MicroSave India Focus Note 80

Driving Viability for Banks and Business Correspondents

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Do we need crystal ball gazing to predict if and when business correspondents (BCs) will become profitable (and therefore sustainable)? Perhaps not! Research and empirical evidence[1] from a range of practitioners makes it apparent that stakeholders across the value chain – banks, BCs and agents or customer service points (CSPs) – can become viable, provided certain guiding principles are followed. This calls for banks and BCs to candidly investigate the factors underpinning success in their context, together with mindset change and commitment to operationalise them. This Note highlights the important ingredients that make the business case for banks and BCs stack-up.

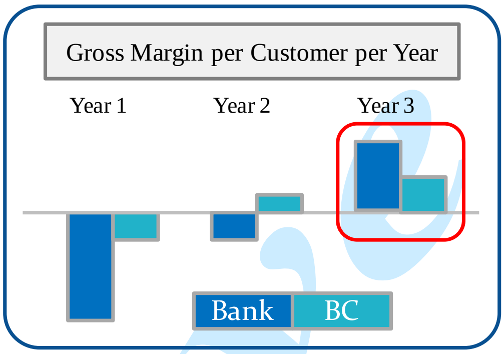
NFA Plus to Meet Customer's Diverse Needs

Financial needs and aspirations of the excluded segment are reasonably broad and not satiated by 'no-frills-savings-account' (NFA) alone.[2] For example, the benefits of regular and periodic savings are well recognised, and often availed through informal means, even though the terms 'recurring deposit' or 'fixed deposit' might be incomprehensible to them. Likewise, they might find insurance complex to comprehend and at times invest in it with a perception that it is a savings product, but the risk protection offered is quite clearly acknowledged. They would be too delighted to have a single integrated account to receive pension (under Social Security Pension), wages (under the Mahatma Gandhi National Rural Employment Guarantee Scheme or MGNREGS) and other benefits, rather than being loaded with two or three different accounts, of which the NFA offers no value-addition and therefore, to no one's surprise, frequently lie dormant.[3]

Unfortunately, customer context and ground reality is often clouded by statistics on dormancy, without enough root-cause analysis. This results in decisions that mar the foundation of viability.

Enable a Basket of Products

Even regular savings accounts are profitable for banks when incremental margins, from a variety of products customers subscribe to, are added to the relatively small float from the basic account. Therefore, expecting NFAs to cover costs and provide sustainability to the business merely from float is far-fetched. Off-take of one (or two) additional products on-top of an NFA (or an MGNREGS or a pension) account, by each customer on an average, can start yielding positive gross margins for



the bank and the BC by the third year of operations, illustrated through the exhibit above for a BC. Wherever banks have taken the lead in enabling BCs to offer a broader portfolio and innovative products like overdraft or micro-insurance, or where State Governments have shared generous commissions out of savings derived from switching over to electronic benefits transfer (EBT), the lead-time to break-even can even be condensed to two years.

This translates into banks enabling BCs (technically and operationally) to offer a basket of five to seven bank-led products. These could include savings, remittance, insurance, credit and EBT, supplemented by products that can easily ride on the same electronic/mobile channel, such as mobile top-up or rail/bus tickets. Together these provide customers enough choice and opportunity to subscribe to multiple products, depending upon their context, needs and affordability.

Recognise Value as an Alternate Channel

Branch based banking is extremely expensive, and therefore not an optimal option for serving customers at the bottom-of-the-pyramid is an obvious opportunity. However BC's acceptance as a low-cost alternate channel is yet to gain recognition, partly due to 'unscrupulous' BCs who have muddied the waters for genuine, long-term players.

While revenue will take time to reach meaningful levels, the cost side of the equation cannot be ignored. A rupee saved is a rupee earned. More importantly, outreach through BCs seems the only credible alternative on the horizon, therefore serious efforts to relook at the financials and to make adjustments for them to work is in order. The following exhibit demonstrates a direct cost saving opportunity for banks by leveraging BC as an alternate channel.

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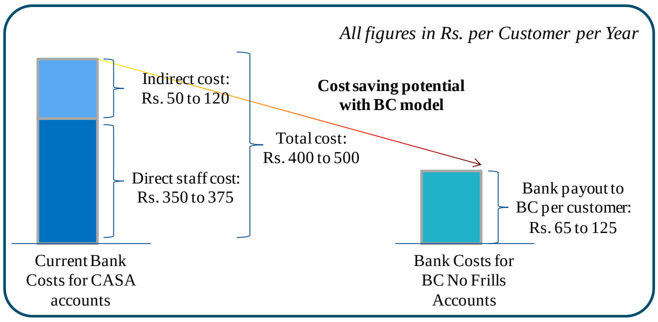
[1] See *MicroSave* India Focus Note 68: "SBI Tatkal - From Cash to Cash Cow"
[2] See *MicroSave* India Focus Note 65: "Successful Banking Correspondents Need a Compelling Product Mix"
[3] See *MicroSave* India Focus Note 62: "Revival: Responding to High Dormancy Levels in No Frills Accounts"



Legitimacy of Partnership

A BC is truly an extension of the bank. It is no different from how banks expand and operate their own network, except that it has taken the form of an outsourced arrangement. It is a new approach, therefore needing time, efforts and experience to stabilise and become seamless. The current exclusive focus on quantity of targets achieved, ignoring quality in this endeavour, are not allowing enough opportunity for the bank-BC partnership to flourish and to grant the much-warranted legitimacy to this relationship. Furthermore, it is essential that the relationship moves from BCs as vendors of a service that must be sourced as cheaply as possible, to that of BCs as partners with whom banks can work to deliver quality financial services.

Change of Perspective

A change of perspective is desirable on two counts. Firstly, the focus needs to shift from compliance with RBI directives on accounts opened to viewing them as another customer segment that can be profitably served through the BCs. Secondly banks need to recognise BCs as an alternate channel to service the wider low-income segment (not just unbanked), that otherwise is unviable to service through traditional banking and is usually denied access, convenience and quality service.

Once banks recognise BCs as their extended arms and better mutual trust is established, efforts to ensure win-win in the true spirit of partnership will gain ground. This will inevitably lead to segmenting customers, offering them suitable products addressing their needs, servicing them through the most efficient channels and investing in awareness building and targeted marketing.

Options such as gradual migration of a set of existing bank customers to the BC channel can then be explored, giving banks opportunity to decongest branches and to provide improved service to their preferred customers. BCs will, in-turn, get an assured incremental revenue stream to motivate them to offer superior service levels and to address customer expectations better.

Push the Envelope

Cash is king: benefits and remittances home are welcomed by all. No wonder EBT and remittances are witnessing substantial consumer-pull driven demand. They are anchor products offering a great opportunity for unbanked customers to experience banking, and therefore have the potential to accelerate financial inclusion.

Banks needs to create facilitating environments for remittance to scale and sustain, including:

1. Charging reasonable sums according to customer's willingness to pay, which, based on ample evidence,[4] is reasonably elastic, given few and expensive alternatives available.
2. Attractive commission structure that is (a) compelling for BCs and agents/CSPs to continue their businesses and drive momentum and (b) a hindrance for malpractices such as over-charging customers.[5]
3. Integration of BCs with core banking systems (CBS) to institute seamlessness.

EBT needs buy-in and commitment from government departments. The early adopters have started witnessing the benefits like improvements in transparency and lower leakage. Some like the Uttar Pradesh Forest Corporation have adopted EBT for payments to tendu-leaf collectors and are very encouraged by the results.[6] However, it is still a long-journey for most States. EBT makes considerable business sense for banks and they need to play catalyst in getting the late-adopting government departments on-board.

Gear-up for Competition

Policy makers are pushing convergence of EBT and the Financial Inclusion Plan[7], along with opening up of competition amongst BCs within districts, which is much desirable, breaking the silo-ed monopolies that were beginning to form. Competition will help market-forces let the best player win, instead of the current practice of distribution of villages to BCs, akin to land-grab, ignoring merit and performance and putting customers at a disadvantage.

Conclusion

Financial inclusion is not a burden on banks. It is indeed a business opportunity to be tapped. However it requires non-traditional approaches and a paradigm shift in outlook. Multiple consumer businesses (telecom, FMCG, agri) recognised this opportunity early on and now have a well oiled-machinery in place to deliver the services and to harvest the gains. Many of the lessons learned can very well be applied by the banking sector.

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[4] See *MicroSave* India Focus Note 67 "Clients' Willingness to Pay "Reasonable Fee" for BC Services"
[5] See *MicroSave* India Focus Note 71 "Sustainability of BC Network Managers (BCNMs) in India - How are BCNMs Paid?"
[6] See *MicroSave* study on EBT: http://microsave.net/research_paper/finos-electronic-benefit-transfer-system-for-tendu-leaf-collectors-a-study
[7] See Reserve Bank of India (RBI) Circular # 153 on Operational Guidelines on Implementation of EBT and its Convergence with FIP