Agent Network Management - Corporate retail networks as business correspondents of banks

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This is the fourth of five policy briefs to study the intricacies of expanding financial inclusion

BACKGROUND

While branchless banking through business correspondents (BCs) has been in force since 2006, for-profit companies have been allowed to operate as BCs for banks recently in September 2010. Following the international experience of developing countries facing the issue of limited access to financial services, policy makers in India have now accepted that financial inclusion, earlier seen as a social responsibility, has to be treated as a viable business activity. It is clear that expanding the scale and scope of financial services to all parts of the country and all segments of the population calls for a commercial approach to be sustainable.

Executive Summary

With the RBI allowing for-profit corporate to engage as business correspondents for banks, banks are gearing up to partner with the corporate sector in order to leverage their wide retail network in rural areas. While this partnership offers huge opportunity to achieve the unfulfilled goal of financial inclusion, the models of engagement are still evolving. On one hand, corporate have to deal with financial viability and inherent technology risks, on the other banks have a much higher stake at maintaining financial stability, liquidity management and reputation risk. The BC model has been proven to be commercially viable by the fifth year and companies dealing in FMCG, oil, agri inputs, pharma and telecom have greatest potential to act as BC to banks. Going forward it is important to address the needs of the widely heterogeneous population in the country and put in place models and systems that will best exploit the latent synergy in banks and corporate, moving India towards universal financial inclusion in its truest sense.

The advantages and disadvantages in using for-profit corporates as BCs:

While allowing for-profit companies to act as BCs, the RBI listed out the various pros and cons of this move.

Advantages :

- Corporates with existing widespread retail networks bring in larger resources, substantial organizational strength and financial backing needed for a large network of BCs.
- Large corporates tend to have efficient monitoring and control systems for management of retail outlets.
- Retail agents of large corporates may find it more comfortable to deal with the company that they are already used to and familiar with, rather than with the bank.
- Large companies can run into reputation risk if they fail as BCs. Thus, there is a strong incentive to ensure that agents do not jeopardize the company goodwill and reputation.
- Corporates are more likely to work as BCs for a longer period than individuals, thus ensuring continuity of services.

Disadvantages:

- Concerns of mis-selling of banking products by the corporate distribution network in the interest of revenue maximization.
- Conflict of interest: a retail agent of a corporate may tend to provide banking services only to those customers who patronize the corporate's products to enhance his earnings.
- Corporate BCs could misuse customer related information for their own commercial interests.
- Unfair coercive practices by corporate agents for marketing financial products / recovery of loans etc. could lead to reputation risks for the banks.
- The risk of continuity of business still persists with the corporate who may decide to discontinue the retail agent, making it difficult for banks to find immediate replacement of agents.

With for-profit corporates allowed to operate as BCs, the issue at hand now is - what would be the best route to deploy different corporate retail networks as BCs that can move the fastest in scaling up financial inclusion in the country?

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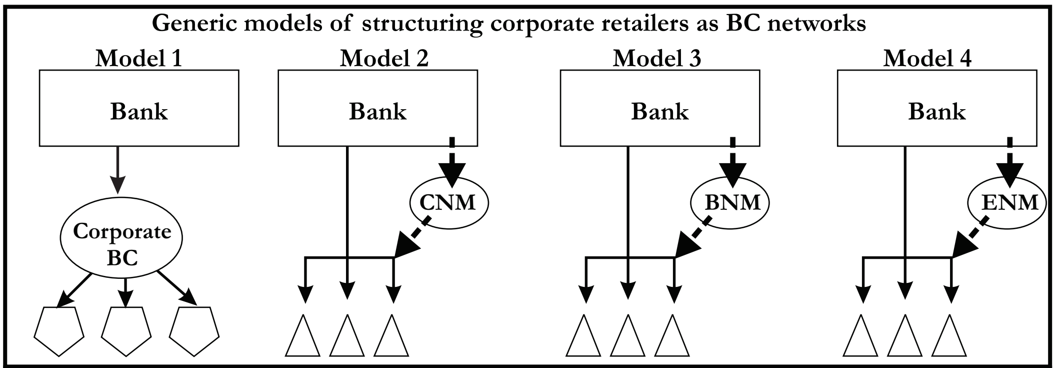
Models of engagement: Banks and Corporates as business correspondents

There are various ways in which corporates and banks can engage, each with its own structure of agent network management.



Agents of BC retailers BCs – Retailers BCs – Retailers BCs- Retailers
CNM – Corporate Network Manager (Principal corporate managing the BCs)
BNM – Bank Staff Network Manager (Bank Employee managing the BCs)
ENM – External (outsourced) Network Manager (External agency managing the BCs)
Source: Thorat et al (September 2010)

1 **Corporate as BC and retailer as sub-agents:** The corporate entity becomes the BC of the bank and offers its retailers as sub agents. This is most likely in businesses where retailers deal exclusively with the corporate products or depend on the corporate significantly for their business.

2 **Banks select some corporate agents as BCs with the corporate as network manager:** Banks take selected retail agents of a corporate entity as BCs in a clusterised network. The corporate acts as the network manager and ensures performance and compliance of BCs in accordance with the expectations of the bank.

3. **Retailer as BC with a bank employee as network manager:** While retailers are engagedJ as BC agents, an employee of bank manages the network. Here the corporate entity is used for identification of retailers to be engaged as BCs.

4. **Retailer as BC with network management outsourced by the bank:** Similar to the previous modeJl, except that network management is outsourced to a third party manager by the bank.

Suitability of corporate retail networks as business correspondents

A study by Dr. YSP Thorat and others, 'Feasibility Of Engaging Corporate Retail Networks As Business Correspondents of Banks – A Study', in September 2010 examined the relative suitability of five types of corporates with extensive retail networks in rural areas. There are a number of factors that determine the effectiveness of a retail network as business correspondents - number of footfalls, linkage with parent corporate body, product portfolio offered to customers etc.

- FMCG retailers were rated with low suitability as BCs: Retail outlets selling FMCG products have relatively lower connection with the corporate companies whose products they sell, also there is no homogeneity amongst the type of customers visiting the outlets. Thus, FMCG retail outlets may not fit well with the requirements of operating a cash in/cash out network on behalf of banks.

- Pharmaceutical retailers were rated with low suitability as BCs- Pharma retail outlets are easily accessible by the customers, however they have indirect contact with the corporates with dealers being the interface. These outlets do get high footfalls but converting them to banking customers would require huge shift in focus.

- Agri-input retailers were rated with moderate to high suitability as BCs - Retail outlets selling agri inputs like seeds, fertilizers have strong links with the corporate as well as with clients. These outlets are well suited to set up and run cash-in/cash-out networks and there is also willingness from retailers to operate as BCs due to high business potential that might result once customers are able to access loans from banks.

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• Airtime (telecom) retail outlets were rated with moderate to high suitability as BCs- Telecom retailers are managed by corporates through a huge distributor network with strong controls. A telecom operator is cued into making money from millions of small transactions, each with a small margin.

• Oil pumps were rated with high suitability as BCs– Oil pumps have a very close association with the parent oil company which provides infrastructure and technical support to the retail outlets. Also oversight arrangements are in place by the parent company for monitoring of the functioning of the retail outlets. Oil pumps are expanding into providing other goods and services at their outlets, including bank ATMs. With their expertise in handling significant amounts of cash and network management, when it comes to willingness and capability, these are the best suited to operate as BCs.

Comparative rating of corporate retail networks for suitability to act as BCs	
Type of product	Suitability
FMCG	Low
Pharmaceutical	Low
Agricultural inputs	Moderate to high
Airtime (Telecom)	Moderate to high
Oil pumps	High

Viability of the BC model:

According to a survey conducted in Udaipur and Surat districts under the Thorat study, estimates based on assumptions of average 300 footfalls per day in a BC located in or near a marketplace show that a BC agent would breakeven after recovering minimal investment costs in the fourth year. If however, the BC agent is required to invest in the POS terminal, then the cash flow of the BC turns positive in the fifth year. The BC is in a position to earn a minimum income of Rs. 120,000 from the sixth year onwards. While being a commercially viable proposition, the BC model will also increasingly provide coverage of financial services to the unbanked. Estimates made by the Thorat study indicate that savings accounts would be the first to expand. Loan accounts and other financial services would be slower to grow as familiarity and trust builds in the new system.

Year wise and category wise projections of feasible coverage

Products and coverage (% of people not having bank account)	Year 1	Year 2	Year 3	Year 4	Year 5
Saving Bank	10	30	60	70	75
Loan accounts	3	10	20	30	35
Insurance and other products	3	7	10	14	17
Remittances	3	7	10	14	17
Source: Thorat et al September 2010					

Current initiatives in corporate-bank engagement:

While international experience shows that it can take up to a year for banks and corporates to flesh out engagement strategies, some initiatives have already begun in India:

• ICICI is working with Aircel to distribute its various financial products including savings accounts, pre-paid instruments and credit products.
• Bank of Baroda and Punjab National Bank have tied up with TCS and HCL.
• IDBI Bank, Corporation Bank and Indian Overseas Bank are looking at TVS, Larsen & Toubro and oil companies.

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- The Corporation Bank has tied up with Bharat Petroleum Corporation Ltd (BPCL) to provide basic banking facilities for small-distance commercial vehicle drivers, auto drivers, conductors, cleaners, etc through the business correspondent (BC) model. It has already set up handheld devices in about 10 BPCL outlets that will enable deposit, withdrawal of cash through smart cards.
- State Bank of India has entered into a joint venture with Airtel to spread banking facilities to the unbanked and under banked areas of the country. The JV will become the business correspondent of SBI and offer banking products and services at affordable cost to the citizens in unbanked and other areas. Airtel retailers will be set up as customer service points.

Risks in the use of corporate retail networks as business correspondents

There are of course inherent risks both for banks and for corporates that go with these entities charting new territory and business models. For corporates the risks are mainly two: a) Failure to generate adequate revenue b) Technology risk that involves suitability of technology, possibility of failure of technology and the accompanying issues.

The risk that banks face in dealing through business correspondents relate to five points a) Interface with the customer b) Interface of the BC with its own staff who would be putting through banking transactions c) Interface between the bank and the BC d) Technological interface between the three different tiers in transaction e) Possibility of fraud and loss inherent in any finance based business. Therefore, on one hand, the BCs would be exposed to the possibility of not generating adequate revenue and dealing with inherent technology risks, on the other it is the banks who would have a much higher stake at maintaining financial stability, liquidity management and reputation risk. A strong risk mitigation system needs to evolve mutually between the banks and corporates to prevent both entities from running into significant losses which can arise from the risks discussed above.

Concerns of the Regulator in using Corporate Networks as BCs

Even as the Reserve Bank of India has given permission for corporate to act as BCs to banks, the regulator has expressed concerns arising from these models as mentioned in the earlier section. The main concerns stem from the need to ensure financial stability and maintain customer protection. In addition, the issue of concentration risks is also important, which can happen when corporate agents offer a very large and significant service to a high percentage of population in local areas. The RBI would like this to be addressed effectively by the banks through proper contracting for services.

However, there has been an understanding that ensuring systemic integrity of financial sector institutions and maintaining customer protection needs to be balanced with acceleration of financial inclusion. Having a sound monitoring system in place, both with the BCs and banks to manage performance of BC agents is therefore an imperative. .

Way Forward

Given the heterogeneity in India, both banks and corporates would need to evolve appropriate models keeping the needs of population in mind. As RBI Deputy Governor Dr. Subir Gokarn emphasized in March 2011, *"Establishing a relationship with first-time consumers of financial products and services offers the opportunity to leverage this relationship into a wider set of financial transactions as at least some of these consumers move steadily up the income ladder. In other words, the commercial viability and profitability of a financial inclusion strategy need not be viewed only from the perspective of immediacy. … The social costs and consequences of badly conceived and executed inclusion strategy could be enormous. We need to bring all relevant knowledge and experience into the development of the strategy in order to maximize the possibility of it succeeding."* While the risks in the partnership are to be well understood and addressed, there is a definite synergy that begs to be exploited in this relationship between banks and corporates for India to achieve universal financial inclusion in its truest sense.

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