North District has a total of 1840 SMEs, (KRA, 2014). All the 1840 SMEs formed the target population for the study. Questionnaires were the main research instruments that were used in this study. Data was analysed using quantitative technique. Inferential statistics included Analysis of Variance (ANOVA), Pearson correlation and Multi linear regression analysis. These were used to establish the relationship among the study variables and to test the formulated hypotheses at 95% confidence level and 5% level of significance. It is evident from the finding table that 87% of variation or change in the financial inclusion is explained by the overall cost of banking. This implies that this factor is very significant (since the p-values< 0.05) and therefore need to be considered as a strategy in increasing the financial inclusion of SMEs. More agent banking outlets should be opened to offer more services to increase the geographical coverage.**

Keywords: **Small and Medium Enterprises, Reduced Overall Cost, Financial Inclusion.**

1. INTRODUCTION

The economic development of countries is partly attributed to the extent of financial inclusion amongst the citizenry. There are a number of strategies that financial institutions have embraced to enhance financial inclusion; agency banking is presumably one of them. It is thus important to examine the various attributes of agency banking and how they influence financial inclusion. According to the Alliance for Financial Inclusion, (AFI, 2012), agency banking describes a banking model where banks provide services through non-bank agents, such as grocery stores, retail outlets, post offices, pharmacies, or lottery outlets. This model allows banks to expand services into areas where they do not have sufficient incentive or capacity to establish a formal branch. This is normally the case in rural and poor areas where a high percentage of people are unbanked. Agency banking is quickly becoming recognized as a viable strategy in many countries for extending formal financial services into poor and rural areas. In recent years, agent banking has been adopted and implemented with varying degrees of success by a number of developing countries, especially the Latin America. Brazil is more often than not considered as the global pioneer of agency banking due to the fact that it was an early adopter of the model and over the years has developed a mature network of agent banks covering more than 99% of the country's municipalities. Other countries in Latin America that have followed suit include Peru 2005, Colombia 2006, Bolivia 2006, Equador 2008, Venezuela 2009, and Argentina 2009. Other countries that have adopted and utilized the agency banking model are Pakistan, Kenya, South Africa, Philippines, Uganda and India. The regulation, design and implementation of agent banking vary across countries. The differences are evidenced in the variety of services offered by agents, the types of businesses acting as agents, the types of financial institutions that work through agents and the business structures employed to manage them, (AFI, 2012). Agency banking was introduced in Kenya in 2010 according to OPM, (2011). It is observed that the involvement of key stakeholders in implementation of agency banking cannot be understated. The stakeholders were drawn from both the public and private sectors. The stakeholders should participate in rolling out of mobile financial services model. The OPM, (2011), report further underscores the importance of prioritizing and coordinating the national financial inclusion agenda. It is asserted that Kenya engaged in discussion with the Alliance for Financial Inclusion, (AFI) regarding support for strategic financial inclusions. Agency banking is a model that is aimed at enhancing financial inclusion by reaching out to millions of people in need of financial services.

Agency banking is the new innovation that banks are using to take services to the unbanked and under-banked at a cheaper rate. Agency banking was introduced during the 2009 budget and was enshrined in the Finance bill of 2009. Agency banking takes customers out of the bank halls to kiosks and villages. Investors have pumped billions into new platforms that offer agency banking services. Among the platforms are M-kesho and 24/7 from Equity bank, Co-op kwa jirani of Co-operative bank among others. Given that more Kenyans without bank accounts will gain access to mobile banking services, transaction fees charged to mobile banking customers have reduced. One notable feature mobile platforms share is that their agents also serve as banking agents, (Mulupi, 2011). The financial platforms are widely expected to lead to regional and national economic growth due to the increased access to advanced financial services by those who need it the most; the unbanked and semi-banked. Since traditional barriers to commerce like access, cost and time have been eliminated; economic growth is set to hasten with independent, real-time and unencumbered access to financial services, (Mulupi, 2011).

Businesses with strong cash flows have benefited from the newly-introduced agency banking. By June 2011, over 30,000 outlets around the country had been enrolled as mobile money transfer agents. These left banks with a smaller pool of businesses from which they could pick the cash-rich operations they needed to roll out the agency banking model, (Kinyanjui, 2011). The Kenyan Small Medium enterprises population has remained largely unbanked and therefore financially excluded. Small Medium entrepreneurs' access to banking services in these areas has been hindered by the assumption that the enterprises have low incomes which are not sufficient to sustain banking operations; hence most formal banks in Kenya have shied away from offering banking services to SMEs for many years. Recently, commercial banks in Kenya in collaboration with the mobile phone service providers came up with the new innovation of mobile and agency banking. Given the potential for the transformative impact of such a service to the SMEs, despite the known impact, most of Kenyan SMEs owners are still not utilizing the agency banking to the full potential if used at all, (Mwando, 2013).

2. STATEMENT OF THE PROBLEM

According to research conducted by Athane, (2011), a large percentage of SMEs around the world do not have access to formal financial services like savings accounts, credit insurance and payment services and this has led to the poor performance of SMEs. The Kenyan SMEs sector has grown rapidly, and the government estimates that the SMEs sector constituted 89.7 per cent of total employment created in 2012, (GoK, 2013). Due to the importance of small and medium enterprises in relation to the economic development in a country, studies linked to this field are extremely important to enable researchers and stakeholders to improve their knowledge and expertise in the management of small and medium enterprises, (Harash et al. 2013; Harash et al. 2014). In Kenya empirical studies by Nondi & Achoki, (2006), in a survey of financial management problems in small hotels and restaurants in Kenya, found that 26 percent of these establishments reported lack of working capital as the most serious problem they face in their operations. Musau, (2013), studied the utilization of agency banking by commercial banks in Kenya where she found that agency banking had positively affected banks' performance. Aduda et al (2013), also studying agency banking effect on commercial banks in Kenya found a positive correlation between money flowing through agent banking system on banks profitability. Whereas these studies in Kenya and other countries have confirmed that agency banking model has positive impact on bank performance, no study has been conducted to determine the effect agency banking has on the users of the services who mainly include the SMEs.

Research which focused on the commercialization of innovations in Kenya also found that small scale firms experience great difficulty in attracting investment funds, which inhibits their ability to adopt modern methods of production. Introduction of agency banking in Kenya was meant to address the low financial access in Kenya among small enterprises (most of which are SMEs firms) and the poor individuals with the promise that financial access promotes growth, (Mwando, 2013). As a result, Kenya's financial inclusion landscape has undergone considerable change with the overall conclusion that it has expanded; however 33.7% of households remaining unbanked, (FSD, 2013). Despite the gains in financial inclusion with the introduction of agency banking, a significant population of SME's remains financially excluded. This study therefore sought to bridge the gap by assessing the contribution of the reduced overall costs by agency banking in the financial inclusion of small and medium enterprises in Kenya.

3. LITERATURE REVIEW

According to Arora and Ferrand, (2007), access to finance is critical for sustainable economic growth and social development. Financial inclusion empowers low income people and marginalized sectors of society to actively participate in the economy, which leads to increasing employment and decreasing poverty level. Apart from increasing access to those excluded from financial services and reducing reliance on informal financial sources such as Accumulating Savings and Credit Associations (ASCAs), Rotating Savings and Credit Associations (ROSCAs) and shylocks, agent banking has reduced the need for more staff and branches to reach customers. The set up for an agent bank is less costly and more flexible than for traditional commercial bank branches. It reduces the need to invest in staff and physical infrastructure. Lower transaction costs are incurred since client/ entrepreneurs would visit the agency at any time without incurring any additional cost like transport cost to bank their cash. Agencies are more accessible for illiterates and the very poor who might feel intimidated in branches with low amount of money they would wish to withdraw and deposit, (Ba & Pavlou, 2002).Lower transaction costs are incurred since client/ entrepreneurs would visit the agency at any time without incurring any additional cost like transport cost to bank their cash. Though most people are not aware of these costs, to some extent they do influence the customer decision to use agency banking or not to use the agency banking hence influences the performance and growth of agency banking. Ombutura & Mugambi, (2013).In their study, agent quality was assessed using three parameters namely float adequacy, age of an agent in agency business and the core business of the agent.

A study by Bean, (2009), on The Great Moderation, the Great Panic and the Great Contraction, states that agency banking has reduced cost and enhanced efficiency in the financial sector with a possibility and availing financial services at much lower cost to consumers. It has also increased the ease of banks' expansion hence outreach to far flung market pockets of bankable populations. The amount of money expended by financial service providers to serve a poor customer with a small balance and conducting small transactions is simply too great to make such accounts viable. In addition when financial service providers do not have branches that are close to the customer, the customer is less likely to use and transact with their services. However we see the emergence of new delivery models as a way to drastically change the economics of banking the poor.

Financial inclusion is the core of the Central Bank of Kenya's reform agenda to support Kenya's development blue print, vision 2030. Financial inclusion is defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at affordable costs, (Rangarajan‟s committee). Financial inclusion is defined as the policy goal of reaching all financially excluded households with a full range of responsibly delivered, affordably priced and reasonably convenient formal financial services, (Chriten, 2011). Evidence shows that financial inclusion is key to reducing the economic vulnerability of households, promoting economic growth, alleviating poverty and improving the quality of peoples' lives. Financial inclusion is a process that ensures ease of access and ability to use formal financial system by all members of an economy. Due to the high connectedness between financial and social exclusion, inclusive financial systems have been identified to transcend individual gains to enhance societal benefits. It's attributes of enhancing appropriate financial decision -making and capability of financial users are expected to complement the investment redistribution role of financial service providers. Thus, an all-inclusive financial system enhances efficiency and welfare by establishing a, functional‟ equilibrium between the financial and real sectors of an economy. In a wider context, financial inclusion contributes to economic growth through value creation of small entrepreneurship and businesses, positive spillovers, improvements inhuman development indicators, (health, nutrition, and education), reduction in inequality and poverty, (Chriten, 2011).

4. RESEARCH METHODOLOGY

This study adopted the descriptive survey design. The target population of the study was the SMEs operating within the Nairobi North Tax District and are legally registered by KRA as taxpayers on the category of SMEs. Nairobi North District has a total of 1840 SMEs, (KRA, 2014). All the 1840 SMEs formed the target population for the study. Questionnaires were the main research instruments that were used in this study. This research used primary sources of data obtained from respondents by use of questionnaires. The questionnaire contained both open ended and closed ended questions and was self-administered through a drop-and-pick method. Data was analyzed using quantitative techniques. Inferential statistics will include Analysis of Variance, (ANOVA), Pearson correlation and Multi linear regression analysis. These was used to establish the relationship among the study variables and to test the formulated hypotheses at 95% confidence level and 5% level of significance.

5. FINDINGS

The study sought to determine the effect of overall reduced cost of banking on SMEs operating within the Nairobi North Tax District and is legally registered by KRA as taxpayers on the category of SMEs as the first objective of the study. The respondents were presented with statements with factors that affect the overall cost of banking as presented in Table 1. The table presents that respondents agreed Agency banking has reduced the cost of transactions with a mean of 2.51 and standard deviation of 1.371. The respondents also agreed that customers are affected by the distance of the branch of the bank they serve and the proximity of the bank from the agent's establishment in terms of travel cost with a mean of 2.32 and standard deviation of 1.196. The respondents were undecided on the statement that SMEs are charged higher rates on transactions than larger firms with a mean of 3.92 and standard deviation of 0.468. The respondents disagreed with a mean of 4.22 and standard deviation of 0.842 that lack of reputation and contact in the banking market makes agency banking less attractive making it more expensive to borrow however the respondents agreed that agency banking translates to overall reduced costs with a mean of 1.80 and standard deviation of 1.156. An average mean of 2.95 indicates that respondents agreed on most of the statements in regards to the overall cost of banking and a standard deviation of 1.01 indicates that the variation in responses was minimal.

The findings are similar to (Ombutura & Mugambi, 2013) who was of the opinion Agencies are more accessible for illiterates and the very poor who might feel intimidated in branches with low amount of money they would wish to withdraw and deposit. Though most people are not aware of these costs, to some extent they do influence the customer decision to use agency banking or not to use the agency banking hence influences the performance and growth of agency banking.

Table 1 Overall Cost of Banking

Statement	Mean	Standard Deviation
Agency banking has reduced cost of transactions	2.51	1.371
Customers are affected by the distance of the branch of the bank they serve and the proximity of the bank from the agents establishment in terms of travel costs	2.32	1.196
SMEs are charged higher rates on transactions than larger firms	3.92	.468
Lack of reputation and contact in the banking market makes agency banking less attractive	4.22	.842
Agency banking translates to overall reduced costs	1.80	1.156
Average	2.95	1.01

Based on the study findings, there is a positive strong relationship between overall cost of banking and the financial inclusion as shown by the Pearson's co-efficient correlation which is significant as indicated by the P-value at 95% level of confidence. In addition, the study also concluded that reduction in costs affected significantly the financial inclusion of SMEs. Respondents agreed that Agency banking has reduced the cost of transactions. The conclusion is consistent with World Bank (2014b) report on Mozambique where it was noted that advancing financial inclusion levels in Mozambique would also require a more competitive and diverse financial sector to make products affordable to larger parts of the population.

6. CONCLUSION

Findings from the study indicate that overall cost of banking is positively and greatly related to financial inclusion of SMEs. This implies that this factor is very significant (since the p-values< 0.05) and therefore need to be considered as a strategy in increasing the financial inclusion of SME's. Regression results indicated that the relationship between overall cost of banking and financial inclusion is positive. The relationship between the predictor variable and financial inclusion is significant at 5% level of significance.

7. RECOMMENDATIONS

In regards to the current study, the findings of the study indicate that reduced costs improves usage of agency banking. Lower transaction costs are incurred since client/entrepreneurs would visit agents any time without incurring any additional cost like transport cost to bank their cash. Therefore, more agent banking outlets should be opened to offer more services to increase the geographical coverage of different banks. The commercial Banks should establish training centers where employees working in agent banks and entrepreneurs come for short courses in order to improve their performances. The government should encourage use of agency banking through reducing the serving costs for the providers which would make costs more affordable for the customers. This is very critical to enhance and promote financial inclusion among the unbanked, (Omwansa & Waema, 2014).

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