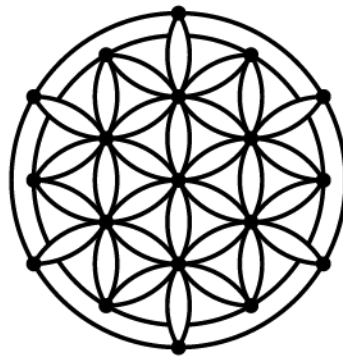
POWERING FINANCIAL INCLUSION BY STRENGTHENING THE AGENT ECOSYSTEM

A White Paper by Indicus Centre for Financial Inclusion



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POWERING FINANCIAL INCLUSION BY STRENGTHENING THE AGENT ECOSYSTEM

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I Background

Over the last decade, India has made impressive strides towards financial inclusion -banking presence has spread across rural India through a large network of agents and outlets increasing from 67,694 in 2010 to 5,99,217 in 2020. 78% of Indian adults today have a bank account, compared to 35% in 2011. A relatively well functioning payments infrastructure has been created and is spreading rapidly through the length and breadth of the country. Having created the pathways and infrastructure for banking and financial payments, the next step now is to enable its active usage by the masses.

A 2018 survey showed that 30% of registered bank users reported not using their accounts in the preceding three months[1]. While dormancy of Jan Dhan accounts has fallen from 40% in 2015 to 18% in 2020, this still translates into 7 crore inoperative accounts, the bulk of which is in low-income states of Uttar Pradesh, Bihar and Madhya Pradesh[2]. The financially excluded now are predominantly women, those who live below the poverty line and they are younger than 35[3]. It is time therefore to go more granular and remove the remaining regional and gender gaps in financial inclusion. A sustainable and viable network that serves the unmet financial needs of low-income segments is the critical need of the hour given the directions and targets set by the PM.

Banking Correspondents have had a central role in making finance accessible to the unbanked population of India. Launched in 2006, the Business Correspondent (BC) model is essentially a regulator-led effort that not only aims to make financial services accessible through a branchless banking facility but also supports the national agenda for employment generation (RBI, 2008). BC Network Managers or BCNMs distribute banking products with the help of multiple agents, who act as the retailing points for delivering banking services at locations other than a bank branch or ATM. The BC model, however, has faced structural and implementation issues and has been unable to deliver the expected outcome as a sustainable model for financial inclusion in India.

However, around a quarter of the agents are incurring losses and investment in upgrading skills is low. Almost 70% of the agents surveyed reported the need for further training[4]. Greater emphasis on service quality and the right alignment of incentives for the banks and agents or Business Correspondents (BC) is now the logical next step.

This White Paper examines the challenges in the agent network that keep India from achieving the optimal usage of banking and financial service amongst its poor. Section II sets the background on the current status and expectations from the agent network while Section III details six categories of challenges to address: insufficient viability for a sustainable network, inadequate commission charges for G2P transactions, inadequate compensation at every level of the value chain, poor quality of agents, low offtake of financial services by women and operational challenges that inhibit quality of service at the agent outlets.

The solutions recommended in Section IV of the White Paper have two critical takeaways – one, the time has come for increased granularity and differentiation – across geography, across agents, across

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products and services, and across type and extent of compensation. Second, the government has to continue to play a proactive coordinating role and make stakeholders at all levels - DFS, RBI, Bank managements - see the bigger picture and grow the pie together towards facilitating a sustainable agent network. Without that, each of these players will remain bound by their necessarily narrower objectives.

II Status and Expectations from Business Correspondents

Banking agents or Business Correspondents have had a central role in making financial services accessible to India's unbanked population. From its inception in 2006, the Business Correspondent model has essentially been a regulator-led effort, recognising the lower costs involved in branchless banking. Though there have been different BC models, the most common is seen as an arrangement of banks, Business Correspondent Network Managers (BCNMs) and agents or BCs in hierarchical terms. BCNMs distribute banking products with the help of multiple agents, who act as the retailing points for delivering banking services at locations other than a bank branch or ATM. For a BC model of financial inclusion to be sustainable and successful in the long run, all parties in the value chain (agents, BCNMs, banks and now technology companies involved in the digital transaction platforms) need to be viable. More importantly their incentives have to be in line with what they are expected to deliver. That is not the case now.

Further, as India emerges out of the Covid19 slowdown with renewed strength, the government is intently examining how new financial technologies can play a key role in achieving a rapid upturn, where benefits accrue to the poorest seamlessly and with little leakages. Clearly the Aadhaar-PMJDY-DBT mechanism is the best suited for the government to use, be it for improved welfare targeting or enabling income opportunities and employment at the bottom of the pyramid. The government-to-person (G2P) flows, in other words, Direct Benefit Transfers (DBT) have been a significant contributor to higher transactions for rural agents. CGAP's latest Focus Note on Agent Networks (CGAP, 2020) has showcased India's G2P-led model of financial inclusion as a case study for the world. This can be dramatically improved upon through a redesign of the incentive/payment mechanism.

One of the key problems that remains to be addressed is the sustainability and service quality of the agent network that services these transactions at the last mile. More than a quarter of the agents are conducting their businesses, incurring losses (See Figure 1). One of the reasons is that inadequate compensation to banks for government transfers leads to lower compensation to BCs which in turn leads to poor training, service quality and restricted accessibility to the public. In addition, there has been a trend towards rising share of non-dedicated agents; while 45% of the agents surveyed in 2017[5] were dedicated agents, 36% of these reported making losses compared to just 21% non-dedicated agent. Further, 34% of these dedicated agents expressed their intent to start other businesses as well. The high share of non-dedicated agents prevents them and their customers to benefit from specialization. Moreover, this impacts the financial sustainability of the whole program and its ability to meet its full potential in optimally delivering financial services to those who need it most. Therefore, inadequate compensation to BCs runs the risk of leaving the purpose of financial inclusion unfulfilled.

Figure 1. Agent Network Management in India

Banks manage 31% of agents directly, while BCNMs manage the remaining 69% —a trend that is similar across locations

Agents managed by BCNMs	Agents managed by banks
• Perform a median of 35 transactions daily compared to 25 conducted by agents managed by banks	• Comprise a larger proportion of agents who receive refresher training (96%) than agents managed by BCNMs (84%)
• Offer more services (median 7) compared to agents managed by banks (median 6)	• Experience less service downtime (46%) compared to agents managed by BCNMs (63%)
• Comprise a larger proportion of agents who offer interoperability (79%) compared to agents managed by banks (70%)	• Realize higher profits (USD 39) compared to agents managed by BCNMs (USD 31)
• Comprise a larger proportion of agents who offer G2P services (70%) compared to agents managed by banks (67%)	• Comprise a smaller proportion of agents who make losses (28%) compared to agents managed by BCNMs (30%)

Banks led the agent banking models with active support from BCNMs to elevate financial inclusion and support various DBT programs

Source: MicroSave Agent Networks, 2020

Before we lay out the challenges that currently face the Business Correspondent network in India, we must first acknowledge, unfortunately, that there is hardly any data available from RBI or banks on the state of the business correspondent network. The RBI has been releasing a financial inclusion progress report as part of its Annual Report since 2012, giving a snapshot at the national level, tracking parameters aligned to the targets set under the Financial Inclusion Plans.

According to the RBI Annual Report 2019-20, there are 5, 41,175 Business Correspondents in villages, and 6,35,046 urban locations covered by agents; presumably this number includes the 1.26 lakh Bank Mitras operating under PMJDY. Much gets hidden in aggregated data. The report does not provide any visibility into the activity of agents or accounts at a granular level. In fact, the RBI has no specific details of the business correspondent outlets.

In January 2020, the National Strategy for Financial Inclusion (NSFI): 2019-2024 laid out a detailed data collection framework, including surveys at a regular basis to tap the views from consumers. Granularity is the key here as, without granular data, specific problems at specific locations will not be understood and the growing challenges of exclusion, rising from digitisation of payments, will be difficult to address (ICFI, 2019). The strategy document now needs to be followed up by timely implementation.

It is time for the financial inclusion mission to take a more holistic view of service delivery and a usage-based approach. Rather than monitor indicators based on targets and mandates, a more appropriate choice of measures to monitor financial indicators would be categorized into three segments:

1) **Access to infrastructure**: This would include the spread of bank branches, ATMs, deployment of Bank Mitras, data connectivity at the granular level, device uptime of micro-ATMs etc.
2) **Availability of services and products**: The bouquet of financial services being offered at the access point and the offtake (opening of accounts, cash services, remittances, government benefits, savings, insurance, pensions etc., the activity of the Bank Mitras in the number and type of transactions, etc.). Mystery shopping exercises and consumer surveys would help ensure superior monitoring.
3) **Sustainability of last mile coverag**e: This includes commissions paid out, income earned by the agents and by each partner in the value chain of service provision etc.

III Challenges to address

This section lists the six categories of challenges in the agent network that keep India from achieving the optimal usage of banking and financial service amongst its poor. The solutions to these challenges are detailed in the next section.

1. Insufficient viability for a sustainable network

Given that the agent network has been rolled out primarily in response to mandates under the Financial Inclusion Plans, the business case for agents in the field is yet to become clear for a majority of the players. Without adequate compensation, the incentive to become an agent is lower, and many agents are only able to operate as they have a diversified income portfolio and include shopkeepers, paan-shops, etc. Therefore, those that stay and specialize in the business are low and the entire objective of spreading the banking habit falters.

One of the key findings from surveys has been the possible attrition at the last mile due to unattractive commissions on one hand and increasing operational burden from PoS-related issues, record keeping associated with Goods and Services Tax (GST) etc. The PMJDY Mission made a significant breakthrough in retaining agents, and yet the dormancy rate of agents began inching upwards within the first two years. Though agent revenue and profitability improved with higher transactions particularly through DBT and the minimum remuneration of Rs. 5000 per month was fixed under PMJDY, a little over a quarter of the agents reported losses in 2017. During the Covid-19 lockdown month (April-May 2020), rural agents saw higher activity for DBT transactions, urban agents saw a fall in income by 30% (MicroSave, 2020).

The question of agent viability and incentives can be seen through three lenses, which have feedback loops:

1) **The cost of transaction –** The costs of setting up a business and operating it vary significantly depending on the infrastructure used – for instance, a State Bank of India agent may need Rs. 80,000 to 100,000 for the setup of laptop, computer and printer and UPS etc., while other agents may use their mobile phones for transactions. With such variation depending on the infrastructure involved in setting up/onboarding an agent and the operating expenses, it is difficult to fix a one-size-fits-all response to remuneration.

2) **Location of agent -** The extent of economic activity in the catchment area of the agent will determine the revenues earned and the regional disparity across the country leads to most locations being below par. There are more than 470,000 villages in India with population less

than 2000, and according to the RBI 392,069 agents cover these villages. Clearly, such small and often hard to reach areas will not generate sufficient scope for offtake of banking and financial services, and yet, these basic services must be accessible to every location in the country for financial inclusion to be meaningful. Further, the question of connectivity and stability of network for digital transactions and linking to the core banking system remains as an operational issue that plagues specific locations.

3) **Products offered at the agent level** - There has been a segmentation amongst agents, with varied services, making for three types of BCs:

(i) ***Asset Business Correspondents****, who are allowed to arrange loan transactions between the customers and the banks*

(ii) ***Transaction Business Correspondents****, the largest in number in India currently, who essentially conduct Cash-in-Cash-out CICO business and DBT flow.*

(iii) ***Branch linked Business Correspondents****, who operate under mandates given by PMJDY and State Level Banking Committee to open accounts.*

Unfortunately, the cash withdrawal transactions (handled by Transactions Business Correspondents) are not being adequately compensated for the risk in handling physical cash, especially in remote locations. While setting up and operating costs of an ATM costs runs up to Rs. 50,000 per month in rural areas, banks compensate agents for cash transactions on the basis of number of transactions, with a cap on the fee paid for each transaction. This arrangement favours agents with high volume of transactions, while the majority who have few transactions receive inadequate returns.

Moreover, the business of cash transactions has become unattractive to stand-alone agents, who would otherwise have had the incentive to raise more business for the banks. Instead, this business falls to retail stores, as an add-one service similar to mobile recharge. However, here too there are complications caused by low compensation. Industry conversations reveal that about 80% of the BCs can handle cash dealings only upto Rs. 10,000 a day, but any additional requests lead to either the agent overcharging the customer, declining the transaction, or looking at the customer as a footfall for his main business – all three options lead to erosion of trust and failure of the bank to connect with the customers for extended relationships. Inadequate compensation therefore hits at the very objective of spreading the banking habit amongst the unbanked. Ensuring an appropriate monthly fixed remuneration, thus, becomes vital in certain locations.

Taxation issues: Adding to the stress of viability is the GST imbroglio, typified by the complications created by tax compliance. Despite repeated flagging of these issues by the banks and BCNMs, these continue to act as strangleholds on businesses. There are multiple issues e.g. though the Central Board of Indirect Taxes and Customs (CBIC) approved nil GST for rural and PMJDY account holders, remittance transactions are made using a common Indian Financial System Code (IFSC), which does not distinguish rural or PMJDY accounts. As a result, this waiver goes unutilised as banks and agents pay up on all remittances, to avoid any compliance wrangles. Further, as in other cases of compliance, there are issues raised by difference in interpretation of the rules by GST officials, leading to double taxation. Then there are banks who play safe and make the 10% tax deduction at source for all transactions, while BCs are also exempt from tax deducted at source for cash withdrawals - this complicates the cash flows and accounts for rural BCs in particular who are not trained in claiming refunds. A White Paper by BCFI details the issues that remain unresolved.[6]

2. Inadequate commission charges for G2P transactions

If the Union government were to raise the commission on G2P payments, it would make significant difference to agent viability. Low and irregular commission pay-outs to agents has been one of the biggest concerns since the DBT programme began and this has remained unresolved, despite being flagged repeatedly through various studies. In 2012, the Task Force on an Aadhaar-Enabled Unified Payment Infrastructure had recommended a 3.14% transactions processing charges to the banks, in reality the rates allowed by the Central and state governments have been 1-2%. In January 2015, the Finance Ministry fixed DBT commissions for banks: for urban schemes, at the National Electronic Funds Transfer/ Aadhaar Payment Bridge rate, but for rural schemes, the rate was fixed at 1%, subject to an upper limit of Rs. 15 per transaction. There has been no costing rationale offered for the transaction charges currently fixed by the government.

The Business Correspondent Federation of India reports that there are nearly 10 lakh agents in rural and urban unbanked areas, working on a commission-based model for DBT earning 0.5% of the transaction amount or Rs. 15 whichever is lower. [7] While the 3.14% pay-out set out in 2012 is often viewed by governments as an unacceptable financial burden, it is true that with the expansion of the network as more DBT schemes flow through these accounts, the cost of processing DBT payments through agents will fall.[8] However, there is no recent costing exercise to determine the appropriate rate and banks as well as BCNMs report this as a loss-making activity.

It is well known that low revenues have a direct bearing on service quality. Much of the issues related to lack of access, gender imbalance, low usage, etc. can be traced back to the compensation problem. However, the cap imposes an additional burden as it prevents low-value transactions to be cross-subsidized by higher-value transactions. When cross-subsidy is not possible, then either customer charges need to be high or a direct subsidy needs to be provided. But these options are also not provided to the BCs. Therefore, BCs that survive will be more likely to under-invest and put in lesser effort on low-value transactions. In other words, the incentive structure (low compensation, caps, and no subsidy) is effectively designed to provide low-quality services to the poor. This has the unintended consequence of keeping them away from the digital transaction domain.

3. Inadequate compensation at every level of the value chain

One of the other much-contested issues has been the distribution of the compensation adequately across each level in the value chain, to ensure sustainable services throughout. Most banks report losing money servicing G2P payment disbursements. While they receive 1.0% to 2.0% (in a best-case scenario) of the cash disbursed, their total 'cost to disburse', including BC and CSP costs is in the range of 3.0% or more. It is important to ensure that agents get a fixed minimum monthly remuneration, irrespective of the services rendered, especially in locations where transaction levels are low and do not meet the minimum monthly transaction number of 100.[9]

4. Poor quality of agents

As the agent network has been rolled out mostly in response to mandates by the government and returns are low to banks and BCNMs, there is little incentive to invest in better training, which impacts service quality in the field. To address the issue of ensuring competent service at the last mile, RBI had recommended a certification process for agents, whose framework was finalised by the Indian Banks Association in 2017. Banks are responsible for the training and capacity-building of agents hired directly by them, while in the case of corporate BCs, the BCNM is responsible for the training sessions with bank support. The Indian Institute of Banking and Finance (IIBF) offers a certification course for BCs, while the Business Correspondents Federation of India (BCFI) offers an online training and

professional certification for agents. The RBI set up the framework for a Self-regulatory Organisation (SRO) and last year the BCFI moved towards becoming an SRO working towards better service and customer grievance redressal standards within the BC network.

However, around 70% of the agents reported the need for more training, and the areas that needed special focus were centred on the use of transaction devices, knowledge of products and operational procedures. Further, the minimum qualification for certification is 10th Standard, but with high dropout rates in the last two years of senior secondary, the qualifier is a barrier to getting suitable agents especially in rural areas.[10] There is also a serious deficiency of women agents and the qualification and certification regulations are not conducive to drawing more women in.

5. Low offtake of financial services by women

The gender divide is a significant challenge to overcome in India, across many indicators. The PMJDY and DBT Mission have made a huge leap in connecting women to the banking and government benefits programmes. So we find that 55.4% of the 41.6 crore PMJDY accounts have been opened for women, and yet according to the Global Findex and FII surveys done in 2017, usage of these accounts lags those of men. Women, in rural areas especially, are reluctant to visit bank branches, where they are often dealt with summarily by male staff. Smart phone access is also lower amongst women and digital transactions need another level of training for them. Understandably then, they are more comfortable using the agent meeting them at their own homes, and when these agents are women, the trust factor is magnified[11]. However, women agents form less than 10% of the total agent network. So far, the focus has been on using women in Self Help Groups as Bank Sakhis and though this initiative has worked very well where SHGs are already in place, scaling up to cover larger parts of the country calls for a more direct approach by increasing the number of women agents.

6. Operational challenges that inhibit quality of service at the BC outlet

Apart from quality training of agents, there are numerous operational issues that need to be addressed inadequate support from the bank branch, poor network connectivity and device breakdowns preventing seamless transactions, low capacity of agents and BCNMs to manage operations at the last mile, insufficient monitoring by NPCI and RBI of the reasons behind transaction failures at a granular level[12], poor grievance redressal standards and supervision etc.

The solutions to these challenges involve a range of actions that are detailed in the next section.

IV The Way Forward

With the digital infrastructure and agent network largely in place across the country, it is time to move away from the one-size-fits-all regulatory mindset towards more differentiation and granular detail. A strong and vibrant agent network helps to declutter the branches and reduce banking overheads. While the industry reports that urban agents have stabilised to a large extent, with rising transactions through varied service offerings, the rural agents still need to be hand-held.

A. What can the government do?

1) One way of enhancing agent viability is through adequate compensation on government transfers. The Department of Financial Services (DFS) needs to conduct a comprehensive analytical and comparative costing exercise to determine the appropriate range of transaction charges on government pay-outs.
2) Since costs and technologies are ever changing, an institutional mechanism that updates the costing exercise regularly is required. For instance, commissions charges for agents should be

differentiated specific to the location e.g. higher for rural areas where economic activity is low. The key therefore is that DFS must put in place an appropriate institutional mechanism, and not a one-time correction.

3) There should be a basic monthly fixed remuneration, suited to the wage levels of the operational area and a variable component to incentivise transactions. For this, the Finance Ministry/NITI Aayog needs to institute a regular exercise to map the entire country at the panchayat level and relook the entire mapping every three years to determine specific locations that need extra commission or effort.
4) There are considerable challenges with the taxation of financial services offered through agents, which remain unresolved despite being reported by the industry representatives, both banking and BCNMs. While the issue of double taxation has to be resolved by the GST Council, the government can move to exempt low-value transactions done through agents and reimburse the banks for the same, as has been done with nil MDR on low value digital payments.

B. What can banks do?

1) Banks should be outsourcing more services, including deposit and loan products, to the BCs which shall eventually translate into more savings at the branches. In other words, it is time that banks move away from treating their agents as cash-dispensing human ATMs and utilise their services for offering banking and financial products. The evolution towards digital payments and offtake of banking products is crucial to meaningful financial inclusion.
2) There must be systemic change in the evaluation of branch performance, as well as that of the branch manager, to include activities through agents, extension of services and products to the target population of financial inclusion.
3) Product differentiation is key to raising usage of banking and financial services. Banks need to tailor products to suit the needs of low-income consumers. These also need to be offered through the agents and not restricted to the branches. For instance, when it comes to housing loans, almost all banks offer terms suited to salaried customers with well-defined EMIs, rather than for low-income customers who tend to have irregular income flows.
4) As part of their annual reports, banks must report their products suitable for the low-income segments, women and those with irregular incomes.

C. What can the RBI do?

1) The RBI will need to identify how it can bring the banks and their agents more closely aligned with each other. This includes encouraging practices such as data sharing about the customer that will enable the agent to act as the relationship manager and match the needs of the customer to the correct product, sharing information about inactive accounts so that agents can follow up etc.
2) Agent certification and training programmes should be broad-based across the country. Rather than the current IIBF certification which industry reports as being more demanding than necessary, the RBI should include the country-wide skilling infrastructure developed by the National Skill Development Council; courses already designed by the BFSI Sector Skill Council of India can be offered through the Pradhan Mantri Kaushal Kendras. This will allow ramping up of the training and certification to suit the needs of the diverse population.
3) The criteria for certification should not exclude the deserving candidates, though less educated. For instance, removing the stipulation of 10th standard pass would open the field for women agents in rural areas.
4) There has to be a greater focus on increasing the number of women agents, particularly in locations where access and usage of accounts by women is low.

5) In order to accommodate greater number of agents, rather than one single examination, agent certification should be offered at three levels, aligned to increasing specialisation. For instance, Level 1 would be basic services of account opening and Level 3 would have specialised services of loans and recurring deposits etc. Such grading will also satisfy the youth's aspirational values towards career progression.
6) In order to address the issue of transaction failures, the RBI must work towards ensuring an upgrade of the technological infrastructure of acquiring banks so that transactions done by agents can be routed directly to NPCI and not depend on the ability of the acquiring bank infrastructure to complete these transactions. This will help prevent transaction failures that are occurring from the mismatch in systems.
7) It is time for the financial inclusion mission to take a more holistic view of service delivery and a usage-based approach. Rather than monitor indicators based on targets and mandates, the RBI must use a more appropriate choice of measures to monitor financial indicators, categorized into three segments: access to infrastructure, availability of services and sustainability of last mile coverage. Granularity is the key here as, without granular data, specific problems at specific locations will not be understood and the growing challenges of exclusion, rising from digitisation of payments, will be difficult to address. [13] There must be gender-disaggregated data to ensure that the gaps are identified at every level of access and usage. The National Strategy for Financial Inclusion (NSFI): 2019-2024 that has laid out a detailed data collection framework, including consumer surveys, needs to be followed up by timely implementation.
8) Customer grievance redressal should be backed by a portal, which acts as a common interface for lodging, tracking and redressal status of the grievances pertaining to financial sector collectively by all the stakeholders, as recommended in the NSFI[14]. Mystery shopping exercises should be initiated by the RBI to ensure that banks and agent outlets are serving the customer needs effectively.

V Conclusion

India has indeed come a long way in spreading banking across the country and all segments of the population. However, there are significant challenges remaining in access and usage of banking accounts. It is here that the agent at the last mile proves to be the most valuable link in the chain. For sustainable and meaningful inclusion, agent viability and service quality must be at the forefront of policy objectives. In this White Paper, we have outlined the major challenges, with recommendations for each main stakeholder – the government, Reserve Bank of India and the banks. At this juncture of India's financial inclusion journey, all stakeholders should move towards a granular approach of remuneration, products and services aligned with the specific, local needs of the customers and the agents.

In conclusion, improvements in the ecosystem that governs financially inclusive mechanisms will be an ongoing process. India's successes in putting in place the core infrastructure for digital payments and business correspondents now need to be supplemented by ensuring accessible and quality service availability. The above recommendations will go a long way in meeting the goals of universal financial inclusion.

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