How Agent Banking Changes the Economics of Small Accounts

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One of the primary impediments to providing financial services to the poor through branches and other bank-based delivery channels is the high costs inherent in these traditional banking methods. The amount of money expended by financial service providers to serve a poor customer with a small balance and conducting small transactions is simply too great to make such accounts viable. In addition, when financial service providers do not have branches that are close to the customer, the customer is less likely to use and transact with their service. However, we see the emergence of new delivery models as a way to drastically change the economics of banking the poor. By using retail points as cash merchants (defined here as agent banking), banks, telecom companies, and other providers can offer saving services in a commercially viable way by reducing fixed costs and encouraging customers to use the service more often, thereby providing access to additional revenue sources.

Using confidential cost and revenue estimations provided by three service providers in Africa, one in Asia, and three in Latin America, we have found that agent banking does improve the economics for these institutions compared with branches, especially for high-transaction, low-balance accounts that are common among poor users.[1] Our analysis focuses on four types of agent banking delivery channels:

1. *POS-enabled bank agent* – This is an agent managed by a bank that uses a payment card to identify customers.
2. *Mobile phone-enabled agent* – This is an agent managed by a bank that uses a cell phone to identify customers.
3. *Mobile wallet* – This is an agent that is often managed by a telecom, uses a cell phone to identify customers, and provides store-of-value accounts called mobile wallets that are backed by bank deposits. Customers can use mobile wallets to send, receive, and store electronic monetary value. For this analysis, we consider them a store of value account that provides a useful comparison for a savings account directly provided by a financial institution.
4. *Bank-provided account linked to a mobile wallet* – This is a bank account that is linked to a mobile wallet. The bank does not manage the agent and pays a fee to the telecom for deposits and withdrawals.

The cost and revenue estimation is done on a per account basis for transactional accounts, commitment savings accounts, reverse commitment accounts, and time deposits.[2] It focuses on the costs and revenues incurred by the financial service provider associated with account opening, financial margin, and transactions for low-cost accounts. Our revenue assumptions are based on a view that financial service providers can and should charge for withdrawals and transfers through agent channels. Although some institutions in the sample do not, we contend that this may be counterproductive when reaching new low-income markets where customers have a higher willingness to pay for nearby transaction services and where the financial margin earned on lower-balance accounts will be insufficient to cover the cost of maintaining that account. We envision that clients will transact more with greater proximity to agents.

In our consolidated estimations, institutions charge for withdrawals and transfers, but do not charge any account opening fees, monthly fees, or deposit fees, since these tend to be barriers to uptake among the poor and are generally not used by the institutions included in our sample. We also include a standard corporate overhead and back-office cost per account that remains constant across delivery channels.

We do not consider additional costs incurred by the broader financial system, including additional cash management costs transferred to branches or agents when transactions move outside the branch. We have chosen to ignore these costs because our model focuses on the costs to the account provider. In the case of agents, we assume that the agent receives sufficient commissions to cover the cash handling costs they incur. In addition, in order to maintain our focus on the economics of an account, we do not consider additional benefits such as opportunities for cross-selling, generating client loyalty, and strengthening a provider's brand.
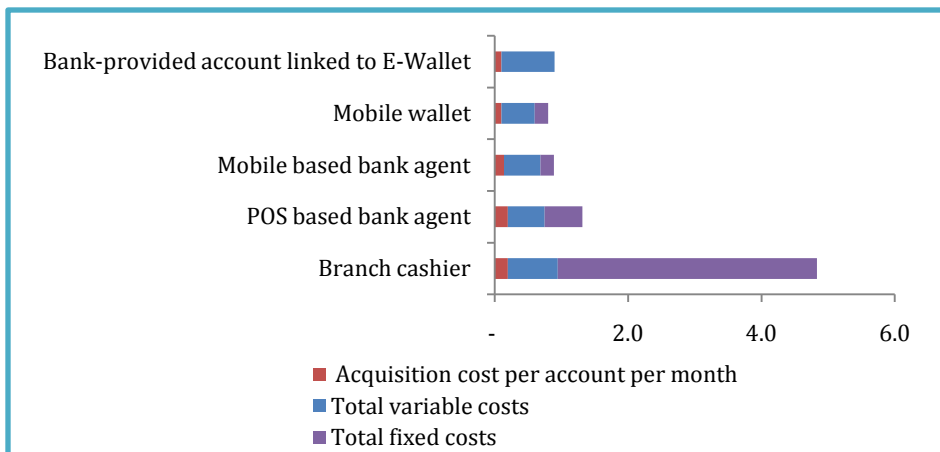
Agent Banking Systems Are Cheaper to Operate Than Branches

We find that agent banking systems are up to three times cheaper to operate than branches for two reasons. First, agent banking minimizes fixed costs by leveraging existing retail outlets and reducing the need for financial service providers to invest in their own infrastructure. Although agent banking incurs higher variable costs from commissions to agents and communications, fixed costs per transaction for branches are significantly higher. According to our analysis and as shown in Figure 1, setting up an agent costs 2 percent to 4 percent of the cost of a branch cashier. So even when functioning at maximum capacity, a branch cashier incurs more than 78 cents in fixed costs per transaction, compared to just 11 cents for a POS-enabled agent and 4 cents or less for a mobile-enabled agent or mobile wallet.

Figure 1. Monthly Costs (US$) Associated With an Illustrative Transactional Savings Account (2 deposits, 2 withdrawals, 1 transfer in agent channels)

Second, acquisition costs are lower for mobile-enabled agents and mobile wallets. By using mobile phones instead of payment cards, mobile wallets and bank accounts linked to a mobile wallet are able to acquire customers at less than 70 percent of the cost of a branch or POS-enabled agent. In some countries, mobile wallets may also benefit from lower-cost Know Your Customer requirements, such as the elimination of requirements to provide photographs and photocopies of documents.

Costs Are Incurred Only If Transactions Are Realized

In an underutilized branch, fixed costs are distributed over a smaller number of transactions, resulting in significantly higher costs per transaction. Agent banking systems, on the other hand, receive a commission only if transactions are realized. For example, according to the average estimations of the institutions in our sample, if delivery channels are utilized at 100 percent of their capacity, total costs per deposit transaction will be two to four times higher in a branch than with an agent channel. If delivery channels are utilized at 50 percent of their capacity—a common occurrence with the providers in our sample—total costs per deposit transaction will be three to eight times higher in a branch. As long as the agent sees enough transactions to be incentivized to provide the service, capacity utilization has little effect on an agent's cost structure for the financial service provider.
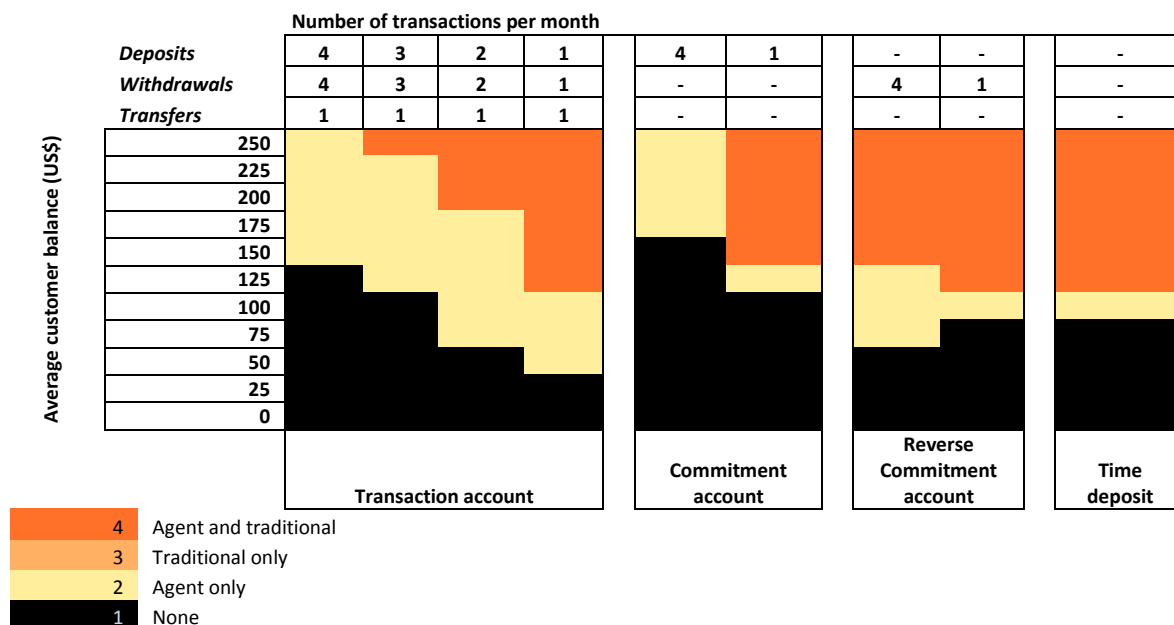
Agent Transaction Platforms Benefit From Additional Transactional Revenue Sources

By bringing the channel closer to the client, agent transaction platforms may also benefit from additional revenue associated with transactions acquired by the agent, such as person-to-person transactions and bill payments. Although customers can conduct these transactions in a branch, proximity may increase their willingness to pay for these services and increase the number of transactions conducted through the channel. For example, a recent study found that households using M-PESA doubled the number of remittances they sent between 2008 and 2009. This rapid increase in the number of transactions conducted is likely the result of proximity and ease of use. This is especially relevant when serving poor customers with low-balance accounts, because it is hard for the provider to cover the operational costs of the account on financial margin alone and because the provider needs to move to a transaction-driven revenue model. On a small-balance account of less than $50, a 6 percent financial margin represents less than $3 in revenue per year. In contrast, a typical mobile wallet conducting 1.5 transactions per month will earn more than $7 per year just from person-to-person transactions and bill payments.

Agent Banking Works Best for Low-Balance, High-Transaction Accounts

As a result of lower transaction costs and a transaction-driven revenue model (rather than a float-driven model), agent banking systems are most cost effective for transactional accounts with low balances and frequent transactions. For example, an account that sees two deposits and two withdrawals per month will incur more than 70 percent fewer costs if the customer transacts through an agent rather than a branch. In addition, transactional accounts can make money off the transaction services provided (e.g., P2P transfers, bill pay, etc.), as is the case with most mobile wallets. In fact, Figure 2 shows that a transactional account conducting two deposits and two withdrawals per month is only profitable through a branch if it has a balance greater than $200. In contrast, the same transaction account can be profitable through an agent channel, even with a balance of less than $75.

Figure 2. Profile of Profitable Customers by Type of Delivery Channel

Number of transactions per month

Deposits	4	3	2	1	4	1	-	-	-
Withdrawals	4	3	2	1	-	-	4	1	-
Transfers	1	1	1	1	-	-	-	-	-

Average customer balance (US$): 250, 225, 200, 175, 150, 125, 100, 75, 50, 25, 0

| Transaction account | Commitment account | Reverse Commitment account | Time deposit |

Legend:
- 4 — Agent and traditional
- 3 — Traditional only
- 2 — Agent only
- 1 — None

High-balance accounts with zero transactions, such as time deposits, do not reap the benefits of lower transaction costs given their low transaction volume, although they still benefit from lower acquisition costs. As a result, POS-enabled agents have no cost advantage versus a branch, while mobile-based bank agents and accounts linked to a mobile wallet incur only up to 20 percent fewer costs, according to our analysis. Commitment accounts with increasing balances, a large number of small deposits, and only one withdrawal over a pre-set period of time can be profitable through agent banking systems or branches, depending on their average balance and transaction volume. As demonstrated in Figure 2, as deposit transactions increase, the agent channel becomes the more viable option. Reverse commitment accounts show a similar pattern, although branches are viable at smaller average balances.

Challenges to the Profitability of Agent Banking

Our analysis based on the estimations of a set of financial service providers demonstrates that agent transaction platforms improve the economics for these providers compared with branches, especially for high-transaction, low-balance accounts that are common among poor users. While POS-enabled agents expand the set of profitable customers, the profitability frontier can be pushed even further with mobile-based agents and mobile wallets. However, multiple factors remain to be analyzed:

- We believe banks cannot rely on agents to cross-sell financial products. As a result, in order to increase overall customer profitability, banks may need to incur additional costs in marketing and deploying sales forces, including branch employees, to cross-sell additional financial products to agent customers.
- Back-office and technology costs may vary depending on the delivery channel, since a bank may lean towards more complex and higher-cost core banking systems than a telecom would because of increased regulatory requirements and more complex procedures and product offerings.
- Based on the data provided by institutions, our analysis assumes that fees on transactions through agents are not higher than in traditional banking channels. However, given the benefits of greater proximity, we believe there may be increased customer willingness to pay for transaction services delivered nearby.

[1] In cases where the cost or revenue data varied significantly between financial service providers, we used an average to obtain an appropriate estimate.

[2] This analysis pursues a similar approach as Ignacio Mas' "The Economics of Branchless Banking" (2009). A transactional account is an account where the account owner deposits and withdraws on a regular basis (monthly, weekly or daily). A commitment savings account is an account where a customer makes regular small deposits over a period of time until a pre-specified goal is reached. A reverse commitment savings account is an account where a customer makes one large deposit and then several small withdrawals over a period of time. A fixed deposit is an account where the customer deposits a large amount and does not access the funds for a pre-specified period of time.