MicroSave India Focus Note 24

Making Business Correspondence Work in India

Carolina Laureti & Brett Hudson Matthews

Background

As of 2007, 46% of the adult population in India lack a savings account.[1] The Business Correspondent (BC) initiative in India is a regulator-led effort to address the lack of convenient savings services for low income people. It was launched in January 2006,[2] but subsequent performance has disappointed. Many stakeholders now concur that the BC model must be transformed from its current status as a "social add-on" into a sustainable business.[3]

This India Focus Note summarises the findings of a 3-month project by *MicroSave* India to clarify prospects for a sound business model for BC operators under current regulations. The study analyses three diverse cases that involve differing institutional arrangements and strategies for sustainability.

Eko – Eko Aspire Foundation and Eko India Financial Services Pvt. Ltd. were formed in September 2007 to extend banking facilities in unbanked areas via mobile phone-based technology and a network of retail outlets called customer service points (CSPs). As BC to the State Bank of India, Eko is now piloting a 'No Frills' savings account[4] in Uttam Nagar, a suburb in west Delhi.[5]

Prayas – Prayas JAC is a Delhi-based NGO that started its BC operations towards the end of 2007, partnering with ICICI Bank in two of its branches in Jahangir Puri and Bawana. Prayas offers the 'APNA' no frills bank accounts using a point-of-sale (POS) device, a dedicated smart card for each client, and biometric authentication. The technology is supported by FINO.

Drishtee – Through its network of village-based service delivery agents or 'kiosks', Drishtee Development and Communication Ltd. is delivering its own microcredit product. It has also partnered with two banks (SBI and HDFC) to deliver 'No Frills' savings accounts. Its POS-based technology is provided by A Little World (ALW).

Methodology

The study firstly estimates, for the three business models, costs and revenues of the current BC business ("reference" period) consisting in delivering no frills bank accounts with only cash withdrawal/deposit facility. It then analyses the behavior of costs and revenues under various scale-up scenarios in an effort to identify general principles for BCs that wish to achieve sustainability.

All parties (BCs, banks and technology companies) must make money. An important assumption in modeling was that the current offer prices of banks and technology companies do not change during scale up. Since the focus is on sustainability of the BCs, these prices can then be treated as a proxy for the sustainability of other players in the model.

Revenue: Transactions or Balances?

Bank commissions are the primary source of revenue for BCs. They are usually based on the number of new clients enrolled, the volume of transactions, and client balances. Each BC may also sell a limited number of products other than the 'No Frills' account (for example, recurring deposits or insurance). The table summarises revenue structures for the three cases.

Basis of Commission Payments	**Eko**	**Prayas**	**Drishtee**
Client enrollment (per new client)	Rs.10	Rs.30	Rs.10
Per transaction	none	Rs.1	none
On value of transaction	0.5%	none	0.5%
On balances outstanding (quarterly)	None	2%	None
On active accounts (quarterly)	Rs.40	None	None
Other revenues BC business	Yes	Yes	Yes

Note: Drishtee and Eko then pay commission to their agents and super agents from these revenues

There are two revenue models: one based on the value of transactions and the other based on the value of balances.

- The transaction-based model ties BC earnings directly to work activities performed. A commission of 0.5% on deposits and withdrawals discourages transactions of less than about Rs.150-200. Sadly, recurring deposits of less than Rs.100, which might appeal to poor savers, could bankrupt the BC as the cost of service delivery exceeds the income.
- The balance-based model (Prayas—ICICI) ties BC earnings to the overall balance/health of their clients' accounts. While this creates incentives for BCs to invest in client education, balances may be very small at first even if transactions are frequent. This makes the path to sustainability slower and less predictable.
- Revenues earned by the BCs from their agents (licensing and franchise fees, security deposits etc.) have no material impact on the profitability of the business models studied.
- Client enrollment fees are valuable but supplementary.

[1] Report on Currency and Finance (2006-2008), Reserve Bank of India.
[2] RBI/2005-06/288 (RBI Circular dated January 25, 2006).
[3] As evidenced at the recent policy retreat on BC/BF (CGAP/Access, at the College of Agricultural Banking, Pune) on May 15th, 2009.
[4] 'No frills' accounts are low cost accounts requiring no minimum balance.
[5] The Eko business concept is detailed by Sanjay Bhargava et. al. in 5 *Whitepapers on Financial Inclusion* (posted on the Eko website).

Cost Drivers

The chart presents the 7 cost categories of the models studied.

	Description	E	P	D
1.Fees to agents	Payout to the retail outlets (typically a portion of the commission the BC Company receives from the bank).	✓ +		✓ +
2.Marketing/ promotion	Financial education of customers, promotional materials (sign boards and pamphlets), and call center (for customer queries, grievance and satisfaction).	✓ +		
3.Channel management	Identification and training of agents and service personnel. Monitoring of outlets' on-going performance, client satisfaction and service quality.	✓		✓
4.Processing transaction cost	Opening/closing of accounts, processing of cash withdrawal/deposit. Transport and insurance costs to handle cash. Cost of balancing the cash in the till.	✓	✓ +	✓
5.Liquidity cost	The opportunity cost of working capital required to meet cash withdrawal needs of the clients.		✓	✓
6.Technology cost	Hardware: front-end and back-end devices, communication hardware. Software: platform's development and maintenance and integration with bank data system (Core Banking System).	✓		
7.Overhead cost	Back office staff, running costs of the offices and depreciation of capital investments.	✓	✓	✓

E = Eko; P = Prayas; D = Drishtee.
(+) "Plus" identifies the most important cost categories for each case.

The main cost observations are:

- Access to a strong distribution system is critical, as no one can afford to build a dedicated system from scratch: Prayas and Drishtee are levering systems they already developed, while Eko is building a network of *'kirana'* shops in the complementary business of mobile airtime.
- The technology-based 'self-service' model (e.g. in mainstream banking, the ATM) is not yet available. Service personnel are still needed to process transactions in every case. The cost per transaction remains significant.
- In the long term, the most relevant (variable) cost for both Eko and Drishtee is pay-out to their retail agents, typically a share of the commission received from the bank.
- Unlike the other models, Prayas delivers services directly through its staff, who also act as tellers in the NGO's offices. The result is a higher ratio of fixed to variable costs and a longer path to break-even.
- Balance-based models face potentially enormous client education costs to attract substantial savings.

Recommendations for BCs: Crossing the Double Hurdle

BCs and their agents must break even twice – first through sign-ups, and second through converting sign-ups into active users. After agents have signed up everyone they can in their service area, a very different skill-set, time horizon and marketing strategy are needed to hit the second stage of profitability. "A majority of No Frills accounts opened by BCs have remained non-operational. Retaining customers after the initial transactions proves to be a big challenge."[6]

Transaction-based BCs can achieve rapid sustainability by targeting clients who demand larger, one-time transactions like remittances, cheque deposits and time deposits. They must also discourage loss-making transactions like small deposits and withdrawals, and small recurring deposits. If recurring deposit limits are kept high, and time deposits actively marketed, losses from the former can be more than offset through profits in the latter. The willingness and ability of banks to accomplish system integration between their core banking system and the BC is another critical success factor.

Balance-based BCs require a longer investment horizon. Offering a wide range of useful financial products around the no-frills leader should impel a gradual rise in balances over time. Withdrawals and frequent small transactions must be discouraged. Moderately large recurring deposits (>Rs.150) have a major positive impact over time, especially if maturing ones can be retained/rolled over into time deposits.

In both models BCs can hit break-even faster through adding supplementary business lines with quick, profitable pay-back. For BCs with microcredit experience this is a natural add-on, since they have already incurred the cost of setting up and maintaining a viable distribution channel. The agent model can reduce the overall cost of delivery as agents can usually take on and manage more of the lending risks, and may require lower salaries than MFI staff. However, agents' activities are also subject to less direct control. The BC will be dependent on the agents' initiative for the pace of business growth, and dependent on their networks and business performance for portfolio quality.

As volumes increase, banks may increase product complexity and mix transaction- and balance-based incentives in their models. BCs should be careful to master one approach before focusing on the other, as the two approaches have very different institutional, control and marketing implications, and require different skill sets from staff and agents.

Conclusions

This study analyses three of the many experiences in branchless banking in India and attempts to reach general recommendations for making BC models sustainable.

In the long run, the incentives in balance-based models will greatly promote financial inclusion. However, these models are significantly more difficult and costly to manage than transaction-based ones. An evolutionary transition from a transaction-based approach to an integrated approach will be healthy for Indian microfinance.

[6] *Report of the Working Group to Review the Business Correspondent Model*. Reserve Bank of India, Mumbai, Aug. 2009, p. 12.