

MicroSave India Focus Note 18

MFIs as Business Correspondents – To Be or Not to Be?

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May 2009

Background and Significance

The Reserve Bank of India (RBI) has encouraged the use of Business Correspondents (BCs) as a means for promoting financial inclusion in India. This IFN examines the viability of the BC model for MFIs, based on field experiences in India.

What is a Business Correspondent?

A BC provides banking services to clients on behalf of a bank.¹ NGOs, MFIs set-up under Societies² / Trusts Act, Co-operative Societies and Section 25 Companies can work as BCs.

Products on Offer

On behalf of a correspondent bank, a BC can collect small value deposits, disburse and recover small value loans; receive and send small value remittances; cross-sell third party products such as micro insurance, mutual funds and pension products, and engage in bill payments for services.

Stakeholders involved in BC Model

A typical BC model has three stakeholders:

- Banks** are interested in BC relationships so as to reach the unbanked, generate additional deposits, and sell other banking services.
- Correspondents** earn commissions from the enrolment of clients, transactions and deposits.
- Technology Providers** act as interface between the correspondent and the bank - responsible for providing technological solutions such as the authentication device³ and client cards.⁴ FINO⁵ and ALW⁶ are the two leading technology providers.

The profile of the organisations where BC model was reviewed:

	<i>Drishtee</i>	<i>Prayas JAC</i>
Profile		
Legal Entity	NGO	NGO
Operational Area	11 States	Delhi
BC of	State Bank of India	ICICI Bank

	<i>Drishtee</i>	<i>Prayas JAC</i>
Operational Unit	Kiosks	Branches
Technology Provider	ALW	FINO
Products - Savings		
Zero Bal Savings A/c	TINY	APNA
Normal Savings A/C	Yes	No
Term Deposits	Yes	No
Recurring Deposits	Yes	No
Products - Others		
Bank Loans	Yes	No
Insurance	No	No
Mutual Funds	No	No
Transfers	No	No

Typical Delivery Model

- Clients are enrolled by the BC after a thorough verification of the documents. Some banks charge enrolment fees (ICICI Bank charges Rs.200 per client, while SBI charges nothing).
- A card containing information about the client and the transactions is issued to the clients.
- All transactions are conducted at the BC's office and at the end of the day, the BC settles its account with the bank. The BC has to deposit money, if deposits are greater than collections. Otherwise, the bank deposits the difference to the BC's account on the next day.

Key Growth Impediments

Policy level:

- **Operational Limit:** One of the major setbacks for the model has been the operational limit of 5 kms for urban areas and 15 kms for rural areas for a BC by RBI.⁷ Demonstrating the RBI's desire to respond to challenges in the BC model, this has now been marginally relaxed to 10kms and 30kms⁸ respectively but still remains a significant limitation.
- **No Fees:** Another serious challenge to the BC model has been the prohibition of charging fees to the end user, which has made the development of a viable business model extremely challenging. As a result, it appears that many banks are offering "No Frills" accounts through the

¹ See RBI circular RBI/2005-06/288; DBOD.No.BL.BC. 58/22.01.001/2005-2006.

² RBI has advised banks not to engage NBFCs as banking correspondents.

³ A typical authentication device includes a biometric fingerprint reader, thermal printer and GPRS mobile phone.

⁴ Client cards are cards given to the clients by the bank for data storage and identification.

⁵ Set up in 2006, FINO works on developing solutions for the banks working with rural poor on BC model. One of the solutions developed by it is a personalised biometric smart card that is provided to each customer to act as a digital passbook for transactions.

⁶ A Little World is a technology provider, that works with banks and government schemes to provide low cost technology solutions for data management and authentication of poor clients availing financial services.

⁷ RBI Vide Circular - RBI/2007-2008/295 DBOD.No.BL.BC.74 /22.01.009/2007-2008

⁸ RBI Vide Circular - RBI/2008-2009/455 BOD.No.BL.BC.129 /22.01.009/2008-2009

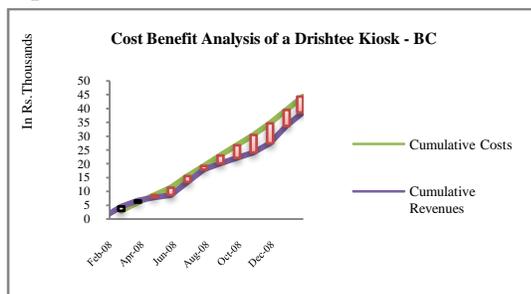
BC model as part of their corporate responsibility in response to RBI's pressure to promulgate financial inclusion. The current model creates incentives for both banks and BCs to open "No Frills" accounts (to report to the RBI and to gain the account opening fees from the bank respectively) and then to let the accounts lapse into dormancy – a pattern clearly seen across India.

Operational level

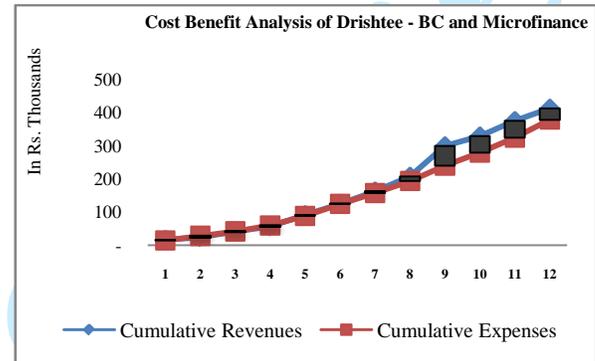
- **Processing Time:** It often takes almost 2-3 months to either activate the account or deliver activated cards for many of the clients - unsurprisingly, many accounts go dormant as a result.
- **Account opening fees:** Clients are apprehensive about the account opening fees charged by ICICI Bank. Public sector banks such as SBI, Union Bank of India, Vijaya Bank do not charge any fee for opening a zero balance account.
- **Island account:** Clients expect banks to offer cheque deposit facility as well as ATM Card. They complain that the card cannot be utilised anywhere else except BC's office, thus it has a very limited use. Many clients note that if the account is not networked with the rest of the banking world as other bank accounts are, they would not accept it as a bank account.
- **Deposits:** Some BCs do not allow any other than the account holder to deposit. It is impractical to expect clients to come to the branch every time they want to deposit.
- **Evidence of transaction:** Fixed Deposit (FD) clients get a print out/mini statement on a thermal print paper that lasts for a couple of days. Thus, the clients feel that the investment is insecure in absence of a lasting evidence of transaction.

Viability of BCs

Cost benefit analysis of BC at Drishtee and Prayas JAC demonstrate that the model as a standalone unit⁹ may take a very long time to break-even. The analysis reveals that the gap between the revenue and cost widens with increasing scale, which may further discourage MFIs to continue as BCs. A similar trend was observed for a kiosk (operational unit of Drishtee).



Also, as the kiosks were suffering losses, Drishtee itself also demonstrates a similar trend of growing losses over time as the BC model is rolled out. However, if Drishtee included micro-credit operations with its BC kiosks, then the breakeven period reduces significantly. Similar results have been seen in the BASIX group's KBS.



Conclusion

Experience to date suggests that BC operations in its current shape (primarily savings) might be viable only in a longer term perspective. Also, the real issue is to how to convert clients with zero-balance accounts and low-balance accounts into higher balance users as long as they face the problem of 'island accounts', 2-3 month activation lags. This model may be viable in a shorter run, if:

- Banks/BCs are permitted to charge small scale fees for the services they provide (there is broad consensus that the poor would be happy to pay such fees for a quality savings service)
- BC is taken up as one of the few activities by the correspondent with optimal cost-sharing arrangement among different business activities and the BC starts cross-selling other financial products which adds up to BC's business by providing commissions:
- Banks/BCs conduct research to understand the real needs and aspirations of the poor and tailor products to respond to these.
- Added to these the BCs might need capacity building in the areas of mobilising deposits and the banks can think of using core banking solutions to provide better services to the clients belonging to lower end of the spectrum .

These steps could add immense value to the business of BCs/MFIs resulting in symbiotic benefits for their operations ... and real and rapid financial inclusion in India.

⁹ Here standalone unit means that the agency offers savings products singularly and not juxtaposing it with other line of activities and revenue streams such as micro-credit.