



BRAZIL'S BANKING CORRESPONDENTS

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Microfinance is about building a distribution channel for low-value, high-volume financial products, and about managing the credit risk of small loans to poor people. Banks in Brazil have developed a powerful delivery channel that increases access to financial services. It has not been specifically designed for typical “microfinance” clients – i.e. the self-employed poor, but over time may be used to deliver micro-enterprise credit.

The banks have developed a home-grown, highly sophisticated delivery channel they call “banking correspondents” (BCs). Using technology and partnerships with retail, lottery and postal outlets, these banks have opened millions of new accounts in a few years in urban slums, peri-urban areas, and even rural and remote locations. They offer a wide range of financial services, including savings, credit, money transfers, account opening, government benefits, and insurance.

In late May, I accompanied Manish Khera and Puneet Gupta from ICICI Bank (India) to Brazil, to see how banking correspondents work. Terry Gallagher and Manuel Thedim at IETS, a leading Brazilian research institute and policy think-tank, helped organize meetings and provided valuable translation. Adam Parsons at the World Bank office in Brasilia also joined us and helped with interpretation. Many thanks to these colleagues for their assistance.

We met with management and senior executives at five banks -- Banco Popular (run by Banco do Brasil), Banco Postal (run by Banco Bradesco), Caixa Economica Federal, Unibanco, and Lemon Bank. We also visited Netcash, a private company that manages BCs for Lemon Bank and Banco Popular.

Below are some initial observations. A forthcoming CGAP paper will address how banks and MFIs in other countries can develop a similar channel.

BACKGROUND

What are banking correspondents?

Banking correspondents (BCs) are a full-service retail channel that Brazil's banks have developed using technology (POS devices and communications networks) and business arrangements with grocery stores, drugstores, gas stations, other retailers, the postal company, and the lottery outlet chain. The BCs offer many services, including deposits, withdrawals, bill payments, new account openings, money transfers, insurance, airtime top-up and government benefit and pension receipts. Forty-one percent of Brazil's adult population does not have a bank account.¹

The largest operators of BCs are:

- Caixa Economica (state-owned, ~14,000 BCs)
- Banco Postal, run by Banco Bradesco (private, mostly postal outlets, ~7,900 BCs).
- Banco Popular, owned by Banco do Brasil (state-owned, ~6,200 BCs)
- Lemon Bank (private, ~3,500 BCs)

These BCs now serve every municipality in Brazil, including remote places reachable only by many hours of travel in a boat or plane. Since 2000, when the model first emerged, these banks have together opened about 8 million new current accounts, largely for people that did not have bank accounts earlier.

How do they work?

The banking correspondent model is technology-intensive. The banks use some combination of the following devices at the retail outlet, post office, etc: a POS, a bar scanner that scans bills for bill payment transactions, an entire PC, a PIN pad, and a sort of teller machine with a screen. Caixa reports 2 types of setups, with dial-up connection (R\$5,000 to set up, R\$200 per month in telecoms charges (US\$ 2000/US\$ 80)), and with satellite connection (R\$7,000 to set up, R\$400 per month in telecoms charges (US\$ 2800/US\$ 40)). Banco Popular has 3 versions, depending on the transaction volume – a simple POS, a PC with high-speed connection, and a stand-alone mini-branch with several computers. Some BCs are always-online, and others dial-up every few hours to update the central server.

The retail outlet provides a staff person to man the device and handle transactions for clients. Clients are given bankcards, which in some cases are debit cards (e.g. VISA Electron). To make a withdrawal, clients swipe the card, enter a PIN, and request an amount from the attendant. The entire process can take as little as 5 seconds or so, since the POS device is connected by VSAT (satellite telecoms), to the central server that stores account information. A similar procedure is followed if the client is depositing money or making a transfer. For bill payments, the client hands over the bill and the attendant swipes it through the barcode scanner. He/she takes the cash payment from the client, and prints out a receipt.

Operational approaches differ. Caixa and Banco Postal identify retail outlets themselves and handle all equipment, training, contracting, etc. Lemon Bank and Banco Popular are start-up banks that have lean operations and use intermediaries to identify, train and support BCs. Banco Popular has only 80 staff, but has 7,900 BCs and 2.8 million new clients in less than 2 years of operation. These banks use a number of “management companies” to manage the correspondents. These are private companies, some that focused earlier on technology networks and management, which today find, contract and monitor BCs on the banks’ behalf. Management companies assume all liability for cash handled by the BCs.

¹ World Bank: Brazil Access to Finance study.

Risk and return (in the form of transaction fees) are shared among the bank and the retail outlet. If there is an intermediary that supports the retail outlet (i.e. a management company such as Netcash), this company also takes a share of fees.

For retailers, the main benefit is the increased foot traffic at the store, particularly on days when pensions and government benefits are distributed and there are lines of customers at the banking counter.

Why Brazil?

There are several reasons why BCs have emerged in Brazil.

First, Brazil’s banks are all highly technologically advanced. (In part a legacy of the hyperinflation

years – for many years, checks deposited anywhere in Brazil have been cleared within 24 hours – in the US, it can take 3 days). Apparently Banco Bradesco was one of the first banks in the world to offer Internet-banking. Lemon Bank was founded by two Internet entrepreneurs.

Second, the government's populism has urged state banks to serve poor people and rural areas. It has also relaxed account-opening norms and rules on using agents to deliver banking services, to make the model possible for unbanked areas.

Third, strong unions and strict rules on work hours and salaries make it expensive for banks to open new branches in underserved areas. This may have encouraged a search for alternate channels.

Fourth, the opportunity to deliver high-priced credit gives banks incentives to build a distribution infrastructure to reach many more borrowers. Brazil's interest rates on consumer credit (50-60% p.a. on credit card debt) are high because of high discount rates (18-19%) and the requirement that banks place 45% of sight deposits in reserve at the central bank, at 0% rate of interest (nominal). To push microfinance, the central bank permits banks to take 2% from the 45% allocation and make small loans at 24-48%. Since otherwise the 2% would earn nothing, this opportunity may have also encouraged the build-out of a delivery channel in low-income and rural areas. (This is debated by microfinance experts in Brazil).

BANKING CORRESPONDENTS AND THE POOR

Are the BCs reaching poor people?

It is not clear how poor are the customers of BCs. Clearly, the channel has had great success in bringing the "unbanked" into the financial system: there are now more than 27,000 BCs, and the four banks mentioned above have acquired roughly 8 million new account-holders in the past 3-4 years. Government has helped: Banco Postal was required by its tender with the postal company to first serve those municipalities without banking services.

By some accounts, however, the BCs are serving poor people. According to research being done by the World Bank, nearly 50% of Caixa's BC clients earn less than R\$200 per month (US\$ 80), or double the minimum wage in Brazil. Nearly 60% of Banco Postal's clients are in the same category.

But this is not by intention. Most banks admit that their BCs are targeting the fairly large layer of pensioners and informally-employed low-income people. Going further down-market to self-employed micro-entrepreneurs isn't on the books yet.

Nevertheless, the BC model seems to be a powerful way of increasing access to financial services for all customers – regardless of poverty level. The channel is an attempt by banks to reach unbanked communities, NOT an attempt to deliver microfinance in the traditional sense. However, as banks grow increasingly comfortable in these communities by operating through BCs, they may become more knowledgeable about what financial services poor people require. Over time, this positive first step may lead to more tailored products for micro-entrepreneurs.

Will the BC channel deliver micro-enterprise loans?

When asked about micro-credit, most bankers claim that the consumer lending they do through BCs is exactly that. The central bank's earlier loose definition of micro-credit clearly played a part in this. The central bank is now encouraging banks to make "productive" micro-credit loans. Under this definition the bank must use a loan officer, can charge up to 4% p.m., and can lend up to R\$5,000 (US\$ 2,000).

But since it only involves a POS device and a store employee, the BC channel is not well-equipped to make loans of this type yet. To overcome this, those banks that are focused on lending (Banco Popular, Banco Postal and Caixa) will have to partner with local MFIs / NGOs who can appraise and monitor these clients better, or build a scoring methodology using account transaction patterns to help assess risk.

It is not clear that banks will be able to make sizeable micro-enterprise loans on the basis of the savings and other transaction data they capture. However, Banco Popular is trying to cut this process short by providing loans to each and every customer, to build a credit history the bank can use as the basis for further, bigger loans. All Banco Popular customers receive an automatic R\$ 50 loan in their account which they must repay. If they do, they are recorded as a good borrower and may receive a larger loan. If they do not, the bank lists them on a blacklist and eventually reports them to the credit bureau.

This approach daringly sidesteps the careful lending methodologies that the microfinance movement is known for. If it results in acceptable initial losses, the bank may be able to generate a powerful database that can drive individual loans to micro-entrepreneurs.

BUSINESS MODEL

What's the business model?

The banks are trying to make money with transaction fees and with consumer lending. Lemon Bank, which mostly handles bill payments, is clearly focused on generating fees, which it shares with its management company intermediaries and the retail outlets. Apparently, it may also ramp up insurance and credit products. Banco Popular, Banco Postal and Caixa place greater emphasis on making lending operations profitable, since they are largely pricing the current account product to break even (i.e. Banco Popular gives clients 12 free transactions – 4 withdrawals, 4 deposits and 4 balance inquiries – per month, and charges no monthly fee).

But so far the banks haven't hit upon a winning lending methodology. Clearly, the banks are using the BC channel to deliver consumer credit and small loans against pensions to accountholders according to the definition of "micro-credit" laid down by the central bank. (2% per month interest rate, maximum loan size of R\$1,000). However, since most new clients don't have a credit history, the banks are lending somewhat blindly. For at least one bank, arrears are roughly 10-12% but portfolio-at-risk according to microfinance's 30-day definition is about 33%. (SPC, the main credit bureau these banks use for this clientele, only tracks negative information). As mentioned earlier, Banco Popular is incurring losses to build its own credit history database. Banco Postal claims to be using its in-house scoring model to try to manage risk better.

THE FUTURE – RISKS AND OPPORTUNITIES

What's in the future?

The main challenge for banks will be to find a way to manage credit risk and build viable lending operations to consumers and micro-entrepreneurs through the BCs. Scoring (Banco Postal) and partnerships with MFIs (Banco Popular) are currently being explored.

Bank employee unions seem to be arming for a battle, given the rapid growth of BCs (from zero to 27,000 in about 5 years), and the exquisitely lean operations of some banks (i.e. Banco Popular, LemonBank). As mentioned earlier, serving 2.8 million new account-holders, Banco Popular has a staff of only 80. Apparently retail unions have also made noises because retail employees are being asked to handle banking transactions, not retail work – and some employees may see handling considerable amounts of cash as risky.

Second, the BC operations are still in their high-growth stage, and a shake-up of some sort may take place in the not too distant future. Competition to set up BCs is starting, especially since there may be only one or two reliable retail partners to be found in many areas. Bradesco (which runs Banco Postal) and Caixa may have the edge, since the post offices are reliable local partners, and lottery outlets appear to be nearly universally-frequented. In addition, for the 2/3rds of its BCs at post offices, Banco Postal bears no fixed costs (it paid R\$ 200m for the franchise). The fixed infrastructure and staff costs are all borne by the postal company.

For the startup Lemon Bank, the strategic challenge is converting transactions to clients. The bank estimates that it handles 5 million transactions per month, for 1.5-2.5 million individuals. However, it only has 16,000 active current accounts. Will an infrastructure that only handles bill payments have a strong future if other BCs nearby offer the full range of services?

Third, as it becomes harder for banks to pick up new customers, and once the novelty of the BCs wear off for rural and low-income communities, banks will have to invest more in financial literacy training, marketing and other customer segments. For example, adding more acquiring devices in the communities will increase the number of e-payments transactions that take place, make it more attractive for customers to hold debit cards, and possibly bring in merchant accounts. Banks could also focus on business customers such as suppliers and wholesalers in these areas.

Operational challenges are still being solved

Two important challenges must be solved if the delivery channel is to work, especially in distant communities: first, banks must figure out how to manage cash liquidity and risk at rural BCs where transport of cash in and out is difficult or impossible. If there isn't enough money at BCs to give pension-holders their cash, or customers cannot deposit money because the BCs have too much cash on-hand to accept any more transactions, the system will quickly lose credibility. In addition, frauds have occurred and some banks have had to scale back some of their BC networks.

Second, customer adoption is still an unsolved problem— Banco Postal reports using staff from the postal company to go out and educate customers about why bank accounts are useful.

Questions

Finally, there are a number of questions that only time will answer:

Can e-payments channels fully replace all aspects of branch banking for the currently unbanked? And in the long term, can these channels achieve profitability and ensure consistent service despite being operated by independent third parties on the banks' behalf? In villages where banks only find one viable retail partner to deliver services, are customers doomed to a local banking monopoly? Will banks ever be able to service the very poor and illiterate through third parties? Finally, how will specialized microfinance institutions react to banks that develop e-payments channels in their backyards? This paper has encouraged partnerships among these institutions, but would customers benefit more if MFIs chose to compete or to serve a different market segment?

PICTURES



BC at a supermarket – the white sign says “current accounts, bill payments, loans.” It also said “seguros” – insurance – below “Empréstimos” (sp?) but this has somehow disappeared. The sign with the faces says “credit without a guarantor or proof of income.”



Peri-urban area. The man in the orange shirt sits on the steps of a drugstore where Lemon Bank had a BC. Lemon closed it because everyone was going to the Caixa BC across the street at the supermarket.

Caixa prefers putting BCs in the supermarket because it encourages the welfare beneficiaries to spend on food and not medicines (which are available for free at the government hospital).



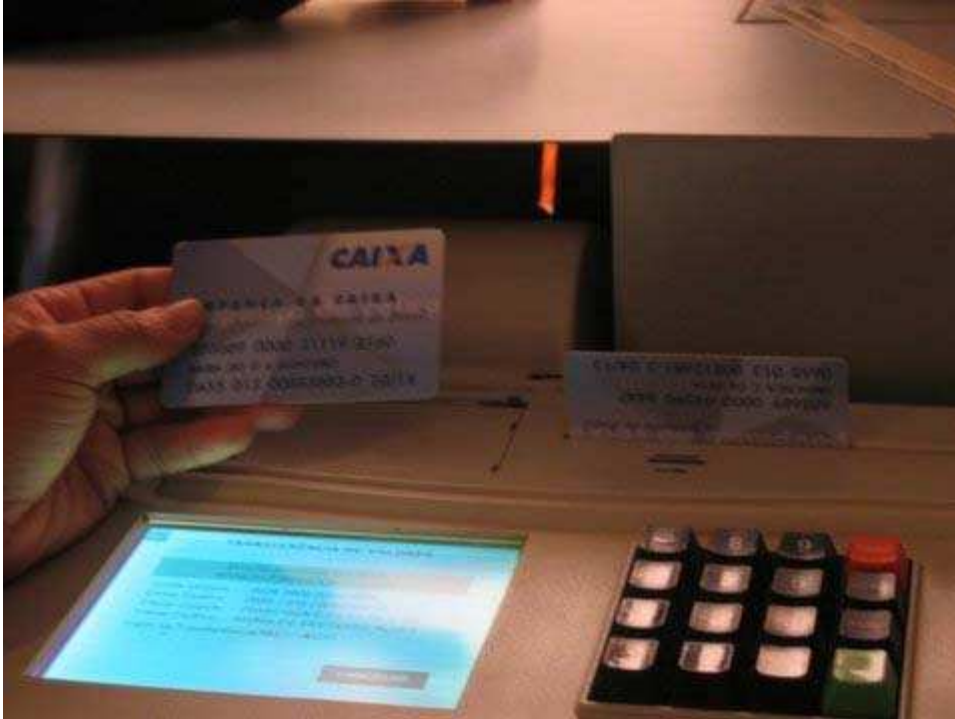
The Caixa BC in the supermarket. The bench at the right is for people to sit while waiting in line. The supermarket owner installed the closet-like room for security.



The outside of the supermarket. Note the Caixa Aqui sign.



The inside of the BC. The woman is a store employee designated for this position. This bill payment took about 5 seconds to complete. He handed over the bill and cash. She scanned the bill's barcode and handed back a receipt.



A card-to-card transfer taking place. A young boy came in with the PIN numbers for both cards written on a piece of paper. All he needed was the PIN number for the sender's card. The operator scolded him for having this written down.



Lemon Bank BC in a favela supermarket outside Sao Paulo. Note the hanging sign in blue and green which shows icons for phone/light/water payments. Note the PC and the black POS machine / PIN-pad. The man in the suit helps run the management company (intermediary contracted by Lemon Bank) that identified this supermarket, installed the equipment, monitors operations, and covers transaction risk.

