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Business Correspondent Model vis-à-vis Financial Inclusion in India: New practice of Banking to the Poor

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Abstract- Financial inclusion i.e., access to adequate and timely credit, and other financial services is of utmost importance for socio-economic development of poor and unbanked sections. It enables them to alleviate their poverty levels through self-employment generation and promotes them as a part of rural banking system. Accordingly, Indian Government is being initiated various financial measures in the banking sector, and different microfinance models have been playing an active role in providing microfinance and other financial services to the rural poor. However, despite these efforts, a large number of social groups remained excluded from the basic opportunities and services provided by the formal financial sector. In these circumstances, as a part of financial inclusion drive, Indian government with the help of Reserve Bank of India (RBI), has come up with a new model in the realm of banking sector, called as 'Business Correspondent (BC) model'. This model primarily aims at providing affordable banking facility to the hitherto unbanked population with the help of Information and Communication Technology (ICT) based application and capacity building. Against this backdrop, this paper attempts to introduce the concept of financial inclusion and highlights its need. It briefly reviews the Indian banking sector and reports the level of financial exclusion in India. In the second part, it provides a brief understanding on Business Correspondent model and emphasizes how BC model could significantly helps in promoting financial inclusion of the hitherto excluded population. It concludes by emphasizing some of the operational challenges in its functioning and suggests a way forward.

Index Terms- Business Correspondent Model, Financial Exclusion, Financial Inclusion, Self-help Groups.

I. Introduction

Financial inclusion is a global phenomenon that has gained wider currency in the development literature in contemporary times. Given the magnitude of poverty in the Third World economies, wherein a large segment of the population do not have access to basic financial services, the idea of financial inclusion – commonly understood as 'banking to all' – has become conspicuous in these economies. A recent United Nations (UN) study observes that financial inclusion of the poor is a global challenge to the achievement of the Millennium Development Goals (MDGs) (2006:1). This report draws attention to a plethora of problems that are being faced by poor in accessing financial services, and reveals the stark reality that a large number of people are not in a state of saving money as formal banking services are not within their 'reach'.[1] According to this report, structural barriers prevent the poor from accessing banking facilities, thereby resulting in financial exclusion. The study further argues that the poor do not have savings bank accounts, let alone insurance policies (Ibid).

The increasing body of literature delves into the causes for financial exclusion. A recurring theme in financial exclusion is 'access to institutional finance' and lack of it, which not only leads to income inequality but also results in slower economic growth. Lack of access to adequate institutional credit and other financial services compel poor individuals and small enterprises to depend on their own limited savings and earnings. This restricts their choice to invest in their small business enterprises and take advantage of growth opportunities (Ellis, 2007:82; Kunt and Patrick, 2009:119; World Bank, 2012: ix). Outlining the causes of financial exclusion, Arora points out that poor human development, high illiteracy and poor awareness levels prevent a large section of the population, particularly women, from accessing basic financial services, which prevent them from reaping the benefits of formal financial institutions[2] (2012:179). Recent estimates show that, globally, over three billion people lack access to basic financial services, of which about 90 percent are from Africa, Asia, Latin America and the Middle East. This has led to a considerable demand from the developing countries for a more inclusive financial system that would cater to the demands of the poor in these regions (John, Julius and Worapot, 2009:55 and Consultative Group to Assist the Poor (CGAP), 2012:1).

The absence or the lack of formal institutional arrangements to provide sustainable financial services is believed to be one of the basic causes that force the poor to increasingly turn to and depend upon the informal financial institutions. For instance, the United Nations (2006:1) and CGAP (2012:1) reports assert that poor households with inadequate access to finance largely depend upon semi-formal or informal financial providers, such as private microfinance institutions (MFIs), pawnshops and conventional moneylenders, and other rotating savings and credit

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1 Here, the term 'reach' not only signifies the availability of various financial services, but also accessibility related issues.

2 Primary activities of a financial institution is buying, selling or holding financial assets. Financial institutions provide various types of financial services. Formal financial institutions such as banks, credit unions, post offices etc. largely run by Government. For more details on Indian financial system, see Ratti (2012), Indian Financial System & Indian Banking Sector: A Descriptive Research Study, pp.1-8.

associations. However, these informal financial institutions seem to be less reliable and insecure, and also expensive than the formal financial institutions. Inadequate access to financial services, along with the overarching dominance of the informal financial providers, may impede the decision-making capability of the poor as they are restrained from making a rational choice while deciding the investments.

Given this background, financial inclusion is increasingly becoming a major focus of research, and the recent literature on the subject focuses on emphasizing the possibilities and prospects of well-designed financial arrangements. Scholars note that better financial services lead to the social and economic development of the rural population. With a view to economic development, scholars argue, a 'well-functioning financial system'[3] with access to adequate institutional finance enables the poor to start investing money in various income-generating activities and maximize the returns, and reduce their vulnerability to the financial risks that they encounter in their daily lives. It helps to bring poor people into the mainstream of the economy, and allows them to contribute more actively to their personal economic development. It enhances mobilization of savings and contributes to economic growth by supporting capital accumulation. While correlating access to banking in terms of savings with social development, it is argued that savings in banks enable the poor to invest in education and health that facilitate a better living standard, along with a marked social development. Having a bank account and access to other financial services through formal financial institutions helps the low-income segments to accumulate funds in a secure place. This, in turn, will have a sobering influence on the informal sector, and hence benefiting those who were otherwise excluded from it (Kirkpatrick, 2000:366; United Nations, 2006: iii; Ellis, 2007:82; Beck, et al., 2009: 120).

II. FINANCIAL EXCLUSION

Financial exclusion is broadly related to lack of adequate access to a range of financial services. People belonging to the lower income strata are unlikely to get access to mainstream financial services and products, and reap the benefits out of it. Further, it prevents the poor and disadvantaged segments in taking key decisions regarding human and physical capital accumulation. Given the above, the repercussions of financial exclusion could be a far-reaching, which not only destabilize the livelihood opportunities but also push them into a complex phenomenon of 'poverty trap'[4] (Mahmoud et al., 2011:5 and Joshi, 2011:81). Some scholars extend this argument beyond accessibility dimension by relating financial exclusion to income status of the poor. Income levels of an individual in any country determine the propensity to save from it. Underlining this view, Joshi (2011:14) observes that majority of population in India neither has savings accounts nor receives credit from formal financial institutions. They seldom make or receive payments through formal financial institutions. Apart from access and income dimension, Sharma (2008:3) discusses that exclusion can be due to problems related with geographical conditions, transaction cost, lack of experience in marketing or self-exclusion in response to negative experiences or perceptions. It is becoming clear from the above arguments that financial exclusion is primarily due to lack of income, access and limited exposure to the financial sphere. These constraints invariably have serious repercussions on living standards of the poor.

III. INDIAN BANKING SECTOR AND LEVEL OF FINANCIAL EXCLUSION

Banking system forms the fulcrum of financial system in India. It carved out a niche in the public sector by providing a variety of financial services to the people. Post independent India

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3 A financial system is the set of institutions and of institutional arrangements that have been established to serve the financial needs of the people. The main objectives of a financial system are to meet the borrowing requirements of business firms, individuals and government; to gather and to invest savings; and to provide a payment mechanism. A well-functioning financial system has some important characteristics. Those are as follows: (i) a clear and appropriate policy regulatory framework that is implemented effectively; (ii) adequate, credible information available to different market players (including providers, consumers and regulators); (iii) appropriate knowledge-based services to the same players; (iv) access to an effective payments infrastructures; (v) effective competition between suppliers; (vi) a diversity of sustainable suppliers and (vii) an innovation in products and process. For more details, see Ratti (2012), Indian Financial System & Indian Banking Sector: A Descriptive Research Study, pp.1-8.

4 It is argued that poverty traps exist and account for the continued existence of poverty in low-income economies, and there are many factors which contribute to poverty trap in these countries. A poverty trap arises when poor individuals with limited access to credit and capital markets, low income or asset endowments and poor infrastructure. The Chronic Poverty Report (2008-09) identifies five main traps that underpin poverty. Those are (i) insecurity, (ii) limited citizenship (iii) spatial disadvantage (iv) social discrimination and (v) poor work opportunities. The report analyses that the poor people frequently live in insecure environments and they have limited assets or entitlements to cope with the shocks and stresses. They do not have meaningful political voice and lack effective political representation. Remoteness, lack of political representation, weak economic integration, lack of access to public and private goods and services and work opportunities etc put them under poverty trap. For more details see, The Chronic Poverty Report (2008-09), "Escaping Poverty Traps", Chronic Poverty Research Centre.

(particularly during 1947-1980) has initiated several measures in the banking sector such as state cooperative banks (1955), the Reserve Bank of India (1955), nationalization of banks (1969) and creation of Regional Rural Banks (1976) etc. (Misra et al., 2008:279). The 1980s had witnessed a significant shift in the Indian rural credit by setting up of National Bank for Agricultural and Rural Development (NABARD). This period was marked by the active involvement of RBI and NABARD in providing microcredit to the rural poor. Banks allocated large proportions of credit to priority sector, including agriculture, small-scale industries and other sectors; and identified them as critical for bringing about economic and social change in rural areas (Basu, 2008:20). In addition to these, financial reforms were initiated in the banking sector in the early 1990s to create an efficient, competitive and stable financial sector and to enhance the efficiency and profitability of the banking system. During this phase, the banking sector had introduced two innovations in the rural credit structure. These include the initiation of microfinance scheme by the NABARD (1992) and launching of the Kisan Credit Card[5] (KCC) scheme (1998) by RBI. Both innovations exclusively targeted to cater to the financial needs of the farmers, the poor and women to improve their socio-economic conditions (Government of India, 1999:61). Despite a well-developed banking system in India, a large number of groups remain excluded from the basic opportunities and services provided by the financial sector for a variety of supply and demand side reasons.[6] In one of the major and first of its kind, the All India Rural Credit Survey (AIRCS) in 1954 documents that the credit needs of the financially excluded population are often met by the informal, non-institutional sources rather than the formal institutions. The excluded sections are drawn from the small and marginal farmers, women, unorganized sector workers including artisans, the self-employed and pensioners (Dev, 2006: 4310). A more recent study on financial exclusion in India point out that only 55 percent of the population have deposit accounts, while only a handful 9 percent have credit accounts with banks. Indeed, India has the highest number of households (145 million) that are excluded from banking system (Biju, 2013:57). The 59th round survey of National Sample Survey Organization (NSSO) (2008) reports that 89 million farmer households in the country (73%) do not have access to credit either from institutional sources. Among the excluded, the plight of financial exclusion of the dalit households is deplorable. The All India Debt and Investment Survey (AIDIS) (2002-03) claims that dalit households in rural India obtained more than half of their total debt from informal sources. The share of formal sources in the total debt of these households was only 44.8 percent, lower than the corresponding share of 59 percent for non-dalit households. Among informal sources, conventional moneylenders were the predominant sources of debt for these households[7].

In terms of region-wise, the report of the Committee of Financial Inclusion (2008:5) observes a geographic dimension to understanding the extent of financial exclusion. The report cites that, inaccessibility, distance and lack of proper infrastructure are the reasons for financial exclusion in a country like India with a large rural population. Thus, the report underscores the need for expansion of geographical coverage and ensuring outreach of various financial services to the entire population without any demand and supply constraints. This strengthens the fact that financial exclusion in India is high in general, and it also varies widely across regions and social groups in India. Thus, the absence of institutional credit and the vacuum created by the state as a major credit facilitator was gradually filled up by the private sector. Under these conditions, in order to provide an alternative banking structure to branch-based banking services, the RBI in the year of 2006 adopted the technology based agent bank model through Business Correspondents (BCs)/ Business Facilitators (BFs) model.

IV. BUSINESS CORRESPONDENT MODEL

With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, the RBI in the year 2006 adopted the technology based agent bank model through business correspondent (BC)/business facilitator (BF). It is being acknowledged as an alternative banking structure to branch-based banking services, which enables public sector banks to use the services of Non-Governmental Organisations/Self-Help Groups (NGOs/SHGs), Microfinance Institutions (MFIs) and other Civil Society Organizations (CSOs) as intermediaries in providing financial and banking services (RBI, 2006). The model primarily intended to reach out to the geographically diverse population, particularly rural areas and those who remained financially excluded from the mainstream banking fold. The significant feature of this model is to ensure doorstep delivery of financial products and services to the above said sections. According to the RBI guidelines, the BCs are permitted to carry out financial transactions on behalf of bank as agents, which is called as branchless banking. This model is being aided by technology oriented tools as point of service

5 The Government of India (GoI) introduced Kisan Credit Card (KCC) scheme in August 1998, which aims at providing adequate and timely support in a flexible and cost-effective manner to farmers by catering to their cultivation needs, including the purchase of seeds, fertilizers, pesticides and livestock. Currently KCC is being implemented by all the District Central Cooperative Banks, Regional Rural Banks (RRBs) and Public Sector Commercial Banks throughout the country. As on 31 March 2012, the banking system has issued 11.39 crore KCCs. The total amount sanctioned is INR. 5, 72,617 crore. See NABARD Annual Report, 2011-12: 63.

6 In India there are 30,000 rural and semi-urban commercial banks, 14,000 Regional Rural banks (RRBs), around 12,000 District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (however, around 66,000 PACS are stated to be functional; the remaining are dormant) [Report of the Steering Committee on Micro-Finance and Poverty Alleviation, 2007:12].

7 Cited in Pallavi (2007): Access to Bank Credit: Implication for Dalit Rural Households, Economic and Political Weekly, p.3219.

handheld devices, mobile phones and a biometric scanner (Karmakar, 2009:7).

Frost and Sullivan (2009) are of the view that the BC is an authorized agent to undertake transactions on behalf of a specified bank. The BCs or bank agents have the advantage over bank branches as they can deliver banking services doorstep across the geographical landscape. One of the significant advantages of this model is that it helps people to overcome regional barriers of language and culture, and inadequate infrastructure in rural areas. Khan (2012:1450) stresses that BCs can bridge the gap between the service providers (the banks) and the service seekers (clients) who are under-served and unbanked; and this model evolved to counter the scarcity of required manpower to reach all people in the current banking system.

The following table provides an understanding of the BC Model.

Table. I: Salient Features of BC Model

Salient Features of BC Model	Guidelines for engaging BCs
Applicable to	The scheduled commercial banks including RRBs and Local Area Banks (LABs). The banks may formulate a policy for engaging BCs with their Board’s approval.
Eligible individual/entities as BC	• Individuals like retired bank employees, retired teachers, Retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of kirana/medical/Fair Price shops, agents of Small Savings schemes of Government of India/Insurance Companies, authorized functionaries of well run Self Help Groups (SHGs) which are linked to banks etc. • NGOs/MFIs set up under Societies/Trust Acts and Sections 25 Companies; • Cooperative Societies registered under Mutually Aided Cooperative Societies Acts; • Post Offices; and • Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets. The banks will be fully responsible for the actions of the BCs and their retail outlets/sub agents.
Scope of activities may include	• Identification of borrowers • Collection and preliminary processing of loan applications including verification of primary information/data; • Creating awareness about savings and other products and education and advice on managing money and debt counseling; • Processing and submission of applications to banks; • Promoting, nurturing and monitoring of Self Help Groups/Joint Liability Groups/Credit Groups/others; • Post-sanction monitoring; • Follow-up for recovery, • Disbursal of small value credit, • Recovery of principal/collection of interest • Collection of small value deposits • Sale of micro insurance/mutual fund products/pension products/other third party products and • Receipt and delivery of small value remittances/other payment instruments. The above activities can be conducted by BCs at places other than bank’s premises.
KYC norms	Banks may use the services of BC for preliminary work relating to account opening formalities. However, ensuring compliance with KYC norms under the BC model continues to be the responsibility of banks.
Payment of commission/fee	The banks may pay reasonable commission/fee to the BC but the BCs cannot charge any fee to the customers directly for services rendered by them on behalf of the bank. The banks (and not BCs) are permitted to collect reasonable service charges from customers in a transparent manner.

Source: FICCI (2012), Promoting Financial Inclusion: Can the constraints of political economy be overcome?, FICCI Federation House, New Delhi.pp.66-67.

V. BUSINESS CORRESPONDENT MODEL VIS-A-VIS FINANCIAL INCLUSION: THE POSSIBILITIES

BC model aims at developing and strengthening the relationship between unbanked people and the formal financial system. The salient features of this model include identifying the borrowers, collection and verification of loan applications, creating awareness on various financial services, products and transactions, post-sanction monitoring, collection of small value deposits etc. The best advantage through BC model is, on the one hand banks get vast exposure to the rural population without its physical presence in terms of branches while on the other the unbanked people belonging to the remote areas get easy access to basic banking facilities at their doorstep by the person among themselves. It also promotes and nurtures SHGs/JLGs wherever relevant and works as a potential contributors in creating awareness about various financial operations. It is, therefore recognized as an economically feasible and customer-friendly banking model for the poor

Scholars note that under BC model, an authorized agent (who may or may not be a direct employee of the financial institution) personally travels within a wide geographical area, particularly rural regions, to enroll people as bank clients, and further delivers loans, and collects repayments (Frost and Sullivan, 2009:19). On the functioning of the BC model, the report of the committee of financial inclusion (2008:ii) observes that adopting appropriate technology enables the business correspondent directly go to the customer instead of the other way round. Banks can use the services of BCs for opening a bank account, under the compliance with KYC norms[8]. The RBI guidelines strictly instructed the banks to ensure that BCs cannot charge any fee to the customers for services on behalf of the bank. Recently, the RBI has expanded the scope of BC model responding to government policy of opening 'no frills accounts'[9] and some of the electronic benefits has been transferred to these accounts to process government payments such as the National Rural Employment Guarantee Scheme, Pensions and other social payments with the help of POS devices (CGAP, 2012:3). In this regard, BC models can have the potential to deliver the services even to the rural and geographically typical regions, which is one of the core strategies of accelerating financial inclusion.

8 With a view to simplify the applying procedures for the customers, the Reserve Bank India introduced Know Your Customer (KYC) norms in August 2005. According to the RBI norms, banks can accept any evidence to their satisfaction for establishing the identity and address proof of the customer. In other words, these KYC norms simplified the procedures to open an account for those whose financial transactions are of modest amounts. See Ramji (2007:16).

9 The 'no-frills account' (NFA) is an important financial product that allows financially excluded individuals to access banking services with low or nil minimum balances; and also either with low or no charges. NFA encourages the poor people to save more by providing the credit in the form of overdraft facility. See Khan (2012).

Table.II: Key Statistics of BC model

Key Statistics on BC model upto March, 2013	
Total No. of Bank Branches	105753
Rural Bank Branches	39336
No. of BCs appointed by banks	195380
No. of villages covered under BC model	221341
No. of Point of Sale (POS) devices installed	967740

Source: Reserve Bank of India, Census 2011: Telecom Regulatory Authority of India.

VI. ISSUES AND CHALLENGES

Although BC model shows great promise and holds potential to cater the financial needs of the rural unbanked populace, the experiences are still mixed. Some of the major reports argue that the model has not taken off in the way it was envisioned in 2006. As for as the viability of this model is concerned, CGAP report (2013:4) reveals the existing regulations do not allow sufficient flexibility for the BC arrangement to be viable. It argues that most of the banks have not really encouraged and promoted the BC banking channel, as required. Further, the report adds, majority of the no-frills accounts opened under this model are not operational. Opening of such accounts to provide deposit services, in order to make these accounts profitable, have not made the desired progress. This has made it unviable for the banks to consider this framework further. Similarly, RBI annual report (2011-12) observes, despite the efforts of the banks to provide training to BC staff, the capacity for internalizing new technologies, new products and systems remain a big challenge. From the business correspondent's perspective, it is pointed out that mobilizing communities for accessing financial services, particularly savings, became a big challenge for them. Due to shortage of sufficient funding, BCs at the village level are unable to mobilize and conduct group meetings in the case of SHGs/JLGs to explain the advantages and to promote BC model.

Pertaining to the performance of the BC model, FICCI's Report (2012:34) highlights the lacunae regarding the recruitment of BCs and functioning of BC model. It identifies that although RBI permitted variety of individuals to work as BCs, very few have been engaged by banks. Regarding the performance of BC staff, the report throws a light on lack of professional orientation. It identifies that they are mostly irregular in the maintenance of records and delay the processing of loans, which subsequently generates a low volume of business for banks. With regard to the operational aspects, it observes that the handling of a large amount of cash is risky, particularly in the hilly regions due to higher security risks, difficult terrain and poor connectivity. Since the BC staff often operates in isolation, there are high chances of fraud and misappropriation. RBI's report on Business Correspondent model (2009:7) reveals that computer based technology is an issue because of lack of standard-training and maintenance. Due to the absence of appropriate technology, BC face problems in finger print storage and retrieval needs. Above all, lack of proper financial education of the clientele is a barrier to the effective utilization of the banking facility provided to the clients through this model.

VII. WAY FORWARD

The literature on this subject comes up with certain measures that would address some of the critical challenges faced by the BC model. In fact, it requires a holistic approach on the part of banking sector, business correspondents and customers as well to improve its service offerings and financial performance. Without an operationally and financially viable channel, the promise of reaching basic financial services to the underprivileged and unbanked population will not likely be possible with the BC model. In this concern, the banks ought to play an instrumental role in developing and promoting BC model. Besides, the banks also create awareness on easy accessing and optimum utilization of various financial services under BC framework. The RBI review repot on BC model (2009:16) recognizes the fact that the process of financial inclusion involves the three critical aspects: (i) access to banking markets, (ii) access to credit markets and (iii) financial education. It is, therefore the BC model should encompass each of the above three aspects in order to be able to address the issue of financial inclusion in a holistic manner.

Grameen Foundation report (2013) suggests that the technology and infrastructure should be robust and easily upgradable. Importantly, it should be cost effective. Training of BCs and financial literacy must be emphasized. BC model should be customer centric, in which it must address customer needs, delivers high quality demand-driven services and invest in customer awareness. The end beneficiaries need to be financially literate to make apt use of banking services. Particularly, women and low-income groups must cultivate the habit of utilizing all available financial services and products under this model, which is essentially redesigned and aimed at their economic upliftment. Given the right impetus by the banks and other financial institutions, the BC banking channel has the great potential to ensure the process of financial inclusion and bring the rural unbanked population within the banking fold.

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