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BRIEF

Extending Financial Services with Banking Agents

Only three years ago, about a quarter of Brazil's nearly 6,000 municipalities lacked any formal banking services. The reason for this was all too familiar: Reaching poor clients in rural areas is often prohibitively expensive for financial service providers. But banks in Brazil overcame this obstacle by using local agents (correspondent banking) to manage their operations at the village level. Today, banking agents have helped extend financial services to practically all (98 percent) of the country's municipalities.

Banking agents are retail vendors, lottery outlets, and post offices—trusted local establishments that can double as a kind of bank branch for their customers, processing everything from bill and pension payments to deposits, withdrawals, and money transfers.[1] Banking agents' lower set-up and running costs promise to help banks and microfinance institutions reach more and poorer people living far from the nearest branch, with more financial products, at lower cost, than traditional microfinance or banking channels.

An estimated US$1 billion in transactions were processed through Brazil's 90,000 agents in 2005, and about 12 million current accounts were opened across this network in only three years, according to Banco Central do Brasil. Brazil's *correspondentes bancarios* have already influenced many other markets, including Colombia's *correspondentes no bancarios*, Peru's *cajeros corresponsales*, and banking agent networks in Mexico and Chile.

THE LOCAL ALTERNATIVE

Banking agents process transactions with point-of-sale (POS) card readers, barcode scanners, and sometimes personal computers that connect with the bank's server using a dial-up or other data connection.[2] The clerk at the retail or postal outlet collects and disburses cash and, in some cases, opens bank accounts for new clients and fills in credit applications. The retail outlets earn a portion of the transaction fee. Some generate so much business from handling these transactions that they dedicate an employee to operating the POS device. Some banks use management companies to identify, equip, train, and support banking agents and to assume all liabilities for the cash they handle. These intermediaries are compensated with a portion of the transaction fees.

All told, it costs much less to use banking agents than to set up bank branches. For the price of one branch, 40 banking agents can be opened, according to the Peruvian Superintendency of Banks.

Furthermore, agents may be helping banks attract customers who would otherwise shy away from using a bank branch. Poor clients may be more comfortable banking at their local merchant, in part because rural clients—10 percent according to CGAP's customer research in Brazil—are illiterate and need help conducting and understanding their transactions. Many have long-standing relationships with local merchants. In contrast, banks in many Latin American countries have a reputation of being expensive, and branches—and their staff—are often seen as intimidating and unwelcoming.

KEY CHALLENGES TO MAKE BANKING AGENTS A VIABLE DISTRIBUTION CHANNEL

Poor clients are not yet using the full range of financial services. Cross-selling all kinds of financial services through banking agents and getting poor people not only to use the agent network, but also to

1. Increasingly, financial services are being provided through retail agents by nonbank entities, such as mobile phone companies and nonbank issuers of e-money and other electronic stored-value instruments. This Brief focuses on models where the financial service provider is a licensed and prudentially supervised institution, such as a bank.
2. Different technologies, including mobile phones, also can be used to transmit transaction details. In mobile phone-based models, customers can conduct many transactions on their own, without having to visit a retail agent.

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become true clients of their bank are still challenges faced by many financial institutions. Poor users of agent-based banking in Brazil often open an account only because they need one to access their welfare payments or because their employer deposits their salary directly into the account. Poor clients do not seem to fully trust banking through agents. Only 6 percent of clients save through agents in Brazil, for example.

The right technology is one problem, the right business model is an even larger challenge. Viability of the business model depends on many factors, including (*i*) business processes to select appropriate agents, (*ii*) developing appropriate products for new types of clients, (*iii*) adequately motivating agents, (*iv*) managing cash liquidity of each point, and (*v*) conducting cost-effective marketing campaigns.

Safeguarding cash and managing cash liquidity at banking agents is difficult. In Brazil, 99 percent of the 750 users and nonusers of banking agents interviewed use banking agents primarily to pay their bills once a month. Because agents in Brazil handle more cash inflow than outflow, even small retailers may collect up to US$ 20,000 in cash in one day. To mitigate risk, banks ask their agents to refuse larger payments or require them to deposit money in a bank branch when a certain limit is reached. Balancing cash-out products, such as welfare payment processing, and cash-in products, such as bill payments, should reduce the agent's cash on hand.

Striking a balance between security of the system and its customers and providing space to innovate viable business models. Policy makers and regulators are interested in banking agents for their potential to extend the financial system infrastructure cost-effectively into rural and underserved areas. But existing regulation is typically overly restrictive on some fronts and underprotective on others. Changes to the regulatory framework in Brazil, Colombia, and Peru have opened things up for banks to establish often large-scale agent networks. Countries like India, Pakistan, Kenya, and others are close behind. The approach taken in regulation on questions such as the types of outlets permitted to serve as agents, the kinds of activities agents are permitted to perform, and the protections (and means of redress) afforded to customers who are often great distances from the provider of their financial services all have a potentially significant impact on the viability of banking through agents.

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