Financial Distribution SUMMIT 2015

CII's 4th International Conference

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Rethinking distribution:

Smart solutions for smart customers

November 2015

pwc

CII

Confederation of Indian Industry

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Chairman's message

Throughout the previous summits on Financial Distribution, we have been focusing on under-penetrated and rural markets and have emphasized the need to reach out to the people who are still not part of the organized financial services sector. But I believe very strongly, basis research and prudent analysis of statistics that even in the urban markets and in the metros, there is a lot of headroom for financial services players to tap into new customers and there is still a sizeable segment of the population with disposable income which has not been channelized into the capital market.

The 4th edition of the Financial Distribution Summit actually tries to discern and address those pertinent roadblocks which are acting as a deterrent to increasing the footprint of the various market players. In an eco-system which is changing rapidly, where technology is defining and shaping the way we do business with our customers, financial service players are investing in new age technology to create differentiation and provide the customer with superlative experience so that customer stickiness continues.

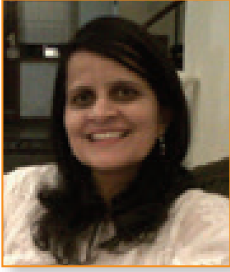
New players entering the market like Fintech players and the small banks and payment banks are disrupting the business environment and setting the bar high for customers by providing them with choices and convenience that traditional players had never experimented with. Further, the use of digital platform via social media, mobile apps, etc. the urgency to gratify the customer and remain constantly engaged with the customer has taken precedence.

The CII-PwC report captures the nuances of the changing distribution landscape and what it may look like in the near future. Providing relevant case studies and global examples, we have tried to draw some semblance to the India distribution story and mine interesting learnings from them.

We hope you enjoy the report and find this report insightful.

Regards,

V Ganesh



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Foreword

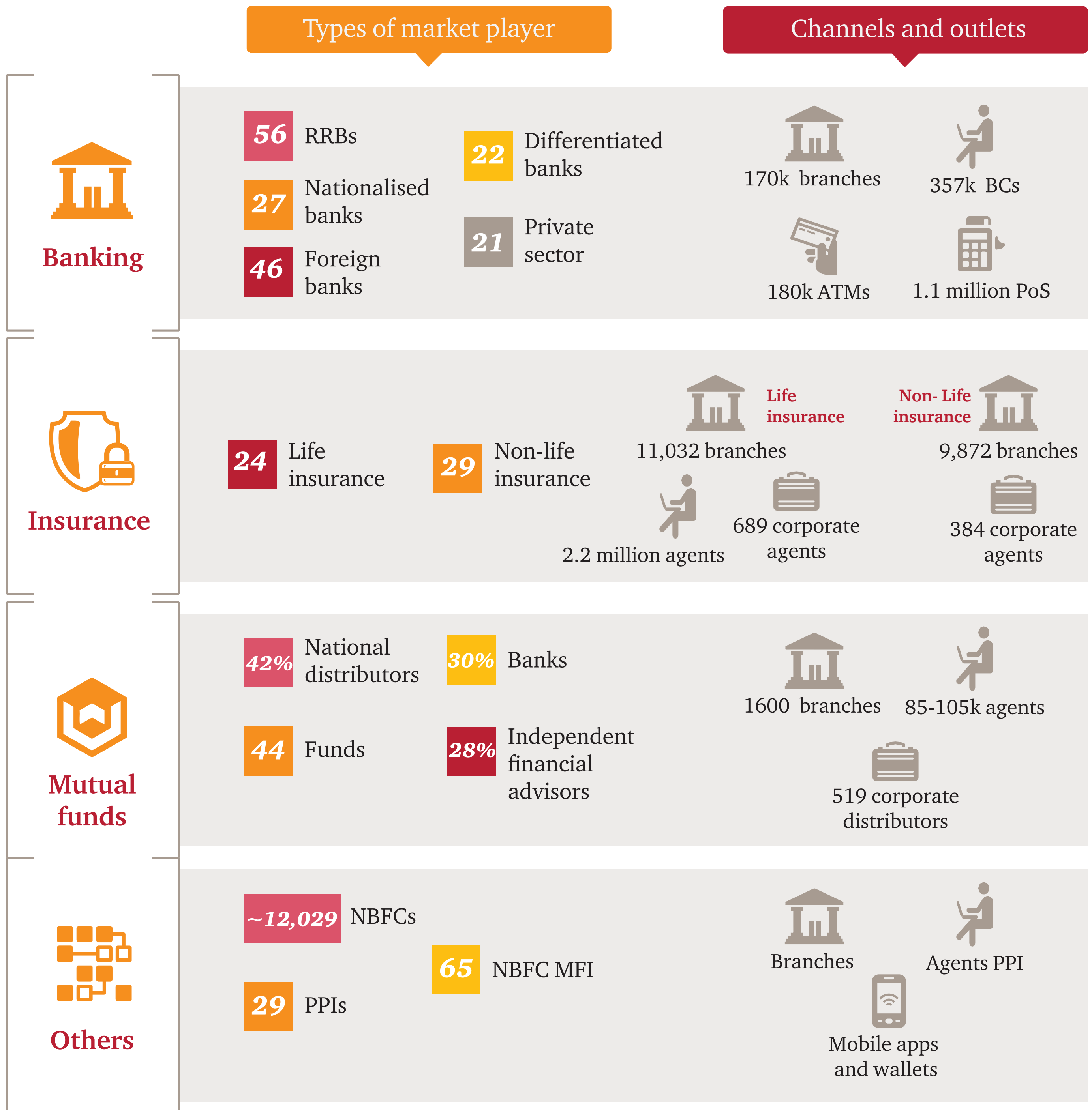
It gives us great pleasure to partner with CII for the Financial Distribution Summit 2015. We have shared our thoughts and perspectives on financial distribution, at a time when the world is changing and, with it, the rules of engagement. Providers of financial services and distributors need to understand what the future holds for them and reimagine their roles by embracing change.

In a financial services industry dominated by branches and agents, can new-age technology innovators steal a sizeable share of the market? Can service providers expect to broaden their market if they use a multi-channel approach to reach their customers? Is social media of any real importance to distributors? What difference will small finance banks and payments banks make to this ecosystem?

In 'Rethinking distribution: Smart solutions for smart customers', we have attempted to answer these questions. We have identified how the future will be different from what it is today and how financial institutions, distribution channels and agents can respond to this change to capture new opportunities. We have included case studies outlining the impact of new distribution solutions. Changing customer preferences, shifting structures of trust, technological breakthroughs, regulations and the entry of new nimble players are all-powerful forces changing our world. A snapshot of the financial services industry and its challenges has been provided.

We hope you will find the report useful and relevant. We welcome your thoughts and views and look forward to the discussions at the summit.

Rapid disruption in the distribution of financial services in India



Rethinking distribution smartly:

Opportunities in the new marketplace

1. *Rethinking distribution smartly: Opportunities in the new marketplace*

The world of financial services is changing in ways that are more dramatic than we would have imagined even five years ago. Inspired by Apple stores and other similar outlets, banks are using smart technology to remodel their branches into smarter retail-like outlets. On the other hand, small retail shops are increasingly equipping themselves to provide a wide range of financial services from opening bank accounts to issuing insurance policies using high-tech handheld devices. The enhanced communication landscape completely rewrites the ground rules for the distribution of banking, insurance and mutual funds products from the point of view of both the customer—who has increased choice and is empowered by the availability of instant options—and the conduit—in this case, the 'human' channel or the agent. Clearly, this necessitates a relook at the way financial institutions, employees and agents operate in the new financial ecosystem. It is as much an issue of survival as it is of eventual success.

Winning in this new market will require players, particularly the existing ones, to unlearn and relearn the ground rules. The entry of new players, many of who will be challengers and disruptors, will push the market to higher levels of competition. Simultaneously, market participants will be forced to focus on specialisation and differentiation in order to respond to an extremely diverse market. Ensuring a seamless experience to a range of consumers while building lean, cost-efficient structures will necessitate greater collaboration among market participants, including banks, insurance and asset managers, commodity and pension solution providers, authorised non-banks of different categories, and technology disruptors.

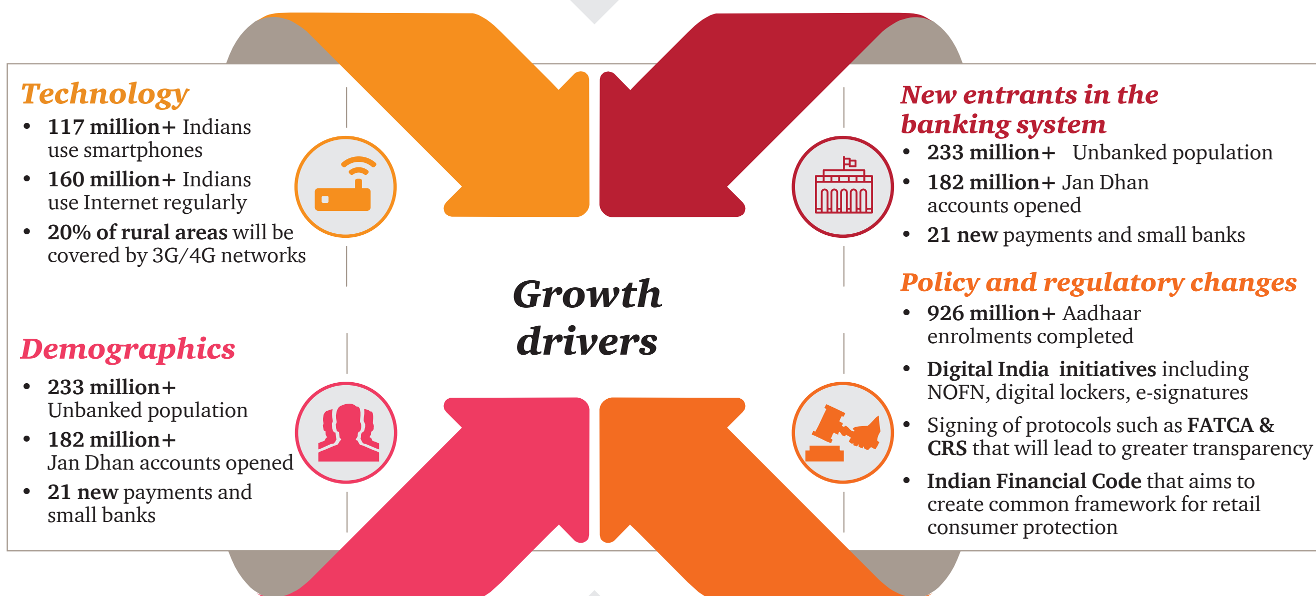
Banks dominate the formal financial system in India, with 70.5%[1] of the total assets of the financial system. This, as well as other factors related to the development of markets and trust structures in the economy, has meant that universal banks are the dominant providers of financial services to consumers with access to the formal system. Retail banks, serving as customer-facing ends of the delivery channels for their own products as well as partner products like insurance and mutual funds, have stitched together distribution models to suit the needs of their primary consumers, while insurance and asset managers have aggressively grown their presence through physical as well as digital channels. With greater clarity on regulations and policy push, asset classes such as equities, commodities, forex derivatives and pension products have also found traction. Even as the markets are becoming better regulated and closing on arbitrage and uncertainty, consumers are becoming more empowered through information and execution, particularly on their mobiles. Thus, while technology start-ups or fintech companies will 'unbundle' traditional banking, it is expected that new opportunities will be created through improved trust, transparency and better consumer experience, moving consumers away from their sticky preference for gold and real estate, or just plain cash under their pillows.

Four overarching growth drivers are providing an impetus to change in the delivery and consumption of financial services: demographic factors, technology changes, regulation and the entry of a substantial number of new, differentiated banks. As non-banking digital companies and new banks, premised on low cost–high tech models to deal with low value–high volume customers, make their mark in the banking universe, the delivery of financial services must be reimagined by the supply side. Easy adoption of tech solutions by a young population of digital natives and adopters provides insights into changing customer expectations and consumption behaviour, which will be an equally important part of the solution.

We foresee the following trends playing out in the distribution of financial services:

Supply-side trends

- New banks will lead to major shifts in inclusion and trust building
- Serving new customer segments will require financial institutions to tailor distribution strategies to customer type
- Agents will need to reorient, retrain and work with complementary technology solutions
- New and future technology will drastically reduce the cost of delivery infrastructure



Demand-side trends

- Mobile as a channel of delivery breaks barriers of geography and physical presence
- The app-happy consumer is used to simple design and direct communication and can learn as they transact
- E-commerce and use of social media are rewriting the rules of engagement for consumers

Growth drivers and resulting trends impacting the distribution of financial services

Supply-side trends: Increasing outreach through digital

1. New banks will lead to major shifts in inclusion and trust building.

Marking a significant departure from their usual practice of granting bank licenses once in a decade, the RBI announced 21 differentiated banks and 2 private universal bank licenses in the last two years. As these licensees roll out plans to go to market, competition between themselves and with the existing universal, cooperative/regional banks and non-banking companies will ensure that these new players venture into unchartered geographies and untouched customer segments. By awarding licenses to telecom giants, business correspondents and microfinance companies, the regulator has ensured that inclusion at the last mile is entrusted to those who have built successful business models in the space. The new banks are expected to create a robust infrastructure for the last mile, such as agent networks and education, cash collection services, and technology investments for non-metros and rural areas. But, more importantly, they will lead to some major shifts in the traditional relations between financial services and consumers.

For example, payments banks, forced to work on thin margins, will need to provide customers with a portfolio of services to drive profitability. This is a very interesting subversion of a fundamental reality. While banks accessed high-quality data on their consumers, being primary account owners, they also offered saving products like demand and time deposits that provided the banks their operating base of liabilities. Despite several efforts at enhancing the efficiency of the payments system, float at banks is the other common reality, emanating from, as well as leading to, rigidities and friction in settlement. On the other hand, payments banks, by their very construct, have little incentive to keep float or target idle money for their balance sheets (deposit cap of 1,00,000 INR and no term deposits). To generate income, they have to look at providing more comprehensive solutions to their clientele as well as improving the efficiency of payments.

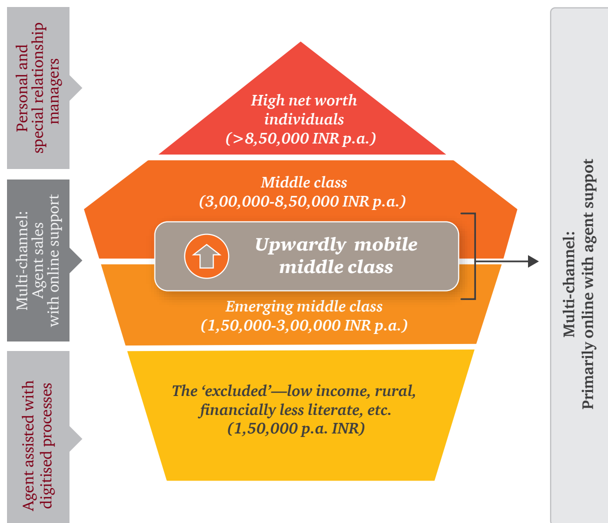
The most significant change that can be hoped for with increased competition is improvement in transparency and trust. While regulation of financial services has always been based on these tenets and the Indian markets are already ahead in terms of regulatory activism for retail consumers, for new banks, this should become business sense. Because they are digital and start with the assumption of low returns, these players will have the opportunity to reinvent their customer covenants, basing their differentiation on transparency of charges and fair treatment of customers. Any loss of trust leads to major disruptions, not only for the player concerned but also for the markets as a whole. Therefore, regulators are expected to keep a hawkish eye on consumer protection in these new segments, in order to grow and sustain the market.

For banks, insurance companies and mutual funds that aim to go beyond metropolitan areas and large towns, collaborating with payments banks, small finance banks and PPI providers will be critical to reaching the last mile. The new players will benefit from the trust already enjoyed by these formal institutions, even as they revitalise the last mile and use the potential of digital for more sustainable inclusion.

2. Serving new customer segments will require financial institutions to tailor distribution strategies to customer type.

The distribution networks of tomorrow will vary depending on the customer segment they cater to. The lifestyle, priorities and needs of each customer segment are different and hence they will need to be catered to in different ways.

For instance, the ability to harness transaction data on new customer segments possessed by payments and small banks, will allow cross-selling of comprehensive financial services to lower income customer segments through intelligent combinations of mobile and physical delivery channels. The upwardly mobile middle class, which has traditionally been the favoured customer of financial institutions, will see ‘choice’ expand, both in terms of products and service providers.



Different channels for efficiently catering to various income segments[2]

Acquiring and servicing such customers will need specialised digital channels, as customers begin making decisions based on convenience and not just affordability. Servicing HNIs will continue to require a very personal and specialised approach, increasingly taking into account the global reality of multi-jurisdiction wealth creation as well as the regulatory complexity of global co-operation agreements such as FATCA or CRS.

3. Agents will need to reorient, retrain and work with complementary technology solutions.

As technology starts disrupting traditional models of delivery, agents will see an overhaul of their roles and responsibilities. Tech-based solutions provide consumers with the option to research and make well-informed purchasing and investing decisions at their own time and convenience. Easy modification and customisation of browsers and websites help with product illustrations and recall of information and policy details. These features also help the millennials to use various services, access different mediums and research either immediately or in short bursts over a period of time. As customers take greater ownership of decisions regarding consumption of financial services, agents, who have traditionally been at the forefront of customer acquisition, may evolve into facilitators and augmenters of digital and direct sales. They can provide a human outlet for verification, customer servicing and grievance redressal.

Both banking and insurance have witnessed uptake of the digital medium as a partial substitute for physical sales and distribution channels. Comparison websites for loans, credit cards and insurance products are replacing middlemen for digital adopters and the young demographic. This presents interesting possibilities for using technology to supplement the human channel, as well as to train agents on a real-time basis and keep an eye on them from a risk management perspective. Hopefully, this area will see fast innovation in technologies, including the use of artificial intelligence or multilingual apps that can empower organisations to deal with a large number of agents/brokers/correspondents, thereby providing a consistent experience to consumers and minimising the risks of mis-selling and misrepresentation.

4. New and future technology will drastically reduce the cost of delivery infrastructure.

Increasing complexity of customer needs, financial products and customer protection regulations is adding significant cost overheads to distribution networks as people need to be upskilled, technologies need to be upgraded and business models, refined. Innovations like open API, SaaS, open source code, cloud computing, distributed ledgers, crowdsourced identity systems, and hardware like mobile PoS and tablets all hold great promise for reducing costs and infusing greater flexibility into operating models to scale efficiently and rapidly. The 'pay as you go' business model innovation in SaaS, for example, allows providers smaller initial investments, with flexible scaling as needs evolve. Further, it is less demanding on IT resources, easier to administer and easier to access from a wider range of devices and locations. Open APIs allow providers to grow volumes from existing customers and attract new customers without friction, thus permitting customers to adapt and utilise banking services in the manner they prefer.

Crowdsourced and open source technologies can drastically cut the costs of development, modification and upgradation. Internet businesses like search engines and browsers have already seen their share of open source solutions with a large market share. Global examples of open source developers in financial services include Allevo, a Romanian company that has launched an open source core banking transaction processing software, and OpenGamma, a UK start-up that has launched an open source risk analytics platform for financial institutions.[3] The latest evolution in transaction processing technology comes from bitcoin and its blockchain. The distributed ledger accounting system of the cryptocurrency network can form the backbone of future transaction processing networks, eliminating the need for central counterparties, concentration risks and intermediary fees.

On the financial inclusion front, mobile-led technologies are advancing rapidly in the wake of increasing telecom and smartphone penetration. Mobile-based customer interface and sales platforms and alternative connective technologies like NFC, ultrasound, and Bluetooth are enabling providers to create specific use cases for customers.

Analytics adds the next layer of innovation. Big data technologies, machine learning and artificial intelligence are beginning to be deployed globally with increasing frequency, in order to understand customers in greater depth and optimise distribution formats and networks. For example, wealth management stands to be disrupted by the rise of 'robo-advisors' or autonomous AI-based mobile applications that automate the process of investment and portfolio management for the mass affluent segment, largely eliminating the need for relationship managers and branch infrastructure.

Thus, the confluence of software and hardware innovations, flexible IT operating models, mobile, internet and alternative connective technologies, and analytics is likely to fundamentally alter the financial services distribution paradigm.

Demand-side trends: The empowered customer

1. **Mobile as a channel of delivery breaks barriers of geography and physical presence.**

   The mobile phone has now become the primary channel and point of contact with the consumer. While one could begin to worry about the future of mobiles as wearables or other technologies disrupting this communication channel, in the Indian context, it is safe to assume that the mobile is here to stay as a delivery channel for the foreseeable future. The anticipated use of the mobile as a channel is primarily driven by changes in consumer behaviour and preferences, shaped by developments of the last decade in telecom and the consumption of entertainment and commerce over ubiquitous mobile phones. However, again, given the size and diversity of India, the mobile phone has greater relevance owing to the sheer extent to which it acts as a substitute for lack of physical connectivity. The other advantage of the mobile is the ability for consumers to become 'known' even when they do not have formal literacy, documents or other collateral. As formal financial services suppliers struggle to balance regulatory compliance on transaction monitoring with scale and expansion, consumers' constant connectivity and willingness to engage on their mobile phones will help break traditional barriers of geography and physical connectivity.

2. **The app-happy consumer is used to simple design and direct communication and can learn as they transact.**

   One of the primary barriers to inclusion has been the lack of trust in financial products. While this may result from episodes of market disruption for the included, for the excluded, the sheer complexity of the communication and product is the prime culprit. Grasping the details of a basic loan, investment products or credit cards requires a fair amount of financial sophistication—for instance, understanding commission structures and charges for pre-payment. The problem of complexity is often compounded by hidden fees and back-end charges that hamper adoption.

   However, with digital becoming the increasingly popular media for sales initiation, simplicity in products and transparency in charges are expected to become a commonplace consumer expectation. In their other facets of life, consumers, particularly those using mobile phones, are responding enthusiastically to the app-based delivery of services, intuitively learning and responding to simplicity of design and communication by accepting the alternatives that work and rejecting many that do not. As the potential of this learning behaviour becomes obvious to providers, financial literacy is expected to improve consistently as consumers transact, borrow or invest.

   Many global fintech providers have differentiated themselves from large institutions through promises of transparency and great consumer experience. Financial institutions, particularly the new digital entrants, will have the opportunity to build upon similar solutions within the regulated framework, even as traditional players look to enhance their digital capabilities to match up. Tech entrants in payments and financial services are already introducing intuitive and simple product features like one-click payments, or one-tick check boxes for travel insurance products, that are becoming popular with consumers. This trend will gather greater momentum with the proliferation of smartphones and increase in data usage.

3. E-commerce and use of social media are rewriting the rules of engagement for consumers.

In India, e-commerce has increasingly become a defining force of customer experience. Consumers are quickly getting used to being pampered by e-commerce players as well as other service providers who are using digital technologies to enhance and differentiate themselves largely on the basis of customer experience. Customers are beginning to expect similar differentiation in the delivery of financial services. Of the Internet users in India, 56% use WhatsApp every day, 51% use Facebook and an additional 28% use Facebook Messenger every day.[4] Combined with the market potential of Twitter, Snapchat and Instagram, which are becoming increasingly popular in India, social media is clearly emerging as a popular channel for the instant dissemination of information for most financial products.

The power of social media as a channel for customer acquisition is undeniable in India, and large banks and financial institutions are successfully experimenting with platforms for social media payments, game-based insurance applications, and interactive wealth management and investment apps for the middle-class digitally savvy population. With 'click-bait' advertisements, social media channels have the ability to catch a target audience's interest, create awareness and lead to conversion.

Social media also has tremendous power as a forum for the instantaneous redressal of customer grievances. The viral nature of the platform allows any unattended complaint to cause severe damage to the brand. Innovative solutions aggregating customer feedback and grievances across websites like Facebook, Twitter, LinkedIn and Snapchat help service providers remain on top of customer service and revolutionise the after-sales customer experience.

While all this is truly exciting, the underlying consumer behaviour that requires attention is the shift in the way trust structures and society work. Normal, non-commercial people are opening their doors to complete strangers to come and stay with them through websites like CouchSurfing or Airbnb. Further, anyone can double up as a taxi driver, restauranteur, or dance or yoga instructor without going through the traditional brick-and-mortar institution that provided space and authorisation for such bringing together of suppliers and buyers of services. It is possible that, buoyed by the information at their command and their ability to penalise service providers for malpractices by simply calling them out on social media (the more instant equivalent of the traditional withdrawal of licenses after interminable regulatory and judicial processes), new consumers are willing to experiment. For financial services distribution, this should be good news. However, the supreme reality of intermediation between savers and investors is a matter of systemic risk .Eventually regulation will call for careful picking and choosing from many of these fashionable trends. Crowdfunding and bitcoins are good examples of the complexity of these market opportunities and the regulatory concerns that need to be balanced.

Snapshot of distribution of financial services in India

2. Snapshot of distribution of financial services in India

In post-independent India, development of banks, capital markets and insurance has taken place via nationalisation and large-scale policy interventions. The timing, pattern and intensity of these interventions have varied across the different sub-sectors within financial services. For example, insurance was nationalised in 1956 and 1963, banks in 1969, and mutual funds emerged with the creation of UTI in 1963 and the entry of PSU funds in 1987. The competitive landscape within these sectors is also varied. LIC and UTI emerged as monoliths in their sectors, while in banking, 26 public sector banks emerged with SBI and its associates occupying prime positions. The financial inclusion agenda focussed on credit delivery, making banks predominant players in creating and growing distribution networks.

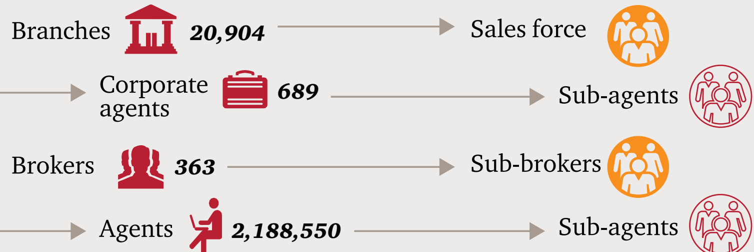
Liberalisation of the Indian economy in the 1990s opened the doors for private sector participation. Banking and capital markets were opened up in 1993, but the opening of insurance took another six years till the creation of the IRDA. New regulators came into being for securities, insurance and commodities markets to regulate anti-competitive and monopolistic practices, and each has taken upon the task of regulating their sectors in right earnest, building upon some of the best global practices and learning. Customer protection, suitability and appropriateness, grievance redressal norms for all market segments thus developed in parallel or at different times and focussed on risks in their respective segments. While the regulatory framework was built around products, the market was building itself around customers, trying to cater to their needs and spanning across asset classes. This was particularly pronounced during the 90s as the new consumer was the archetypal salaried middle class with predictable life cycle requirements of salary, savings, investment, loan, mortgage, insurance, pension in order to afford future housing needs, consumption, education or retirement.

Current distribution architecture for financial services may not be optimal.

The above mentioned developments and the entry of global financial services giants in India (within the somewhat restrictive or conditional rules of FDIs: sectoral caps, rules for capitalisation and downstream investments) resulted in a distribution architecture for financial services. This has not only served the needs of the consumer but also limited the penetration of financial services to relatively small numbers. In quantitative terms, banks, insurance companies and mutual funds operate over 140,000 offices and work through nearly three million agents. The predominance of banks in the Indian financial system is not reflected in their share of sourcing new financial services businesses other than savings and credit, thus reflecting the limitations of the cross-selling model across the product classes. Just about 9.43%[5] of new premiums for life insurers are sourced through banks, and bank-sponsored mutual funds account for about 17% of AUM.[6] Prima facie, there is scope for leveraging the existing outreach of banks and improving cross selling, leading to reduction in costs and increase in customer choice.

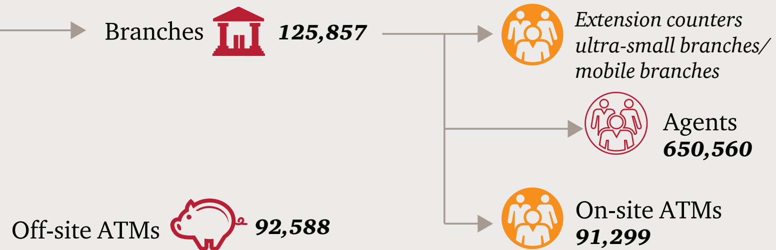
Financial institutions | Distribution channel

Insurance



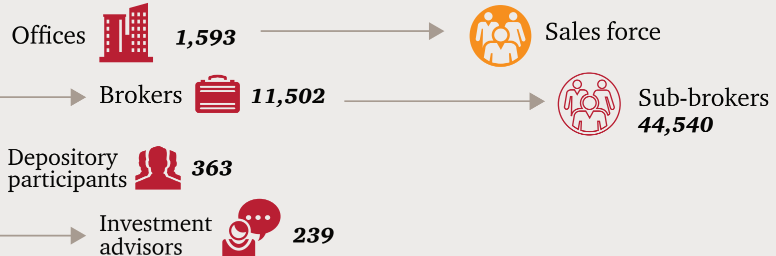
9.43% of all new premium business sourced from banks

Banks



16.8% of MF AUM with bank-sponsored MFs

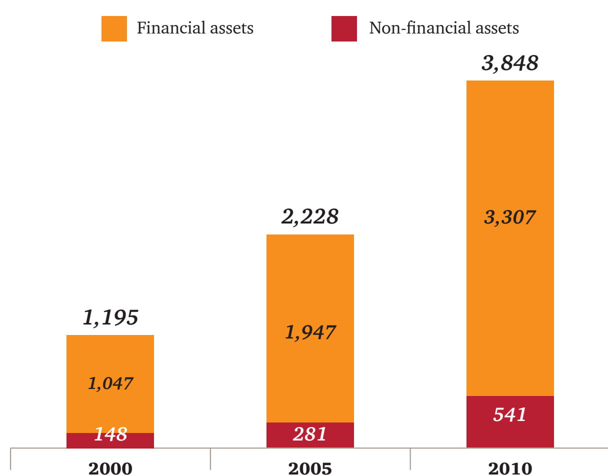
Mutual funds and stock exchanges



Snapshot of the current distribution networks of key financial services providers in India[7]

Preference for non-financial assets remains sticky.

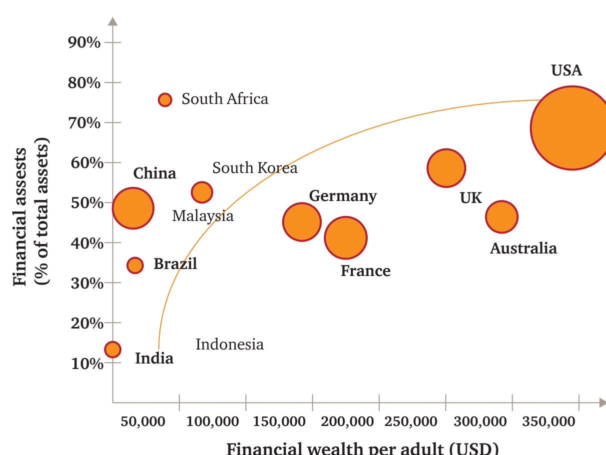
The good news is that India continues to remain an economy with high savings rate, with gross domestic saving being amongst the highest in the world at 29% of the GDP (2014).[8] The bad news is that the savings through financial investments in India is one of the lowest. The worse news is that preference for non-financial assets is sticky and has not changed over the years despite growth in the size of gross assets of households. A survey on 'How households save and invest' estimated that only 24.5 million households who constitute about 11% of total households invest at all.[9] A large portion of household savings are allocated to physical assets like property and gold, and the share of financial savings has largely remained constant over time. Even within financial assets, the preference for liquid bank deposits dominates investment decisions of Indian households, with mutual fund, insurance and pension penetration still in single digits.



Growth of household assets in India[10]

Achieving better asset allocation will present large opportunities.

Contrast India's saving and investment with how the world saves and manages its assets. India fares poorly not only when compared to developed markets but also when compared to China, Brazil or South Africa. For Brazil and China, the ratio of financial assets to total assets of households is between 40%-55%, while for developed nations this can vary between 40%-70%. Assuming that India aspires to emulate the US growth path, there is a need to grow the share of financial assets more than five times. India, like Indonesia, seems to face structural barriers to distribution and asset diversification. Significantly, low penetration of financial assets in India may stem from the unique combination of historical, developmental and demographic reasons, but it is clear that this presents large opportunities for markets and government. As India grows and develops, the share of household wealth allocated to financial assets can be expected to increase.

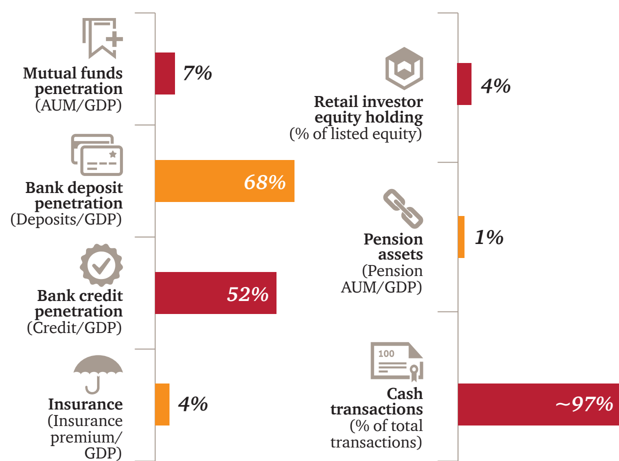


Financial assets share of wealth and financial wealth per adult across key economies[11]

Consumers will benefit from choice and diversification of asset class.

Compositional changes in the allocation of financial assets are almost a necessity for India. With the Indian economy persistently facing funding gaps in critical sectors, the additional influx of domestic sources of capital into markets will be a necessary prerequisite for sustainable and equitable growth. After analysing comparative global economies, it can be seen that economic growth involves an increasing allocation of household financial wealth to market instruments other than bank deposits. In advanced economies, the share of market investments is nearly 60% of all household financial assets. Contrast this with India where bank deposits currently account for 70% of all financial investments. It is clear that a major shift in household investment choices is needed to calibrate financial markets with India's future growth path.

For consumers, this shift should be good news as it increases choices and presents opportunities for diversification as well as optimising returns. In the risk-reward trade off, bank deposits stand at the extreme end of the spectrum despite being low on return post tax and post inflation basis, owing to the minimal risk due to deposit insurance.

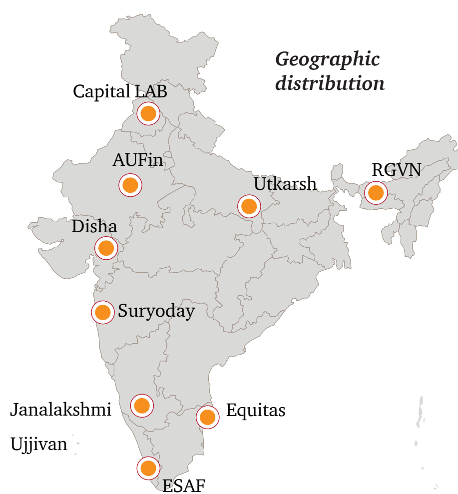


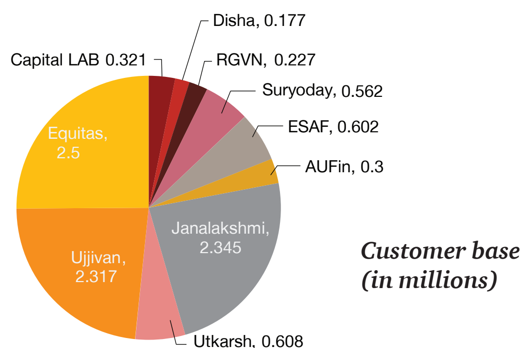
Penetration of financial services in India[12]

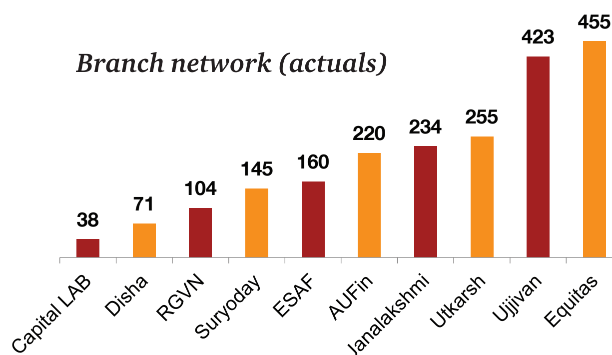
New institutions should provide choices; distribution will be pivotal

In 'A hundred small steps: Report of the Committee on Financial Sector Reforms' (2008), the committee proposed a departure from the credit-led inclusion approach to a broad-based access to payment services, savings, insurance products and inflation protected pensions. The committee envisioned the creation of specialised banks, a liberal bank licensing regime, easing regulations on the use of business correspondents and creating a liquid secondary market for PSL assets. More recently, the Nachiket Mor Committee Report established ubiquitous and sufficient access to payments, savings, credit and investment products as its core vision. To achieve this, the Mor Committee Report proposed the creation of a co-opetitive environment in which providers are focussed on their competitive strengths while leveraging partnerships and shared infrastructure to provide comprehensive services to their customers. The committee was built on the recommendations of 'A hundred small steps' by proposing twin differentiation–the creation of small finance banks and a new specialised banking entity that will focus only on payments and savings, i.e. payment banks.

The licensing of 11 payments banks and 10 small finance banks in July and August 2015 respectively is the culmination of the Mor Committee's recommendations on promoting differentiation, co-opetition and ubiquitous access. This will release a large number of distribution touchpoints across the country. The small finance bank licensees, for example, are geographically distributed evenly across the country and have a cumulative customer base of 9.8 million serviced through 2,501 branches.

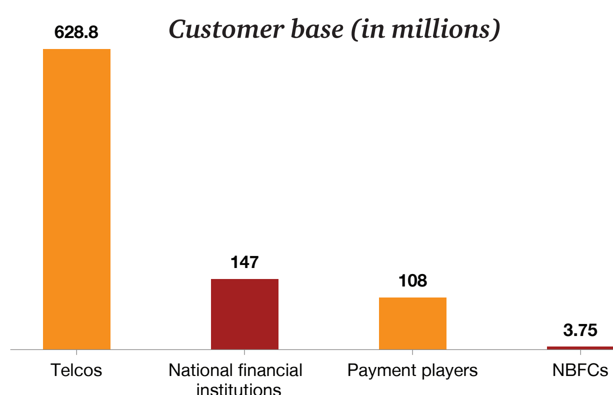


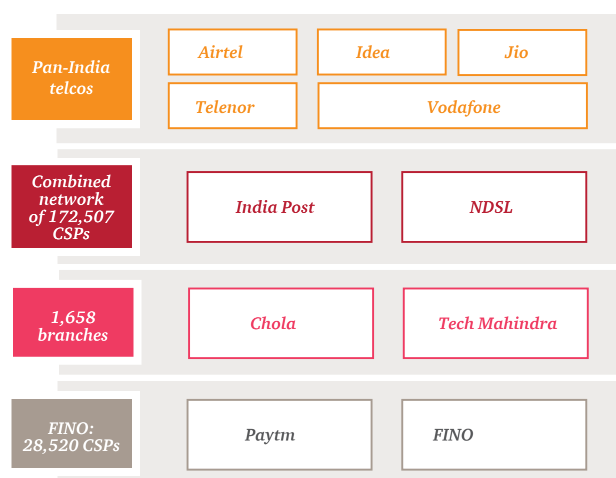




Geographic outreach, customer base and branch networks of small finance bank licensees[13]

Payments bank licensees have even greater national presence and outreach. The four telecom networks alone have 628 million customers, which is greater than the banked population in the country. Post Bank's network of 154,882 offices is greater than the entire extant bank branch network. In terms of digital outreach, Paytm claims to have 100 million transacting users on its marketplace and wallet, which is a larger customer base than most of the largest banks.





Payment bank licensees' customer base and outreach[14]

Increase in the number of players and distribution points will solve some issues while some may still remain.

1. Financial awareness and trust

While public sector banks enjoy widespread trust, particularly amongst rural populations, majority of Indians remain wary or are unaware of investment products and insurance. The new payments and small finance banks are established players in their markets and enjoy widespread brand recognition and levels of trust. It can be hoped that they are able to leverage this and extend it to their banking businesses as well while building upon partnerships with existing institutions to bring about gradual change in customer outlook, perception and uptake. In a pessimistic scenario, any disruption may create further damage to the trust and therefore innovation and aggression will need to match wits with prudence and sensitivity to the nature of this new consumer.

The proliferation of mass media and recent memory of high profile cases of fraud, mis-selling and money laundering in the financial services will pose key challenges to the market.

2. Low viability of agent networks

Poor incentive structures and asymmetries in the principal agent model have rendered bank agents financially unviable. A 2013 study by CGAP called 'National Survey of Branchless Banking Agents in India' reports only 24% of BCs as satisfied with their level of remuneration. The study also provides evidence to support the theory that the primary reasons for becoming a BC is still social rather than pecuniary. Cross selling remains low for business correspondents with account opening and G2C services generating the largest volume of sales and transactions. Investment products are virtually absent and insurance sales are declining. The study concludes that the viability of bank agent networks in India was a pressing issue and that prolonged usage of the BC channel was unlikely to promote financial inclusion substantially. It will be important for new banks to find models and incentive structures that adequately remunerate agents and complement inherent social motivations

to become a bank agent, thereby increasing the pool of potential bank agents substantially. Licensees also have the added advantage of large existing distribution networks, for which the banking business will add another layer of complexity and costs, but also potential revenues. It will also be key to retention and productivity in the likely scenario of a war for distribution between existing and new banks.

Low viability of agents drives attrition in financial services networks, which is the highest in comparable large industries, at over 70% for insurance and about 34% for banks. Agent replacement and retraining costs, combined with disruptions in customer service, are a major challenge to moulding a sustainable agent network. Promoters of new banks come from industries operating largely through agents and have greater experience of acquiring, managing and incentivising agents to remain with their principals. Leveraging lessons from across successful consumer facing industries will be key to bottom line optimisation.

3. Infrastructure and connectivity

The quality and reliability of physical and digital infrastructure, transport, communication and utilities services in India has been a key impediment to experimenting on distribution formats. According to the Global Competitiveness Report 2014-2015 by the World Economic Forum, India ranked 87 out of over 140 countries on quality of infrastructure in 2015. New banks will have to contend with disruption from power outages, inaccessibility to the Internet and poor physical connectivity.

4. Tax incentives and disincentives

A large part of the battle against physical assets has to be fought through fiscal measures. India's preference for gold is cultural to a large extent and provides savers the smartest and most liquid alternative at a micro level. However, the data provides good reason to believe that high gold consumption is not all cultural but also related to the utility of gold as a lucrative way to legitimise undisclosed wealth. Similarly, while preferences for real estate is part rational and cultural, arising out of demographic shifts, nuclear families, and its ability to protect and grow savings and create revenue streams, real estate is also a major store-value for unaccounted wealth. These issues will remain beyond the control of the markets and policy solutions will be needed to address them and provide tailwinds to rational allocation of assets, increasing consumer choice, and growth of the market.

Addressing operating challenges

and paving the way forward

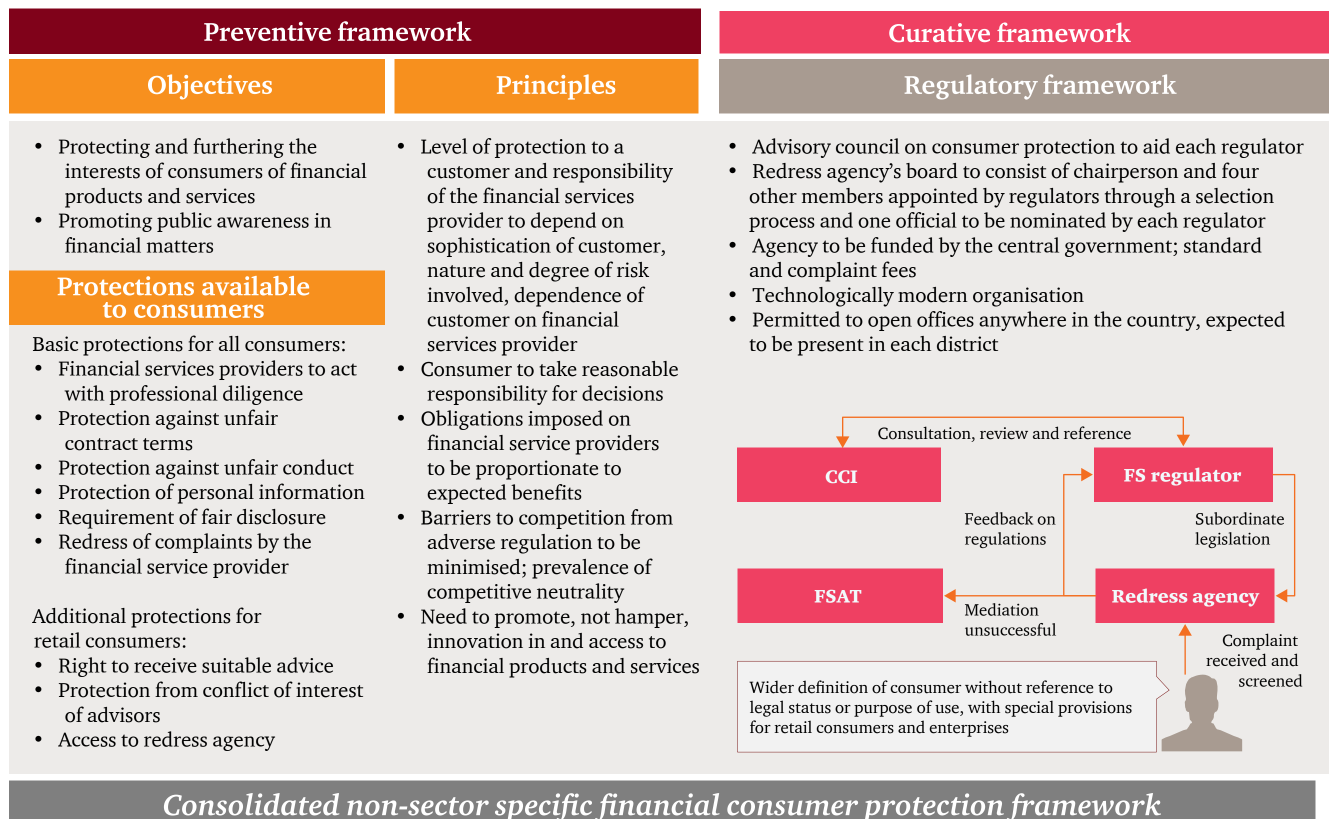
3. *Addressing operating challenges and paving the way forward*

With market developments discussed in this report, we believe that the distribution architecture will change, and with it, the macro picture on asset allocation and consumer choice will also change. There is likely to be a two-way causality here as both factors influence each other and create momentum. Global examples included in this report point to the way forward for India's financial services. However, we have to bear in mind that Indian distribution architecture, with low legacy issues, may also leapfrog and innovate ways to reach out to hitherto excluded segments of the market, and we may see uniquely Indian distribution innovations in times to come.

This process will be supported by the convergence of policy preference for diverse asset classes, regulatory activism driving inclusion from all regulators, and also some proactive or reactive measures to address issues that have persisted in the Indian financial markets. A discussion of some of these trends is outlined below:

1. **Uniform customer protection framework**

   The parallel development of a product centric customer protection framework has been a major regulatory barrier to cross leverage financial networks and create a unified distribution platform. This has been the case despite regulators' views on customer protection being largely in sync. The FSLRC report, released in April 2013, envisaged an overhaul of the existing legal and regulatory architecture for financial services in the country. The report proposed a sector neutral, principle-based approach to consumer protection, emphasising fundamental guarantees to consumers, such as protection against unfair contracts, unfair conduct, data privacy and fair disclosure. Providers were required to exercise professional diligence and an FRA was proposed to resolve consumer complaints. Interestingly, the report identified the consumers' right to receive suitable advice and providers' obligation to ensure 'suitability' of financial products. The increased burden of compliance and disclosure on providers was to be in proportion to the envisaged benefits to consumers, and competition and innovation concerns were to be balanced against incremental consumer protection measures.



While the draft IFC is yet to be implemented, the Ministry of Finance and financial sector regulators have pressed ahead with implementing their non-legislative recommendations. A slew of regulatory measures targeted at enhancing consumer protection, improving disclosure, transparency and incentives of distribution networks and liberalising operating models have ensued.

Following the Mor Committee Report, RBI notified a consumer code of rights, reemphasising the primacy of 'suitability' and 'appropriateness' to be adopted by banks. BC regulations and branch banking guidelines were liberalised to permit greater operational flexibility to banks. In the wake of a high profile case of fraud and mis-selling, a set of draft guidelines on wealth management and distribution of third-party products was notified, which proposed tough checks on banks' permitted distribution models and products. SEBI recently announced a comprehensive regulatory framework for investment advisors and through the industry body and SRO-AMFI, discouraged aggressive incentive structures for mutual fund distributors. Similarly, IRDA and PFRDA have tightened the framework for corporate agents, brokers and distributors.

Changes to the consumer protection framework are not restricted to the financial services sector alone. In the light of the growing role of e-commerce and electronic distribution and marketing, a draft Consumer Protection Bill, 2015, has been introduced in the parliament. The Bill envisages establishing clear rules governing mediation and settlement of disputes, liability sharing and obligations of parties transacting over digital networks.

India is gradually moving towards a unified customer protection framework (across regulators and legislators) built on the principles of sector neutrality, appropriateness and reasonable distribution of responsibilities between providers and customers. However, the presence of a large unbanked population and unsophisticated users implies that the weight of obligations on providers will be much higher than in a developed economy.

2. Use of technology for identification, authentication and tracking to reduce friction

Among various rigidities that impede the uptake of financial services, lack of adequate documentation and data for identification and authentication is perhaps the stickiest of challenges.

The new ecosystem will see this friction being reduced with market players leveraging various tools including eKYC using Aadhaar and Digital India initiatives, such as digital lockers and e-signatures that are API-enabled. Data available through multiple independent proofs is currently housed by different institutions which do not connect with each other for data sharing. Securities markets have already moved to the common KYC framework, and current regulatory focus is on creating this as a pan-market database for KYC documentation. This will eliminate unnecessary duplication of documents, paperwork and effort in establishing the identity of an individual or an entity. Policy initiatives like eKYC and Digital India can facilitate electronic sharing of KYC information for verification, paving the way for common KYC databases.

Using digital risk management frameworks make providing financial services faster, cheaper and more efficient. With digital records of insurance history, credit history and cash flow history, the providers and their channels can determine which product is suitable for the customer. Selling will then become more targeted, which will make it easier to close a sale.

3. Clarity on regulatory frameworks for digital channels and innovation in distribution

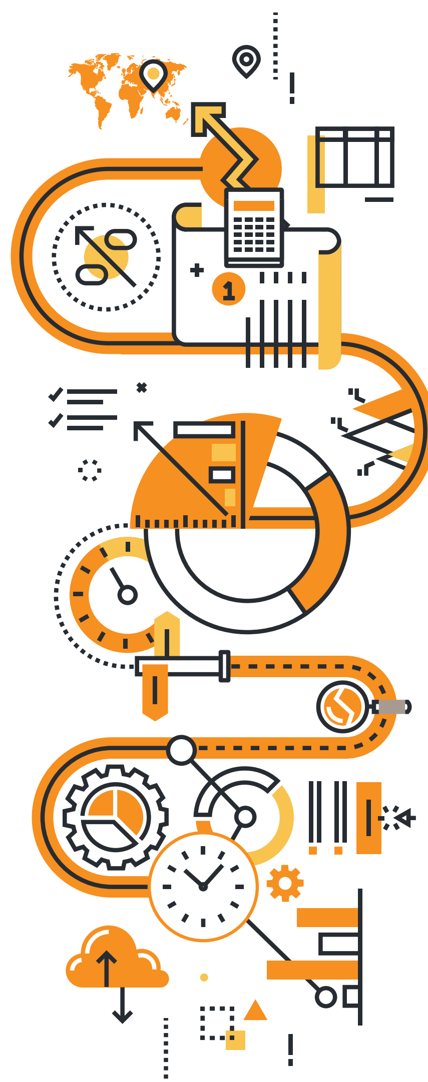
The digital marketplace model of distribution, first widely seen in e-commerce, is rapidly spreading to other businesses, including the financial services. Customers can now compare, review and buy insurance policies, subscribe to mutual funds, and apply for credit cards and loans on a variety of websites. Financial services providers are also increasingly sourcing customers through digital channels—ICICI reported that 38% of its

incremental retail term deposits were sourced via digital channels;[15] HDFC reported that 63%[16] of customer transactions were initiated online; while Citibank reported that 40% of its customer base actively used mobile channels and 50% actively used Internet banking.[17]

Regulators acknowledge the benefits from digital channels to customers via increased transparency and availability of information, essentially acting as a powerful customer protection and awareness tool. Digital is also a powerful market force driving providers to enhance and innovate on their customer protection frameworks—in the age of social media, price comparison, review websites and digital marketing, the exponential spread of information on digital networks will be a major driver of brand value for financial services providers—something other retail segments like FMCG and e-commerce learned early on in their digital transformation. Compliance and disclosure requirements are also better addressed on digital platforms, and do away with much of the cost associated with a physical network and paper trail.

Internet-based businesses continue to be regarded with a certain amount of scepticism and caution by policymakers across the world despite the attendant benefits, because while benefits come early, risks hit late, and hard. The regulation of marketplaces and digital distribution channels has, therefore, been a work in progress in most parts of the world. In India too, regulators have issued concept papers or guidelines, but much of this requires greater clarity as well as integration between different regulators. As the market unifies customer experience, it is important that regulators close in on the siloed product-based regulation. For example, IRDA notified rules for web aggregators in 2013 and upgraded them in 2015—the rules cap the volume of permissible business through the aggregator, place significant training requirements on staff, impose minimum capital requirements, and restrict the use of outsourcing and contract employees. In 2014, SEBI issued a consultation paper on digital crowdfunding platforms in which it proposed limiting the hosting of new marketplaces to accredited entities with SEBI—like depositories and stock exchanges—a move that elicited much criticism from industry. As RBI has not issued rules governing the activities of loan marketplaces, ambiguities continue to plague such innovation and the memory of MFI's experience with state moneylending guidelines looms large. Guidelines for banks on Internet banking, mobile banking, ATMs and WLAs limit the extent of services and additional revenue streams these channels could potentially leverage. These channels may, for example, only exhibit ads of the parent bank, precluding an essential characteristic of a marketplace.

Given that India has already brought in proactive payments regulation and licence payments banks, it is hoped that a similar response to digital aggregation and distribution will also emerge, sooner rather than later.



The way forward: Policy tailwinds and global best practices to drive market innovation and expansion

As Indian financial services enter this exciting phase of building for the future, they may do well to learn from innovative solutions playing out across the world. Globally, in order to increase usage of payments, savings, credit and insurance, several technology-based solutions have achieved early success in reaching underserved consumers with successful products.

1. Alipay: Small businesses and low-income households as key drivers

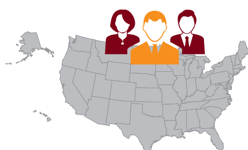
India's underpenetrated market for formal financial services is comparable with China in the early 2000s, where SMEs and individuals were primarily using informal finance. With economic growth, spread of mobile and Internet usage, and innovative saving solutions for households and small businesses, adoption of digital financial products such as payments, savings, mutual funds and loans increased significantly in the last two decades.

Case study 1

Alipay captured the imagination of the Chinese customers and small enterprises through its platform for digital payments, savings and credit.

- Alibaba launched this platform in 2004
- Empowered Chinese SMEs in the global and domestic market
- Alipay's saving instrument tapped into the savings culture in China

300-320 million registered users in China **+ 17 million** overseas in the first 10 years **=** Population of the **United States of America**



Alipay has the **largest market share** of digital payments in China **~ 50%**

520 billion USD transactions, which is greater than the combined volume of transactions at **eBay and Amazon.**

Market and ecosystem conditions	The banking sector in China has been driven by state-owned banks. The People's Bank of China is the largest bank in China and also operates as their treasury. Policy and regulatory constructs did not favour small businesses and households. Despite that, the economic boom in China in the 1980s-2000s created a vibrant SME sector. Customer protection laws in China were weak and, hence, the formal financial institutions did not provide products targeted at small businesses and households. One prominent exception to the Chinese growth story was the famous liquidity crunch faced by Chinese banks in 2013. Liquidity crisis in the Chinese economy created an opportunity for shadow banks. The Chinese were a saving society, where credit cards could not make much headway. There was a tendency to not buy something if there was no money for it. Since they usually used hard-earned savings for their purchases and transactions, they were generally distrustful of delivery channels and products that they could not touch and feel. Additionally, they wanted returns out of all their transactions.
What Alipay did differently	Alipay already had critical mass in terms of ecommerce customers who used the wallet for paying on Alibaba, TaoBao and T-Mall. These customers already had money on their wallets for payments, bill processing and phone expenses besides their e-retail. Alipay's true innovation in terms of channel utilisation was to take the idle, non interest earning wallet money and invest it. They created Yu'e Bao, which was a money market fund. Using the aggregated sum and investing it when banks needed money allowed them to offer greater interest rates vis-à-vis traditional instruments.

2. DirectAsia: Multi-channel and direct selling to reduce cost

With the diverse customer segments that Indian financial services providers cater to, using a multi-channel approach becomes imperative, but middlemen inevitably increase the cost of delivery of services. An example to observe is DirectAsia, one of Singapore's leading insurance providers, who removed middlemen and, instead, employed effective use of multi-channels. DirectAsia reduced prices, made underwriting quick and let their customers customise their insurance. This was achieved by deploying the direct-to-consumer model and deployment over multiple channels (online, call centres and physical offices).

Case study 2

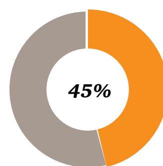
DirectAsia, an insurance company, used direct-to-consumer strategy that was deployed across multiple channels to shake up the market.

- DirectAsia was launched in 2010 to deal with vehicle and travel insurance
- Lowered insurance pricing by removing the middleman
- Used multiple channels such as online, call centre and physical office

75,000 customers served since its inception

~ **98%** customer satisfaction score vs 71% industry average

Using



25-45% saving for consumer due to direct selling model

17,000 claims fulfilled thanks to highly trained staff enabling payouts in a week

Market and ecosystem conditions	The insurance industry relied on the tried and tested model of using agents for distribution of products. This not only increased the cost of insurance products but also made the claims process very cumbersome. The products were usually generic as customer feedback wasn't reaching the insurance company due to the extra layer of the agent being present.
What DirectAsia did differently	DirectAsia reduced prices, made claims easy and empowered customers to pick and choose certain aspects of insurance. This was achieved by deploying the direct-to-consumer model over multiple channels (online, call centre and physical office), training employees and making customer service a priority.

3. EasyPaisa: Bundling for successful relationship-building with consumers

It will be very interesting for providers to look towards globally successful practices of bundling financial products with high-utility non-financial goods. Bundling of insurance products with telecom or remittance services has succeeded in developing countries in Latin America, Africa and Asia. EasyPaisa in Pakistan is one such success story.

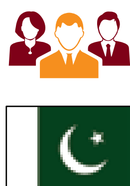
Case study 3

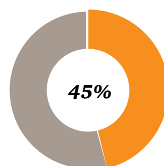
EasyPaisa, Telenor partnered with Tameer Microfinance Bank to become the largest branchless banking service in Pakistan.

- EasyPaisa was launched in 2009 to cater to all telecom customers and not just Telenor customers
- Offered convenience in the form of branchless banking and differentiated accounts with an option to pay for more
- Offered additional financial services that piggybacked on remittances and recharges

13 million
customers served since its inception

~ 60k outlets
across the country





45% customers
are opting for other financial services and health insurance

113 million money transfers totalling **3 billion USD** in 2014

Market and ecosystem conditions	The Pakistani population is vast, and in rural areas of the country, deploying traditional bank infrastructure was not appropriate due to the expense and lack of access to physical branches. 88% of the Pakistani population does not have access to financial services. In 2010 there were only 16 million bank accounts for a population totalling 180 million (CGAP, 2010).
What EasyPaisa did differently	The careful selection and deployment of agents enable market capture. EasyPaisa also used the piggyback strategy to deploy insurance initially at its own cost, which caught on, and now, close to 45% of the customers use financial services other than the main product, which used to be recharges and remittances.

4. Jumo: Big Data is the big story

The future of financial services sector in India will be defined by data analysis. Big Data mining is now being used for generation of political data, macro-economic predictions and social indicators. African service providers like Jumo have used innovative data analytics to offer financial solutions.

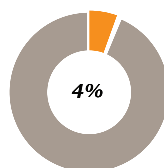
Case study 4

JUMO used other sources of data and created a market for micro loans leveraging on technology.

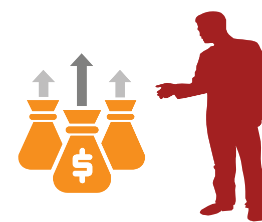
- Partnered with telecom players to offer borrowing and saving opportunities
- Uses a proprietary algorithm that has over 40k variables to pick best loan candidates
- Offered a digital ecosystem for payments and used agents for cash in and cash out

11 million active mobile wallets since its inception

~ **1 million/month** run rate of loans



Non-performing loans ratio due to technology



5 million loans disbursed so far with an average value of 200 USD

Market and ecosystem conditions	In Africa, due to its vast area, the market incumbents had a major challenge in providing infrastructure. This meant that mostly the urban customers were banked and had access to financial services. Even presently, formal banking penetration is extremely low and mobile wallets are the prevalent way of depositing and transferring money.
What JUMO did differently	JUMO partnered with telecom players to bring savings and credit products to consumers using a proprietary algorithm with 40k variables. JUMO used a mobile wallet technology but created a digital ecosystem with the help of agents to enable payments and create value for digital money.

Abbreviations

AMFI	Association of Mutual Funds of India
API	Application programme interface
ATMs	Automated teller machines
Aug	August
AUM	Assets under management
BCs	Business correspondents
CCI	Competition Commission of India
CGAP	The Consultative Group to Assist the Poor
CII	Confederation of Indian Industry
CRS	Certified residential specialist
CSP	Customer service point
eKYC	Electronic Know Your Customer
FATCA	Foreign Account Tax Compliance Act
FDI	Foreign direct investment
FMCG	Fast-moving consumer goods
FRA	Financial Redress Agency
FS regulator	Financial service regulator
FSAT	Financial Sector Appellate Tribunal
FSLRC	Financial Sector Legislative Reforms Commission
G2C	Government-to-customer
GDP	Gross domestic product
HNIs	High net worth individuals
IFC	International Finance Corporation
INR	Indian national rupee
IRDA	Insurance Regulatory and Development Authority
IT	Information technology
KYC	Know Your Customer
LIC	Life Insurance Corporation of India
MF	Mutual funds
MFI	Micro Finance Institution
mn	Million
NBFC	Non-banking financial company
NFC	Near field communication
p.a.	Per annum
PFRDA	Pension Fund Regulatory and Development Authority
PoS	Point of sale
PPIs	Prepaid payment instruments
PSL	Priority sector lending
PSU	Public sector unit
RBI	Reserve Bank of India
RRBs	Regional rural banks
SaaS	Software as a Service
SEBI	Securities and Exchange Board of India
SME	Small and medium enterprises
SRO	Self-regulatory organisation
UK	The United Kingdom
USA	The United States Of America
UTI	Unit Trust of India
WLA	White Label ATMs

Endnotes

[1] *As of 2014. data for banks, FIs and NBFCs extracted from DBIE, RBI. Data for mutual funds taken from Statistical Handbook, SEBI and AMFI. Data for insurance and pension AUM from the annual reports of IRDA and PFRDA respectively.*

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