

CENTRE FOR MICRO FINANCE at IFMR

Business Correspondent Model: A Preliminary Exploration





Business Correspondent

Model:

A Preliminary Exploration

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Table of Contents

Executive Summary.....	3
BC Model in India - A Primer.....	6
Zero Mass Foundation - A Little World	9
Indian Grameen Services – Krishna Bhima Samruddhi	16
FINO Fintech Foundation-FINO	28
Adhikar-FINO.....	34
Synthesis and Looking Ahead.....	38
Works Cited and References.....	43

Executive Summary

In order to promote financial inclusion amongst the unbanked, the Reserve Bank of India (RBI) developed a set of guidelines to formalize branchless banking, which they called the Business Correspondent (BC) model. Under this framework, banks can partner with third party agents to provide financial services such as credit and savings on their behalf. Since its inception in 2006, various banks have promoted the BC model in all corners of the country, though few of these efforts have scaled up beyond modest pilots. There is scarce documentation on how these pilots work in the field and whether they contribute to the BC model's financial inclusion objectives. Thus, before endorsing the existing business correspondent model as an effective channel for financial inclusion, there are a number of key questions that must be answered. Are BC's bringing the unbanked into the formal banking system? Who are the clients of BC's and what are their needs? How are incentives and regulations aligned for the banks, BC's and other entities involved? Are the institutional setups between BC's and the promoting banks efficient and scalable? The Centre for Micro Finance gathered information from four BC model implementations to help fill this knowledge gap. Based on the preliminary findings presented herein, CMF hopes to conduct further research on the model.

The CMF research team conducted field visits to four BC pilot sites and met with dozens of practitioners, bankers, clients and other closely involved stakeholders. Approximately fifteen to twenty BC clients were interviewed for each case study. It is worth noting that the research team spoke only to active clients recommended by the BC, and responses and opinions regarding the model were culled from this sub-sample. Inactive BC clients were not approached, so their views and needs are not represented here. From conversations with BC's the team received the impression that overall usage rates were low and thus the clients interviewed were not representative of the entire population.

In the selection of BC implementers, the research team chose pilots that reflected the gamut of implementation arrangements. The first case study documents the work of Zero Mass Foundation (ZMF), a Section 25 company (Sec-25) and BC created by A Little World (ALW) in rural Orissa. A Little World is one of the leading Indian technology companies that participates heavily in financial inclusion and government payment schemes. Another large technology provider, Financial Information Network & Operations Ltd. (FINO), is captured in the third and fourth case studies, where it partnered with its own Sec-25 BC called FINO Fintech Foundation and a separate microfinance institution called Adhikar, respectively. These three case studies focus more on the operations of the BC than the promoting banks, which were either nationalized public sector or private banks.

In contrast to the preceding pilots, the second case study presents a distinct institutional arrangement wherein the BC and the promoting bank are linked to the same parent company. Here Krishna Bhima Samruddhi (KBS) Bank, a Local Area Bank (LAB), has partnered with Indian Grameen Services (IGS), both orbs within the BASIX universe, in the Mahabub Nagar district of Andhra Pradesh. As a Local Area Bank created for microfinance, KBS operates under regulations separate from commercial/public sector banks. Overall, the research team chose these pilots to highlight how regulatory constraints and varied institutional incentives play out operationally.

During each field visit, the research team probed to understand the operations of the pilot, specifically staff responsibilities, areas targeted, products offered and the clients' perspective. With regard to financial sustainability, at this stage we cannot construct nor compare detailed financial snapshot of each pilot, but have provided a basic picture of the model's viability where possible.

Observing the four case studies there are trends and lessons that emerge. Overall, the current regulatory regime appears to yield little room for the BC model to become financially viable for either the promoting bank or the BC. Banks view

BC operations as inherently non-profitable; most only allow BC's to open no frills savings accounts as they feel uncomfortable allowing a third-party agent to do credit evaluation. Even in the event that banks allowed BC's to distribute credit, the Reserve Bank of India restricts banks from charging more than their prime lending rate (PLR) for BC credit. This reduces potential margins against BC's relatively higher operating cost, or would force banks to raise their PLR which they are not inclined to do. Thus, banks are inherently disinclined to view the BC as a priority, and many perceive the model as a Corporate Social Responsibility (CSR) activity. Some public sector banks, for example, subsidize the cost of BC components such as smart cards or point of service (POS) devices for clients, though this is not a sustainable option for them.

For business correspondents, the commission structure is not adequate to cover costs, which for most are based on a per-transaction fee. The transaction-based structure is weakened by reported low rates of no frills account usage by clients. This applies to all the case studies, save KBS / Indian Grameen Services, whose joint ownership structure gives unique benefits. BC's tied with technology providers plan to leverage their services for disbursing government benefits, in which they foresee higher usage and a more feasible business model.

From the (active) client perspective, the research team found a surprising heterogeneity of both the financially included and previously excluded individuals. Those among the former group tended to be shopkeepers with outside accounts who signed up for the BC services for their door-stop convenience. Additionally, there was a universal desire among BC clients for credit, though because of the aforementioned constraints, few had received it. Again, KBS / Indian Grameen Services is the exception, offering both credit and savings to its BC clients.

The final section, **“Synthesis and Looking Ahead,”** offers more nuance based on the four case studies presented.

BC Model in India: A Primer

Third party agent banking was launched in 2006 in India, with the intent of increasing the ambit of the formal banking sector. It builds on the regulatory inertia of prioritizing financial inclusion, particularly the RBI's 'no frills account drive which began in November 2005. For the drive, Dr. C. Rangarajan, Chairman of the Prime Minister's Economic Advisory Committee, had advised that each semi-urban/rural bank branch open 250 such bank accounts annually which, if implemented, would result in approximately 11.5 million customers nationally (Rangarajan 2008).

To support the financial inclusion effort, as well as leverage advances in banking technology, two kinds of third party banking agents were created – Business Facilitators (BF) who would primarily be involved in processing and opening accounts and Business Correspondents who could, in addition to the BF functions mobilize deposits and disburse credit on behalf of the bank .¹ Over the years, regulation on Business Correspondents has undergone several iterations, and even as this paper went to print, recommendations from the RBI's Working Group to Review the Business Correspondent Model, published in August 2009, were being reviewed.²

As per the current regulations, the following entities are permitted to act as BC's for banks: NGOs (typically microfinance institutions (MFIs) set up as Societies/ Trusts), Cooperative Societies, Section 25 companies in which no NBFC/telecom company/bank held more than 10% of ownership, post offices, retired government/bank employees and ex-servicemen. In order to operate within the regulation, technology service providers organizations such as FINO, EKO and A Little World have created Section 25 companies with whom they partner.

1. RBI CIRCULAR RBI/2005-06/288 DATED JANUARY 25, 2006 Available at : <http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/68417.pdf>

2. RBI WORKING GROUP REPORT IS AVAILABLE HERE: HTTP://WWW.RBI.ORG.IN/SCRIPTS/BS_PRESSRELEASESDISPLAY.ASPX?PRID=21221, our published on August 19th 2009 much after this paper and the case studies were conducted. The main recommendations of this report were to increase the eligible entities who could act as business correspondents and to allow banks to charge a reasonable service charge from BC clients, in a transparent manner.

Key components of the regulatory framework surrounding BC's include:

- Banks pay a (undefined) commission to BC's though BC's/banks are not allowed to charge the end-user a service charge for any BC transactions;
- BC's can service clients only within a 30 km radius from the bank branch and in case of urban areas the radius should not be more than 10 km;
- All transactions undertaken through BC's must be recorded in the books of the bank by the end of working day;
- Know Your Customer (KYC) norms must be observed by the promoting banks for all BC clients

In the three years since the promotion of the business correspondent model by the Reserve Bank of India, a number of banks have taken interest, including but not limited to the State Bank of India (SBI), Punjab National Bank (PNB), Union Bank of India and HDFC. According to the RBI's Working Group, as of March 2009, approximately 88.60 lakh no-frills accounts have been opened through business correspondents (RBI Working Group on BC Model 2009).³

Most of banks' forays have been experimental rather than full-fledged strategic or scalable approaches; accounts have been opened through a diverse set of institutional arrangements. The most typical arrangement appears to be a bank-Section 25 partnership where the Section 25 company is floated by a technology service provider such as FINO or A Little World. Since the technology companies themselves cannot, by regulation, act as BC's, they are provided by associated NGOs, FINO Fintech Foundation and Zero Mass Foundation, respectively. The technology company then acts as a partner for operations with their associated NGO and the bank. Promoting banks do not always choose a single model or BC entity. The Union Bank of India (UBI) has engaged with various business correspondents including Infrastructure Leasing and Financial Services Limited (IL& FS), FINO and DRISTI for distinct services.

3. Yet, as the case studies will discuss, access does not equate to usage. The RBI Working Group concurred that few of the BC accounts were active.

There are a few pilots where NGO-MFIs act as BC's for banks, for example Adhikar's work in Orissa (described in the fourth case study), or Indian Grameen Services' many partnerships with banks. Since this model is still in experimental mode, arrangements which are not strictly within the regulatory framework have also cropped up. For instance, the research team encountered a bank that used Self Help Group (SHG) members as BC's to service clients in a remote village.

Finally, in an exceptional partnership, Krishna Bhima Samruddhi (KBS) Bank, a Local Area Bank, works with Indian Grameen Services (IGS) where IGS offered a full suite of products including credit, insurance and savings.

It's not obvious which arrangement is the most effective, but it's clear that there are implications for products and services offered to clients. For example, the research team observed that when a technology provider and its allied Section 25 company partner work with a bank, savings products dominate. The Reserve Bank of India created a Working Group to understand the growth, challenges and successes of the BC model since inception. Officials on the group included bankers as well as RBI members and was chaired by Shri P. Vijaya Bhaskar, CGM in-Charge, Department of Banking Operations, RBI. The Working Group recommended a number of changes to the current regulatory regime including an expansion of entities that could act as BC's. As this paper went to print it is yet to be seen whether these recommendations will be incorporated into policy.

Zero Mass Foundation – A Little World

Model: Public sector bank ties up with Sec25 Company and technology provider who partners with to provide financial services

Location: Tangi village, Cuttack district, Orissa

Introduction

The first case study is of a 5-month old pilot project in a remote region of Orissa's Cuttack district, where a major public sector bank entered into an agreement with Zero Mass Foundation (ZMF) whereby ZMF offers BC services to interested individuals.

A sister company of ZMF, A Little World (ALW), provides the technology platform for the business correspondent operations. Currently ZMF offers only no frills savings accounts as a BC, and has enrolled close to 1,050 clients since the pilot's launch.

Issues raised in this case study, including financial sustainability for both the BC and the promoting bank, are fairly common in this type of arrangement. They highlight the dynamics and incentives that crop up when banking activities are outsourced to entities that do not otherwise provide financial services.

Organizations Involved

A Little World - A Little World (ALW) is a for-profit technology company that has partnered with dozens of banks in India on financial access and inclusion initiatives. The technology it provides is an expensive, but convenient method for the remote delivery of banking services. Most well-known is a mobile phone device that can record and store bank customer bio-metric information as well as remotely send transaction activity to a central server. As ALW is a profit-seeking enterprise it is not empowered to act as a business correspondent under the current regulatory regime. To circumvent regulation, ALW created an independent Section-25 company, Zero Mass Foundation, with which it can partner as a technology provider. In this case study A Little World was paid by the promoting bank for providing the technology.

Zero Mass Foundation - Zero Mass Foundation (ZMF) is a close affiliate of ALW and registered as a Section-25 company to act as a business correspondent. In its BC capacity, it is the front end for the delivery of select financial services on

behalf of the public sector bank in Tangi. These activities include the enrollment of clients into no frills accounts, door-stop service for account deposits and withdrawals as well as recruitment and training of customer service providers. Zero Mass Foundation is paid a commission by the public sector bank for each customer enrolment as well as for each transaction.

In this type of model, ZMF/ALW enter into an agreement with the senior management of a bank at their head office. Then a joint decision is taken on where the operations will occur and the target number of clients, after which the relevant local public sector branch is informed of their new role. Thus, all issues related to commissions, revenue sharing etc are taken at the head office level and applied with very little input from branch offices.

Figure 1: BC Organizational Arrangements

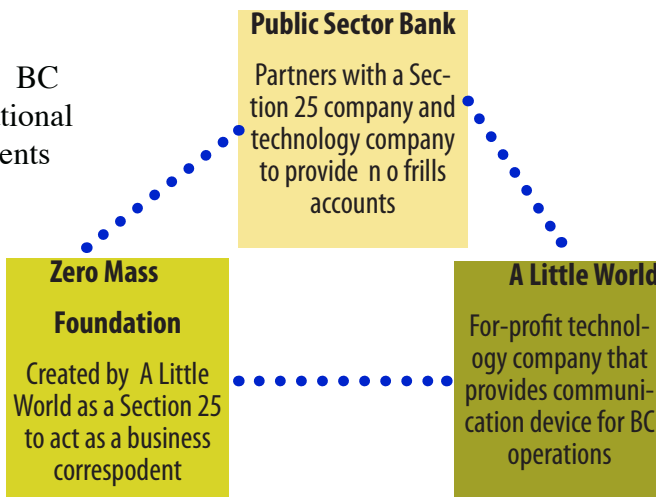


Table 1: Snapshot of Cuttack District, Orissa	
Area	3,932 sq km
Population (in 000's)	2,341
Number of Villages	1,865
Literacy Rate	76.13%
(Orissa HDI Factsheet 2004)	

Location

The BC's operations in Tangi are triangulated between Bhubaneswar (Orissa's capital), the smaller industrial town of Chowdwar and the Tangi tehsil; all three localities are within ten to twenty five kilometers of each other.

Tangi, the site of ALW's operations and the research team's field visit, is an administrative sub-district, known as a tehsil, in Cuttack with a population of around fifteen thousand. While Tangi is close to several industrial towns such as Chowdwar, most of the tehsil's villages are backward and have no access to formal banking services. Normally, Tangi residents must travel at least ten kilometers to access formal banking services.

Operational Arrangements

Zero Mass Foundation (ZMF) employs one supervising field officer who operates out of a Bhubaneswar office and two "mobile," Customer Service Providers (CSP) who interface with clients in Tangi and report to the field officer. While CSPs report to their Bhubaneswar-based supervisor, they are enabled by A Little World's technology to work and communicate remotely (more on the technology later). While ZMF hoped that one day the CSPs could settle into a fixed location, given the low number of customers they are currently roving. ALW dispatched a single staffer to manage the BC transaction database who works with the ZMF officer in Bhubaneswar.

The promoting public sector bank has a local office in Chowdwar that manages the BC client database. At the time of writing, the BC pilot was less than half a year old and therefore the Chowdwar public sector bank manager liaised regularly with ZMF to launch operations and hammer out procedure.

BC Operations

In the five months since the BC pilot's launch in Tangi, ZMF has enrolled approximately 1,050 clients into no frills savings accounts, the only product currently offered. The enrollment procedure is swift and showcases the model's reliance on technology. Once a CSP receives affirmation from a potential client, he snaps a photo with a high-resolution camera and imprints the client's bio-metric information using ALW's mobile phone device. Upon registration, the customer is given a bio-metric ID card with their photograph and ZSN number.

For any subsequent transaction, the customer service provider swipes the client ID card into their mobile phone device, which instantly verifies customer sta-

tus. For withdrawals, the customer must also place their finger onto the mobile phone device for bio-metric authentication.

As mentioned earlier, the mobile phone device allows customer service provider to visit clients' homes/shops and conduct transactions. In addition to the client interface, the technology also facilitates the transmission of transaction information to the ALW parent server, and by extension, the public sector bank's database. Customer service providers can upload transaction data to the ALW server in Bhubaneswar from any location and at any time of day. An added convenience is that the device can function and transmit data in the absence of both electricity and an internet connection.

At the conclusion of each working day, in compliance with RBI guidelines, the ALW officer transmits information he has received from CSPs on the server to the local public sector bank branch in Chowdwar.

Technology for BC Operations

In their work ZMF's customer service providers depend heavily on ALW's mobile phone specifically designed for agent banking. The device records and stores customer information including bio-metric data like fingerprints and photographs, and transmits transactions to the ALW backend server. Each phone has the capacity to store information on up to fifty thousand clients. ALW hard-wired each phone with a new-generation data transmission platforms including General Packet Radio Service (GPRS) or Enhanced DataRates for GSM Evolution (EDGE); this improves data transmission capacity and rates.

Products and Services Offered

As a BC in Tangi, Zero Mass Foundation is empowered by the promoting public sector bank to offer only basic no frills savings accounts and as of May 2009, had opened approximately 1,050 accounts via their operations. Both the promoting bank and ZMF expressed hesitation at the prospect of extending credit via BC; namely the promoting bank balked at outsourcing credit evaluation to an inexperienced third party while ZMF felt uncomfortable taking on banking activities. Therefore, credit was not explored as an option. The research team discovered that Zero Mass Foundation and A Little World had received a mandate to distribute National Rural Employment Guarantee Act (NREGA) wages through its BC though this channel was not operational at the time of writing. Thus, basic savings accounts were the sole product offered in Tangi for business correspondent clients.

While over one thousand accounts had been opened within the span of several

months, anecdotal information on these accounts suggested low usage. The research team talked with several clients as well as members of the BC operating team from which they formed the impression that savings accounts were often accessed on a monthly, and less frequently, weekly basis. Daily usage was absent though many of the clients earned their wages on a daily basis as labourers; this could be partially the result of irregular daily income streams as well as the schedule of the CSP.

While the current product arrangement does not bode well for the financial viability of ZMF's BC model, the disbursement of NREGA wages holds promise. Staff at ALW and ZMF believed that a high percentage of the population in Tangi held NREGA cards, could participate in the programme, resulting in handsome transaction fees for ZMF from the government. However, their enthusiasm was tempered by concerns for a viable commission structure; they advocated a payment system tailored to the demographic and operational status of each state. Several months after the research team's visit, A Little World was recently selected as the technology partner for the State Bank of India (SBI) to disburse NREGA payments through business correspondents.⁴

Clients' Perspective

The research team approached clients in Tangi who had opened no frills savings accounts through ZMF to understand why they had availed of the service, their usage behavior and satisfaction levels. Approximately thirty clients were interviewed, recommended by ZMF's CSP because they were relatively active users of their BC accounts. The research team therefore did not approach clients who had not used their accounts, and thus observations presented should be not generalized for all BC users. Most respondents interviewed were poor female farmers who split their yearly work between agricultural and daily wage labor.

BC clients cited a range of reasons for opening up their savings accounts, most frequent among them was their view of the scheme as a convenient risk-mitigation and consumption-smoothing tool. Additionally, several of the families used the accounts to deposit portions of remittances they had received from migrated relatives. BC clients conveyed their satisfaction with the door-stop service especially in the absence of local ATMs or bank branches. Despite (active) client satisfaction, few of those interviewed said they used their account frequently. As mentioned earlier, many of the clients relied on work as laborers or farmers

4. On September 22nd 2009, the government of Orissa signed an historic Memorandum of Understanding (MOU) with the State Bank of India to deliver NREGA benefits to all 6234 Gram Panchayats via State Bank of India and allied Business Correspondents. The State Bank of India has selected A Little World as its technology partner for this endeavor.

which are irregular and unpredictable sources of income. To contrast, a BC client who worked as a schoolteacher received a predictable/reliable wage saved via her account frequently. Another reason behind low usage was high participation in self help groups (SHG). They claimed to use the SHG as a source of short term credit and savings for consumption; they perhaps differentiated between the function of the SHG savings and their BC account savings, preferring the former for short-term needs and the latter for emergencies.

Thus BC account usage and floating balances remained low for most of the clients interviewed. Given that the BC hinges its financial sustainability on commissions for each transaction, the observed account inactivity has troubling implications for cost-effectiveness, from the BC's perspective.

While BC clients interviewed valued their savings accounts, they also hoped for an expansion into credit products. In their yearly financial life cycle, they explained that a loan for agricultural inputs at the beginning of the season could improve output and productivity. Yet, at time of writing, for reasons mentioned above, both the BC and the promoting bank were averse to offering loans. From the promoting bank's perspective, savings alone is not profitable for a bank, and the research team believed this lopsided product arrangement relegated the BC activities to the Corporate Social Responsibility (CSR) arena.

Conclusion

This case study gives a snapshot of a business correspondent pilot where a technology provider and its Section 25 affiliate have tied up with a public sector bank to enroll 1.050 clients into no frills savings accounts. While anecdotal evidence suggests that active clients value this product, usage is low. Despite client interest in credit, expansion into products beyond no frills savings appeared unlikely given the reluctance by both the bank and BC. Both low usage and the absence of credit products cast doubt on the financial sustainability of the operations for the BC and the bank, respectively.

ZMF's situation brings up a tension inherent in agent banking, that of the separation between the two functions of warehousing risk and distributing financial products/services. Historically both activities were bundled at banks, but with the arrival of agent banking and the business correspondent model, the functions are effectively split.

The reported low-usage of the BC no frills accounts is not a new phenomenon. The Centre for Micro Finance conducted two studies to examine the usage and awareness of the no frills account drive in two districts deemed "100% financially included." In both locations, Cuddalore District in Tamil Nadu, and Gulbarga District in Karnataka, usage was extremely low. In Cuddalore, one year after the

drive, within a random sample of accounts, only 11-15% had been used more than once (Thyagarajan pg 28).⁵ The research team believed that low usage was a product of the distance between the villages and the branches, other savings options available, lack of money to save and no awareness on the function of the no frills accounts (Ibid pg 47). Many households believed a no frills account was simply an avenue to a loan or government scheme. Of course the clients interviewed for this separate study had not been ushered into the no frills account drive via the BC model but by the bank itself. Still, it's useful to examine the dynamics behind low account usage as possible explanations behind the ZMF BC client behavior.

5. The CMF research team randomly selected several dozen no frills accounts from ten banks who had participated in the drive. Out of this sample they found only 11-15% of the accounts had been used at least once. The study is available here: http://ifmr.ac.in/cmfr/publications/wp/2008/Thyagarajan_No%20Frills_Cuddalore.pdf

Indian Grameen Services – Krishna Bhima Samruddhi

Model: Unique model where Krishna Bhima Samruddhi, a microfinance Local Area Bank works very closely with Indian Grameen Services as an integral part of their growth and outreach strategy

Location: Mahabub Nagar, Andhra Pradesh

Introduction

This case study documents the operations of Indian Grameen Services (IGS), the business correspondent for Krishna Bhima Samruddhi (KBS), a local area bank.⁶ There are two major factors which distinguish BASIX's operations in Mahabub Nagar those of other BC pilots. The first is the nature of the promoting bank, as KBS is a local area bank (LAB) while most other BC's are promoted by public sector banks.

The second distinction is that both the business correspondent and the promoting bank, while distinct organizations, work seamlessly with each other. The BC works almost as an extension of the bank – offering all the services that the bank offers through a third party agent. KBS claims that this model is now breaking even, which is unusual in the BC model experience in India with most sector stakeholders maintain is not viable in its current form.⁷ Interestingly, the IGS-KBS arrangement is the least technologically advanced of the four studies presented, relying only on Point of Service (POS) devices and vouchers. This case study is an effort to understand the implementation of this unique BC model and whether some of the positive aspects herein can be incorporated into the BC models around the country.

Organizations Involved

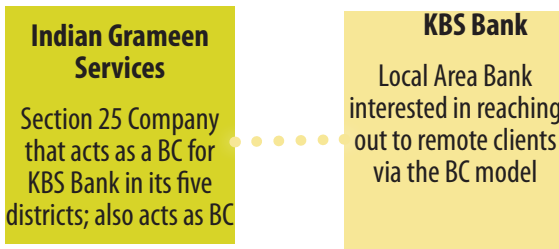
Krishna Bhima Samruddhi Bank (KBS): The holding company of the BASIX group is BASICS LTD which contains two fund-based companies – one is the aforementioned local area bank, KBS Bank. KBS Bank was licensed in 1999 and operates in three districts in Andhra Pradesh, including Mahabub Nagar, as well 6. Local Area Bank (LAB) scheme came into being in 1996. LABs are private banks which may operate only in two or three contiguous districts. Since inception, only four licenses have been approved by the RBI.

7. Some preliminary analysis by CGAP reveals that of the models currently operational in India, KBS' model has proven to be the most cost-effective. The analysis is here: [HTTP://WWW.MICROFINANCEINDIA.ORG/DOWNLOAD_REPORTS/PPT_GREG_CHEN.PDF](http://www.microfinanceindia.org/download_reports/ppt_greg_chen.pdf)

as two districts in Karnataka. KBS has engaged in providing micro credit, savings as well as other livelihood promotion products and services in these districts for a decade. It chose to incorporate the BC model primarily out of economic and regulatory necessity; namely the cost of opening and maintaining new branches remained relatively high. The BC model also gave KBS extra leverage in servicing remote areas and thus, the ability to acquire new customers more rapidly.

Indian Grameen Service (IGS): IGS was created by PRADAN to promote and support livelihood development activities in rural areas. It currently supports other BASICS group companies. In mid-2008, Indian Grameen Service began acting as a Business Correspondent on behalf of KBS bank.

Figure 2: BC Organizational Arrangements



Location

With a predominantly rural and agriculturally-dependent population of 3.5 million, Mahabub Nagar is situated on the western side of Andhra Pradesh and is one of the three A.P. districts where KBS operates as a local area bank. In terms of development indicators, Mahabub Nagar’s literacy rate is 45.53 %, compared to the average of Andhra Pradesh of 61.5% (MSME Development Institute 2008). According the India Andhra Pradesh Human development report 2007, Mahabub Nagar district ranks last among 23 districts in the state.

Table 2: Snapshot of Mahabub Nagar, Andhra Pradesh	
Area	18,473 sq. km
Population (in 000’s)	3,509
Number of Villages	1,865
Literacy Rate	45.53%
(AP Development Report 2007)	

BC Operations and Structure

As mentioned earlier, BASIX’s BC operations include two entities within the BASICS group, KBS Bank and Indian Grameen Service. The districts where KBS

operates currently in Andhra Pradesh are Mahabub Nagar, Raichur and Gulbarga where the bank has five, four and five branches respectively. Each of these branches is associated with at least one IGS contact point which one can think of as the IGS BC hub. These hubs are not physically located in the bank branch but in some market area close by. A typical BC hub is based out of the market area of that neighborhood and looks like any other storefront (see photograph below). Each of these hubs is then federated into further points of contacts which one can refer as IGS BC spokes within the catchment area. These spoke points are used to cater to the most far-flung and remote locations within the areas surrounding the hubs. Typically each spoke is covered by a single Customer Service Provider (CSP). (see Figure 3)

Indian Grameen Services hires and trains all its staff for BC operations. The roles



Photo taken by Binit Rath during field visit in May 2009 to IGS

and responsibilities for each BC hub are described on the following page.

Table 3: KBS - BC Arrangement in Mahabub Nagar District, A.P.

District	KBS Branch	BC Hub	Spoke(s)
Mahabub Nagar	Kodangal	Kosgi	Doulathabad
	Atmakur	Wanarpathy	Gpalpet
			Pebbair
	Gadwal	Ieeja	Maldakal
			Ghattu
	MBNR	Narayanpet	Marikal
			Makthal
		Badepally	Thimmaji pet

8

Field Executive: The Field Executive takes care of all BC operations at a particular hub as well as additional business development services provided by IGS. He or she screens client profiles before forwarding the loan application to the KBS bank branch level banking committee for loan approval. In practice the Field Executive is accountable for almost everything carried out by the BC in the particular geographic location. An FE earns in the vicinity of 18,000 rupees per month.

Transaction Assistant (TA): The role of transaction assistant is fairly technical. At the end of day the Customer Service Providers report and transfer transaction data to the TA who in turn uploads data from point of sale devices to the KBS bank branch. Cash handling and book keeping at the hub are also the responsibilities of the transaction assistant, and the latter activity takes on tremendous importance given IGS' limited use of technology. As compared to other BC's studied, at IGS there is no use of smart card technology. Rather, at the end of each working day, vouchers of all transaction are sent manually to the mother KBS branch. Only after receiving the receipts the accountant at the branch verify the transaction. After meeting several transaction assistants, the research team learned that power cuts often hamper his ability to send data to the main bank branch.

Customer Service Provider (CSP): The Customer Service Provider is this model's main contact with BC clients. CSP's visit villages regularly, meet with clients and collect loan dues as well as savings. On average a CSP earns somewhere in the

8. This chart is an excerpt provided to the CMF Research Team by a member of the IGS staff in Mahabub Nagar. A version of this chart is available online at http://www.micro-financeindia.org/download_reports/ppt_kbs.pdf

main products offered.

Micro-credit

Micro-credit is typically disbursed within a joint liability group (JLG), with occasional exceptions though Indian Grameen Services plays no role in JLG formation. Each group is required to open a savings account prior to availing credit and sequester ten percent of the credit as a fixed deposit. This acts as collateral for the entire loan amount, as ten percent of the loan goes directly into the savings account upon dispersal. The average loan size for an individual joint liability group member is Rs 18,000 and the average group size is five members. As mentioned earlier, field executives of IGS review and approve loan applications at the BC hub before sending them to the KBS branch level banking committee for final approval. During his assessment the FE assesses client profiles and the potential profitability of the activity for which loan is being taken. Loans are granted only for productive activities, including Agriculture (Crop, irrigation and land development), Agri Allied (Dairy, sheep & goats, poultry and fishery), Non farm loans (Grocery shops, artisans, tailoring, mobile vendors etc), General purpose (SHGs, Women & Federations) and housing loan (repair & extension). There is no specific tenure for any loan as it varies for each credit product.

Interestingly, as KBS Bank is a Local Area Bank, it is not placed in the same regulatory category as commercial or public sector banks. For loans, KBS is not locked into Prime Lending Rate and can charge as high as 24% interest, which is more in the range of microfinance institutions. This gives the model a greater chance for viability for the promoting bank.

Micro-saving

There are a number of savings schemes available for clients including the a) mandatory pre-loan savings b) Recurring Deposit Scheme c) Daily Deposit Scheme. As mentioned earlier, before availing a loan, each BC client must open a mandatory savings account. The usage of these mandatory accounts is low in comparison with the Recurring Deposit scheme (RD), which is slightly more popular among clients.

In urban areas an additional savings scheme offered is the daily deposit scheme (SDD) which resembles products which were once offered by NBFC's such as Sahara and Peerless. Clients of the SDD tend to be shop keepers and small business owners. However from conversations with stakeholders, the research team found anecdotal evidence that usage rates of these accounts is not high. Some

clients told us that they avail the SDD to acquaint themselves with IGS and KBS so that credit will be easier to access.

In addition to these three schemes, there are a number of additional savings products available via Indian Grameen Services. In essence there is no difference between the services KBS offers and those offered by IGS. Interest rates are generally slightly higher than commercial rates, and several employees cited that higher interest rates were necessary to attract customers. As many private and public sector banks operate in the district, KBS and thereby IGS found a slightly higher interest rate necessary to compete.

Micro- insurance

At least four insurance products are offered via IGS including life insurance via partnership with Aviva, livestock health and micro enterprise insurance with Royal Sundaram and weather insurance in partnership with ICICI Lombard. KBS strongly encourages creditors to purchase accompanying insurance, and many of the clients whom the research team interviewed had some sort of insurance cover. In general, the indemnity of the insurance is same as the accompanied loan amount. For e.g. A person with a loan of Rs 15,000, could purchase an indemnity of Rs 15,000.

Agricultural/Business Development Services

As mentioned earlier, the Ag/BDS services are not part of the BC model itself but an independent intervention of IGS in the same operating region. Major modules within Ag/BDS training include productivity enhancement, risk mitigation, local value addition and alternate market linkages. Each village or a group of village is covered by one Livelihoods Service Provider (LSP) who is responsible for organizing and providing these services. Training, which comes with a fee of Rs 450 per annum, might entail sample testing, consultancy on advanced agricultural techniques and the provision of high quality seeds and fertilizers. For dairy farmers, it focuses on right breed selection, feed and fodder management practices, artificial insemination, etc. Value addition and market linkages attempt to teach entrepreneurs to harness local resources to improve margins and profits. For example in Wanarpathy, IGS helps dairy farmers with value addition to their milk prior to selling and create market linkages with Reliance Dairy in Mahabub Nagar. From field visits, the research team learned that roughly one quarter of those farmers who received an initial round of Ag/BDS return for a second round though the reasons behind this are not well known.

According to KBS, approximately 23, 139 savings accounts have been opened via the BC model and 7,927 loans have been disbursed. Their customer base is 13,400, meaning that many of their clients are utilizing more than one savings product. These numbers are spread across the five operating districts and do not represent just the Mahabub Nagar District.

Table 4: Indian Grameen Services (all amounts in rs. 000) as of March 31, 2009.	
Number of Savings and Deposit Accounts	23,139
Deposits Outstanding	20,444
Number of Loan Accounts	7,927
Loans Outstanding	112,408
Total Customer Base	13,400
Revenue to the Bank	
	28,181
Cost to the Bank	
Payment to BC	7,221
Other (Including Funding, HR, and other Supervision costs)	17,347
Net earnings to the bank	3,613
Operating Result of BC	(-3,114).

9

Technology for BC Operations

Front End Technology: The major technology used at the front end is a Point of Service (POS) machine, carried by CSPs on their field visits, and which looks much like a typical credit card swiping device. Each customer receives one account book in which all past transactions are recorded and account balances are updated. After each transaction, the CSP updates the transaction in POS and the customer's book and provides a receipt to the customer with a duplicate for himself. As mentioned earlier, smart cards are not part of the transaction.

Backend Technology: At the BC hub, the TA uploads data from each CSP's POS device at end of each day, then uses customized software to upload into a central server at the KBS branch. As mentioned earlier, irregular power supply can

9. The above chart was taken in its entirety from the presentation of Manmath Dalai at the CGAP Thematic Policy Retreat on the Business Correspondent Model on May 19th 2009. His presentation is available here: http://www.microfinanceindia.org/download_reports/ppt_kbs.pdf

delay these daily uploads. At the KBS branch a designated accountant is responsible for account reconciliation with the business correspondent. It is important to note that the authentication of the transactions is complete only after the receipts of each transaction are received manually. This typically takes a day to reach the branch office.

Though the technology is not the most modern, the resultant operations are fairly cost effective. KBS calculated that the cost per customer acquisition for KBS is Rs. 1,357 while for the BC is it Rs. 819. Subsequently, each client transaction costs KBS Rs. 22 while for its BC it is slightly lower at Rs 20.¹⁰

Clients' Perspective

The research team interacted with roughly twenty BC clients, split evenly between rural and urban areas. The interviews were qualitative and intended to understand how the BC model engaged with clients' financial needs, financial behaviors and their livelihoods. The questionnaire probes about the client's general financial status as well as specific queries on their level of satisfaction with BC services.

Rural Clients

IGS Clients in the rural area of Mahabub Nagar district where the research team visited fell into one of three categories, dairy farmer, crop farmer or local vendor/shop owner. Prior to the arrival of Indian Grameen Services, most of the clients had never opened a bank account, though a few had opened now-defunct accounts. Other local options include an AP Grameen Vikas Vank, as well as Self Help Group (SHG) Bank Linkage Programme, to which many of the women interviewed belonged. The average size of the SHG was fifteen, and many women had joined a decade earlier and the average individual's monthly savings was Rs. 30. While most members used SHG loans to invest in a family income generating activity, in some cases the entire group created a community enterprise such as a brick kiln, in which they invested Rs. 2 lakh.

Most of the Indian Grameen Services clients the research team approached were in their second or third loan cycle. As mentioned earlier, all clients receive loans via joint liability groups (JLGs), formed by members themselves. One request from the clients was that they hoped they could transition to much-larger individual liability loans. Additionally, households were restricted to one loan at a time, constraining some families who owned more than one business. The research team also found that most of the loan accounts were accompanied by

10. This information was taken from the aforementioned KBS Presentation at the CGAP/ACCESS thematic policy retreat

equivalent insurance covers; i.e a shop owner had purchased a micro enterprise shield, where dairy farmers had purchased live stock insurance.

From the research team's interviews, it appeared that IGS clients did not value their mandatory savings account and complied only to receive a loan. Drawbacks included the illiquidity of the savings account, as well as the low interest rate. In contrast, more clients expressed satisfaction with the recurring deposit (RD) scheme, to which clients add rupees simultaneous to loan repayment installments. Finally, the bulk of rural clients interviewed had opted for the Ag/BDS training service offered by IGS. While the Ag/BDS is not compulsory, IGS strongly encourages participation as a risk mitigation strategy for businesses.

Urban Clients

Comparing IGS' operational environment between rural and urban areas yields insights into client profiles, product needs and financial behavior. In contrast to the rural hamlets, IGS faced stiffer competition from commercial banks in the urban areas where it operates. Most of IGS' clients already had an account in a different bank, and also deposited money into some form of a chit fund. Additionally, while rural clients' livelihoods were diverse, urban clients were primarily shop owners. Females were present in lower proportion in urban areas than in rural areas. Finally, awareness levels of KBS Bank were much higher in rural areas and not urban areas, where they faced fewer competitors.

Urban clients tended to place more importance on savings instruments than rural clients as motivation for engaging with IGS. Indeed, the research team found that savings schemes such as the daily deposit scheme (SDD) and recurring deposit (RD) scheme were slightly more popular than in rural areas, where the usage team observed extremely low usage of daily deposits. One reason for this could be the different earning patterns of rural versus urban clients as urban clients tended to be shopkeepers who earned on a daily basis, while rural clients are engaged in agriculture which has an irregular income stream etc. .

It appears from discussions with the bank's officials that there is slight institutional preference towards against giving loans in urban areas, which they perceive as more difficult due to weakened social networks and lack of places to meet for low-income households. According to KBS officials, the percentage of loan account to overall accounts is less in urban area.

Model's Strengths and Challenges

The research team found one of the major strengths of this model is the close-

ness of the business correspondent, IGS, and the promoting bank, KBS. Being from the same parent organization fosters synergy, closer collaboration, shared objectives and greater trust than what might occur in other models. Additionally, Indian Grameen Services is not one of many delivery mechanisms for KBS, but rather the core delivery mechanism. Thus, the BC operation becomes an essential part of KBS' growth and outreach strategy. While the research team has not performed a costing exercise, according to IGS and KBS officials, the commissions offered to IGS are adequate for sustainability.

Additionally, as a Local Area Bank, KBS Bank is able to charge an interest rate on loans as high as 24%, unlike commercial banks. This higher interest rate reflects the higher costs of catering to a small loan and is in the same range as what many MFIs charge their clients. Commercial banks are unable to charge this rate since they must follow rules which state that loans below Rs. 2 lakhs must be priced at the prime rate of interest. This is part of the key reason why KBS Bank is able to break even, as they claim, and also why they are able to pay BC an adequate commission.

On a broader level it's worth acknowledging that KBS Bank has been engaged in what might be termed microfinance activities for over a decade and is more oriented to both the demographic and product needs of this target group. Thus there is a high degree of engagement between IGS and clients, which helps promote products. Part of the explanation for this lies in the fact that the KBS/IGS partnership relies on the microfinance and Joint Liability Group (JLG) model to deliver financial services to their clients. The microfinance model necessitates close relationships between the MFI staff and clients, which is the relationship between IGS staff and their clients.

Despite the success of this model, there are a number of challenges and obstacles to scalability as well as replication elsewhere. The first is the prevalence of loans in the IGS-KBS model. Although loans show the greatest potential to enable the BC model to become viable, as seen in other case studies, banks are typically not willing to outsource credit evaluation to BC agents and BC agents themselves are not comfortable evaluating bank clients. Additionally, with the exception of KBS-IGS partnership, loans have proved to be the most difficult to provide to BC clients due to the inflexibility in interest rates.

Another challenge is the impression that the usage of savings products is extremely limited. It seems the credit products are cross subsidizing the saving products and savings product cannot be financially viable for the BC on its own since usage of these accounts is so low. Other obstacles include technology, as the current low-tech field technology appeared to slow the pace of operations (though they were less expensive than other models). Attrition of field staff at IGS is a major problem and poaching is a constant undercurrent. Finally, as KBS

is a local area bank, its “brand,” carries less wattage than other nationalized and commercial banks, dampening its ability to attract new clients.

Overall, this model appears to work because the BC is able to work almost as an extension of the bank and because KBS has flexibility with the interest rates which other banks do not have.

Conclusion

To summarize the research team’s findings and observations, the BC of BASIX’s local area bank KBS, Indian Grameen Services, is distinct from other BC models in a number of ways. In fact, the BC operations seemed more like a microfinance institution rather than a typical business correspondent, as the KBS Bank is in fact a microfinance bank. Layered atop this is that Indian Grameen Services and KBS Bank are both part of the same superstructure of BASIX and the BASIX group. As a result, the operational distinctions between the two entities were sometimes hard to define.

In comparison with other BC’s, Indian Grameen Services offers a wide suite of products including credit, savings and insurance. Additionally, the BC provides others complementary services not directly related to the BC model such as Ag/Business Development Services. While there are a variety of services offered, loan products dominate in terms of activity and demand. Mandatory savings of 10% of the loan amount go hand-in-hand with credit, though these fixed deposits are unpopular among clients. Compared to the mandatory fixed deposit, the recurring deposit scheme was decidedly more popular, particularly among urban clients. Additionally, many of the clients who had taken loans had also purchased insurance against their income generating activity. Thus, the model emphasized holistic development of the client and their livelihoods.

Operationally, Indian Grameen Services did not use the latest or most sophisticated technology for loan disbursements or data transfer. However, they appear to be on the road toward financial sustainability. KBS management revealed that Indian Grameen Services is expected to break even by early 2010. This might be the result of the flexibility in interest rates charged on loans, and the commission structure for the BC from KBS which both KBS and IGS officials claim to be adequate. Since KBS is a LAB it does not have to conform to the same RBI lending rules. As such, there are able to pass on some of these profits to their BC IGS, making the entire system viable in the medium-term.

FINO Fintech Foundation-FINO

Model: Sec25 Company ties up with technology provider who partners with a bank to provide financial services

Location: Karaikudi town, Sivaganga district, Tamil Nadu

Introduction

This case study focuses on a pilot in southern India where a Section 25 company has partnered with a technology company to provide BC services on behalf of a major public sector bank. Since October 2007, roughly 3000 no frills savings accounts have been opened through the model and roughly 200 loans have been disbursed. FINO Fintech Foundation and Financial Information Network Operations (FINO), the BC and technology partner, respectively, are allied in the same vein as the first case study on A Little World and Zero Mass Foundation. While the location and actors are different than peri-urban Orissa, the institutional arrangements raise many of the same issues discussed in A Little World including financial sustainability, lack of product diversification etc. The pilot also highlights a larger conceptual quandary of the BC model – namely whether they are instruments for the financially excluded or just convenient new services for the financially included. Fintech/FINO's operations in Karaikudi concentrated on hawkers and shopkeepers in and around the town, many of whom already had bank accounts elsewhere. Finally, much like the ALW/ZMF case study the research team observed that the public sector bank did not view the BC model as much more than Corporate Social Responsibility (CSR), which tempered their enthusiasm for expansion.

The case study zeros in on the town of Karaikudi, in Tamil Nadu where a Fintech pilot began eighteen months ago. The pilot began when they entered into an agreement with a major public sector whereby Fintech would provide BC services to interested individuals in Karaikudi town and the villages surrounding it. The bank and the BC settled on a client target for expansion and as was the case with A Little World, the BC made all major arrangements with the bank's head office and only then became engaged with the relevant local bank branch.

Organizations Involved

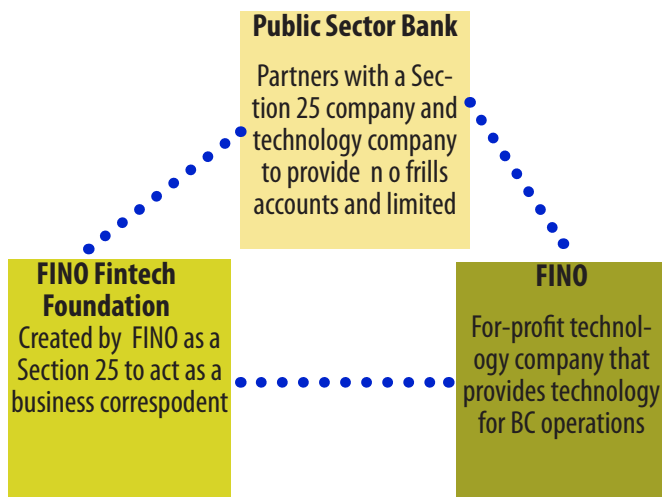
FINO: FINO is a for profit technology provider created in 2006 with the specific mandate of increasing financial inclusion to low-income household. FINO works as a technology partner with more than a dozen banks and ten MFIs including ICICI Bank, AXIS Bank, BISWA Microfinance and Janalaxmi Microfinance amongst

others. In their work with the BC model, FINO uses bio-metric technology for identification and the provision of financial services.

FINO Fintech Foundation: FINO Fintech Foundation is a Section 25 institution set up by FINO to provide BC services to clients via bank partnerships. India's regulatory framework prohibits for-profit companies to act as a business correspondent, thus Fintech, a Section 25 company acts as the front end for the delivery of financial services, partners with banks and the banks provides a commission for each transaction. In Karaikudi, Fintech trains BC agents, provides savings service to clients, facilitates credit for BC clients who are eligible for loans and

works to create a smooth working environment between the bank, the BC agents and FINO.

Figure 4: BC Organizational Arrangements



Location

Karaikudi is the biggest town in Sivaganga, one of the more backward districts in Tamil Nadu. According to the Census of India in 2001, Karaikudi has a population of 86,422 and a district-wide literacy rate of roughly 72% (Census of India 2001).

BC Operational Structure

While in theory Fintech's business correspondent agents, the equivalent of customer service providers (CSP), work separately from the promoting bank, in practice they sit at the banks' premises and work closely together. As evidence of this proximity, the bank actually vetted and interviewed the BC agents prior to their employment by Fintech. Given the relatively low number of clients at the time of writing, the two BC agents worked without Fintech supervision. Instead,

they collaborated with the local bank manager, who was involved in much of the day-to-day work.

For the pilot, each BC CSP took responsibility for one area, divided fairly arbitrarily because one agent owned a motorcycle and was assigned a rural zone thirty minutes by bike from Karaikuddi town. The second urban area was within walking distance, between two to fifteen minutes on foot, of the promoting public sector bank itself and almost all clients were neighborhood shopkeepers. Each BC CSP claimed to serve around 80-90 clients per day.

As mentioned earlier the local bank manager closely supervised the BC staff and set targets for operations. According to interviews with Fintech, the promoting bank pursued a fairly conservative agenda in opening new accounts and extending credit. For example, FINO/Fintech projected that they should expand operations to 20,000 new accounts while the bank believed only 5,000 new accounts was feasible. Additionally, while the demand for credit among BC clients was high, the bank approached loans with extreme caution and felt uncomfortable outsourcing credit evaluation to a third party. Their sentiments echo those of the public sector bank involved in the A Little World pilot in Orissa which felt equally unsure over allowing ALW to do credit evaluations. Thus only around six percent of clients served by Fintech in Karaikuddi have received credit.

An interesting component of the pilot revolves around cash handling risk management. Customer service providers are often responsible for carrying and disbursing large amounts of cash, which leaves the door open for potential fraud and theft. To manage this risk, all Fintech CSPs are required to deposit Rs 10,000 to qualify for the position. Of this lump sum, the agents should have access to Rs. 5000 at any given time to provide BC clients with withdrawals. Resultant disbursements from the agents' accounts are then reconciled and reimbursed within a day. Even with this fail-safe system in place, the bank manager was still cautious about withdrawals and required advance notice for disbursements. Part of this stemmed from the management information system, which was not explicit about each BC client's account at any given time.

Technology for BC Operations

Fintech utilizes FINO smart cards and point of service (POS) devices for the delivery of BC services at the doorstep of clients. Typically, the client hands over his/her FINO smart card to the Customer Service Provider (CSP) who swipes it in his POS device which is also equipped with the ability to collect bio-metric identifications. BC agents only require bio-metric information when a client requires a withdrawal, for a deposit the FINO smart card is enough. Once the transaction is complete, the Fintech Business Agent prints two receipts of the transaction

– one for his records and one for the client. A transaction takes roughly two minutes.



A FINO Agent uses the biometric point of sales device (picture taken by Doug Johnson, Centre for Micro Finance)

Products and Services

Like other BC's promoted by public sector banks, the primary product offered via Fintech is a no frills savings account. As mentioned earlier, Fintech has opened approximately 3,000 such accounts, all of which were enrolled during the pilot's initial phase, which lasted from October 2007 to January 2008. On January 20th 2008 the accounts were activated and in Fintech's approximation, about half of the accounts are active. No further accounts have been opened since January 2008, though both the bank and Fintech plan to expand.

Very few BC clients have received individual loans due to the bank's high level of discomfort in allowing third party agents to conduct credit evaluations. The procedure to obtain a loan involves getting three co-guarantors. In practice, the Fintech Business Agent finds four BC clients who desire a loan and they become each other's guarantors.

Clients' Perspective

The research team surveyed several dozen BC clients in and around Karaikudi. Again, readers must keep in mind the selection bias inherent in this exercise as the team spoke only to active clients, thus leaving out inactive customers. All of the BC clients the research team met were men, Fintech confirmed that three quarters of pilot clients were male, and most worked as shopkeepers. In Karaikudi, these enterprises included roadside restaurants, photograph studios, shoe

shops & goldsmiths while in the rural areas they operated petty grocery shops, small restaurants, florists, vegetable sellers etc. Most of the enterprises they owned amassed earning on a daily basis.

Interestingly, many of the clients interviewed availed additional banking services beyond the BC, as some used additional savings accounts at a nearby public sector bank. Usage of their non-BC accounts appeared to be tied with their enterprises. For example they might use the accounts to deposit checks from business partners or create demand drafts for suppliers. Other common savings outlets among respondents were post office savings accounts and chit funds.

Why would these shop owners, particularly those based in Karaikudi within a stone's throw of a bank and with other formal savings outlets, opt for a BC no frills account? Convenience featured prominently among explanations, with the "door stop" service of BC agents particularly appealing. To a lesser degree, respondents said that they preferred not to deal with a bank and the requisite paperwork and hassle. Overall, every client valued the ease with which they could manage savings through the BC. It is worth reiterating that under the current regulatory regime, BC clients are not charged anything beyond normal fees/interest rates. The research team probed to gauge whether clients would be willing to pay extra for the doorstep convenience. Few said they would be willing to pay, but perhaps this stemmed from the service being free from the beginning.

Clients whom the research team met saved on a daily basis with the BC, with deposits ranging from fifty to two hundred rupees. Withdrawals among respondents were larger than daily deposits, often over Rs. 1000, and thus done only after a period of accumulation. Recurring reasons for withdrawals were school fees, business expansion or other household consumption needs. As clients met the BC CSP daily for deposits, they could inform him several days in advance about a withdrawal. If this was not possible, they called the BC CSP on his mobile. Due to cash management procedures, namely the desire to mitigate risk of fraud/theft by allowing CSPs to regularly handle thousands of rupees, a CSP must be given advance warning for a large withdrawal.

Credit was a point of frustration for many respondents, as less than ten percent of the 3,000 BC clients had been granted a loan. Both clients and the Fintech agent believed that relative to the typical loan size of Rs 10,000, the red tape were onerous. For the few clients who had actually received loans via Fintech, an interesting dynamic developed between daily savings and loan repayment. Clients who had taken a Rs. 10,000 loan with a ~Rs. 500 weekly repayment reported that they saved daily for five days and then on the sixth day transferred those savings towards their outstanding debt. Beyond savings and credit, some of the respondents desired services such as an ATM account for bulk purchases as well as insurance products.

Models Strengths and Challenges

This pilot presented a surprising reality in Karaikudi – many of the BC clients were not only financially included but regularly accessed other formal financial services. It would appear that this pilot does not fulfill the objective behind the Reserve Bank of India's sanctioning of the BC model, which was to improve financial inclusion and deepen of the banking sector.

Further, a sizable number of the BC clients interviewed were within walking distance of the promoting public sector bank and some even operated shops situated across the street! This raises an important question – if these clients are not financially excluded, if they have ready access to the bank and lastly, if they value doorstep delivery of savings service, should they be charged for it? While the desire to pay was not high when the research team talked to clients, one suspects that this is primarily because they currently already receive the service free. This is an important question to think about since some accounts show that BC operations cannot be sustained by the float generated out of savings alone.

This case study demonstrates what was observed in the ALW/ZMF case – that banks often view the BC as a CSR opportunity rather than a commercial one. This is partially because thus far the regulatory regime does not allow it to be economically viable for banks or for BC's. In order to make it viable, the sector must find ways to make this model work for both parties and indeed for clients.

Adhikar-FINO

Model: NGO-MFI acting as Business Correspondent for a major private bank working with FINO as the technology provider

Location: Bhubaneswar, Orissa

Introduction

The fourth case study examines a pilot that, at time of writing, was on the verge of shutting down.¹¹ The research team examined the operations of Adhikar, which acts as a business correspondent on behalf of a private commercial bank in Bhubaneswar, Orissa. For this pilot, Adhikar has linked up with FINO as its technology partner. While this paper has discussed BC arrangements where a non-governmental organization and a technology partner work together (Zero Mass Foundation-A Little World and FINO-FINO Fintech Foundation), this is the first case study where the two are completely independent entities. Unlike the close association between Zero Mass Foundation and A Little World, or FINO and FINO Fintech Foundation, Adhikar and FINO are not associated beyond pilot operations.

The pilot amassed around 1000 clients and mobilized Rs 60,000 rupees of savings through basic savings accounts. However, after roughly six months of operations Adhikar found that their BC was not economically viable nor could they surmount a number of logistical issues. As a result, they are considering closing down their BC operations (at the time of this document going to press, Adhikar was already winding down its operations). Beyond the problems with the model, this situation raises reputational risk for Adhikar in their future work.

Organizations Involved

Adhikar: Adhikar is part of a non-governmental organization that works in microfinance, livelihood creation and human rights advocacy, primarily catering to the poor in Orissa. As a microfinance provider it is a Section 25 company whose services include joint liability group loans, insurance and remittance facilitation.

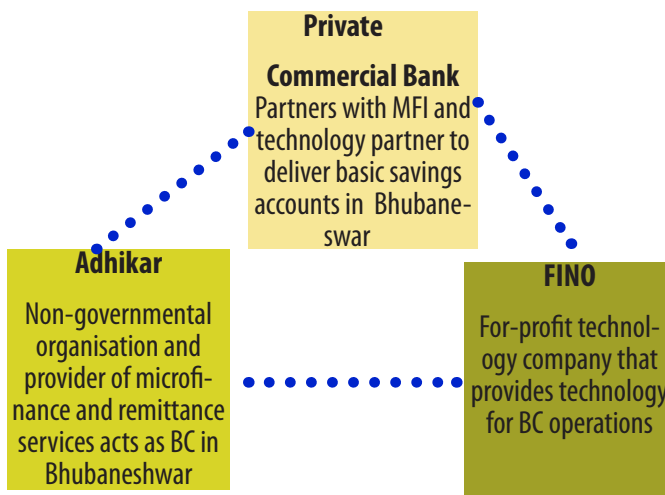
FINO: Financial Information Network & Operations Ltd. (FINO) was founded on in 2006 to develop technologies that facilitate the delivery of financial services for low-income clients. Since inception, FINO has partnered with many microfinance institutions and banks to provide innovative technologies.

11. The model's apparent dysfunction was part of the research team's motivation for targeting it as a case study.

Location

The study was undertaken in Bhubaneswar's Jayadev Vihar area. Bhubaneswar is the capital of state of Orissa and has a population of around 800,000 spread across roughly 150 square kilometers. As the location is urban, much of the population works in non-agricultural activities including the service, transport and trade sectors. This socioeconomic backdrop is obvious in the characteristics of Adhikar's BC clients, most of whom are shop-owners.

Figure 5: BC Organizational Arrangements



BC Operational Structure

Adhikar created two small branches to cater to its BC clients, and according to employees the cost of running a branch is at least Rs 20,000 per month. One FINO agent sits at each of the Adhikar branches to assist in the preparation and utilization of the bio-metric smart cards. The BC offices typically have one computer with a camera and printer managed by the FINO employee.

Clients are enrolled after the Adhikar Customer Service Provider visits an area, typically daily markets where there are permanent shopkeepers as well as roving vendors, and motivates people to open a BC account.

After the basic information required to open an account and bio-metrics is recorded and, a enrollment fee of Rs 200 is collected from the client, smart cards are distributed. Adhikar mentioned that they sometimes experienced delays between enrollment and disbursement of smart cards. For any future transaction, the clients swipe this smart card into a point of service (POS) device brought by

the Adhikar agent. As with most BC operations, at the end of the day, the transaction data is sent to the promoting bank branch. Adhikar receives Rs 30 rupees for opening an account and Re. 1 rupee per transaction from the bank.

The technology is similar to what was described for the Karaikudi case study for with FINO smart cards and point of service (POS) devices are used. In terms of products only basic savings accounts were offered through Adhikar's BC services.

Clients Perspective

Approximately 1000 customers have enrolled for BC service, out of which 500 accounts are active, according to Adhikar. Most of the BC clients whom the research team approached are young shop-owners, between 25-35 years old, who conduct business within Bhubaneswar municipal corporation-sanctioned vending zones, for which vendors pay Rs. 3000 per /month in rent. These vending zones consist of shops that sell groceries or paan (a popular combination of betel leaves, areca nut and other ingredients that is chewed). The research team's observations suggest that, most of the respondents appear above the poverty line and in solid financial standing.

Adhikar claims that their target clients are the financially excluded though the vendors in the area appeared to have multiple points of access to financial services. Aside from public and private sector banks there were chit funds like Sahara and a local chit fund (Sri Ma Mangal) present. These options were reflected among respondents, of whom many already had a bank account with one or more of these sources. Additionally, banks in the area had begun lending money to the vendors through joint liability groups (JLGs). As a result, the BC clients expressed little interest in Adhikar's BC services and savings account usage was fairly low, particularly because credit was not available through the BC channel. Some respondents had enrolled with the explicit intent of receiving a loan through Adhikar and expressed disappointment at its unavailability. Again, the methodological caveat must be noted that the research team spoke only to a dozen active clients who might not have represented the full sample of the 1,000 enrolled clients. Some of the respondents said they enrolled only to procure a smart card, a prestigious item that proxies for status. For these customers, usage is extremely low, sapping resources and lowering revenue for the BC operations.

Additional complaints from BC clients concerned the frailty of FINO's smart card, which was easily damaged. While damaged smart cards could be replaced by the Bank at no cost to client, there were inconvenient delays. Clients also expressed dissatisfaction that the account did not come with facilities such as check-book

or an ATM card. Again, these gripes are likely more acute because other banks in Bhubaneswar are aggressively targeting the vendors for loans, No Frill's Accounts with check books and other facilities.

Models Strengths and Challenges

According to Adhikar, the local bank officials do not prioritize the BC activities. Thus there are delays on several fronts including the opening of accounts and the delivery of money needed for client withdrawals. As Adhikar is also a lender in these areas, these delays hurt their reputation and could have a negative long-term impact. Adhikar also faced frequent staff changes at the bank – understandably, new staff took time to understand Adhikar's operations and priorities. Risks over cash handling were unsettling to operations, as Adhikar felt the bank did not adequately share the risk in the case of fraud or theft.

Adhikar also believed that the commissions for BC operations were so low to render the entire function as not economically viable and therefore impossible for Adhikar to manage beyond the pilot. Initially, after discussions with bank officials, Adhikar had expected to break even on the BC model within a year. However, despite the compensation they received for enrollment and transactions, Adhikar stated that they were able to recover only 20-30% of the total cost of a full-year of operation.

As this paper went to print, Adhikar is now working with the bank to close down their BC operations and branches. The bank has already sent letters directly to the clients communicating the same and requesting them to withdraw deposits, either from the BC or the bank, within 75 days. According to Adhikar, some of the BC clients want their Rs. 200 enrollment fees back as well.

Conclusion

This relatively unsuccessful pilot has shown that cooperation between the bank and the BC is essential; it also demonstrated the consequences when business correspondent cannot cover its costs. This experience has underlined the importance of active support from the bank throughout the pilot period, cross-selling of other financial products (including insurance and remittances) and educating the clients about what BC's can and cannot offer.

Adhikar believes that apart from setting savings target for the BC's, banks should set internal target for their business operations under the model along with defined time frame for the pilot phase. This might encourage more proactivity during the pilot phase and attention to what works and what does not.

Synthesis and Looking Ahead

This section synthesizes some of the most important observations from the four field visits along with additional conversations with stakeholders. While the lessons are not meant to be purely prescriptive, some of them do lend themselves to policy recommendations. The findings should primarily serve as a basis for discussion and further research.

Who are the BC Clients?

At the macro-level, these case studies illustrate that the BC model may not always engage with the financially excluded. In fact, in some instances, as in Karaikudi and Bhubaneswar, many of the BC account holders are shopkeepers within walking distance of banks who already hold bank accounts at different institutions. This is not to generalize that all BC pilots target the same population. Indeed the research team found that many of KBS' rural clients, and some in Tangi, had never availed of formal financial services and prior to the BC model had been financially excluded. In their report, the RBI's Working Group also found that beneficiaries of BC services tended to be illiterate and ill-informed of the BC structure, a fairly different demographic than encountered during many of CMF's field visits. The differences raise a some normative and practical questions, such as is there an ideal BC client profile? And how do BC's and banks target their customers?

Of course, access to a bank account does not imply usage. Indeed, from the research team's conversations with implementers, it appears that a majority of no frills accounts, the primary product of the BC model, are not used by clients. This situation demonstrates that there is a great need for data on the number of BC accounts opened, on the number of active accounts, average amounts in the accounts, number of withdrawals and deposits and on the number of accounts that receive loans. The Reserve Bank of India can mandate that this kind of information be given to them on a periodic basis which will allow the sector to understand who is using BC accounts and for what reasons. Most importantly, it

will help the sector understand to what extent the branchless banking delivery model is able to alleviate financial exclusion.

BC Products and Model Viability

From the research team's brief field studies it appears that branchless banking can, in some circumstances, work moderately well for the provision of no-frills savings accounts but not if this is the only product offered. Offering savings products alone is simply not a viable arrangement for the bank. Indeed, there are not many other examples of countries where branchless banking has been successfully used to deliver savings products alone. While micro-savings is a product that some clients demand, the fee income which BC's earn is not enough to cover their costs. Both FINO Fintech in Karaikudi and BASIX BC operations told the research team that savings was something which clients wanted. However, the fee income is simply not remunerative enough to only offer this service. In order to become financially viable, there might be a case to support charging the end-user for these services, and for product diversification as in the case of KBS.

Some BC's have argued that especially in the initial operational stages, the commission should be set at a combination of fixed and variable compensation. This is because during setup, BC's must invest a large amount of capital in technological infrastructure such as smart cards, Point of Service (POS) devices, database, training staff etc. For current providers, not-for-profits, financial viability tends to hinge on how much support the promoting bank is willing to give, which is fairly arbitrary. For example some banks as part of the fee arrangement provide the money for POS devices and for smart cards. Others provide money for the smart cards but not the POS devices. Thus, it becomes difficult for many BC's, especially those not associated with technology providers, to provide this kind of outlay for capital expenditure. Although the model is only in its pilot phase, future endeavors should attend to a clear business plan and costing structure,

opposed to the fairly ad hoc behavior the research team observed.

From the demand side, one of the key factors to emerge is that in both urban and rural areas, BC clients see the model as a means to access future credit. Anecdotaly, the poorer the target group, the greater the demand seemed to be for loans. This may be because the respondents need immediate consumption money or expect to use credit to monetize future savings. Unfortunately, loans are not forthcoming because banks are not inclined to delegate credit evaluation to BC's nor to disburse large amounts through this channel. As the liability for default would be borne by the bank, despite their distance from selecting clients, their hesitation is understandable. Some BC's appear uncomfortable taking on what might be termed as purely banking activities.

One other reason why banks are unwilling to offer loans through BC's is the interest rate cap on loans made through BC's. Under regulation, banks cannot charge more than prime lending rate for these loans, which are typically lower than Rs. 25,000 . One of the few BC model which was able to overcome this is the model floated by BASIX through KBS bank, wherein they created Joint Liability Groups (JLG) groups and offered them microfinance loans. Local Area Banks are not bound by rules for commercial banks and as such, KBS was able to charge a higher rate of interest. Thus, if the model is expected to promote credit, there should be a re-examination of interest rate caps that banks can charge on BC loans.

Additional Services and Disbursing Government Benefits

It would appear that many of the active users of the BC model, particularly in urban/peri-urban areas, desire additional services on their accounts such as ATM cards, check facilities and in some cases, the ability to allow their suppliers/business partners to deposit money in their account. This is especially the case where other banks in the same area offer No Frills Accounts for free with all of these perks. For example in Bhubaneswar, street hawkers are mobilizing into groups of ten to avail of loans from a particular commercial bank and the savings-based BC model promoted by FINO-Adhikar is not popular with them.

Given that the BC model is currently not financially sustainable, it is difficult to imagine that banks are in a position to offer them facilities in excess of what is already being offered.

In contrast to other products and services, branchless banking appears to have worked well for disbursing government benefits. Conversations with banks (SBI, UBI, PNB) reveal that this is the most common transaction activity under the BC model in India, with most banks citing their work in Andhra Pradesh. However, the BC's believe that there are a few modifications that would facilitate the process including a more flexible commission paid by governments to banks/BC's. Currently, for compensation the Andhra Pradesh state government pay the BC's/banks 2% of the total amount disbursed as commission, out of which 1.75% goes to the BC and 0.25% goes to the bank (Johnson 2008). BC's believe that this rate would not be sustainable in all states.

Government and Regulatory Support

Finally, the research team encountered a view among BC's that national and state governments as well as the Reserve Bank of India should promote the model to ensure its scale and viability. In Karaikudi, the promoting bank admitted that they felt no pressure from their Head Office to lend via the BC model, whereas they were given more explicit "top-down" pressure to disburse credit to SHGs and other microfinance institutions.

In a counter-example, the Government of Rajasthan (GOR) teamed up with BASIX and Infrastructure Leasing & Financial Services Limited (IL&FS) to create and deposit Rs. 1500 into the bank accounts of 50 lakh financially excluded families via smart cards. The scheme originated at the government level and thus ensured strong support among banks such as the Punjab National Bank (PNB) and the State Bank of India (SBI).

Looking forward, experts debate the feasibility of widening the scope of entities that can be business correspondents. As mentioned earlier, only not-for-

profit organizations (apart from individuals like ex-servicemen) can currently act as Business Correspondents. To make the model viable and more popular, it may make sense to allow for-profit organizations like NBFC-MFIs to join the fray. These institutions have a strong understanding of client needs and strong connections with communities. In general, the regulators need to assess whether they have created an enabling or dis-enabling environment for the BC model to flourish.

Future Questions

This preliminary field-based exploration yielded insights into the strengths and challenges of the Business Correspondent model. Yet there are still outstanding issues that should be answered with future research, using both secondary and primary data:

- **Analysis of Transaction Data** - As mentioned earlier, sifting through and analyzing the usage data of BC clients would yield information on client profiles, financial behavior, accounts balances etc.
- **How are BC clients targeted? What effects take-up and usage?** In its work, the CMF research team did not acquire adequate information on how BC's and promoting banks decided on client targets for their model, nor on how they marketed the services to potential beneficiaries. More extensive field work would be required to capture these dynamics, as well as comprehend from both active and inactive clients' as to why or why not they were using the BC services.

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