MicroSave India Focus Note 90

Taking Financial Inclusion to the Next Level

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Banks and business correspondents (BCs), under the direction and supervision of the Reserve Bank of India (RBI) and the Ministry of Finance (MoF) are making concerted efforts towards financial inclusion (FI). In January 2012, *MicroSave* facilitated a dialogue amongst select banks, and institutional/MNO (mobile network operator) BCs to reflect on the progress made, the lessons learned, challenges faced and identify critical areas needing attention and collaborative efforts.

The following emerged as priority areas required to make access to financial services real and meaningful for the excluded.

Transforming BCs into an 'Alternate Channel'

Forward looking and innovative banks have taken partnership with their BCs to new levels over the past year. These efforts have, nevertheless, been far from universal. Many BCs have the motivation, potential and business need to deliver as a full-service alternate banking channel. It is imperative to recognise this and nurture and support BCs around:

***New Customer Segments*:** Banks can consider allowing BCs to service low income customers as a natural extension to servicing the no-frills-account (NFA) holders in their operative areas. This can include new acquisitions and, potentially, migration of existing accounts. This can be a winning proposition for all, with marginal customers getting door-step (and perhaps superior) services; BCs enhancing their business case; and banks decongesting their branches, and shifting efforts towards the profitable high net worth customers.

***Enhanced Product Portfolio*:** *MicroSave* has established the need for,[1] and RBI has repeatedly emphasised that financial inclusion (FI) objectives must include,[2] a range of products. This means offering: transaction accounts; recurring/commitment savings possibly with overdraft facilities; remittance/payment services; insurance policies; and suitable credit products. Once banks start leveraging BCs as their extended arms, regular banking products (even full KYC based) can be made available. This further enhances the value proposition for banks, BCs and, above all, customers.

***Operational Collaboration*:** Base branches often have a limited role, visibility into or support for BC activities. FI is considered as non-core, one-off business, managed centrally or through local head offices. This needs to change, making BCs part of the local operations. If BCs were to become an alternate channel, local branches would discover the synergies and value from them, and collaborate more effectively.

***FI's Integration with Mainstream Banking*:** Progressive banks like State Bank of India have already provided direct core banking system (CBS) access to BCs, thus taking giant strides to bridge the divide between FI and mainstream banking. Cost considerations may prevent some of the other banks following suit. FI will increasingly emerge as a business opportunity at the bottom-of-the-pyramid, requiring strategic measures such as integration into mainstream banking.

***Standardisation and Interoperability*:** Better integration of platforms and technology deployed for FI purposes with those for mainstream banking is essential to fully reap the benefits of BCs as a new channel. While there is considerable ongoing debate about need for, and form of, interoperability – it should follow a market- and consumer demand-driven approach.

Strengthening the Business Case and Sharing Risks

Providing the much needed legitimacy to BCs would also address many issues around weaker business cases and uneven risks that BCs face.

***Revenue Adequacy*:** Many banks now realise the need to compensate BCs appropriately, keeping in view their investments, cost structures and responsibilities. Charges are being re-aligned, recognising consumer willingness to pay a premium for better services. [3] Larger players like MNOs are making significant investments to incentivise their agents/ channel members and to build awareness.

***Partner Selection Approach*:** Some banks have suffered in the past on account of poor quality of services delivered by BCs. At times, this has been due to adoption of lowest-bid/cost approach, with insufficient emphasis on quality and performance. For a sustainable solution, banks must start to embrace filtering criteria based on performance and quality metrics to weed out the non-performing/non-serious bidders. External entities can potentially conduct assessment of BCs,[4] to aid banks' due-diligence efforts.

***Business Terms*:** BCs sometimes face the situation of sudden amendments to agreed business terms, causing their precarious business plans to go awry and putting them at considerable risk. Another challenge BCs face is

[1]See *MicroSave* India Focus Notes 47, 65, and 80, and Briefing Note #113
[2]See Khan, H.R. Deputy Governor, RBI, August, 2011, Special Address at the FICCI-IBA conference on Global Banking
[3]See *MicroSave* research on Cost and Willingness to Pay
[4]See *MicroSave's* Agent Network Manager / Business Correspondent Network Manager Rapid Institutional Assessment

delayed payments, usually for government disbursements (G2P or EBT). These delays translate into large working capital financing requirements for BCs.

Sharing Cash Risk**:** Several BCs have taken on the responsibility for cash management and associated risks. Banks are more experienced and better equipped to manage cash. They can perhaps extend support to BCs, leveraging existing arrangements to manage cash at branches, ATMs and kiosks.

Collaborating to Address Other Risks**:** With the BC model, many other risks come into play, mitigation of which requires close collaboration between banks and BCs. Major risks include: (i) brand/reputation risk; (ii) risk arising out of fraud/ delinquency by agents or BC network managers; (iii) mis-selling; (iv) customer information & data security; and (v) business continuity & disaster recovery.

Joint Marketing Efforts**:** Most institutional BCs are typically entrepreneurs or small businesses without the wherewithal or capacity to make huge marketing or awareness-building investments on their own. Banks can consider enhancing BCs' efforts by marketing them along with their mainstream banking. BCs are a new, lesser known, and often a location-less, agent-based channel. They therefore need even greater attention to awareness building and establishing trust amongst consumers and communities. There are some funds available to support this through NABARD. More investments in building awareness at national level would give impetus and legitimacy to the cause of financial inclusion.

Coherence of Policy Directives

At the regulatory and policy level there has been enormous support and enablement to assist BCs become sustainable. There are, however, still several areas where policies that can be made more coherent.

Ministry of Finance and RBI**:** The current target-based approach towards enrolments has resulted in a compliance mindset. This has led to enormous levels of account inactivity/dormancy, mushrooming of fly-by-night operators and lack of serious intent by banks to pursue the opportunity as an alternate business. While it is important to reach targets, an over accelerated pace would serve little purpose, if the milestones are achieved on paper, without any significant impact on the excluded. Policies should also be directed towards achieving quality and motivating account activity/adoption of financial services.

In this context, an approach towards stabilisation of services in the villages with more than 2,000 population is warranted. The remaining villages between 1,000 and 2,000 population should be covered in a gradual manner, providing contiguous territories and economies of scale to the existing BCs. Coverage targets should be made feasible for banks, while laying increased emphasis on quality and the activity in these new accounts.

State Government Policies**:** Many banks are fulfilling the mandates for electronic transfer of government benefits and payments. BCs delivering these services make significant investments in technology, staff and operations with a view to getting reasonable returns over the period of the arrangement. However at times, state departments are seen to withdraw the mandates or reduce the scope of services, without adequate compensation for BCs. Recent moves by certain state governments removing mandates for social security pension payouts from banks is a case in point.[7]

Policy requirements like the mandatory delivery of cash into the hands of the MGNREGS (Mahatma Gandhi National Rural Employment Guarantee Scheme) beneficiaries, rather than into their accounts, create a losing proposition. There is little incentive for recipients to save surplus funds, or to use their accounts to access additional financial products. The BCs and their field staff are forced to take on substantial cash management risks and are not incentivised to increase the frequency of contact beyond the pay-days.

Level Playing Field**:** BCs comprise individuals, small and large institutions, and even multi-national corporations. This diverse mix is increasingly feeling the need for a level-playing field to ensure smaller players are not crowded out. Some examples include the need for mobile technology-based BCs to receive network access from MNOs on equal terms; or allowing uniform opportunities to participate while deliberating standards or platforms to be established by national level institutions.

Conclusion

Despite unprecedented efforts over the past five years to increase real access to financial services through the BC model, the potential of the model is yet to be realised. While innumerable participants have emerged in this sector, only a handful have really exhibited commitment and achieved any meaningful scale to make a difference. Even amongst the committed players who have delivered, signs of despondency and despair are now appearing. Their coffers are starting to run dry while several challenges still remain insurmountable. We seem to be at a critical inflexion point, where actions or inactions of the stakeholders could bring about a fundamental shift or permanently mar this sector. It is critical that banks, regulators and government take notice of the difficulties that participants in this nascent and fragile sector are facing and demonstrate commitment to address their challenges in order to take financial inclusion to the next level.

[5]See Social security pensions to go directly into *Panchayat* account