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Global Lessons on Partnerships for Financial Inclusion

Key Takeaways

As governments push harder on achieving the inclusion objective, the role of non-banks has been increasing worldwide in providing access to payments and financial services. India has been following this global trend, even as the primacy of the bank-led model continues. Given that all countries are looking at digital financial inclusion as the most effective and efficient method of lowering costs of financial services, the mobile phone becomes the cheapest, most accessible channel. Whether the model is bank-led or non-bank led for inclusion, partnerships between banks and non-banks are key to a successful mission. With Payments Banks now ready to launch this year, evidence from across the globe gives the following lessons for India on making partnerships work:

- A successful partnership is one which has clearly delineated the competitive advantage of all the partners, with the best placed partner (bank or non-bank) able to drive the initiative according to its own strengths. Partnerships break down when the players see each other as competitors and do not recognize the long term benefits of staying in the venture.
- Banks can leverage the strengths of the non-banks and use the partnerships to raise their own customer base and core business. The most successful example comes from the Commercial Bank of Africa (CBA) that launched MShwari, a mobile money savings and borrowings account, in partnership with Kenya's largest telco, Safaricom.
- Revenue sharing arrangements are key to a successful partnership – this calls for understanding the motivations behind each partner's business, adjusting revenue sharing for maximum benefit to all and reviewing the shares as roles evolve with time.
- When a company in the supply chain depends exclusively on channel related revenue, it must have sufficient control over the business to maximize its benefit. This scene plays out in India in many places where banks do not give the BC agents their dues in revenue and in decisions in the field, impacting service delivery at the last mile.
- Banks will only invest in developing and selling banking products through the channel if they have sufficient visibility at the last mile and control of the operations. Partners and policymakers in India should keep this balance in mind.
- Agent viability is crucial for successful implementation of digital financial services and during the early phase of the implementation, when transactions are low, agents must be compensated by other players in the chain. The high level of dormancy in agents in India is a critical issue that needs to be addressed at the earliest.
- Regulators should be wary of creating an environment leading to sub-optimal partnerships between banks and non-banks. The regulatory environment in India has evolved, allowing Payments Banks, relaxing the rules on Business Correspondents etc. Allowing interoperability for BCs and cash-out for PPIs can help further in pushing innovative solutions to increase usage of accounts.

The role of the regulator is paramount in allowing a free and fair playing field for banks and non-banks, allowing partnerships to flourish and also putting in adequate customer protection to allow for failed ventures. The RBI has been on the right track by coordinating on the USSD issue, allowing small PPIs to function albeit in a limited role, bringing in niche banks like Payments Banks etc. Over time, this would also mean debate and discussion on new legislation that may be appropriate, in keeping with the evolving technology, payments systems and needs of the economy.

Background

In India, regulation has favoured a bank-led model for financial inclusion, and yet, recognizing the crucial role that non-banks can play, it has expanded the boundaries over the years, first allowing non-banks as Business Correspondents, then as Pre-Paid Instrument Issuers and now in the shape of the proposed Payments Banks and Small Finance Banks. From 2006, the RBI and the government pushed expansion through the bank-BC model, and the banks responded by increasing the number of BC agents in the field. While there are quite a few Business Correspondent firms that are operating in the country, they operate under significant constraints that have been well-documented over the years. Few Business Correspondent firms have achieved a sustainable, profitable business model, high transactions in the accounts or even bringing significant savings deposits or accessing credit-worthy customers for the banks. As a recent MicroSave report (MicroSave, 2014) notes, “the BC channel has lurched from one challenge to another. Large scale outreach and the provision of formal financial services to low-income groups have not yet been attained”.

Non-banks who have tried the PPI route have been constrained by regulation, and the RBI is now working on allowing cash-out facility using the Aadhaar-enabled authentication platform. Given these challenges, the RBI accepted the recommendations of the CCFS for niche banks and final

guidelines for Payments Banks and Small Finance Banks have been issued, with the last date for applications for licenses set for 2nd February 2015. The new banks offer an excellent opportunity for banks and non-banks to work together; while the past record of such partnerships has been rocky, both have a lot to gain if they can tie up this time round as niche banks. It is in this context that this policy brief looks at global examples of successful bank-non-bank partnerships that can give valuable lessons for Indian industry.

Global Partnerships for Inclusion

Contrary to the belief that non-banks can crowd out banking services amongst the unbanked, global evidence shows that successful inclusion calls for both sides working together in synergy. Banks can leverage the strengths of the non-banks and use the partnerships to raise their own customer base. The most successful example comes from the Commercial Bank of Africa (CBA) that launched MShwari, a mobile money savings and borrowings account, in partnership with Kenya's largest telco, Safaricom in 2012. CBA moved from being a mid-tier bank in Kenya to the second largest within two years (Business Daily Africa, June 9, 2014). Not only did its deposit base jump from 30,000 to 7.5 million, more pertinently for inclusion, the average amount held in a deposit account came down to Sh16,000 from Sh1.9 million. With the lowest average deposit balance per account now in the country, CBA has clearly tapped into the use of mobile platform by low income customers. Even though it was believed that these income segments would use the accounts mainly for transactions, data from an Intermedia survey of users (CGAP, April 2014) matched the company accounts to show that, on the average, customers were definitely parking funds in the account for short term savings. Further, the transactions history gave the bank good data for offering small loans and its loan accounts grew to 897,000 in 2013 from 89,000 the previous year. The largest bank, Equity Bank was pushed to second rank with 840,000 borrowers at the end of 2013.

Banks in India have tried the route of JVs earlier and have not always found the going easy. The Payments Banks space offers another option and these opportunities are being explored now.

As banks and non-banks get together it is important to be informed on what works for a successful partnership. A report by IFC-CGAP (Flaming et al, 2014) examines the economic structure of implementation of mobile financial services to see that while companies have many options on distribution of roles and revenues across each player, banks, telcos, payment service providers and agent networks are all crucial for the ecosystem to function. While the actual outcome of a business venture would depend on the market forces and the regulatory structure in a particular market, some of the lessons from the study as reported here are relevant to India at this stage.

Aligning Partnerships for Inclusion

The IFC-CGAP report has studied partnerships across the globe for mobile financial services using a framework of three key concepts. The first takes up the competitive forces that create the impetus for the partnership; these forces underlie the commercial motivations behind the partnerships, the core business model, etc. The second key concept focuses on the management of the four core businesses that generate revenue in the supply chain: the payment service business, banking, telecommunications and the agent network, while the third concept is that the revenue sharing agreements should sustain all companies in the supply chain. Both successful and failed partnerships are analysed in this framework for insights that can guide banks, non-banks and policy makers.

Understanding the incentives set by market structures: It is clear that market structures determine the economic incentives that drive the various players, and this has implications for the investments and revenue shares in the contractual agreements. Most countries have telecom sectors that are extremely competitive, characterized by client churn and falling revenues from traditional voice services. This has led them to innovate with various services, aiming to leverage their brand, lower distribution costs and add to their existing revenue streams. Banks too can have strong motivation to invest in mobile financial services, but where leading banks have established business models anchored in corporate and high net worth individual services provided through the branch network, mobile channels are typically looked at as an additional service to their existing customers and very few are truly interested in mass banking. In general, banks that do see an opportunity in new mobile financial services are those aspiring to be mass-market banks, young banks looking for a niche, and microfinance institutions with limited branch infrastructure. India has a large banking sector, they range from large public and private sector banks to significantly smaller ones; while the RBI urges banks to innovate, each would have a different motivation for expanding these new services. The partnerships for Payments Banks will provide an opportunity to mid-size banks that are looking for innovative outreach.

Allowing competitive advantages to drive the partnership: Given that each partner comes to the table with a set of relative strengths, a successful partnership is one which has clearly delineated the competitive advantage of all the partners, with the best placed partner able to drive the initiative according to its own strengths. This is not an easy task and definitely will not happen if the partners see each other as competitors. Pakistan has a good example of a successful partnership: Telenor has a clear advantage with regard to customer base, agent distribution network, communication network, marketing and financial strength, and Tameer brings its microfinance service license, banking, risk management and compliance expertise to

the partnership. Thus, while Tameer is legally responsible for the business, Telenor drives most of the customer facing aspects of business. Such clear delineations are possible only when all parties look at the long term interests, rather than short-term gains or losses. Here again there are lessons not just for prospective bank-telco partnerships as Payments Banks but also in the current bank-BC model, where the strengths of BC firms at the last mile are often not recognized and given sufficient attention by banks (MicroSave, 2014).

Regulation also has a crucial role to play and can be adverse when it prohibits the most motivated promoters from exercising adequate control over their initiative. This happened in Ghana where MTN has been the driving promoter but cannot own the e-wallet accounts or the agent network, leaving little room for growth. Such a situation has been circumvented now in India by creating Payments Banks, subsuming non-banks into the bank sector, and by allowing PPIs to continue.

Allowing renegotiations as incentives evolve: The IFC-CGAP study also shows that as incentives change over time, the lead position may change as the business model evolves. When the relative interests of the partners shift, there should be renegotiations to suit the new situation. However, regulations that restrict ownership of financial service models to banks may strain partnership arrangements, when the core business model is no longer compelling for banks. Again, this is a lesson for India for possible regulatory changes in the future, as technology and market structures evolve, to allow each player to exploit its own interests and potential for overall benefit of the inclusion.

Creating a level playing field: One of the most telling results from this study for India is the need to create a level playing field in markets where banks and non-telco payment providers compete with services provided by telcos, who own the communication channels. Competition regulation therefore becomes crucial to ensure that non-telcos can operate mobile financial services under appropriate rules for "fair channel access." This was exemplified recently in India where it has taken more than two years to get fair access to the USSD channel, a move that was possible only through intensive coordination by the banking and telecom regulators.

Managing the Revenue Share Agreements

A key guidance for partnerships in India comes from the insights in the study on revenue sharing. As the study notes, "Revenue distribution agreements are the mechanism for balancing the interests of all companies in the supply chain, and are one of the most important aspects of partnership arrangements". The long drawn out negotiations on usage of the USSD channel between banks and telcos, the break down in earlier joint ventures and the stress points in the bank-BC relationship in India today point to the need to pay attention to this issue. In fact, inadequate arrangements for timely and appropriate revenue flows between banks and BC have strained commercial viability at the last mile, affecting service delivery and usage of accounts. Since public sector banks are leading the inclusion mission in India, this is one area where the RBI, IBA and BCFI can actively work together to coordinate processes between the players.

The IFC-CGAP study looks at four distinct core functions in the supply chain- payment services, telecom, banking and agent network management, and in each case the core business of the service provider influences the revenue sharing arrangement. A successful partnership understands the motivations behind each partner and adjusts revenue sharing for maximum benefit to all. To begin with, the payments services business is key to the business model for an independent provider like a BC or a PPI, but for a bank or telco, the payments channel may be a source of generating more revenue for their core businesses. When a company depends exclusively on channel related revenue, it is critical that it has sufficient control over the business to maximize its benefit. This scene plays out in India in many places where banks do not give the BC agents their dues in revenue and in decisions in the field.

For the banks, investment and effort in developing and selling banking products through the channel will be undermined if the bank does not have visibility in the client-facing part of the value chain. In a partnership, therefore, a bank will therefore look for sufficient control, visibility, and revenue share to warrant the investment. In Ghana, banks had little control of the channel, which was branded by the telco, as regulations explicitly forbid agents from using bank related terminology in branding as well as from cross-selling or marketing any of the participating banks core products and services. When client accounts reside on the telco platform and the banks only hold the float balance of clients, this discourages any significant interest or investment in providing appropriate banking services to the poor; while this insight is suited for mobile money implementations, it is useful for current negotiations between banks and telcos for Payments Banks.

Like banks, for telcos the primary motivation for entering the digital financial services is increased value added to the main communication business. With falling ARPUs now, the study notes, forward looking TELCOs are eager to add services to their network that can generate additional revenue streams and maintain loyal customers. Another interesting insight from the study that has already played itself out in India is that where mobile operators play no other role in the implementation, they tend to maximize their revenues from charging communication fees, and the fees can often be high enough to undermine the economics of the entire supply chain. This has been seen in the tussle over the use of the USSD channel, where revenue sharing became contentious enough to stymie the usage totally. On the other hand, where telcos own the mobile financial services implementation or are able to generate other revenues, they have been able to subsidize the communication expenses; it will be

interesting to see how this plays out as telcos take up to become Payments Banks in India.

The CGAP-CAB surveys (CGAP, 2012 and 2013) have shown the strained finances and high level of dormancy in CSP agents in India, a situation that undermines the inclusion mission. The case studies from across the world show that it is essential to ensure that agents receive sufficient income early in the implementation to maintain their active participation. This is particularly important in the early phase when transaction volumes are low and insufficient to support the agents. In such situations, other partners should push funds to the agents in the early phase, and wait for their own commercial viability over a longer period.

Another useful insight for India is that revenue sharing agreements between telcos and banks tend to be more complex. The study has brought out many approaches to sharing revenues. For instance, on one hand, each keeps its respective core business revenues and shares the payment service revenues. For example, the partnership may split all transaction-related revenue while the telco keeps all airtime sales revenue and the bank retains all income related to float intermediation and banking services. On the other hand there are successful relationships where part of the respective core business revenues is shared across the partners.

Further, the partners must keep in mind the fact that digital financial services are an evolving business, and revenue sharing agreements have to be renegotiated over time. This is especially so since airtime sales and OTC transactions have greater revenues in the early phase, while banking services grow only over time. Partners must align their roles and economic motivations, keep in mind the interest of maintaining a relationship in the long term and ensure that partners are well positioned to fully exploit the revenue opportunities over time. In Pakistan, Tameer and Telenor review the revenue split on a regular basis, as the product, market and regulations evolve.

The Way Forward: Lessons for the Regulators

While India has moved on with a positive step towards allowing a greater role for non-banks through Payments Banks, getting the unbanked to use financial services will continue to be a challenge in the country. Thus going forward policy makers in India should aim to keep the landscape open for competition, one that fosters innovation.

As the IFC-CGAP study notes from global experiences regulation can often lead to sub-optimal partnerships between banks and non-banks. For instance, in many markets, by their very nature of business, non-bank players will have more motivation and competitive advantage than banks to extend services to the unbanked, and bank-based regulation can deny these companies from leading. The regulatory environment in India has fixed this issue through the proposed Payments Banks and relaxing rules on Business Correspondents. However, allowing interoperability for BCs and cash-out for PPIs can further help in pushing innovative solutions to increase usage of accounts. On the other hand, there is always the concern that regulation that forces collaboration at an early stage of industry development may restrict the incentive of companies to invest in a new implementation, as individual players may not be clear about the long term business case in such partnerships.

For the RBI therefore, the challenge lies in allowing a free and fair playing field for banks and non-banks, allowing partnerships to flourish and also putting in adequate customer protection to allow for failed ventures. The RBI has been on the right track by coordinating on the USSD issue, allowing small PPIs to function albeit in a limited role, bringing in niche banks like Payments Banks etc. Over time, this would also mean debate and discussion on new legislation that will be appropriate, in keeping with the evolving technology, payments systems and needs of the economy.

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