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Why E/M-Banking Will Soon Reach Scale In India

(An Optimistic View)

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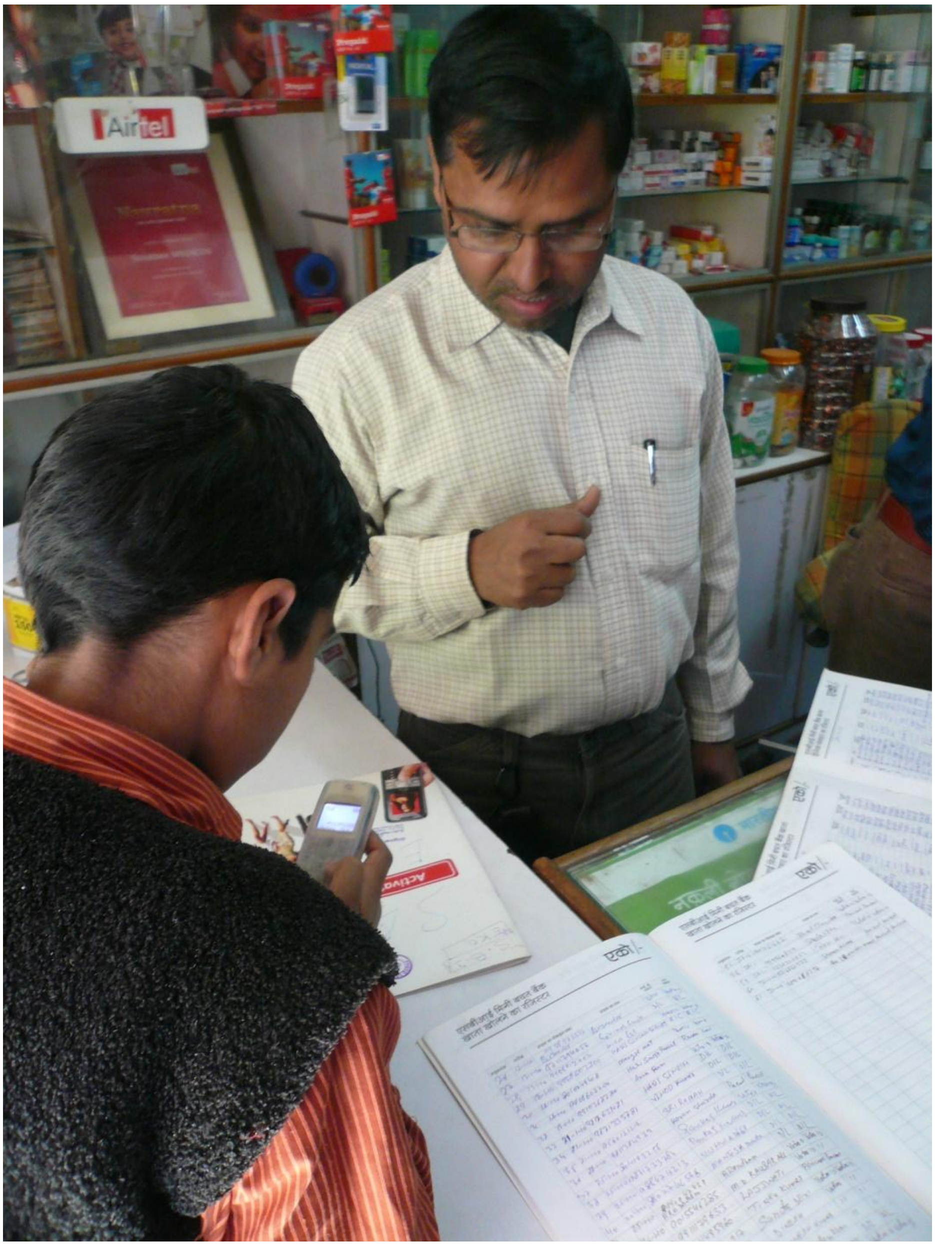

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Introduction

India has huge opportunity to leverage the potential of e/m-banking and build a cash-light economy. In addition to its cutting edge information technology industry and relatively dense population, the Government of India is clearly determined to achieve financial inclusion and is taking aggressive steps to see this happen.

Grounds for Optimism
Conditions Precedent and Strides Forward
(for more comprehensive analysis and details see Appendix 1 below)

- The mobile penetration rate in India is already more than 69%[1] and is growing by in excess of 40% per annum. Internet subscribers have grown over five-fold from 36 million to over 200 million[2] in a span of 9 years.
- Many domestic Indian companies, as well as multinational players, have come up with mobile phones that cost as little as Rs.1,000 ($21) per unit. In fact, in 2010, Vodafone introduced a mobile phone for just Rs.700 ($15).
- Rs.462 billion ($9.2 billion) has been allocated for MNREGA[3] and the National Social Assistance Programme[4] during 2011-12 alone. Future government programmes, including monetising those currently delivered in-kind (e.g. fertiliser and domestic fuel subsidies), are set to be paid through e/m-banking infrastructure. These G2P programmes could provide the basis for sustainable agent networks, the massive rollout of bank accounts and, potentially the beginning of a cash light eco system.
- The regulatory environment has been progressively liberalised to enable financial inclusion – most recently the rules governing remittances were liberalised, adding to key regulatory steps like the acceptance of for-profit entities (and thus corporations) as business correspondent network managers.
- Other regulations designed to drive banks to open a growing number of rural branches have also been put in place. Finally, all banks have been required to come up with plans to promote sustainable financial inclusion – and to have agent-based presence in all villages of population > 2,000 by March 2012, which is likely to be further extended to cover villages of population > 1,000 by March 2013.
- The infrastructure is also being built through a combination of UIDAI's *Aadhaar*, NCPI's IMPS and a variety of business correspondent network managers (the best known of which are FINO, A Little World, Oxigen, Nokia Money and Eko – which together already serve more than 50 million customers), as well as a growing number of bank-telco tie-ups.
- The government will continue to push, order and drive until financial inclusion is delivered to its expectations – as most recently evidenced by the letter of 2st October 2011 from the Ministry of Finance to all banks in the country (see Appendix 2).

Providing financial services to the under-served or un-served through a market-led approach is essential for the sustainability of financial inclusion. However the lack of viable business models has prevented market-led approaches being followed at scale. While this is evident across many countries, it is more prominent in India, which has seen many pilot projects (some of which managed to achieve significant outreach) that are still not sustainable.

"It costs us Rs.200 to open an account and every transaction at a branch costs Rs.20. So, the average account balance needs to be Rs.2,000-3,000 (to be viable)," says a senior banker at SBI, not wanting to be identified. "It was Rs.133 in June [2011]."

" … most banks have asked their BCs [business correspondence] to not just do transactions, but also house their NFAs [no frills accounts]. Only 30 banks have enterprise licenses for banking software. The others pay per user," says a manager in UIDAI's financial inclusion team, not wanting to be identified. So, loading NFAs on to their core banking system is a cost without adequate returns.

\- Economic Times, September 20th, 2011

[1] As of April 2011- source Buddle.com
[2] Source Ispai.in
[3] Mahatma Gandhi National Rural Employment Guarantee Scheme – supporting the poorest households by paying them for 100 days of assured work each year.
[4] Includes old age pension, widow pension, disability pension etc.

The Reserve Bank of India (RBI) and the Government of India have undertaken reforms, policy initiatives and enrolment drives over the last five years to give impetus to the financial inclusion agenda. This has had its own positive and negative effects on the fledgling branchless banking initiatives. While government intervention and drive has ensured scale for some of the players involved as agents of banks, it has also, according to critics, diverted the focus from savings and credit services for the poor to remittances and government social security payments. This reflects one key risk in India: that the financial inclusion agenda is largely being driven by broader interests such as the distribution of MNREGA and other government transfers and/or UIDAI. While there is a broad coincidence of interests, in the end there may be a case of the tail wagging the dog, with resultant perverse outcomes.

Nonetheless, on the whole, it can be said that RBI and government policy initiatives and reforms, though largely focussed on coverage, have helped the development of e/m-banking systems. They have done this by enabling the establishment of the underlying infrastructure of branch-based and/or agent-based networks adopting a variety of technology options (primarily smart card- and mobile-based with many variants). These infrastructure rails have, in turn, enabled the testing and refinement of business models for a more market-driven environment, which is likely to emerge in times to come.

Universal financial inclusion, talked of for decades by policymakers, will start coming to fruition, as business-models leverage the underlying infrastructure to deliver financial and other services. The requisite pieces have been coming together, though at varying pace. Some changes have taken place rather rapidly in the past few years. While the majority of these are driven by regulatory and policy compliance, the outcome has indeed been the gradual creation of an agent network and opening of basic banking accounts (the no-frills-accounts). These accounts have provided a welcome first experience of formal financial services for the many unbanked.

While electronic remittance (particularly State Bank of India's *Tatkal*) and transfer of benefits (EBT) are witnessing considerable consumer demand, the absence of a compelling value-proposition in basic no-frills savings accounts is keeping the customers, the agent network managers and the Indian banking system from realising the full potential of the branchless banking model.

The Drivers For the Future

The following are the factors, drivers and other developments that will enable Indian electronic and mobile banking to grow exponentially in the coming years.

A Huge Un- and Under-banked Population

Only one sixth of the 600,000 villages in India, have banking services. Almost half of the country's population is unbanked. The 'bottom of the pyramid' which comprises the largest section of the Indian population, not just in rural markets, but also many segments and pockets of urban markets, offers a large untapped market with a tremendous business potential. Financial inclusion is slowly but surely being seen not just as a social responsibility, but as a potential business model too, for two reasons:

1. Because the Reserve Bank of India is essentially forcing banks to look for real business cases (some of which rest on the cost of serving the growing crowds at branches), and
2. Because of the huge untapped market for banking services (including the un/under-banked urban poor that potentially are an easy, but large, opportunity with a stronger business case).

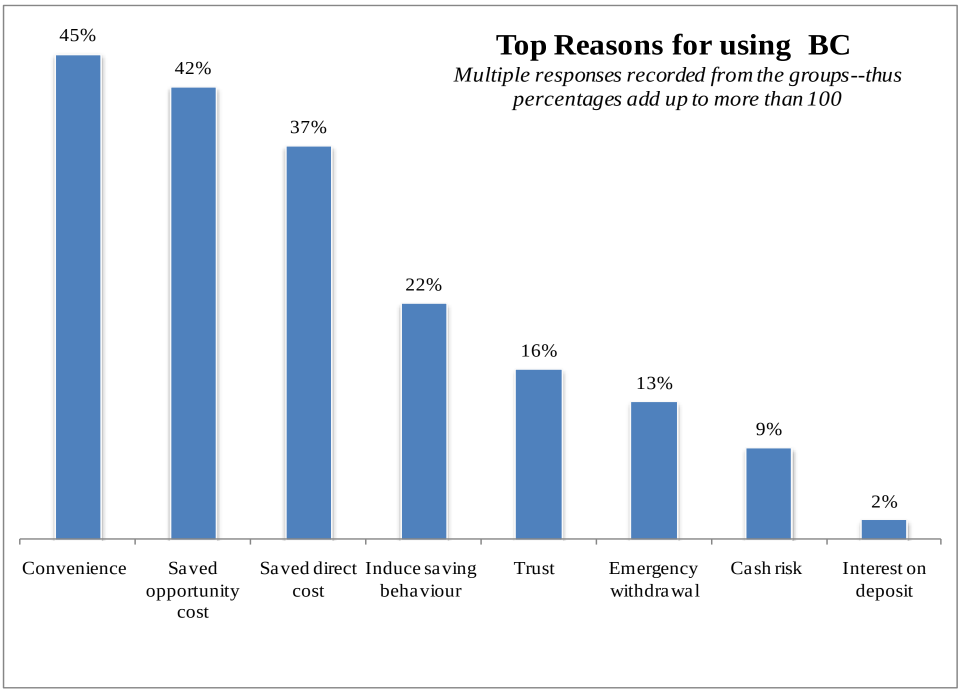
Demographic Dividend

India has one of the largest youth populations (between the age of 14-29), which is roughly 27% of the total 1.2 billion. Adding the 30-44 years age bracket, the proportion is 47%. Apart from the sheer size of this segment, these age groups are the early adopters of new services and are more technology savvy, which presents a huge opportunity for e/m-banking service providers. Interaction with residents in rural areas during *MicroSave* research reveals that:

- For a majority, access to financial services is a household need, and not necessarily an individual need, and hence
- Even if the head of the family or the account holder is illiterate, younger members of the family are competent enough to execute transactions and use electronic or mobile banking services.

Demand for Agent-based, Bank-backed Services

Research indicates that the urban and rural poor fully understand the need for formal financial services – and are very aware that they are losing money in the informal sector and whenever they leave money in the household. Many low income households also express a clear need for credit facilities – but 51% remain dependent on informal sector moneylenders.[5] Similarly, they are very aware of the drawbacks and costs of informal remittance schemes, and are keen to use formal banking systems to send money to family and friends.



Furthermore, currently the poor incur significant direct and opportunity costs to transact in what are (because of the growing flow of MNREGA and other payments) increasingly over crowded bank branches that have not kept pace with the growing demand. The direct and indirect costs associated with travelling to a bank branch are not inconsequential. More than 70% report direct costs of more than Rs.10 ($0.22), and opportunity costs of wage labour range from Rs.50 to Rs.150 ($1 to $3) and sometimes more. As a result there is growing willingness to conduct transactions through agents and to pay for these services. 82% of respondents say they are willing to pay for services that will reduce their real and opportunity costs. While most might not be willing to pay for deposit transactions, they are typically willing to pay 1-2% of the withdrawal amount.

Financial literacy, linked to products and e/m banking processes and channels will play an important role in giving an initial thrust in up-take. This has been another missing piece in the bid to reach out to large numbers riding largely on social security payments. While the RBI has mandated the setting up of Financial Literacy and Credit Counselling Centres, these remain weak, and (in the main) poorly implemented – both in terms of content and execution. A new approach to financial literacy is required. Traditional financial education programmes both in poor and rich contexts have taken a didactic, class-room based approach to conveying analytical financial concepts like budgeting, saving, managing debt, and calculating interest rates. We need to re-think the process of financial education to merge it with product marketing, communicating benefits delivered, and generating awareness of risks associated, along with safe-guards in place, thus making it more relevant for customers, and more cost-effective for financial institutions.

[5] Shukla, Rajesh, Prabir Kumar Ghosh and Rachna Sharma, "Assessing the Effectiveness of Small Borrowing in India", NCAER Centre for Macro Consumer Research, Delhi, 2011

Action Points to Advance the Agenda

1. Workshops, market research, and costing exercises with banks to help them understand and assess the potential of e/m-banking, as well as strategic decisions on:
- Market segments;
- Customer pain points and value propositions;
- Anchor products (EBT/NFA; remittances or others);
- POS v. mobile-based systems or the need for ATM cards;
- Pricing, agent commissions and the role of marketing; as well as
- Sequencing the expansion of product offerings over time.

2. Workshops with banks to help them understand the opportunities and challenges of establishing and managing an agent network – including:
- Trade-offs between branch-based individuals and institutional network managers from the bank's and clients' perspectives;
- Recruiting and training agents;
- Managing agent networks;
- Liquidity management; and
- Achieving scale.

3. Financial education, focussed around hands on experiential/social and product marketing and tailored products (see below) to drive acceptability and use.

Government of India and Reserve Bank of India – The Sticks

Governments across the world are driving the financial inclusion agenda and India is no exception. Together with the central bank, the Government of India has given ambitious targets to banks of covering 72,800 villages by March 2012. Each bank has been asked to articulate specific targets it is willing to achieve, along with a detailed plan on how they will do so. RBI has driven banks to get board approval for these financial inclusion targets, and has linked future branch expansion to the achievement of these targets. Progress against these targets is reviewed regularly by both the Ministry of Finance and RBI, and senior officials are making it clear that they want to see a broader range of accounts and transactions occurring in these accounts. This has significant implications not just for the business models of banks, but also for the sustainability of business correspondent network managers and their front-line business correspondent agents. Hitherto finding a sustainable model has proved difficult but the new emphasis on transactions and flexibility in product pricing provides an opportunity to resolve the double break even challenge.

Targets for the larger banks under financial inclusion plan for coverage of villages with population more than 2,000 by March 2012:

State Bank of India:	12,391
Punjab National Bank:	4,800
Bank of Baroda:	2,900

Total coverage required by RBI: 72,721 villages – of which 72% now already have BC presence.

"Let me reiterate that financial inclusion is not mere State Benefit Transfers. … It is not enough to open a No Frills Accounts (NFA) and maintain that banking services are available. *De minimus*, four banking products need to be provided for it to qualify as availability of banking services. These are:

a. A savings cum overdraft account
b. A pure savings product ideally a recurring or variable recurring deposit
c. A remittance product for EBT and other remittances
d. Entrepreneurial credit such as GCC, KCC

… Beyond this, banks are free to provide any other products such as insurance, mutual funds, etc. as per their assessment and capability."

– Dr. K.C. Chakrabarty, Deputy Governor Reserve Bank of India in "Financial Deepening by Putting Financial Inclusion Campaign into Mission Mode", June 2010

It is quite clear that product diversification away from mono-product offering of minimalist (and often inappropriate) no frills accounts is essential for meaningful financial inclusion to occur – and for banks to build a sustainable agent-based business model. To date banks in India have shown little propensity to do this, whereas elsewhere there is growing evidence of the banks pursuing such strategies – particularly under the Bill & Melinda Gates Foundation sponsored GAFIS programme.

While some critics may argue that such an approach will do more harm than good, the intentions of both the government and RBI cannot be doubted. In a country as diverse as India with social-economic parameters that compare with sub-Saharan Africa, some degree of regulatory push (and conservatism) is perhaps needed to nudge the predominantly public sector banking infrastructure in the right direction, while ensuring enough controls, checks and balances exist. After all, with the burgeoning middle class in India, banks have plenty of opportunities to expand and maximise profits using their traditional business models.

In the short-run, some of the regulatory interventions may appear to do more harm than good; however, in the long run, this level of engagement with financial inclusion, at the highest levels of policy-making can only have a beneficial effect. What is perhaps needed is to support policy makers by way of structured advocacy inputs which reflect on-the ground reality.

Action Points to Advance the Agenda

1. Technical assistance for banks on the development, testing, communication and roll out of a range of products designed to be delivered on e/m-banking platforms. These are likely to include targeted savings instruments (for school fees etc.); recurring deposits with automatic access to emergency loans; fixed deposit accounts; small-scale overdrafts etc.

2. More hands-on policy advocacy reflective of ground level realities in financial inclusion in India as well as cross learning from neighbouring countries with similar socio-economic profiles. The conference at the College of Agricultural Banking on "Business Correspondent Model for Financial Inclusion: Lessons Learnt and Mapping the Future", as well as the recent MMT Conference in Mumbai which bought together regulators, banks, business correspondent network managers and technology providers from across southern Asia, provide valuable opportunities for information and experience exchange.

Government of India and Reserve Bank of India – The Carrots and Enablers

Progressive Regulations

The Government of India and RBI have not just followed a stick approach but have also been strong enablers providing the carrots as and when needed. In India agent-based banking, by design, will be a bank-led approach for years to come.[6] Banking is a tightly regulated sector in India and the cautious approach of the RBI has often helped overcome crisis situations, including the fiscal crisis that engulfed most of the world in 2008. RBI has also often been criticised for being a closed/risk averse regulator as far as agent-based banking is concerned. Nonetheless the RBI has been slowly and cautiously liberalising the regulatory environment related to branchless banking over the last 4-5 years. This clearly shows RBI's determination to

[6] Dr. K.M. Chakrabarty, Deputy Governor, RBI noted in June 2010, "Finally, let me stress that currently we are marketing the paradigm of financial inclusion through the bank-led model. It is thus for the banks to rise up to the challenge and meet it in full measure. What we mean by no access to finance for the excluded is that no access from the formal financial system; so a word of necessary caution for banks; the paradigm of financial inclusion is ultimately one of the continued relevance for the banking sector as other actors are waiting anxiously in the wings waiting for a go ahead." However, it is generally held that the RBI will never tolerate non-banks offering agent-based financial services; and indeed at this stage, appear unwilling to consider financial inclusion-focused "microfinance banks" with differential requirements that have been promoted in Pakistan.

Nonetheless, some small steps have already been made … Till recently payment systems in India were the domain of banks, but with the legislation of Payment and Settlement System Act, 2007 (PSS Act) the arena has been opened up for entry of non-banking entities. Currently 31 non-banking entities have been permitted to operate payment systems such as issuance of pre-paid payment instruments. The entry of non-bank entities has the potential to change the payment system landscape as these entities can leverage on their product offerings with latest technological features to cater to wide segments of the market. Entry of non-bank entities could promote competition and thereby provide more choice to the customers.

enable and encourage client-friendly, agent-based banking, while trying to ensure that there is a true business case for banks offering these services.

Some of these progressive steps are highlighted below:

- Allowing "for profit" entities, including MNOs, to become Business Correspondents (BCs) for banks has been a step-change, reflecting the recognition by the RBI that profit motivation is a requirement to attract the right market-maker organisations that can provide scale and longevity.
- Permitting banks to charge a "reasonable fee" to the customer, increasing the chances of creating a viable business proposition. Evidence so far shows that customers are ready to pay if their needs are fulfilled and they receive good service (see above).
- Relaxed KYC guidelines for low value accounts[7] has helped banks and BCs bring a larger section of the unbanked population into the fold of formal banking.
- Guidelines for products used as modes of remittance to make it easier for non-account holders to remit reasonable sums of money.
- Banks have also been permitted to provide money transfer facilities up to Rs.10,000, per day with a monthly limit of Rs.25,000 from a bank account to beneficiaries who do not have bank accounts, with cash pay-out facility at an ATM or through BCs.
- The provision of guidelines for banks advising them to devise ways of combining fixed and variable components in payouts for business correspondents to make the agent networks viable while revenue streams from transactions or revenue from account opening are limited.
- Permitting non-bank entities to issue mobile-based semi-closed prepaid instruments. To start with, these instruments were considered as a separate category, and a cap of Rs.5,000 was imposed on such prepaid instruments, but recently the limit has been increased to Rs.50,000. The RBI has also permitted closed prepaid instruments to certain entities, provided they meet more stringent guidelines on their merchant partners.

These policy changes and liberalised guidelines are steps in the right direction and it is fair to say that the core regulations required to catalyse the building a sustainable ecosystem for the under- and un-banked are now largely in place.

Requirements and Opportunities for Foreign Banks (and Possibly New Banks) from New Banking Licenses

The new banking license guidelines from RBI mandate at least 25% of the branches to be opened in rural and semi-urban areas. This could be a significant opportunity for foreign banks, as well as the large NBFC/corporate houses wanting to set up banks under the new Draft Guidelines for Licensing of New Banks in the Private Sector, who otherwise struggle to get RBI approvals for opening new branches in lucrative/high-potential urban markets. Foreign banks and the NBFC/corporate houses seeking Indian banking licenses will have an opportunity to locate their semi-urban branches strategically in a way to serve both the under-penetrated urban pockets and the adjoining rural regions, thereby achieving break-even within acceptable timeframes. This hub and spoke approach to managing an agent network has significant potential – and could be of significant interest to foreign those seeking to get a real foothold (and the blessing of RBI) in India.

Amongst some bankers, a contrarian thought is emerging, namely that financial inclusion cannot be only achieved through branchless banking, and that a more judicious mix of brick and mortar structures networked with agent based e/m banking channels may be the answer to outreach with sustainability. This model, which has low cost branches as the hub and agents as the outreach spokes, needs to be tried out as it appears to hold great potential not only for the market in India, but internationally as well.

[7] Low value is defined as balances not exceeding Rs.50,000 in all their accounts taken together and total credit in all accounts not exceeding Rs.100,000 in a year.

Action Points to Advance the Agenda

1. Engagement with foreign banks with significant presence in India and advanced plans for branchless banking (these include Standard Chartered Bank, HSBC Ltd., Citi Bank N.A., Royal Bank of Scotland N.V., Barclays Bank, Deutsche Bank and BNP Paribas). Testing of the viability of small branches linked to m-banking outreach models, thus creating replication effect across the country.

2. Engagement with NBFCs/corporate houses with advance plans (and ideally applications in) for banking licenses. Testing of the viability of small branches linked to m-banking outreach models, thus creating replication effect across the country.

3. Workshops, market research, and costing exercises with banks to help them understand and assess the potential of e/m-banking, as well as strategic decisions on: market segments; customer pain points and value propositions; anchor products (EBT/NFA; remittances or others); POS v. mobile-based systems or the need for ATM cards; pricing, agent commissions and the role of marketing; as well as sequencing the expansion of product offerings over time.

4. Workshops with banks to help them understand the opportunities and challenges of establishing and managing an agent network – including trade-offs between branch-based individuals and an institutional network managers from the banks and clients' perspectives; recruiting agents; managing agent networks; liquidity management; and achieving scale.

G2P Schemes – Electronic Transfer of Benefits

The inefficiencies in the current manual systems of government to person (G2P) payouts of benefits that result into delays, errors in payouts and most importantly significant leakages, are drivers for the Government of India to find more efficient, and preferably automated, methods.

The RBI has recently issued "Operational Guidelines on implementation of Electronic Benefit Transfer (EBT) and its convergence with Financial Inclusion Plan (FIP)". The Union Finance Ministry has advised all state owned banks and financial institutions to make payments only through electronic transfers and not through cheques from 1st September 2011. This move is part of the e-governance initiative to move towards a paperless funds transfer system and will help banks by reducing paper handling costs.

The size and scale of G2P transfers in India is significant, and even a small percentage enabled through e/m- banking channels can provide these channels the needed legitimacy and first steps to sustainability. The largest proportion of government transactions with the citizens comprises revenue collection and transfer of benefits under various social programmes.[8] According to estimates, electronic platforms for government payments to and from individual households could save an estimated Rs.1,000 billion (USD 20.0 billion) a year – representing almost 10% of the total payment flows between the government and households.

> "A World Bank study released earlier this year enumerated the rot in Indian welfare programmes. About 91% of subsidised grain meant for the poor in Bihar never reached them. Only 32-51 % of the pensions for the elderly, destitute, widows and the disabled reached them."
> - Economic Times, September 20th, 2011

In addition, other government departments like Food and Public Distribution, Education, Health etc. are planning to route cash subsidies and salaries through banks and business correspondents. In order to prevent the prevalent massive abuse by segments that are not needy, the central government is also contemplating paying subsidies on a variety of schemes directly to needy beneficiaries through bank accounts. A committee to work out the modalities of this, along with Unique Identity Authority of India (UIDAI), has already been recently setup. Payouts of many state government schemes are also now being routed through BCs.

[8] For example, the total budget allocation for MGNREGA and National Social Assistance Programme (includes old age pension, widow pension, disability pension etc.) for 2011-12 is Rs.400 billion and Rs.62 billion (USD 8.0 billion and 1.2 billion respectively).

Nonetheless, the flow of such substantial funds does provide an opportunity to build more comprehensive and sustainable agent networks – and to encourage clients to use them, if only (initially at least) to withdraw government benefits. FINO is largely built on managing G2P payments, and is now looking to expand its payments and range of products. But even now, largely built on the narrow base of primarily MGNREGA, Social Security Pension (SSP) and *Rashtriya Swasthya Bima Yojana*[9] payments, FINO manages around 5 million payments each month for its 40.41 million customer base through a network of over 21,000 transaction points in 397 districts across India.

Central government has ear-marked 6% of these funds for administrative and transfer costs for the state governments, banks, BCNMs and agents that manage these payments. The BCNMs have requested a service charge of 2% on disbursal of these payments, which could enhance their viability considerably. But many state governments are not passing on these fees, and thus many, if not most banks continue to squeeze the BCNMs, who in turn often struggle to pay their agents. The National Payments Corporation of India's (NPCI's) Inter Bank Mobile Payment System (IMPS)[10] has the potential to allow the central government to pay these subsidies direct once the state governments have identified the qualifying individuals and sent the list to the relevant department. However there are concerns about the real willingness of the larger banks with the largest branch and ATM networks to implement the IMPS as this would give extraordinary access to smaller, often metro/city-based banks to rural infrastructure, previously safeguarded by the system of lead banks and service areas.

The G2P payment schemes present an opportunity to provide the un-banked experience of the formal banking system. Unfortunately, much of this experience has not been entirely positive. As the widespread dormancy amongst no frills accounts demonstrates, routing G2P payments through bank accounts does not *per se* lead to financial inclusion. As noted above, the G2P payments do provide an important anchor product for the development of agent networks and a high potential gateway for bringing the un-banked into the formal financial system. To realise the potential of this gateway, banks need to (a) oversee and manage the roll out of customer responsive agent networks delivering a range of financial products and services that meet the needs of low income households in rural and urban India; (b) develop a better understanding of consumers' financial behaviour; and (c) build consumer trust to encourage them to use these accounts for wider financial purposes instead of emptying the accounts at the first opportunity after the G2P payment is completed.

Banks need, and are working, to create facilitating environments for remittance to scale and sustain, including:

1. Charging reasonable sums according to customer's willingness to pay, which, based on ample evidence, is reasonably elastic, given few and expensive alternatives available.
2. Attractive commission structure that is (a) compelling for BCNMs and agents/CSPs to continue their businesses and drive momentum and (b) a hindrance for malpractices such as over-charging customers.
3. Integration of BCNMs with core banking systems (CBS) to institute seamlessness.
4. Wider financial literacy initiatives directly and in association with BCs.

EBT needs buy-in and commitment from government departments. The early adopters have started witnessing the benefits like improvements in transparency and lower leakage. Some, like the Uttar Pradesh Forest Corporation, have adopted EBT for payments to tendu-leaf collectors and are very encouraged by the results. However, it is still a long-journey for most states. EBT makes considerable business sense for banks and they need to play catalyst in getting the late-adopting government departments on-board.

[9] *Rashtriya Swasthya Bima Yojana* is a government health insurance scheme covering poor households for hospitalisation expenses up to Rs.30,000 and already has more than 25 million cards already distributed and 2.5 million hospitalisation cases already settled.

[10] The IMPS provides a platform for account holders of participating banks to transfer money to any other account holder in the network. The only prerequisite is a mobile handset. Currently twenty eight banks are participating in the network and 14 million mobile money identifier (MMIDs) have been issued.

Action Points to Advance the Agenda

1. A detailed costing analysis would help central and state governments and the RBI arrive at remuneration models for banks, BCNMs and frontline agent BCs for the growing G2P market.

2. Support for NCPI to encourage and optimise the use of the IMPS infrastructure including: reviewing users' experience and opportunities/barriers to use as well as its potential for delivering G2P payments.

3. Technical assistance for banks on the development, testing, communication and roll out of a range of products designed to be delivered on e/m-banking platforms and thus increase the amount of savings left on deposit in accounts receiving G2P payments. These are likely to include targeted savings instruments (for school fees etc.); recurring deposits with automatic access to emergency loans; fixed deposit accounts; small-scale overdrafts etc.

4. Financial education, focussed around hands on experiential/social and product marketing and tailored products to drive acceptability and use.

NPCI's IMPS and the Focus On Interoperability

Enabling customers to transact seamlessly across service providers is important as the services scale and customers start having a choice of multiple providers. Inter-operability will also reduce the risk arising out of an existing provider going out of business, leaving enrolled clients with no alternatives, and causing loss of savings. The RBI has always put an inter-operable system at the heart of its financial inclusion initiatives. A significant step in this direction has been through the commencement of Inter Bank Mobile Payment Service (IMPS), provided by the National Payments Corporation of India (NPCI) – see above. This enables account holders registered for this mobile based service with any of the partner banks, to be able to transact with one-another seamlessly.

The service has scaled up at a remarkable pace - from a pilot project involving four banks in August 2010, to 28 banks and over 14 million members now. Despite fast growth, there are just 10 million registrations out of the 350 million bank account holders – perhaps in part due to the cumbersome registration and transaction processes. Merchant payments were recently added to the service provided through IMPS and this opens possibilities for mobile payments for grocery and vegetables. However, to begin with, customers will probably limit these payments to known and distant vendors, such as for utility bills. IMPS is enrolling several utility service providers and the facility to pay bills on the mobile phone will be available to millions of users soon.

Several BCs are now exploring integration to this service to enable interoperability for their agents and clients. UIDAI (see below) is also keenly exploring need and demand for inter-operability along with the role unique identity based systems and infrastructure can play in making it real and viable.

Aadhaar – Unique Identification Authority of India (UIDAI)

The unique identification project was initially conceived by the Planning Commission as an initiative that would provide identification for each resident across the country, and would be used primarily as the basis for efficient delivery of welfare services. It would also act as a tool for effective monitoring of various programmes and schemes of the government. The UID will encompass the collection of details, including a person's biometric data e.g. iris, fingerprints, etc., coupled with his/her demographic information and location in India.

Efforts are underway to link the unique identification number (UID) project with the financial inclusion programme of the country. Financial inclusion has many hurdles in India, but the two of the most troubling of them to regulators and customers are: 1) authentication of individuals without a fixed address or formal documentation; and 2) secure access to banking services in remote areas. UIDAI aims to provide everyone with a UID number/card linked to a mobile phone number, and/or linked to a bank account – this, together with well developed agent networks, could provide play an important role in efforts towards financial inclusion. The UID, with its reliable and credible identification process, should help overcome major challenges involved in fulfilling even the most basic Know Your Customer (KYC) norms – thus significantly reducing account opening costs for banks. RBI has recently added the letter issued by UIDAI to the list of valid KYC documents for opening of savings account in banks (earlier it was only accepted as a valid document for opening of "small account").

The UID project also plans to introduce a micro-payment platform in order to facilitate banking in rural India. However, there is growing concern that the UIDAI will not achieve these ambitious goals. It is repeatedly accused of unilaterally expanding its mandate (thus stepping on the territory and toes of other government departments). This has reportedly prompted the Planning Commission to expressed concerns that UIDAI is departing from set government procedures and suggested a re-look into its structures. Furthermore there have been rumours that much of the central, state and local government machinery does not want the project to succeed in its attempts to stem the "leakage" from government payment programmes. Most recently, the UIDAI budget for 2012-13 was slashed by the Planning Commission by more than 50% from Rs.3,000 crore in 2011-12 to just Rs.1,400 crore – against the Rs.3,500 crore requested by UIDAI.

> "This is not the first instance of government's proclaimed interest in UIDAI coming into conflict with actual functioning. As the UID Authority headed by IT czar Nandan Nilekani tries to speed up the process, it is frequently running into resistance from the bureaucracy, which has been wary of fresh ideas and "outsiders". Nilekani had earlier complained to the Cabinet about delay in providing him with enough personnel to ensure smooth functioning.
>
> \- The Economic Times, June 10, 2010

Emergence of Business Correspondent Network Managers

Growing Evidence of Sustainable Agent Commission Models

Agent network managers (or business correspondent network managers) as channel intermediaries have had considerable dependence on banks for their products, pricing, branding, marketing and promotions, and often times their very survival. (The exceptions to this are those analogous to IFMR, adopting a well diversified approach to build portfolio of partnerships and products). As a consequence, early moving BCNMs have struggled in the past on many fronts. The major battles fought have been around:

(a) establishing legitimacy of this new form of banking channel with their banking partners on the one hand, and with the agents/CSPs and consumers on the other hand, and

(b) negotiating revenue streams (essentially commissions received on account of various activities undertaken on behalf of the banks) and a broader product mix to offer, in order to achieve viability within reasonable timeframes.

These efforts are now increasingly coming to fruition. With the learnings over the last three to four years, banks have starting recognising the importance of the BC channel and have become cognisant of their challenges and true cost of operations. Driven by the recognition of customers' willingness to pay an appropriate price for services and the persistent efforts of BCs, leading public sector banks like State Bank of India (SBI) have revised the commission structures to levels that are significantly more promising. This is a much needed step in the right direction to boost the confidence of existing players and to attract new participants. Private sector banks like Union Bank of India (UBI) and ICICI Bank recognised the importance of BC channel early on. They have understood that opening and maintaining an account with a branch for marginal customers with small float in their accounts is far more expensive than enabling BCs to open and maintain such accounts. They are also recognising the role BCs can play as an alternate channel to service existing marginal and low-net-worth bank customers. In turn, to drive viability for BCNMs and their BC agents, they have adopted more liberal approaches towards selection of BCNM partners (like giving greater importance to credentials and technical capabilities of the provider, rather than choosing the lowest-cost bidder) and compensating them for various activities undertaken (from enrolment through to transactions).

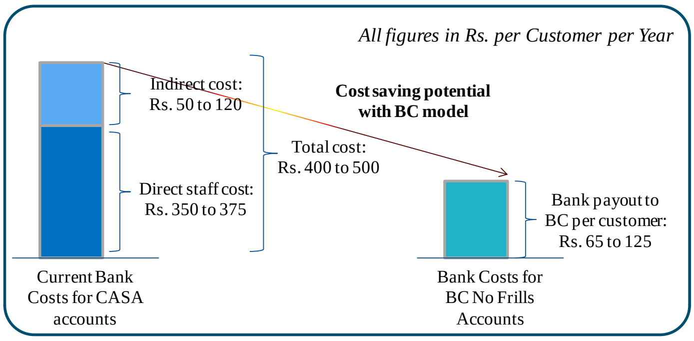
Banks have started to play an important role in enhancing the legitimacy of BCs as their new distribution and service channel. Leading banks like SBI, PNB and UBI have geared-up their marketing efforts by prominently displaying signage, tariff-cards and service information at CSP locations. Local branch managers and staff are now more aware about BC activities and have been assigned mandates to monitor the performance of agents linked to their branches, to provide necessary operational support and address their issues. Information about agents linked to a particular branch is increasingly prominently displayed at branches, assisting in building awareness. At times, banks incubate new agents within the branch, by training and handholding them and enabling customers to open accounts and transact with the new agent, building familiarity and trust before the agent moves out to a standalone environment. SBI has started following the strategy of discouraging certain low-value, high-volume services at their branches and instead diverting customers to their nearest agent points. Progressive banks have enabled integration of BCNMs to their core banking systems (CBS) resulting in real-time access by BCNMs to banking products, transactions and information, providing an important enabling thrust to their initiatives.

Apart from banks, other financial service providers are increasingly viewing agent networks as an important channel. The Pension Fund Regulatory and Development Authority (PFRDA) has designed an ultra-low cost micro-pension product (NPS Lite) to make small investments viable for the low income masses, to be delivered largely through agent networks. In order to promote the up-take, the Government of India, through '*Swavalamban* Pension Scheme' is providing a matching incentive of Rs.1,000 per annum for four years, for an equivalent contribution made for each account. Many pure-play MFIs are considering offering micro-pension and micro-insurance products, expanding their relationship and providing more value to their client base. Several state governments are sharing generous commissions with BCs out of savings derived from switching over to electronic benefits transfer (EBT). Many government departments too are leveraging electronic transfer of funds for services received and are very encouraged by the results.

Hard Economics

Branch-based banking is extremely expensive, and therefore not an optimal option for serving customers at the bottom-of-the-pyramid – thus BC-based banking is an obvious opportunity. However BC's acceptance as a low-cost alternative channel is only just beginning to gain recognition, partly due to 'unscrupulous' BCs who have muddied the waters for genuine, long-term players.

While revenue will take time to reach meaningful levels, the cost side of the equation cannot be ignored. A rupee saved is a rupee earned. More importantly, outreach through BCs seems the only credible alternative on the horizon, therefore serious efforts to relook at the financials and to make adjustments for them to work are in order. The following exhibit demonstrates a direct cost saving opportunity for banks by leveraging BC as an alternate channel.



A BC is truly an extension of the bank. It is no different from how banks expand and operate their own network, except that it has taken the form of an outsourced arrangement. It is a new approach, therefore needing time, efforts and experience to stabilise and become seamless. The current exclusive focus on quantity of targets achieved, ignoring quality in this endeavour, are not allowing enough opportunity for the bank-BC partnership to flourish and to grant the much-warranted legitimacy to this relationship. Furthermore, it is essential that the relationship moves from BCs as vendors of a service that must be sourced as cheaply as possible, to that of BCs as partners with whom banks can work to deliver quality financial services.

A change of perspective is desirable on two counts. Firstly, the focus needs to shift from compliance with RBI directives on accounts opened to viewing them as another customer segment that can be profitably served through the BCs. Secondly banks need to recognise BCs as an alternate channel to service the wider low-income segment (not just unbanked), that otherwise is unviable to service through traditional banking and is usually denied access, convenience and quality service.

Once banks recognise BCs as their extended arms and better mutual trust is established, efforts to ensure win-win in the true spirit of partnership will gain ground. This will inevitably lead to segmenting customers, offering them suitable products addressing their needs, servicing them through the most efficient channels and investing in awareness building and targeted marketing.

Options such as gradual migration of a set of existing bank customers to the BC channel can then be explored, giving banks opportunity to decongest branches and to provide improved service to their preferred customers. BCs will, in-turn, get an assured incremental revenue stream to motivate them to offer superior service levels and to address customer expectations better.

Action Points to Advance the Agenda

1. Continuing research into the profitability (or otherwise) of agents and agent network managers is essential. Models continue to require refinement and it is important to identify and disseminate the key drivers of costs, revenues and profitability to support the development of financially sustainable agent networks.

2. There is a growing need for some form of grading of BCNMs to segregate them according to financial and operational performance, management potential, range of products offered, geographical coverage and similar criteria. This need is being felt by RBI, banks, MFIs wanting to partner with or acquire smaller BCs and so on. Technical assistance to banks and MFIs through rapid or detailed assessment of agent networks providing 360 degree view of their organisation and operations can go a long way in addressing this need across segments.

3. Technical assistance (to banks and BCs) around developing product costing for various models of delivery, coupled with consumer willingness to pay, to arrive at optimal, market-driven product pricing and commission structures and thus create a win-win for all stakeholders.

Entry of Mobile Network Operators and Other Large Corporate Houses

Given the growing importance of collaborations between mobile network operators (MNOs) and banks to deliver on the promise of financial inclusion, the RBI and TRAI (Telecom Regulatory Authority of India) have announced that they will collaborate with one another to avoid any form of regulatory conflict. The RBI is gradually consolidating and revising regulations based on the Mobile Banking Working Group's 2008 recommendations. Some of these include methods for banks to partner with telecom providers, strengthening the security framework, laying down common standards for completing transactions, and so on. TRAI is focusing on dispute settlements and fixing tariff rates for mobile banking access.

In the last year, many large Indian banks have partnered with large mobile network operators (MNOs) and handset vendors to increase their reach through the mobile channel by providing access to financial services. Few such deals are:

1. State Bank of India (India's largest bank) with Airtel (India's largest MNO)
2. ICICI Bank (India's largest private sector bank) with Vodafone (India's second largest MNO)
3. HDFC Bank with Vodafone (now rolling out after a pilot-test in Rajasthan)
4. Axis Bank (India's second largest private sector bank) with Idea Cellular (an innovative and well penetrated MNO)
5. Union Bank (another large public sector bank) with Nokia Money

These MNOs have a distribution network of around 1.0 to 1.5 million retailers across India. This presents a great opportunity to build a nationwide network of agents – something that has so far been a challenge due fragmentation in financial inclusion space. The rural teledensity is merely 33% when compared to 150% for urban areas. This presents a huge untapped market for MNOs which have been adding around 17-18 million clients monthly. MNO's need for innovation and tapping into new revenue streams such as mobile banking is becoming more intense with the rapidly falling revenue streams from core voice, SMS and basic value-added-services (VAS), which has been driven by intense competition and price wars.

MNOs and large corporate players like Nokia are drawing up plans and gearing up for large scale roll-out of mobile commerce and banking services. They are taking the first and inevitable steps of partnering with lead banks, developing their product and distribution strategy and identifying technology platforms to deliver services. Some have undertaken small-scale pilot-tests to begin to learn the business. However, discussions with banks and MNOs demonstrate that, in the main, they neither trust nor understand one another, and that neither has an adequate understanding of the complexities and challenges of setting up and managing an agent network to deliver financial services.

Furthermore, of course, the long-standing problems of using airtime sales networks remain. Chief of these is that agents are asked to deliver the very financial services that are likely to be used to purchase airtime direct on-phone, and thus cannibalise their core airtime sales business. Similarly problems around the comparative commission structures, float and liquidity management requirements, and the time taken to serve mobile money users, all have meant that most MNOs quickly move away from using their airtime sales networks to set up dedicated mobile money cash in/out merchant networks. In India, with the need for diverse products to drive financial inclusion, these cash merchants will also need to be supplemented with sales agents to cross sell products.

The one current exception to this appears to be Union bank and Nokia (with their Nokia Money offering), which is preparing for large scale roll-out after a pilot to fine-tune their approach. Players like Nokia Money have moved beyond their pilots in three cities with Yes Bank and have aggressively rolled out services in more than 25 cities in partnership with Union Bank.

"Union Bank of India has partnered with handset manufacturer Nokia and m-payment vendor Obopay to develop a national mobile money network on the subcontinent.

The Union Bank Money service allows users to store and send money on their handsets and to make payments across locations. Users can pay bills or just top-up their own or their families' prepaid SIM cards. They will also be able to do P2P transfers, as well as use it at accepting merchant points to pay for goods and services.

Union Bank Money will let users withdraw money from the bank's national network of 2,400 ATMs as well as through Nokia's network of 200,000 outlets. As part of the project, Nokia plans to pre-install the application in Nokia mobile devices.

M.V. Nair, chairman and managing director, Union Bank of India, says: "Once the roll-out is complete in 12-18 months, 'Union Bank Money' will be the single largest network in India to provide mobile financial services to consumers in urban as well as penetrate rural areas to tap the unbanked populous."

- Mobey Forum

Questions, however, remain about the suitability of MNO retailing air time agents as business correspondents offering financial services – both because of the challenges of agent economics and issues highlighted above, as well as because of the relatively poor levels of trust they enjoy.

In October 2010, there was much optimism about banks' tie-ups with large corporate houses to act as BCNMs and deliver financial services. However, these tie-ups are taking time to come to large-scale fruition as banks and the corporate houses have different expectations about the arrangements, revenue sharing etc. With the banks' growing recognition of agent-based banking as an alternate channel strategy, and thus the need for large-scale networks through partnerships (supplemented by some organic growth), it may be anticipated that these issues will be addressed and resolved in the near future.

HUL, ITC & TCS Join Banks' Rural Drive

"Banks are sewing up corporate partnerships as they set out for a big push in rural India. This follows the recent Reserve Bank of India (RBI) decision to allow "for profit" companies to be business correspondents of banks.

Companies in fast-moving consumer goods, software, telecom, fertiliser, cement and two-wheelers will soon join hands with banks in mutually beneficial arrangements. State Bank of India (SBI) is likely to tie up with FMCG majors Hindustan Unilever and ITC for its financial inclusion. A senior SBI official said the bank had informally tied up these two companies as business correspondents.

A few public sector banks are in talks with Airtel to take advantage of the telecom major's rural distribution networks. While multiple banks can use a company as a business correspondent, more than one bank cannot be in the same village.

ITC has 6,500 e-choupal centres in 40,000 villages from where it sources wheat, rice, pulses, soya, maize, spices, coffee and aqua products. The company also helps villagers with crop insurance and other banking products.

A questionnaire mailed to ITC and HUL however remained unanswered. Bank of Baroda and Punjab National Bank have tied up with TCS and HCL. Others like IDBI Bank, Corporation Bank and Indian Overseas Bank are looking at TVS, Larsen & Toubro and oil companies. Even small private sector banks like Dhanalaxmi are looking at increasing no-frills accounts by 35,000 in six months, helped by corporate tie-ups and other means."

\- A.B. Manju in MyDigitalfc.com, October 18, 2010

Action Points to Advance the Agenda

1. Banks and MNOs are likely to need extensive technical assistance with agent selection, training and management. In the short run they are unlikely to recognise this, but once they have a year or two of experience, this reality will become clear (as *MicroSave* has seen in a wide variety of banks, MNOs and countries over the last 2-3 years – the single most common challenge has been agent network development and management).

2. As part of this, it will be important to differentiate between cash merchants and sales agents, as well as their roles and responsibilities. At present, in most agent network rollouts, and indeed directives, in India this distinction is not recognised and there is an implicit assumption that all business correspondents can play the role of sales agents as well as cash merchants. This is likely to need to change once product diversification is underway or the EBT/remittance focus of the larger network managers broadens to encompass a range of products.

Investments in Business Correspondents

Despite large on-going losses, business correspondent network managers are still deemed to be investment-worthy as evidenced by the large investments that the sector has drawn from investors.

- ***FINO***, received an investment of Rs.1,500 million ($34 million) from Blackstone Group, in July 2011, for a minority stake. The fund will be used for overall growth of the company and meeting long-term capital requirements. FINO also raised Rs.700 ($16 million) from VCs like Intel Capital, Headland Capital and International Finance Corporation in 2009.
- ***A Little World***, a business correspondent for SBI and currently almost exclusively focused on remittances and SBI's *tatkal* product, raised about $8.5 million from Dubai's Legatum Group and Hyderabad-based Caspian Advisors. It also sold a 20% stake to SBI for Rs.800 million in October 2010 in what was clearly a very strategic move for the company.
- ***Eko***, a business correspondent for SBI and currently largely dependent on remittances and SBI's *tatkal* product has raised $5.5 million from US based PE fund Creation Investments Social Ventures Fund I, with Promus Equity Partners and a consortium of high net worth investors. Eko has served 912,455 customers through its 1,300 service outlets and 100 employees, and has so far processed Rs.10 billion ($223 million) across 2.3 million customer transactions. The company intends to use the fund to expand its mobile banking platform and agent footprint, and to scale its product offering.
- ***SEED Financial Services***, a Delhi-based BC for 19 banks including the biggest lender State Bank of India (SBI), is looking to raise US$5.5 million from private investors. The company is in talks with domestic and foreign investors to raise funds. SEED aspires to go for an IPO within 3-4 years.

These strengthen the belief that investors too are confident that the e/m-banking industry in India will soon achieve its full potential.

Action Points to Advance the Agenda

1. Expand work on optimising the transparency, efficiency and quality of agent networks – through conducting action research focused on customer satisfaction, agent sustainability and options for product diversification as well as through providing technical assistance in return for rights to document lessons learned.

2. Continue the work of the Business Correspondent Network Managers' Forum to help BCNMs with typical apex institution mandates – reporting, grievance settlement, sharing of best practices and lessons learned, setting and enforcing standards etc.

MFIs and SHGs as Business Correspondents

Indian microfinance institutions (MFIs), which have seen a downturn in business and portfolio quality since the Andhra Pradesh crisis that began in late 2010, are cognisant of the risks associated with loans on their books and their a single product focus. Many of them have been actively considering alternate business models, including diversifying into other products like micropensions or microinsurance and becoming BCs. MFIs, with their strong relationships, understanding of client needs, well-established operations and control mechanisms designed to manage scale are very well poised to serve as BCs. Under the BC model, MFIs would lend off-balance sheet and take on the activities that aligned with their core strengths, such as evaluating the creditworthiness of a borrower, disbursing microloans, collecting repayments and cross-selling other financial products on behalf of commercial bank partners.

Examples of collaboration between banks and MFIs are growing. Axis Bank and Janalakshmi, an MFI providing both financial and social services, have established a relationship with the goal of expanding access to financial services for poor people in 51 Indian cities by the end of 2011. The BASIX Group is evaluating the benefits of linking its 3.5 million customers to commercial banks. Cashpor has started a pilot for BC operations with ICICI bank. IFMR Rural Trust has conducted pilots as a BC and is now giving shape to larger scale rollout of operations – this provides an important opportunity to rollout a BC network that offers a diversified and profitable product range from the outset, but will require careful quality control and management. Other MFIs like Sonata, Equitas and Grameen Koota are also considering the BC model in light of non-availability of funds from banks for on lending post crisis.

Both SERP and RGMVP are exploring offering agent-based services to offer a broader range of individual-focused products to SHG members (something that these members have been demanding for many years now, and that limits the effectiveness of SHG-based savings programmes). Both organisations are examining options for using SHG leaders as agents, and are already in consultation with banks and technical service providers. Mobile money and agent-based banking could yet be the salvation of the SHG movement which is currently floundering amid growing portfolio problems – particularly amongst the SHGs formed for largely political ends.

Action Points to Advance the Agenda

1. Supporting two to three of the mid-segment MFIs to make this transition to BCs will yield important lessons for India and beyond. It is also likely to enable a new (and more sustainable!) model for delivery of microfinance services as well as facilitating the delivery of a diversified range of products.

2. SHG networks have the potential to play an important role in efforts to enlarge the scope and scale of agent networks across India. This potential needs to be carefully explored and supporting systems, processes, training materials and quality control mechanisms must be developed, tested and rolled out to allow the SHG-based agent networks to achieve scale and provide quality services.

The End Game: Opportunity to Develop a Cash-light Economy

In India cash still continues to be the predominant payment mode. The value of bank notes and coins in circulation as a percentage of narrow money is very high at 60.07% (2009-10), compared to other emerging economies like South Africa (18.51%), China (18.83%), and Mexico (39.14%). This is a pointer that India has been relatively slow in embracing cashless payment modes and using them as cash substitute. The pre-dominant use of cash could also be attributed to the fact that the process for adoption of non-cash mode of payments started relatively late in the country.

Although even amongst the affluent sections, the use of credit and debit cards had been slow to begin with, it has witnessed considerable momentum in the last few years. Credit card transactions have been growing at over 13.0%, whereas debit card transactions have grown at a phenomenal 40%.[11] Compared with most economies, Indians have exhibited a preference for debit cards (there are over 180 million debit cards vis-a-vis 20 million credit cards issued in India). This upsurge in demand is due to increasing middle class incomes, consumerism and shifting spending patterns. Additionally convenience of use and security associated with cashless instruments has driven the tremendous growth of debit cards in India.

Apart from merchant payments, utility payments are emerging as the other killer proposition for electronic payments. Almost every public and private utility services provider is now enabled to receive payments online and several offer incentives and discounts for online and timely payments. Many of them also offer mobile based payments either directly or through aggregators such as pay-mate, ngPay or mChek.

Between them, merchant (groceries, apparels, other consumer products and durables), utilities (water, electricity, mobile, satellite TV, broadband, taxes) and ticket (bus, rail, air, cabs) payments form a large share of consumers' wallet and most of these have indeed started moving to a cash-light basis. Going beyond online payments, early adopting consumers have also been quick to adopt various avatars of mobile payment utilities or mobile-wallets. Amongst the low-income, unbanked or other segments considered high-risk by credit card industry, various forms of pre-paid instruments such as ITZ cash card, have witnessed a lot of demand. These customers find value in time saved, ease of access and convenience of transacting online using a prepaid instrument.

Electronic and mobile commerce are poised for a big growth in coming years. According to the report on e-commerce released by the Internet and Mobile Association of India (IAMAI), the internet commerce industry in India is expected to reach Rs.465 billion (US$10.4 billion) by end of 2011. The rate of growth of financial services through e-commerce has increased from 28% between 2008 and 2009 to 30% between 2009 and 2010. It is estimated to further increase to 34% in 2011. This presents a huge opportunity to banks and financial service intermediaries to leverage the use of e- and m-commerce to reach out to the under banked and unbanked population who are using the same channels to purchase of other value added services.

The trend towards greater acceptance of cashless instruments is expected to gain further momentum with a strong push by providers on a variety of fronts. Some of these are highlighted below:

1. Credit card issuers have almost halved the transaction commissions charged to merchants to promote card usage and increase penetration of POS terminals.
2. Banks and card-issuers offer basic credit and debit cards free-for-life to consumers. Most have considerable emphasis on promoting adoption and use through incentives, discounts and bundled offers with manufacturers or service providers.
3. MNOs are coming in with new forms of cashless instruments (semi-closed or closed-wallets like Airtel money).
4. Aggregators now provide a one-stop-shop for a new player to plug in to a well-developed eco-system of banks, card-issuers, MNOs, utility providers, thereby considerably increasing speed to market, while expanding the partner eco-system.

India, with 97% of transactions still in cash, has significant potential of becoming cash-light. Much like the quantum jump in mobile services, skipping the fixed-line telephony generation, the quick adoption of debit cards, without first letting credit cards to penetrate, the under-banked and un-banked might lead the way for adopting mobile based, pre-paid and other forms of cashless instruments in India.

And of course, Indian ingenuity will probably result in a rapid growth of self-initiated transactions from mobile phones in order to avoid the fees required for agent-initiated transactions – there is circumstantial evidence of this emerging on Eko's platform already.

[11] Source: Cashless Payment System in India, a Roadmap, IIT Bombay

Action Points to Advance the Agenda

1. Supporting new entrants like MNOs and pre-paid instrument providers to realise the market potential and opportunities for products as well as potential partnerships to extend reach and enhance value proposition for their offerings.

2. Technical assistance to establish linkages between rural service providers (BCs, MFIs etc.) with the providers of FMCG / agro products and utilities in rural areas. This could be in the form of partner search, product development or process mapping.

3. Workshops with various stakeholders like regulators, cash-less instrument providers, large merchant establishments, BCs to bring them under one roof to discuss common issues and challenges and way forward.

Conclusion

India continues to be a unique market and regulatory environment with intense involvement of the regulator and the government. While we can debate whether all of this is good for a fledgling financial inclusion model, the large numbers of under- and un-banked in the country does call for a rapid outreach model. Hopefully, the rapid outreach will make the model sustainable for all the players, banks, BCNMs and agents and at the same time offer services really needed by the clients. These two ends are, of course, aligned and mutually beneficial.

The gradual regulatory evolution to support BCs and banks in their outreach efforts continues – and the results are beginning to emerge. While the emphasis continues to be on numbers, the targets are such that large scale outreach will be achieved within a year. This, coupled with the government's resolve to move to cash based subsidy transfers[12] and social security payments systems, will ensure transactions. Institutions such as UIDAI and NCPI will play expanded roles as systemic back-bones that support different players and bring about inter-operability.

The other exciting development is the move to encourage banks to have 25% of their branches in rural areas. These, presumably low cost branches, can become the hub for financial inclusion and support wider outreach of branchless banking outlets, while acting as nodes or hubs of the model. The antiquated post-office structure is also undergoing rapid transformation and all records will be computerised with plans to link post-offices within the next year.

The initial path is clear: cash is king and benefits and remittances home are welcomed by all. No wonder EBT and remittances are witnessing substantial consumer-pull driven demand. They are anchor products offering a great opportunity for unbanked customers to experience banking, and therefore have the potential to accelerate new product adoption and thus financial inclusion.

Policy makers are pushing convergence of EBT and the Financial Inclusion Plan, along with opening up of competition amongst BCs within districts, which is much desirable, breaking the silo-ed monopolies that were beginning to form. Competition will help market-forces let the best player win, instead of the current practice of distribution of villages to BCs, akin to land-grab, ignoring merit and performance and putting customers at a disadvantage.

Financial inclusion is not a burden on banks. It is indeed a business opportunity to be tapped. However it requires non-traditional approaches and a paradigm shift in outlook. Multiple consumer businesses (telecom, FMCG, agri) recognised this opportunity early on and now have a well oiled-machinery in place to deliver

[12] F. No.21/13/2009-FI (Pt), Strategy and Guidelines on Business Correspondent, Banking Services division, Ministry of Finance, Government of India: " The Task Force set up by the Government for the direct transfer of subsidies on LPG, Fertilizers & Kerosene has already presented its interim report. Pilot for direct transfer of subsidies on kerosene and LPG are being taken up this year. Besides, there are at least 32 other schemes where the benefits are to be transferred to the beneficiaries and adoption of electronic benefit transfer would greatly enhance the efficiency of such transfers, besides reducing the scope of malpractices. Disbursement of MNREGA wages to the beneficiaries is required to be made in a fixed time period. Extension of banking and other financial services to the rural areas will also facilitate and, in fact, accelerate the economic development of such areas."

the services and to harvest the gains. Many of the lessons learned can very well be applied by the banking sector. With government goading, the banks in India will soon recognise and respond to this.

Appendix 1: Top Level Indicators of Financial Inclusion in India (green highlights significant progress)

		March 2010	March 2011	Growth (Nos)	Growth (%)	Source
Coverage						
Target villages with more than 2,000 population identified for extending banking services	Nos	72,721	72,721			RBI
Covered villages with more than 2,000 population (A)	Nos	27,743	53,397	19,429	71.9%	RBI
% Coverage Achieved (100% coverage expected by March 2012)	%	38%	73%			RBI
Target villages with population between 1,000 and 2,000 identified for extending banking services	Nos	130,000	130,000			RBI
Covered villages with 1000 to 2000 population (B)	Nos	27,014	46,443	25,654	92.5%	RBI
% Coverage Achieved (100% coverage expected by March 2013)	%	21%	36%			RBI
Total villages covered (A+B)	Nos	54,757	99,840	45,083	82.3%	RBI
Villages covered through branches	*nos*	*21,499*	*22,684*	*1,185*	*5.5%*	*RBI*
Villages covered by BCs	*nos*	*33,158*	*76,801*	*43,643*	*131.6%*	*RBI*
Villages covered by other modes (ATM, Mobile Van etc.)	*nos*	*100*	*355*	*255*	*255.0%*	*RBI*
Percentage of total growth through branches	%			2.6%		RBI
Percentage of total growth through BCs	%			96.8%		RBI

		March 2010	March 2011	Growth (Nos)	Growth (%)	Source
Accounts and Activity ***No Frills Accounts (NFAs)***						
Total No Frills Accounts (NFAs)	Mn	49.5	74.4	24.9	50.3%	RBI
ICT based NFAs through BCs	Mn	12.6	28.1	15.5	123.0%	RBI
EBT based NFAs through BCs	Mn	7.5	15.6	8.1	108.0%	RBI
MGNREGA Accounts			(as of November 2011)			
Total MGNREGA Accounts (bank and BC based)	Mn		12.8			NREGA website
Total MGNREGA Accounts (Post office based)	Mn		12.3			NREGA website
Percent wages paid through bank accounts	%		50%			NREGA website
Percent wages paid through post office	%		50%			NREGA website
Percent wages paid in cash	%		0%			NREGA website
Average wage paid per account per month - bank account	INR		406			NREGA website
Average wage paid per account per month - post office	INR		425			NREGA website

Appendix 2: Memo from Ministry of Finance To all Banks

Extracts from: F. No.21/13/2009-FI (Pt)

Dated: 21st October, 2011
From: Government of India, Ministry of Finance, Department of Financial Services
To:
1. Chairman/ CMDs of all PSBs
2. Chairman of all RRBs
3. CEOs of all Pvt. Sector Banks

5.4 Business Correspondents (BC):
(i) In habitations without a bank branch, the Business Correspondent would be the main instrument of delivery of financial services. It is necessary to ensure that the business model of BCs is commercially sound and that they become financially viable in a reasonable time, say 2 years. This would require that each BC handles a reasonable number of household accounts, keeping the geographical coverage in consideration.

(ii) Based on the feedback from the various Institutions, it is felt that the BC/Agent should be dealing with 1000-1500 households, or cater to a population of about 5000-8000. In the hilly, tribal and desert areas or where distance is large, the banks could have lesser number of accounts keeping the geographical and other conditions under consideration. DLCC will take a decision in such cases and get it ratified from SLBC. However, it must be ensured that the each BC Agent is assigned a sub-service area within the service area of the branch. Gram Panchayat shall be retained as a unit and BCA could be assigned more than one Gram Panchayats.

(iii) Requirement of BC/BCA may be worked out in such a manner that the BCA is available within a radial distance of 2 km.

6. While appointing BCAs, Banks will keep following features in mind:
(i) It is better to appoint an existing entrepreneur as BCA so that it is an additional income to him/her. This will improve the viability of BCA. While approving location of BCA, the place should be such that easily accessible and be preferable by the place of weekly local 'Haats'.

(ii) Nearly 1 lakh Common Service Centres (CSCs) have been established by the Department of Information Technology. The CSC network will also expand. In order to ensure convergence and to assist viability of BC, it would be necessary that in the villages to be covered, wherever a CSC exists, the CSC is made a BCA. Banks can engage additional BCAs, if required in such cases.

(iii) The selection of BCA must be done by the BC with the consent of the concerned Branch Manager in whose service area the BC is located. Preference should be given to such persons who are already doing some activity in the village.

(iv) The device to be given to BCA should be interoperable through the gateway of NPCIL so that the customer can access to any bank by using the device. The device must have biometric facility plus card or password plus card. The BCA must have on-line connectivity.

(v) The BCA must be responsible to receive and pay money, to transfer money from one to another. Each BCA must necessarily be appointed as Business Facilitator (BF) for all activities permitted by the RBI. BCAs must also be used as deposit mobilisation and recovery agents as permitted by RBI.

(vi) The BCA will also be acting as an extension staff for micro insurance, animal insurance, crop insurance and micro pension. The banks will ensure coordination with the agencies, viz., LIC and other agencies dealing with these products.

(vii) An officer of the concerned branch of the bank must be visiting the BCA once in a week on a fixed time and day and will use this visit to collect application for opening account, loans of all types, recovery follow-up and any other banking issues. This will install greater confidence among the customers and facilitate increased banking transactions through BCAs.

(viii) The BCA must be responsible for routing all transactions of all villages in the assigned villages so that effective marketing and follow up, can take place.

(ix) BCA could be remunerated using different models or a combination based on transactions, number of accounts opened, value of transactions, etc., with safeguards against recycling of funds, the guiding principle being the BCA has motivation to facilitate transactions of the customers and to provide good quality services.

(x) For cash management, a proper arrangement needs to be worked out keeping in view the guidelines of RBI by the banks and with the BCA.

(xi) Transfer of the funds by the account holders of the bank represented by the BC to the account holders of other banks should be possible.

(xii) It is necessary for banks to ensure that there is a continuous improvement in the quality of services through the BCAs. Banks must have regular training programmes of the BCAs along with BCs. This must lead to reduction in footfall of the villages from the villages attached to the BCA in the service area of the branch of the bank.

7. Electronic Benefit Transfer:
(i) Presently 32 schemes are in operation, (Annex-II), funded by the Government of India, under which benefits are to be given directly to the beneficiaries. Transfer of such subsidies into the accounts of the beneficiary under Electronic Benefit Transfer would enhance the efficiency of delivery of such services. Benefits in the areas covered under Financial Inclusion must be transferred electronically into the accounts of the beneficiaries. The Convenor Banks of SLBC must take up this matter in the next SLBC and the roadmap for Electronic Benefit Transfer in respect of each scheme must be finalized.

(ii) RBI issued the operational guidelines on implementation of Electronic Benefit Transfer and its convergence with the Financial Inclusion Plan on 12.8.2011. Under this, one district - many bank- one leader bank model is to be adopted. While all Departments of the Government of India (GoI) and State Governments may, for administrative convenience, deal with only one leader bank, such leader bank will obtain the funds from the GoI/State Government and, in turn, arrange to transfer funds through inter-bank transfer to other banks for credit to the accounts of ultimate beneficiaries. Under the service area approach, while the banks would be responsible for the Electronic Benefit Transfer to the residents in their service area, the residents would be free to choose the bank through whom they would like such transfer of benefits.

(iii) In some states, parallel structures for Electronic Benefit Transfer for some schemes have been created which are inconsistent with the aforesaid guidelines issued by the RBI. Such system should be discontinued henceforth or converted into one district- many banks-one leader bank model as per para-(ii) above.

(iv) It has also been observed that KCC beneficiaries as well as others who are already having bank accounts are asked to open separate account for availing Electronic Benefit Transfer. Any beneficiary having any bank account must not be required to open new accounts and the benefits should be credited to the existing account.

All banks are requested to ensure compliance of the above guidelines.