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Policy Brief # 6

Assessing Agent Profitability: *MicroSave*'s Agent Journal Studies

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1. Background

Profitability of the agents is at the foundation of a successful agent network. For the agent, the profitability not only determines her/his loyalty to the agent network manager (ANM), but also motivates her/him to provide better customer service, endeavour to increase the business and accept the inevitable challenges as the business proceeds. All these factors, in turn, drive the profitability of the ANM and the bank. Profitable agents also help in the recruitment of new agents by spreading a positive word of mouth about the business. In nutshell, the profitability is the major source of optimism about, and belief in, the business model. Hence, it is very important for all stakeholders to understand the drivers of agent profitability and try to make them work in the favour of the agents.

However, developing a precise and realistic estimate of profitability necessarily requires understanding the drivers of profitability. Unfortunately, it is not easy to estimate agent profitability. While revenue calculation is straight forward, estimating the real costs associated with the business is more complex. Revenue can be fairly easily derived from the standard commission structure and transaction data, a record that most agents maintain. The transaction records are also easily retrievable from the servers of the ANM and the bank. However, when it comes to the cost items, most agents do not record expenses incurred in conducting banking business. A good example of this is travel expense, incurred mostly in trips to banks to rebalance e-float/cash positions, which is a key cost driver for an agent with sizable banking transactions and making frequent trips to the bank.

Most agents operate multiple business lines and this further complicates the calculation as many costs are shared among the business lines. These costs include rent, electricity, GPRS connectivity etc. All these factors transform a simple task of calculating profitability into a challenging exercise of gathering precise data and identifying appropriate costing procedures to allocate the shared costs.

In mid 2011, *MicroSave* conducted a series of studies with the agents to understand the issues mentioned above. One of the key objectives of the study was to overcome the data gaps and thus assess the real profitability of agents. For this, a unique research methodology called agent journals was used. The research teams stayed at 23 agent locations from the start to the close of the business to record all transactions - including the (cash in/out, account opening etc.) and non-banking (sale of goods/commodities) transactions - at the agents' outlets. All the relevant details were recorded in a specially designed log for each agent. The research team spent two days at each agent location. This detailed data set was used to calculate the profitability of the agents. The profitability estimates were then analysed in the light of the actual observations of the business operations and qualitative inputs from detailed discussions with the agents. This led to identification of the drivers of agent profitability and the measures needed to improve it. The report presents the profitability estimate for the agents studied and the associated drivers. In the interests of confidentiality, the identities of the ANMs studied have been removed.

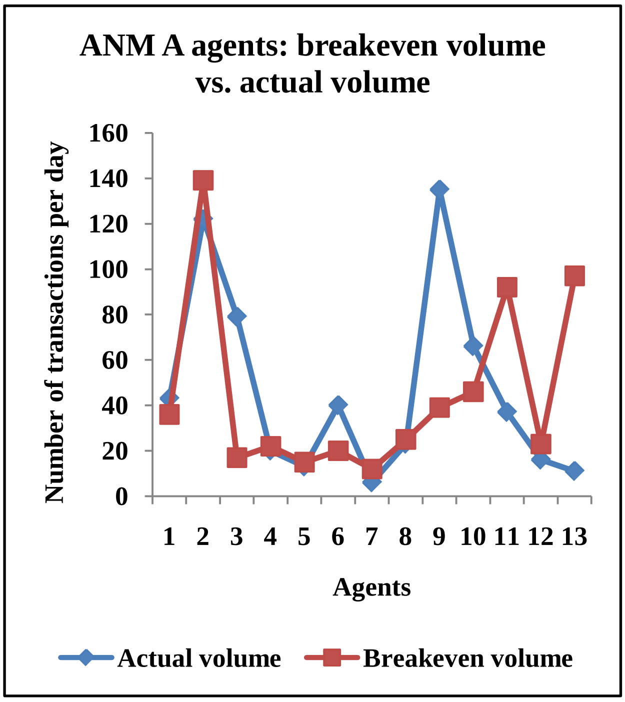
The agents covered during the study had clear and mutually exclusive product focus. Based on this focus, three distinct categories of the agents emerge:
1. Remittance focused agents,
2. NFA focused agents and
3. G2P focused agents.

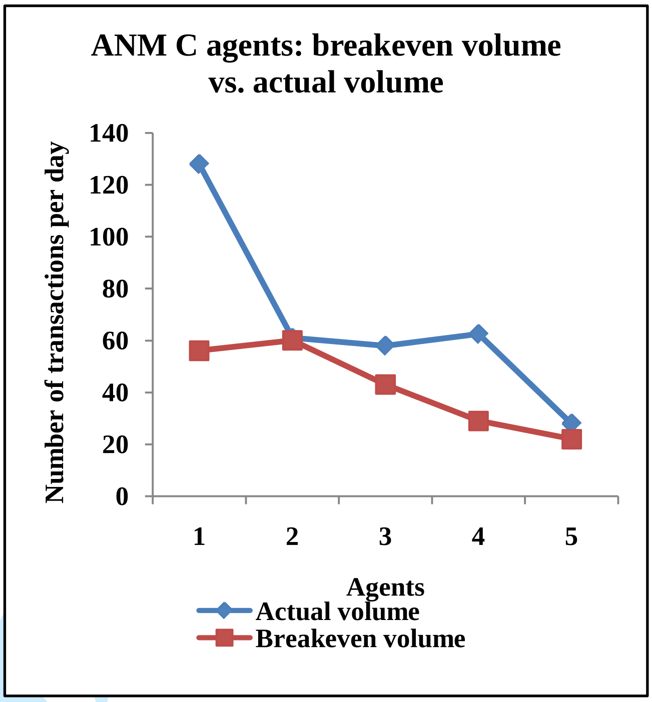
The three categories of agents differ significantly in terms revenue and costs as well as the challenges affecting the two.[1] Hence, they have been analysed separately.

2. Remittance focused agents

2.1 Most of the remittance focused agents perform below or close to breakeven

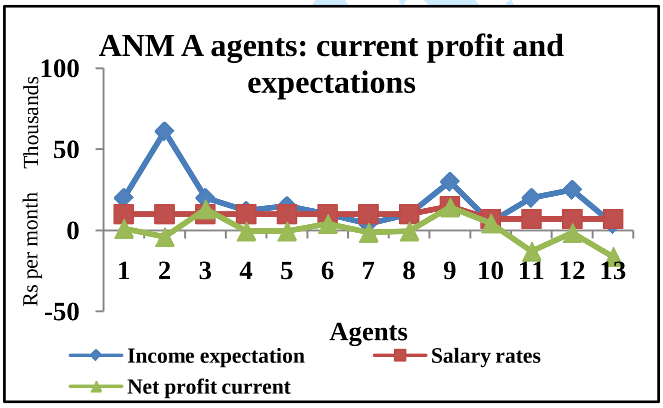
The graph below shows the performance of these agents:[2]

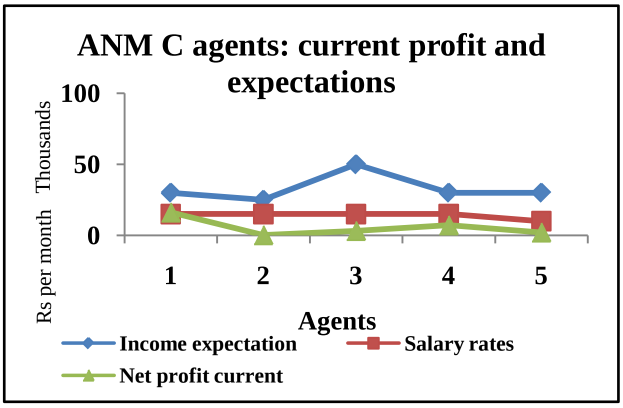




Allocation based costing has been used to estimate costs (for details see Annexure III). As shown in both the graphs above, most of the agents are either below breakeven level or just about attaining breakeven. Specifically, nine out of thirteen agents of ANM A belong in this category. Two out of five agent of ANM C are in this category. Four out of a total of eighteen agents covered under the study are clearly below breakeven.[3]

The graph below shows the comparison of net profit earned with the salary rates of the location and the income expectation of the agents.





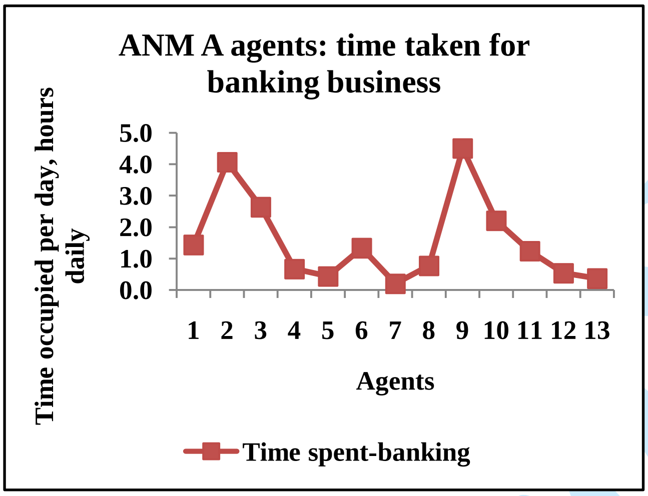
[1] Please refer Annexure I for the difference between the three categories.

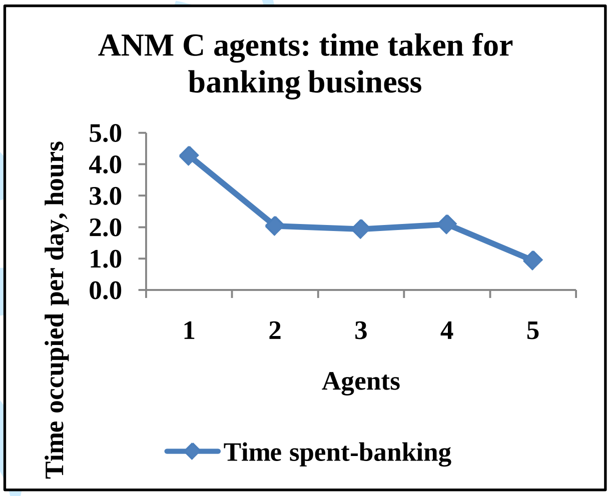
[2] Please refer annexure III for assumptions for calculating the profitability of the agents

[3] Please note that the breakeven number is a function of costs incurred by the agents. The specific cost items are rent allocated to this business, the level of working capital and miscellaneous costs. The range for the two key items rent and working capital is very large in the sample. This is understandable as the location of agents varies from Metros with very high rents to suburban areas of Bihar. Furthermore, the working capital level also varies from Rs.500,000 to Rs.20,000. And of course, once an agent is handling a critical number of transactions, he/she will have to hire an assistant, which drives up expenses. As the sample is very diverse, so are the breakeven numbers for the agents – including the breakeven number of transactions per day, which range from <20 to 140.

Clearly, the net profit of the agents below breakeven is negative. It is also noteworthy that the net profit of the agents who are above breakeven is small by comparison to local salary rates. The picture looks all the more dismal when compared with the income expectations of the agents. Only in one case, that of agent #10 for ANM A, the net profit matches income expectation.

The comparison with the salary rates is important. Profitability has been calculated without any charge for the time the agents put in looking after the banking business. The better the agent's performance, the more time is needed to take care of the banking business. The graph below shows the time taken by different agents for their banking business:





The time required is an essential consideration from two perspectives. First is the potential need for additional manpower as transactions increase. When they first start with the banking business, agents manage the customer footfall themselves and hence save on the salary cost. This helps them enhance their profitability. However, as the transactions increase, it may not be possible to the agent to manage the banking as well as non-banking transactions, and the agent needs to appoint someone exclusively for banking business, which of course, impacts profitability.

The second perspective is that, as time has not been charged in the profitability calculation, a sub breakeven performance means that the agent is actually paying from his pocket to run the business. Four out of eighteen agents in the study were doing just that. Another five agents of ANM A and two of ANM C were just about managing to attain the breakeven level. This is all the more alarming since all those shown in the graph have been agents for more than a year, which implies that they have been struggling with lack of profitability for all this time. Since profitability is one of the key determinants of agent loyalty, the current situation does not augur well – the agent network managers can safely expect still more churn.[4]

2.2 Reasons for lack of profitability

There are multiple factors causing lack of profitability. They fall into two broad categories: those affecting the revenue and those affecting the cost. Based on the agent journal research, the factors are:

- Agents' location;
- Marketing support provided to the agents by the ANM and the bank;
- Liaison with the link bank branch; and
- Quality of the backend support.

The only factor that significantly affects the cost is the level of working capital deployed for funding the transactions, (which also plays into the cost of transport for rebalancing at the bank or with the super agent, when this is required). These factors have been discussed below in detail.

[4] The responses to the survey conducted by *MicroSave* in March 2012 for the study "State of Business Correspondent Industry in India – The Supply Side Story" revealed that agent churn rates amongst the leading agent network managers in India ranged between 22-43%.

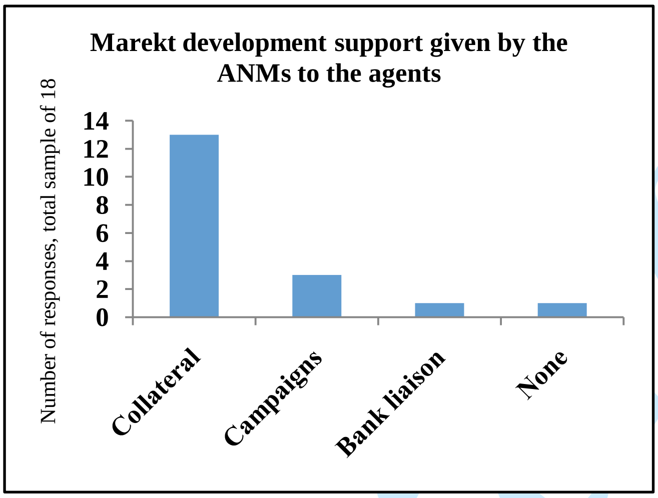
2.2.1 Location of agents

Remittance business is driven by migrant populations. It is characterised by one way flow of cash, from the destination to the source. Thus agents located in the urban areas with a significant migrant population see larger volumes of the business.

However, in any city, however big, the areas with sizable migrant population are going to be limited. Many of the cities may not have any significant migrant population at all. Thus, while choosing to locate agents based on migrant populations may be beneficial for agents, it is limiting for the ANMs, as well as the banks they serve. While remittance-based profitability is currently driving the behaviour of ANMs,[5] in the long-term, and to achieve real network effects, it will be essential to expand the product offering and respond to the wide range of financial needs of the low income market segment.[6] The ideal mix of the products needs to be researched further, but is discussed in *MicroSave's* India Focus Note 79 "Graduating SBI *Tatkal* Customers".

2.2.2 Marketing support to the agents by the bank

Banking outside the brick and mortar branches is still a novel concept for most of the target customers. Almost all of the prevalent e/m-banking models require the customers to trust a channel not traditionally associated with banking, and to use a technology with which they are not familiar. Hesitation is the natural outcome. To counter this challenge, the business model needs to be backed by strong marketing. This is an area where the ANMs, banks and ideally the government, must to play a significant role.



At present the involvement of ANMs in marketing is limited to providing collaterals. Some limited support is also given in form of campaigns, and facilitating bank liaison. There are many cases when agents receive no market development support from the ANM at all. The adjacent graph shows agents' responses on the market development support given to the agents by one of the ANMs.

In order to improve the situation, the ANMs need to adopt a strategic approach to marketing. This approach comprises of three main pillars – 1. corporate brand strategy; 2. product strategy; and 3. product delivery & customer service strategy. The elements must all be addressed as there is much interplay between them.[7] The specific challenges that need to be addressed include identifying and responding to real customer needs; creating a winning message; overcoming limited customer knowledge and trust; selecting the right promotional activities; increasing budgetary allocation to marketing; and addressing customer service related issues.[8] Marketing must necessarily be a joint effort of the bank and ANM. However, banks have to play a much greater role in this due to their stronger brand and reputation, as well as their greater financial resources.[9] In addition, government – both state and national level – needs to highlight and legitimise agent-based banking in India to help overcome trust barriers that are prevalent, particularly in rural areas.

2.2.3 Liaison with the link bank branch

Relationships with banks are very important for the remittance business. Banks can and should help by:

- Referring the customers to agents (this is being done increasingly for remittances of <Rs.10,000);
- Allowing the agents to display their contact details and collaterals in branch premises; and

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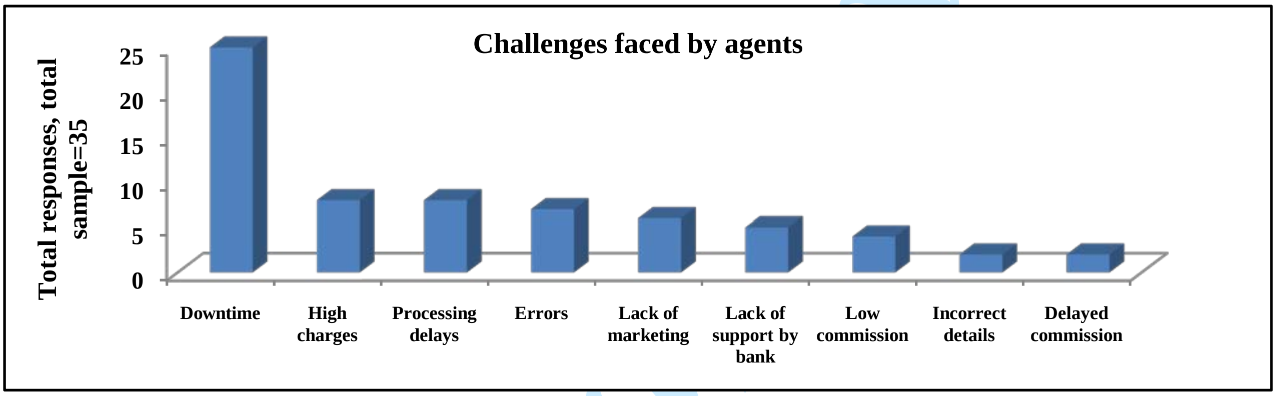
[5] See *MicroSave* Policy Brief # 3 Remittances - The Evolving Competitive Environment
[6] As discussed in *MicroSave*'s India Focus Note 65 "Successful Banking Correspondents Need a Compelling Product Mix"
[7] See Briefing Note 102: "Marketing E/M-Banking More Deliberately and Strategically"
[8] See Briefing Note 103: "Top Marketing Challenges For E/M-Banking"
[9] See Kapoor, Raunak and Shivshankar V, "State of Business Correspondent Industry in India – The Supply Side Story", *MicroSave*, India, 2012

- Processing banking transactions of the agents on a priority basis, thus saving the time for agents.

At present, the liaison is typically more as a result of initiatives by individual agents rather than a network-wide response. Liaison and support needs to be an institutional response, driven by the bank from head office all the way down to each and every branch.

2.2.4 Quality of the backend support

As noted above, agent-based banking is new for customers and requires them to trust novel channels with their money. Trust is essential and is driven by many factors, one of the most important of which is the reliability of the performance of the system. Lack of reliable back end support is the most common complaint of the agents. This can be observed in the graph given below.

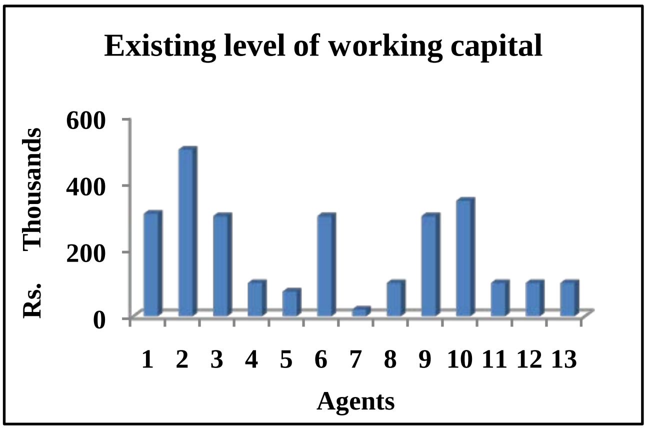


Based on the study findings, it can be said that the current system performance leaves a lot to be desired in terms of trust-inspiring performance. The trouble starts with the attempt to perform the transaction. In many instances, the customers have to visit many agents to get the transactions done. This is most typically necessitated due poor network connectivity, but sometimes also due to limited liquidity with individual agents. The process of sending a remittance is largely error free as the transaction is completed only after proper authentication. However, the instances of delay in crediting the remitted funds to the recipient's account are common. The causes are not clear, as the agents could not point to a specific reason for the delay. These are very nervous moments for the customers as they generally do not get any satisfactory explanation from the agents. Here, the agents also cannot be blamed as they themselves are clueless most of the times in such situations. The call centre support, generally promised by all the ANMs to the agents at the time of enrolment, is inadequate at best.

Inconsistent performance of the back end support system eats into the trust in the services. It also leads to increased cost of doing business and opportunities for fraud – most commonly by telling the customer just to leave their deposit or remittance and assuring them that it will be processed once the system is back up.

Working capital turnover:

Remittance is a working capital intensive business. The adjacent graph shows the level of working capital employed by the agents of one of the ANMs. High levels of working capital require a very efficient turn over the capital to minimise costs. At present, most of agents have very low turnover of the capital they have invested and tied-up in e-money or cash for their agent banking business. This contributes to the sub-breakeven performance of the agents.

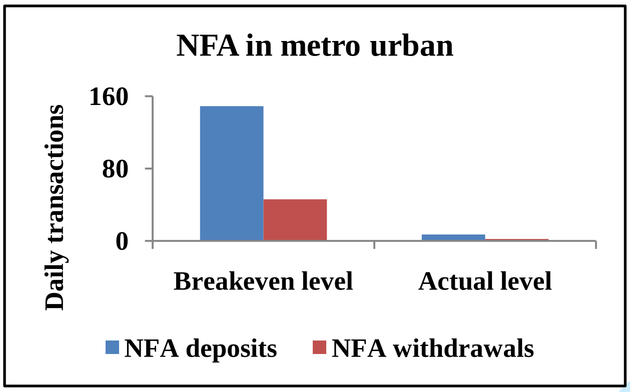


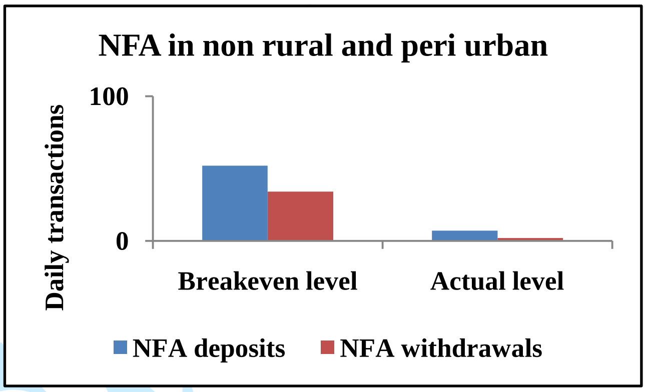
The additional advantages of high turnover of working capital is reduced opportunity cost. Excess cash that remains unused has very high opportunity cost, as the forgone alternative is to use it in the other businesses of the CSP such as airtime sales or stocks of fast moving goods such as rice, flour, sugar etc.. The efficient use of capital helps reduce this opportunity cost.

3. No Fills Accounts (NFAs) focused agents:

3.1 NFA focussed agents have too low volumes to become profitable:

NFA business is characterised by very low volume of transactions – NFAs are still scarcely used. Daily footfall for most of the agents are in single digits. The performance of the agents with significant remittance business is below breakeven.





Unsurprisingly, the breakeven level for the agents with significant remittance activity is much lower than that for agents without remittance activity. This is because, in the former case, fixed costs are allocated between remittance and NFA, while in latter case it is born only by NFA business.

Since the rural and peri-urban agents, are at the receiving end of the remittance corridors, they do not see much remittance business. Remittances sent are typically concentrated in specific, migrant dense, areas of the metros and cities; remittances received are spread across thousands of villages. The agents located in receiving areas rely mainly on NFA transactions for their banking business. This dependence results in poor performance of the banking business due to higher concentration of costs around NFA revenues.

3.2 Drivers and measures for better performance:

The drivers of performance are same as those for remittances. As described for remittances, spreading fixed and semi fixed costs across multiple lines of business and optimising the use of working capital locked in e-float are also essential to improve the profitability of NFA business. However, the most important change necessary to improve the profitability of NFA-focused businesses is improvement in the volume of business. NFA volumes are simply too low to provide meaningful income to the agents at the current commission rates. During the course of various research studies, *MicroSave* has come across extensive evidence of the willingness of the customers to pay for convenient banking services available at the doorstep.[10]This suggests a case for charging reasonable fees and providing better remuneration structure for the agents thus improving the viability.

The reasons of low transaction in NFA accounts are much more systemic in nature than those for remittance transactions. Agents do not have much control over the factors behind poor performance of the NFA transactions. However, the agents feel that following measures will lead to an improvement in the transactions and overall income for them:

- Increased enrolment of customers through more concerted marketing efforts by banks;
- Increased transaction limits to allow larger customers to transact using the channel; and
- An expanded product offering such as loan products, bill payments, MNERGA payments, fixed deposits etc.

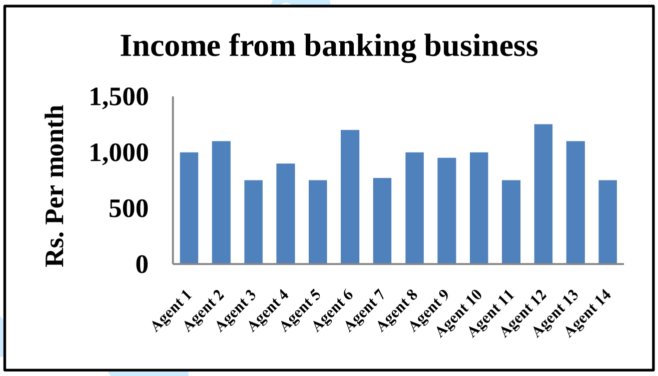
[10] See *MicroSave*'s India Focus Note 67 "Clients' Willingness to Pay "Reasonable Fee" for BC Services"

4. G2P focussed agents:

4.1 Like NFAs, the transactions volumes are low, also unpredictable:

The table shows the income and expenses of ANM B agent. The agent receives a fixed monthly salary of Rs 750 upon doing 80 successful transactions. He also receives 50 paisa for each transaction above 100 transactions. In addition, the agent receives commission on enrolment and card activation at the rate of Rs.5 per customer. His expenses are nil as there are no capital or operational expense from his side. Even the deposit money for becoming ANM B agent is provided by the *Panchayat.* The diagram shows the current income of all the agents in the sample using similar calculation. The average income per agent per month is between Rs.900-1,000.

Expected Income(Rs)	**3,000**
Actual Income(Rs)	
Fixed Salary	*750*
Commission	
-50p/transaction	*150*
-Enrolment & card activation	*250*
Total(Rs)	**1,150**
Cost Incurred (Rs)	**0**
Net Income(Rs)	**1,150**



Due to the subsidisation of the costs, viability is the not the ideal benchmark for the performance. Income expectation works as good proxy. The agents earn, on an average, 50% of their expected or desired income.

4.2 Drivers of performance and measures for improvement:

The only driver of performance in this case is volume of transaction as the costs are fully subsidised. The volume is linked to government mandate and hence is unpredictable. This assumption forms the basis of the following measures to be adopted for improving the performance.

Extend third party services through the existing agents

- G2P focused CSPs are occupied with the banking business for only about a week per month. It would be mutually beneficial to the ANM and agent to extend third party services from existing agent counters.

Aggressive marketing

- ANMs should market and promote the benefits of third party services to the customers to encourage demand. They should also communicate the benefits of these services to the banks, e.g. promotion of alternative revenue streams for agents thus making the channel more sustainable and robust – and less prone to churn, in order to win their support.
- BTL modes of promotion should be undertaken by ANMs to promote third party services among the potential customers. There is a need for such services. A proper marketing will be enable customer to switch from existing channels to ANMs.

Proper communication to agents

- ANMs should also ensure that the agents are briefed thoroughly about the correct incentive structure and the amount of work .This will help the agents to set their expectation along the line of work and will curb any inappropriate expectations.

5. Conclusion:

Profitability is an elusive target for most of the BC agents. This is true for all the agents irrespective of the services offered by them. However, the remittance focussed agents are closest to the breakeven level, enabled by high transaction volumes. Transaction volume also explains why NFA focussed agents, including the ones doing G2P payments, are typically so far away from breakeven. Such agents have too few transactions to result in a viable business case for the agents.

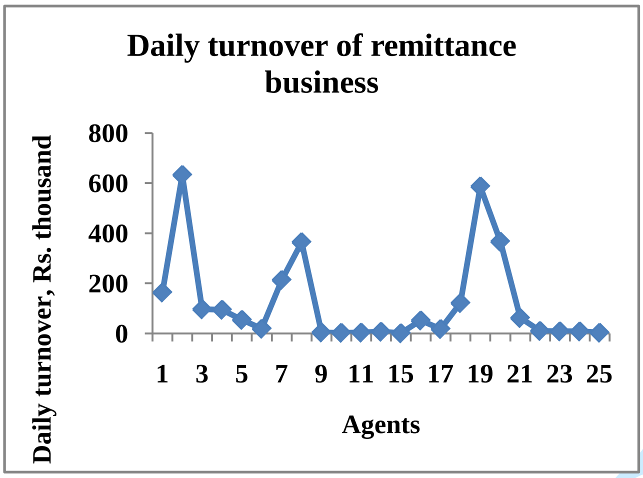
In case of remittance focussed agents, the small gap between current performance and a profitable performance can be filled in through specifically targeted measures to address issues such as technology downtime and marketing support. In case of NFA focussed agents, the key issue that needs to be addressed is the low volume of transactions. A key step towards doing this is improving the value proposition. This can be done by increasing the range of products to include a larger variety of banking products such as various categories of banking products, insurance and investment products. Value added services such as bill payments can also be added to the product bouquet.

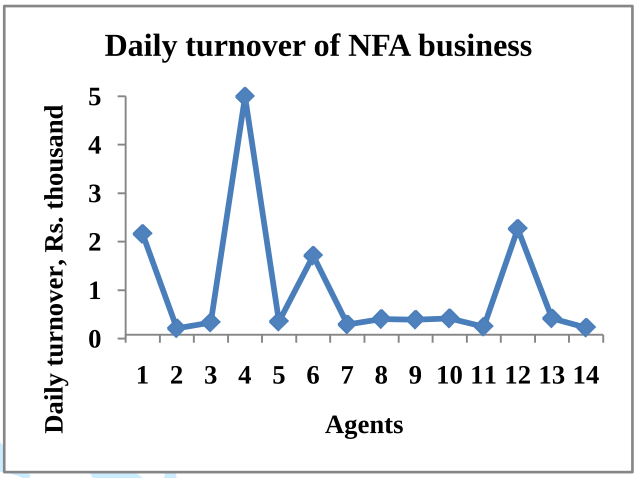
Annexure I
Comparison of the features of different categories of banking business (in the context of profitability)

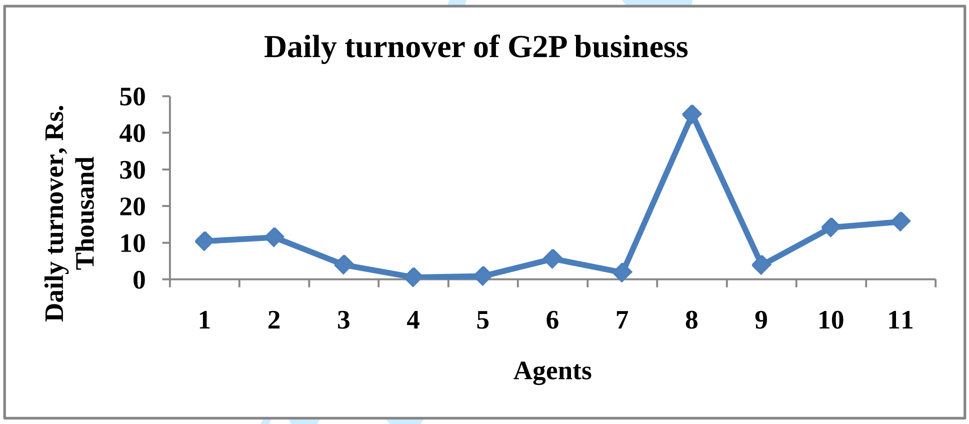
	Remittance focused agents	NFA focused agents	G2P focused agents
Major source of revenue	P2P transfers	Enrolments, cash in and cash out	Enrolments, cash out
Volume of transactions (please refer annexure II)	Very high	Low	High
Ticket size of transactions (please refer annexure II)	Very high	Low	High
Time per transaction	2 minutes on average	2 minutes on average	2 minutes on average
Footfall (corresponds to the turnover)	Very high	Low	High
Levels of e-float (corresponds to the turnover)	High	Low	High
Front end device	Computer/POS/Mobile	Computer/POS/Mobile	Computer/POS/Mobile
Online/offline	Online	Online/Offline	Online/Offline
Need for marketing	Moderate	High	Low

Annexure II

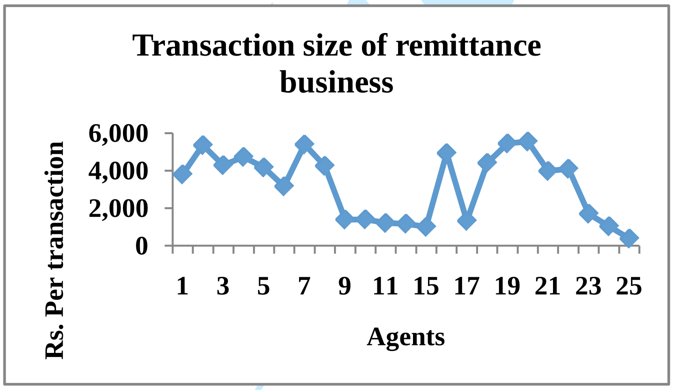
1. Monthly turnover of banking business

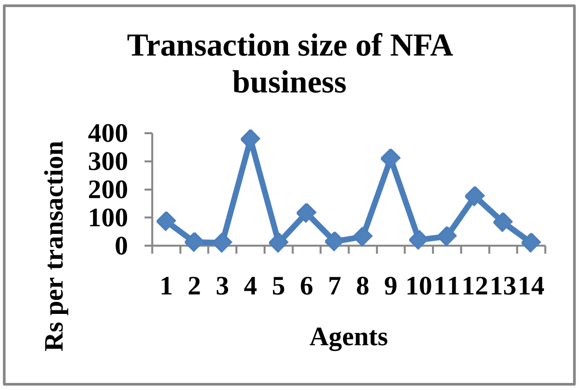


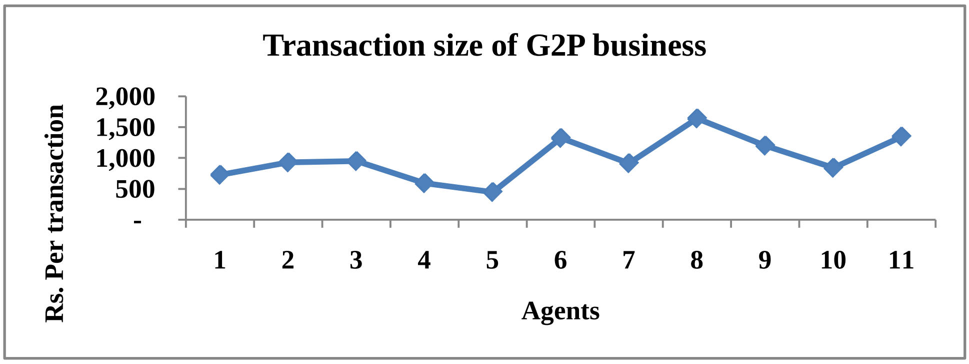




2. Transaction size of banking business



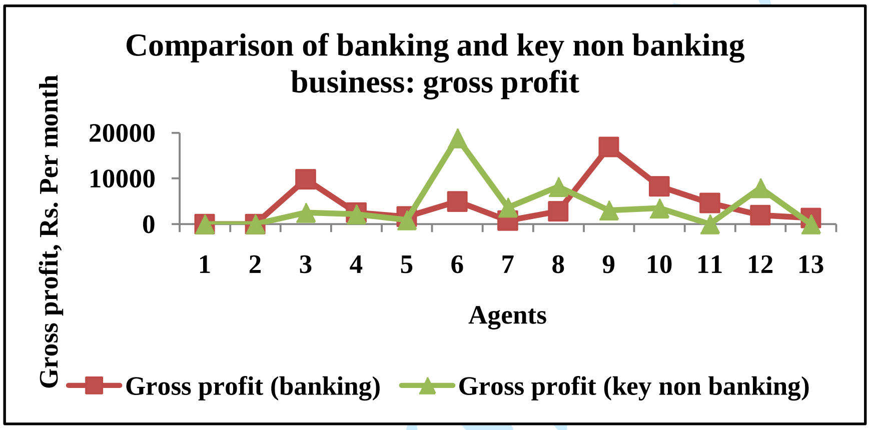


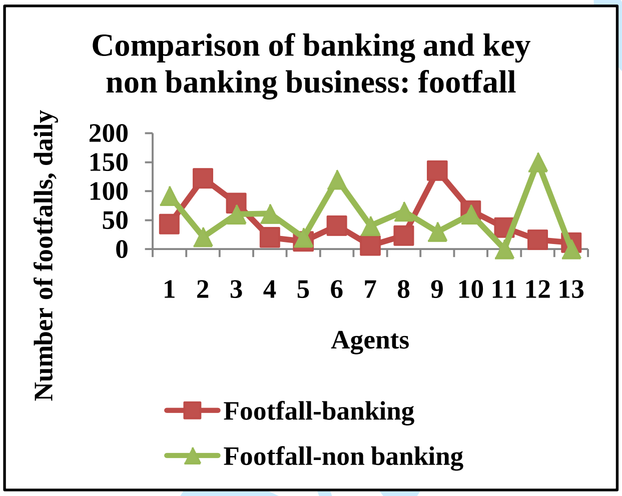


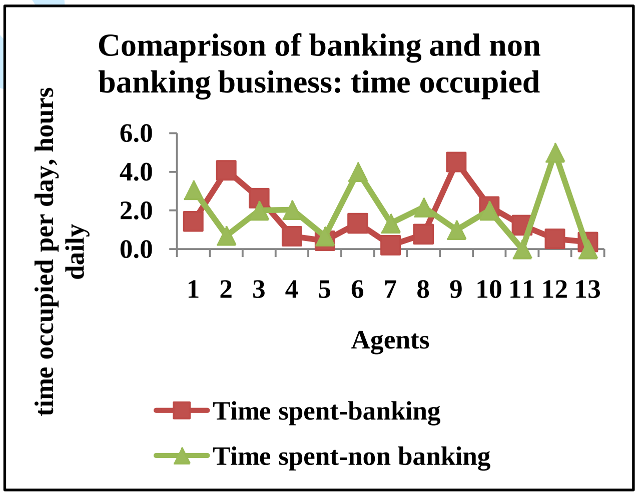
Annexure III
Estimation of profitability
Allocating shared fixed cost is a challenge

Some of the fixed costs such as rent and electricity are shared among the different business lines operated by the agent. This means that such shared costs need to be allocated to banking business based on a suitable criteria. One of the approaches to do so is marginal cost approach. Under this approach, all the shared costs are allocated to the core business and only incremental fixed costs are allocated to the banking business. The basis of such an allocation is the assumption that the shared fixed costs would be incurred even when the incremental business stopped.

Most of the agents have an existing business at the time of the start of the banking business. In the beginning, banking qualifies as the non core business, as it is the non banking business that takes most of the time of the agent and also contributes significantly to the overall revenue. However, as the banking business progresses, in certain situations it can surpass the existing business in terms of the revenue generated and time occupied. Given below is the comparison of the banking and key non banking business based on gross revenue, footfall and time occupied:







As the above graphs indicate, in case of seven out of the thirteen agents, banking business is either at par with the non banking business or is better. In some of the remaining cases, such as agent 8, 10 and 12 the gap between the non banking and banking business is not too wide to clearly distinguish one as less important business.

However, the above scenario changes when the type of banking product is also taken into consideration. The above scenario is possible only with high volume and more remunerative product such as remittance or a significant G2P business. However, for an agent offering only NFAs, the volumes are too small to contribute significantly to the overall revenues of the enterprise or to occupy significant amount of time of the agent.

Thus marginal cost approach is applicable in case of NFA focused agents or other agents still in the initial stages of banking business.

For all agents with significant banking business it is essential to allocate the shared fixed costs on well defined allocation basis to effectively analyse the profitability of the agency business.

For the purpose of this report, gross profit has been taken as the allocation basis for shared fixed cost. A simpler basis would have been the revenue earned by the agents. However, the revenue from banking business is not directly comparable with the revenue from non banking business. The banking revenue is the commission earned for the transactions. The non banking revenue in many cases includes cost of goods sold. Thus the two revenues become non comparable. The gross profit of banking business is actually the revenue as there is no cost of goods sold involved. The two differ in case of non banking business where cost of goods sold is involved. Hence, gross profit is considered to make the banking and non banking revenue comparable. The costs that have been allocated are: rent and electricity. No salary has been charged as the agents themselves operate the business in most of the cases and thus the net profit becomes the reward for not only the risk they take, but also for the labour they put in.

Given below is the profit and loss statement calculated based on the above assumptions and principles:

Calculation of gross profit, the allocation basis:

Business line: banking			
			Rs. per month*
Revenue			**9,812.5**
Commission from Transactions			9,812.5
Cost of Goods Sold			**0**
Gross profit			**9,812.5**
Business line: airtime resale with printing and internet services			
			Rs. per month*
	Activity: airtime resale		**Activity: printing**
Revenue	**16,912.5**	**Revenue**	**3,887.5**
Airtime resale	16,912.5	Printing	3,887.5
Cost Of Goods Sold (COGS)	**16,532**	**COGS**	**16,532**
Airtime purchase	16,532	Paper	777.5
	-	Toner	971.9
Gross Profit	**380.5**	**Gross Profit**	**2,138.1**
Total gross profit			**2,518.7**
Allocation			
Total gross profit			**12,331.2**
Share of banking			**80%**
Share of the only non banking business line			**20%**

*25 working days

Profitability calculation (Rs. per transaction)	**Commission slab 1**	**Commission slab 1**	**Commission slab 1**
Revenue per transaction	**5**	**10**	**13**
Commission per transaction	5	10	13
Variable cost per transaction	**0.26**	**0.72**	**2.33**
Cost of working capital per transaction	0.26	0.72	2.33
Contribution per transaction	**4.74**	**9.28**	**10.67**
Weighted contribution per transaction	**8.48**		

Fixed cost (Rs. per month)	**Full cost**	**Allocated cost**
Total fixed cost	**14,100**	**3,580**
Rent	2,000	1,600
Electricity	600	480
Airtime	500	500
Transport (going to and from bank)	1,000	1,000
Salary of one person (covering living expense only)	10,000	
Breakeven number of transactions per month	**1,664**	**422**
Breakeven number of transactions per day	**67**	**17**