5 The non-bank correspondent business model

The need to extend access to the formal financial system

Financial inclusion is the situation in which all working age adults have effective access to financial products such as payments, savings, credit and insurance from formal service providers. Effective access involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options, which is usually quite expensive. Financial inclusion improves social well-being and alleviates poverty. The usage of formal financial services buffers individuals against liquidity shocks, allows for saving with safe financial tools, obviates the unnecessary liquidation of illiquid investments, and channels savings from unproductive liquid assets toward investments in productive capital.

When defining financial inclusion, access is the most important dimension and represents a necessary but insufficient condition for using formal financial services. Therefore, extending access to the formal financial system is essential to foster financial inclusion. Yet 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 physical, cultural and social barriers that make access difficult through traditional channels. Given these limitations, technology and regulation have facilitated the emergence of a new branchless channel, i.e. non-bank correspondents, with the potential to reach millions of unbanked individuals more rapidly.

The non-bank correspondent business model

Non-bank correspondents are non-financial commercial establishments that offer basic financial services under the name of a bank, becoming access points to the formal financial system. Those establishments can belong to a broad range of sectors (grocery, gas stations, postal services, pharmacies, etc.), as long as they are bricks-and-mortar stores whose core business involves managing cash. In its most basic version, non-bank correspondents carry out only transactional operations (cash in, cash out and bill payments) but in many cases they have evolved to serve as a distribution channel for the banks' credit, saving and insurance products. This business model makes it sustainable for banks to focus on low-income clients with cost-efficient access channels.

In areas where bank branches are a long way away from households, non-bank correspondents pool the cash requirements of all customers and reduce the number of costly (and sometimes risky) trips to the bank. Moreover, since deposits and withdrawals are offset at the agent's till, the total amount of cash that needs to be transported to the bank branch is also reduced. Thus, the non-bank correspondent business model leads to economic efficiencies.

Outsourcing agreements allow banks to turn fixed costs into variable costs, lowering and making more flexible their cost structure. In particular, banks have two main incentives for outsourcing their most basic customer contact activities to retail agents. First, correspondents allow banks to reach new customer segments (low-income, rural, etc.) that are too costly to serve with bank branches, due to the fixed costs involved. Second, in the case of areas already covered by bank branches, transferring some activities to correspondents (i.e. channel substitution) allows banks to cut costs and concentrate their employees' efforts in more value-added activities while also decongesting bank branches and increasing convenience for customers.

The role of technology

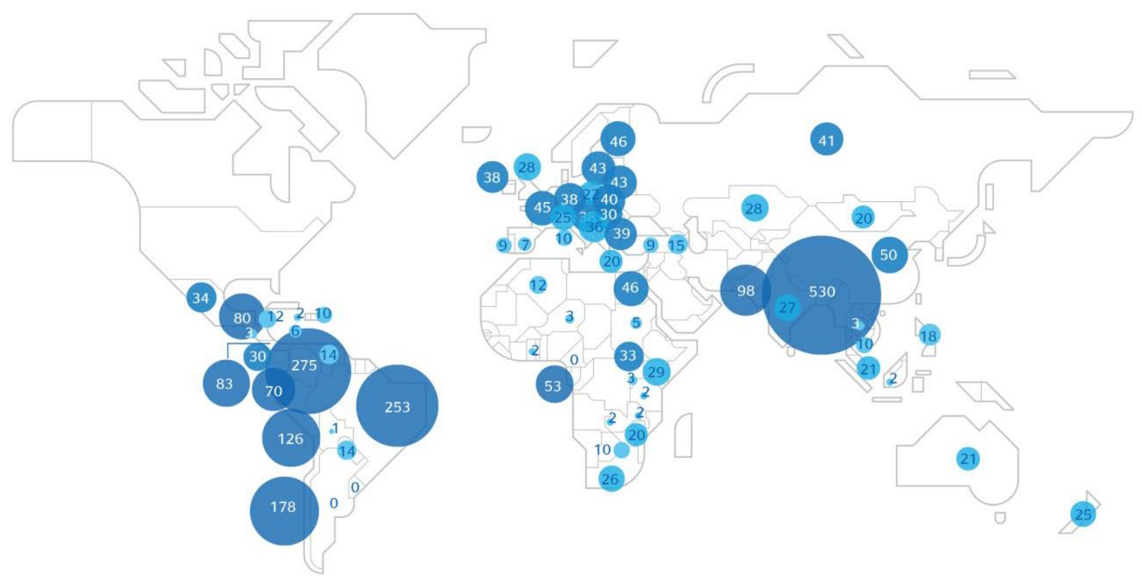
Together with regulation, technology is the essential element that enables the non-bank correspondent business model to function. It facilitates the remote interaction between the financial services provider and its customers at the agent's outlet. In the most traditional system, the interaction takes place using bank cards and point-of-sale (POS) devices connected to the bank through a phone line, wireless or satellite technology. In the case of e-money products, the interaction usually takes place using mobile phones. As well as the appropriate technological connection, non-bank correspondents need to have an active bank account to automatically offset the cash transactions processed at their till.

The procedure works as follows. When a customer makes a cash deposit at a non-bank correspondent, the same amount of money is automatically withdrawn from the agent's account and transferred to the customer's account. As this automatic clearance requires non-bank correspondents to hold enough balance in their accounts, banks sometimes grant them with a credit line or overdraft facility under favourable conditions with the aim of facilitating the non-bank correspondent business model. In the case of cash withdrawals, the remote interaction with the bank allows, first of all, checking that the customer has enough funds in his or her account. Then, the non-bank correspondent provides cash to the customer from its till and the bank transfers the same amount of money from the customer's to the agent's account. The interaction in real time between the three parties (bank, agent and customer), together with the automatic clearance process, creates a safe environment for all parties with no additional settlement risk.

Worldwide distribution of non-bank correspondents

Non-bank correspondents have significantly contributed to extend access to the formal financial system in many developing countries, particularly in Latin America and the Caribbean, which is the world region with the greater number of non-bank correspondents (136 outlets per 100,000 adults). Latin America is followed at a considerable distance by South Asia (83 agents per 100,000 adults) and Middle East and North Africa (72)[1]. The prevalence of the non-bank correspondent business model in Latin America is consistent with the emergence of this business model in Brazil in the year 2000, and with the pioneering specific regulation introduced by many countries in the region. This may be in part promoted by the long-standing banking tradition in this region relative to other emerging markets

Figure 3
Non-bank correspondents per 100,000 adults



Source: BBVA Research

1: For further details, see Cámara, Tuesta & Urbiola (2015). *Extending access to the formal financial system: the banking correspondent business model.* BBVA Research Working Paper, No. 15/10.

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