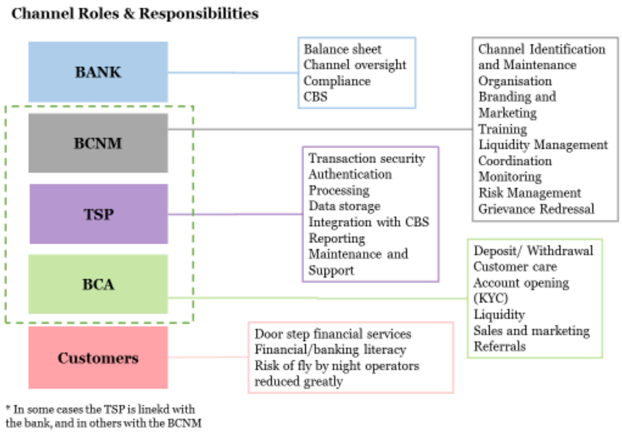
MicroSave India Focus Note #115

Lessons from the Costing Study on BC Networks

Jitendra Balani, Prabir Barooah, Sakshi Chadha and Raj Kumar

May 2015

At the request of Business Correspondents' Federation of India (BCFI), *MicroSave* conducted a costing study on four Business Correspondent Network Managers (BCNMs) and their Business Correspondent Agents (BCAs) to ascertain the costs involved in providing savings, withdrawals, deposits and remittances to the under-banked population. In this Note we present the findings, discuss some of the lessons learnt and assess how these may be useful in developing a sustainable delivery channel offering financial services to bottom of the pyramid market.



BCNMs form a critical link in the financial inclusion value chain by managing a network of agents who perform banking services in underserved areas. We reviewed BCNMs using different technological models (computer-enabled kiosks, mobiles and POS machines) to conduct banking transactions. At the level of BCAs, we covered both rural and urban agents. Key findings included:

Total channel costs are higher than total revenues

Total channel cost[1] is defined as the cost incurred at the level of the BCA along with the average cost incurred by the BCNM to manage one agent outlet. In our study, we found that the total channel costs for an agent outlet is Rs.7,883 or $127 (cost weighted for number of agents per BCNM). For BCNMs, we have considered all staff and non-staff costs excluding commissions paid to BCAs. Instead, we substituted the BCA commissions with their actual costs. This helped us determine separate costs at both the BCNM and BCA levels. BCAs were treated as separate entities and their full cost structure was analysed to get the real cost at their level. The combined revenue per outlet (sum of revenue earned by BCNM and BCA) is only Rs.6,156 ($99). The difference (Rs.1,727 or $28) between revenue and costs highlights the challenges facing BCNMs and BCAs as they seek to achieve break-even.

Split of costs varies across different models

In the overall channel costs, the BCNM and BCA split varies greatly across the model assessed. Kiosk models incur a lower share of costs to the total cost at the network management (BCNM) level compared to other models.

The monthly agent maintenance costs (total cost of BCNM divided by the average number of agents managed) was Rs. 1,775 ($29) for kiosk model (rural and urban areas); and Rs.5,214 ($84) for mobile (rural) and Rs.5,169 ($83) for mobile (urban). Conversely, the BCA level cost is highest for the kiosk based model. In absolute terms the BCA level cost was Rs.14,796 ($239) per month for kiosk (urban), Rs.8,338 ($134) per month for kiosk (rural), Rs.2,913 ($47) for mobile (urban), and Rs.1,185 ($19) for mobile (rural).

Technological Model	BCNM share of total channel cost	BCA share of total channel costs
Kiosk (R)	18%	82%
Kiosk (U)	11%	89%
Mobile (R)	81%	19%
Mobile(U)	64%	36%

This is hardly surprising, given that mobile based BCNMs are more likely to take on a significant amount of cash handling and management compared to their kiosk based counterparts, who leave this function largely to their agents. In addition, a kiosk incurs much greater monthly fixed and variable costs, since a kiosk is more likely to be an exclusive ("dedicated") business establishment requiring full allocation of all the fixed and variable expenses; whereas for most mobile models the costs incurred for the BC business are marginal (incremental).

BCAs who fared better offered more than standard CICO products

Better performing BCAs offered more services than the standard CICO products. They were providing insurance, fixed/recurring deposits, mobile top-ups and Business Facilitator services in addition to standard deposit, withdrawal, account opening and remittance services.

Business volumes are the key

As in any business, the viability and profitability at both the BCA and BCNM level depends on the underlying business volumes. We found that where the BCNM was able to establish its BCA network on vibrant remittance corridors, the BCAs were profitable. One of the BCNMs was actually able to perform comparatively better because of its lower cost structure and higher business volumes – because it largely confined its operations to busy remittance corridors. Similarly, for other BCNMs, business volumes influenced the extent of losses. Where the BCNM has its network spread over areas with lower business potential, both BCAs and the BCNM struggled financially. This is because most fixed costs like field and

[1] We have not included bank in this analysis

non-field staff salaries, and rent must be incurred to manage and service the BCAs. This was clear in the case of one BCNM which is operating extensively in low density rural areas (e.g. villages with <2000 households). The costs to transact Rs.100 ($1.61) ranged from Rs.0.20 to 52.64 ($0.003 - $0.85)[2] for now stable BCNMs that have been in business for more than four years. The range of this ratio is mostly accounted for by the variations in underlying business volumes. In most cases, BCNMs are mandated by banks to set up agent networks in defined geographies leaving little choice for the BCNM to balance its revenue stream through a mix of high and low business potential areas. Remittance corridors have some potential to cross-subsidise BCNMs exposed to remote rural areas.

Business volumes affect the revenue structure

While revenue arrangements differed across banks (and often within the same bank as well), the revenue pay-out is often in relation to how much business a BCNM is able to do.[3] Since the revenue structure at present is driven by the business volume, there seems to be an inherent assumption that there will be enough business for the BCAs and BCNMs to be able to make profits. Our finding, however, contradicts this assumption. The weighted average cost to transact Rs.100 ($1.61) through the channel is Rs.1.81 ($0.03).[4] However, the total cost range for the entire channel ranges from Rs.0.81 (($0.01) to Rs.64.61 ($1.04) to transact Rs.100 demonstrates that there is a huge variability in the business volumes. This is substantiated by the fact that there were a very small number of BCAs, earning monthly gross income of up to Rs.70,000 ($1,120) as opposed to agents who are barely able to gross Rs.300 ($4.8). On an average an agent earned Rs.2,249 ($36) per month – however, the median is much lower. Given that the minimum weighted cost incurred by a BCA is about Rs.3,714 ($60)[5] per month - it is easy to understand the BCA churn rate (already in the range of 30-40%)[6] and BCNMs' concerns about remuneration. Given that BCNMs are not allowed to choose their business geographies, linking revenue to the business volume does not seem to be the best pay-out arrangement.

Basic minimum remuneration must be ensured but left to the BCNMs

To ensure the sustainability and quality of financial inclusion, the government must ensure that all BCAs are able to make profits, equivalent to prevailing skilled wage rates, on a monthly average basis. This will serve to sustain their interest in the business. How this remuneration will be ensured is something that needs to be further debated. Our learnings from the costing exercise and other research done by *MicroSave*[7] reinforces the view that the government needs to play the role of a market maker in these formative years of financial inclusion business. It is, however, very clear from the study that remuneration of BCAs can never be a "one size fits all" formula.

Further, if BCNMs are to be held accountable for customer service to ensure smooth financial inclusion operations and management of related risks, the importance of their role needs to be recognised and remunerated. BCNMs must be remunerated to cover their costs, ensure at least the basic minimum remuneration for their BCAs, and make a reasonable return on investment. Subject to BCNMs ensuring a minimum defined pay-out for their agents, how they remunerate their BCAs should be left to their prerogative. A BCNM's remuneration model for its BCAs could be a function of location, which impacts business potential of a BCA. This in turn could determine the technological and delivery model of the BCNM.

It is fair to argue that BCNMs that want to offer quality banking services to the underserved will remunerate their agents in a way to incentivise them to build, grow and sustain banking markets. If banks or the government were to start remunerating BCAs directly, this may compromise the role and ability of BCNMs to manage the BCAs. The risk of BCNMs exploiting the BCAs could be better managed through efficient audit mechanisms to ensure BCAs are compensated in line with regulatory guidelines as and when issued. BCNMs should be given freedom to develop their agent networks. Currently this remains a bank mandated exercise. We believe that this needs to be changed to allow BCNMs to appoint agents in high business volume areas subject to agents being appointed in the underserved areas – as is the case with bank branches. Again, the remuneration to these BCAs in different geographies should be left to the BCNMs, subject a minimum floor. This will create an even playing field and contribute to the viability of financial inclusion as a business.

Going forward

There is a clear need for common performance metrics essential for benchmarking and assessing BCNMs' performance. Metrics such as maintenance cost per BCA and cost per Rs.100 transacted are vital efficiency benchmarks. Transparent benchmarking and reporting at this stage will enhance competition, and may evolve over time as the sector achieves sustainable business models to support financial inclusion. This, however, is subject to the government creating a level playing field for the BCNMs by allowing them to demonstrate their business models and by allowing them the freedom to remunerate and manage their agents.

[2] Though cost per Rs.100 transacted could go much higher if business volumes are inherently low
[3] BCNM and BCA remuneration most often is linked to the business volume attained during that period
[4] The total cost to transact Rs.100 goes up to Rs.2.63 if we include bank in the channel
[5] In POS and Mobile technology models in rural areas
[6] See *MicroSave* Policy Brief 2: The State of Business Correspondence - Agent Networks in India – The Supply Side Story
[7] See *MicroSave* Policy Briefs 8: What Will It Take To Deliver 'Direct Benefits / Cash Transfer' Programmes Successfully? and 11: Optimising Commissions and Payout Mechanism For G2P Payments Under Electronic and Direct Benefit Transfer