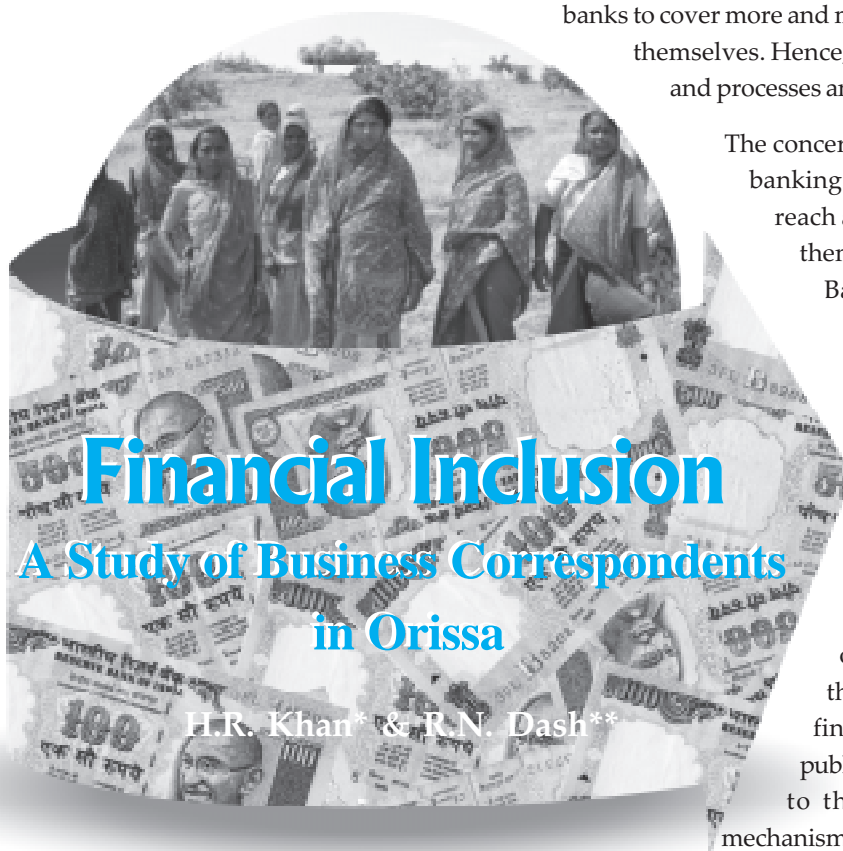


Quest for Financial Inclusion

The vast network of the banking system in the country has prompted the adoption of a bank-centric approach in the delivery of financial services in the rural sector, be it through targeted lending to the priority sectors and the weaker sections, the Government-sponsored poverty alleviation programmes or linkage of the Self-Help Groups with banks.

However, one of the major factors affecting further expansion of outreach of the banking sector is the cost of expanding the branch network and increasing the number of people manning a branch. The relatively high transaction cost of dealing with a number of small accounts also negatively impacts further expansion. When the focus is on cost reduction and improving profit, banks naturally shy away from areas and activities which are cost-intensive, low yielding and fraught with uncertainties. The orientation/ attitude of banks' staff is also not favourable in many cases. In such a scenario, it becomes difficult for banks to cover more and more customers located in far-flung areas all by themselves. Hence, there arises the need for innovative products and processes and alternative modes of delivery.

The concern that in spite of the formidable network, the banking system in the country had not been able to reach a vast segment of the population and provide them with basic banking services led the Reserve Bank of India to emphasize the importance of financial inclusion. In the Mid-Term Review of the Annual Policy for the year 2005-06, the Reserve Bank exhorted banks to make available a basic banking 'no frills' account either with nil or very low balances as well as charges that would make such accounts accessible to vast sections of the population. Subsequently, other modalities such as, General Credit Cards and one time settlement scheme were introduced by the Central Bank to help banks bring about financial inclusion. Several banks, both in the public and private sectors, have responded positively to this measure and devising appropriate mechanism to fulfill this objective.



Financial Inclusion

A Study of Business Correspondents in Orissa

H.R. Khan* & R.N. Dash**

Expansion of Outreach – RBI Guidelines

On the basis of recommendations made by an Internal Group of Reserve Bank of India on Rural Credit and Micro Finance (Khan Committee), banks have been permitted in January 2006 to use intermediaries such as Non-Governmental Organisations/ Self Help Groups (NGOs/ SHGs), Micro Finance Institutions (MFIs), other Civil Society Organisations (CSOs) and private entities including outlets of the corporates in the rural sector in providing banking and financial services through the use of 'Business Facilitators' and 'Business

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Correspondents'. This has the potential of providing services and products - savings, credit, insurance, remittance, etc. at the doorstep of the customers in both rural and urban areas.

Advantages of the New Model

This model has the advantage of choice of a variety of intermediaries such as, NGOs/MFIs and various other formal and informal organizations for appointment as Business Facilitators/Correspondents. This would include the kiosks, e-choupals and the retail chains being established in rural areas by the corporate sector. The regulations permit individuals to be appointed only as 'Business Facilitators', the intermediaries who would provide support services without handling cash.

While the use of intermediaries in services delivery through the Business Facilitator/Correspondent models can generally help banks in reducing their cost, the actual costs would depend on the nature of the intermediary, the efficiency of its operations and the methodology adopted by it to reach out to the customers and the volume of the business handled. Many of the NGOs/other intermediaries are quite technology savvy and use innovative products and processes to reduce cost of operations. Partnership with these organizations would provide the banks an opportunity to look at technology-based solutions and low cost delivery mechanisms that will reduce transaction cost of such services with the volumes required to make such a model sustainable. Use of IT-enabled products and services at the bank and the intermediary level (in the form of simputers, mobile phones, personal digital assistants etc.) have proved to be useful in providing low-cost intermediation at the same time addressing the issues of speedy and

accurate accounting of the transactions at the bank level.

The banking sector, which has a problem in expanding its outreach beyond a certain point and often faces attitudinal issues in matters relating to delivery of services to the small customers, can take the advantage of the local knowledge of these intermediaries in providing financial services in hitherto unreached remote areas. They can support institutions and organisations that can deliver real services as also conceive and implement capacity building initiatives. While the banking sector has in general welcomed these initiatives of the Reserve Bank, banks have not adopted the model with the enthusiasm that was expected at the time of issue of the guidelines. Actual implementation has been confined to a few banks only. It was, therefore, thought necessary by the College to study the implementation of the model by some of the banks who had taken the first steps in appointing Business Correspondents. Two districts of Orissa where the model was implemented by two major new generation banks were selected for the study which was conducted in February 2007.

Banking Services in Orissa

Orissa's economy is predominantly agrarian and rural-oriented. Prevalence of acute and persistent poverty had characterized the economy of Orissa in the past. The recurrent events of natural calamities have further exacerbated the distress of the people, particularly the weaker sections of the society such as, small and marginal farmers and landless labourers. A large number of rural communities are physically excluded for want of connectivity and other infrastructural support. The rural people depend mostly on agriculture to eke out their subsistence. However,

agricultural growth in Orissa is virtually stagnant and employment opportunities are rather limited.

The state has a fairly well spread structure of banks with one branch of commercial bank for around 17 thousand persons on an average. In spite of this, many people in the rural areas do not have access to the banking system and lack proper awareness of the banking products. The bank branches also face the same set of problems discussed above in expanding their outreach to include this chunk of the rural population. The ground level scenario is, therefore, perfectly conducive to introduction of local intermediaries by the banks in the form of the Business Facilitators/Correspondents. Some banks have taken this opportunity and appointed such intermediaries. This process started after issue of the RBI circular in January 2006 and these banks operationalised their Business Correspondents (BCs) sometime in the second half of the year 2006-07.

This quick study was undertaken with the objective of identifying the methods of operation of these Business Correspondents and identifying issues affecting the operationalisation of the model. These two banks, viz. HDFC Bank and ICICI Bank, were using the BCs in Cuttack and Puri Districts of Orissa in expanding their outreach in the rural sector where they did not have a good branch network. The observations of the study are briefly recorded below.

HDFC Bank

HDFC bank had at the time of the study appointed as many as 31 BCs in the country of which 15 were in Orissa. Four of them – all NGOs - Ashraya in Cuttack District and Peoples Forum,

Indian Development Foundation (IDF) and Agency for Backward Community Development (ABCD) in Puri District were identified for the study. Out of the four, the study team visited Ashraya's office and some of the groups financed by the BC around Chowdwar, an industrial township near Cuttack. Representatives of the other three BCs had a meeting with the study team at Bhubaneswar where the details of their operations were discussed.

Ashraya is a registered society mainly involved in shelter construction for economically backward people. It started its operation in the areas affected by the super cyclone in Orissa in October 1999. The NGO has put in place a "people managed habitat process" focusing on locally managed enterprises for delivering cost-effective building materials produced by village-based groups of men and women through a "Building Materials and Services Bank". The Ashraya Resource Centre has been involved in organizing artisans into SHGs, providing habitat finance to the women SHGs in rural areas through an "SHG Cooperative" (on the MACS model) and creating awareness about environmentally sustainable and locally appropriate construction technologies.

Ashraya had been employed by the bank as a Business Correspondent to deliver its loan products to the rural poor using the SHG mode. The BC was appointed in October 2006 and had at the time of the study provided credit to 50 SHGs, another 100 groups being in the pipeline. The SHGs formed by Ashraya in different villages were all women's groups, irrespective of caste and undertook both agricultural and small trading activities. Around 70 groups formed by the NGO had federated into an SHG Cooperative, which, apart from overseeing the

individual groups, also managed a mid-day meals programme at a local school. The SHGs were, however, having their savings accounts with the nearby cooperative bank for the sake of convenience.

Two SHGs financed by the bank through the BC were visited by the study team. While one group was located on the outskirts of Chowdwar township, the other was in a village (Ostapur) about 30 kms from the township. The first group (Chowdwar) had completed two years and comprised 11 women members, who were mostly engaged in small trading activities (biscuits, pan, vegetables, etc.) and dairy. The group had taken a loan of Rs 121000 from HDFC Bank through the BC, payable in 36 instalments (3 years). The loan amount was equally shared among the 11 members (Rs 11000 each) and invested in their respective individual activities. The SHG members meet once a month and the compulsory deposit collected at these meetings was Rs 50 per member (per month).

The second group (Ostapur) had 10 members, all women, who were engaged in agricultural as well as small trading activities. The group met twice a month and an amount of Rs 50 was collected at the group meetings every month towards compulsory saving. In addition, there was a provision for voluntary saving at 4 per cent rate of interest, which was withdrawable any time by the depositor. The SHG had taken a loan of Rs 60000 from the bank through the BC, which was equally distributed among the members (Rs 6000 per member). The loan was repayable in 36 instalments (3 years).

Generally, the loans were given to members by both the SHGs at the same rate at which the group obtained loan

from the bank through the BC. The bank granted such loans at its BPLR, which, at the time of lending to these groups, was 11.5 per cent. Interactions with the members of the group revealed that although the groups were functioning well and the members were engaged in some form of economic activities, they had a desire to diversify to other income-generating activities and were in need of training. They also felt that the loan amounts needed to be higher for these activities to be taken up. The bank had put in place a scoring model for rating the prospective Business Correspondents, comprising both quantitative and qualitative indicators of organization, management, financial accounting, community contact, infrastructure, information system and experience in savings and credit related matters. The entry level rating of the NGO was done through an assessment of its accounting system and assessment of the NGO by its donors, peers and partners. The charter and registration of the NGO was also studied to see whether it was permitted to undertake the kind of activities proposed especially, financial intermediation.

The score card assigned different weights to the following ten attributes, (i) statutory status of the NGO, (ii) Board of Directors, (iii) area of operation, (iv) development strategy and experience in savings and credit programme, (v) finances, (vi) other collaborating agencies, (vii) human resources, (viii) infrastructure, (ix) information system and (x) organization style and culture. Detailed analysis of each of these attributes was carried out to assign a score out of 400.

In addition to the above, the bank also took abundant caution in choosing the SHGs for linkage through the BC and itself undertook the rating of the SHGs

before actually disbursing the loans through the BC. The bank officials pointed out that this due diligence, although not necessary as the BC had the responsibility to identify the borrowers, was useful in the early stages of implementation of the BC scheme as any laxity on the part of banks at this stage might lead to unforeseen problems, which would put the scheme itself in poor light and hamper its adoption by the bank or by other banks. Discussions with the bank officials showed that the bank's loans to the SHGs given through the BCs were at different rates of interest, not exceeding its BPLR. The 'commission' paid to the BCs was in the range of 2 – 3 per cent. Thus, if the PLR was 11.5 per cent, with a 3 per cent commission to the BC, the bank was actually getting 8.5 per cent on the loans to the SHGs. The commission was paid to the BC in installments, with the last installment paid only when the loan was fully recovered from the groups.

Officials of some of the BCs, however, pointed out that the commission of 2 to 3 per cent paid by the bank (in installments) was not sufficient to run the business exclusively as a BC. Ashraya had taken up the work of BC in addition to its other existing activities and at this stage, financial sustainability of this line of work was not the motive. This view was also corroborated by the other BCs appointed by the bank during the discussions at Bhubaneswar. According to another BC, more staff would also be needed for bringing about any significant expansion of its activities as a BC of the bank. This would translate to increase in operational cost of the BC and the present level of commission (maximum 3 per cent) was too low to take care of this. The third BC was, however, of the view that although the commission was low at

present, it might work with increase in volumes.

All the four BCs of the bank used the SHG mode of linkage and in addition to the loan, also provided some training to the group members, particularly in financial matters such as record keeping and accounting. However, in discharging their work as BC of the bank relating to lending activities, these NGOs were not making use of any information and communication technology (ICT) solutions and the entire work at the NGO end was being done manually. All of them had taken up the assignment as the BC in addition to their core line of work and expected that with larger volumes of business and a higher commission from the bank, the activity could become sustainable in the long run.

ICICI Bank

In contrast to HDFC Bank, which was using the Business Correspondent model for "lending" to the rural women through SHGs, ICICI Bank was using the model for "collecting deposits" in the rural areas. The bank had appointed 19 BCs in the state at the time of the study. This, according to the bank, had resulted in mobilizing around 1 lakh new customers, with all the accounts maintained individually with the bank. Like the previous case, the bank also used its own scoring model for rating the prospective BCs. However, so far as the technology was concerned, the bank used ICT solutions for recording borrower information and transactions. This was again a contrast to the BCs of HDFC Bank, who were doing the work manually without using any advanced technology. The study team visited one NGO - KAS Foundation - appointed by the bank as BC, at Nimapara in Puri District and interacted with the officials of the NGO as well as some customers.

KAS Foundation is a micro finance institution (MFI) operating in the states of Orissa, Chhatisgarh and Tamil Nadu and is engaged in formation and financing of SHGs and Joint Liability Groups (JLGs). As a partner of ICICI Bank, KAS Foundation was accepting deposits on behalf of the bank from individual members of the SHGs and JLGs. The scheme had been operationalized in two Districts (Puri and Khurda), initially as a pilot project in May and July 2006 respectively. In February 2007, it was adopted as a regular programme of the bank. The BC was using the FINO model of smart cards with biometric (finger prints) access control to record the transactions (in this case relating to 'deposit' accounts) with customers in rural areas. A portable kit designed by FINO was used at the time of opening the customer's account. The kit which had the size of a brief case and cost around Rs 1 lakh, had in-built facilities to capture the customer's photograph, biometric features (all ten finger prints) and the application form. This portable kit was designed to run on battery and could be easily carried to any village on a bi-cycle.

Smart cards (also called e-pass books) were provided to all customers. Each card cost Rs 120 at the time. Initially the cost was borne by the bank and recovery was made from the account holders subsequently at the rate of Rs 2 per month (spread over a period of 5 years). Although the smart card had provision for 15 products, to start with facilities of only savings accounts were being provided by the bank to the customers, with plans for extending to other deposits, loan and insurance products in a phased manner. After the formalities relating to account opening were over, the bank issued the cards to customers together with a letter and a

brochure giving details of services available to them. The contact address for lodging a complaint was also indicated in the brochure. All the documents and letters were in the vernacular language (Oriya). In addition to the amount of Rs 2 recovered towards the smart card, the bank also recovered monthly charge of Rs 3 towards the cost of transactions from each customer.

The BC's field staff used a POS device - a portable hand held device which cost around Rs 30000 - to record the deposits and withdrawals. They used to go to the villages with the POS machine and collected deposits and made payments towards withdrawals by the account holders. Transactions were immediately entered into the smart card and a receipt generated from the machine was given to the customer, which she was required to countersign. At the end of the day, the BC staff logged through a telephone line in the nearby area and transmitted the data to the bank's back office. The BC's current account with the bank was credited or debited with the net amount transacted during the day. The BC was paid by the bank an amount of Rs 20 per customer at the time of opening of the account and, subsequently, at the rate of Rs 2 per transaction.

Discussions with the BC showed that the present rate of commission given by the bank would be able to sustain the activity provided a field staff handled not less than one thousand accounts. To reach this volume would take time and, like in the case of the BCs appointed by HDFC Bank, this BC was also currently performing the role in addition to its existing activities and had not considered the issue of financial sustainability of this line of business at that point.

Summary of Observations

The major findings that emerged out of this study were as under:

- Both the banks had employed NGOs, which were already operating in the respective areas and had a good reputation in the field, as their Business Correspondents. They employed their own scoring models for rating the NGOs and selecting them as BCs. Thus, the scheme would be initially successful in those areas having good and reputed NGOs to act as BF/ BCs.
- While HDFC Bank was using the BCs for lending in the SHG mode, ICICI Bank was using them for collection of deposits in rural areas. Both, however, had plans to expand the activities beyond this phase. In the process of doing business with the customers, the BCs also provided them some financial education regarding the banks, their products and the benefits that would accrue to the customers by being associated with the banks.
- The commission paid by HDFC Bank to the BCs was around 2 to 3 per cent of the loans disbursed. It was, however, pointed out by the BCs that with the level of commission, such activity alone could not be sustainable at the current business level. All the BCs had undertaken this activity in addition to other activities that they were earlier engaged in. In this connection, it would be pertinent to add that in terms of the RBI guidelines, Business Correspondents/ Facilitators are not allowed to charge any fee from the customers. The banks employing such intermediaries are required to pay reasonable commission/ fee to the Business Facilitators/ Correspondents, the rate and quantum of which may be reviewed periodically. This had caused some concern among banks since as per the current interest rates policy, the interest rate on loans up to Rs 2 lakh should not exceed the BPLR of the bank and in the case of BF/ BCs appointed by banks, this would translate into the interest rate including commission payable to the BF/ BC not exceeding the BPLR.
- The BCs appointed by HDFC Bank were not using any advanced technology solutions, while the BCs of ICICI Bank were using FINO products and FINO's services in this area. Although during the interactions some of the BCs of HDFC Bank showed interest in adopting these models, they were not aware of the details. There was a need for suitably educating them in these areas.
- At the time of the study, the volumes in this line of business were low. Often, technology adoption becomes necessary in the context of reducing cost and expanding volumes. In the case of BF/ BC, even with adoption of technology solutions - FINO or otherwise - the cost would not be automatically reduced unless the volume increases, as was pointed out by the BC of ICICI Bank.
- There is a huge gap in the rural areas of Orissa as in several other regions of the country in the provision of banking services. However, there appeared to be some hesitation among banks in expanding outreach, procuring new business and attaining financial inclusion using the intermediaries, in spite of clear guidelines issued by the Reserve Bank of India in this regard. Only the two banks included in the study had adopted the BC model in Orissa at the time of the study. Even these two banks had adopted a cautious approach while selecting the BCs and one of them even went to the extent of itself rating the SHGs proposed to be financed by the BC.
- It is expected that the successful implementation of the new model by the first movers like these two banks situated in Orissa would have a demonstration effect on other banks operating in the state as well as in other states.

