MicroSave India Focus Note 65

Successful Banking Correspondents Need a Compelling Product Mix

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Introduction

Banking correspondents (BCs), or agents, are expected to underpin financial inclusion efforts in India. However, to date, the business case for BCs remains uncertain,[1] despite the Reserve Bank of India's (RBI's) efforts to relax policy to encourage successful growth of BCs. Nonetheless some commentators do still see the future of financial inclusion and microfinance in India dependent on successful BC models.[2] This Note lays out why a compelling product mix is central to a successful BC network.

Product Up-Take Has Been Poor To Date

The 2009 Skoch Report[3] noted that 89% of No Frills Accounts (NFAs) were dormant. Subsequent *MicroSave* research has nuanced this, revealing that:

1. Dormancy may be marginally lower than this in part because of legacy issues: many NFAs were initially opened with little intent to create transactional accounts, but rather for banks to report numbers to the RBI or for political purposes.
2. The rate of dormancy depends heavily on: a) the through-put of electronic benefit transfers (EBTs) – particularly MGNREGA[4] payments; b) whether the BC is bank branch-based, or more convenient if the agent is located in, or regularly visiting, the villages.[5]
3. The cost of operating bank branch-based accounts is often high in terms of direct costs (transport etc.) and opportunity costs (travel and the time customers have to wait for service in many branches). 77% of respondents in a recent *MicroSave* study lose Rs.10-50 in direct costs for branch visits, more if lost wages are included.[6]
4. Poor people have aspirations for more than a "No Frills", "Basic" or "Tiny" account. As *MicroSave* research in South Africa also demonstrated, unsurprisingly, people do not like the implicit label of being poor, or unworthy of full banking facilities. They aspire to full service account - ideally with card and cheque facilities (even if they are unlikely to use these).

Yet Research Shows An Enormous Need

An estimated 400 million Indians remain unbanked – and many more under- or poorly-banked. This despite the growing international consensus on poor households' need for savings services – most recently and powerfully elaborated in "Portfolios of the Poor"[7]. It is clear from research around the world that poor people need a variety of savings services to:

1. Smooth erratic cash flows, thus protecting nutritional in-take, keeping children in school etc.
2. Respond to emergencies and shocks arising from illness, accident, death etc.
3. Build-up lump sums to invest in business, land, social functions like weddings etc.

This variety of needs cannot be met by a single transaction account as characterised by the NFA. Poor people also need a recurring deposit account to give discipline and structure to the process of saving.

The deposits achieved by the itinerant agents of Sahara and Peerless bear testimony to the need for opportunities to save regularly through convenient channels.

	Sahara	Peerless
# of agents	>415,000	>140,000
# of deposit accounts	20,800,000	Not available
Rs. Deposits (December 2010)	18,055.7 million ($401 million)	Not available
Rs. Deposited & Redeemed since 1987 (Sahara) and 1956 (Peerless)	415,630 million ($9,236 million)	177,930 million ($3,954 million)

In addition, some households also need a fixed deposit account to set aside harvest proceeds or lump sums generated from the sale of assets such as livestock etc.

[1]See *MicroSave* India Focus Note 24 "Making Banking Correspondence Work in India" and 32 "Crossing the Second Break Even".
[2]See *MicroSave* India Focus Note 60 "Speculation on the Future of Financial Services for the Poor in India"
[3]**Kochhar,** Sameer, "Speeding Financial Inclusion", Skoch Foundation, 2009.
[4]The Mahatma Gandhi National Rural Employment Guarantee Act, which provides guaranteed 100 days of paid labour for poor households across India.
[5]**Platt** et al. "No Thrills – Dormancy in NFA Accounts", *MicroSave*, 2011
[6]Cost & Willingness to Pay report, *MicroSave*, 2011
[7]**Collins** et al., "Portfolios of the Poor", *Princeton University Press*, 2009.

The Alternative Options For The Poor Appear Unattractive

Because of the pressing needs highlighted above, and in the absence of access to safe, convenient and easily accessible options to save in banks, the poor resort to managing their money through informal systems. These include hiding money in the homestead (typically in bamboo or under the mattress), joining village savings clubs or chit funds[8] or signing up with one of the itinerant deposit collectors that make the rounds in so many Indian marketplaces. All these options have risks:

1. Money kept at home is often spent, simply because it is there; which is exactly why almost all people interviewed in *MicroSave* studies talk about needing to "get money out of reach – out of the house".
2. Savings clubs and chit funds are risky, and sometimes members do not meet their obligations, or run off with the pooled money.
3. Even if the deposit collectors do meet their obligations, they charge exorbitantly for the service they offer. Typically, a deposit collector prints a card with 30 boxes on it (one for each day of the month) and the saver commits to saving a certain amount each time the deposit collector visits. Once the card is full, the deposit collector gives the saver the lump sum generated, less one box as a fee. Thus if the saver commits to saving Rs.50 per day, she will get Rs.1,450 at the end of the month.[9]

The willingness to pay really quite significant sums for the convenience of a deposit collector highlights the potential for delivering a convenient, lower risk formal sector alternative through local BCs operating in the markets and villages.

High Volumes Are Required To Make The BC Model Viable

But it is not easy, or low cost, for banks to deliver savings services to the poor. Low income people typically make high volumes of low value transactions, and maintain limited balances in their accounts (or at least their transaction accounts). These behaviour patterns challenge the traditional economics of banking. In Africa, where transaction charges are commonplace, the charges levied by mobile phone-based banking systems are easily accepted. There are concerns that this might not be the case in India. Indeed, initially the RBI prohibited the levying of transaction charges; however "reasonable charges" are now acceptable. However, research by *MicroSave* suggests that many people are indeed willing to pay for a safe, convenient and accessible service.[10] 56% were willing to pay 1% and another 23% were willing to pay around 1-2% of the value of each withdrawal. But there may be considerably more resistance to paying for deposit transactions.

Nonetheless, setting up a BC system is an expensive proposition. In addition to the very significant investments required in technology (particularly for card-based systems that require point of transaction devices), the development and rollout of an effective, well trained, appropriately incentivised and tightly monitored agent management is also a costly and challenging proposition.[11]

High Volumes Will Attract Banking Partners

Commercial banks in India are under significant pressure from the RBI to set and then meet financial inclusion targets. These targets are now set in terms of both the number of accounts opened, and also of the activity in those accounts, so the old approach of opening accounts and then letting them lapse into dormancy is no longer a realistic option.

With the sanctioning of "reasonable fees", banks with a commitment to serving the low income market, such as the State Bank of India, now have the real opportunity to do this on a commercial basis and further extend their customer base. A well-managed network of BCs could provide the safe, convenient and accessible local banking service that so many poor households want.

By diversifying the range of services offered through the BC channel beyond the basic EBT and NFA, banks can drive the volumes and revenue streams to make the channel profitable. The latent demand for commitment savings is clear. Well structured and incentivised recurring deposit products could yield substantial stable balances and thus float for banks. In a similar vein, bancassurance products, which are largely used by poor households as long term savings mechanisms, are also likely to be a popular use of the BC channel. Over time banks can begin to offer automated overdraft/ emergency loan facilities on the basis of individual account holder's transaction history.[12]

This type of client-responsive product mix is likely to create the level of activity necessary to make the BC channel sustainable for both banks and the BC network manager, as well as for individual BCs themselves … thus creating true and meaningful financial inclusion.

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[8]Chit funds are Rotating Savings and Credit Associations (RoSCAs) – under which a group of people pool their savings regularly (usually weekly or monthly) and give the lump sum thus generated to each member in turn until all the members of the group have received the lump sum. Thus a 7 person RoSCA completes after 7 meetings and all members have received the lump sum.

[9]30 days of saving Rs.50 = Rs.1,500 less the fee of Rs.50 paid to the deposit collector.

[10]Cost & Willingness to Pay report *MicroSave*, 2011

[11]See *MicroSave* Briefing Notes 73 and 74 "Managing Agent Networks to Optimise E- and M-Banking Systems"

[12]Indeed some banks (including Central Bank of India, CBI, State Bank of Bikaner and Jaipur and Punjab National Bank) are already experimenting with this and offering very small overdrafts along with the NFAs as people open the account, in order to allow them to build a credit history.