

The banking correspondent business model

Extending access to the formal financial system*

Financial Inclusion Unit – April 2015

*This presentation is based on Cámara, Tuesta & Urbiola (2015). "Extending access to the formal financial system: the banking correspondent business model". BBVA Research Working Paper No. 15/10.

1

Motivation

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The relevance of access to the formal financial system

Access is the most important dimension when defining financial inclusion. It represents a necessary but insufficient condition for using formal financial services (Cámara & Tuesta, 2014).

Traditional access channels seem to be limited in guaranteeing universal financial access. From the supply side, bank branches and ATMs are not cost-efficient for financial institutions to serve certain segments of the markets. Moreover, from the demand side, there are barriers that make access difficult through traditional channels.

Technology and regulation facilitate the emergence of a new branchless channel, i.e. banking correspondents, with the potential to reach millions of unbanked people more rapidly.

There is no systematic information on the number of banking correspondents. The IMF's Financial Access Survey only compiles country level data on bank branches, ATMs and, for the first time in 2014, mobile money agents.

Motivation

Improving the understanding & measurement of access

What are banking correspondents?

- Non-financial commercial establishments that offer basic financial services under the name of a financial services provider, becoming access points to the formal financial system.
- This business model makes it sustainable for banks to focus on low-income clients with a cost-efficient access channel.

In our paper we provide the **first harmonised database** on the number of banking correspondents by country.

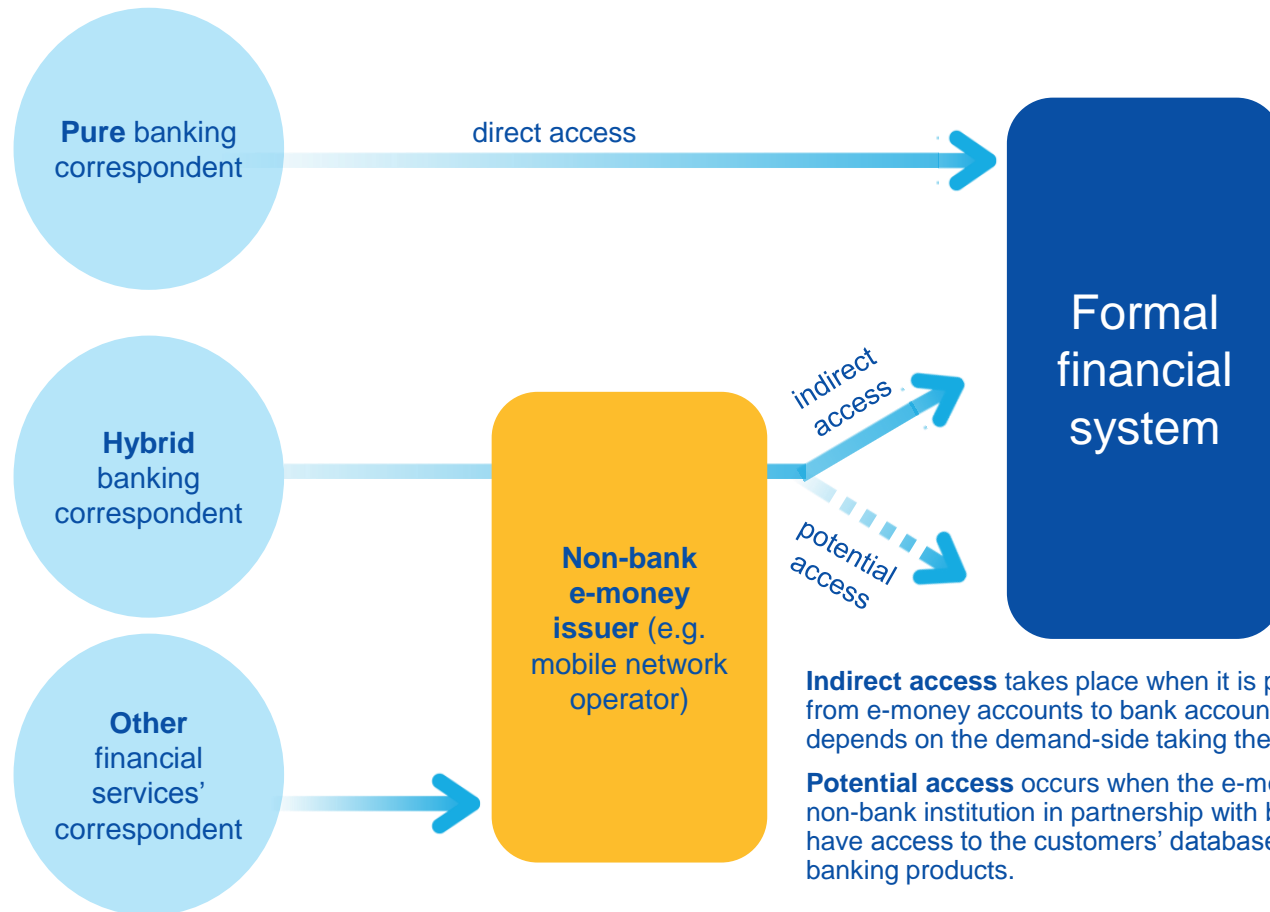
As financial inclusion relies on customers' engagement with the formal financial system, we classify banking correspondents into two models, **pure & hybrid**, depending on the degree of engagement that they facilitate.

2

Classification & characteristics

Classification & characteristics

Banking correspondent models (I)



Indirect access takes place when it is possible to make transfers from e-money accounts to bank accounts. Yet financial inclusion depends on the demand-side taking the initiative.

Potential access occurs when the e-money product is offered by a non-bank institution in partnership with banks. In this case, banks have access to the customers' database and may exploit it to offer banking products.

Classification & characteristics

Banking correspondent models (II)

Pure banking agents

This **outsourcing** allows banks to turn fixed costs into variable costs, lowering and making more flexible their cost structure. In particular, banks' main incentives are:

- **Reaching new customer segments** that are too costly to attend with bank branches.
- **Decongesting bank branches** and therefore concentrating their employees' efforts in more value-added activities while also increasing convenience for customers.

Hybrid banking agents

- Mobile network operators have always used retail agents to sell pre-paid airtime.
- These **pre-existing agent networks** are also used as a distribution channel for financial services when firms enter the e-money business.
- Therefore, mobile network operators face **lower entry costs than banks** to offer basic financial services in remote or widely dispersed areas.

Classification & characteristics

Necessary requirements for banking correspondents

Technology connection

Technology is the essential element that enables the banking correspondent business model. It facilitates the remote interaction between the financial services' provider and its customers at the agent's outlet.

Bank or e-money account

Banking correspondents need to have an active bank or e-money account to offset the cash transactions processed at its till. As the automatic clearance requires banking correspondents to hold enough balance in their accounts, banks sometimes grant them with a credit line under favourable conditions.

Managing cash

A safe environment with no additional settlement risk is created by the real-time interaction between the three parties (bank, agent and customer) and the automatic clearance process.

Classification & characteristics

Valuable attributes for banking correspondents

Proximity & opening hours

- The closer the merchant is to the customers, **the broader the access to the formal financial system becomes.**
- A similar argument applies to opening hours.

Security conditions

- The banking correspondent business **increases the amount of cash** handled by the store and its customers.
- Although banks are not exposed to the risk of burglary, they are concerned about the **reputational implications** of extending access to their services through risky locations.

Reliability

- Poor people may be prevented from going to bank branches because they are new environments for them where they do not know how to behave, in contrast to **local merchants whom they know well.**
- Particularly reliable businesses, such as pharmacies or post offices, may improve the reputation of the financial system when used as agents.

Classification & characteristics

Operations and compensation

The range and complexity of the **operations offered by banking correspondents** depend on:

- Each bank's **distribution strategy**
- The country-specific **regulation** of banking agents



- **Cash-in, cash-out** and **bill payments**.
- **Low value-added activities** that do not require highly skilled human capital.
- This type of outsourcing requires a **higher degree of trust and engagement** between the bank and its agents.
- Moreover, there are **legal barriers** to outsource operations involving KYC requirements.

What do banking correspondents get in exchange for the financial services they provide?

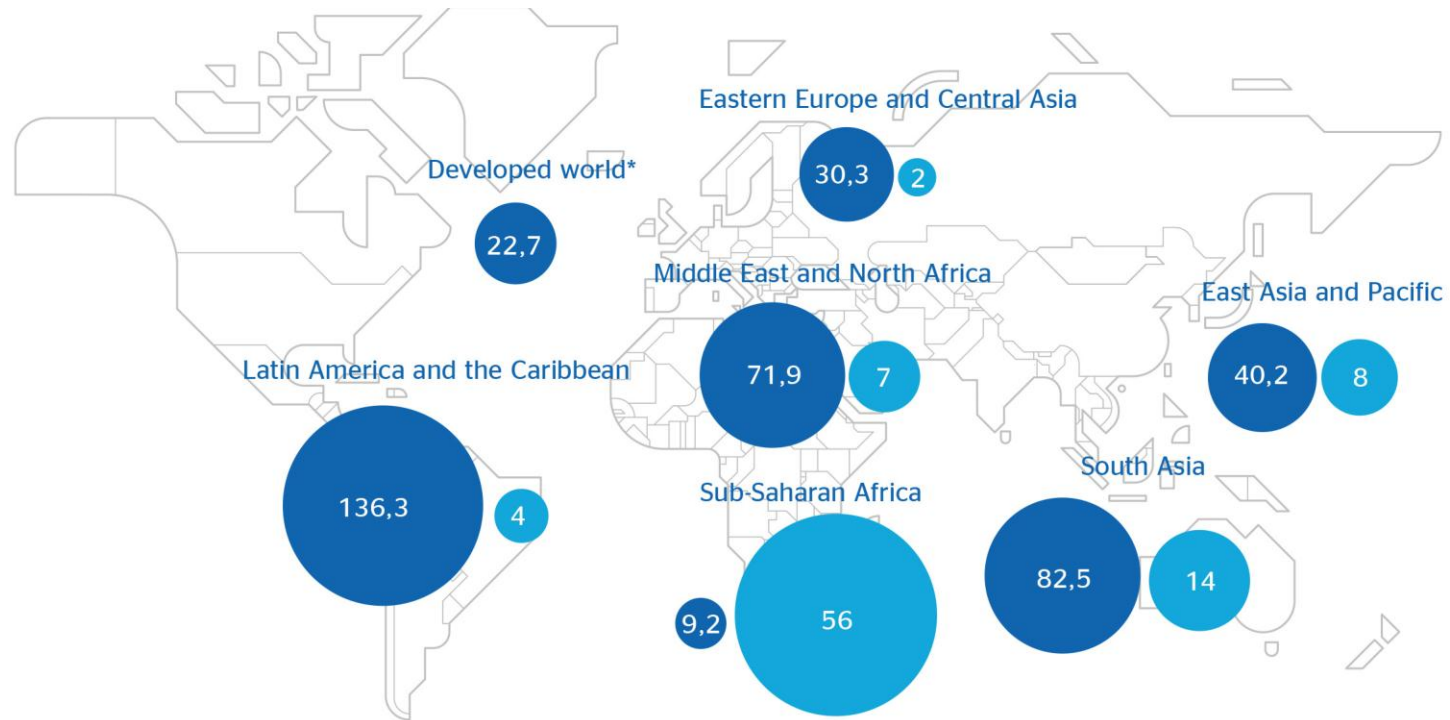
- **Monetary compensation**, generally paid by the financial services' provider and based on the number and amount of transactions.
- **Indirect benefits**: an increase in the flow of people into the stores (potential customers) and reputational benefits.

3

The database

The database

Regional distribution of the pure and hybrid models (I)



● Pure banking correspondents per 100,000 adults

● Number of e-money providers that may potentially use hybrid banking correspondents

*Developed world comprises Australia, Canada, United States, New Zealand and Western European countries

The database

Regional distribution of the pure and hybrid models (II)

Pure agents

Latin America and the Caribbean is the world region with the highest rate of pure banking correspondents. This is consistent with:

- The emergence of this business model in Brazil in the year 2000.
- The pioneering specific regulation introduced by many Latam countries.
- The long-standing banking tradition in this region relative to other emerging markets.

Hybrid agents

Sub-Saharan Africa presents the largest number of e-money providers that may be potentially distributed by hybrid agents. This is consistent with:

- The more permissive regulatory environment on the continent.
- The leading role of mobile network operators in financial inclusion by drawing on the high penetration of mobile phones.
- The secondary role played by many banks, as partners of the telecom firms in the deployment of e-money services.

4

Conclusions

Conclusions

Our contribution

Providing the first database with systematic information on the number of banking correspondents in 70 countries. We aim to start a project to collect harmonised information, across countries and over time, to analyse the speed at which access is growing through this business model and the regional variations in this trend.

- We also offer a database with information about the number of **e-money providers** and their classification. This is a by-product that aims to be a proxy of the relevance of the hybrid model, given the absence of information on the number of agents.

Exploring how banking correspondents contribute to enhancing financial inclusion. We classify them in terms of the degree of engagement that they facilitate between individuals and the formal financial system.

- The **pure model** facilitates the highest (direct) degree of engagement.
- The **hybrid model** represents a lower (conditional) level of engagement.

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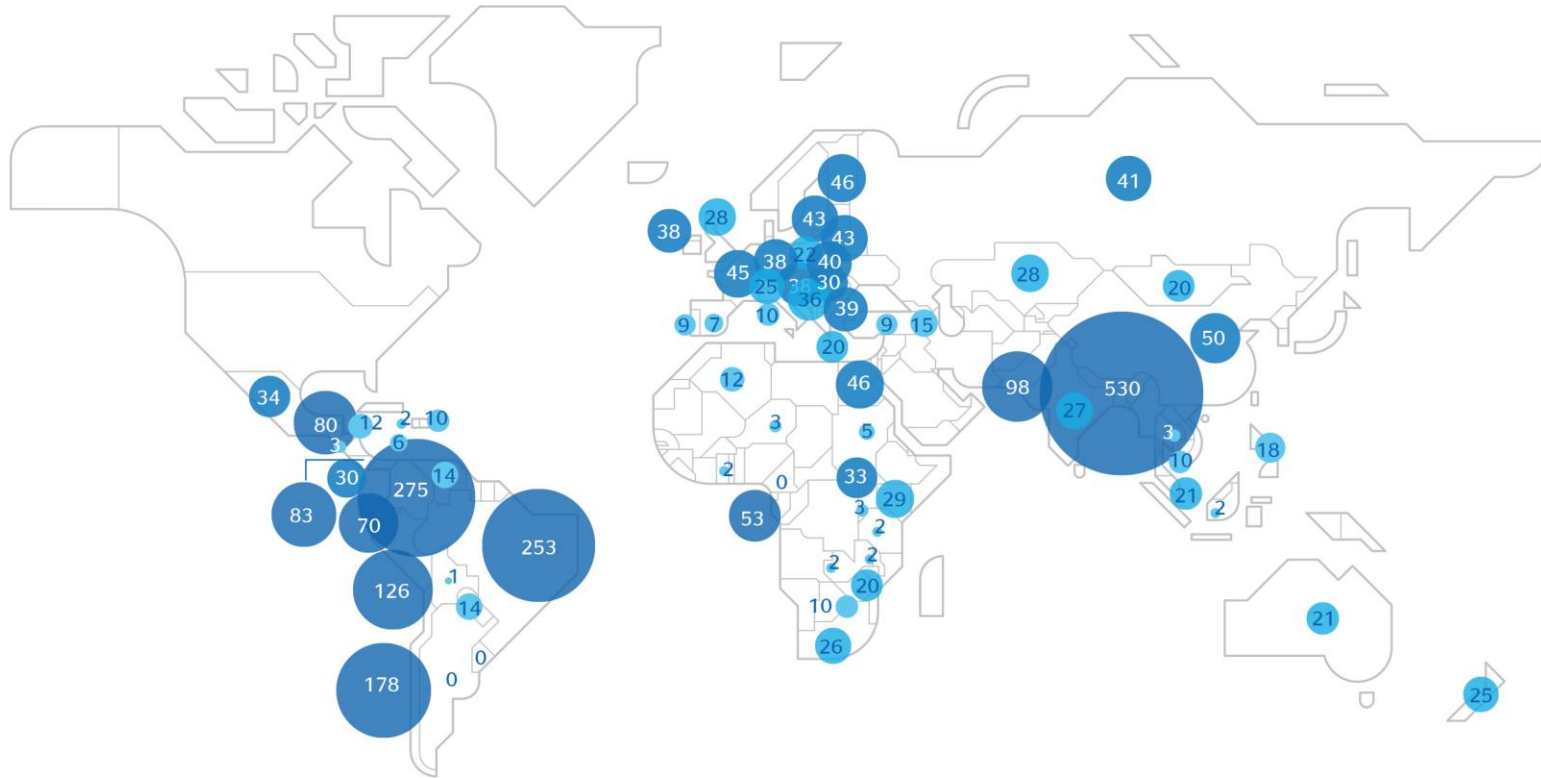
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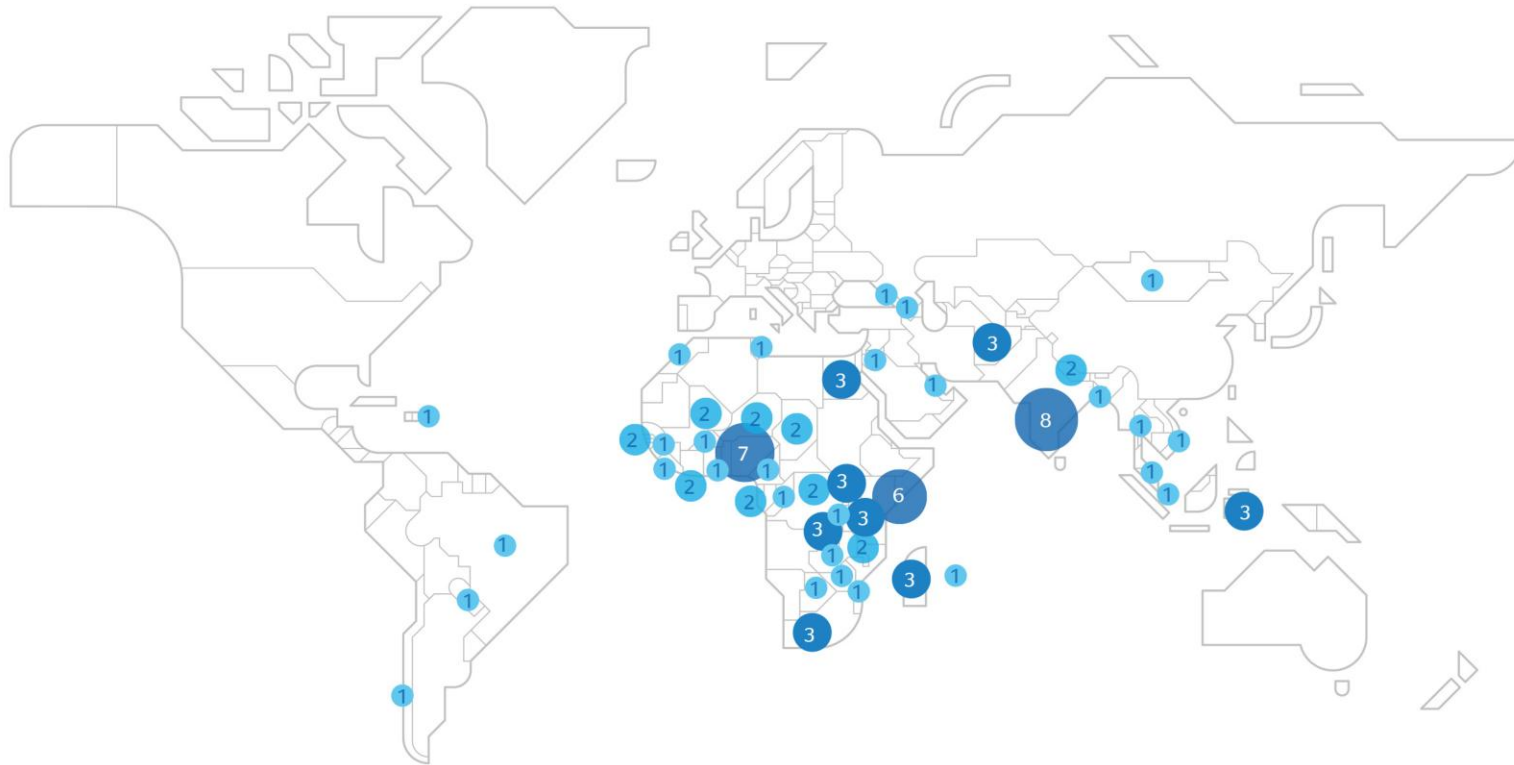
Annex

Annex (I)

Pure banking correspondents per 100,000 adults



Annex (II)
E-money providers that may potentially use hybrid agents



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