

Indian Financials

An On-ground Guide to Financial inclusion

6 December 2013

BSE Sensex: 20997

There has been a substantial increase in rural focus for banks over the last few years, which has coincided with a rapid rise in the reach and acceptance of the business correspondent channel. Business correspondents (BC) act as gateways for the banks and, in turn, authorize local entrepreneurs in rural areas to act as financial service agents for the banks. This increased reach, coupled with improved technology and a variable cost model, has emerged as a viable path to financial inclusion. We recently visited five such financial inclusion outlets in two states and representing two business correspondent networks – Sahaj e Village (Sahaj) in Uttar Pradesh and Vakrangee Softwares (Vakrangee) in Maharashtra. Four of these were rural and one urban. Our focus on these visits was to understand and experience the proximity of these rural locations offer to larger towns, products offered at these centers, ease of transaction and access for customers as well as customer acquisition, and education initiatives being taken in some of these locations. Key takeaways are as below:

Business correspondent model gaining acceptance in rural areas: Key reasons are – a) improvement in technology, especially usage of biometric identification, b) better internet connectivity (more predictable transaction times), c) last mile reach (greater ease of access), d) local presence (increasing trust), and e) direct transfer of benefits to bank accounts (rising awareness and acceptance).

Transactional intensity and spread are still low; likely to increase: While awareness has been created, transactional intensity is yet to pick substantially – in terms of services utilized (primarily savings deposits) as well as the frequency of usage (once-a-month benefit withdrawals). Availability and acceptance of more products (term deposits and credit products) will be the key to sustain and increase volumes and profitability.

Business model still evolving, but is viable and getting profitable: There are various business models being tried. We believe that correspondent outlets offering bundled services (financial, consumer and government) attract greater footfalls and therefore have maximum potential. Standalone profitability for banking services is still elusive for most outlets, but bundling of services supports their overall profitability and lends greater diversification. For increasing profitability, banks will be seeking greater cross-sell and deepening usage of banking channels, while scalability and execution will be the key drivers for business correspondents and village entrepreneurs.

There are pitfalls and challenges as well: Some well-known challenges are small ticket size and ensuring low-cost delivery mechanisms. There are some practical problems like clout of money lenders, insufficient documentary proof for income and identification, unpredictable internet connectivity and mismatched fingerprints. Some quirky issues also exist – customers are habituated to passbooks and have discomfort with technological advances; also, there is mistrust of large institutions.

A basic savings deposit account smart card



A POS machine at a financial inclusion outlet



Source: Sahaj, IDFC Securities Research

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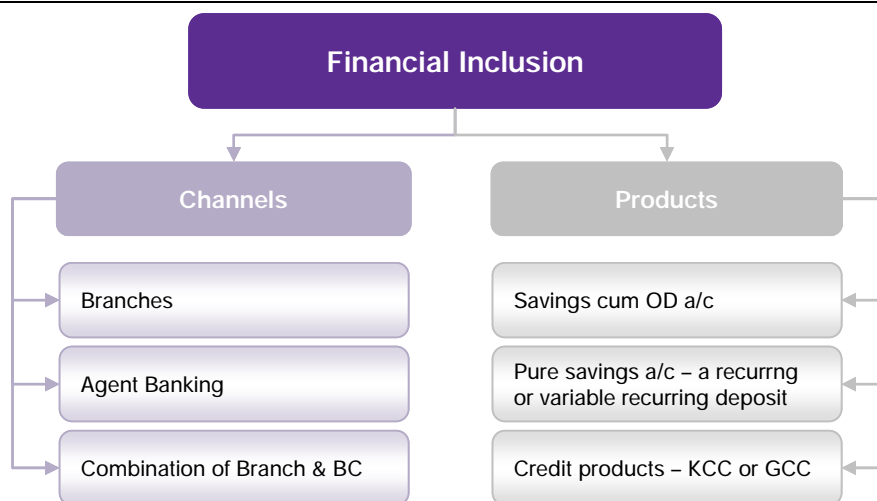
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Financial inclusion in India: An Overview

Financial inclusion has been gaining importance over the past couple of years at the behest of the RBI and the government. The RBI encourages banks to adopt the ACTA model for financial inclusion, as below:

- A – Accounts, i.e. focus on account acquisition
- C – Cash-in and cash-out, i.e. allowing cash-based transactions to ensure “last-mile” delivery
- T – Transactions, i.e. encourage and facilitate transactions such as deposit/ withdrawal/ transfers
- A – Adjacencies, i.e. build a supporting revenue stream for banks through other products

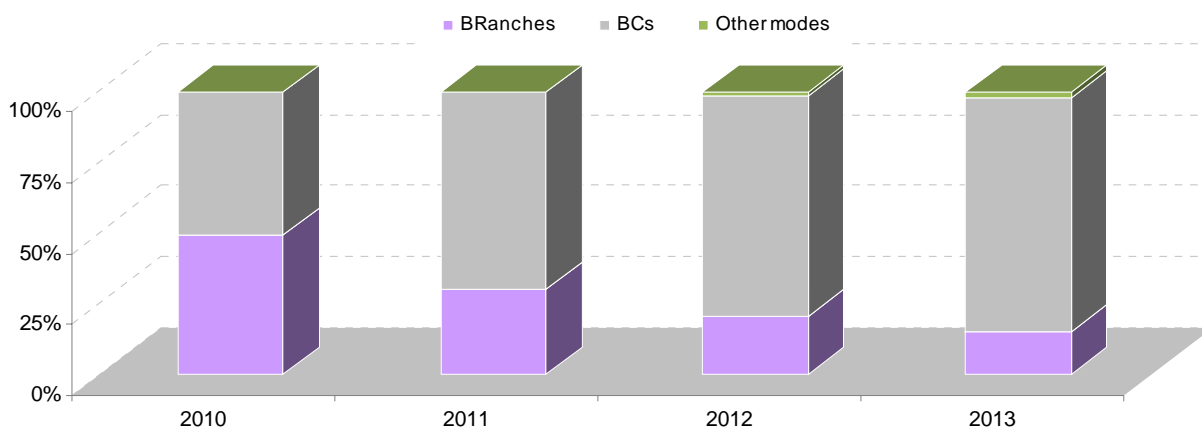
Exhibit 1: Financial inclusion – delivery and products



Source: RBI, IDFC Securities Research

Since FY10, the number of banking outlets in villages (through all channels) has grown to ~2,70,000 (CAGR of 58% over FY10-13). A majority of this addition has come from the BC model.

Exhibit 2: Modes of delivery under the Financial Inclusion Plan

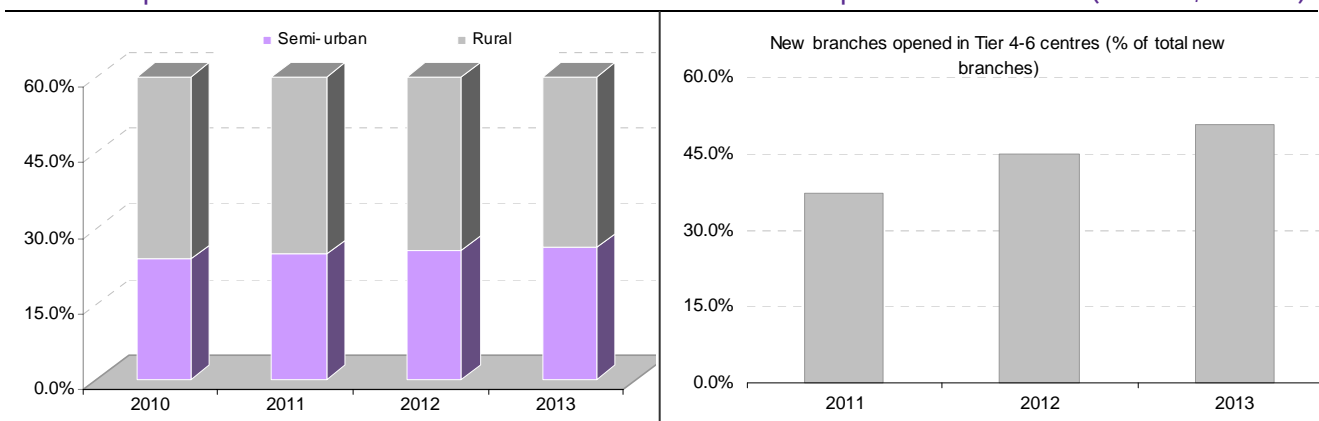


Source: RBI, IDFC Securities Research

Rural branches

In Jul-11, the RBI mandated that rural centres should account for at least 25% of branches opened in a year. The proportion of semi-urban and rural branches increased to 62.6% in FY13 from 60.5% in FY10. The proportion of branches opened in tier 4 to tier 6 centres increased to ~51% in FY13 from 37.3% in FY11.

Exhibit 3: Proportion of semi-urban and rural branches



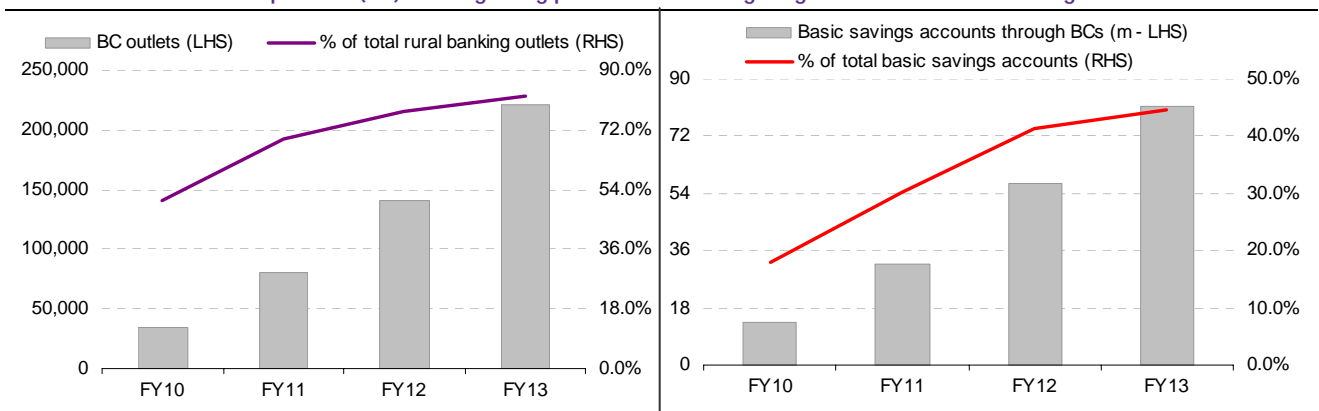
Source: RBI, IDFC Securities Research

The RBI also relaxed KYC norms for financial inclusion accounts in 2005. This was further facilitated by e-KYC services based on Aadhar. In phase I, 74000 villages with a population of more than 2000 were chosen for financial inclusion. Phase II focuses on 4,90,000 villages with a population of less than 2000. These are expected to be brought under the financial services ambit by Mar-16.

The Business Correspondent Channel: A Key Catalyst

The business correspondent channel was put in place by the RBI in 2006 to extend banking services in ‘un-banked’ and ‘under-banked’ (RBI terminology) areas. In 2010, the apex bank allowed ‘for profit’ organizations to operate the BC model, which led to a sharp increase in the number of new accounts. Business correspondents account for ~82% of rural banking outlets and ~45% of financial inclusion accounts (Basic Savings Bank Deposit Accounts) as of March 2013. In the three years since 2010, the number of business correspondents has registered a CAGR of 86%. This has increased banking penetration and density in rural segments and imparted significant ‘network’ benefits for this channel. The number of savings accounts opened through business correspondents has increased from 13.3m in FY10 to 81.3m in FY13 (82.9% CAGR), which account for ~63% of financial inclusion accounts added in the period.

Exhibit 4: Business correspondent (BC) model gaining prominence with higher growth in outlets and savings accounts

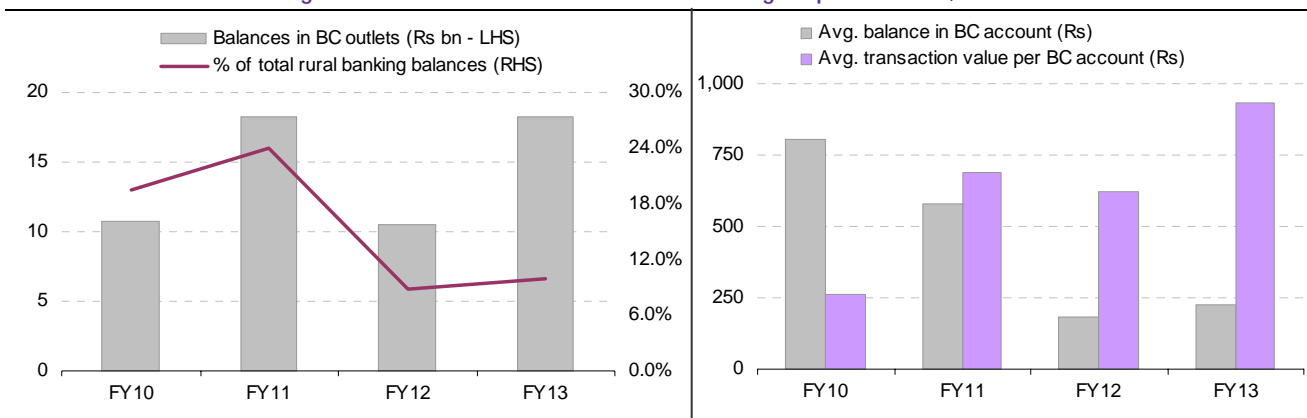


Source: RBI IDFC Securities Research

The outstanding savings deposit balance in BC accounts was Rs18bn as of FY13 with an average balance per account of ~Rs225. The average balance has decreased from ~Rs800 as of March 2010 due to the sharp increase in the number of accounts since then. More recently, however, the average balance has started stabilizing. The average number of savings accounts per BC also appears to have stabilized at 360-400. Despite the fall in the average account balance, transactions in the model have witnessed a significant rise – growing almost tenfold from ~27m in FY10 to ~251m. The average value per transaction has also grown by ~4x from Rs260 in FY10 to Rs934 in FY13 and is still rising.

Exhibit 5: Growth in BC savings account balances

Average deposit balance, transaction value for BC accounts

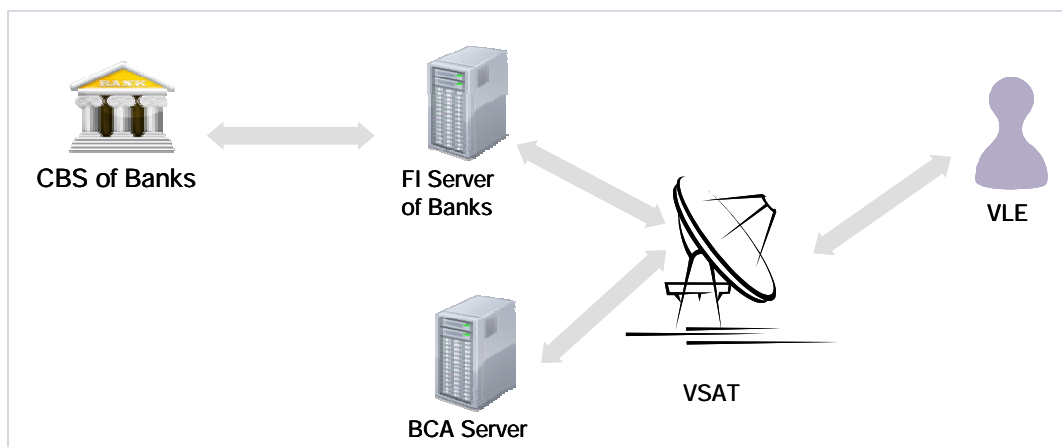


Source: RBI, IDFC Securities Research

□ The business model

A bank authorizes a BC agent to set up and operate its financial inclusion accounts. The agent sets up customer service points, which are run by Village Level Entrepreneurs (VLEs). The VLEs are franchisees of the agent. The customer service points can be stationary or mobile depending on the individual VLE's operating model. Transactions are carried through point-of-sale machines owned by the BC and are biometrically verified (usually through fingerprint scanning). The bank offers both fixed and variable fees for transactions. The fixed fee is usually paid for new accounts while transactions like deposits, withdrawals and transfers get a variable fee. The fees are usually split between the BC and the VLE (various arrangements are in practice).

Exhibit 6: Business correspondent model – a snapshot



Source: Banks, IDFC Securities Research

Financial Inclusion: An On-Ground Experience

We recently visited a few financial inclusion outlets operating under the business correspondent model for a first-hand experience of products offered, proximity of rural locations to larger towns, account acquisition methods and overall customer experience. We visited five outlets (four rural and one urban) across two states (Uttar Pradesh and Maharashtra) and two business correspondent players (Sahaj and Vakrangee). The Sahaj outlets that we visited were located in 1) Sultanpur, Bakshi ka Talaab; 2) Thana Chowk, Itaunja; and 3) Sitapur Road, Lucknow, in Uttar Pradesh. The Vakrangee outlets were located in 1) Khadki, Pune; and 2) Bhor in Maharashtra.

Summary takeaways and observations from our visits:

- A) Initial focus of all players in the system is new accounts, which would help increase banking density (defined in terms of population per office) and penetration – a key RBI motive – and revenues.
- B) Strategic focus of all banks is liabilities, i.e. increasing savings deposit balances.
- C) Lending at the financial inclusion service centres remains challenging with banks and customers lacking confidence in business correspondents' ability to undertake the activity.
- D) Business correspondents (BCs) focus on transaction value than account balance as banks pay them in proportion to the transaction value.
- E) Direct Benefit Transfer, which involves linking bank accounts to UIDs (unique identification issued by the central government), is likely to be an important source of transaction revenue for the banking industry. Food subsidies (FY14 budget at ~Rs900bn) which are likely to be brought under the direct benefit transfer scheme over the next 2 years. With the implementation of the Food Security Bill, direct benefits could rise Rs1.3trn.
- F) Some financial inclusion service centres also offer third-party financial products, including life insurance and non-life insurance products. However, insurance penetration is currently quite low.
- G) The rural service centres' USP is convenience and ease of access, which help significantly reduce travel time and cost of customers.
- H) Some urban service centres have "decongestion of existing branches" as their main objective. Banks have been transferring their low-value but transaction-intensive accounts to these centres.
- I) The average transaction size is small. Most people are still testing the technology as well as the correspondent in many cases. Transaction values are expected to start increasing as confidence gradually increases.
- J) Some centres offer government service portals, telecom recharges, utility bill payments and other consumer products to supplement banking services with a view to increasing footfalls.
- K) Poor internet connectivity and power supply disruptions have been causing inconvenience in some areas.
- L) Most customers are quite comfortable with the biometric verification system.

□ **Outlet 1 – Sultanpur (Sahaj)**


<p>Location</p>	<ul style="list-style-type: none"> • Sultanpur is a village ~28km north of Lucknow city 	 <p>Sahaj franchisee outlet at Sultanpur, Lucknow district, Uttar Pradesh</p>
<p>Demographics</p>	<ul style="list-style-type: none"> • Sultanpur has a population of 2,266 and a sex ratio of 889 (2011 census) 	
<p>Outlet description</p>	<ul style="list-style-type: none"> • The centre is a small 70-80sq ft roadside shop with a signboard indicating banking products of Central Bank of India and signage of the business correspondent. • The nearest Central Bank of India branch is ~8km away. • There are no private banks in the area. The VLE operating the centre is Mr. Ram Singh. 	
<p>Services offered</p>	<ul style="list-style-type: none"> • Government services: Land records, birth and death certificates, income certificates, caste certificates and domicile information. • Business services and products: DTH and mobile recharges, railway reservations and solar lamps. • Financial services: Savings deposit accounts of Central Bank of India (deposit and withdrawal) and life insurance products. 	

Exhibit 7: Outlet setup at Sultanpur, Lucknow district, Uttar Pradesh



Source: Sahaj, IDFC Securities Research

Our observations at the outlet

Government services

- ♦ Uttar Pradesh is among just a few state governments in India having online portals for some basic, high-frequency activities. The portal offers many services, but only a few are operational given the considerable time taken to process many types of requests.
- ♦ Online issuance of land ownership certificates, cast certificates and income certificates account for most of the services. Mr. Singh indicated that he gets 5-7 such requests daily.
- ♦ Requests for government services tend to be seasonal or periodic. For example, requests for income certificates usually spike during school admission time (driven by applications for income-based scholarships). Requests for land records increase during sowing (for payment of various agricultural subsidies, etc).
- ♦ Customers usually pay Rs30-50 per certificate issued by the state government. Certificates are delivered 3-5 days after placing an online request.


Financial services

- ♦ Mr. Ram Singh started the operations about 18 months ago and has managed to garner about 900 savings bank accounts since then.
- ♦ He estimates that half the people of the village have bank accounts.
- ♦ He has an overdraft limit of Rs10,000, which is secured against the initial deposit paid to the business correspondent. He visits the nearest Central Bank of India branch to settle accounts 2-3 times a week.
- ♦ We counted 4-5 customers at the centre seeking deposit or withdrawal transactions in ~1.5 hours. The average transaction size is Rs100-500. We saw life insurance policies (ING Life Insurance and Bajaj Allianz Life) being offered. Mr. Singh said he sells 3-5 policies a month with a cover of Rs10,000-50,000.

Business services

- ♦ Mobile phone and DTH recharges are the most frequent transactions in the B2C category. Mr. Singh also sells solar lamps offered by Sahaj at a price of Rs200 per lamp.
- ♦ The centre also offers railway reservation services through Sahaj (www.ezeego1.com), though the lack of a stable internet connection is a big challenge.

❑ **Outlet 2 – Thana Chowk, Itaunja, Lucknow (Sahaj)**

Location	<ul style="list-style-type: none"> • Itaunja is a town, ~30km from Lucknow. • The outlet is on a state highway, which provides it better access and visibility than outlet 1 	 <p>Sahaj franchisee outlet at Thana Chowk, Itaunja, Uttar Pradesh</p>
Demographics	<ul style="list-style-type: none"> • The population of the town is ~7,000. 	
Outlet description	<ul style="list-style-type: none"> • The centre is housed in a small 60-80sq ft shop on the ground floor of a two-storey shopping complex. • It is operated by Mr. Sudhir Awasthi, a Sahaj franchisee since 2009. The outlet was busier than the Sultanpur one (outlet 1). • It had five PCs with internet connectivity and cubicles like in a cyber café for each computer. 	
Services offered	<ul style="list-style-type: none"> • Government services: Land records, birth and death certificates, income certificates, caste certificates, domicile information and exam results. • Business services and products: E-commerce, DTH and mobile recharges and railway reservations. • Financial services: Savings deposit accounts of Central Bank of India (deposit and withdrawal) and life & non-life insurance products. • E-learning and courses for computer fundamentals and language skills among others. 	

Our observations at the outlet

- ♦ The flow of G2C and B2C transactions is largely similar to that of the Sultanpur one.
- ♦ Mr. Awasthi also sells 10-15 two-wheeler insurance policies every month. He has a soft tie-up with a vehicle dealer across the road.
- ♦ On the education services front, Mr. Awasthi focuses on modules developed by Sahaj. This is his largest revenue source and also a stable one. He has 40 enrollments for the popular 3-month computer fundamentals course. Students receive a certificate from Sahaj on completion of the course.
- ♦ Fee for the course (Rs1,650) is shared equally by Sahaj and the VLE. Mr. Awasthi informed us that he gets ~10 new enrollments every month, mostly through word-of-mouth publicity.


Exhibit 8: Outlet 2 setup at Itaunja, Lucknow

Service charges at outlet 2



Source: Sahaj, IDFC Securities Research

❑ **Outlet 3 – Sitapur Road, Lucknow (Sahaj)**

Location	<ul style="list-style-type: none"> The outlet is situated on the outskirts of Lucknow on State Highway 24 leading to Sitapur district. 	 <p>Sahaj franchisee outlet at Sitapur road, Lucknow district, Uttar Pradesh</p>
Demographics	<ul style="list-style-type: none"> Lucknow is the capital of Uttar Pradesh Population as per 2011 census is 4.8m with a sex ratio of 871 	
Outlet description	<ul style="list-style-type: none"> The outlet is operated by the VLE. Ms Neha Yadav started this outlet about a month and a half ago. At 100-110sq ft, the outlet is larger than those in Sultanpur and Ituanja. It has a set-up similar to the Ituanja centre (five PCs with internet connectivity). 	
Services offered	<ul style="list-style-type: none"> Government services: Land records, birth and death certificates, income certificates, caste certificates, domicile information and exam results. Business services and products: DTH and mobile recharges and railway reservations. Financial services: Pension for widows and senior citizens. Skill development: The centre offers a fundamental computer course, and advanced ones in networking and software programming. 	

Our observations at the outlet

- ♦ Business activity is slow as the centre is new.
- ♦ Ms Yadav is focusing on computer courses, especially for women. She has just 4-5 students on the rolls but indicated that enrollments are picking up.
- ♦ She informed us that pension payments are an important service and that the number of requests has started increasing.

Exhibit 9: Snapshot of various courses offered at Outlet 3 (Sitapur Road, Lucknow)



Source: Sahaj, IDFC Securities Research

□ Outlet 4 – An Ultra Small Branch of Bank of Maharashtra, Khadki, Pune (Vakrangee)

Location	<ul style="list-style-type: none"> • Khadki is a city neighborhood and cantonment area of Pune, Maharashtra
Demographics	<ul style="list-style-type: none"> • Pune is the second largest city in state of Maharashtra (8th largest in India) • It has a population of ~5m (2011 census) with a sex ratio of 915
Outlet description	<ul style="list-style-type: none"> • The outlet, measuring 30-40sq ft and situated on the ground floor • It is part of the 'decongestion' model of Bank of Maharashtra. • A parent branch is situated directly above on the first floor.
Services offered	<ul style="list-style-type: none"> • Pension services: The outlet is primarily a pension disbursement counter for the parent branch; the bank has transferred its pension accounts to the outlet for this purpose.

Our observations at the outlet

- ♦ The centre handles an average monthly pension transaction value of Rs25m-30m. We saw a long queue of pensioners spilling outside the branch.
- ♦ The outlet started operations only about two months ago.
- ♦ Transactions are updated real time on the bank's core banking platform (unlike at the rural outlets discussed here).
- ♦ While the branch could also do other deposit account-related transactions, we observed only pensioners waiting to withdraw money from their accounts.
- ♦ The average size per transaction is Rs5,000-6,000, higher than that of the rural centres.

□ Outlet 5 – An Ultra Small Branch of Bank of Maharashtra, Bhor, Pune (Vakrangee)

Location	<ul style="list-style-type: none"> • This outlet is located in a village ~18km south of Bhor, • Bhor is a municipal town with a population of ~18,000. Bhor is located ~55km South-West of Pune.
Demographics	<ul style="list-style-type: none"> • Bhor has a population of ~18,000 and a sex ratio of 975. • The village in which the outlet is located has a population of ~3,000. • The average income level of the village is estimated to be ~Rs4,000 per month.
Outlet description	<ul style="list-style-type: none"> • The 2-month-old outlet is housed in a small 60-80sq ft shop situated at the centre of the village. • It is operated by Mr. Zede. • The parent branch of Bank of Maharashtra is situated ~18km away in Bhor.
Services offered	<ul style="list-style-type: none"> • Government services: UID (Aadhar) card enrolment and electricity bill payments. • Banking services: The centre offers basic savings accounts and pension accounts besides facilitating loan applications to the nearest branch of Bank of Maharashtra. • Other financial services: Life insurance products.

Our observations at the outlet

- ♦ Mr. Zede has two assistants, who are paid ~Rs3,000 per month.
- ♦ He has garnered ~500 savings deposit accounts since the centre opened two months ago. The total transaction value for the period is ~Rs200,000.
- ♦ The outlet recently also started offering term deposits (currently, aggregate value is Rs200,000). These are mainly proceeds from sale of land by locals.
- ♦ He also facilitates loan applications by customers to the Bank of Maharashtra branch – mostly for agriculture loans (rice, sugarcane), from the nearest branch.
- ♦ He estimates average savings deposit balances from his customers at Rs500-600 currently.
- ♦ We observed a large number of school children visiting the outlet for UID application.
- ♦ We also spotted a few daily wage earners who had come to deposit part of their income (Rs50-100 per day) into their savings accounts.

Financial Viability of the Business Correspondent Model

We have evaluated the financial viability of the BC model at each link of the value chain – the bank, the agent and the VLE. We have taken Bank of Baroda (BOB) and the Sahaj model (India's largest service centre agency) for our analysis. We believe each of them needs to be profitable in the medium term for the business model to sustain and expand. We have also estimated the overall profit/ loss of the model for the industry.

Exhibit 10: Snapshots of savings account data for banking industry and Bank of Baroda

Period of evaluation	Bank of Baroda FY14 (annualized)	Banking industry FY13
Financial inclusion accounts through Business Correspondents (m)	1.6	81.3
Balances in financial inclusion savings accounts (Rs m)	4,000	18,220
Transaction value (Rs m)	4,040	233,880
Number of transactions (m)	5.1	250.5

Source: IDFC Securities Research

Key assumptions

- Revenues are based on funds available for lending as well as investments after considering appropriate reserve requirements (CRR and SLR).
- We assume funds available for lending are utilized at the base rate of the bank.
- We have not taken into account other businesses, including third-party product distribution.
- Operating costs are largely recurring save some initial outlay for connectivity and infrastructure.
- The commission paid per new account is Rs100.
- The commission paid per transaction is 2% of transaction value.

1. Banking players – profits are work in progress

We have created a sample profitability model for BOB, one of the pioneers of the financial inclusion model in India, as well as the entire banking industry.

Exhibit 11: Profitability analysis – bank vs. industry

(Rs m)	Bank of Baroda FY14 (annualised)	Banking Industry FY13
Average Savings Deposits Balances for BC accounts	4,000	18,220
CRR (%)	4	4
SLR (%)	23	23
Available loanable funds	2,920	13,301
Base rate (%)	10.25	10.25
SLR yield (%)	8.00	8.00
Interest income on loans	299	1,363
Interest income on SLR	74	335
Cost of deposits (%)	4	4
Interest expense	160	729
Net interest income	213	970
Operating expenses	341	9075
of which: Account opening	160	2,397
Transaction	81	4,678
IT cost - initial	100	2,000
Economic profit/ (loss)	(128)	(8,105)

Source: IDFC Securities Research

Key conclusions:

- There is a small economic loss in each of the cases on current costs, excluding initial IT/ infrastructure costs. BOB is close to breaking even.
- We expect cost/ income to reduce sharply going ahead due to absence of initial IT costs, stabilization of account opening costs, and decrease in transaction costs due to improvement in technology and connectivity.
- We expect revenues to move up sharply as transaction volumes rise with increasing density of accounts in a particular geography or cluster.
- Revenues from third-party products (e.g., life and non-life insurance) would also increase in the medium term.
- We expect banks to retain focus on the current business model as it is not capital-intensive and costs are largely variable (linked to scale up in transactions)
- With penetration levels increasing, we expect financial inclusion operations will be profitable for banks in the next 12-24 months.

2. Village Level Entrepreneur – benefits hinge on new account openings

Profitability of a VLE is difficult to predict as it depends on various factors and, most importantly, his own initiative. For the purpose of our analysis, we make certain simplifying assumptions to fit a normalized business case – though this is unlikely to fit neatly into any particular VLEs business model. Our assessment assumes a VLE operating in a ‘rural’ setting rather than an ‘urban’ one.

Exhibit 12: Profitability analysis – VLE

Initial capital	
Refundable deposit (Rs)	10,000
Equipment cost (Rs)	5,000
(per month)	
Financial inclusion revenues - VLE share (50%)	
Account opening commission	50
Deposit/ withdrawal commission	1%
No. of deposits/ withdrawals per day	20
Average transaction value (Rs)	250
Transaction revenues (Rs)	1,500
Number of accounts opened	50
Account opening revenues (Rs)	2,500
Total monthly revenues (Rs)	4,000
Costs incurred/ income foregone	
Interest on deposit	128
Rent for premises	1,000
Electricity, connectivity and other costs	1,000
Total expenses	2,128
Economic profit/ (loss) as VLE (per month)	1,872
RoIC (annualized, %)	150%

Source: IDFC Securities Research

Key conclusions

- RoIC is quite high (~150% of capital invested) even after imputing economic/ opportunity costs.
- Profitability levels are currently highly leveraged to new account openings; i.e., profitability would dip sharply if new account openings decelerate.
- Sole dependence on banking services is a challenge. Combined with other services (e.g. G2C and B2C services), it becomes a much more viable and profitable segment of the business.
- We have considered revenues/costs only from banking-related activities. Most VLEs may have supplementary sources of revenues, which may in some cases dwarf revenues of the banking segment.
- Banking is a relatively small business segment for many VLEs, but carries low incremental capital costs and offers a revenue diversification avenue.
- Transaction charges are a very small, but increasing, portion of overall revenues.

3. Business correspondent – scalability and execution challenges

The business correspondent is the gateway between the bank and the VLE. Its revenues depend on selecting the right VLE and providing it technical support. Forecasting the financials and profitability of business correspondents is more challenging as most agents are in rapid expansion mode, revenues are far from stable (and largely variable), and costs are significantly higher due to preponderance of fixed costs (initial and set-up costs). Moreover, a business correspondent, similar to a VLE, could have other sources complementing its financial/ banking revenues. We use an 'idealised model' that focuses on a theoretical standalone financial business correspondent that gets its revenues only from the financial/ banking segment. This model, therefore, carries the risk of understating overall revenues and profitability of the actual business correspondent.

Exhibit 13: Profitability analysis – business correspondent

Profitability analysis – BC agent (50% share)	
Number of outlets	10,000
Account opening commission	50
Deposit/ withdrawal commission	1.00%
Accounts opened per outlet per month	50
Total accounts opened per year	6,000,000
Deposit/ withdrawal/ transfer transactions per BC per day	20
Average value of transaction (Rs)	250
Account opening revenues	
Account opening revenues	300
Transaction revenues	150
Total revenues per year (Rs m)	450
Operating/ imputed costs	
Initial costs per VLE	15,000
Initial capex - total	15
Employee costs	
Employee costs	120
Other operating costs	150
Total operating costs	270
Pre-tax profits	
Pre-tax profits	180
Tax	60
Post-tax profits	120
Net profit margins (%)	26.7

Source: IDFC Securities Research

Key conclusions:

- The profit margins of this segment appear to be high due to low capex requirement.
- Scalability of this model, however, is likely to be limited to the allotted clusters or number of outlets.
- The initial costs – employee and set-up costs – will likely be relatively high for most business correspondents and will have to be recovered as the business gains scale.
- The proportion of account opening revenues would be high in the initial years but gradually give way to transaction revenues.

Appendix (About Sahaj and Vakrangee)

□ Sahaj e-Village (Sahaj)

1. Sahaj is an associate company of SREI Infrastructure Finance (48.3% stake as of Mar-13) and is the largest of the 28 Service Centre Agencies selected by the Government of India for implementation of its National e-Governance Plan.
2. Sahaj has a mandate of setting up 28,006 Common Service Centres (CSCs) in six states, namely Assam, Bihar, Odisha, Tamil Nadu, Uttar Pradesh and West Bengal.
3. These centres offer a host of government services and can also augment their revenues by offering select other business services. In 2012, these agencies were allowed to act as business correspondents to offer banking services and, thereby, increase financial inclusion in the country.

Exhibit 14: List of Service Centre Agencies – outlet implementation against targets

SCA Name	States	Target outlets	Operational
Sahaj	Assam	2,833	2,833
	Bihar	5,565	5,410
	Odisha	3,648	2,421
	UP	1,045	8,063
	Tamilnadu	8,118	1,976
	West Bengal	6,797	6,216
Total		28,006	26,919
CMS Computers	AP, MP, Maharastra, Rajasthan, UP, Gujarat	17,354	16,332
Zoom Developers	Odisha	13,636	9,770
Reliance Communication	Himachal Pradesh, Uttarakhand	7,597	7,597
Vayam Technologies	UP	6,409	6,409
AISECT	Chattisgarh, MP, Punjab	6,000	6,000
Basix	Odisha	4,096	4,200
Spanco	Maharashtra	3,166	3,050
United Telecom	Jharkhand	2,943	2,943
Kerala State IT Mission	Kerala	2,694	2,694
Others		16,917	7,704
Total		108,818	93,618

Source: NeGP, Sahaj, IDFC Securities Research

4. Under this initiative, Sahaj has won the bid for business correspondent operations in five of the 20 banking clusters: 1) Odisha, 2) UP, 3) Bihar, 3) West Bengal, Sikkim, Andaman & Nicobar, 4) Tamil Nadu and 5) Assam.
5. Other key business correspondent agents (BCAs) are FINO (largest BCA with eight clusters) and Vakrangee Softwares (three clusters).

Exhibit 15: Service Center Agencies offering Business Correspondent services

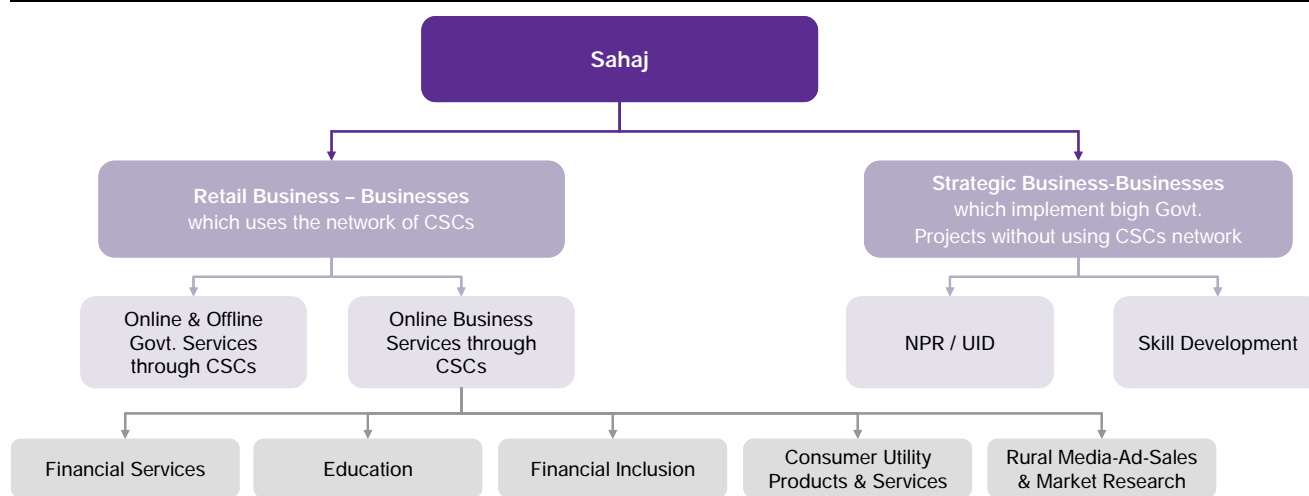
Cluster No.	Clusters	BCA
1	Maharashtra	Vakrangee
2	Bihar and Jharkhand	FINO Paytech
3	Delhi and Rajasthan	Vakrangee
4	Chattisgarh	AISECT
5	Odisha	Sahaj
6	Madhya Pradesh	AISECT
7	Uttar Pradesh - 1	Sahaj
8	Uttar Pradesh - 2	FINO Paytech
9	West Bengal - 1	FINO Paytech
10	West Bengal - 2, Sikkim, Andaman & Nicobar	Sahaj
11	Andhra Pradesh - 1	FINO Paytech
12	Andhra Pradesh - 2	FINO Paytech
13	Bihar - 1	Sahaj
14	Bihar - 2	FINO Paytech
15	Karnataka and Goa	FINO Paytech
16	Punjab, Haryana, Himachal Pradesh, Jammu & Kashmir	Spanco, Reliance Communications
17	North East	Sahaj
18	Uttarakhand	Reliance Communications
19	Tamilnadu, Kerala and Puducherry	FINO Paytech
20	Gujarat, Dadra and Daman	CMS Computers, and Reliance Communications

Source: Sahaj, IDFC Securities Research

Business model

- Sahaj offers the rural consumer a host of products and services through its owned technology network, which also acts as an interface for service providers.
- Sahaj’s services bouquet can be broadly categorized into: a) government services, b) business services (includes banking services), and c) strategic government project implementation.

Exhibit 16: Sahaj services bouquet

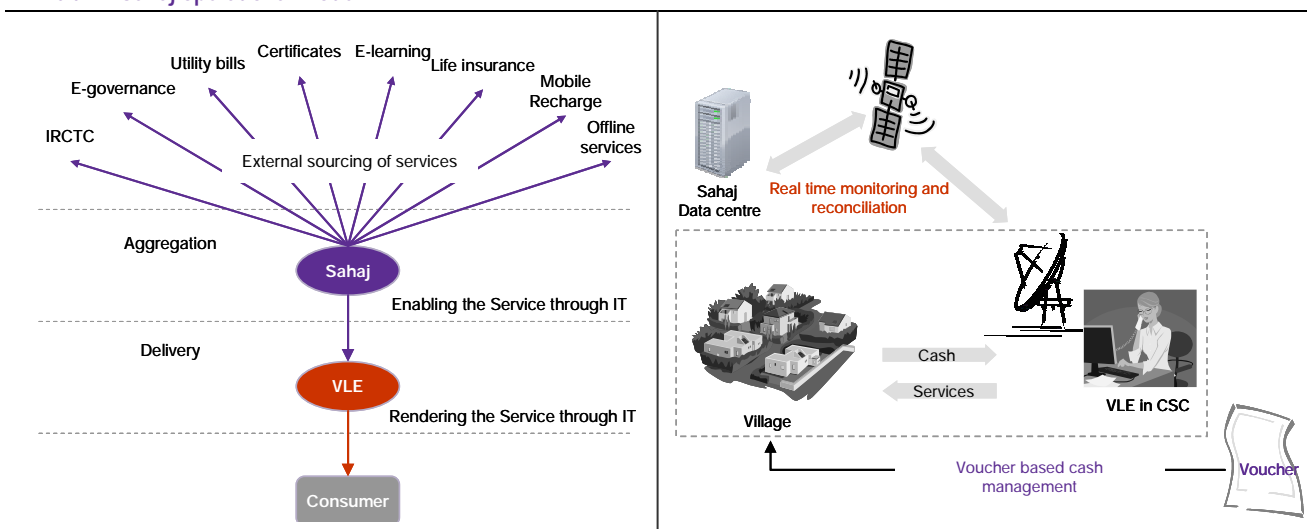


Source: Sahaj, IDFC Securities Research

- For offering banking services, Sahaj has tied up with banks operating in its clusters through the business correspondent model. Sahaj has alliances with State Bank of India, Punjab National Bank and Central Bank of India.

- Sahaj operates through a franchisee model. The franchisees (known as Village Level Entrepreneurs - VLEs) double up as business correspondents for the banks linked with Sahaj. To become a VLE, an initial refundable deposit of Rs10,000 is to be paid to Sahaj. A one-time cost of Rs5,000 needs to be borne by the VLE for devices necessary for the centre's operations.
- All services are offered through a centralized Sahaj portal which is accessed by VLEs for executing and recording transactions.

Exhibit 17: Sahaj operational model



Source: Sahaj, IDFC Securities Research

- For every transaction, Sahaj and the VLE earn a transaction fee from the consumer. For government services, Sahaj and the VLE earn 25% of the transaction fee each with the remaining 50% going to the government. The sharing structure for business services is determined by Sahaj and the service providers.
- Sahaj customer service centres are located across villages. A service point typically has a PC with internet connectivity owned by the VLE.

Vakrangee Softwares

Vakrangee Softwares (Vakrangee) is a service agency implementing financial inclusion through the business correspondent model. Vakrangee is the agency for three clusters, namely Maharashtra, Rajasthan and Delhi. Vakrangee is also a business correspondent offering financial inclusion services in these states for 31 banks, with the mandate to set up 50,000 banking centres over a period of seven years. Vakrangee now has 3,200 outlets in the aforementioned clusters.

Exhibit 18: Vakrangee outlet mix

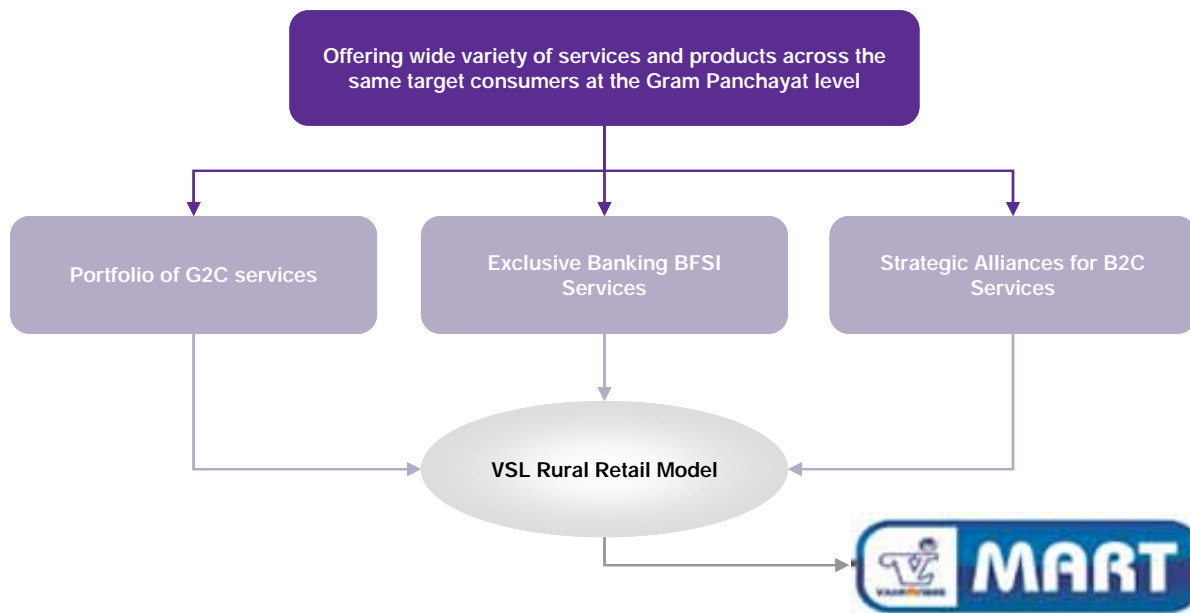
Urban-Rural mix	Statewise break-up	Operational (across states)
Urban – 10,000	Maharashtra – 27,000	3,200
Rural – 40,000	Rajasthan – 9,900	
	Delhi – 1,100	

Source: Vakrangee, IDFC Securities Research

Business model

- Vakrangee aims to offer a variety of services (G2C, B2C and financial inclusion) at the village level through rural retail outlets called VMARTs under an alliance-cum-franchisee model.

Exhibit 19: Vakrangee outlet mix

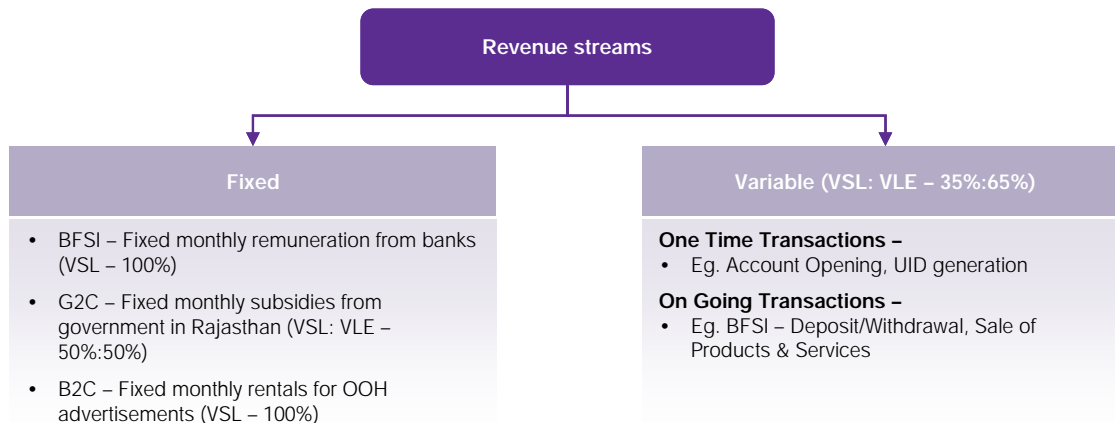


Source: Vakrangee, IDFC Securities Research

- For offering banking and financial inclusion services, Vakrangee has alliances with 31 PSU banks. For business services, Vakrangee has several B2C alliances across categories and entities, including LIC, GIC, Vodafone, Airtel, Tata Motors and Mahindra & Mahindra.
- For delivery of these services, Vakrangee operates on a franchisee model. These franchisees, or VLEs, are also business correspondents for banks tied up with Vakrangee.
- Vakrangee earns a commission for every transaction at its rural outlets. For government services, the subsidy/ fees paid by the government is split equally between VLE and Vakrangee.

5. For business and financial inclusion services, commissions are a combination of fixed and variable remuneration for the VLE and Vakrangee.

Exhibit 20: Vakrangee outlet mix



Source: Vakrangee, IDFC Securities Research

6. The investment in the rural outlet is primarily made by the VLE and stands at ~Rs1,50,000 per outlet. The initial investment by Vakrangee in a new outlet is a minimal ~Rs20,000. All operating costs are borne by the VLE.
7. A rural retail outlet usually takes about three months to set up. The process includes choosing the VLE with a KYC check, training the VLE and setting up the IT infrastructure.

Vakrangee Softwares Ltd Financials

(Unrated)

Income statement

As on 31 March (Rs m)	FY09	FY10	FY11	FY12	FY13
Net sales	2,943	4,275	8,897	13,532	15,472
<i>% growth</i>	31.5	45.3	108.1	52.1	14.3
Operating expenses	2,313	3,610	7,543	11,167	11,948
EBITDA	630	665	1,353	2,365	3,523
<i>% change</i>	(38.0)	5.5	103.5	74.7	49.0
Other income	4	5	6	46	52
Net interest	(32)	(66)	(176)	(558)	(860)
Depreciation	532	420	550	874	1,571
Pre-tax profit	71	316	668	1,029	1,437
Deferred tax	17	33	95	214	97
Current tax	8	48	92	106	296
Profit after tax	46	235	481	709	1,043
Non-recurring items	(469)	(1)	(7)	18	3
Net profit after non-recurring items	(423)	234	474	727	1,046
<i>% change</i>	(182.5)	(155.4)	102.8	53.2	43.9

Key ratios

As on 31 March	FY09	FY10	FY11	FY12	FY13
EBITDA margin (%)	21.4	15.6	15.2	17.5	22.8
EBIT margin (%)	3.4	5.7	9.0	11.0	12.6
PAT margin (%)	1.6	5.5	5.4	5.2	6.7
RoE (%)	1.7	8.3	14.7	18.3	22.3
RoCE (%)	3.1	6.6	16.3	19.5	18.5
Gearing (x)	0.1	0.2	0.4	1.0	1.0

Valuations

As on 31 March	FY09	FY10	FY11	FY12	FY13
Reported EPS (Rs)	(1.0)	0.5	1.0	1.5	2.1
Adj. EPS (Rs)	0.1	0.5	1.0	1.4	2.1
PE (x)	826.1	169.9	87.5	62.7	42.8
Price/ Book (x)	14.2	13.3	11.8	10.6	8.6
EV/ Net sales (x)	13.0	9.5	4.9	3.6	3.2
EV/ EBITDA (x)	60.6	61.0	32.2	20.6	14.1
EV/ CE (x)	11.7	9.8	7.6	5.1	4.3

Balance sheet

As on 31 March (Rs m)	FY09	FY10	FY11	FY12	FY13
Paid-up capital	214	225	237	250	503
Reserves & surplus	2,469	2,777	3,320	3,919	4,636
Total shareholders' equity	2,683	3,002	3,557	4,198	5,167
Total current liabilities	155	974	1,181	1,572	2,334
Total debt	225	686	1,634	4,591	5,419
Deferred tax liabilities	345	461	517	732	830
Other non-current liabilities	-	-	5	70	78
Total liabilities	724	2,120	3,337	6,965	8,661
Total equity & liabilities	3,407	5,123	6,894	11,162	13,828
Net fixed assets	2,658	2,873	2,724	5,516	4,371
Investments	21	21	34	15	23
Total current assets	728	2,146	4,137	5,631	9,432
Deferred tax assets	-	83	0	1	2
Working capital	574	1,172	2,956	4,059	7,098
Total assets	3,407	5,123	6,894	11,162	13,828

Cash flow statement

As on 31 March	FY09	FY10	FY11	FY12	FY13
Pre-tax profit	71	316	668	1,029	1,437
Depreciation	532	420	550	874	1,571
Chg in Working capital	(444)	(594)	(1,657)	(994)	(3,005)
Total tax paid	(8)	(48)	(92)	(106)	(296)
Ext ord. Items & others	(469)	(1)	(2)	83	11
Operating cash Inflow	(318)	92	(533)	886	(282)
Capital expenditure	(291)	(635)	(401)	(3,667)	(426)
Free cash flow (a+b)	(609)	(542)	(934)	(2,781)	(708)
Chg in investments	-	-	(13)	19	(9)
Debt raised/(repaid)	210	461	949	2,956	828
Capital raised/(repaid)	-	11	12	13	252
Misc	-	-	-	29	-
Net chg in cash	(399)	(70)	14	236	364

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