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www.*MicroSave*.net
info@*MicroSave*.net

Are Banks and Microfinance Institutions Natural Partners in Financial Inclusion?

Ignacio Mas, Akhand J Tiwari, Alphina Jos, Denny George, Krishna UM Thacker, Nitin Garg, Raunak Kapoor, Shivshankar V., Swati Mehta, Vartika Shukla

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List of Abbreviations

ANM	Agent Network Manager
BC	Business Correspondent
BoP	Base of the Pyramid
CBS	Core Banking System
CSP	Customer Service Points
EBT	Electronic Benefit Transfer
FD	Fixed Deposit
FO	Field Officer
MFI	Micro Finance Institution
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MIS	Management Information System
MoF	Ministry of Finance
NBFC	Non-Banking Finance Company
NFA	No-Frills Account
NGO	Non-Governmental Organisation
PIN	Personal Identification Number
PPP	Purchasing Power Parity
RBI	Reserve Bank of India
RD	Recurring Deposit
RNBC	Residuary Non-Banking Company
SHG	Self-Help Group
SHPI	SHG Promoting Institution

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1 The business correspondent model in a nutshell

Since 2006, the Reserve Bank of India (RBI) has permitted banks to use the services of third parties as business correspondents (BCs) to help increase the outreach of banking services. BCs are a mechanism that allows banks to offer its clients micro-loans, micro-savings, micro-insurance and micro-remittances services beyond its brick and mortar branches. The BC model is increasingly being recognised as the most suitable approach for achieving financial inclusion in the long run as it allows banks to service customers and extend their geographic reach at a much lower cost.

There are five logically distinct players in the BC model:

1. ***Banks*** are the principals, as far as they have the legal relationship with end-customers as account issuers and must have lead branding in the service.
2. ***Business Correspondents*** (BCs) are entities appointed by the bank to offer banking services to bank clients beyond the brick-and-mortar branches of the bank. Their role is to oversee the orderly development and proper functioning of the bank's indirect channel. They must be have a direct contract with the bank, and are subjected to specific regulations issued by the RBI.
3. ***Agent Network Managers*** (ANMs) Mostly BCs also assume the role of Agent Network Managers but in very few models, BC contracts a separate entity to function as ANM. The ANMs' role includes: identifying, screening and training of new CSPs; supervising and offering ongoing business improvement advice to existing CSPs; or putting in place liquidity rebalancing mechanisms for CSPs (e.g. hiring 'runners' to collect or distribute cash to CSPs, or managing a set of bank accounts through which CSPs can deposit and withdraw money effectively). ANMs typically act as outsourced partners of BCs, though the degree of reliance on ANMs varies from one BC to the next.
4. ***Customer Service Points*** (CSPs) or ***agents*** are specific individuals or retail outlets that maintain the direct contact with customers. Their role is to collect account opening documentation, offer cash-in and cash-out services, receive payments, and in some cases conduct certain credit processing and evaluation functions – all on behalf of the bank. The CSPs may be staff of or retail outlets directly owned by the BC, or they may be contracted by the BC to perform these functions.
5. ***Technology Service Providers*** (TSPs) provide an electronic solution that allows customers and CSPs to transact remotely, and provides BCs with management tools to oversee the entire branchless channel. The solution needs to be sufficiently low-cost, secure, scalable, robust and user-friendly to be adopted by a large number of users with a low support requirement. TSPs are typically contracted by banks, though in many cases the BC and TSP may be the same or related companies.

The BC model is highly dependent on technology, as the technology platform is what allows trust to be extended from the bank through the BC to individual CSPs. The platform must ensure that transacting parties are properly identified, that the necessary transaction request and confirmation information is collected and transmitted in real time, and that transactions are authorised, recorded and reconciled correctly. The technology solution may be defined by a set of key choices:

- ***Device used to capture transaction requests***: using clients' mobile phone, or a point-of-sale terminal operated by the CSP
- ***Client authentication mechanism***: using two-factor authentication (typically phone or card in the customers' possession + personal identification number [PIN]), or single-factor (fingerprint)
- ***Communication environment***: online only (mobile or internet), or online + offline (involving local storage of transactions in smartcards and intelligent devices).

2 Business value for banks: hope and reality

The BC model offers banks a vision for tackling un-served customer segments in a way that is profitable and sustainable. It is based on serving poor or remote communities at a much lower incremental cost per new customer acquired or per new village covered than traditional branch-based banking. However, this remains a speculative view for most banks, as they struggle to deploy BC networks in a scalable manner and to trigger sufficient usage by customers to produce significant revenue. While banks do not doubt that branchless banking is the key to financial inclusion, they are seeking answers to some fundamental questions:

- What is the customer value proposition that can drive client demand and recurring usage?
- What is the business model that aligns the incentives of the various players involved (banks, BCs, CSPs, ANMs, TSPs), consistent with the revenue that can be expected to be generated from low-value customers?
- How can they scale up the BC network, while limiting the upfront investment required and financial risks involved?

Noting the lukewarm response of banks to the BC model, in March 2010, The Reserve Bank of India asked all nationalised banks to submit detailed financial inclusion plans, which, collectively, would ensure full financial inclusion by March 2013. Subsequently, the Ministry of Finance (MoF) mandated all nationalised banks to financially include 73,000 out of 600,000 villages in India with a population of more than 2,000 people by March 2012. The current focus of most commercial banks is to achieve the outreach target stipulated by the MoF by engaging a number of BC partners, and riding on the government's need to register masses of people in order to collect cash benefits from programmes such as the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) programme. Even as banks press ahead to meet their stated targets, they remain unsure of the commercial viability of the BC model. As a result, the BC model feels like it is being driven by a supply push, with insufficient evidence of client demand.

Clear notions of customer value must drive the business case for banks and their BCs. Recurrent usage generates a willingness to pay by customers. The customer value question can then lead to the business model question: how to tap into the customer willingness to pay through an appropriate pricing model, and how that revenue ought to be split across the various partners in the delivery chain. This process is illustrated in Figure 1 below.

Figure 1: The business case continuum

Customer value is generated by a combination of functionality (*what* I can do) and convenience (*how* I can do it). The functionality available through BC channels is extremely limited, as BC deployments still offer mainly a plain vanilla savings account with few features and often no payment options. (Please see box below for a snapshot of current products offered through the BC model.) In its current form, the BC model in India also offers little convenience to customers. Most BC deployments suffer from server downtime, spotty CSP coverage, insufficient float or opening hours at existing CSPs, and lack of CSP interoperability across banks and BCs. Trust in CSPs is also a problem, and that can be attributed to low usage for two reasons. On the demand side, customers fail to gain familiarity and get comfortable with banking services being available at locations that are not bank-owned. On the supply side, insufficient recurring revenue induces some agents to overcharge for the few transactions they do, which further undermines trust in the BC model.

Current products offered under BC model

Savings products:

- No Frills Account (NFA) is a single, liquid account, and is not consistent with the fragmentation or mental model of savings of low-income households. A potential solution for this is to design the product in line with the planning of finances by these households, which leads to savings such as PayPlan products.[1]
- Recurring Deposits (RD)/ Fixed Deposits (FD) are still mostly non-existent in the BC networks. Some products are simplistic and require committed savings from clients who have unpredictable cash flows. There are no documented success cases of RD/FD products.

Payments and receipts products:

- *MicroSave* research[2] suggests that customers primarily look for trust and time taken for delivery in a remittance channel/product. Further, remittance products thrive on network effects. The current product offerings are only along select corridors and are not interoperable, which undermines network effects. At present, none of the existing remittance products offers the convenience provided by informal mechanisms (like couriers), which typically offer delivery of the cash at the recipient's doorstep. However, banks are rapidly becoming the cheapest, quickest, most secure and thus most trusted way to send money, and remitters and recipients alike seem to prefer this channel to the other options available.[3]
- Electronic Benefit Transfers (EBT) payments are even more complicated as multiple benefits are paid in multiple accounts. Operational issues with the EBT processes also undermine the credibility of payment systems.
- With respect to bill payments, there are only few billers at present, while aggregators are mostly missing from the scene. In addition, the target clients of BCs, which are hitherto unbanked, do not use most the billers present.
- There are limited options to use payments and receipts for other financial services. Overdraft and linked credit scoring is not yet in the product line of services offered by most banks.

Yet the opportunity for mobilising savings at the base of the pyramid may be larger than banks anticipate. Imagine the targeted was to induce a savings balance per account equivalent to a month's worth of household income – that seems like a reasonable threshold of impact. For a family living at the $2 per day poverty threshold, that translates into a savings balance of around $100. (That is $2 per day *per person at purchasing power parity [PPP] exchange rate* x 5 people per household x 0.3 PPP/market exchange conversion rate x 30 days per month.) Median savings balances of $100 can much more easily be profitable for banks to offer.

Once customers see value in the service offered, they will be willing to pay for the service. A recent *MicroSave* research indicates that customers are willing to pay for BC services if it offers convenience and functionality to them. With customers paying for the service, the revenue from the business will improve which will result in higher revenue splits for the stakeholders.

In areas where banks have an established presence and branches are heavily crowded (especially in urban areas), banks have a more specific incentive to offer e/m-banking services so as to decongest their branches. This allows them to move lower-value customers away from costly bank branches to cheaper agency banking alternatives. Here the business case is easier, as it depends strictly on cost reduction and not necessarily on additional clients or additional usage per client.

[1] Mas, Ignacio, "Making Mobile Money Daily Relevant", March 2012.

[2] *MicroSave* India Focus Note 91 "Banks: The Preferred Remittance Services".

[3] Please see the reports "Understanding Remittance Networks – Gujarat, Orissa and Bihar" and "Understanding Remittance Networks in Punjab and Uttar Pradesh". Also see *MicroSave* India Focus Note 92 "Are Banks All Set To Dominate Domestic Remittance Market In India?"

3 Channel-building challenges

Creating a sufficiently large retail footprint is a major challenge for banks and the BCs who work on their behalf. Several approaches may be considered:

- ***Partnering with existing retail franchises***. This is the model that is most prevalent in Latin America, where banks are able to patch together networks of post offices, lottery houses, pharmacies and convenience stores. This allows for rapid signing up and training of many stores at once. However, in India few sizable retail franchises have presence in slums and rural areas.

- ***Leveraging existing retail distribution networks***. This model entails partnering with distributors such as Hindustan Unilever or PepsiCo who have relationships with and physical distribution into a large number of retail outlets. The distributors might therefore provide access to and relevant screening information on a multitude of stores, and they might provide logistical support with movement of cash and other documentation through their fleet of trucks. While this model makes intuitive sense, it has not been proven to work anywhere. The main reason is that such distributors keenly want to take advantage of branchless banking to take cash out of their daily operations, but are not generally willing to burden their operations further to build the branchless banking channel. In other words, they see themselves as clients of branchless banking services, not as drivers of the BC model.

- ***Aggregating individual mom-and-pop shops***. This is the predominant distribution model used by mobile operators in selling airtime, and it is the predominant model used by mobile operators in Africa to develop their mobile money schemes. Unlike the previous strategies, this approach has fewer economies of scale as shops need to be identified, screened and trained individually. This is a laborious task, and in a country as big as India, it presents formidable logistical challenges. No BC in India has so far found the business case for aggregating the CSP channel in this laborious fashion.

- ***Ride on existing prepaid airtime channels***. To the extent that mobile operators have already structured mom-and-pop shops into a functioning airtime distribution channel, there would be an opportunity to tap into this channel as a whole. However, it has proven difficult to adapt the economics of the airtime channel to work for banking alongside airtime: these services have different volume/margin characteristics, and airtime distributors fear cannibalisation of their existing revenue sources. Therefore, top-level distributors are generally not very supportive of the CSP model.

- ***Partner with organisations with an established client base and service channels***. A different approach is to collaborate with grassroots organisations that already have a mass of customers and the channels to service them. These organisations can then serve both as a marketing base, cross-selling banking services into their clients, as well as a BC channel. There are a number of grass-roots non-bank financial service providers, which we here collectively call microfinance institutions (MFIs), that could play such a role, and it is these that we focus on in this report.

4 Enter microfinance institutions: what they can offer banks

As stated above, one potentially viable channel that banks can collaborate with to reach the base of the pyramid (BoP) market more economically is microfinance institutions, which have experience in providing financial services to low income and rural populations. These institutions have a number of assets that they can bring to the table:

- ***Ready access to an established client base***, the majority of which is unbanked. MFIs have field staff, which can advocate for bank products, and typically run group sessions, which present opportunities for cross-marketing banking services to their clients.
- ***Experience in cash management.*** MFIs already have experience in providing financial services to the low-income segment and their staffs are trained in cash management techniques. Unlike other common entities such as FMCG networks that are preferred as channel partners for providing BC services, MFIs have a track record in liquidity and cash management, accounting and reconciliation.

- ***Established internal audit and monitoring system.*** Most of the MFIs have an established internal audit and control system in place to monitor their credit business. With some level of customisation, this system can offer high synergies to monitor banking services offered through the MFI.
- ***Resources to help build an effective BC channel***. MFIs could take on the role of BCs/CSPs themselves, through their field staff and local branch infrastructure. Alternatively, they could facilitate the development of a local BC network by: *(i)* helping identify local businesses among their microenterprise client base that might become CSPs; *(ii)* applying their due diligence skills in evaluating and selecting CSPs; and *(iii)* using their field staff to train and supervise CSPs on an ongoing basis, given their familiarity with cash management and accounting and reconciliation processes.
- ***Client insight for new product development***. MFIs typically have a good understanding of the financial needs and aspirations of their clients. They could therefore become key partners of banks in figuring out broader financial service propositions targeting specific segments. Limited customer value in current BC deployments creates an opportunity for MFIs to work on customer engagement, collaborating with banks to experiment on saving service propositions.
- ***Client relationship management***. MFIs are already in the business of providing financial services to the un-banked and under banked segment. Over the years, most MFIs have developed good client relationship management capabilities, primarily due to their high levels of involvement with clients in their existing group based credit model. Although, largely credit-focused, this experience in client relationship management could be valuable when providing banking services to clients.

5 What microfinance institutions might get in return?

These are strong advantages to drive a BC play. But MFIs will only want to put these assets and competencies at the service of banks if they feel they get sufficient value in return. Here the story is more nuanced, as it depends crucially on the type of microfinance institution involved. Below we review the perspective for a range of microfinance players; in each case we focus on their top two opportunities from engaging with banks under the BC model. The full potential list of benefits that might accrue to a given MFI would then be comprised of the collection of benefits discussed below.

Non-Banking Finance Companies (NBFCs). These are for-profit microcredit institutions, which, although they are specifically precluded by the RBI from being a BC, can engage in BC activities through an associated not-for-profit company. BC activities offer two key opportunities for them:

- ***Improved efficiency and accountability***. NBFCs could use BC technology to record all transactions electronically as they occur at group meetings. This would: *(i)* enable immediate tracking of all payments happening in the field; *(ii)* help automate reconciliations at the branch when the cash is delivered; and *(iii)* speed up group meetings, thereby allowing a heavier case load per field staff. Moreover, NBFCs could use an alternative BC channel and require members to conduct cash transactions at local CSPs rather than at the group. Freed from having to handle cash logistics, group meetings would be much faster and may need to be less frequent. Supporting a bank's BC services might therefore be a way to fund the necessary technology infrastructure.
- ***Reduced vulnerability to political cycles***. NBFCs have tended to be mono-product, focused in particular on group-based lending methodologies. Many NBFCs now feel an urgency to diversify their activities in the aftermath of the Andhra Pradesh microcredit crisis. While they can be expected to remain credit-centric, embracing a fuller range of financial services will help them escape the image of being the new moneylenders. Working under the BC model will help move them out of the political questioning they are currently under.

Not-for-profit MFIs. These MFIs are incorporated as a Trust or Society, or under Section 25 of the Companies Act of 1956. Their interest in the BC model is primarily based on the following two needs:

- ***Stabilise bank funding***. These MFIs are very dependent on bank credit to fund their own lending activities. Becoming a BC for one or more banks may be a way to establish a much deeper, more synergistic relationship with these banks. By helping banks with their strategic objectives –including helping them achieve their financial inclusion mandates—they expect the bank to treat them as a long-term partner rather than getting tactical transactional pricing when they request wholesale funding. Moreover, they can make a moral case that the deposits they help raise from their MFIs clients should be returned to the MFI through a wholesale funding arrangement.

- ***Leverage existing customer base to cross-sell additional financial services***. Not-for-profit MFIs would typically have more of a vocation than the for-profit MFIs to serve their clients more fully, with a broader range of services. The BC model offers an opportunity to broaden the MFIs service set at relative low additional cost and risk. It would also help diversify the MFI's income streams by generating fee income on BC services.

SHG Promoting Institutions (SHPIs). These are not-for-profit organisations that promote SHGs and organise them into a federated structure. SHPIs provide funding support to SHGs by matching SHGs with net surplus and net deficit positions, and by facilitating bank linkages. The BC model can help the SHPIs' mission in two critical ways:

- ***Ensure sustainability of SHG Federations***. SHG clusters and federations need a recurrent source of income for them to remain viable in the longer-term. By taking on BC promotion activities, federations can gain a new high-profile role and a source of income that is independent from their member SHGs (in the form of BC commissions payable by the partner bank).These BC commissions can be earned by servicing the banking needs of their own SHG members as well as from people in the community at large.
- ***Improve accountability in SHGs***. SHPIs have precarious information on their member SHGs. The information they receive is largely self-reported, and percolates up slowly through the federation structure as meetings occur at each level (SHG, cluster, federation). If groups were able to deposit or withdraw money immediately after a group meeting at a local BC, the information on the status of credit repayments at the group level would become immediately and verifiably visible to the SHPI.

Non-Governmental Organisations (NGOs). Under this rubric, we include grass-roots, not-for-profit organisations which do not have microcredit as their main focus. Their main interests in the BC model are:

- ***Expanded range of intervention tools***. NGOs are often focused on particular vulnerable segments or communities, and their aspiration is to support them through a broad and integrated programme of interventions. Being able to offer their clients a safe place to save is often considered an important ingredient in reducing their vulnerability. NGOs have no aspiration to become financial institutions themselves, and hence would be happy to partner with banks who are able to support them in offering savings services to their members.
- ***Increase sustainability***. NGO funding typically runs on grant cycles. This puts the continuation of their activities at risk, because grants may not be renewed. Supporting a BC activity may offer them a stable source of funding, by earning BC commissions.

In addition to these four categories of MFIs, we considered other types of financial service providers, which might in principle become BC enabling partners for banks. However, their alignment with the interest of banks is questionable, mainly because they are able to offer their own deposit mobilisation service, and hence BC services present product conflict issues. These other categories of financial service providers are:

- ***Residuary Non-Banking Company*** (RNBCs). RNBCs are a class of NBFCs and hence face the same restrictions in functioning as BCs for banks. However, RNBCs are able mobilise deposits on their own account under different types of flexible individual savings products.
- ***Cooperative Institutions*** are eligible to offer all financial services except remittances to its members, and hence BC services would also present a direct product conflict. Cooperatives also enjoy a higher level of autonomy and flexibility that will be affected if they introduce BC services, as they will then need to be monitored by the partner bank.
- ***Chit Funds*** are positioned as high-return savings vehicles and used by customers for accessing lump sum money. Therefore, being able to access No-Frills Accounts (NFAs) through a BC model will be an unattractive proposition for chit fund customers. (The RBI guidelines on the BC model do not clearly define the eligibility of chit funds to operate as BCs for banks).

6 Strategic threats to MFIs: potential disruption to current business

Beyond the opportunities presented by the BC model, MFIs need to be cognisant of the adverse impacts that embracing the BC model may have on their current business. We consider below three main types of impacts, though the severity of each may vary depending in the type of MFI. In many cases, these threats are flip-sides of some of the benefits discussed above.

Impact on group meetings. The group articulates the methodology of most MFIs, so they need to be careful in assessing how the introduction of front-end technology and BC operations can support or disrupt the conduct of group meetings. This depends on how the BC channel is structured:

- ***Field officer or group leader acts as the CSP***. In this case, savings operations would be conducted during the group meeting. Offering saving services along with credit will result in longer group meetings. In fact, MFIs might opt to shift savings operations to a separate meeting in order to preserve the focus of the credit meeting on repayment. Increased duration of group meeting or more frequent meetings will lead to reduction in loan officer caseload, which will affect the business turnover and profitability for NBFCs. On the other hand, SHPIs and NGOs may not consider the increase in group meeting duration as a burden because these institution traditionally aim to maximise group interactions, which present an avenue to offer various information and services to members and members can also mutually benefit from the group.
- ***Third-party outlets acting as CSPs***. BC operations with technology enablement can help in making meetings cashless, and that can reduce meeting duration or frequency. Cashless meetings may be more attractive to business-oriented MFIs and especially NBFCs, but they may challenge the very essence of SHPIs and NGOs.

Erosion in repayment discipline. MFIs also need to make sure that BC operations do not lead to loss of group liability, which is one of the core principles of group-based microcredit. This may happen if meetings are less frequent, or if the availability of individual products from banks leads people to question the usefulness of group-based products. Loan repayments using technology-enabled BC channels may also lead to a situation where clients blame non-repayment of loans on CSP - or technology-related problems ("The *system was down", "I'd lost my mobile phone", "The agent didn't have liquidity", "I sent money to the wrong account", "I forgot my PIN"*, etc.).

Cannibalisation of existing business. Most MFIs suspect that in the long-run, banks might be potential competitors for their lending business. NBFCs and not-for-profit MFIs, which offer microcredit as their core business, suspect that banks may gain access to their clients through the BC channel and start extending credit directly to them. However, SHPIs and NGO MFIs see this as an opportunity where they can act as originators and service the loan and banks provide constant funding support.

Burden on institutional capacity. MFIs need to evaluate the existing management capacity–skills and bandwidth—to negotiate with the multiple stakeholders involved in BC operations. NBFCs with larger operations and used to managing relationships with funders and investors may not find it very difficult to manage the new relationships, although for regulatory reasons they will need to place a separate corporate identity and team to manage this. MFIs and NGOs with smaller operations and with little experience of managing strategic relationships may find it trying and may need to bring in dedicated people with the right calibre. Institutional capacity will also be need to effect the cultural change that MFIs need to undergo in order to offer savings along with credit. SHPIs may not face this cultural shift as they already have the experience of handling saving products.

7 MFI-bank partnership in India: state of play

Table 3 below summarises the strategic fit of the BC model for all the various stakeholders, identifying the potential opportunities and challenges for each. Indian MFIs are working through these strategic considerations and many are actively considering the BC option. They are all at different stages of implementation: some have already initiated pilot tests, some are on the brink of getting started, many others are preparing or exploring options and partnerships, and most are watching the space closely and seeking to learn from others' experience.

During this study, the *MicroSave* team visited six MFIs that are in various stages of functioning as business correspondents. Their story is described below.

Grameen Financial Services (GFS) is an NBFC that also acts as an umbrella organisation for its subsidiaries that include Grameen Koota that provides microcredit and GKDT, not for profit trust, which conducts BC operations. GKDT commenced BC operations in 2010 for Bank of India with mChek as their technology service provider. GKDT has separate staff who assisted in opening accounts and facilitated transactions for the microcredit clients of Grameen Koota. GFS' primary motive behind functioning as BC is to make their operations efficient, cash-lite and reduce risk. Currently the pilot has come to a standstill because the model was financially unviable. This is mainly because as an NBFC they cannot use their existing resources for BC activities and anomalies such as technology / network failure and lack of bank's support.	**Chaitanya** is an SHG promoting institution. It started operations in 1991 and currently has more than 2,300 SHGs consisting of 80,000 customers across 12,000 villages in 18 districts of Maharashtra. Chaitanya has collaborated with Yes Bank under the Yes Leap programme to provide credit to SHG members. Currently a pilot is under way since January 2012 with two clusters comprising of 33 groups. Chaitanya wants to observe the progress of the pilot with only credit for a period of six months before providing savings services in partnership with Yes bank. Chaitanya plans to appoint federations as BC that will be responsible to collect group compulsory savings as well as voluntary savings. Chaintanya's primary expectation from this arrangement is to make their operations efficient.	**Rajiv Gandhi Mahila Vikas Pariyojana** **(RGMVP)** is the flagship poverty reduction program of the Rajiv Gandhi Charitable Trust (RGCT). Based out of Rae Bareilly, RGMVP (as of December 2011) reached out to over 400,000 poor households in 34 districts. RGMVP has collaborated with Bank of Baroda and Tata Consultancy Services (technology partner and BC for the bank). RGMVP aims to drive financial inclusion for its SHG members by providing access to banking services through the Business Correspondent mode. In addition, one of the major objectives for RGMVP to enter the BC business is to lend sustainability to the block level federations. This will provide a strong reason for the existence of these federations and provide additional revenue stream for them.
Margdarshak is a livelihood-financing institution that does lending through its NBFC arm in Uttar Pradesh. Margdarshak currently has 25 branches in 16 districts reaching out to 27,000 clients with a portfolio outstanding of Rs.180 million ($3.6 million). Margdarshak plans to function as an Agent Network Manager for Eko (BC for ICICI Bank and State Bank of India). To start with, Margdarshak plans to integrate their MFI operations with mobile banking and later offer bank linkages to customers. Margdarshak believes that to create an impact, MFIs need to offer a wider range of products – savings, remittances, insurance along with credit in a financially sustainable manner.	**CASHPOR Micro Credit** is a not for profit company that provides microfinance exclusively to BPL women in eastern U.P. and Bihar. In August 2011, CASHPOR enrolled as a BC for ICICI Bank with Eko as the technology service provider. CASHPOR uses its existing human resource and branch infrastructure to offer ICICI Banks *Apna* savings account. As on date, Cashpor has been able to enrol approximately 50,000 clients and mobilised savings of Rs.150 million ($3 million). CASHPOR wanted to extend their financial service to poor from credit to savings and thereby earn addition revenue. CASHPOR also expects funding assistance from banks by virtue of acting as business correspondent.	**Prayas Jan Shikshan Sansthan** (JSS), an NGO working for juvenile development also wanted to offer financial services such as savings and credit. In December 2007, Prayas established BC operations with ICICI Bank and FINO as a technology service provider. Prayas uses its existing human and capital resources to offer *Apna* savings account, working out of the two existing branches in *Jahangirpuri* and *Bawana*. Prayas has 5,000 customers, of which 50% of customers transact on a regular basis. Outstanding saving balance is approx. Rs. 4 million ($80,000).

The overall picture so far is somewhat disappointing: there are many pilots across the country but none of these pilots have achieved scale or demonstrated success. In the absence of a success story, all the players involved now seem to be awaiting the emergence of standard business models, which they might emulate. In this wait for proven models, many pilots have died down after the initial euphoria and many more are being started without sufficient conviction of eventual success. We attribute the relative lack of progress primarily to the following factors.

Lack of commitment from banks. As stated above, in the absence of proven business models, banks do not see a sustainable business case in financial inclusion and are undertaking financial inclusion activities mainly to comply with mandates from the authorities. There is insufficient focus on appropriate product design that would make the service more relevant and appealing to the BoP; there is very little customer engagement in product and service design. There is also little apparent willingness to charge customers due to the misconception that customers are unwilling to pay and the perceived political risk of charging poor customers for services that the middle class get free in a bank branch. These factors conspire to obliterate the economics of the BC model. As a result, banks are forced to offer unattractive commission structures to channel partners, they under invest in technology and infrastructure, and they do not invest in scalable account opening processes. In turn, this results in inadequate monitoring and supervision of channel partners, and insufficient co-ordination with channel partners. These factors have created an ecosystem that inhibits success.

Lack of focus among MFIs. The lack of proven business models and a lack of belief that the model can offer a viable business case also holds true for the MFIs. Some MFIs have ventured into this business with the expectation that they will get quick results and profits, without thoroughly thinking through the strategic fit for them and their staff and the value proposition for their clients. As a result, most deployments have failed. This creates a vicious circle of underinvestment in technology, infrastructure and human resources.

Multiple/complex partnerships. The multipartite BC engagement structure that prevails in India seems overly complex for the current incipient stage of market development. This puts a big burden on cooperation, which is not always forthcoming, undermines synergies, and results in wafer thin profit margins for each player.

Restriction on NBFCs acting as BCs. The RBI restricts NBFCs from directly functioning as BCs. Hence, NBFC-MFIs have to function as BC through a sister company incorporated under a suitable legal structure and with completely separate staff and physical infrastructure. This has cost implications that further reduce the business case for NBFCs to enter the market.

Table3: How different stakeholders in value chain stack-up

Stakeholders	(+)	(-)	Action Points
Banks	• Another channel to carry out BC activities and help them achieve their financial inclusion agenda • Credit information of MFI clients can be accessed by bank since MFI transactions happen through savings account of bank. The information may be critical for banks (to understand clients credit behaviour) if it were to directly serve (credit products) such clients • In case the same bank (which is partnering in	• Clients may be hesitant in the initial days to save with the same institutions from which they have taken loan • The product may be mis-sold to customers. In many instances when MFIs function as BC, customers open a bank account misunderstanding it to be a pre-requisite for obtaining loans • When MFI loan officers act as agents, customers may not receive the same level of convenience that they will get from a retailer-agent. Because when MFI loan officers act	Since banks have better reputations and larger brands than MFIs, Banks have to be careful while selecting MFIs as their Business Correspondents.

Stakeholders	(+)	(-)	Action Points
	BC arrangement) has granted loans to concerned banks for on lending, it can track (to some extent) the health of concerned MFI based on MIS data on individual client savings account	as agents customer transactions get restricted to specific day and time of the week	
MFIs	• Cash lite operations (cash gets substituted with e-float) • Efficiency in operations (less frequent meetings, more time for business development, higher case load/loan officer, hassle free reconciliation) • Real time MIS updates • Platform for selling other financial products • Smooth shift towards individual lending • Lesser cash risk insurance premium • Security of field staff since cash handling volumes go down significantly • Information channel (in case of mobile technology) for communicating with clients and cross-selling other products • Reduced risk of political intervention, as Business Correspondents operate under direct purview of the RBI and are managing savings rather than just credit[4]	• In cases where NBFCs do not contract a separate entity to set-up and manage agent network and liquidity, their ability to make operations cash lite is restricted • MFIs have long been working on concept of joint liability. In business correspondent settings, MFIs monitoring over individual groups becomes less intensive. Senior management may resist such a change that goes against their fundamental business logic • Banks can become possible competitors by lending to existing microcredit clients of MFI who have NFA of concerned bank • Technology and other external factors may become an excuse for clients for not paying. Regular follow-ups required to address such issues may make operations less efficient than desired levels	• MFIs should consider such an arrangement only if there is a possibility to outsource cash-risk on third party agents. Otherwise, the cash risk will pass on to new entity floated for BC operations without any significant gains on efficiency front either.
SHPIs	• Opportunity around getting access to assured lending from partner banks which acts as wholesale credit partner for SHPIs • MIS data from technology platform would help SHPIs to monitor groups, which	• SHGs are built strongly around the concept of mobilising group savings and SHPIs play a vital role in managing these savings. • With individual savings accounts being opened for members, the importance of SHGs may be reduced • Further SHPIs may fear	SHPIs should differentiate the advantage of both saving individually and saving in the group. Saving in the group comes with the benefit that it can be used for on-lending with the group for emergency purposes. This will not be available if members start

[4] Please see *MicroSave* India Focus Note 75" Microfinance in India – Is Business Correspondent the Way Forward?"

Stakeholders	(+)	(-)	Action Points
	currently happens through physical records being maintained at each SHG (federation) • Opportunity to sell other mainstream financial services through a common technology platform	that their role in saving mobilisation may get reduced if customers start directly saving in their individual accounts instead of saving at group meetings	saving individually
Group Leader[5]	In this case, there is no additional direct benefit that may accrue to the group member.	• Cash carrying risk – since group leader will have to travel to nearby CSP location to deposit cash • Maintaining records for amount given by individual members • Misappropriation of funds by group leader	• Organisation should pass on benefits of decreased cost of operations to group leader by giving nominal pay-out to group leaders for undertaking additional responsibility • Otherwise, similar such arrangements can be facilitated by the organisation so that individual members pay nominal amount per month to group leader
Loan Officer	• Reporting requirements may go down as MIS updates happen real time	• Resistance to change and adapt themselves in a technology intensive environment • A potential increase in case load of individual loan officers as MFIs try to instil efficiencies in the system with meetings become less frequent • Customer hassles around technology related troubleshooting • Feeling of not being needed in the organisation with their fundamental function i.e. recoveries, being routed to third party channels • Likely to lose control on groups with interactions becoming limited	• Organisation needs to clearly communicate the long term strategy behind such a move and communicate new role which would be expected out of field staff • Also, staff needs to be adequately trained to understand technology and related processes for effective trouble-shooting
Customers	• Shorter and less frequent meetings saves time • Opportunity to save in a bank account and access	• Clients having to walk to the nearby agents to repay now substitute doorstep deliveries.	• Clients should be educated on technology interface to keep the active and

[5] In business model where a group leader is responsible for collecting repayments from individual members and deposit them at CSP point

Stakeholders	(+)	(-)	Action Points
	other banking products • Confidentiality and flexibility – if individual members can pay their dues to third party agents at a time convenient to them. In group meetings, discussions happen in a group of 5-10, hence people are exposed to larger audience if they are not able to repay.	• Charges for transactions, if levied on customers would further restrict them to transact, especially when they make comparisons with earlier settings • Adaptability to technology interface may be major issue for clients who are not educated enough (especially in case of mobiles being the front end interface)	engaged in changed settings • Feasibility of subsidising charges for repayments via electronic channels should be considered especially in the event of operations becoming more efficient for concerned service provider
CSPs	• Additional revenue line (in case CSP already has a core business)	• Given the experience of low activity in NFA accounts, many a time CSPs may become over dependent on MFI operations (particularly repayment collections) for their revenue streams • Liquidity issues in case of loan disbursals being cashed-out from CSP point	• MFIs need to constantly innovate to offer multiple products along side NFA so that both customers as well as CSPs see a value in the proposition. • Since CSP is likely to know its customer base well, MFIs can see CSPs as potential referral agents for recommending clients for its micro-credit program and should get incentivised for the same • Service provider should roll-out multiple products so that CSP has enough volumes to keep him engaged in the ecosystem.

8 Getting ready: key strategic requirements for MFIs

Once MFIs have figured out the opportunities and potential impact that BC operations may have on their core operations, the next step is for MFIs to explore the key strategic requirements that BC operations entail. Some of the broad areas that must be considered include:

- ***Cashflow profile***. What are the upfront investments that they need to make in order to function as BCs? What is the time horizon that will be required to break even? What will be the funding sources to cover these investments?
- ***Key partners***. What are the criteria to be used to select the partner bank and TSP? To what extent does the MFI want to retain the various channel management roles (as BC, ANM and CSP) itself, or to delegate it to third parties? What are the key roles and responsibilities between the various partners? We address this set of questions further in the next two sections.
- ***Customer acceptance***. What is the level of client literacy and their ability to understand the new BC-based services? What are the marketing messages and use cases that will most inspire customers to try the service?

- ***Technology and operational readiness***. What is the current state of technology that is available for BCs? Are the MFIs' back-office systems ready to handle real-time transaction accounting? Does the MFI have sufficiently robust processes to handle account openings in conjunction with banks?
- ***Staffing and training requirements***. What will be the additional staff requirement for BC operations? This will be particularly important for NBFCs that cannot use their existing staff members for BC operations. Moreover, what will be the training requirements for their staff to be able to offer BC services to clients? While most of the staff will have prior experience in cash management, many might have very little experience with technology or savings services.
- ***Regulatory clearances***. Does the MFI comply with legal requirements for a BC? This will be an issue particularly for NBFCs.

9 Key choices for MFIs in channel development

One key decision in a bank-MFI tie-up is to decide who will act as the CSP, in other words, who will take on the task of dealing directly with clients to promote the service, collect account opening documents and offer cash in/out on an ongoing basis. The CSP represents the point where cash is concentrated, and hence the CSP primarily takes on a substantial cash management role.

One possibility is that CSPs are fitted into the existing MFI/SHG group structure. Field officers of the MFI take up the role of being the CSP, as an add-on to their group management functions. This leverages the front-line staff that NBFCs or not-for-profit MFIs have, but places a larger operational burden on them and is not consistent with an MFI strategy of driving towards cashless groups. This approach also means that members will not realistically have cash in/out opportunities outside of group meetings (perhaps unless they are willing to travel to the MFI branch which might also act as a CSP), which limits the convenience of the savings proposition. It is also likely that the savings channel will be used primarily by MFI clients who need to attend the meetings anyway, and it will not cater so much to people in the broader community.

Alternatively, the group or cluster leader (herself an MFI client) can be nominated to act as the CSP. This is more feasible for SHPIs, which operate more and bigger groups but have fewer front-line staff. This offers the opportunity of using the BC model to create new entrepreneurial opportunities for SHG clients in support of their members. Because the group or cluster leader is locally based, she can continue offering CSP services outside of group meetings, to meet members' needs on a more continuous basis and also to better serve people in the community who are not themselves members.

A third possibility is to appoint third-party retailers –mom-and-pop shops in the community—to act as CSPs. This takes the cash in/out business outside of groups, and is more consistent with a vision of cashless MFIs and shorter meetings. This approach would be better placed to create a dedicated, continuous CSP service for the whole community.

Figure 2 below illustrates the cash management models that can be adopted by MFIs for savings, credit (repayment and disbursement) and other services, depending on who takes on the CSP role and what support the MFI branch offers the CSP in managing its cash holdings (we call this a super-CSP function).In the figure, the arrows represent movement of cash. If it were for a loan repayment, this would offset an accounting adjustment of repayments due; if it were for a deposit transaction, there would be a simultaneous transfer of electronic value in the opposite direction against each arrow. The four models work as follows:

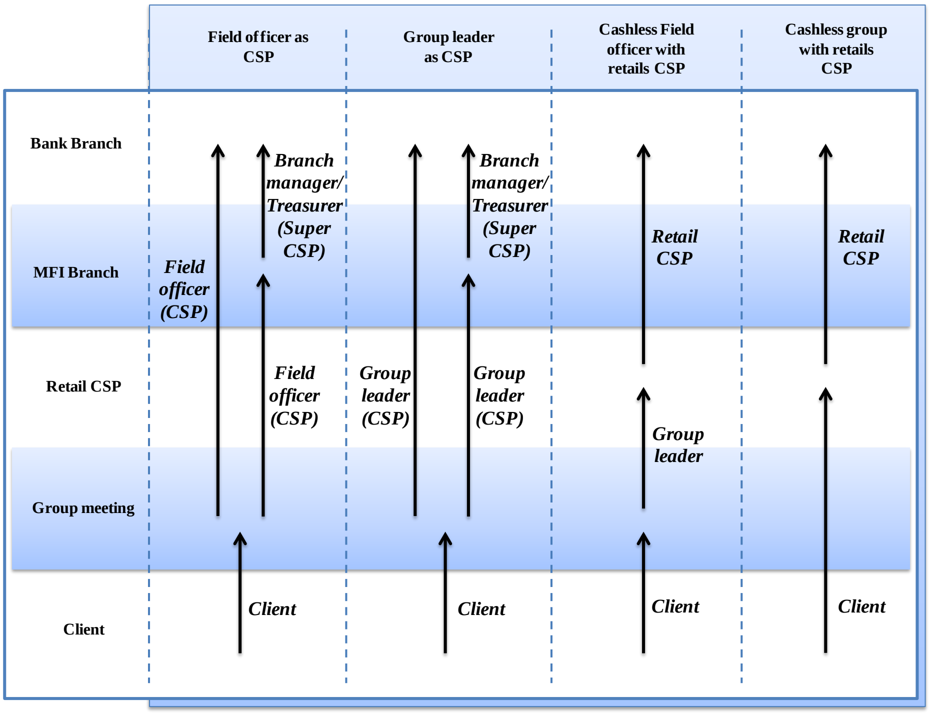

Figure 2: Service channels: Cash management under different loan repayment/ BC options

- ***Field officer as CSP***. The field officer of the MFI collects the loan repayments and deposits raised in the course of a group meeting. The field officer deposits the net balance in the nearest bank branch or with the branch manager/cashier at the MFI branch. In the latter case, the MFI branch acts as super CSP and takes on the role of depositing the money in the bank branch.
- ***Group leader as CSP***. The group leader, a client of the MFI, collects the repayment and savings raised, either during a group meeting or outside of it. The group leader then deposits the money in the bank branch or with the branch manager/cashier at the MFI branch, which acts as super CSP as in the previous case.
- ***Cashless field officer supported by retail CSPs***. The group leader collects the repayments as above, but deposits the money at a retail CSP outlet nearby. The retail CSP takes on the task of depositing the money in the bank branch.
- ***Cashless groups with retail CSP:*** MFI clients use the CSP directly for cash in and cash out, completely outside of group meetings. Clients will remotely make repayments using their bank account balance.

To the extent that the MFI relies on third-party stores as CSPs, there are different roles that the MFIs can assume in managing the CSP network on behalf of their partner bank.

- ***Drive the channel: be both BC and ANM***. The MFI can be a direct BC for banks and manage their own agent network. This maximises their control over the channel, as they can take a broad range of roles to ensure that CSPs work effectively for their members and their field officers. However, this places a high operational burden on the MFI, which it may not be prepared to absorb. SHPIs and NGOs may not have the right competencies and skills required for agent network management; NBFCs do but they are precluded by regulation from using their own resources for BC operations so they will need to develop a parallel infrastructure to build and manage the CSP network.

- ***Structure the channel: be BC but not ANM***. The MFI can be the BC of record and take the strategic lead in orchestrating the creation of a CSP network, but delegate the day-to-day operation of the network to an ANM. In this fashion, the MFI can take steps to ensure that the network is built in such a way that it covers its geographic footprint and serves the interests of its members, but without getting involved in liquidity management and direct supervision of the agents. This does, of course, introduce one more party (the ANM) into the BC service chain, which needs to be managed and adequately remunerated. This model may be more suitable for an SHPI, which can appoint SHG federations as ANMs.

- ***Support the channel: be ANM but not BC***. In this case, the bank and the MFI look to an existing BC to orchestrate the development of the CSP channel, but the MFI offers to support the CSPs appointed by the BC that fall under its geographic area of operations. This model would make more sense if a single party takes on the dual role of BC and TSP (e.g. Eko, FINO, A Little World, etc.). As an ANM, the MFI would be responsible for helping CSPs manage their liquidity and for supervising their activities. This model helps MFIs to remain focused on their core lending business while offering some logistical support to BCs within their geographic footprint.

In addition to sorting out how to structure the CSP channel, MFIs and their partner banks need to evaluate the technology options that link the various channel players, keeping in mind the value proposition that they want to offer to their clients. A key decision is who interacts with the technology platform:

- **Interactions managed by MFIs' field staff**. Field staff can be given feature phones, smart phones or point-of-sale (POS) terminals, through which customer transactional data can be captured in real time. If the MFI's objectives are to improve efficiency in their credit operations only, members do not need to be involved directly with the new front-end technology. However, if savings are to be mobilised, clients will need a way to authenticate themselves to authorise withdrawals. This can be done by deploying cards and assigning a PIN to each member (two-factor authentication) or through a biometric fingerprint reader incorporated into the field staff's device (single-factor authentication).

- **Allowing direct interactions by clients**. Mobile-based technology puts customers in more direct control of their money because they can initiate simple transactions (such as balance inquiries and basic electronic payments) themselves. A mobile-based service also presents unique opportunities to establish a direct communications channel between the MFI and all its clients via text messaging campaigns, which could be useful to announce new services, remind customers of loan repayments due, promote savings behaviour, etc. A mobile-based system may be cheaper overall to the extent that it uses phones that people already have, but not all customers may own a phone or be comfortable running data applications on it, which limits its spread across the MFI's member base.

10 Key choices for MFIs: Partner selection

MFIs need to work with a bank that shares their vision of financial inclusion and is recognised and trusted by their members. The banks must demonstrate a commitment to invest in the processes required to handle account opening and customer support, and to specifying turn-around times for loan approval and disbursals, account opening, and transactions processing along with a monitoring function in place. The MFI must feel comfortable that the bank will be sufficiently agile and adaptable to meet challenges as they arise. As most MFIs have their own set of objective to be met by offering BC services, it is very advantageous if the partner bank is interested in innovation especially in the product and front-end technology or user interface, to align BC operations with the MFI's objective. The following are some guiding questions that frame these requirements:

- What is the bank's perspective on financial inclusion? What is the bank's attitude towards the BC model? Does the bank view financial inclusion as a long-term business strategy or primarily just as a social obligation or to meet the need to meet the targets given by the RBI or the Ministry of Finance?
- Does the MFI already have a strong relationship with this bank (at the head office and locally) for current microcredit operations?
- Is there a dedicated financial inclusion team at the bank? Will a dedicated person or team be available to handle questions and issues as they occur? What are the standard policies adopted for the business correspondent model by the bank?
- Does the bank have a wide physical and brand presence in the area of operation of the MFI? What is the reputation of the bank among the communities that the MFI works with? How will the bank

ensure that local branches support the BC operations? Does the branch have enough staff and facilities at the local branches to accommodate BC operations?

- What are the products that the bank expects to offer through the BC channel? Are those appropriate for the MFI's customer base? Is the bank flexible enough to refine and change their products and processes to meet the demands of the target population? Is the bank open and eager for the MFI to participate in product design and experimentation?
- What initial and on-going support can the bank provide? (e.g. provision of equipment, initial operating subsidies for staff costs of 6-12 months, liquidity management, training or marketing support) Is the bank willing to commit to service-level agreements on account opening and dispute resolution? Is the bank willing to connect the MFI clients directly on its core banking system (CBS), hence allowing for intra- and inter-bank payments?

The selection of TSP is also a very important factor because the technology used by TSPs and their level (or lack) of support will influence customer acceptance and trust. Many of the TSPs for BC activities also have their own separate BC operations, and MFIs need to be comfortable that these other activities will not pose conflicts. The key considerations before selecting a TSP include track record of the company, reliability and robustness of the technology, security features, flexibility and usability. The following are some guiding questions that frame these selection criteria:

- Does the technology company have long-term experience in developing, rolling-out and supporting the required technology for BC activities? Does it have a good reputation among banks and BCs? Does it seem financially sustainable? Does the TSP have expansion plans and is it willing to work with BCs on a long-term basis?
- Is the technology standards-based? How flexible is the technology to meet the MFI's specific needs? How easy is it to integrate with the MFI's own technology platform? Is the technology user-friendly and appropriate to conduct BC operations? Does the technology company have a willingness to modify their technology based on the field situation and to serve customers appropriately?
- Is the current technology used by the TSP cost-effective? What kind of hardware is required and is it difficult to maintain? What are the typical up-front and on-going costs?
- Does the TSP provide training and on-going field support to BC staff and agents in the use and trouble-shooting of the technology? Does the TSP have a dedicated customer service hotline to call for questions and issues as they arise? Is the TSP willing to provide field level support to deal with daily/routine technological problems?
- Can the MFI generate the reports it needs?

11 Conclusion: the waiting game

In India, the business case of the BC model is yet unclear. The main limiting factor is very low customer activity rates. Low usage is compounded by the prevalence of unduly low pricing models on the basic savings proposition, which is based on a perception that customers have low willingness to pay for savings services. These two factors are of course linked: usage and willingness to pay are both a function of the strength of the value proposition that customers perceive. Ventures that have incorporated a remittance service have found both higher usage and the ability to charge higher transaction prices. However, the limited geographic coverage of these services limits the value of the remittance service. Where the value proposition is based on remittances, scale and network effects are all-important.

The BC channel provides banks and their partners with a plethora of opportunities. It is urgent that banks explore the value of services beyond no-frills accounts. The key to the success of any BC (or mobile money) deployment is value for customers to remain engaged. The service needs to be a mass-market solution and not limited to success with a small portion of the target segment. Banks can partner with MFIs to test and develop alternative value propositions, but banks remain in control of the product. So far, all their efforts in financial inclusion have been concentrated on channel-building rather than on construction of an attractive product proposition. This imbalance needs to be addressed. The challenge in the BC game is to provide services that customer wants and to find synergies between different players.

Thus, MFIs are potentially and excellent channel and product development partner for banks, as long as they have the capacity and resources to dedicate to it. MFIs can help all stakeholders to leverage their existing engagement with the customers. In this way, MFIs' core competence of customer engagement and management can be more fully exploited.

The BC channel has enormous potential in the long-run, and there are obvious synergies between large banks and grass-roots MFIs. However, while banks' interest is dominated entirely by the need to fulfil customer acquisition mandates, their activities will remain focused almost exclusively on channel development. MFIs can only urge banks to refocus attention on the product proposition, but they cannot themselves make it happen. While that remains the case, MFIs must be careful in making commitments to banks, which entail disruption to their group operations and significant investments. The best position they can take is one of "active wait and see:" monitor the space closely, work with banks in BC deployments in a limited, cost-effective manner, continue building stronger relationships with banks, and jump at opportunities that might present themselves to work with banks to sharpen the product side on a localised basis. The entire sector is still searching for a blueprint, and MFIs have valuable inputs to bring to that.

Further reading

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