

## The effects of alternative banking channels on profitability of commercial banks- case of the Co-operative bank of Kenya

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### -----ABSTRACT-----

*This study sought to establish the effects of alternative banking channels on profitability of commercial banks in Kenya. This research espoused a qualitative research methodology that involved the collection and analysis of statistical data from primary and secondary sources. For purposes of this study, data for a period of four years was analyzed, examined and compared to manifest the rapport between alternative banking channels and profitability of commercial banks. The primary data was sourced from the books of accounts of the Co-operative bank of Kenya and questionnaires distributed to staff, customers and bank agents to justify that the use of alternative banking channels really impacts on profitability of commercial partners. The branches were selected depending on their incorporation of ABCs services in their operation. Out of a population of 120, a sample of 80 was targeted. The branches of cooperative bank of Kenya were unit of analysis whereas the employees, agents and customers of the same bank were used as unit of inquiry. A multi-stage sampling technique was used to identify the branches and respondents of the questionnaires. In the first stage geographical region was identified based on the regions in which branches are demarcated. In the second stage branches which were actively using ABCs were identified while in the last stage branches which had a percentage threshold of 90% and above were selected. The primary data collected through questionnaires were to ensure correctness and consistency before using SPSS statistical tool for analysis and presentation. The study found out that banks should try to make sure that ABCs' services are designed in the way that customers can easily use them; they are faster which will lead to high subscription rate for previously unbanked segment; banks must also use modern technology in their ABCs services as these will make them user friendly, faster and convenient; Customers should subscribe to ABCs services since they will save them time, money as well as enable them to perform several transactions at their comfort anywhere and at any time.*

**KEY WORDS:** *Alternative Banking Channels (ABCs), M-Banking, Jumbo link, E-Banking.*

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## I. INTRODUCTION

### 1.1 Background of the study

Alternative banking delivery channels are new conduits and techniques for providing banking services directly to customers. Recent economic crisis along with increasing market intricacy has placed extraordinary pressure on financial institutions. The demand for a digital lifestyle in addition to the technological insurrection it brings to residences and places of work, as well as the momentous demographic shift and a regulatory structure, are subjecting the finance sector to significant challenges in a time of rigorous market uncertainty. Conversely, times like this present opportunities for commercial banks to embrace change resulting in innovation over the delivery of financial services (Kohali & Sheleg, 2011).

In an endeavour to optimize services and diminish costs, banks are regularly migrating towards a 24-7 service where clients are enjoying the superior sense of independence that this creates. Accessibility is the central pillar as customers demand instant access to deposits, loans and status of their account. In an effort to drive even superior differentiation from the competition, financial service organizations are currently exploring alternative banking channels. The global banking industry has been revolutionized over the past three decades by an onslaught of latest technologies in addition to an extensive change in the rules governing the application of this technology (Saxena, 2010). Therefore, many banks have begun adapting their delivery channels and shifting from frontal individual service to direct sales and marketing through email, phone and other electronic transactions. The broad understanding is that this generates value both for the bank and its customers (Valluri, 2012).

Since banking services are commonly similar between the institutions, the approach must guarantee that each channel is shrewdly positioned to optimize its contribution to the bank's differentiation from the competition. Technology has revolutionized the way financial institutions conduct business. Mobile and wireless markets are the fastest growing markets in the world. Banks are now competing with telecommunication firms to provide money transfer services for example Safaricom's M-Pesa service provides services such as deposits, withdrawals and even loan facilities.

These are services that were hitherto previously performed mainly by banks (Ian, 2009). This has been achieved due to the fact that there is now a wide acceptance of mobile phones as a cost effective delivery channel of bank services. The acknowledgement that there is a deeper mobile phone penetration than banks and also the realization that it is not just enough to provide services to the customer but convenience is also becoming a major factor. Mobile banking enables customers to access bank services through their mobile phones anywhere anytime and also allows for services such as balance checks, utility payments, purchase of airtime and money transfers be accessed even beyond normal banking hours (Dzaja, 2007).

Banks also contract agents through agency banking to provide services to customers in hard-to-reach and geographically detached areas. A bank's agent can be an individual or sole proprietorship, a limited liability company, a partnership, society, Trust, public entities, state corporation or a Savings and Credit Co-operative Society (SACCO). Each of these has its own unique requirements that must be fulfilled so as to qualify to operate as an agent for the bank (Ramirez & Richardson, 1988).

One of the main challenges to offering financial services to the underprivileged through branches in addition to other bank-based delivery channels is the high costs involved in these conventional banking methods. The cost to the financial service providers to serve a poor client with a small balance in addition to conducting small transactions is just too great to make such accounts viable. In addition, when financial service providers do not have branches that are close to the customer, the client is less likely to use and transact with their service (Porteous, 2006).

The use of agents therefore diminishes transaction costs as well as addressing the lack of inducements or capacity to institute formal branches in definite areas (Porteous, 2005). Regulation allowing agent banking enables for sufficient business enticements for both agents and financial institutions to amplify outreach by delivering financial services via a network of agents (Melzer, 2006).

## **1.2 Statement of the Problem**

Commercial banks in Kenya have embraced alternative banking channels which represent a shift in delivery of banking and financial services since the alternative banking have become synonymous with commercial banks in Kenya. What remains unclear is how these new methods of delivering financial services affect the profitability of commercial banks. Alternative banking channels have undoubtedly transformed the way financial services are delivered. The convenience of banking services derived from alternative channels is well recognized.

The speed of service delivery is another major factor associated with alternative banking channels. More and more people are resorting to alternative banking channels for various reasons and the systems serve customers well. Whether these channels have led to high profitability for commercial banks or not is the subject of this study. As a result, the study endeavors to delve deep into the ways in which these channels affect the profitability of commercial banks.

## **1.3 Objectives**

The study on effects of alternative banking channels on profitability of commercial banks in Kenya is aimed at evaluating the various parameters that influence the profitability of commercial banks. Therefore, the study will analyze the definite effects of alternative banking channels on profitability of commercial banks in Kenya with special reference to the Co-operative bank of Kenya. The objectives of the study are;

### **1.3.1 General Objective**

To examine effects of alternative banking channels on profitability of commercial banks in Kenya with the Co-operative bank of Kenya as a point of reference.

### **1.3.2 Specific Objectives**

- i. To ascertain the effect of revenue from alternative banking channels on profitability of commercial banks in Kenya.
- ii. To assess the effect of convenience of alternative banking channels on profitability of commercial banks in Kenya.
- iii. To evaluate the various ways in which cost influences alternative banking channels on profitability of commercial banks in Kenya.

### **1.4 Research Questions**

The following research questions will guide the study;

- i. What impact does revenue of alternative banking channels exert on the profitability of commercial banks?
- ii. How does convenience of access to banking services through alternative banking channels influence the profitability of commercial banks?
- iii. How does the reduced cost of service delivery derived from alternative banking channels influence the profitability of commercial banks?

### **1.5 Justifications**

This study is important to researchers, bankers, academicians and policy makers. To the researcher, it will enlighten the him/her and offer a practical opportunity to discover what the effects of alternative banking channels on profitability of commercial banks entail. **To the banker, it will** provide information on the impact of alternative banking channels on profitability and enable them to understand how ABCs operate and the benefits to their organizations in general. The findings of this study could illuminate future developments in the banking sector. To the policy makers, the study is important because the findings, deductions and suggestions of this study will inform policy making in terms of ground situations and decision making.

### **1.6 Scope**

The study will be confined to the Cooperative Banks' Head Offices in Nairobi and the respective branches. The focus of the study was the effects of alternative banking channels on profitability of commercial banks in Kenya with closer detail paid to C-operative bank of Kenya. The study will be carried out during the months of April 2013 and June 2013.

### **1.7 Limitations**

#### **1.7.1 Nature of Work**

Nature of work is a factor which may limit the range and effectiveness of this study. The staff of the organizations are expected to perform their duties as usual and sometimes their workload may be overwhelming, this may make it hard for the employees to give due attention to the researchers' demands and thus may not cooperate fully. The researcher has to be flexible so as to gain quality and adequate information without compromising on the work of the employees and make the employees of the organization not feel burdened by the research to get the best of the research work.

#### **1.7.2 Time Constraints**

Time is a very sensitive issue at the place of work which affects the process of research in the sense that, matters concerning alternative banking channels are broad and cannot be exhausted in the stipulated time. Therefore, time is anticipated to be a hindrance in conducting the study. Nevertheless, the researcher did make considerable effort to achieve maximum results in the stipulated time.

#### **1.7.3 Confidentiality**

Most of the information concerning financial performance in detail of commercial banks is confidential and the public may not be privy to it. As the researcher I was however able to get all the required information due to the fact that I am staff in the bank.

### **1.8 Conceptual Framework**

Five variables were isolated as the potential variables that influence the use of alternative banking channels by the customers as explained in the literature review. The variables were cost, revenue and convenience, subscription rate and speed. These were considered as independent variables. All the independent variables were expected to have positive effects on the profitability of the bank that was taken as the dependent variable. This was taken as percentage target for each branch under the study. Technology influences the cost, convenience, speed and the revenues from the ABCs services. Technology was therefore taken as an intervening variable.

Revenue is a very significant indicator of the effect of alternative channels on the profitability of commercial banks. Due to the novel avenues of revenue, the commercial banks have achieved higher profits from the alternative banking channels. The convenience associated with alternative banking channels in accessing and delivery of financial services is noteworthy in the profitability of commercial banks. Alternative banking channels have made it so easy to access financial services thus motivating more clients to subscribe and use of banking services. The enhanced access and subscription to commercial banks has led to higher profitability.

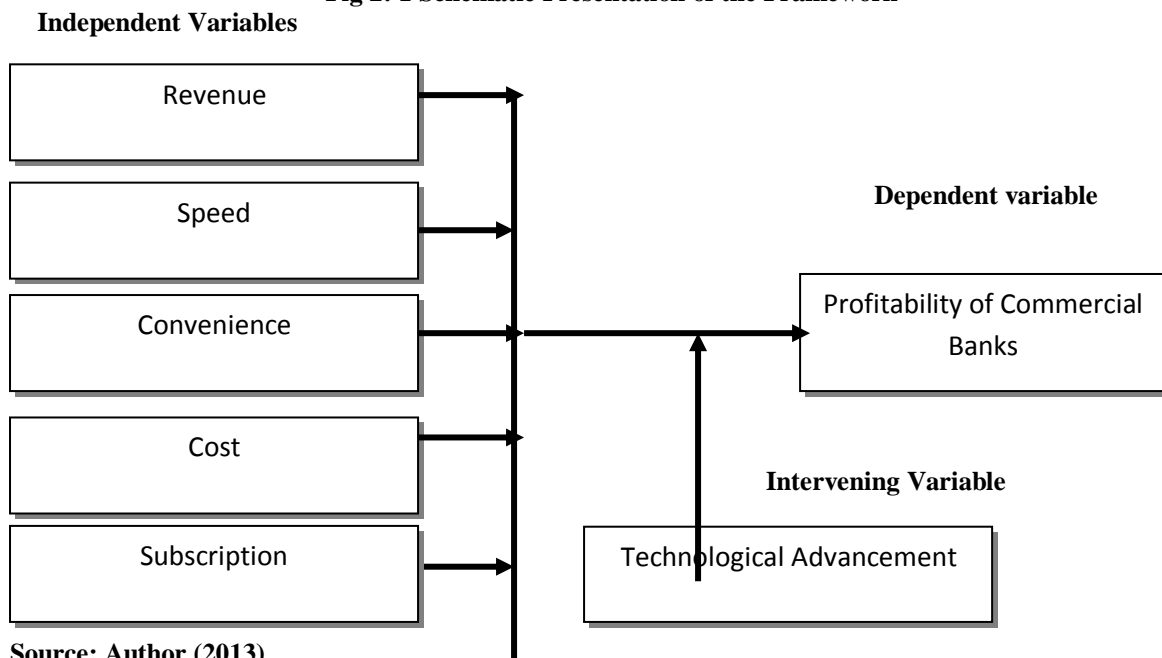
One very significant feature of alternative banking channels is the reduced costs associated with banking. This is achieved by the reduction of staff through self-service channels since the number of staff is drastically reduced. The diminished cost impacts on the profitability of banks since it erases the avenues of expenditure and creates fresh fields of revenue.

**1.9 Summary**

Alternative banking channels have a direct effect on the profitability of commercial banks because various studies indicate that these channels enhance the profitability of commercial banks. An evaluation of published literature on the subject points to a strong connection between alternative banking channels and the profitability of commercial banks. Through reduced costs, convenience, high subscription rate, higher speed of transactions and increased streams of revenue, alternative banking channels enhance the profitability of commercial banks.

The ease with which banking services can be accessed has led to higher subscription rates that boost turnover. Convenience has made it possible for the unbanked segment to subscribe to commercial banks which has in turn increased the revenue earned by commercial banks. Moreover, the higher speed of transactions means more transactions at a time leading to higher profits. Finally, the reduced costs due to low manpower required to facilitate the delivery of banking services has enhanced the profitability of commercial banks.

**Fig 2: 1 Schematic Presentation of the Framework**



Source: Author (2013)

**II. CORRELATION ANALYSIS**

The main objective of the study was to find out the relationship between ABC and profitability of a bank. Different variables that influence customer to opt for ABC services were singled out so as to find out the relationship they have with profitability. The variables were Revenue from the services, cost of the services and convenience of the services. In order to get this relationship, Pearson (r) Correlation coefficient was determined using SPSS software. This was done so as to ascertain the strength and direction between independent variables (Cost, Convenient, and Revenue) with dependent variable (Profitability)

**Table 2.0: Pearson Correlations**

		CONVENIENCE	REVENUE	COST	Commission
CONVENIENCE	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	80			
REVENUE	Pearson Correlation	.719**	1		
	Sig. (2-tailed)	.000			
	N	80	80		
COST	Pearson Correlation	.812**	.749**	1	
	Sig. (2-tailed)	.000	.000		
	N	80	80	80	
Commission	Pearson Correlation	.885**	.859**	.883**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	80	80	80	80

Table 4.9 provides the correlation coefficients for the independent variables against dependent variables.

The percent commission (Profits) has a significant strong positive relationship with convenience ( $r=.885^{**}$ ,  $P<0.01$ ) with 95.0% confidence level as shown in table 2.0. This means that increase in convenience of using ABC services will result to more customers finding it easy to work with banks therefore increasing the commission target of the banks hence increasing profit of the bank thereof. This finding is in agreement with (Kroner, 2011) who stated that the influx of alternative banking channels has increased the convenience at which customers can access banking services.

The percent commission (Profits) has a significant strong positive relationship with revenue of ABCs ( $r=.859^{**}$ ,  $P<0.01$ ) as shown in table 2.0. This means that many people find ABC services to be simple and convenient thereby increase the subscription of different bank products thereby increasing the commission target of the banks and increasing profit of the bank as the number of transactions increase. This finding is in agreement with (Ian, 2009) who stated that alternative banking channels have resulted in increased profits by commercial banks specifically because of the new streams of revenue.

The percent commission (Profits) has a significant strong positive relationship with cost of ABCs transactions ( $r=.883^{**}$ ,  $P<0.01$ ) as shown in table 2.0. This means that decrease in cost of using ABC services will result to many customers finding it easier to use this service and at the same time any cost related with financial transaction or other bank services are reduced drastically through use of ABCs thereby making many customers to prefer using this services instead of bank counters increasing the commission target of the banks and increasing profit of the bank as the number of transactions increase. The banks also find it cost effective to employ use of ABC as many of the work is done by machines and agents. This finding is in agreement with (Ivatury& Pickens, 2006).

### 5.3 Conclusions

The objective of the research paper was to find the effect of ABCs on the profitability of a bank. Three research questions were derived from the specific objectives and their answers are as follows:

- (a) What impact does the revenue of alternative banking channels exert on the profitability of commercial banks?

It was deduced that bank profits are significantly statistically dependent on the revenue of ABCs. The test statistics showed that the relation was significant  $0.859^{**}$ ,  $P<0.01$ . This indicates that when the revenue generated as a result of using ABCs increases the profit of the bank increases in the same direction

- (b) How does convenience of access to banking services through alternative banking channels influence the profitability of commercial banks?

Convenience was taken as ease to which customers can access banking service, the speed at which the services are rendered and the simplicity of using the ABCs. It was observed that when Convenience of accessing banking services through ABCs increases, the profit of the bank increases in the same direction

- (c) How does the reduced cost of service delivery derived from alternative banking channels influence the profitability of commercial banks?  
Cost was taken as fee that bank charges during using of ABCs services by the customers and other expenditures that customer may incur during accessing banking services. Likewise it was observed that when cost of accessing banking services through ABCs increases the profit of the bank increases in the same direction
- (d) Does technology have impact on banks profit in relation to ABCs  
ABCs are based on modern and any improvement in technological advancement has an impact on ABCs which in turn affects profitability of a bank. From the correlation analysis there is a notable increase in correlation coefficient of all the independent variables under the study.

### 5.5 Suggestions for further research

The study limited itself on effects of ABCs on the profitability of a bank. However there is need for research to be done in the following areas:

- Challenges facing banks in implementing ABCs in their operations
- How safe are ABCs to customers

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