

# Financial Inclusion – A Brief on Its Evolution and Future Expectations

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## Background

In Jan 2006, the Reserve Bank of India issued a new set of guidelines allowing banks to employ two categories of intermediaries - Business Correspondents (BCs) and Business Facilitators (BFs) - to expand their outreach. According to the guidelines, while the BCs are permitted to carry out transactions on behalf of the bank as agents, the BF's can refer clients, pursue the clients' proposal and facilitate the bank to carry out its transactions, but cannot transact on behalf of the bank.

Since then, the business correspondent (BC) model in India has witnessed numerous regulatory and policy changes through its journey of more than eight years so far to make it more effective and efficient. In 2011-12, there was an epoch policy level intervention by Department of Financial Service, GoI and Reserve Bank Of India to increase the depth and breadth of Financial inclusion in this country through the Common Business Correspondent Model.

## Common Business Correspondent Model

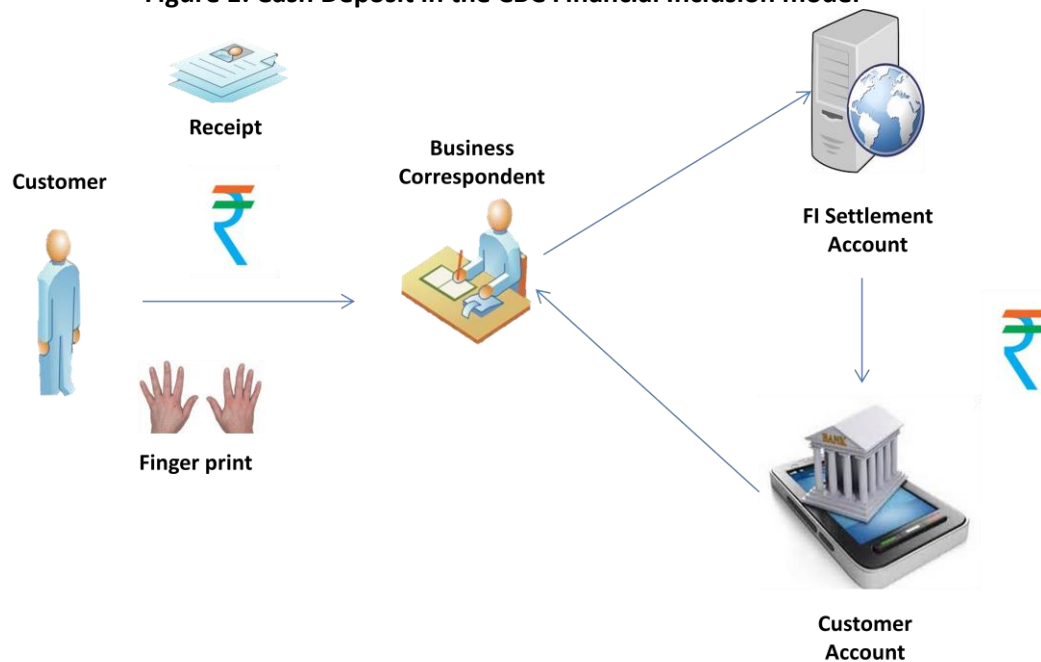
With a view to ensuring greater financial inclusion and to provide comprehensive financial services to the underprivileged, particularly in unbanked and under-banked areas, the Department of Financial Services (DFS) in 2012, decided to engage the services of Common Business Correspondents as permitted by Reserve Bank of India after dividing the country into 20 clusters. The objective was to partner with non-banking corporates who have the technical know-how as well as financial muscle to invest in the required infrastructure so that a brick and mortar bank branch at Panchayat Level can be outsourced to these Non-Banking Corporates wherein 33 basic Bank services can be delivered to the citizen through real time banking transaction after seamless integration with the Core Banking Solution of the Respective Bank. This was a significantly positive and visionary step towards Financial Inclusion. The idea of the Common Business Correspondent (CBC) model was to find market driven solutions to the problems in the Financial Inclusion landscape to make it sustainable in the long term.

Following were the salient and differentiating factors in this model

- i **Higher Economies of Scale:** By giving a Common Business Correspondent company, exclusivity over the selected cluster, the idea was to ensure that the higher scale of operations would reduce the cost per BC outlet due to sharing of resources.
- ii **Emphasis on Transactions:** The emphasis of the CBC was to put more emphasis on transactions rather than only creation of accounts. Earlier models were focused on making new accounts but the new model emphasizes more saving formation and more CASA money generation for the respective Bank.

- iii **Real time banking:** The earlier BC models were mostly offline and there were lot of issues of trust among customers. The CBC model ensured that the Non Banking Corporate develop their own solutions and infrastructure to integrate with the Bank's Core Banking Solutions so as to be able to conduct real time transactions at the BC outlet itself.
- iv **De-risking the Bank:** The technology and banking architecture of the Common Business Correspondent project is such that all the transactions of customers happened through a pre-paid manner by debiting instantaneously the equal amount from an intermediate banking settlement account (as shown in Figure 1 below) of the BC for any Cash Deposit transaction happened in the BC outlet and crediting the equal amount of cash to the intermediate settlement account of the BC for the amount of Cash withdrawal happens in the BC Outlet. Therefore, the BC is required to keep sufficient balance in the Settlement account for any transaction to happen successfully otherwise the transaction becomes null and void. This kind of pre-paid mechanism put in place de-risks the chance of any siphoning off citizen money.

**Figure 1: Cash Deposit in the CBC Financial Inclusion model**



**Urban/Rural Mix :** It generally takes a while before an unbanked rural area develops the culture of banking and hence most BC outlets in rural areas remain stressed during the initial years. It was mainly due to this that corporates were unwilling to enter into rural areas to start BC outlets. The CBC project entitles the BC to set-up “one” urban branch for “four” rural branch so that urban outlet cash flow squares off the economic stress in the rural branches to large extent.

- v **Focus on Bank Deposits/CASA:** Studies done on the previous BC models showed that since it was mainly heavy on withdrawal transactions, Banks had an inherent perception of it as a CSR objective. The CBC model ensured that deposit transactions were equally targeted. The CBC has begun to unleash the immense untapped savings/CASA potential in the unbanked regions and given Banks an incentive to actively pursue the goal of Financial Inclusion.
  
- vi **Win-Win Business proposition for Both Bank and BC :** Overall the basic idea of the CBC model is to ensure that all the broad goals of Financial Inclusion are met by providing proper incentives and a viable business proposition to Banks and BCs to work towards widening the access to financial services across India.

## Current Situation

Currently the following FI models are in practice:

1. Bank own Kiosk Model- Bank – Bank identifies an Individual in the hinterland to set up and operate the BC outlet. As Bank does not have the time and wherewithal to do the continuous hand holding and capacity building required to grow the banking business as well as address day to day operational issues faced by the BCA, this has not really scaled up. Secondly, the BCA does not have other marketing alliances to enhance his/her business opportunity other than the banking transactions.
  
2. Offline BC model- In this model, the non banking corporates set up and manage the BCAs who travel around the hinterland doing the financial transaction in the offline mode and reconcile with the respective bank for getting their transaction commission. But because of offline transactions, there is probability of siphoning off money from the customer as well as the BC sometimes loses the transaction commission because of erroneous transactions.
  
3. Common BC Model: As far as the Common Business Correspondent model goes only 3 out of the 20 clusters created are currently active with the rest going with multiple Business Correspondents and models. Though the Common Business Correspondents were supposed to be the only BC in the given cluster for all PSU banks, this is no longer followed in practice as in the same cluster, different BC models are operating with multiple agencies. There are also multiple types of technologies and operating methodologies in the implementation, ranging from real time to completely offline to kiosk mode. Some models and banks allow biometric Aadhaar enabled transactions, while most kiosks and other models are not. Implementation of OFF-US transactions at BC outlets is moving at a very slow pace. Overall there seem to be lot of inefficiencies and impediments in the system and some directed and coordinated steps would be needed to bring about positive change.

## **Interventions to address the deficiencies in the existing Models**

### **1. Real Time BC Model**

- i Studies have shown that all offline models are extremely risky and open to fraudulent practices and eroded a lot of trust in the end customer
- ii The real time model connecting the BC directly to the Banks CBS must be made mandatory for all BCs to drastically lower the risk of potential fraud as well as delivering the updated transaction report to the end consumer thereby building trust with the .BC.

### **2. Healthy ratio of Rural/Urban Outlets**

- i BC agencies have realized that business is very profitable in the urban and semi-urban areas and concentrate only in such areas.
- ii It is essential to ensure a good mix of urban outlets and rural outlets where it is difficult to sometimes breakeven in certain areas.
- iii It should be mandatory to have 4 rural BC outlets for 1 urban outlet to ensure deeper penetration in unbanked regions across India.

### **3. AEPS**

- i Aadhar is the most cost efficient identification and authentication system for the bank customers by linking their account numbers to the Aadhaar number to make all accounts AEPS ready.
- ii Similarly, the Aadhaar Payment Bridge at the back end between the beneficiary Ministries/departments and the disbursing banks automated the direct benefit transfer successful and reduces the leakage in the system considerably.
- iii Therefore, the BC Model should be made compliant with AEPS system to not only make Direct Benefit Transfer a great success but also to reduce the leakage in the delivery system considerably.

### **4. e-KYC**

- i The entire account opening process can be made paperless and faster through the use of e-KYC (Aadhaar based KYC) by banks
- ii The implementation of e-KYC should be given priority by all banks as this will allow customers to open all types of accounts at a BC outlet through e-KYC.

## **5. Stable and sustainable commission structure**

- i The BC model has been designed considering the huge operational cost for a bank branch to sustain it at the Panchayat level. At the same time it must be noted that. Many low value transactions that happen in a BC outlet are not very remunerative but few high value transactions are able to compensate for them.
- ii This must be taken into account while deciding a Win-Win commission structure for both Bank and BC.
- iii Hence putting an arbitrary cap for all transactions will make the BC model unviable
- iv The Upper Cap if any in urban areas must be at least equal to the Average cost of urban transactions in banks

## **6. Discontinuing Transaction Limits**

- i Viability of the BC model is higher when regular and business customers with capacity for higher transactions use the same channel for availing banking services.
- ii In the real time BC model, the banking transaction is done on pre-paid model as described earlier obviating the need of any misappropriation of fund by the BC as the money received by the BC for any Deposit is instantaneously debited by the bank from the Settlement account of the BC.
- iii Therefore, the current restriction on transaction value which is applicable to the off-line BC model should be immediately scrapped. Some of these limits which need to be removed are
  - a. Daily Transaction limit
  - b. Amount per transaction limit
  - c. Monthly transaction limit

## **7. White Label BC**

- i A highly interoperable platform similar to that provided for the ATM infrastructure could be provided for the Business Correspondent business in the long term
- ii Since a high amount of investment is required for each BC outlet, it must be possible eventually outlets to provide BC services for multiple banks all in one place.
- iii The same model used for White Label ATMs could be broadly used for creating White Label BCs as already suggested by the Nachiket Mor report.

## **8. Building trust factor**

- i It is hence essential that all BCs be in a permanent retail outlet based model so that their long term presence begins to create a banking culture in the surrounding unbanked areas.
- ii The ability for customers to do real time transactions in a retail outlet format is also critical for creating trust among customers.

- iii Outlet needs have the look and feel of a bank's extended office so that it inspires confidence among the full range of potential customers including the poor.

#### **9. Multiple Product Offerings**

- i The BC model should be a “distributed banking model” rather than only a “financial inclusion drive” to meet regulatory compulsions or social objectives.
- ii The entire retail banking product suite (including current accounts etc) should be made available over the BC platform.

#### **10. Services other than banking**

In order to increase sustainability, The BC should also be allowed to provide a range of services along with the Banking Business correspondent services at the outlet as long as it does not violate the rule of the land. E.g.

- a) G2C (Government to Customer) Services
- b) Insurance
- c) B2C (Business to Customer) Products/Services
- d) ATM Services

#### **11. Bank Deposits/CASA through BC channel**

- i Widespread use of the CBC model across India has the ability to tap the huge savings potential in untapped regions across the country.
- ii Such untapped CASA money shall be a great booster for the Bank to take the Financial Inclusion activity more seriously and shall extensively cooperate and collaborate with the BC for deeper expansion of the BC activity.

#### **12. Creating banking culture**

- i Bank account creation has seen a reasonable amount of success but actual level of transactions needs improvement.
- ii Policy thinking should shift towards creating a banking culture which is best measured by the number of banking related transactions.
- iii Only BC outlets with over 100 transactions a month should be counted as genuine BC outlets to separate the Chaff from the Grain.

## **Conclusion**

In India, more than 51% population is still unbanked. Therefore, Banks should see it as a huge untapped opportunity to create CASA money at cheaper rate so that it can be loaned at higher margin to maximize the profitability for the bank. But the banks themselves can not set up and run these branches at the panchayat level looking at their own operational cost. Therefore a BC model has been designed to attain the objective in this case. In this initiative, the BC has been playing a crucial role by investing in the capex and the working capital to make it a success. Therefore, a win-win situation can be created by rightly incentivizing the BC as per the risk-return principle.

It must be noted that. Many low value transactions that happen in a BC outlet are not very remunerative but few high value transactions are able to compensate for them. This must be taken into account while deciding a Win-Win commission structure for both Bank and BC. Hence putting an arbitrary cap for all transactions will make the BC model unviable. The Upper Cap if any in urban areas must be at least equal to the Average cost of urban transactions in banks

It has been observed across the globe that a strong financial system automatically creates stimulus for great economic activities in the surrounding catchment area. Therefore, a robust BC outlet through the Common BC model with small tweaking as recommended above shall create miracle in the Unbanked population in the hinterland .by significantly creating the CASA money for the bank, sustainable business model for the BC creating thousands of direct and indirect employment and last but not the least contributing the growth of GDP of the country.