THE EFFECT OF AGENCY BANKING ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM SIZED ENTERPRISES IN NAIROBI COUNTY

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Abstract

Agency banking model has been found to be very successful in propelling the performance of commercial banks in many developing countries that includes Kenya, Colombia, Brazil, Peru and India but the effect on SMEs businesses remain unknown. Bank agents have been found to 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. Studies in Kenya and around the world have focused on determining the effect of agent banking model on financial performance of commercial banks with no attention being paid to effect of agency banking on financial performance of end users who include small and medium sized enterprises. Driven by this knowledge gap, this study sought to determine the effect of use of agency banking services on financial performance of SMEs in Nairobi County. The study used descriptive study design and extracted five years data from year 2009 to 2013 relating to SMEs financial performance as measured by return on assets and amount transacted through agency banking model. The study sample was identified through stratified random sampling technique where SMEs in Nairobi County were classified into their industry and a sample of 120 SMEs using agency banking services selected. Multiple regression analysis was used to show the relationship between dependent and independent variables. The study found that agency banking has led to financial inclusion of small SMEs and has significant positive weak relationship with financial performance of SMEs in Nairobi County. The adoption of agency banking by SMEs and mainly the medium sized enterprises is still low with the transaction costs of transacting through agent bank being high and the perceived risk of transacting through agent banks. The study recommends reduction of transaction costs through agent banks, banks to allow agents to be able to convert cheques into cash, deal with foreign currency exchange among other services and banks to develop strategies to manage the perceived risks of using agency banking which will include end user education and formulation of regulations to ensure highest security measures for the firms.

Key Words: *Agency Banking, Financial Performance, Small and Medium Sized Enterprises, Financial Performance*

Background of Study

The introduction of agency banking in Kenya was meant to facilitate and enhance access to affordable financial services especially to the poor, low-income households and micro and small enterprises, which largely comprise those segments which are un-served and under-served by the financial sector. This was based on the promise that financial access leads to widespread economic development; and hence the development of the financial sector is seen as essential to the realisation of Vision 2030. In fact, the realization of vision 2030 goals hinges upon widening financial access and use of affordable financial services and products by a majority of the Kenyan population (FSD, 2013). The need to embrace innovative changes in financial sector aimed at enhancing financial access, led to publication of agency banking guidelines published by the CBK in 2010, where effective December 2010, financial institutions were allowed, under strict conditions to operate agencies through third parties (Cracknell, 2012). This was further motivated by agency banking model widespread and success over the past decade in Latin America and Brazil. Latin America is the only region with the strongest development towards agency banking with Brazil being the most developed market where agency banking has significantly lead to developments in the financial system structure (Bloodgood, 2010).

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). The financial performance of Kenya's SMEs sector firms, even though mostly not documented, has been hampered by low demand, poor infrastructure, lack of human capital, and lack of appropriate financial products. The amendment of Kenya's finance Act in 2009 to facilitate use of third parties by banks to provide banking services marked the introduction of agency banking in Kenya. Consequently, the CBK issued the agent banking guidelines to regulate agency banking. Since its introduction, agency banking has enabled bank customer to access the banking services within the comfort of their neighbours-hood. Agency banking has dramatically reduced the cost of delivering financial services to unreached people. The cost reduction creates the opportunity to significantly increase the share of the population with access to formal finance and, in particular, in rural areas where many people in developing countries live (Lyman, Pickens, and Porteous, 2008). Development of agency banking is expected to lead to improved financial performance of SMEs sector business. According to Ivantury (2006), agency banking can benefit the users of the service by lowering transaction cost, longer opening hours, shorter lines than in branches, more accessible for illiterates and the very poor who might feel intimidated in branches, to the agency; increased sales from additional foot-traffic, differentiation from other businesses, reputation from affiliation with well-known financial institutions, additional revenue from commissions and incentives, increased customers base and market share by banks, increased coverage with low-cost solutions in areas with potentially less number and volume of transactions, increased revenue from additional investments, interest and fee income, improved indirect branch productivity by reducing congestion (Ivantury, 2006).

Agency banking, which is a part of branchless banking model, can play a key part in delivering better, safer and more reliable financial services than those usually available to the unreached (Musau, 2013). Lyman et al (2006) indicate that protecting client funds is priority for many financial regulators under agency banking, as loss of funds can have serious consequences for customers, as well as for public confidence in financial systems. Therefore, agency banking needs to be regulated and banks should comply with prudential rules created to ensure systematic stability and depositor protection. Countries with the most prominent branchless banking models have taken varied approaches to handling and protecting client's funds. Hence, although agency banking is a bank based model, it has different regulatory treatment from the branch banking (Collins 2010).

Agency banking establishment in Kenya has not been without challenges with one of the biggest challenge being the establishment and the effectiveness of the agent network. Agents are the touch- points where the subscribers of the service can get money into and out of the system. In instances where a subscriber arrives at an agent with the need to withdraw a large amount it does happen that the agent do not have enough cash to satisfy the cash-out request. This leads to frustration and is one of the reasons why take-up of these systems is slower than what is expected. This problem is often approached in a way where the system keeps track of the actual cash available in the drawer of each agent in order to guide subscribers where they can withdraw big amounts (Musau, 2013).

Research Problem

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). Agency banking has proved to be a cost saving network as compared to the banking branches and keen to take the agency banking advantages, Kenyan banks have embarked on an aggressive entry into this segment. Agency banking model has been very successful in propelling the performance of commercial banks in many developing countries that includes Kenya, Colombia, Brazil, Peru and India but the effect on SMEs businesses remain unknown. In addition, bank agents have been found to 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 (Veniard, & Melinda, 2010). However, what remains unknown is the effect of agency banking on the main users of agency banking services who includes the SMEs.

Various studies have been done in Kenya on agency banking. 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 also 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 had been conducted to determine the effect agency banking on the users of the services who mainly include the SMEs.

It is not known whether the development of agency banking model in Kenya has led to increased financial performance of small businesses, majority of which fall under SMEs sector. This study therefore sought to bridge the gap in literature by assessing the contribution of agency banking on financial performance of SMEs sector businesses in Nairobi County. It sought to answer the question; what is the effect of agency banking on financial performance of SMEs sector firms in Nairobi County?

Objective of the Study

To determine the effect of agency banking on financial performance of small and medium sized enterprises in Nairobi County

Theoretical Review

The study was guided by theories developed over the years on the subject of the study, which presents set of arguments that required further research. These theories include the bank-led theory, Porter theory of competitive advantage and agency theory.

Bank-led Theory

The theory was brought forward by Lyman, Ivatury and Staschen (2006) and is based on the argument that, a licensed financial institution delivers financial services through a retail agent. The theory supports agency banking model by stating that the work of a bank is developing financial products and services, but distributes them through retail agents who handle all or most customer interaction (Lyman, et al, 2006). The bank is the ultimate provider of financial services and is the institution in which customers maintain accounts. Retail agents have face-to-face interaction with customers and perform cash in/ cash-out functions, much as a branch-based teller would take deposits and process withdrawals (Owens, 2006). In some countries, retail agents also handle all account opening procedures and, in some cases, even identify and service loan customers. Virtually any outlet that handles cash and is located near customers could potentially serve as a retail agent. Whatever the establishment, each retail agent is outfitted to communicate electronically with the bank for which it is working. The equipment may be a mobile phone or an electronic point-of-sale (POS) terminal that reads cards.

Bank-led model offers a distinct alternative to conventional branch-based banking in that customer conducts financial transactions at a whole range of retail agents instead of at bank branches or through bank employees (Lyman, et al, 2006). This model promises the potential to substantially increase the financial services outreach by using a different delivery channel (retailers/ mobile phones), a different trade partner (Chain Store) having experience and target market distinct from traditional banks, and may be significantly cheaper than the bank based alternatives. In this model customer account relationship rests with the bank and agency banking leads to increased financial outreach which in turn leads to increased performance of SMEs sector businesses (Tomaskova, 2010). In relevance to the study, it can be concluded that to commercial banks offering agency banking, adoption of the agency banking model is just meant to create their distribution channels as opposed to enhancing financial access and wellbeing of SMEs. This implies that, the financial performance of banks that have adopted agency banking could have improved as a result while that of users of the service remaining unchanged.

Porter Theory of Competitive Advantage

The theory was proposed by porter (1985) and states that and businesses should pursue policies that create high quality goods that sell at high prices in the market. Competitive advantage theory stresses on maximizing economies of scales in goods and services that garner premium prices. Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources, such as high grade over or inexpensive powers, or access to highly trained and skilled personnel human resource (Porter, 1990).

In reference to agency banking, adoption of agency banking model by commercial banks and use of the agency banking facilities by SMEs leads to competitive advantage on the firms. Failure to adopt agency banking by the firms implies that some banks will be better off than the others and hence, for the banks to remain relevant, they ought to adopt agency banking model. The banking industry in Kenya has been characterized by stiff competition between the banks with each competing for market leadership. It is advantageous for any bank when it is a market leader because it has significant financial and perpetual benefits which then lead to consistently and focus on quality; it also enhances the use of the full range of banking tools to solidify performance and leads to ownership of core benefits with a balance of national and economic massages. The secret of gaining competitive advantage among the banking service provider is by building themselves as brand and target to retain brand loyalty and enhance brand presence where it is limited and this has been achieved by the use of agents banking in the unbanked locations in Kenya. Branding helps banks to distinguish and differentiate themselves from competitors (Musau, 2013). Use of agency banking facilities by SMEs will give them competitive advantage from reduced transaction costs, convenience in banking and increased performance.

Agency Theory

The theory was proposed by Jensen and Meckling (1986) and view commercial bank as the principle and correspondent bank as the agent whereby problems arise owing to misunderstanding or incongruence of their interest. Agency theory will occur where the bank agency fail to observe the agency regulations as issued by the central bank and hence putting the interest of the bank at risk since it is the one required to ensure that the agents comply with the regulations. Generally, according to agency theory, intermediation places financial institutions (banks and their agents) as intermediating between money and the market or households. Resource (money) allocation based on perfect and complete markets is hindered by frictions such as transaction costs and asymmetric information (Aduda et al, 2013).

Agency theory analyzes the relationships between a business firm's owners and its managers who, under law, are agents for the owners. The key issues in agency theory centre upon whether adequate market mechanisms exist that compel managers to act in ways that maximize the utility of a firm's owners where ownership and control are separated. Under the terms of agency theory, a principal (P) passes on authority to an agent (A) to conduct transactions and make decisions on behalf of the principal in an effort to maximize P's utility preferences. Agency problems emerge because contracts between principals and their agents are neither costless written nor costless enforced. Managers, as agents of a firm's shareholders, may not devote their best efforts toward managing the firm unless those efforts are consonant with maximizing their own welfare. In the commercial banking industry, ownership is becoming increasingly diversified among individual and institutional shareholders, and the dominance of individual stockholders in the industry appears, on the whole, to be decreasing. These trends may exacerbate agency problems in the banking industry if these problems truly (Williamson, 1981).

In relation to agency banking and SMEs, agent banks are retail establishments contracted by the banks and authorized by the central banks to render services for banks by ensuring that all security measures are in place and the SMEs transactions and information is secure. Since agency banking offer services including savings deposits, credit withdrawals, bill payments, new account openings, money transfers, insurance, and government benefits including pension receipts to provide access to SMEs, the agents my obtain the information and use it in a way that puts the interest of commercial banks and SMEs at risk hence creating an agency problem.

Research Design

The study employed a descriptive research design. A descriptive study is used to describe or define, often by creating a profile of a group of problems, people or events, through the collection of data and tabulation of the frequencies on research variables or their interaction

(Cooper and Schindler, 2003). Descriptive research design was chosen because it enabled the researcher to generalize the findings to a large population. The descriptive research approach was also appropriate due to the fact it allowed analysis and determination of relationship between dependent and independent variables.

Target Population

The study target population was all the SMEs in Nairobi County. The target population is the specific population about which information is desired. According to Kothari (2005), a population is a well defined set of people, services, elements, event, and group of things or households that are being investigated. Total of 4,560 SMEs were registered in Nairobi County by the ministry of industrialization in 2011. These include 2,500 in the manufacturing sector, 1,500 in the general trading and 560 of them in the service industry (Government of Kenya, 2012).

Sampling Frame and Techniques

Sampling is the process of selecting a number of individuals for a study in such a way that the individuals represent the larger group from which they were selected (Creswell, 1994). Stratified random sampling was used in identifying the respondents. The researcher classified the SMEs into Manufacturing, trading and service strata, after which purposive sampling was used to select respondents who were using agency banking. The SMEs owners or senior personnel were the respondents since they could provide the reliable information. Total of 120 SMEs using agency banking from all sectors in Nairobi County were studied.

Data Collection

The study collected data using questionnaires which had both open and closed ended questions. The close ended questions were considered appropriate since they conserved time and they are easy to fill as well as easy to analyse as they are in an immediate usable form. Open ended questions were used as they encourage the respondent to give in-depth response without feeling held back. The use of questionnaires was justified because of cost effective and gave adequate time to the respondent to fill in and return to the researcher (Mugenda & Mugenda, 2003). The questionnaire had two sections, section one on background data and section two on use of agency banking. SME financial performance was obtained from the secondary data sources which included the annual financial statements. Five years financial performance data was collected from year 2009 to 2013.

Data Validity and Reliability

The accuracy of data collected largely depended on the data collection instruments in terms of validity and reliability (Mugenda and Mugenda 2003). Validity is the degree to which results obtained from the analysis of data actually represents the phenomenon understanding. Reliability on the other hand refers to a measure of the degree to which research instruments yield consistent results (Mugenda and Mugenda 2003). In this study, data reliability was ensured by pre-testing the questionnaire with a selected sample. After analysis a Cronbach alpha of 0.5 % and above was acceptable. The pre-testing assisted to enhancement of clarity of the questionnaire.

Data Analysis

Data collected was analysed using descriptive statistics. The descriptive statistical tools such as frequencies, percentages, mean and standard deviation helped the researcher to describe the data. In addition inferential statistics also used to determine the accuracy of the models developed. Multiple Regression analysis was used to determine the relationship between agency banking and SMEs firms' financial performance. SPSS version 21 was used to analyze the data which was then presented into tables, charts, graphs and figures.

Analytical Model

Regression analysis model was used to show the relationship between agency banking and financial performance of SMEs sector firms. The model took the form of;

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon}$$

Whereby,

Y= SME financial performance as measured by Return on Capital

X_1= Agency banking use as measured by total cash withdrawals and deposits done through bank agents

X_2= Size of SME as measured by number of employees

X_3= Quality of labour used by SMEs as measured by employees education and years of experience

$\beta 1$, $\beta 2$ and $\beta 3$ are coefficients of determination

ε is the error term which will be assumed to be zero in this study

Test of Significance

The study used ANOVA and z tests to determine the level of significant of the variables on the dependent variable at 95% level of significance. Coefficient of correlation (R) was used to determine the magnitude of the relationship between the dependent and independent variables. Coefficient of determination (R^2) was also used to show the percentage for which each independent variable and all independent variables combined were explaining the change in the dependent variable.

Regression Analysis

This part sought to achieve the main objective of the study by obtaining the mathematical relationship between independent and dependent variable which include agency banking services, size of SMEs and quality of labour being used by the firms. The effect of each of the independent variables on dependent variable was also obtained.

Agency banking has a weak positive relationship with financial performance as shown by R of 0.3128. However, the relationship is not very strong since agency banking can only account for 9.78% of changes in financial performance as shown by R square. The findings are consistent to that by Mwangi (2011) agency banking positively affected financial performance of commercial banks.

Model Summary, Financial Performance and Agency banking

R	R Square	Adjusted R Square	Std. Error of the Estimate
0.3128	0.0978	0.0891	0.0710

The ANOVA results in table 4.6 below shows that the positive relationship between agency banking and financial performance is significant since the p value is 0.0012 which is less than the 5% significance level.

Model ANOVA, Financial Performance and Agency banking

	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.0563	1	0.0563	11.1690	0.0012
Residual	0.5188	103	0.0050		
Total	0.5751	104			

The coefficients of the model developed showing the relationship between financial performance and agency banking is shown in table 4.7 below. As it can be seen from the table, the coefficients are significant since p value of 0 and 0.0012 are less than 5% significance level.

Model Coefficients, Financial Performance and Agency banking

	Unstandardized Coefficients	Std. Error	t	Sig.
Constant	0.3068	0.0331	1.2722	0.0000
Agency Banking	0.0539	0.0032	0.3420	0.0012

Regression between Financial Performance and SME Size

SMEs size has a weak positive effect on financial performance as shown by R of 0.1112 and R square of 0.0124. Perry et al (2007) also found a positive correlation between SMEs size and profitability due to economies of scale with small firms having lower financial performance.

Model Summary, Financial Performance and SME Size

R	R Square	Adjusted R Square	Std. Error of the Estimate
0.1112	0.0124	0.0128	0.0074

ANOVA of the model between financial performance and size of SMEs. The model is significant at 95% confidence level since the p value is 0.0258.

Model ANOVA, Financial Performance and SME Size

	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.0071	1	0.0071	1.2900	0.0258
Residual	0.5679	103	0.0055		
Total	0.5751	104			

The model coefficients are shown in table 4.10 below.

Model Coefficients, Financial Performance and SME Size

	Unstandardized Coefficients	Std. Error	t	Sig.
Constant	0.2058	0.0096	21.4433	0.0000
Size of SME	0.0011	0.0001	-0.1136	0.0026

Regression between Financial Performance and Quality of labour used by SMEs

SMEs quality of labour has a positive and strong relationship with financial performance as shown by R of 0.7402 and R square of 0.5479.

Model Summary, Financial Performance and Quality of Labour

R	R Square	Adjusted R Square	Std. Error
0.7402	0.5479	0.5101	0.0740

The positive relationship between financial performance and quality of labour was found to be significant at 95% confidence level with a p value of 0.0153.

Model ANOVA, Financial Performance and Quality of labour used by SMEs

	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.0113	1	0.0113	2.0652	0.0153
Residual	0.5638	103	0.0055		
Total	0.5751	104			

The model coefficients obtained are presented in table 4.13 below.

Model Coefficients Financial Performance and Quality of labour used by SMEs

	Coefficients	Std. Error	t	Sig.
Constant	0.2097	0.0105	19.9110	0.0000
Quality of Labour	0.0101	0.0008	0.0144	0.0154

Analytical Model

This sought to determine the objective of the study which was to determine the effect of agency banking on financial performance of small and medium sized enterprises in Nairobi County. Size of SMEs and quality of labour were included in the model as control variables. The data was analyzed by multiple regression method. The results obtained show a strong and positive relationship between dependent variables and independent variables with an R of 0.9459 and R square of 0.9351. Hence, the model developed could explain 89% of changes in financial performance as measured by return on assets.

Overall Model Coefficient

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.9459	0.8948	0.9351	0.0708

The model was observed to significant with a p value of 0.0048 which is less than 5% significant level. The ANOVA results are shown in table 4.15 below.

Overall Model ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.0688	3	0.0229	4.5763	0.0048
Residual	0.5062	101	0.0050		
Total	0.5750	104			

The model coefficients developed are shown in table 4.16 below. All the variables were found to be significant at 5% significant level. The model developed is $Y = 0.3223 + 0.1229X_1 + 0.01X_2 + 0.0762X_3$ where Y is financial performance as measured by return on assets, X_1 is agency banking, X_2 is size of SMEs and X_3 is the quality of labour. The positive effect of agency banking is in line with that of Amaral and Quintin (2006) who found that capital constrained SMEs will scale down their capacity, and operate below the efficient scale of production. Secondly, high cost of capital or limited outside financing will force SMEs firms to substitute (low-skill) labour for physical capital.

Overall Model Coefficients

	Unstandardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.
Constant	0.3223	0.0354		0.0969	0.0000
Agency Banking	0.1229	0.0000	0.3300	0.1114	0.0024
Size of SME	0.0100	0.0001	0.0149	0.5807	0.0117
Quality of Labour	0.0762	0.0008	0.0101	0.0070	0.0099

Summary of the Findings

This research sought to evaluate the effect of agency banking on financial performance of small and medium sized enterprises in Nairobi County. A descriptive research design was adopted in collection and analysis of data as to achieve the research objective where 120 SMEs in Nairobi County were studied. To ensure reliability of information provided, 73% of the respondents were SME managers, 17% SMEs owners and 10% (10) middle level management staff. The study used size of SMEs and quality of labour in the study as control variables. The data was analyzed by multiple regression method.

The study found that agency banking had weak but positive relationship with financial performance as with coefficient of correlation of 0.3128. The coefficient of determination of 0.0978 implied that agency banking could only account for 9.78% of changes in financial performance. The positive relationship between agency banking and financial performance was significant since the p value was 0.0012 which is less than the 5% significance level. These findings were consistent with those of Mwangi (2011) who found that agency banking positively affected financial performance of commercial banks. Size of the SMEs was found to have weak but positive effect on financial performance with coefficient of correlation of 0.1112 and coefficient of determination of 0.0124. The relationship was significant at 95% confidence level with a p value is 0.0258. The findings agree with those of Perry et al (2007) who also found a positive correlation between SMEs size and profitability due to economies of scale with small firms having lower financial performance.

SMEs quality of labour was also found to have positive and strong relationship with financial performance with a coefficient of correlation of 0.7402 and coefficient of determination of 0.5479. The positive relationship between financial performance and quality of labour was found to be significant at 95% confidence level with a p value of 0.0153. The study found a strong positive relationship between dependent and independent variables with a coefficient of correlation of 0.9459 and coefficient of determination of 0.89. Hence, the model developed could explain 89% of changes in financial performance as measured by return on assets. The model was found to be significant with a p value of 0.0048 which is less than 5% significant level. The model developed was $Y = 0.3223 + 0.1229X_1 + 0.01X_2 + 0.0762X_3$ where Y is financial performance as measured by return on assets, X_1 is agency banking, X_2 is size of SMEs and X_3 is the quality of labour. These findings were similar to those of Amaral and Quintin (2006) who found that capital constrained SMEs scaled down their capacity, and operated below the efficient scale of production. Further, high cost of capital or limited outside financing forced SMEs to substitute (low-skill) labour for physical capital.

Cash deposits was found to be the major use of agency banking by 64.76% of SMEs, 24% using agency banking or bill payments, loan repayment 4.76%, 3.81% and 1.9% for balance enquiry. This indicated low adoption of agency banking services by SMEs with reasons for the same quoted as high costs of transactions via agent banks, security issues and poor perception of agency banking model by end users. However, agency banking model was found to enhance financial inclusion for small SMEs who previously indicated challenges to accessing financial services. 61.9% of the studied SMEs had been using agency banking for over 3 years, 21.9% years 1 to 2 while 16.19% had been using agency banking for less than one year. Studied SMEs were found to have less experienced and qualified employees. 95% of SMEs employees were found to have experience of less than 6 years with 57% of the employees having high school education and less. This was explained by the fact that most SMEs studied (using agency banking) were small and hence unable to pay and attract very experienced staffs. The main challenges facing SMEs were found to be inadequate financing as highlighted by 35.29% of the respondents followed by poor perception (27.15%), competition from big firms (25.34%) and inability to access export markets (12.22%).

Conclusions

From the study findings, the study concludes that agency banking lead to financial inclusion of small SMEs and has significant positive weak relationship with financial performance of SMEs in Nairobi County. This is as a result of increase in financial access to business and consequently leading to increased SMEs firms' financial performance due to reduced transaction cost and liquidity advantage. Lack of financial access limits the size of firms, as well as their growth, profits, activations and their scope of operations. Also, as a result of lower transaction costs and a transaction-driven revenue model (rather than a float-driven model), agent banking systems are most cost effective for transactional accounts with low balances and frequent transactions which is the case for firms.

The study also concludes that adoption of agency banking by SMEs and mainly the medium sized enterprises is still low with the transaction costs of transacting through agent bank being high and the perceived risk of transacting through agent banks. This is because use of agency banking entails use of technology in SMEs banking which ensures that firms are able to access financial products and services more conveniently, reliably and affordably. Reaching SMEs in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch 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 service.

The further concludes that the main uses of agency banks include cash deposit and payment of bills with no SMEs indicating withdrawals of cash via the model. Also, size of SMEs and quality of labour employed has positive and weak relationship with financial performance of SMEs in Nairobi County. However, when agency banking is combined with size of SMEs and quality of labour, a strong positive relationship with financial performance was established.

Policy Recommendations

There is low adoption of agency banking by SMEs. However, Agency banking has enabled cost saving and accessibility of financial services by SMEs and mostly small firms. SMEs are able to access the basic banking services which include cash deposit or receiving of payments and payment of bills. However, despite these achievements of agency banking, cost of transactions and security are the most critical factors limiting adoption of agency banking. There exists a positive relationship between adoption of agency banking and SMEs financial performance.

First, the study recommends that commercial banks should develop strategies to manage the perceived risks of using agency banking which will include end user education and formulation of regulations to ensure highest security measures for the firms. The support staff working under agency banking model should also be trained and measures to deal with client confidential information enhanced.

The government through Central Bank of Kenya should also formulate regulations aimed at managing risks of agency banking so as to facilitate adoption of agency banking services by SMEs and hence promote their financial performance for economic growth. In addition, the banks should continuously adopt new technology to ensure that their systems remain secure and hence increased agency perception by end users.

The costs of agent banking services are high where even cash deposits are charged transaction costs. The Central Bank of Kenya should develop policies to regularize the charges of agency banking model. The costs should be set being lower than the banking hall charges. The transaction costs should be lower since the fixed costs in agency banking model are minimal.

Banks should also allow agents to be more financially inclusive than just offering the cash transfer services, agents should be able to convert cheques into cash, deal with foreign currency exchange among other services. The selection criteria of agents should be restructured so as to favour heavy cash operations in order to meet the demand of handling large cash transactions by SMEs.

Limitations to the study

The researcher encountered quite a number of challenges related to the research and most particularly during the process of data collection. Some respondents were biased while giving information due to reasons such as privacy and busy schedules at their places of work.

Due to inadequate resources, the researcher conducted this research under constraints of finances and therefore collected data from SMEs located in Nairobi County. SMEs in Nairobi County were sampled and assumed to be representative of all SMEs in Kenya. Due to resources constraints, the researcher could not have been able to travel to other parts of the country to collect data.

The research was constrained by time factor and therefore longitudinal methods of study could not be used. The researcher could also not have able to confirm the data provided and where there were inconsistencies, the same clarified with the respondents.

Further, the sample size used was small and hence could not have been representative and enable generalizations since 100 SMEs cannot be representative of all SMEs in Nairobi County. Small sample size has low statistical power and reduced chance of detecting a true effect.

Recommendations for Further Research

Arising from this study, the following directions for future research in finance are as follows: First, this study focused on SMEs located in Nairobi and therefore, generalizations cannot adequately extend to other SMEs outside Nairobi. Future research should therefore focus on all SME in Kenya.

The study recommends another study to be done in other areas of Kenya to establish whether the findings can be generalized. SMEs from other Counties or countries can be studied to determine the consistency of the results on SMEs in different localities. This will ensure that more accurate results are obtained

The agency sector in Kenya is also very wide and comprises of other agencies including mobile money agents which differ in their way of management and have different settings and regulations all together, hence a further study should be carried out to investigate the factors which influence other agencies and their effect on financial performance of SMEs.

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