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Economics of the Business Correspondent Model

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Abstract

This paper studies the business correspondent model by surveying banks and business correspondents. Business correspondents are retail agents engaged by banks for providing banking services at locations other than a bank branch. In such a model, the bank comes to the customer, thereby shifting travel costs and certain transaction costs to the bank. The authors find that among the two predominant models prevailing in Tamil Nadu—the corporate agent model (where the banks appoint a corporate agent who in turn appoints a BC) and the standalone model (where the banks directly appoint a BC)—the standalone model seems to be economically more viable prima facie. They find that a number of factors contribute to the success of a BC such as the selection of a BC by a bank, proximity of the BC to the bank branch; a village with significant population that can be potentially tapped; reliable working of technology instruments; and transparency regarding remuneration of BCs.

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Economics of the Business Correspondent Model

1. Introduction

The need to bring in the lower sections of society into formal, safer credit circles has long been felt in India. The Reserve Bank of India (RBI) has been pursuing its goal of financial inclusion since the 1950s with the building of rural cooperative structures, the popularisation of social banking, the spread of self-help groups (SHGs) in the 1970s, and the rapid expansion of bank branch networks in the most recent decades. While these measures have helped in building a strong banking network across the country, studies show that 40% of the country's population still does not have any access to formal means of credit (Basu and Srivastava, 2005).

To tackle the issue of financial exclusion in India, the RBI spearheaded a financial inclusion campaign. Beginning with the launch of no-frills bank accounts in 2005, it also introduced easier Know Your Customer (KYC) norms and simplified the process of opening bank branches in unbanked and under-banked districts and areas (Subbarao, 2009). However, the constraints of the brick-and-mortar approach soon became apparent. Consequently, in 2006, based on the recommendations of the Internal Group on Credit and Microfinance (RBI, 2005; Bhaskar, 2006), the RBI decided to permit banks to employ business correspondents/facilitators (BC/BF) so that they may serve financial products/services to the low-income segment. The primary responsibility of ensuring financial inclusion has been taken up by the commercial banks, and they have introduced BC models to help forge a closer relationship between the poor people and the organised financial system. However, several studies have shown that in India, the BC model is affected by an improper incentive structure; other studies have shown that the absence of BCs is the primary reason for the failure of the model.

Among the branchless banking models that could serve the needs of the poor and the marginalised, the agent-based models that required business correspondents and business facilitators were identified as having the potential to be most effective (Mas, 2009). Several commercial banks in India introduced the business correspondent (BC) as an intermediary between the bank and its customers in unbanked areas (areas without any formal bank branches).

To supplement the work of the BCs, technology such as point-of-sale (POS) machines, fixed kiosks, mobile phones, and other portable devices were introduced (Rath et al., 2009). These devices require transaction processing capabilities and internal memory storage. Mobile phones with SMS-based transaction processing capabilities are also used in this context. The use of such technology results in certain costs. However, these are mostly fixed costs; the variable costs arising out of each transaction using such technology is quite low.

The BC model in India has been primarily led by banks, but the players in this model are different from those in the traditional banking models. The BC agents range from unemployed youth to *kirana* shop owners, microfinance institutions (MFIs), not-for-profit institutions, and other non-bank-related agents. Technology also plays a vital role; technology is irreplaceable for the success of the model. Several risks—systemic as well as compliance risks—also arise in such a model. There are also risks in business continuity (Dev, 2006). Since the BC is the face of the bank for the client, the acts of the BC have a deep impact on the financial activities of the client. Additionally, since finance is all about exchanging the cash that people need on a daily basis for a promise of value, trust is highly important. The costs faced by the service providers are well known, but the users of the service also face costs—these could be anything from the cost taken to go the place where they can make transactions to the costs faced in queuing up and waiting for the services. Thus, proximity becomes important. Together with all these aspects, there is the regulation to ensure that the users are not exploited.

The model has faced several criticisms and many studies have called the BC model unviable. Accounts that were opened have remained dormant. Since the BCs do not have any incentive structure, they are not motivated to work. In many cases, the BCs have started their own business; therefore, they cut corners and offer poor services. The Banks are worried about losing their reputation as the BCs are the face of the bank to the clients, and they have not done much to publicise their BCs. This makes the clients further doubt the intention of the BCs. Moreover, banks in India allow most BCs to open no-frills accounts only and do not allow them to conduct any credit-related activities.

However, given that a similar model has been highly successful in Brazil, several questions remain. How is the Brazil model superior to the bank-led model in India? What sort of models can succeed in poor areas? How can we translate the BC model into financial inclusion? How can the

BCs' work be incentivised? What about the economies of scope and scale? Which model can be used to effectively channel the credit needs of the poor? This study aims to answer these questions, which form the bases of the study.

The rest of the paper is divided into the following sections. Section 2 reviews the extant literature and section 3 discusses the research questions. Section 4 describes the research methodology and section 5 presents the framework for a BC model. Section 6 analyses the data from the survey of the banks and the BCs. Section 7 concludes the paper with a discussion of a few policy implications.

2. Literature Review

Financial inclusion broadly refers to the provision of formal financial services that are accessible to all. In the case of credit, financial exclusion refers to those individuals or households who are denied credit by the financial system in spite of demand (Dev, 2006). Of the 600,000 habitations in the country, only about 30,000 have a commercial bank branch. Just about 40% of the population across the country has bank accounts (Subbarao, 2009). While households that receive credit from moneylenders are not considered to be financially excluded, financial inclusion is meant to refer to access to institutional credit from formal financial systems.

However, financial services include not only credit but also the provision of other services such as savings, remittances, and insurance. Given the increasing number of migrant labourers working in places far from home, remittances have become the most important financial service that is lacking for a majority of the migrant population. The recent efforts taken by the commercial banks towards financial inclusion have been mostly associated with the opening of bank accounts for individuals who previously did not own one. A broader idea of financial inclusion should focus on increasing the productivity of vulnerable groups and ensuring sustainability in the long run (Subbarao, 2007; Mor and Ananth, 2007). This means that banks should go beyond bank accounts and credit—they need to tap into savings and additional income to reduce risk and to help smoothen consumption, while simultaneously trying to increase asset values. With regard to the level of farmer indebtedness in India, the percentage of farmers indebted to formal sources is 56%; 64% of them are indebted to informal sources of credit (Dev, 2006). The rise of MFIs has ensured that credit in some form is available to the poor, but this has not translated into poverty

alleviation. In many cases, MFIs have exacerbated indebtedness. Financial inclusion, therefore, does not stop at credit. This paper looks at financial inclusion through savings and insurance products and examines the business correspondent (BC) model with the same scope.

Since 2006, starting with the C. Rangarajan committee, all suggestions on financial inclusion were related to reducing the barriers to access of financial services. These barriers have been multi-faceted: from geographic to conditional and price-based barriers; from the non-existence of bank branches, to products failing to meet the needs, to prices and charges levied being very high leading to the self-exclusion of a large section of the population (Dasgupta, 2009).

Commenting on rural bank branches (RBBs), the planning commission report (2009) comments that while banks have opened branches in rural areas, they have not tried to attract customers; these branches have been viewed as liabilities more than assets. There is some truth in saying that the poor have not been serviced because of high fixed and transaction costs. There are two main challenges that banks face in serving the poor. On the one hand, they have to devise a viable revenue model that is consistent with the cash flow needs and the perceptions of value of the poor. On the other hand, they have to minimise the operational burden of managing millions of small-value transactions (Mas and Almazán, 2011). The constraints of the traditional brick-and-mortar approach have been widely acknowledged, and the RBI has permitted banks to employ business correspondents/business facilitators (BC/BF) to conduct business on behalf of the banks. Among the different avenues of banking available, branchless banking or the use of BCs has the lowest cost from the bank's perspective. According to Mas (2009), the average cost per transaction in India via the BC is the lowest at INR 4.50 per transaction; the cost of a transaction at an ATM is INR 18, and at a bank branch, it is INR 45. Regulated financial institutions such as commercial and state banks already exist in India, and they are experienced in managing financial services and handling money. However, it is difficult to establish banks in all areas. To extend financial services to the poor, it is essential for banks to keep the fixed costs low while trying to establish Customer Service Points (CSPs) to cater to the lower-income clients. Thus, the BC model is critical in the Indian context.

This alternative delivery channel is often referred to as "branchless banking." While there are many models of branchless banking, almost all the models depend on technology-based solutions and non-banking retail agents working for the bank. This paper studies the business correspondent

model, where intermediaries (called business correspondents or banking agents) undertake cash transactions on behalf of the bank; these intermediaries are largely mobile. In such a model, the bank comes to the customer, thereby shifting travel costs and certain transaction costs to the bank. The onus to reduce costs is now on the banks. A mix of rural and urban deposits has strategic importance to banks, as rural India can help banks increase their low-cost current account/savings account deposits, thereby spreading the business risks (Raj, 2011). In countries such as Kenya and the Philippines, the comparable model is non-bank-led; in India, the BC model is wholly bank-led (Lozano, 2010).

In a bank-led model, the bank usually manages the balance sheet while the BC company and its sub-agents open the accounts, perform cash-in/cash-out transactions, and interact with the clients. A BC company is connected to agents, who in turn, connect clients to banks. Most of the time, these clients do not have direct access to banks. The model usually accommodates a technology partner/vendor who provides cards, undertakes data storage, authentication, and processing of transactions, and ensures the security of transactions (RBI et al., 2009). The bank has to pay a fee for service provision to the technology vendor as well as the BC. According to regulations, all the revenues obtained from the services are to be collected by the bank. The technology vendors, BCs, and CSPs are not permitted to charge fees from the clients for the services rendered. The bank's revenue may come from the extension of various services—accounts, savings, credit, and payments. This model helps banks to decongest their branches; they can now tailor products for their high-end customers; and they have the opportunity to develop business in new locations.

A branchless banking network has certain cost advantages. It has multiple nodes of delivery and lower costs in terms of transport and time. Banks usually have a minimum balance rule that deters low-income customers; the products offered under the BC model usually do away with this rule in order to extend reach to a wider clientele. In the branchless banking models currently operational in other countries (such as Kenya, Brazil, Columbia, and the Philippines) and in India as well, the pricing structure has a pay-as-you-go model as opposed to the fixed monthly charges that are applicable at banks. Since the main aim has been to lower the barriers to adoption, there is no registration charge or a monthly charge. Further, there is no minimum balance requirement. Instead, the model uses transaction-/use- dependent pricing. That is, customers are charged only when they avail a service. The charge either is a fixed amount (where the size of the transaction

does not matter) or is set as a percentage of the transaction, in which case the size of the transaction does matter.

The model also serves as a platform for product innovation. Financial institutions would be able to profitably package transactions into savings, loans, and insurance products to those at the bottom of the pyramid (Mas, 2010). Most banks avoid selling such products to this section of the population, especially when the individuals are located in areas far from the bank branches, due to the high costs of collecting/distributing small amounts. The BC model provides a viable alternative delivery channel through the use of agents that carry out such work on behalf of the bank. In Brazil, for example, customers of Caixa Econômica Federal can open and deposit money in a current account, make person-to-person transfers, and get loans using simple bankcards and card readers at over 12,000 lottery outlets, supermarkets, and even butcher shops (Porteous, 2006). It makes more sense for banks to venture into business with established retail chains and franchises. This way, banks can contract with and network through a collection of outlets. Moreover, all retail chains have their distribution network through which the banks can transport cash—either from those outlets with excess cash or to those needing liquidity. The retail head can act as a network manager, ensuring efficiency and negotiating risks.

Nonetheless, banks will continue to have a role in ensuring financial inclusion. The BC agents and sub-agents are still required to go somewhere to deposit the excess cash or to bring back cash in case they fall short. In the new agent-based banking ecosystem, the agents handle last-mile delivery; however, banks still need to be at the heart of the operations and networks, managing transactions in real time. However, this has not happened in India. The banks' response to BC activities has been quite slow, which has limited the expansion and sustainability of the model (Laureti, 2009). As far as BCs are concerned, conducting cash transactions helps them earn the transaction fees; a BC company can use under-utilised staff to generate revenue. The BC company communicates electronically with the bank for which it is working. All financial transactions are conducted by the BC or its sub-agents. An electronic record of the transaction is routed directly from the BC to the bank or is handled by a payment processing agent or technology vendor that settles the transaction between the accounts (Lyman et al., 2006). Banks will aggressively target the poor as a market only if they find ways to serve these customers profitably. Since poor people do not have much money, often live in sparsely populated areas, and rarely have documented

credit histories, banks have found these potential clients to be of little interest and too costly (Ivatury, 2006). To make a network viable, it is imperative that banks develop models that keep per-customer fixed costs minimal and try to reduce unit transaction costs. It is essential to develop inexpensive delivery channels and low-cost means of handling transactions. This can be done by leveraging existing retail networks and infrastructure and by partnering with a technology vendor for equipment such as POS machines, cards, or mobile phones. In a branchless network, banks do not have to spend on salaries; instead, they just have to compensate their agents and retail outlets with a commission.

In a bank branch, customer transactions produce net costs for the bank; in agent-based models, the costs per transaction are low enough to yield positive net revenues for the bank with each transaction. Therefore, an essential requirement for addressing the needs of the poor sections of the population is to move towards a transaction-based model so that profits can be generated from customers with a negligible average balance if a minimum number of transactions is ensured each month (Mas, 2009). Mas recommended remuneration for the agent based on a commission per transaction that has a fixed part (that remains the same regardless of the value of transactions) and a variable part (that is expressed either as a percentage or as stepped increases depending on the value of the transactions). The commission could be higher for deposits than for withdrawals because the transaction cost for withdrawals is higher, and it gives agent an incentive to bring in new business (Mas and Siedek, 2008).

In Brazil, the number of bank accounts that were opened doubled between 2000 and 2008, and 50% of all the accounts that were opened through the BCs are active. The Brazilian banking correspondent model is driven by retailers. The services are provided by the retailers using PoS devices, and financial transactions occur in real or near-real time. The BCs in Brazil focus mainly on transaction and payment services such as government benefits, pension, and utility payments. However, it is not possible to fully replicate this model due to demographic differences; further, the model is driven by remittances and bill payments. South Africa also follows a banking correspondent model, where the Mzansi account acts as the no-frills account and is integrated with a mobile phone banking network (Citi Foundation). The clients of this service have a few pre-defined transactional needs. The transactions could be remote transactions such as money transactions to people living in a different geographic area, payments from government, payments

from other people, or payments for certain services. The other kind of transactions are proximity transactions, which are either cash-in transactions or cash-out transactions that involve conversion of physical cash to electronic money and vice versa. However, the clients also need other financial services in the form of financial products. In India, the RBI has advised that the banks should, at a minimum, offer a savings and overdraft account, a remittance product, Kisan/general credit card, and entrepreneurial credit.

While talking about products for the poor, the planning commission report (2009) brought out the importance of those products that help reduce vulnerability; these include avenues for savings, remittances, insurance, and pension needs. The prime reason for people remaining in poverty is the lack of savings, contingency planning, and risk mitigation. As a result, in times of a disease or crop failure, with almost non-existent savings in the form of liquid cash, the poor have had to resort to takings loans from MFIs and money lenders, who charge interest rates ranging from 24% to as much as 100%.

Demand deposits do not require a steady income flow but help to store excess cash when available and to cover any unexpected expenditures when needed. Demand deposits have flexibility, which allows poor households to "maximize their intermediation by being able to transact in any sum, no matter how small, at any time" (Collins et al., 2009: 181). It acts as a savings device that commits the poor to save with regularity over a period of time, though it needs a structure that ensures discipline in making regular deposits and prevents daily temptation of using the liquidity for consumption. Contractual savings products can also be offered. As opposed to demand deposits, contractual savings set a period after which the amount can be withdrawn. The purpose of such prodicts is not to have an emergency reserve but to accumulate funds for increasing their asset value or encouraging entrepreneurial activity. Wage for livelihood is more important than credit for self-employment among the poor, but it is important to ensure that credit earns income (Dasgupta, 2009). A study by CGAP found that of all the products offered under branchless banking in various countries, medium-term savings is the cheapest when compared to analogous products offered by banks. CGAP's study also revealed that on average, branchless banking is 19% cheaper for its clients; for money transfers, it is 54% cheaper than informal options (McKay and Pickens, 2010)

The poor have many informal means to save—they save by leaving cash at home or by joining

savings clubs. Many also save in non-financial means by purchasing jewellery and other valuables, equipment, land, or farm animals. While saving cash at home is convenient, it is vulnerable to theft. Most such forms of savings, however, cannot be used in emergencies or to mitigate risk.

Savings can either be compulsory savings and voluntary savings (Laureti, 2009). While MFIs have opted for compulsory savings to help the poor manage and save their money, it is important to provide them with opportunities for voluntary savings such as demand deposits (which help in times of emergencies) and contractual savings products (that help them accrue significant amounts of money over a long period of time). Similarly, the poor have indicated a need for insurance products for contingencies. Therefore, developing financial products tailored for the poor is the need of the hour.

Poor clients borrow from multiple sources at the same time (Gokhale, 2009). These loans are primarily taken for consumption purposes; once the loan amount is exhausted, there is an urgent need for another loan. However, the availability of a lump sum in a savings account or in recurring or demand deposits can help bridge the need for multiple high-interest loans. Poor households have clear financial needs and have intense financial lives (Collins eta l., 2009). Their multiple-loan borrowing habits point to the time preference of the poor.

Murdoch and Rutherford (2003) wrote that the provider of any financial services for the poor should remember two fundamental aspects: flexibility and convenience. Flexibility refers to the time and value with respect to the savings, deposits, or credit repayments made, while convenience is the opportunity to make financial transactions such as loan repayments, deposits, and withdrawals frequently and close to home at low costs (Rutherford and Morduch, 2003).

If a middle-class individual in an urban area decides to keep aside 5% of his/her income for future use, banks provide multiple options for this cash—recurring deposits, time deposits, and other savings options. Such options make sense to these individuals because they have a steady source and level of income. However, such options do not apply to poor households because they are paid in cash; in order to access modern banking, they would need to convert this cash to electronic money, which would then need to be converted to cash again because his/her environment does not support electronic cash. Such a process is time consuming and expensive; therefore, the poor do not approach a bank. Moreover, the income received is irregular and unpredictable; therefore

they cannot have a rigid rule such as keeping aside 5% of the income. Financial planning for such people is a daily process; they need to plan as to what to do with their money every day. They also require good bridges between physical and electronic cash. Therefore, to serve such clients, the banks would be required to place withdrawal and deposit points nearby, both physically and culturally, which provide avenues or immediate and frequent financial transactions.

Initial experiments with the BC model did not meet with the success that was expected. When it was begun in 2006, the product that was initially offered was mainly the no-frills account, which allowed only withdrawals and deposits. One of the primary reasons for the poor take-up of the model was the mismatch between the products offered and the products demanded. Remittances and cheque clearance services were not offered; therefore, most of the accounts that were opened have remained dormant. This led to low usage and losses for the BCs (Laureti, 2009). On the business front, one particular BC may work with only one bank in one area; however, in another area, it may work with another bank. The BC is not allowed to directly charge fees from the clients for transactions; however, the bank is obliged to pay its BC a commission or fees for the services rendered. The bank is required to settle the transactions by the end of the day or in 24 hours.[1]

Mas (2009) identified the most important factor for the sustainability of the model to be the financial incentive for the parties involved. In a brief sketch of a CSP-dependent model, Mas emphasised the importance of proximity in the scalable and efficient provision of financial services. As observed in Kenya, from a supply side perspective, there is no business case for banks to build branches everywhere; neighbourhood stores can be used by the poor to conduct basic financial transactions. On the demand side, the poor have voiced a need to transfer value within family and business networks; in Kenya, the response has been in the form of mobile transactions, which are becoming as common as the use of mobiles for communication (Mas, 2010).

A BC model can base its revenue on either transactions or account balances. However, because of the nature of the customers, account balances are often low and are insufficient to generate enough revenues. Therefore, banks usually go for a transaction-based model. Transactions either

[1] RBI Circular dated 22 March 2006 (RBI/2005-06/331) and RBI Circular dated 24 April 2008 (RBI/2007-08/295).

are free or involve a fee—a flat fee or a percentage of the transaction value (McKay and Pickens, 2010). The pricing of the transaction depends on the services it is offered on and other factors such as the frequency of service and the client profile. However, it has been found that percentage pricing is cheaper for low-cost transactions and gets costlier as the transaction value increases (when compared to flat pricing). The CGAP study reveals that the smaller the transaction value, the cheaper branchless banking is compared to formal banks—for clients as well as banks.

For the banks and the technology vendor, the revenue is wholly dependent on the volume of transactions for which the customers are charged a commission. To ensure profits, the stakeholders must focus on a high volume of transactions. Most e-money accounts are a 'payment' service, which denies interest payment and deposit insurance for such accounts. However, once the e-money or money deposited via an agent is put in a 100% prudentially-regulated institution, this money is as much at risk as cash in a bank (Tarazi and Ehrbeck, 2011). This money already provides the option of safe storage; it can also be used for interest-bearing savings. This way, the low-income customers can earn returns on their capital.

Even though it was started in India in 2008, the BC network has not spread efficiently, leading to issues with regard to the sustainability of the model. The number of dormant accounts is very high, leading to an unviable business case. Agents/ BCs handling cash have added operational risks. The risks of irregular accounting, fraud, and misappropriation worry the regulators. The BCs are losing money and do not find incentives to participate. One of the biggest risks is operational risk: when a customer makes a transaction and receives a receipt for it, there is a risk that the transaction has not been communicated to the bank. Similarly, when an agent performs a cash-out transaction, he/she bears the risk that the bank might not reimburse him/her for the payment. There is also an operational risk and a liquidity risk. To manage liquidity, the BC must be able to balance cash turnovers, which depend on factors such as access to the his/her bank account and the time taken to process a transaction.

With regard to the regulatory aspect, there are a range of cross-country experiences that testify to the achievement of a balance between financial inclusion and financial stability through a facilitating regulatory framework, especially relative to consumer protection and reputational risk mitigation in various countries. Some pioneering countries are:

- Brazil, where new regulations were attempted to achieve universal access by enabling

partnerships between banks and third-party agents. Brazil was an early leader in agent banking through the large-scale introduction of banking correspondents to distribute welfare grants to unbanked Brazilians. The oversight is focused on the financial institution, with the central bank getting access to all data related to the agents while attempting to also give the financial institution enough freedom to articulate the relationship with the agents on their own terms.

- Kenya and the Philippines, where central banks had a key role in supporting mobile phone payment schemes and allowed regulatory space to mobile phone operators. In Kenya, the e-money transfer service (M-PESA) offered by the mobile network operator Safaricom has achieved impressive progress.
- The Philippines launched the first successful mobile payment service in a developing country in 2004. Once market innovation and learning satisfied the needs of regulators and mobile operators, regulations were created and implemented to provide legal certainty and create a level playing field to allow new players.
- Bolivia and Uganda, where it was demonstrated that taking micro-deposits can flourish in a regulated financial system with timely and appropriate policies. Regulators incorporated non-profit innovators into the formal system by creating legal paths towards a license. New laws specially designed for previously unregulated NGOs were passed, whereby they could retain their non-profit status and still be allowed to collect deposits and offer extra financial services.
- Indonesia, where it was proved how public-owned financial institutions could become the driving force behind economic development in rural areas. The government-owned development bank, Bank Rakyat Indonesia (BRI), which specialises in microfinance, is the biggest provider of rural financial services in Indonesia. Even when the Indonesian banking system collapsed during the Asian financial crisis, BRI's micro- banking division remained relatively profitable.

The lesson to be learned from the examples of these countries is that prudential regulation has an important role to play in ensuring that the initiatives taken to provide basic financial services do not themselves become a source of risk or fraud. Prudential regulations need to ensure the soundness of financial institutions providing basic financial services to the excluded on the one hand; they need to put in place robust consumer protection guidelines on the other. Such

regulations would bolster public confidence in the various initiatives taken to ensure greater financial inclusion. If the regulations are to foster financial inclusion, they need to be commensurate with risks. Hence, while understanding the experiences of other countries in terms of regulations as well as the model is important, the regulations would need to focus on the consumer as they are at the bottom of the pyramid and are mostly illiterate.

3. Research Questions

a) How can we translate the business correspondent (BC) model into an effective model of financial inclusion?
b) Why do banks go in for the BC model?
c) What is the economics of a BC? What is his/her profile? Is there potential for more revenue? How is this possible?

4. Methodology

The study involved extensive surveys using the questionnaire method in Tamil Nadu. Although the field work was based in Tamil Nadu, the scope of the findings is national. The study involved two levels of analysis. We first interviewed five banks to understand how they went about the BC model for financial inclusion, the viability of the model, and so on. Next, we interviewed their BCs in a semi-structured manner to understand the economics of their scope and scale of operations. We hope to interview their clients in the next phase of research to understand the impact of BCs on their financial behaviour.

Qualitative as well as quantitative data was collected. Appropriate statistical tools were used to analyse the data and its implications on the social and economic/public policy in India, which will be discussed in the final section.

5. Framework of Business Correspondent Model

The business correspondent model offers a new channel through which banks can extend services to their clients. This new channel works through a process of collaboration by the bank with one or more partners. In this section, we outline the major bank-BC models that are present in Tamil

Nadu. The framework helps in analysing and comparing the BCs, their way of operations, and their economics of operations.

5.1 Corporate Agent Model

The corporate agent model is probably the most popular among the bank-BC models. The entities in this model are the bank, the corporate agent, the technology vendor, the customer service point (CSP), and the client (Figure 1). In this model, the bank appoints a corporate agent. The corporate agent(s) could be an NGO, SHG, or any Section 25 company as defined by the RBI on the appointment of BCs (CGAP, 2010). The corporate agent then employs a suitable technology vendor.

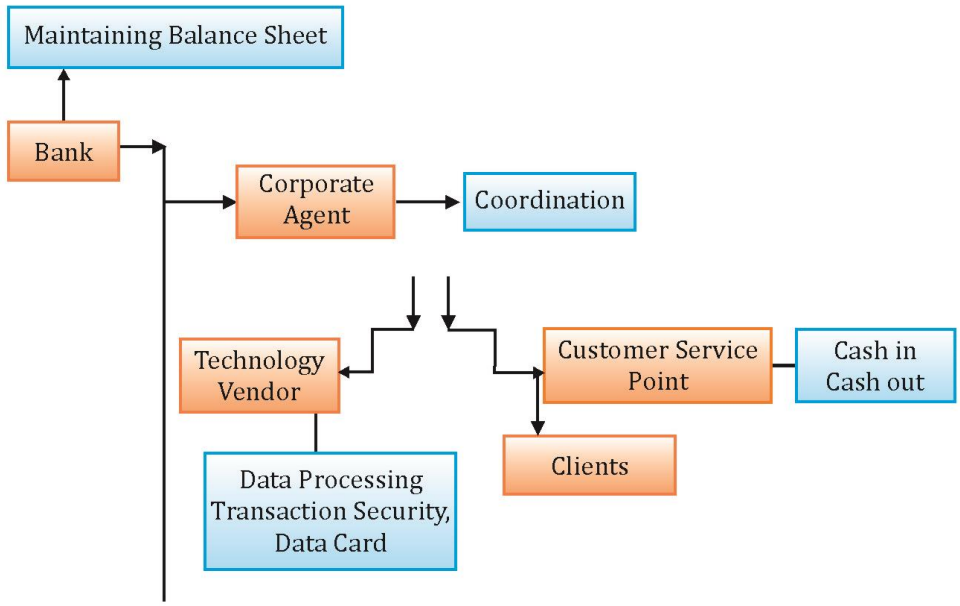

Figure 1: Corporate Agent Model Framework

Technology vendors provide a range of hardware services, processing capacity, and connectivity. They are in charge of providing the data card to the client and processing data at every stage, whether it is creating the account or handling transactions in the client's account. Technology choice is a very crucial link.

Customer service points (CSPs) are individuals, shops, or other outlet points that are responsible for direct contact with the clients. They are chosen by the bank officials in a village. If a village is thinly populated, one CSP is appointed for two villages. The CSPs open bank accounts, conduct

KYC compliance checks and cash withdrawals, receive payments, and in some cases, extend credit. They offer a range of services such as providing old age pension (OAP) transfer, Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGS) transfers, recurring deposits (RDs), and loan products. Their income consists of two parts: a fixed component for the creation of accounts and a variable component, which is solely based on the transaction of the clients. The variable income has two components—income related to government schemes and income related to banking products. Cash-in/cash-out transactions are handled at the CSP level.

For the channel to become financially viable, the regulations require that all revenue from the services should be collected by the bank. The technology vendors, BCs, and CSPs are not permitted to charge fees from the clients for the services rendered. The bank's revenue may come from the extension of various services: accounts, savings, credit, and payments. The bank then pays the service charges to the BCs and technology vendors as agreed in the contract.

5.2 Standalone Model

The standalone BC Model involves four entities, namely, the bank, the technology vendor, the BC, and the client. It is probably one of the most straightforward models, in which the BC is very aware of the commission he/she will receive from the bank at every stage because the banks have a direct relation with the BC. Here, the bank directly employs a BC per village or for the villages identified. The BC operates in the identified area, and he/she carries out operations with the help of the technology partner identified by the bank, as shown in figure 2. The BC can earn money on a transaction basis through his/her clients (the villagers) after they have created the accounts through him/her. Sometimes, the banks also paid some fixed income to the BC if the number of transactions exceeds the threshold limit. In this case, the bank employs the technology vendor who provides the necessary technology to the BC. Here, the cash-in/cash-out transactions happen at the BC level.

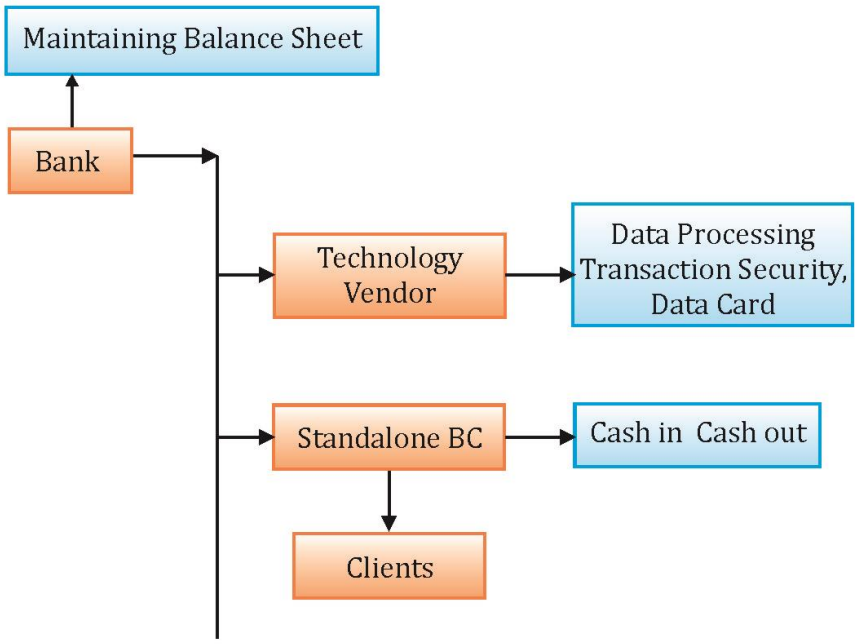

Figure 2: Standalone BC Framework

5.3 Customer Pay Model

Several banks have found that many of the services (remittance of money, demand drafts) that they offer in their branches are gaining momentum with BCs as well as CSPs. Initially, the popularity was in urban areas where there was a huge migrant population; however, of late, these services have become popular in peri-urban and rural areas. To tap into these customers who use mobile remittances, the banks share the commission they receive with the BC/CSPs. Since the commission from the customer is shared between the BC/CSP and the bank, we call this the customer pay model.

The customer pay model is very different from the two models discussed earlier (the corporate agent model and the standalone BC model). In the first two models discussed in this section, the bank pays the commission and drives financial inclusion. For any channel to become financially viable, the regulations require that all revenue from the services should be collected by the bank. The technology vendors, BCs, and CSPs are not permitted to charge fees from clients for the services rendered. The bank then pays the service charges to the BCs and technology vendors as agreed in the contract. This helps to mitigate risk and fraud in the system.

6. Analysis

6.1 Analysis of Banks

With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, in 2006, the RBI permitted banks to use the services of intermediaries (BCs) for providing financial and banking services. For this purpose, the state-level bankers' committee (SLBC) assigned various banks to provide banking services in unbanked areas. Indian Overseas Bank (IOB) was the lead bank allocated to the villages in Tamil Nadu for the appointment of BCs to achieve financial inclusion as per the census 2001.

6.1.1 Bank profile

We interviewed five banks to understand their financial inclusion and BC policies and practice. The banks we interviewed were IOB, Indian Bank, ICICI Bank, Canara Bank, and State Bank of India. These banks covered 60–70% of the BC operations in Tamil Nadu and are more than a representative sample for understanding the economics of the BC in Tamil Nadu. The basic driving force for a bank to adopt the BC model was cost. Setting up a branch in all remote rural locations and profiting from the same were not possible. The banks we interviewed explained that the primary reason for preferring the BC model was the lower cost in setting up a BC to acquire clients as compared to setting up a branch for the same. The banks followed the RBI guidelines[2] for the appointment of BCs for regulatory purposes; however, in most cases, the appointments involved locally respected individuals. This was done for multiple purposes—to convince clients to enrol, to get clients to use their accounts, and to have control over any possible defaults. Hence, the banks choice of BCs is very critical to the success of the financial inclusion drive.

6.1.2 Product profile

Business correspondents are retail agents engaged by the banks for providing banking services at locations other than a bank branch. The BCs and the BC agents (BCAs) represent the bank they are associated with; they enable a bank to expand its outreach and offer a limited range of banking services at low costs, particularly in areas where setting up a brick-and-mortar branch is not viable.

[2] http://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2234.

Creating accounts was the first target. This facilitated the government's social transfer of the monthly old age pension (OAP) and the Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGS). The clients catered to were mostly people below the poverty line. Almost all the banks urge their BCs to offer deposit accounts (microsavings/savings and recurring deposit accounts) to their clients through their banks; banks will soon offer insurance products as well. Most branches recorded average deposits of INR 30–45 lakhs.

6.1.3 BC profile

Banks are permitted to engage as BCs individuals/entities such as retired bank employees, retired teachers, retired government employees, ex-servicemen, individual owners of *kirana*/medical/fair price shops, individual public call office (PCO) operators, and so on. Further, since September 2010, the RBI has permitted banks to engage for-profit companies registered under the Indian Companies Act, 1956 (excluding non-banking financial companies), as BCs in addition to the individuals/entities permitted earlier. The five banks that we interviewed seemed to follow one of two BC models. They follow either the corporate agent model or the standalone BC model. Only one bank followed both the models. The customer pay model was used by all the banks when the clients use the banking services of the customer and pay a commission. Banks were selective in their choice of the BC in that they wanted their BC to have basic education and to be adaptable to technology. The BCs were selected by the local banks. Banks expected their BC to serve only them in a particular circle. However, a BC could serve another bank in a different circle.

6.1.4 Technology choice of banks

The technology is chosen by the bank. They decide the technology platform but give the BC options. The banks expect the BC to use a handheld device, smart card, etc. that the bank procures from a technology vendor. If the BC has higher capacity, he/she can buy a laptop and have Internet connection as well. Some examples of the technology partners of banks are TCS, Fino, A Little World, and Integra.

6.1.5 Marketing strategy of banks

As agents of the banks, BCs are an integral part of the business strategy for achieving greater financial inclusion. The banks' marketing strategy involved the minimum products they offered plus the MNREGS and OAP, which the government of Tamil Nadu had pushed through them. The

banks' main motivation was decongestion in the branch and cost reduction per client, while gaining more clients through the BC. The government products were push products; the BCs could have an assured income through these products. Could they leverage the banking products as well in order to make more income for themselves, thereby creating financial inclusion? This is where the strategy of pull comes into play; this can explain why some BCs can succeed and some cannot.

6.2 Economics of the BC

The most important entity in the chain of financial inclusion is the BC. In his/her success lies the success of financial inclusion. Therefore, we need to access and understand the demographics of the BCs, their profile, and their motivation, as well as their potential to make money and leverage from the banking products to their clients. We interviewed 49 BCs from all over Tamil Nadu; 11 were standalone BCs while 38 were CSPs from the corporate BCs attached to the five banks.

6.2.1 Demographics of BCs

Tables 1–4 present the demographics of the BC. This is vital for understanding their costing and revenue. On average, the age of a CSP agent is 32 and that of a standalone BC is 38. Banks seem to recruit young people as BCs. They are clearly looking for people with energy and optimism, but do not compromise on the status of the person. On probing about the motivation for a person to become a BC, almost everyone said that they were working to serve their society and not to benefit from income. This validates the fact that the BCs selected had good standing in society and wanted to further the same.

Table 1: Age of BC Agents

	Maximum	Minimum	Average
CSP	43	21	32
Standalone BC	51	32	38

Table 2: Gender of BC Agents

	Male	Female
CSP	36%	64%
Standalone BC	46%	54%

Table 3: Education of BC Agents

	Finished Class 10	Finished Class 11	Graduate	Above Graduate
CSP	23%	37%	34%	6%
Standalone BC	27%	36%	27%	10%

Table 4: Years of Operation of BC Agents

	More than three years	More than 2 years but less than 3 years	Less than 1 year
CSP	5%	92%	3%
Standalone BC	64%	36%	0%

In our sample, a majority of the BCs (CSP and standalone) were female (Table 2). The education level of the BCs was found to be rather high: 34% of the CSPs and 27% of the standalone BC agents were graduates. We found that 92% of the CSPs had just finished 2 years of operation. On the other hand, 64% of the standalone BCs had been operational for more than 3 years. Hence, a majority of the BCs we interviewed had been operational for long enough to discuss the pros and cons of the system.

6.2.2 Products offered

Tables 5and 6 show that on average, the CSPs in the corporate agent model opened 954 accounts; however, only 574 of them were active. Standalone BCs opened 1533 accounts on average and had 1366 active. The higher degree of activity in the case of the standalone BCs could be one reason for their higher income per month.

Table 5: Number of Clients in Corporate Agent Model

	Opened	Activated
Average	954	574
Highest	2823	1800
Lowest	100	70
Standard Deviation	644	457

Table 6: Number of Clients in Standalone Agent Model

	Opened	Activated
Average	1533	1366
Highest	2700	2500
Lowest	700	700
Standard Deviation	760	646

Figure 3 shows that the BCs mainly offered MNREGS and OAP products. In our sample, out of 38 corporate BCs, 55% offered MNREGS and OAP products. Further, 29% of the corporate BCs provided basic bank accounts and jewellery loans, and 13% offered the savings-cum-MNREGS product. Additionally, 3% of the corporate BCs offered only the MNREGS product. In the case of standalone BCs, 64% offered both MNREGS as well as pension products, and 36% offered MNREGS accounts as well as pension and savings products (Figure 4).

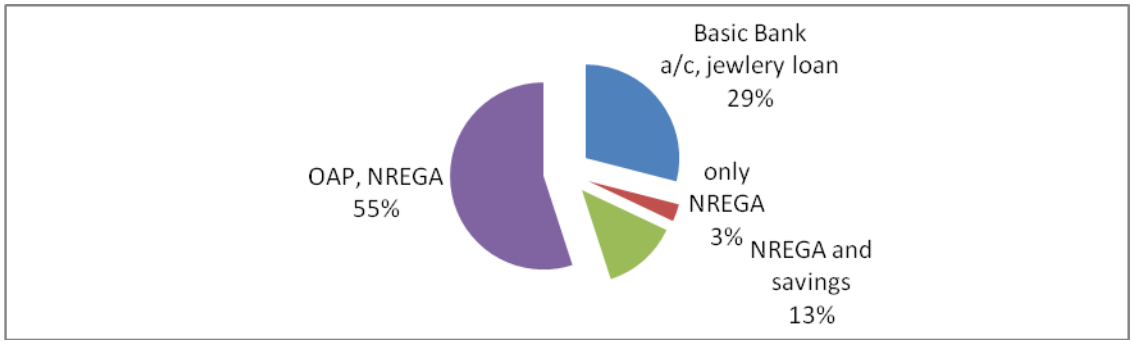

Figure 3: Products Offered by Corporate BCs

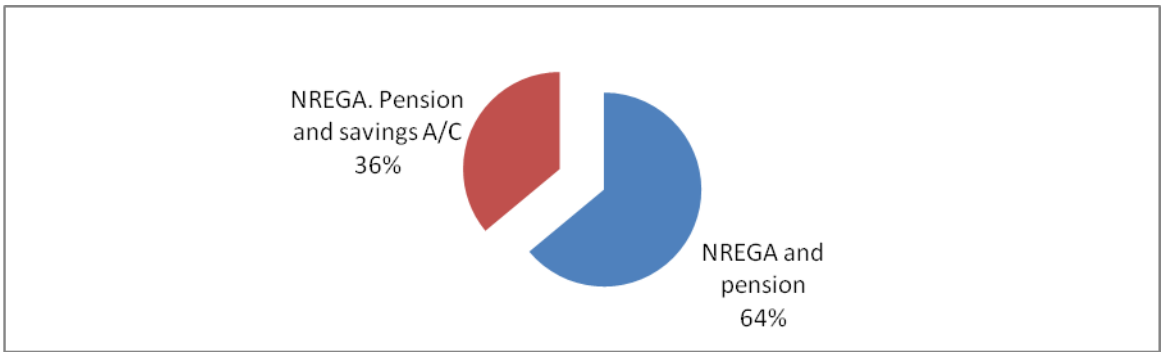

Figure 4: Products Offered by Standalone BCs

6.2.3 Costs incurred by BCs

Providing services to the client is of prime importance to the banks. Therefore, it is essential to know how often the BC meets his/her clients to serve their needs. In our survey, 42% of the CSP agents travelled daily to serve their clients; 50% of the CSPs reported that they served their clients every alternative day. However, 8% of the CSPs reported that they served their clients only twice a week (Figure 5).

In the case of standalone BCs, 73% served their clients almost every day, and 23% served them on alternative days (Figure 6).

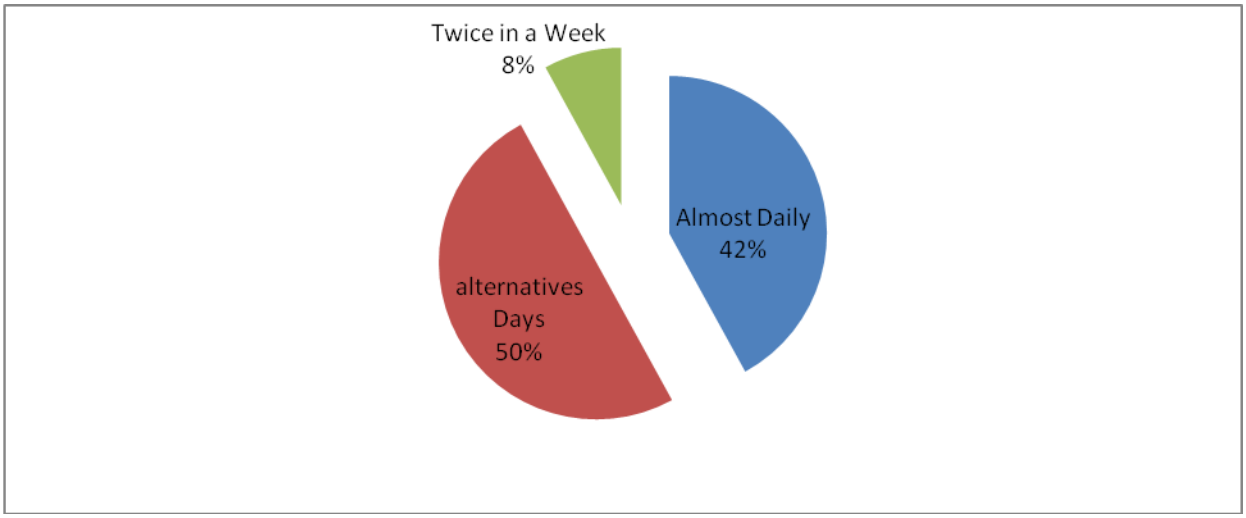

Figure 5: Frequency of Service Provision to Clients—Corporate Agent Model

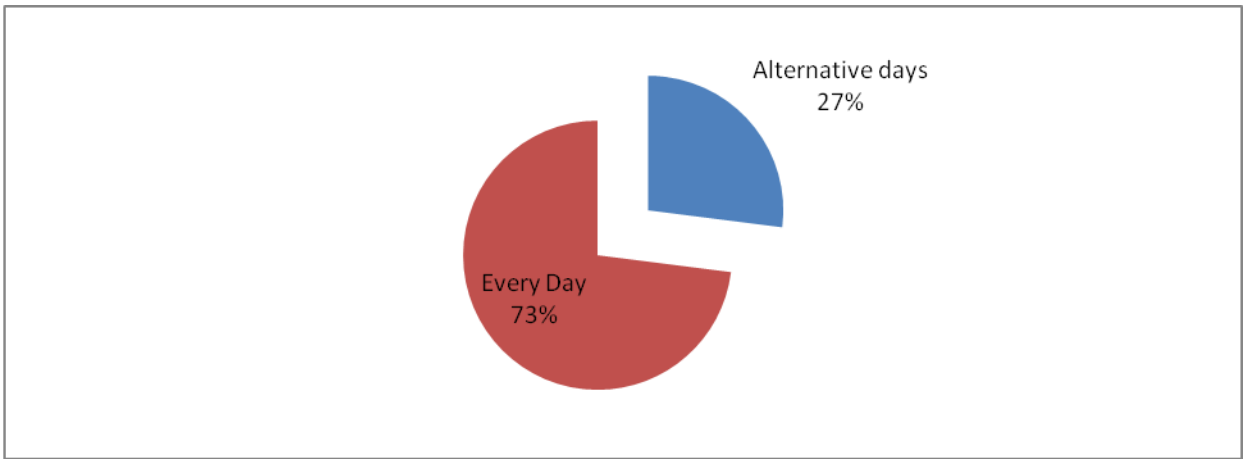

Figure 6: Frequency of Service Provision to Clients—Standalone Model

The BC has to travel to the bank to get cash for serving his/her clients. The time taken and the distance to the bank are important factors that the bank needs to consider to minimise the BC's hardship. Figures 7 and 8 show that in most of the cases, the CSP operators or the standalone BC agents have to travel a minimum of 3 km to visit their banks. Figure 7 shows that 53% of the CSPs travelled less than 3 km to visit their nearest bank branch; 26% of the CSP operators travelled 3–5 km and 21% have travelled more than 5 km to visit their bank branch. In the case of the standalone BCs, 46% travelled less than 3 km, 9% travelled 3–5 km, and 45% travelled more than 5 km to visit their bank branch (Figure 8).

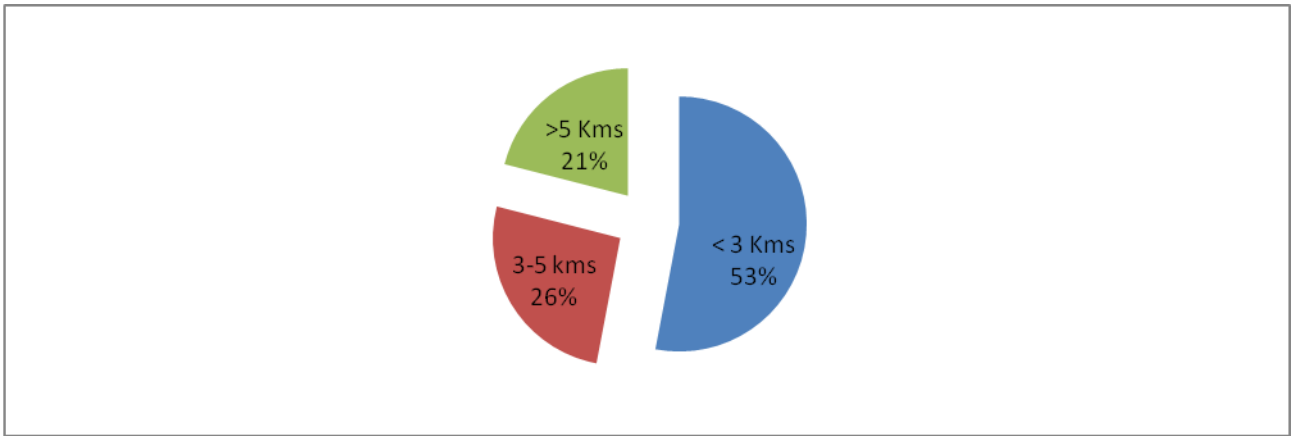

Figure 7: Distance Travelled by CSP Operators from Residence to Bank

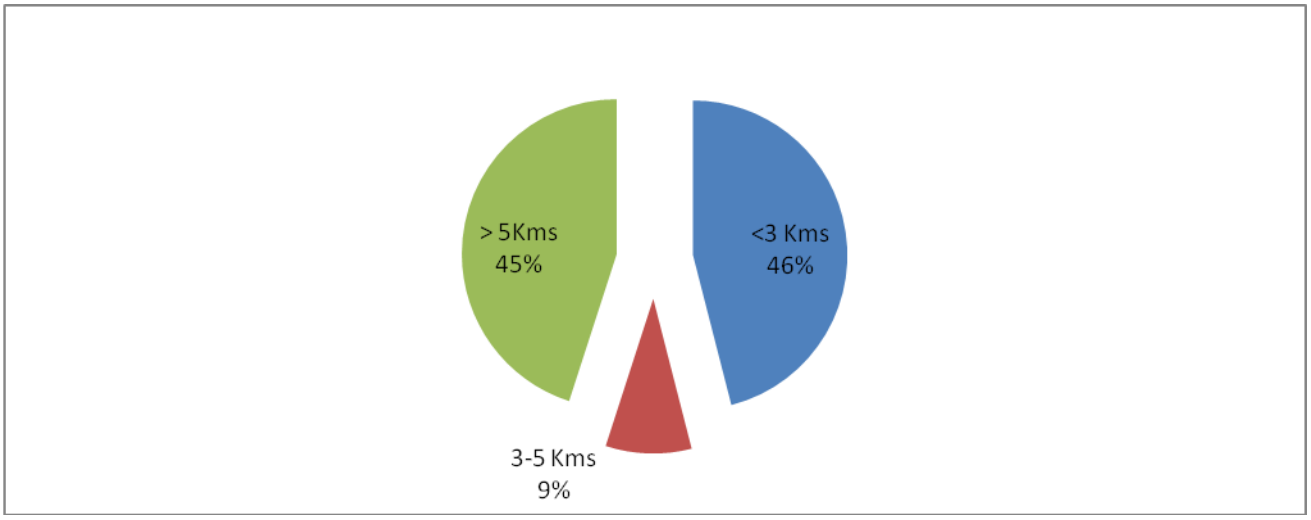

Figure 8: Distance Travelled by Standalone BCs from Residence to Bank

Table 7 shows that the cost incurred by the standalone BC is greater than that incurred by a CSP. The average cost incurred for a CSP is about INR 370 and it is about INR 1,000 in the case of a standalone BC. This has implications for the profit made by the agents.

Table 7: Monthly Cost of BC models

	Maximum	**Minimum**	**Average**	**Standard Deviation**
CSP	1200	100	369.23	231
Standalone BC	3000	400	1095	747

6.2.4 Occupation and income of BCs

In our sample, 86% of the CSPs reported being a BC as their main occupation. Some of the CSPs also engaged in real estate, beauty parlour business, and MNREGS work. Additionally, 64% of the

standalone BC agents had other occupations. Of the sample of 11 standalone BCs, 7 had occupations ranging from tailoring, being part of an NGO, running a photocopy or textile shop, and being involved in agricultural labour. The average monthly income from the BC activity of the CSPs was approximately INR 3,000 and that of standalone BC agents was approximately INR 7,000. When we added their other income to the BC income, we found that the average income rose on average to INR 4,700 for CSPs and INR 3,800 for standalone BCs (Tables 8–10).

Table 8 indicates that more standalone BCs were involved in an occupation other than their BC occupation as compared to the corporate BC. However, Tables 9 and 10 indicate that the standalone BCs seemed to make greater income from their BC operations. Is this a reflection of their costs and revenue structure? The potential to make an income from the BC operations can be understood from its potential revenue streams.

Table 8: Occupation of BC Agents

	Only BC	BC and Other Occupation
CSP	86%	14%
Standalone BC	36%	64%

Table 9: Monthly Income of Corporate BCs

	Maximum	Minimum	Average	Standard Deviation
Income from BC	8000	0	3,122.22	1632.56
Income from other source	8000	1200	4,733.33	3407.83
Total Income			7,855.55	

Table 10: Monthly Income of Standalone BCs

	Maximum	Minimum	Average	Standard Deviation
Income from BC	11000	4000	7,136.34	2346.17
Income from other source	7500	1500	3,800	2464.75
Total Income			10,936.34	

6.2.5 Revenue structure of the BC model

The revenue earned by BCs has two components: fixed and variable. The fixed revenue comes from opening a bank account for clients as well as issuing and activating the smart card. The BC receives INR 10 per bank account opened; the BC receives INR 3.50 for issuing a smart card to existing account holders and INR 3 for activating these cards. We found that the BCs' acquisition of clients in the beginning of their operations was rather easy and quick. It slowed down after a few

months once they had about 1,000 clients. Hence, with the initial acquisition of 30–40 clients a month, their monthly fixed income was between INR 600–700 a month. This was at their peak period of acquiring clients. After the peak period, the BC could acquire a maximum of 10 clients per month, which would add a maximum of INR 200 to his/her monthly income. The fixed income is neither sustainable nor enviable enough for the BC to remain sustainable.

The variable income is based on transactions made by the BC's clients. Therefore, the BCs motivate their clients to use their accounts actively. The sustainability of a BC is dependent on the variable revenue, which depends on the number of transactions made by their clients. On average, a client makes two to four transactions per month. If a corporate BC makes less than 100 transactions per day for his/her clients, he/she would receive INR 0.70 per transaction. If the transactions exceed 100, the BC would receive INR 1.20 per transaction. On the other hand, standalone BCs receive INR 1 per transaction. The economics of the BC agents based on our survey is presented in Figure 9. Based on the number of transactions made by the (active) clients, the average variable income for a CSP is INR 434.6, INR 836.4, and INR 1238.2 for two, three, and four transactions, respectively (Figure 10). We calculated the variable income of standalone BCs also. The average variable income for a standalone BC is INR 2365, INR 3732, and INR 5099 for two, three, and four transactions, respectively (Figure 11).

Adding more clients/accounts is crucial from the perspective of growing the BC business. An expansion of geographical coverage could also help in growing the number of clients. Existing technologies may be helpful in this regard. However, from the sustainability point of view, a BC may need to focus on increasing the number of transactions, which yields variable income. Therefore, from the sustainability point of view, an extended range of products (e.g., savings, insurance, loans, fixed deposit, bill payments, and transfers) could increase the number of transactions for a BC, and thereby the variable revenue required for their sustainability. In Figures 12 and 13, we present a forecast of the monthly variable income when the (average) number of transactions reaches 5, 6, and 7. The forecast is based on the assumption that the BC will incur an additional cost (25%) for every additional transaction beyond the current average of 2–4 transactions (since the BC has to travel to the service area, among other factors).

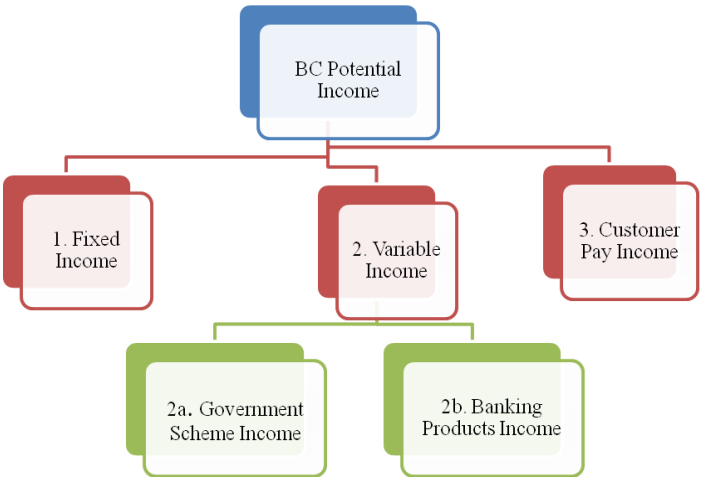

Figure 9: Potential Income of a BC

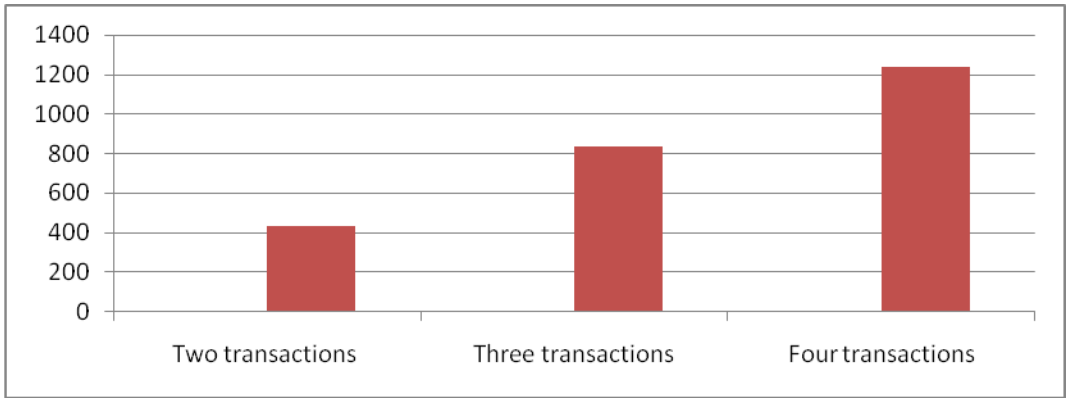

Figure 10: Variable Income of CSPs

Figure 11: Variable Income Standalone BCs

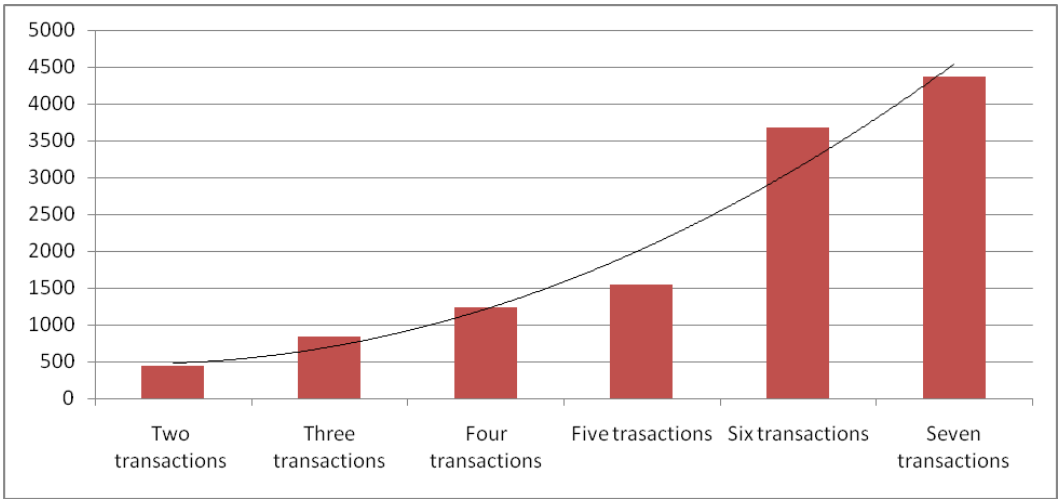

Figure 12: Forecast of Monthly Variable Income of CSPs

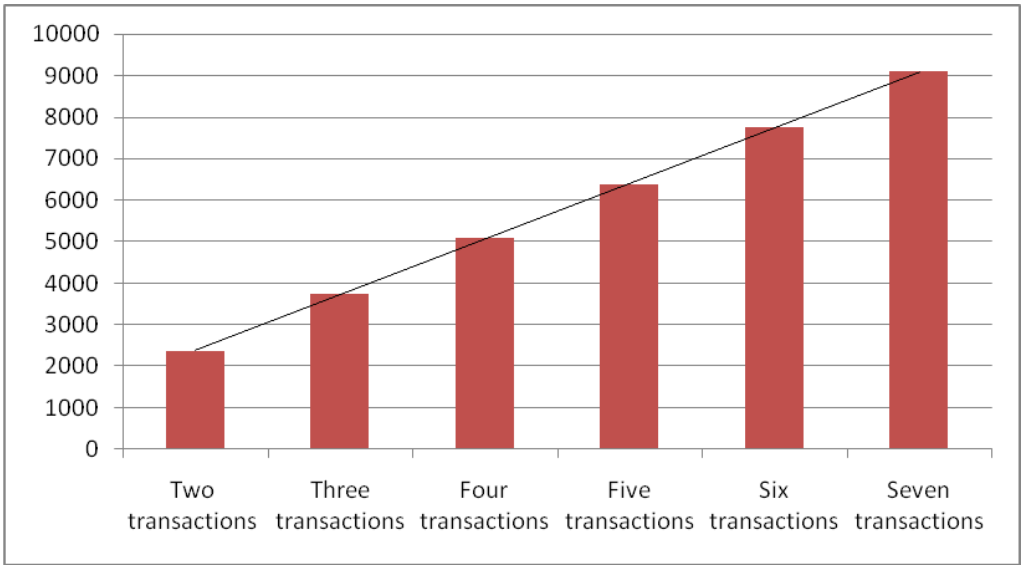

Figure 13: Forecast of Monthly Variable Income of Standalone BCs

7. Conclusions and Policy Implications

The analyses in the preceding sections attempted to map the economics of the BC model. We found the existence of two predominant models in the context of Tamil Nadu—the corporate agent model and the standalone model. The standalone model seems to be economically more viable *prima facie*. We find that a number of factors contribute to the success of a BC. Figure 14 presents the most important factors that contribute to the viability of a BC model.

1. **Choice of BC:** In most cases, we found that the most important starting point is the choice of the BC. When a bank invests some time to choose the BCs, their probability of success is rather high. An ideal BC is a person who has a good standing in the village, someone with a little

business acumen and who is not dependent solely on the BC income. Our research also showed that women whose husbands were well employed made good BCs.

2. **Proximity to link branch:** The BCs have to visit the branch they are linked to almost every day for making cash transactions. It is, therefore, very important that the link branch is close to their residence.

3. **Choice of village:** The village that gets allotted to a bank for BC services is chosen by the lead bank in the corresponding state. This allotment of villages is done based on an old census. Therefore, many banks complained that several of the villages allotted to them had large-scale migration, which resulted in very low potential for their BCs. The choice of village should, therefore, be reconsidered.

4. **Working of technology:** Many BCs complained that the technology provided does not work at all times. One major problem with such situations is that clients lose faith in the BC. Both the BC as well as the client lose time. Since the success of the BC critically depends on the continuous working of technology, the choice of technology matters.

5. **Transparency in remuneration sharing:** Many BCs complained that the remuneration sharing between them and the corporate BC was not well defined. There were several products and various rates. The BCs received their monthly remuneration by cash transfer to their accounts. The process of sharing remuneration should be made transparent.

In conclusion, we realise that since a village has a restricted clientele, the way forward would involve taking care of these factors as well as increasing the scope of operations of the BC. Merely increasing the number of clients per BC would bring neither quality service to the clients nor income to the BCs. Increasing the number of products offered per client is what will sustain this model. As this study had a limited sample, it would be worthwhile to study a larger sample for greater clarity with regard to policy change.

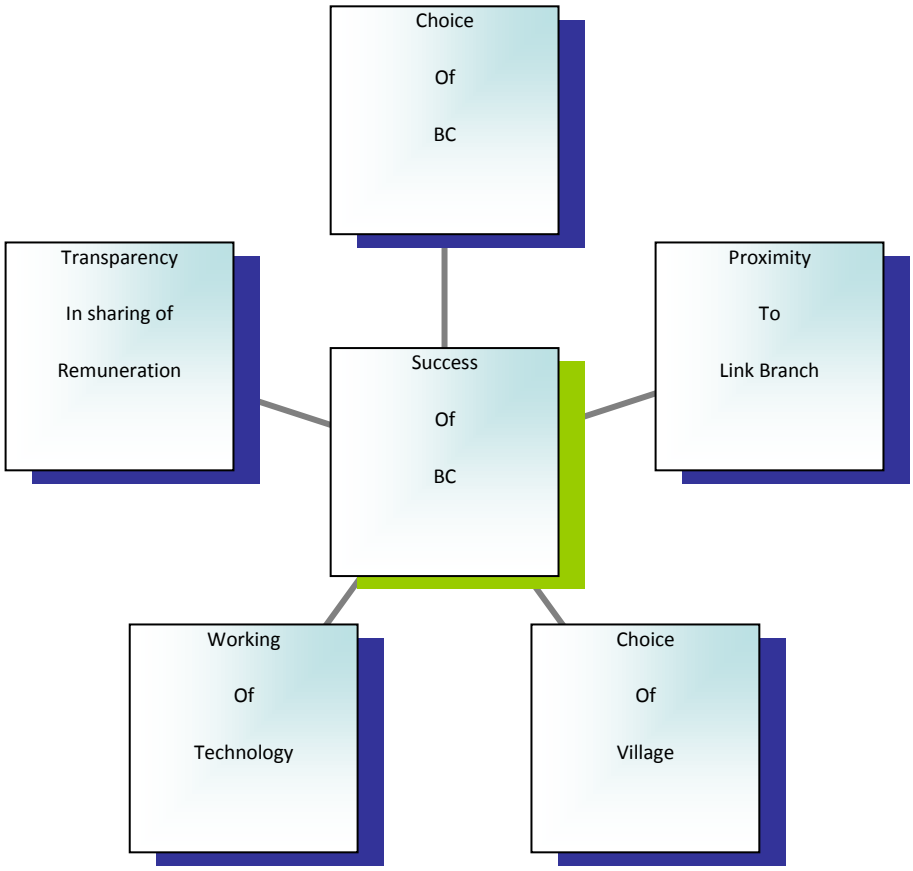

Figure 14: Environmental Conditions Necessary for Success of BC Models

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