Confederation of Indian Industry

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Contents

Chairman's message p3/Foreword p5/Key opportunities: Untapped markets p6/
Leveraging digital technologies p8/Risks and challenges p14

Bridging the gap with digital

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Chairman's message

V Ganesh
Chairman, CII's 3rd Financial Distribution Summit 2014 and Chief Executive Officer
Karvy Computershare Pvt Ltd

We are presented today with a phenomenal opportunity to transform the reach and scope of the Financial Services Industry. While the industry has witnessed significant growth in the last two decades, inclusivity of this growth across regions and segments continues to be a challenge. In that stead, recent times have witnessed a number of initiatives focusing on financial inclusion. With our industry influence continuing to be considerably skewed towards urban/tier 1 cities, the time is now right to consider these under-serviced markets from both a social and business perspective.

The challenge is to build a robust distribution network to penetrate these untapped markets while continuing to enjoy a reasonable rate of return on such investments. While the need for such financial services is apparent, entering such markets has its own set of risks including lack of knowledge of the financial products being offered, customer stickiness to traditional saving practices and the need for additional controls to monitor channel performance. Evolving regulatory requirements and unique market characteristics must also be considered when constructing distribution strategies for these markets.

Technology plays a major role in achieving this endeavor to expand our reach. The digital technologies available to us today provide ample opportunities to not only reach our desired target segments, but to also educate them about our propositions and distribute complex financial products and services. It is paramount that the industry leverages the leaps and bounds that we have witnessed in our technological capabilities to build innovative distribution models. Not only would technology reduce the cost of reach, it also allows for cleaner processes and controls, apart from providing fresh approaches for distribution and servicing as well as the flexibility to quickly learn from mistakes and implement smooth transitions.

Our industry has already witnessed the use of a number of interesting methodologies to address the challenges of distributing to these markets, be it bundling new products with existing ones through established financial channels, enhancing the productivity of channels with technology or directly reaching customers through social media and other digital avenues. There are significant learnings to note from other countries as well as other industries, including the FMCG, telecom and e-commerce sectors. We can look towards these case studies to frame a comprehensive distribution roadmap and take the growth and expanse of the financial services industry to a new level.

With this in the background, the summit has been designed to achieve many of these objectives and I do hope that you find it meaningful and interesting.

Foreword

Vivek Belgavi
Partner, Financial Services
PwC India

Once considered a rather exorbitant luxury, technology today is ingrained in every major process that runs a successful organisation. With applicability across the value chain, we find ourselves transitioning from the practice of business needs determining solutions to a scenario where the phenomenal growth in technological innovation is disrupting business models and inventing new hybrid industries.

This technology fuelled approach is particularly redefining the financial services space, both in terms of expanding the breadth and depth of existing customer offerings, as well as leading to the conception of radical new products. With customers displaying distinct ease in adopting new technologies, firms need to be designed to adapt and change with the same ease. The emergence of smartphones, the increased accessibility of 3G and 4G networks, and other digital trends have increased customer expectations, and companies must be able to meet these expectations in a highly demand-elastic market.

We are witnessing a clear shift in paradigms as financial inclusion and geographical expansion are gathering more importance, from social, regulatory as well as business perspectives. Innovations in the digital space will provide key opportunities for financial services firms to effectively reach out to these new segments and capture market share. These technologies will also equip firms with the ability to seamlessly counter the additional risks that arise from such aggressive expansion.

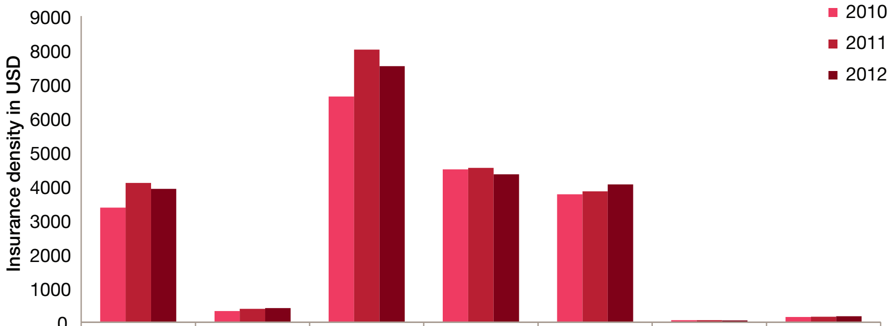
In this report, PwC focusses on key distribution opportunities available to the financial services industry and how digital technologies are a formidable means to capitalise on them. We look at major digital models and solutions that can be adopted to increase financial distribution efficiencies and also highlight the risks and challenges that companies need to be aware of while considering these alternate distribution strategies.

As we progress into the third edition of CII's Financial Distribution Summit 2014, PwC is pleased to present this paper, and we thank CII for their support in all our endeavours and for giving us this opportunity to be the knowledge partner at this prestigious event.

Key opportunities
Untapped markets

The financial markets in India have witnessed significant growth in the last two decades. There is more to be satisfied than to ponder over in terms of growth statistics. What is more encouraging is the potential that these sectors seem to have for geographical growth, expansion and inclusion. In comparison with global trends, the Indian market still has huge potential in terms of market penetration. Across the insurance, asset management and banking sectors, there exist clear opportunities to enter markets, capture share and service new customers.

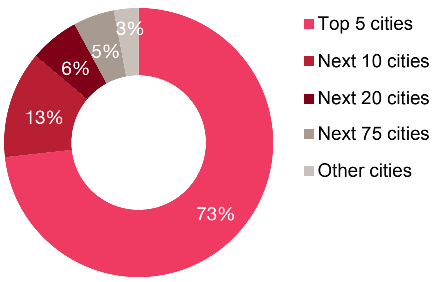
The Indian insurance industry has seen significant growth in insurance penetration and density over the last decade[1]. During this period, penetration increased from 2.7% in FY01-02 to 3.96% in FY12-13. Similarly, insurance density increased significantly from 11.5 USD in FY01-02 to 53.2 USD in FY12-13. However, there is still a huge market segment which remains untapped, especially beyond the top five cities. Further, when compared to the global industry, India has some way to go. In 2012-13, India's density of 53.2 USD was comparatively lower than China's density of 178.9 USD and Brazil's density of 414.2 USD. This clearly highlights the huge market potential that still remains untapped in India.



	Australia	Brazil	Switzerland	UK	US	India	PR China
2010	3369.2	327.6	6633.7	4496.6	3758.9	64.4	158.4
2011	4094	398	8012	4535	3846	59	163
2012	3922.3	414.2	7522.1	4350.2	4047.3	53.2	178.9

Asset management companies (AMCs) also have significant opportunities to consider. The overall assets under management (AUM) have grown to approximately 8,250 billion INR, as on 31 March 2014, reflecting a CAGR of 14.6% over the last 21 years. This is strongly coupled with the Sensex growth which hit a record peak of 22,386.27 on 31 March 2014, reflecting a CAGR of approximately 11.5% in the last 21 years[2]. With investor sentiment on an all-time high, a stable government at the centre, easing investment norms and a positive world outlook towards India, a huge amount of investment inflow is expected to push the Sensex even further. This will definitely result in a high growth trend in AUMs. There is, therefore, a huge opportunity for the industry to capitalise on.

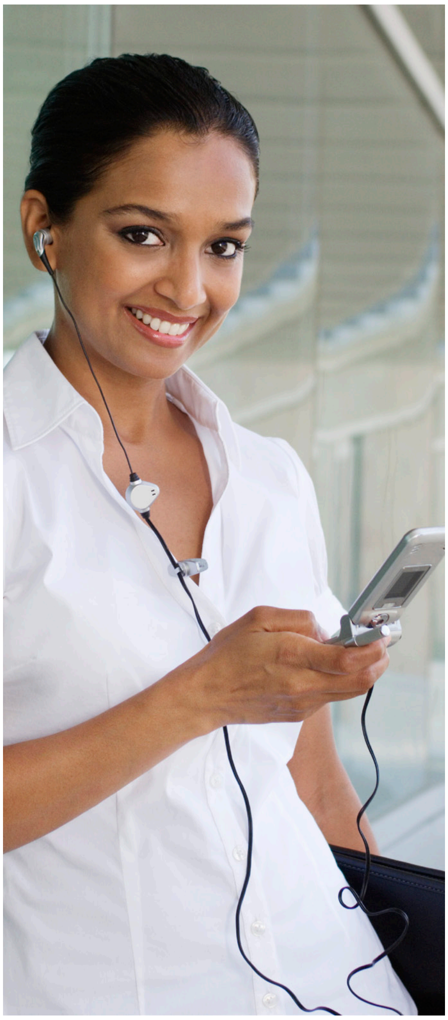
AuM by geography (2014)



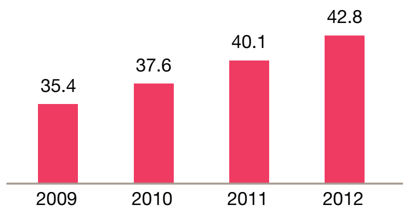
However, AUMs have so far been largely concentrated in the top five cities of the country[2], with smaller cities and rural areas having minimal contribution to the industry. The industry is slowly seeing a shift in focus from T15 (top 15) markets to B15 (beyond T15) markets aided by initiatives such as investor education and differential commission structures for agents operating in B15 markets. This increased focus on B15 markets is expected to open up newer markets and thereby avenues of innovation in distribution.

The banking sector has shown improvement in inclusivity and reach. The latest CRISIL Inclusix report pegs India at a score of 42.8 out of 100 at the end of 2012, a 2.7 point improvement over the previous year. The CRISIL Inclusix score provides a composite measure of financial inclusion, capturing three critical parameters of basic banking services–branch penetration, deposit penetration and credit penetration. The score has been increasing steadily since 2009, and this improvement was witnessed in a number of districts and states: 587 out of 638 districts and 34 out of 35 states and union territories showed progress in their Inclusix scores.[3]

1 *IRDA Annual Report 2012-13 and IRDA Annual Report – 2011-12*
2 *Indian mutual fund industry: Challenging the status quo, setting the growth path, CII and PwC, Mutual Fund Summit 2014*
3 *CRISIL Inclusix, Volume-II, January 2014*



CRISIL Inclusix Score for India



However, there continues to be a huge difference in access to financial services (FS). India's six largest cities account for 10% of the country's bank branches, while at the other end of the spectrum, are eight districts in the north east with just two or less branches each. With 2012 seeing the slowest growth in branches (5.6%) compared to the last three years, there is a clear opportunity for companies to expand their reach through either branch expansion or by focussing on alternate distribution channels.[3]

As is evident, there is considerable potential for the financial services industry to focus on India's traditionally under-banked regions. Further, there are emerging trends that can be effectively utilised to garner revenue from this huge untapped market.

Government initiatives and the evolving industry

Keeping aside the benefits of improving living standards, financial inclusion schemes will have a multiplier effect. The consequent fuller participation by all in the financial system makes monetary policy more effective, thus providing an enabling environment for non-inflationary sustainable economic growth.

The launch of the Pradhan Mantri Jan Dhan Yojna (PMJDY), envisages bringing a sizeable portion of the rural population under the fold of the organised financial industry. The scheme's objectives include one bank account per household with accidental insurance cover. This gives the banking industry a far greater reach in terms of market penetration. The banking industry has also initiated the Bank Sathi scheme to provide ease of access of financial services to the traditionally unbanked. This scheme uses a model that involves agents with tablets that can be remotely connected to branches. In the process, a single bank agent can function as a branch in each catchment area.

These schemes will increase the reach of the banking and insurance distribution channels as well as educate the people about the necessity of various financial products. This presents a huge prospect for the insurance industry to reach the remote untapped markets in a cost-effective way.

Another area to take note of is the micro-insurance industry. The industry has evolved in form and scope, and regulations have played a major role in this transformation. Obligations of Insurers to Rural Social Sectors (2002), Regional Rural Banks as Insurance Agents (RBI-2004) and the IRDA Set of Guidelines for Micro-Insurance (2005) are some of the regulations that have changed the face of this industry. What these regulations have achieved is to facilitate distribution efficiency. In the process, micro-insurance has now expanded to being a social movement with a formidable commercial business opportunity.

Given the large volumes with lesser margins involved in this particular sector, technology needs to be extensively used for maximising benefits as well as ROI. Mobile and tablet based selling and customer service need to become focus areas, apart from continuing to leverage on the established channels in the sector.

These developments will also provide other sectors of the FS industry with new alternate channels to reach remote areas, generate greater financial awareness and provide a platform to bundle and cross-sell, thus helping growth in the long run.

Technology as an enabler

By June 2014, there were 914.92 million wireless users in India, covering a large population of both rural and urban India[4]. This expansive demand has warranted the necessity for differentiated propositions to be offered to mobile customers. Customers now make extensive use of smartphones and are comfortable with consuming anywhere-anytime business services. This in turn has driven companies to build a superior mobile experience as a fundamental part of their service offerings. Customers increasingly expect it and business partners and employees have become more comfortable with communicating and sharing information anywhere, through any device.

The banking industry has already taken the mobile opportunity by the horns and it's time for the insurance and asset management industries to tread the same path. It is the opportune moment for these sectors to develop applications to assist in the sales process for agents and brokers, rather than restricting the scope of applications to vanilla activities such as quote generation or providing product information.

With the imminent launch of the 4G network which will not only provide superior speeds and coverage but also drive down the cost of services, the implications of such developments on financial services delivery are substantial. It will be useful to examine these trends from an 'ideating' perspective. This brings into picture innovative ideas that draw influence from P2P lending which involves the practice of lending money to unrelated individuals or 'peers' without going through traditional financial intermediaries. These are opportunities that no player should let go of in order to enjoy not only topline growth but bottomline growth as well through inherent cost advantages.

4 *TRAI - The Indian Telecom Services Performance Indicators Report, April - June, 2014*

Leveraging digital technologies

When it comes to internet and mobile penetration, India has shown impressive progress:

- *The latest Internet and Mobile Association of India (IAMAI) report pegs India's year-on-year growth of internet users at an impressive 32%.*[5]
- *The number of mobile internet users has also steadily risen, with 159 million mobile internet users in October 2014.*[5]

Internet and mobile[5]

According to the latest IAMAI report, there were 278 million internet users in India in October 2014. India currently has the third largest internet users' base in the world but it is estimated to overtake the US as the second largest in the world after China by December 2014, registering a Y-o-Y growth of 32%.

The number of internet users in urban India has grown by 29% from October 2013 to October 2014, while rural India has seen 39% growth. Furthermore, for nearly 93% of the respondents from urban India, the primary use of internet is search, followed by online communication and social networking. However, in rural India, entertainment is the primary reason for internet usage, followed by communication and social networking.

The number of mobile internet users has also witnessed a steady rise, with 159 million mobile internet users in October '14, and is estimated to reach 173 million by the end of December 2014.

Leveraging the existing infrastructure of connectivity and internet penetration seems a formidable strategy for financial institutions to consider when it comes to distributing financial products.

With proper safeguards in place, social media can be used to perform financial transactions as is already being done by industry participants. Given the engagement millennials have with social media, developing a sound social media strategy will go a long way towards increasing participation of this segment in financial service consumption.

Connectivity forms the backbone on which these digital channels run. The volume of ICT based transactions through banking correspondents (BC) have increased from 26.52 million in March 2010 to 250.46 million in March 2013[6]. Supplementing these established networks and channels, such as the banking correspondents channel, with digital technology will increase channel productivity. Some examples of such strategies include enabling BCs with digital micro-ATMs empowered with cloud infrastructure to reach out to the rural population. Leveraging the network of existing airtime selling retailers to deposit, transfer and withdraw money using unstructured supplementary service data (USSD) mobile technology is another way in which organisations are providing customers with branchless banking services.

Business trends shaping the distribution channels of the future

Advancements in the field of mobile technology and increased internet penetration have led to an evolution in the retail financial management space. These trends have resulted in the mushrooming of new online platforms and services, including those that provide aggregated views of financial products available as well as 360-degree perspectives of personal finances.

Aggregator sites, such as www.policybazaar.com and www.bankbazaar.com, help potential customers compare the prices of financial products and educate them about these products. These sites cover the entire spectrum of financial products, from credit, to deposits, to insurance facilities. They provide financial tools which are intuitive in nature and help identify an individual's financial needs. These tools provide a number of functionalities, including calculating EMIs, eligible insurance amounts and loan repayment tenures, or identifying systematic investment plans to meet savings goals. These sites act as channels through which buyers can identify suitable financial products. Buyers are then guided via various digital and traditional channels to complete the sale.

Another set of online or mobile services that have emerged are platforms that manage the finances of customers through sophisticated views of spend patterns and fund movements. These platforms, such as 'myuniverse', provide a consolidated 360-degree view of the financial portfolios of clients, and also give advisory services through personalised financial recommendations based on parameters such as current investments, liquidity status or risk appetite. Such pro-active suggestion models help clients become more aware of their financial needs and investment opportunities, and create customer demand and stickiness for such services.

5 *IAMAI. (2014). India To Cross 300 Million Internet Users By Dec'14 [Press Release]. Retrieved from http://www.iamai.in*

6 *RBI – Financial Inclusion in India – An Assessment, 2013*

Using digital technologies

Digital technologies are an integral part of a number of channels of a financial services company, be it branches, direct sales force, call centres, internet or mobile. Digital interventions can improve the efficiency of existing processes during each step in the journey of a customer—from acquisition to account management to transactions.

Biometric technologies

Slow account-opening procedures at the point of sale, be it through agents or branches, is one of the most pressing distribution challenges that providers face in acquiring an active customer base. An important determinant of user activity is whether users are able to transact immediately after registering. Consequently, digitised and automated account-opening procedures are expected to increase customer activity and retention, following the registration process. KYC regulations, in particular, mandate the collection of certain identification documents before an account is opened. FINO PayTech, a branchless banking provider in India, offers a full suite of biometric products for enrolment, storage and verification of documents, with all back-end system elements to complete customer applications.

Lack of technological awareness is still a real barrier preventing people from using technology-enabled financial services. However, low-cost easy-use technological solutions, such as fingerprint and voice biometrics, are opening up the spectrum of solutions available.

Biometric registration and authentication

Tangaza Pesa, a money-transfer system in Kenya, uses fingerprint biometrics for business registering and authenticating customers, eliminating the need for ID proof. Fingerprint biometrics offer high security at a low cost, requiring no paperwork and providing the added convenience to customers of not having to remember a PIN. By thinking out of the box and leveraging technology in an innovative manner, facilitated registration and user authentication have become Tangaza Pesa's principal differentiating service offerings.

Unlocking value through mobile technology

The first wave of mobile technology revolutionised communication and reach with phenomenal opportunities to interact with customers as well as to provide innovative products and services. While gains from these traditional uses are now being exhausted, a host of new technological developments continue to expand the value to be extracted from this channel.

The lack of supporting infrastructure is one of the main barriers to the distribution of financial products in rural and semi-urban areas. In the mobile channel space, unstructured supplementary service data (USSD) is an interesting solution that is not heavily infrastructure reliant.

Through this technology, the user can transfer money using the USSD facility of a network provider. The service is free of cost and users do not require internet access. Several mobile service providers are leveraging this technology to transfer money and provide micro-financing services. The airtime selling retailers act as agents in this setup, by accepting deposits and providing withdrawal facilities. They also help users to transfer funds or make utility payments. This technology opens up interesting service opportunities.

Branchless facilities provided by banks through business correspondents can leverage mobile technology to deliver automated, low-cost and secured transactions. Banks have developed a solution that combines a mobile phone (to transfer data using USSD) and a card reader, to work as a micro ATM. A business correspondent can use this device to deposit or withdraw money for a customer, who will be immediately registered in the core banking system. The backend infrastructure for this branchless service can be hosted on a cloud technology solution, which is integrated with different banking solutions. Such technology would also find use in facilitating premium payments or providing user-friendly avenues for transferring funds for investments. Solutions incorporating these technologies are already in the market: a company called Tyme currently hosts and operates mobile money services for MTN in South Africa and is also providing hosted services for EBank in Namibia.

Liquidity management for business agents can also be addressed through the mobile channel, in situations where agents do not have enough cash to complete transactions. Given that brick-and-mortar branches are likely to be geographically dispersed and not always readily accessible in less developed markets, such circumstances could delay the process of receiving funds. The current retail network of mobile service operators (MSO) can be utilised to support the liquidity needs of these agents. Collaborations among MSOs and financial services companies can provide an opportunity of far-reaching penetration, as is evident in the case of M-Pesa. As long as these collaborations follow a bank-led model, the necessary levels of regulation and governance will be incorporated, thus providing more robust systems and more meaningful development of such services.

However, for such cashless services to flourish, building trust in the system is paramount. This can be achieved by building, incentivising and managing an agent network that results in a positive and consistent experience for customers. This entails selecting high-performing agents to operate in strategic and convenient locations with ongoing training and business support as well as continual performance review and management.

Enabling sales representatives through mobile applications could increase the speed of mobile money registrations. Various applications developers in collaboration with financial service companies have developed mobile sales force management tools for this purpose. These tools are also enabled to monitor and evaluate portfolio, transactional and performance tracking, and training delivery.

Financial companies are also equipping their advisors with technology-enabled tools to help them sell better. Special software and standardised videos about products loaded on mobile devices make it easier for customers to understand the products better and also prevent mis-selling. Agents can guide customers while filling the form themselves.

Reaching the customer directly

While supplementing existing channels with digital technology solutions considerably improves channel productivity and reach, some companies have also used such technology to directly reach customers and provide differentiated services.

Insurance store in a box[7]

US auto insurance major, Direct Auto Insurance Co, chose an effective and innovative way to reach out to customers for insurance. The company installed Direct on the Spot (DOTS) kiosks at various public places that had transactional capabilities. Known as 'insurance stores in a box', these kiosks allow consumers to scan their driver's licences to obtain quotes and walk away fully insured in less than five minutes.

The company plans to set up these kiosks at different retail touch-points including supermarkets, malls, gas stations, car dealerships and other third-party retail locations. The kiosks also assist customers in purchasing insurance policies. The kiosks also provide payment options through cards and cash. Further, to incentivise the retail outlets where the kiosks are being set up, the company plans to roll out free gift cards to use within the stores for customers who use the kiosks.

Innovative distribution strategies[8]

Snapdeal—one of the country's largest e-tailers—plans to tap 50 lakh low-income households in slums and villages across the country. The company will launch 5,000 e-commerce kiosks across 65 cities and 70,000 rural areas by the end of 2015 with the help of FINO PayTech, an Indian financial inclusion solutions company. These centres will be manned by village-level entrepreneurs, have personal computers and tablets, and also serve as collection and delivery points of packages since most people living in these areas have no permanent address.

The move is expected to give Snapdeal the opportunity to significantly increase its existing consumer base. Kunal Bahl, the CEO of Snapdeal, told a leading newspaper that the programme would provide the company with access to 5-10 crore new consumers in the next three years.

Non-financial services channels

In the effort to reach out to Tier 2 and Tier 3 customers, financial services companies can also use other avenues to reach these customers. While establishing a distribution network is a long-term strategy, using existing networks provides terrific opportunities to make quick entries into these markets, and financial services companies can learn from the innovative strategies adopted by companies in other geographies and industries.

In the UK, for example, organised retailers such as ASDA and Tesco have been used as channels to distribute insurance. With clear potential for linking with traditional insurance channels, such collaborations provide improved servicing and customer interaction opportunities. These retailers play the role of corporate agents, and can even provide referrals, and are involved during various parts of the insurance value chain.

Using established customer linkages to improve your reach[9]

E-commerce giants Amazon India and Flipkart are in talks with the government-owned Indian Railway Catering and Tourism Corp (IRCTC) portal as they look to tap the railway portal's existing database of more than 21 million consumers. The portal has seen unprecedented traffic and set a record in March 2014 when it booked 5.8 lakh e-tickets on a single day, as compared to 27 tickets a day when it began in 2002.

Revenues from online ticketing on the IRCTC portal are substantial and exceeded the combined sales of Flipkart and Amazon India in the year ended March 2014. IRCTC generated 15,410 crore INR or nearly 2.5 billion USD through online ticket sales in the last financial year, up 24% from the previous year when it sold tickets worth 12,419 crore INR. Flipkart and Amazon India said that they had each hit a billion USD in annual gross merchandise value.

The strategy would provide the companies with a fantastic opportunity to capitalise on the portal's user base and would provide comprehensive reach to a range of demographics.

Customer analytics through digital

Customer analytics helps financial companies understand and maximise the lifetime value of customers being reached out to, in identifying effective channels for communication and distribution, capitalising on cross-sale and up sale opportunities as well as in customer-attrition management. This approach has considerable applications from a distribution perspective, especially in enhancing the appeal of such channels with customers. In the internet channel, for example, customised product propositions can be displayed depending on the source from which the user reached the company website, specific cookie properties and word search analytics. A customer arriving from a search engine could be shown a different product offering compared to customers who have arrived directly. Thus, customer analytics improves the experience of the customer and increases the odds of lead conversion.

Creating a customer view

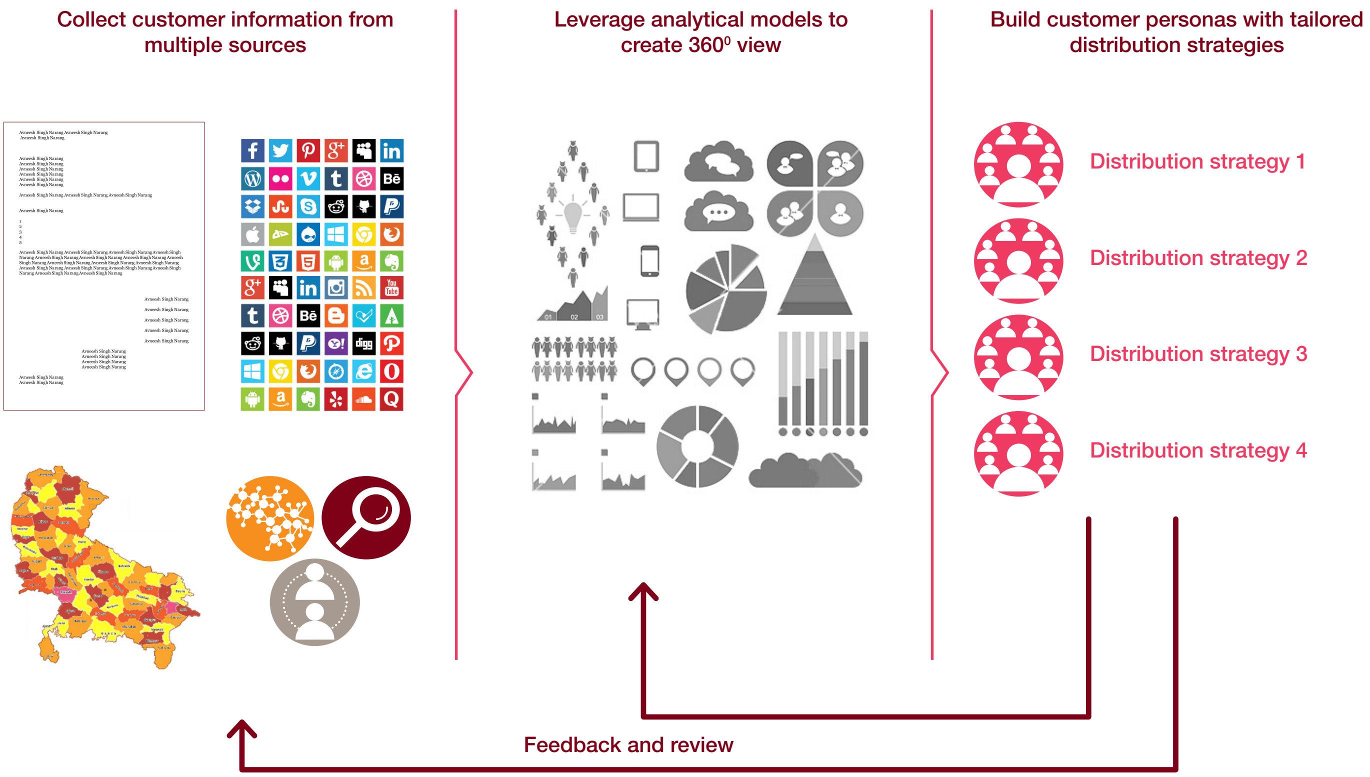
Analytics is heavily dependent on the availability of rich data, and digital channels provide a huge opportunity to accurately and effectively capture such data for use in customer analytics. Traditional information sources when combined with the data from a customer's digital presence help build a comprehensive view of the customer. Inputs from various digital avenues (customer digital footprint) coupled with analytics help identify products that are better suited for individuals or groups of similar individuals. This also helps in better pricing and product positioning.

Through such insights, companies can create alternate customer personas and design distinct distribution strategies for each persona. These strategies would be continually assessed and would evolve based on analytical review. For example, customers who have a significant digital presence may prefer an online-centric proposition and would be more likely to adopt products if approached and serviced through such channels. On the other hand, customers in demographics that statistically show lower involvement in consuming financial services may require

7 (2013, Nov 06). Transactional Kiosks: The Future of Auto Insurance. Retrieved from http://www.directgeneral.com
8 Sarkar, John. (2014, Nov 14). Snapdeal logs onto rural India. The Times of India. Retrieved from http://timesofindia.indiatimes.com
9 Tiwari, Dheeraj, Malviya, Sagar. (2014, Nov 17). Amazon, Flipkart eye tie-up with IRCTC. The Times of India. Retrieved from http://timesofindia.indiatimes.com

more traditional agent distribution tactics. Analytical insights allow companies to allocate resources optimally across these different channels and also provide these resources with tools to improve the likelihood of lead conversion. The same distribution network might offer different customers different propositions based on key signs and indicators arising from such analytical review.

Geospatial analytics is another field that can add value to a company's distribution strategy. Coupling consumer data with geospatial data can provide companies with a unique perspective of geographical areas that may require different distribution strategies. Integrating geospatial potential with actual business performance information may provide the necessary gap analysis companies need to pinpoint strategies that are working and those that are not. Companies can then determine location-wise performance, gaps and plan for remediation. Such insights would further help in-branch capacity planning, incentive structures and training needs assessment, and would enable companies to come up with more targeted products suitable for these demographics and distribution approaches.



Controlling risk

While customer acquisition analytics plays a major role in designing distribution strategies, risk metrics need to also be integrated into these strategies to create holistic solutions and dynamic approaches. Analytics that flow into underwriting decisions and fraud detection should feedback into distribution processes to ensure that adequate checks and controls are in place to reduce risk while facilitating business expansion. The idea is to maximise the utilisation of distribution channels on 'productive' customers both from a revenue and risk perspective. By providing an ability to differentiate between high- and low-risk customers, distributors can focus their time on profitable consumers, thus increasing channel efficiency.

Information such as money-flow patterns in an individual's account, transaction and usage behaviour as well as additional products taken provide a whole new perspective to the underwriting process. It is possible to build analytical models and scorecards that take into account key risk-splitting indicators to develop signs of high risk, which can then be translated into appropriate policies and controls to be followed by distribution networks.

However, when it comes to traditionally under-banked populations, prior credit behaviour may not be readily available and such consumers may not be assessed properly by lending institutions to measure repayment risk. In the absence of information on creditworthiness, in individual lending models, loan officers may be required to interact heavily with prospective clients, driving up the distribution costs. In such scenarios, other information becomes far more important in assessing risk, and analytics provides the ability to develop such alternate models. The distribution strategy thus becomes even more important as it determines the kind of data available for risk assessment.

For example, the channel used by a customer to apply for a product may provide an insight into the customer risk. Customers opting for agent interaction might be of a different risk grade than customers preferring alternate channels. Combinations of demographic, geospatial or existing relationship characteristics could also provide such insights. Analytical techniques would allow companies to identify combinations that provide the best risk estimates.

Accordingly, 'approval-in-principle' models can be created as screening mechanisms to estimate risk using information immediately available during the initial stages of customer interaction. This would reduce the time distributors spend on high-risk customers and improve the effectiveness of these channels as they would have a greater incentive to convert the sale on customers who pass the screening process and who they know would most likely not be declined post sales. Further, such customer bases can then go through simplified operational process flows, bypassing detailed risk assessments, reducing the turn-around-time and improving customer experience.

Analytics also plays a major role in fraud detection. The earlier approach was to develop risk score-based detection models, which sophisticated fraudsters are now able to easily evade. However, linking social networking behaviour with customer information helps build a more resilient customer profile. For example, one of the largest sellers of personal-finance software and a provider of payment systems has begun to verify the identities of users, whose profiles on certain social network sites list detailed employment history and often include endorsements and recommendations. Such insights can be distilled in order to identify key customer segments so that distributors can adopt different levels of scrutiny while pitching products.

The role of social media

The reach of social media is expanding every day, from major cities to Tier 2 and Tier 3 cities in India. A number of internet-penetration initiatives that try to leverage on innovative, lower-cost methodologies are further adding to this expansion. Google's Project Loon, for example, aims to improve internet access and connectivity in rural areas by using high-altitude balloons to create an aerial wireless network with up to 3G-like speeds. Similarly, Facebook is working on a solution that delivers internet access via solar-powered drones. The common thread amongst these approaches is the use of low-cost carriers to transmit networks to regions that are currently remote and inaccessible from an internet-coverage perspective. This increased internet penetration would, in turn, positively influence the growth of social media coverage.

The advantage that social media platforms provide is a phenomenal avenue to keep customers engaged with the brand. Through apps and games, companies are tapping into these mediums to create interest in their products and multiply their reach by using consumers as mediums themselves: by creating content people share, re-post and re-tweet, companies are being able to expand their reach without directly targeting consumers to begin with.

However, social media has gone beyond simply being a means of making your brand presence stronger. The transition from being only a customer communication tool to a customer engagement and transaction tool and a key distribution channel is already taking place. Banks such as Kotak Mahindra and Groupe BPCE, France, have already harnessed platforms such as Facebook and Twitter to facilitate transfer of money. A leading insurance provider has launched an engagement platform on Facebook that enables customers to buy health policies from their Facebook account, interact and share their experiences with the insurance provider and also get instant customer service at their convenience from anywhere, anytime.

Social media as a channel provides companies with the ability to create highly tailored propositions. Using social medial mining tools, companies can assess customer sentiment regarding product propositions and brands and appropriately create highly specific solutions. Lenders can mine social media data to determine borrower identity and creditworthiness and, in turn, reach out to customers online. In the Philippines, and now in Mexico and Colombia, Lenddo uses social media sources such as Twitter and Facebook to determine borrower creditworthiness and extend loans to middle-income borrowers.

There exist social models that help to protect unbanked people who cannot access formal financial services against financial risk. Companies can now create products taking cues from these informal social financial models. In developing countries, the financially challenged generally turn to family and social networks in times of need. This channel has opened up the ability for companies to reach and provide services to these customer segments that have been traditionally under-represented. These products are taking informal savings groups online to broaden the reach of users, improve convenience and quality, and reduce cost. For example, Emoneypool and Yattos in the United States provide an online platform for savings circles—groups of people saving together, taking turns to access collective savings and leveraging the existence of online social networks.

Such new models will prevent insurance fraud and misconduct via means of social control and reduce sales costs. Further, they will help in not only discouraging small claims, but also in cutting administrative overheads, which is the need of the hour.

Risks and challenges

Regulatory implications

New guidelines issued by different financial services regulators will necessitate changes in processes, product mix as well as the technology components adopted by market players. The guidelines illustrate the focus of these regulating agencies to provide greater value to customers while increasing the burden on market players.

- The new Companies Act necessitates that companies have more effective controls regarding their finances. This will result in additional costs as changes will have to be made in existing processes to incorporate these new checks and controls. The supporting technology framework will have to be refined and additional training imparted to employees across the board to make sure that the new guidelines are adhered to. This change provides a huge opportunity for the industry to improve operational efficiency. However, the ability to manage this change would directly impact the growth of these businesses.
- With new guidelines issued by IRDA coming into the picture, the focus of insurance companies has shifted from ULIP products to traditional ones. This has forced organisations to look into their product mix strategy as well as their distribution skills.
- SEBI regulations regarding compliance with the Prevention of Money Laundering Act limit cash transactions in mutual funds, which could pose a challenge to AMCs, as clients beyond the top-15 cities might still prefer to transact in cash. In some cases, clients may not even possess bank accounts, which are mandatory as sources of funding investments.
- Another requirement that needs to be considered from an agent-selling channel perspective is the commission limit SEBI has imposed on mutual fund products. The commission attached to mutual fund products is significantly lower compared to other products, making it difficult to incentivise agents to sell mutual funds. Agents may be tempted to switch products or move to the top five cities, where higher ticket size may provide bigger payouts, thus reducing the chances of expansion in Tier 2 and Tier 3 cities.

The cost of distribution

The allocation of resources across the different channels is crucial when considering the right distribution mix for Tier 2 and Tier 3 cities. Given the more geographically dispersed demand and traditionally lower average ticket size, these cities entail a higher cost. Thus, the use of traditional distribution services needs to be assessed. The key is to balance this constraint with effective incentive structures to encourage agent productivity and thus make up for the lower ticket size through higher volumes. While it is tempting to rely heavily on alternative 'direct' digital distribution channels with negligible operating costs, the gains from these channels are limited due to lower levels of technology access and adoption in these areas and the practical restrictions on the products that can be offered through these channels.

A recent Development Research Group report released by SEBI[10] provides key insights into the distribution conundrum of mutual funds, which can also be applied to the entire financial services industry:

- Areas with the highest mutual fund presence tend to be those where the proportion of households with income higher than 3,00,000 INR and the presence of an independent financial advisor (IFA) happen to coincide.
- However, IFAs do not usually focus on areas having the highest propensity to invest in mutual funds. Therefore AUM levels can be increased by several percentage points if IFAs were made to apply their efforts in the right areas.

10 *Penetration of Mutual Funds in India: Opportunities and Challenges, Chakrabarti, Malik, Khairnar and Verma, 2014*

The study ranked all districts in India by domestic product and found that the top 60 districts (first decile) contributed 41% of total country GDP but over 90% of total national AUM. The next 60 districts accounted for only 4% of AUM. This is partially due to the IFA distribution: over 60% of agents are in the first decile districts while just over 10% in the second decile. However, the distributional efficiency (how much a rupee spent on distribution earns in AUM) is actually higher in the second decile compared to the first decile. Therefore, there is a clear opportunity if agents are incentivised to focus on these districts. Focusing on these 'high propensity' areas with special commission structures incentivising IFA attention to these districts may increase the return on every rupee invested in this channel. Other models could also be considered to promote participation of distribution channels beyond the first decile.

- The industry could consider adopting innovative approaches towards differential empanelment of IFAs for different product types. Relaxed examination norms for certification to sell simplified products could help rope in a larger pool of agents, increasing the penetration of the distribution network in districts where such simplified products may be in higher demand.
- Another largely untapped opportunity present in mutual fund distribution that could lead to further distributional efficiency and participation is to look at empanelment of other categories of financial advisors, such as tied agents for the insurance industry. The objectives of such agents with respect to clients are highly synergistic with those of the mutual fund distribution channel, with the aim of helping clients secure their financial goals. Cross-training of such channels would be minimal and they would have access to a pool of customers who already consume financial services/ investment products.
- Technological supplements to improve the conversion of leads to sales could also incentivise participation in these high propensity areas. Portable scanners, mobile form capture, biometric scanners, etc. could go a long way in reducing cumbersome paperwork and improving the chance of sale completion, thus increasing the expected pay out to agents. SIM cards and GPS mechanisms could be leveraged to ensure such supplements are used in the areas where IFAs should be present, thus pushing IFAs into these right districts.

Similar models could also be adopted by the other financial services sectors to control distribution costs, designing incentive structures to optimise agent proliferation, coupled with technology supplements. Further, supplementing traditional channels with technology tools, while also focussing on direct digital channels and correspondent business models for simpler products, would go a long way in reducing the blended cost of distribution without compromising on agent commission structures.

While incorporating such innovative approaches and differential structures, companies need to pay heed to the behaviour that incentive structures encourage. While the initial drive would be to increase customer base and capture as much market share as possible, companies need to be wary of ending up with dormant accounts and non-performing assets. Commission structures should avoid being front-heavy and should be long-term oriented with incentives promoting continual customer engagement with company products so as to ensure that channels are acquiring customers with the potential for significant customer life cycle value.

Financial literacy

After setting up a distribution network that provides comprehensive access to the target segments, the next major challenge is to ensure that there is adequate demand for your product. Before even considering product propositions and innovative offerings, the first step is for customers to understand the products and their benefits. Financial literacy is an extremely important factor to consider and determines whether potential customers choose newer products over traditional forms of monetary savings and investments that they are comfortable with.

Further, there is clear link between improved financial literacy and its impact on saving patterns. In a study conducted on a random sample of 3,000 people with access to branchless banking facilities across two districts in Uttar Pradesh, it was found that individuals who received financial education intervention saved 29% more than the control group[11]. Moreover, the study found improvements on attitudes related to financial planning.

11 *Does Financial Education Affect Savings Behavior? Evidence from a Randomised Experiment among Low Income Clients of Branchless Banking in India, Calderone, Fiala, Mulaj, Sadhu and Sarr, 2014*

Financial services regulators are well aware of this challenge and have provided guidance to industry participants on the importance of coupling availability of products with education programmes. SEBI, for example, has instructed fund houses to set apart at least 2 bps of net daily assets on investor education, which has helped reduce mis-selling and increase investor awareness. Industry participants share the same outlook. Harshendu Bindal, President, Franklin Templeton Investments (India), believes[12], "While the household savings rate is high in India, most of these savings find their way into unproductive physical assets. The main reason for this is lack of awareness about mutual funds and a robust distribution network beyond the big cities and towns. We firmly believe that financial education is a must if mutual funds have to widen their acceptance beyond the metros to smaller towns." Similar sentiments are also observed by counterparts in the insurance industry. In a recent interview, G Srinivasan, Chairman and Managing Director of the New India Assurance Co, spoke about financial literacy as a challenge for the industry[13].

A number of companies have taken deliberate steps to reach out to their target consumers and educate them on the benefits of expanding their scope of financial products. R Janakiraman, Vice President and Portfolio Manager, Franklin Equity, Franklin Templeton Investments, stressed the role that distributors play in introducing more people to the practice of investments, and mentioned that one of the main objectives of his fund house is to 'enrol a new cadre of distributors' trained in offering sound advice and to spread awareness about the benefits of mutual fund investments[14]. The fund house has established a model where local members of the districts, referred to as MF Sevaks, will coordinate activities like holding investor camps and contact programmes even as they work closely with national-level distributors such as banks and local independent financial advisors (IFAs).

Similarly, the fund house's Shubh Laabh[12] programme will seek to educate investors and grow the market through a three-pronged strategy:

- Building category awareness through various initiatives including advertising and activation programmes
- Increasing the distributor network with quality engagement
- Promoting mutual funds as an investment option to the consumer

With the increasing penetration of mobile phones and internet usage, social networks are another strong platform for disseminating such information. Adopting such an approach would not only provide an opportunity to boost demand, but also favourably establish the brand.

The post-office network as a key channel towards financial literacy

When it comes to financial literacy, one of the key impediments is to find a suitable channel that can effectively educate while still reaching a considerable number of people. Rather than setting up a fresh channel that would involve significant time and cost, companies could instead consider an existing channel that has vast reach across India: the Indian postal service.

With over 1.55 lakh post offices across the country, India Post is the largest postal network in the world[15]. It spans urban and rural areas alike and provides a fantastic opportunity to communicate with people. In fact, the government of India is planning to harness this phenomenal network to reach out to citizens and educate them about its various policies, schemes and incentives, especially those not easily connected with other channels such as the internet and social media.[16]

The channel has already been utilised for distributing products of various financial services companies. IDBI, SBI, UTI, Franklin Templeton and Reliance Mutual Fund have all used the postal service as a distributor in select locations, with dedicated AMFI-qualified personnel to distribute forms, provide information on schemes and receive completed application forms[15]. In the same vein, the branches and postal workers could become key carriers of essential financial product information, thus providing a significant boost to efforts towards improving financial literacy.

Exposure to fraud risk

The final distribution channel mix will directly determine the various customer segments being targetted as well as the frequency and degree of interaction with the customer. These strategies would have a major impact on the level of risk being undertaken by financial companies and therefore influence product features, processes and checks based on the channel being used.

For example, while an internet-based direct channel significantly improves customer reach and increases the chances of superior real-time service delivery, the level of interaction with the customer is far lower and the flexibility of verification of information is limited. Companies would therefore need to consider channel-based strategies to control exposure to risk of incorrect information and associated frauds.

The trade-off is between the ability to provide remote, real-time service with minimal interaction (and therefore negligible cost) and the need to reduce the chance of fraud with stringent know-your-customer programs ratified through physical verification. A model that is predominantly remote and requires minimum customer contact would require innovative verification processes to ensure that the information provided by the customer is accurate and correct. While such information is more directly relevant when considering lending products that are reliant on a physical collections model, other decisions such as creditworthiness and underwriting are heavily dependent on the accuracy of information provided by customers. Risk models that play a direct role in product pricing would be left redundant if the channel strategy reduces the accuracy of this data.

The key to countering such risks lies in the ability to maximise the accuracy of data or design strategies based on the degree of data available.

12 Singh, Priyanka. (2014, Aug 22). Franklin Templeton launches 'Shubh Laabh' in Sitapur. The Times of India. Retrieved from http://timesofindia.indiatimes.com
13 Sharma, Sumit. (2014, Aug 10). Financial Illiteracy A Big Challenge For Insurance Sector. The New Indian Express. Retrieved from http://www.newindianexpress.com
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Improved customer identification

The first objective is to accurately verify the identity of individuals to control exposure to higher risk customers. This option is by using technologies such as biometric identification.

Introducing fingerprinting as a means to accurately capture borrower identity could improve a lender's ability to develop and track robust repayment histories of the borrower and therefore deny credit to high risk customers in a later period based on previous repayment performance.

This is particularly relevant today where credit bureaus must rely on sophisticated matching techniques to accurately match borrowers with correct credit histories, which are heavily dependent on the quality of details available at the time of bureau check and are still prone to mismatch errors. With biometric approaches gaining acceptance among consumers—some mobile devices already come with biometric capabilities—leveraging such technologies improves information reliability without hampering the customer experience and can be seamlessly included in a variety of channels.

Surrogate programmes

Using surrogates to determine and forecast important customer information that is not readily verifiable or available is another strategy to consider. For example, customer income is a significant variable in most risk models; however, income proofs can be a major hindrance to the sales process and can reduce the efficiency of alternate channels, apart from requiring significant efforts to verify. Developing analytically backed income estimation surrogates based on other more easily recordable and verifiable behaviours could remove dependency on such information without limiting risk estimation.

For instance, customers who provide an Aadhaar card, own a particular brand of car, spend a certain amount at a retail outlet, consume a particular brand of automotive fuel or use mobile phones with biometric capabilities could fall under different risk grades, which would then determine pricing, product features and other service levels. Harnessing analytics to find these connections is the key to ensuring that innovative distribution strategies can be fully utilised without increasing the risk of fraud.

Dynamic product design

Companies should also consider dynamic product design based on the channel and programme. For example, internet channels, which limit the amount of verifiable information that can be collected from customers, would be used to distribute vanilla products with higher risk assumptions baked into the pricing models, while channels that foster greater information access and verification could be used to deliver more complex products with higher degree of pricing flexibility. Models would take into account the channel of interaction while forecasting customer risk and arriving at the appropriate pricing and customer engagement strategy.

Considering these risks and challenges is imperative for developing a robust distribution model. Firms need to balance supply-side challenges, such as regulatory requirements and optimal incentive structures, with demand-side stumbling blocks through well thought-out systems, structures and controls, so as to truly extract the potential that technologies such as mobile and digital provide to any distribution strategy. Harnessing the key facets of these technologies would significantly expand the reach, productivity and profitability for financial services firms and help them capitalise on the very apparent trends that are reshaping the way these industries function.

About CII

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organisation, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 7200 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 242 national and regional sectoral industry bodies.

CII charts change by working closely with government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialised services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues.

Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes. Partnerships with civil society organisations carry forward corporate initiatives for integrated and inclusive development across diverse domains including affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few.

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With 64 offices, including 9 Centres of Excellence, in India, and 7 overseas offices in Australia, China, Egypt, France, Singapore, the UK and the US, as well as institutional partnerships with 312 counterpart organisations in 106 countries, CII serves as a reference point for Indian industry and the international business community.

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