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# The Pursuit of Complete Financial Inclusion

## The KGFS Model in India

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**A**lakudi is a remote farming village near the southernmost tip of India in Tamil Nadu State. It would take 30 minutes or more by foot to reach the nearest dilapidated bank branch, though most Alakudi residents have never bothered to make the trip. Within a short bicycle ride or walk along dirt lanes, all 2,000 households in Alakudi can reach a Kshetriya Gramin Financial Services (KGFS) branch. Each branch is painted in KGFS green and orange with an open front, rows of wooden benches, a teller window, two online computers, and three uniformed staff. But the villagers' first contact with KGFS probably would not have happened at the branch.

When the KGFS branch opened in Alakudi in September 2008, staff visited every household to conduct a village and household mapping exercise to demarcate the service area for the branch. They also invited villagers to come to the branch to enroll. As part of enrollment, staff completed a comprehensive know your customer (KYC) check, including a household visit, and compiled a household financial well-being report based on data provided by each household. This report established a household profile, specified financial goals, and formed the basis for KGFS staff to recommend a tailored portfolio of two to three financial products to meet each client's goals. KGFS staff visit each client's home every six months to update the report and give financial advice. Since KGFS arrived in Alakudi, 76 percent of all households have enrolled; of these, 89 percent have already begun to use some of the 15 financial products available at the branch.

The approach used in Alakudi illustrates how the KGFS model is being applied in various parts of India. Three core operating principles differentiate the KGFS model: (1) complete coverage of the population in a focused geographic area, (2) customized client wealth management services, and (3) a broad range of products.

The KGFS approach is still fairly new, though it has moved beyond being a small experiment. Five separate KGFS institutions are working in very different regions of the country and serve a total of

200,000 clients. The oldest KGFS has been in operation since June 2008, and the most recent commenced operations in February 2012. At the end of 2011 KGFS institutions had 110 branches and managed a loan portfolio of \$10 million. Some branches of these institutions have become profitable, though none of the five KGFS institutions has broken even yet on a consolidated basis. Early client response to these institutions shows a significant proportion of households, over 50 percent, enroll within the first 18 months of a KGFS branch opening nearby.

The model's customized wealth management approach starts with identifying household needs and goals to provide services centered on client needs and without biases to sell one product or another. Clients have begun to use multiple financial services centered on client needs from KGFS institutions, especially insurance and pensions. More than 60 percent of enrolled clients across all KGFS institutions use insurance services; 22 percent use only insurance. At the same time, credit remains important, with slightly more than 55 percent accessing a loan product. The ultimate aim is meaningful improvement in the financial well-being of households, an outcome KGFS is evaluating with external research help.

This publication explores lessons from the KGFS model. The intent is not to endorse the model, but rather to use early experience to share ideas and observations. The first three sections explore the three core principles of the KGFS design, explaining how each is implemented and how together they deliver results. The fourth section summarizes the client response so far, reviews how far the financial viability of the model has progressed, and explores the applicability of the three core KGFS principles to contexts beyond India.

Throughout this publication data from December 2011 are used unless otherwise noted. In some cases, data from the oldest 14 branches (each having been in operation more than two-and-a-half years) are used to illustrate how the model has evolved in its more mature settings. That said, the patterns seen at the end of 2011 can show only a work in progress.



## Background on Kshetriya Gramin Financial Services<sup>a</sup>

The KGFS model is promoted by IFMR Trust (<http://www.ifmr.co.in/>) whose mission is to “ensure that every individual and every enterprise has complete access to financial services.”<sup>b</sup> IFMR Trust provided the initial capital of \$10 million to launch the first three KGFS institutions, targeting a return on its equity of 20 percent annually. Each KGFS institution leverages additional financing from capital markets as well as loans from domestic commercial banks. No grant funds have gone into any KGFS. As new investors show interest, additional KGFS institutions will be opened in different parts of India.

In addition to the initial capital for the original KGFS institutions, IFMR Trust invested \$4 million in IFMR Rural Finance. This company owns and licenses the KGFS brand, incubates new KGFS institutions, develops new products, and ensures a consistent approach across all KGFS operations. This licensor–licensee model aims to preserve the core approach of KGFS while tapping into wider pools of capital to accelerate replication. IFMR Rural Finance receives a license fee linked to KGFS revenues.

One KGFS institution in Tamil Nadu is a nonbank finance company (NBFC) licensed and supervised by India’s central bank; it is not permitted to take deposits. NBFCs can make loans and can serve as agents for pension funds, insurance companies, and securities brokerages. However, NBFCs are barred by regulation from serving as agents of commercial banks for savings account operations.

The four other KGFS institutions are using different legal structures that facilitate client access to a full range of financial

products, including savings accounts, while permitting appropriate risk-sharing with partner financial institutions. KGFS management believes that the ideal eventual structure is for each KGFS to be registered as an NBFC. The legal structures will, however, have to evolve given the changing regulatory landscape for NBFCs and use of bank agents in India.

Although all KGFS institutions have a common parent company that provides equity capital to each KGFS, each KGFS institution is designed to be an autonomous, self-contained regional operation with its own management team hired locally. KGFS management believes that this separation, in contrast to a single national institution, enables region-specific innovations as well as superior internal control to emerge.

KGFS institutions were set up in very distinct regions of the country with a view to understanding the design implications of the model in diverse regional contexts. One KGFS serves Thanjavur and Thiruvarur districts of Tamil Nadu, which are fertile agrarian economies. Another operator in Orissa serves Ganjam and Khurda districts, which are economies characterized by subsistence agriculture supplemented by domestic migration. The KGFS in Uttarakhand serves five hilly districts that are sparsely populated, where the underlying economies are dominated by trade and services. The three core elements described in this paper are standard across all KGFS institutions; however, serving diverse geographics has enabled KGFS to learn, adapt, and apply the learnings to new KGFS institutions.

<sup>a</sup> The literal translation is Regional Rural Financial Services.

<sup>b</sup> IFMR Trust was provided seed funding by ICICI Bank in 2008 to incubate new business models in financial inclusion.



## Three Operating Principles of the KGFS Model

Three fundamental operating principles distinguish the KGFS approach:

- 1.** Focused geographic commitment and complete population coverage. Each KGFS institution and branch is responsible for a specific catchment area and is expected to serve the entire population in that area, enrolling as many clients as possible.
- 2.** Client wealth management approach. KGFS staff recommend a customized set of services for each client based on in-depth household assessments.
- 3.** Access to a broad range of products. KGFS works primarily as an agent of banks, insurance companies, mutual funds, and pension funds to offer each client smooth access to a broad range of services.

Implementing each principle involves complex delivery challenges and significantly shapes client interactions.

## Focused geographic commitment and complete population coverage

Each KGFS institution is designed to be a regional institution serving a specific territory with distinct geographic, economic, and linguistic characteristics. As a rule of thumb, a single KGFS institution serves a rural population of 2 million to 3 million through a network of 200–300 branches. The branch is the fundamental business unit. Each branch serves a population of roughly 10,000 individuals or 2,000 households. Branches have two or three staff, called “wealth managers,” who perform all administration and customer service functions. Regional managers oversee 35–40 branches and 90–120 wealth managers. Each KGFS institution has its own chief executive officer and head office structure. All KGFS staff are local residents who have deep knowledge of their respective regions.

New branch locations emphasize outreach to underserved villages, using the following criteria to define the service area:

- No village in the service area should have more than 4,000 inhabitants.
- There should be no branches of any private sector financial institution in the service area.
- There should be no more than one branch of any public sector financial institution in the service area.
- The KGFS branch should be at least seven kilometers from the nearest town center.
- The service area should not extend beyond a five kilometer radius of the branch office.

A village survey records geo-coordinates of every household. This narrow and clearly defined geographical focus ties each branch to the residents in its catchment area. The KGFS model incorporates the belief that geographical focus at all

levels helps customization. For example, staff only use local dialects<sup>1</sup> to communicate with each other and with clients. All signage and documents are in the local language, and branches adjust timings for local convenience. The model is also based on the idea that local ties will help the institution react more quickly to local events, such as a bad harvest or low rainfall, for instance, by relaxing repayment dates or extending emergency loans.

In addition, the model reflects the belief that geographical focus ensures a sustained effort to engage clients intensively. A branch is required to focus on maximum possible enrollment within its territory; a branch constantly tries to deepen relationships with its clients. It does not have the option to enroll clients who reside outside its service area.

For the first month after a branch is established, enrollment of individuals is the only activity. The first part of enrollment occurs at the branch. It establishes biometric identification (fingerprints) and completes KYC requirements. The enrollment process also links clients to the household where they reside. The second part is gathering household information, which may be collected at home or at the branch, depending on what is convenient for the client.<sup>2</sup> The wealth manager gathers baseline information on the client’s household income, expenditure, assets, and liabilities. The adults in the household identify up to five household financial goals, such as covering marriage expenses, having income for old age, paying school fees, or purchasing property. This information is used to generate a financial well-being report, which is then used to develop recommendations of financial products for each client.

1. India has over 22 languages and over 840 dialects.

2. In cases where there are multiple clients from the same household, each client is tagged to that household. Only a single set of information is collected and used for each household.

## BOX 2

### A Public Health Approach to Financial Inclusion

Public health goes beyond medically treating individuals to taking wider responsibility for the overall health of a population. Instead of measuring success by the number of sick patients treated, public health workers seek to achieve outcomes for the total population, for example, lower infant mortality or increased immunization coverage. The KGFS model adopts a similar mindset. Each branch is responsible for the financial well-being of the entire population in its catchment area.

Another public health analogy is KGFS's focus on preventive measures for high-risk households that require structured follow-up, for example, recommending insurance coverage to a household that relies heavily on the earnings of one individual. Of course, the public health analogy is not perfect; public health interventions, such as provision of clean water, have benefits that accrue to the entire community whereas financial services are nearly always private goods.

## Client wealth management approach

The second principle of the KGFS model is to provide tailored financial advice to every enrolled client. This is called a “wealth management” approach, adopting a term common in private banking for affluent clients. The goal of this approach is to ensure that every client uses a tailored combination of financial services that best promotes the financial well-being of the client’s household. The model is based on the belief that clients will make better choices among complex financial services when they have the benefit of advice from trained professionals. Well-delivered advice should produce better outcomes for clients. Examples of wealth management advice include the following:

- Highly indebted households are advised to refrain from further borrowing and to refinance with cheaper debt.
- Households where the current income is too low to meet their goals are encouraged to think about ways to bridge the gap and offered advice on how to finance business expansion, where relevant.
- Households with physical assets concentrated in the village, such as livestock or land, are advised to diversify through financial investments.

This approach reflects the belief that solving financial challenges of households, including optimal asset allocation and retirement financing, is complex and requires considerable expertise as well as innovation. This, in turn, entails that KGFS institutions take responsibility for the appropriateness of advice about financial services while not solely relying on official product disclosures and customer judgment. The KGFS model sets out to develop a system that provides advice that is built on the recruitment and training of wealth managers, automated generation of advice, regular monitoring and auditing, and appropriate staff incentives.

The primary practical question is whether KGFS staff are skilled enough to deliver financial advice. KGFS wealth managers are from the local area and typically have 12 years of schooling. Few have university degrees, and their position at KGFS is often their first professional job. To address skill deficiencies, the KGFS model emphasizes systematic staff training. A curriculum based on a conceptual understanding of household finance is the main building block of staff orientation and ongoing capacity development. New wealth managers must complete a 21-day training course and pass a certification test. KGFS management learned early on that individuals with experience in retail financial services bring a very strong product orientation, and it was almost impossible for them to make the transition to a wealth management approach. As a result, almost all KGFS hires have no prior experience in financial services distribution.

The model also uses automation to address deficient staff skills. Wealth managers base their advice on the household data collected at the time of enrollment. These data are summarized in a financial well-being report that uses a set of predefined wealth management algorithms. (Go to [www.ifmr.co.in/fwr](http://www.ifmr.co.in/fwr) for an example of a financial well-being report.) Automated reports help wealth managers match household goals with an optimal set of services to meet those goals, typically two to three products per household. Wealth managers discuss the report with family members before any services are provided, and the reports and advice are updated every six months.

Maintaining the quality of the wealth management approach is an ongoing operational challenge. Standardized drop-down menus and various cross-checks that triangulate data to remove inconsistencies are used to help ensure the good quality of data entered at the time of enrollment. Even the advice provided to clients has been stan-



standardized through pre-set parameters. For example, recommended insurance amounts are linked to an automated estimate of lifetime net earnings.

Even though the wealth management process is aided by training and automated recommendations, it still relies on the skills of wealth managers to convey advice accurately. To reinforce staff skills, branch wealth managers begin each day discussing one household case chosen at random. When regional managers visit branches, they first discuss household financial well-being reports rather than sales targets or repayment rates. The aim is to make client financial well-being central to daily routines. This is also reflected in how wealth managers spend their time. KGFS estimates that wealth managers spend about half of their working time enrolling and advising clients, and there is a constant search for ways to free up more staff time for more client advice and follow-up.

Audits of a sample of household financial well-being reports are conducted to verify the accuracy of enrollment data. There are plans for a system to check the quality of wealth management advice and how the client is implementing that advice.

The KGFS model also seeks to align staff incentives to the goals of the wealth management approach. Many financial institutions link staff incentives to product sales, such as loan amounts disbursed, insurance policies sold, or savings balances generated. This can lead to pushing high-

commission products, as well as creating consumer protection concerns.

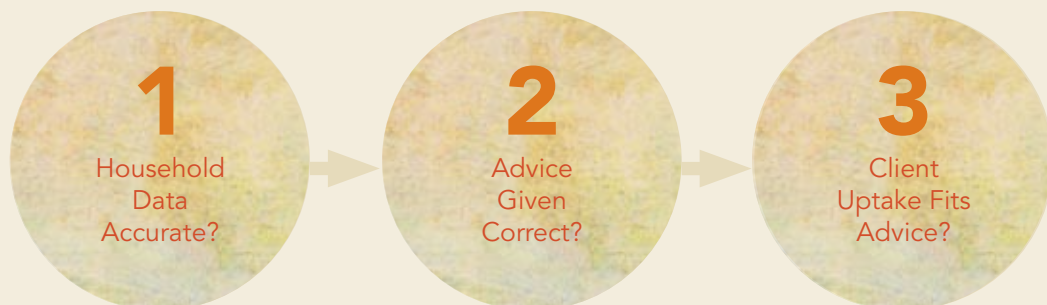
The KGFS model aims for a fundamental shift from a supply-driven, one-size-fits-all focus to a customized sales process centered on client needs. Performance appraisals for wealth managers emphasize completing the household analysis and delivering advice correctly. The KGFS institution evaluates staff on process goals, such as enrollment rates, the accuracy of financial well-being report data, and staff understanding of households and products. The long-term vision is to link staff financial incentives to improvements in household financial well-being.

With more experience and data, KGFS institutions will be able to establish an index that measures changes in wealth, the volatility of cash flows, and the ability of households to meet identified goals.<sup>3</sup> One challenge is establishing an index that staff can clearly understand and relate to their own performance. Causality is another challenge when changes in financial well-being might be linked to many factors beyond KGFS services.

3. Other indices, such as the Progress out of Poverty Index (PPI), measure client outcomes. KGFS aims to build a different kind of index because it works with clients above and below the poverty line, and a poverty line measure would not capture all changes KGFS seeks. The goal is to develop an index that captures a wide range of financial well-being goals at the household and aggregate regional level.

FIGURE 1

### Quality Control of the Wealth Management Process





PART  
3

## Access to a broad range of products

Central to the KGFS vision of complete financial inclusion is the conviction that households need a diverse range of financial services. An important feature of providing a range of services is that products are not bundled; each must make sense on its own. For example, credit and life insurance are always offered separately, and using one does not require having the other. While each KGFS can offer nearly all available products, it is understood that appropriate advice as well as client use patterns will vary by region.

Products are grouped into four broad categories that correspond to client needs and objectives (short descriptions of each product are available in the Annex):

1. **Plan.** Tools that help people manage short-term liquidity needs. These include savings, money market investments, short-term loans (secured and unsecured), and payments services.
2. **Grow.** Products that allow households to increase income or reduce expenses. This category includes working capital and term loans for businesses, higher education loans for students, and refinancing debt.
3. **Protect.** Products that mitigate risk and include many types of insurance (e.g., life, accident, health, shop, and livestock).
4. **Diversify.** This category includes investment instruments that help achieve inflation protection and offer better risk-adjusted returns. These help households diversify their assets away from land or livestock toward assets that are better protected if the local economy hits a slump. Products in this category include pensions and potentially equity-index funds.

To finance their lending, KGFS institutions operate like other nondeposit-taking financial institutions: they borrow funds wholesale and on-

lend directly to clients through a series of credit products (group loans, loans against gold, and small business loans are the three most popular). KGFS institutions sometimes sell their loan portfolios to other financial institutions, a common practice in India. Even in such cases, however, they take a sizeable share of any credit risk to avoid moral hazard and ensure there is a strong incentive to maintain portfolio quality. Interest earned from credit is the main revenue source for KGFS institutions.

To provide services other than credit, KGFS institutions collaborate with other financial institutions. Pension, insurance, securities, and banking all have different regulators in India, and it is difficult, if not impossible, for one organization to be licensed to offer a broad range of products. Also, licenses are most often granted to only a few large financial institutions. So KGFS institutions are designed to operate primarily as agents of larger financial institutions. For example, a KGFS institution acquires new insurance clients, collects premiums, and settles claims on behalf of large insurance firms that issue the policies. This approach combines well-tested products of large financial institutions with the deep reach of KGFS into rural markets. An important motivation for large financial institutions to partner with a KGFS institution is that government policies often require them to extend services to low-income and under-banked clients, in some instances even setting outreach targets.

Economic shocks entail covariant risks that endanger regional financial institutions with a disproportionate exposure in one geography. The KGFS model holds that such risks are best managed on the balance sheets of large financial institutions with deep and well-diversified holdings. This is especially important for insurance and pensions, where the assets of low-income clients may be better protected in large, carefully regulated financial institutions.

FIGURE 2

## Broad Range of Products Support Household Goals



Note: The first KGFS in Tamil Nadu is an NBFC that is barred by regulation from offering any deposit service on behalf of a bank partner, though it can offer the Money Market Mutual Fund product, which is a close substitute for a basic liquid savings account. Other KGFS institutions do not fall under an NBFC legal structure and will be able to offer a deposit service as an agent for a bank. At the time of this writing these products were under development.

While the back-end of a KGFS institution includes multiple partnerships with financial institutions, various operational features make client interface relatively seamless. These features include the following:

- One-stop enrollment
- Client-focused information formats
- Online and real-time core banking system
- Integrated product development with partners
- Risk sharing

**One-stop enrollment.** The KGFS master KYC enrollment process does not have to be repeated for different products. This process meets the requirements of banking, insurance, pension, and securities regulators.

**Client-focused information formats.** A customer management system keeps data on all clients, detailing the complete portfolio of services they are using. The system is structured around a

client's use and wealth management needs rather than tracking product data.

**Online and real-time core banking system.** An essential enabler of integration with large financial institutions is an online, real-time computerized information system of the same standard used by large banks.<sup>4</sup> This integration capability keeps variable costs low, builds the confidence of partner financial institutions, and strengthens client trust through a system that works in real time. However, it is a challenge to sustain systems in some environments, particularly mountainous northern India where KGFS institutions have had to invest in relaying technology that connects branches across valleys and around mountains. They also have had to address unreliable electricity supply by putting in place back-up arrangements and business continuation processes. Nevertheless, technological integration is essential to the model, so KGFS has invested in this from the beginning.

4. KGFS currently uses a core banking system offered jointly by Fidelity and Wipro.

**Integrated product development with partners.** Painstaking product development is central to the partnership model. This work is led by IFMR Rural Finance, the KGFS licensor, which ensures that each KGFS uses standardized products developed jointly with large financial institutions. Each product needs detailed planning and process testing. For example, even though insurance is provided on behalf of an insurance company, KGFS commits to the client that valid insurance claims will be partly paid out on the same day the claim is filed

and that full final settlement will occur within a week. This requires a carefully crafted service-level agreement with the insurance company.

**Risk sharing.** Even where it acts as an agent of other financial institutions, KGFS institutions always commit capital against credit risk as well as operational risks arising from how services are delivered. This financial commitment demonstrates to the partner financial institution that KGFS incentives are aligned and that service quality is a critical feature of seamless delivery to clients.

## Client Response So Far

Enrollment is the gateway to accessing any service from KGFS. Although the client does not have to pay a fee, it takes about 30 minutes to enroll, and a wealth manager has to physically verify the place of residence. Enrollment grows most quickly right after branch opening, but continues to rise more than 30 months later.

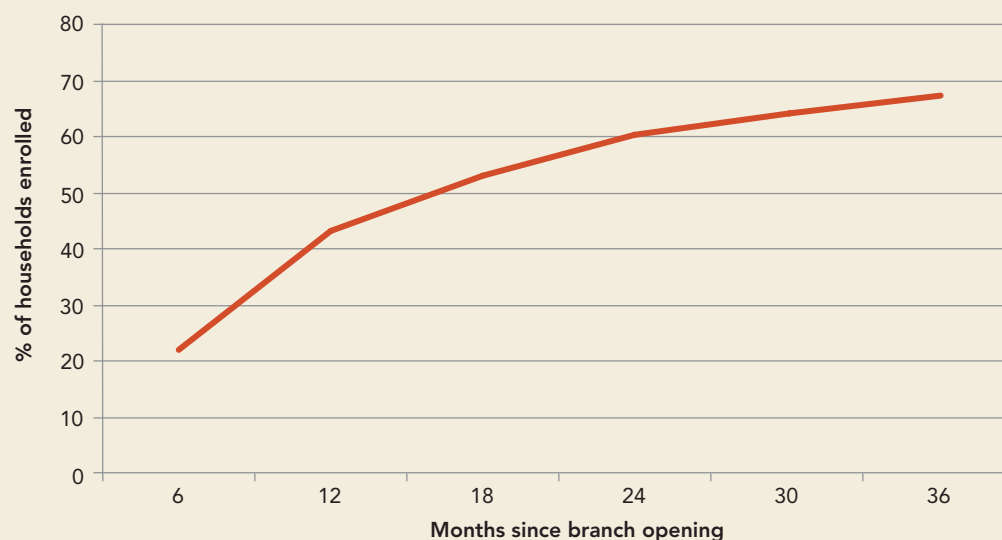
Branches in existence for more than 30 months have average enrollment rates of nearly 70 percent, with some even higher. These are penetration levels few financial institutions achieve in any geography, let alone remote rural India. KGFS staff talk about a “learning effect” whereby more recently established branches that have learned from earlier experiences are seeing even faster enrollment rates. Faster enrollment may also be linked to growing fa-

miliarity with the KGFS brand as well as a broadening of the product offerings since the first KGFS institution started its operations.

Despite persistent enrollment efforts, some clients have not enrolled even after 30 months. Spatial analysis shows that distance-to-branch is a factor. Although no household is located more than five kilometers from the branch, those nearest to the branch tend to enroll sooner than those in the periphery. Households headed by seasonal migrants also tend to have lower enrollment rates, possibly due to not feeling as much need for a local service. And households with large landholdings stay out more often, possibly based on their perception that KGFS is a brand for less affluent households.

FIGURE 3

### Enrollment Rates as Branches Mature



Note: Measures percentages of households enrolled over total households in catchment. The sample cohort is the 14 oldest branches measured at time intervals after branch opening.

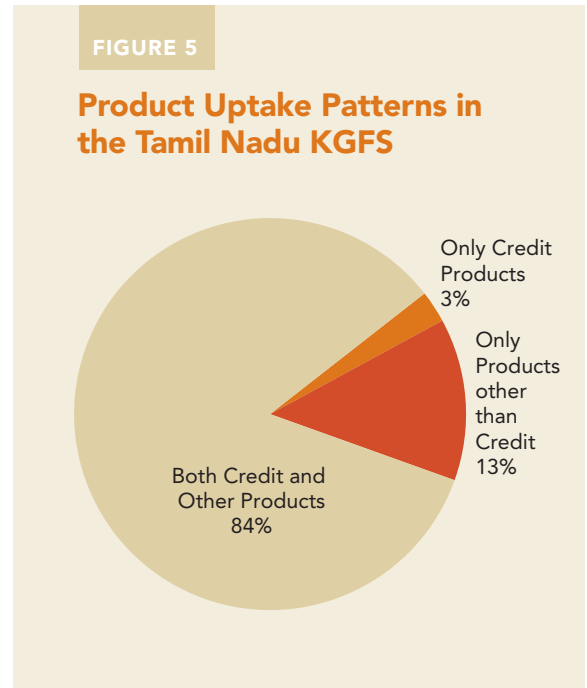


Figure 4 illustrates enrollment by household income level for KGFS in Tamil Nadu. This distribution shows households enroll across a spectrum of income levels, with the largest share distributed among households with between \$500 (INR 25,000) to \$2,000 (INR 100,000) annual income.<sup>5</sup>

Figure 5 illustrates the substantial demand for noncredit services. In the early stages of the expansion of KGFS institutions, there was heavy demand for personal accident insurance, driven by the need to protect the income of household bread-winners. A similar need for protection drives a more recent surge in term life insurance requests. Over 60 percent of enrolled households in the Tamil Nadu KGFS are insurance clients. And almost 20,000 clients signed up for the National Pension Scheme-Lite product in the first 18 months after it was launched.

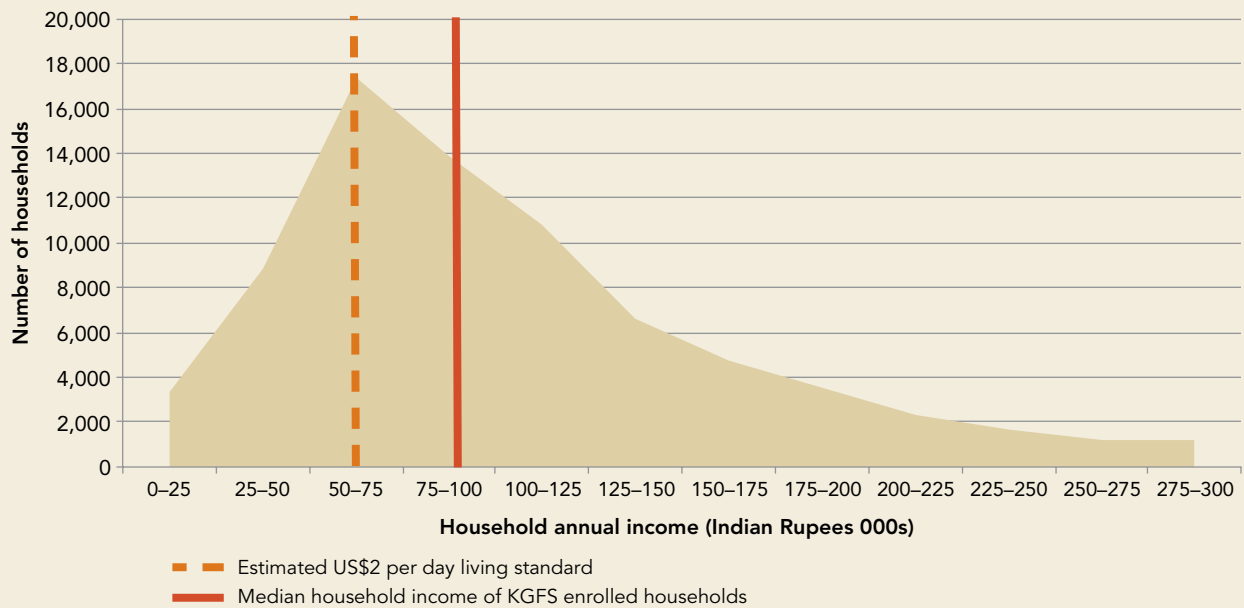
KGFS attributes the uptake of insurance and pension products to the wealth management ap-

5. Based on exchange rate of INR 50 per U.S. dollar.



**FIGURE 4**

**Annual Incomes for Enrolled Households, Tamil Nadu KGFS\***



\* Estimate of \$2 per day based on \$1.25 2005 PPP Index for India, multiplied by 2/1.25, inflated by 7 percent over six years and adjusted to average household size of 4.5.

proach. Branch staff are trained to understand the specific needs of each household and routinely practice explaining insurance and pension products. Since products are not bundled or linked to each other, uptake reflects an independent choice for each product and a more realistic picture of underlying need. As new products become available, especially new deposit services that will be offered by the two new KGFS institutions, there will be opportunities to observe new client behaviors.

## Financial Performance So Far

At this stage of their development, KGFS institutions rely on net interest income on loans for 85–90 percent of total revenues, with fees for other services, such as insurance and pension distribution accounting for the remaining 10–15 percent. Fee revenue related to the distribution of noncredit products is expected to increase as a portion of total revenue as new services like domestic payments gain momentum. But even then the overall contribution of fees for noncredit products is expected to remain under 20 percent. Since fees are determined by KGFS partners under rules that are often set by regulators, opportunities to raise further revenues from fees are limited.

Table 1 presents a stylized branch income and expense statement that illustrates drivers of branch profitability and break-even levels of operations for a single branch. This stylized income and expense statement is typical of the 14 oldest KGFS branches.

The income of a branch depends on a high-quality credit portfolio of at least \$240,000 composed of a broad mix of joint-liability group loans, loans secured by jewelry, and working capital loans for small businesses. According to the KGFS model, demand for loans will grow beyond this level since branch service areas are estimated to have economic outputs of \$4 million to \$5 million. Assuming one-third of households borrow from KGFS, a \$240,000 loan portfolio means an average loan balance of \$360 per household, equivalent to one-fifth of the median income of enrolled households. There would remain significant unmet demand for loans, and over time KGFS expects to have a more diverse set of larger size credit products, such as asset-backed loans for commercial vehicles and farm equipment and infrastructure loans for things like commodity warehouses. These will also generate considerably more income and should improve overall financial performance.

The multi-product approach means that prices charged to clients per product can be reduced as economies of scope kick in. Once enrolled, the marginal cost to KGFS of clients using additional services is very low, especially since all services are provided at the branch and do not require additional household visits.

Beyond recovering branch costs, the profitability of each KGFS as a whole depends on recovering fixed costs incurred by regional hubs and headquarters. KGFS estimates that 30–40 branches operating at full capacity will be needed to cover these additional costs and lift a KGFS to overall profitability.

**TABLE 1 KGFS Branch Break-Even Illustration (\$US)**

Expenses	Amount*	Income	Amount*
Wealth manager salary (3)	\$6,000	Interest income (8% margin over cost of funds on a \$240,000 loan portfolio)	\$19,200
Internet connectivity and technology	\$1,920	Fee income from noncredit products	\$1,920
Rent, electricity, and other branch overhead	\$7,200		
Branch depreciation	\$960		
Loan loss (1% on a loan portfolio of \$240,000)	\$2,400		
<b>Total Expenses (a)</b>	<b>\$18,480</b>	<b>Total Income (b)</b>	<b>\$21,120</b>
<b>Net Income (a) – (b)</b>	<b>\$2,640</b>		

\*Amounts in Indian Rupees, US\$1 = INR 50

The depth of penetration (inclusion of most households and more than one client in many households) in a single local area enables KGFS branches to reach scale in a relatively small geography. It is projected that the Tamil Nadu KGFS institution will achieve full profitability during 2012, based on depth of penetration and the increasing maturation of its 66 branches. This matches KGFS's initial expectations, which took a four to five year view on what is required to achieve deep financial inclusion.

### **Can the KGFS Approach Be Applied More Widely?**

Initial experience shows that clients are increasingly responding to the KGFS approach, operational challenges can be overcome, and financial viability is within reach. Client acceptance is reflected in the high enrollment and take-up rates across multiple products, especially in the significant demand for insurance and pensions. Operational challenges presented by using the intensive wealth management approach and the partnership model have largely been overcome.

The next step was taken with the launch of the fourth and fifth KGFS institutions in early 2012, which was partly funded through equity contributions from strategic investors. Wholesale funding from domestic financial institutions is being developed to finance expansion. The process of adapting to new geographies will remain an ongoing challenge as KGFS institutions open across India. Beyond India, however, how transferable are the three core operating principles in other parts of the world?

The commitment to work with the entire population of a small geographic area should be possible in other environments. The coverage area of one institution may need to be expanded or contracted, depending on the population density of the area covered and how varied the area is economically and linguistically. Branch service areas and regional coverage will have to be adjusted to ensure viability while not losing the emphasis on deep local knowledge.

While KGFS has shown some good progress in the remote mountainous areas of India, it is not cer-

tain whether a focused geographic commitment would work as well in highly dispersed populations—any expansion of a branch's area implies more travel time for both clients and staff. The KGFS approach has also not been tested in more urban geographies where distances are smaller, more service choices exist, and financial service needs are different.

The wealth management principle is predicated on solid information and good advice that enables clients to properly use a full range of financial services. Considerable resources are invested to recruit and train staff who can map client needs to available products. KGFS front line staff usually have only 12 years of schooling, though even this level of education among human resources might not be available in some environments. The demands of the wealth management approach have required persistence and patience that might not suit the appetites of all investors or be appropriate for all policy environments. Another open question is whether wealth management should go to scale without more formal protections against exploitative sales practices and better client recourse procedures being embedded within a country's consumer protection regulations. It is also worth considering whether a balance of staff training and client training might be more feasible and lead to better outcomes than the current KGFS approach of primarily focusing on staff capability to provide good financial advice.

The third principle of integration into the wider financial system certainly has potential within India where regulations and the financial institutions permit the model. Other countries, however, may not have large, sophisticated financial institutions or policy pressures to encourage financial inclusion that enable a KGFS-like agent model to gain traction. Also, regulations permitting organizations to act as agents on behalf of larger financial institutions are not always suitable and often impose significant constraints on agent institutions. In some countries, there may be more of a need for a "do-it-alone" style organization, such as the microfinance banks that work well in some environments.

Of course, the acid test for the KGFS model is whether it improves household financial well-being, especially relative to other models and ap-

proaches. Globally there have been a series of microfinance impact evaluations recently, most of which aim to measure the short-run (12–18 months) household impact of access to a single financial service, typically short-term credit (Bauchet et al. 2011). With a view to understanding what outcomes can be attributed to the KGFS approach, IFMR Trust has commissioned an impact evaluation of the KGFS institution in Tamil Nadu. This randomized evaluation<sup>6</sup> will examine the following:

- Household impacts from access to a broad range of financial services, not just credit.
- Impact on client outcomes from a wealth management approach that tries to better match service needs with use.

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6. The principal investigators for this evaluation are Rohini Pande (Harvard University) and Erica Field (Duke University).

- Aggregate village-level impacts on variables, such as social networks, wage rates, and migration behavior.
- Impact over a three-year duration, twice as long as most randomized impact studies. An even longer duration to fully understand transmission pathways would be ideal, but randomization is difficult to sustain over longer time frames.

The baseline work for this impact study is already underway with results expected in 2014–2015.

But even with what can be observed today, the KGFS model demonstrates how a business model can be reconfigured to pursue complete financial inclusion: committing to reach as many households as possible in a service area, putting client needs at the center, and offering a wide range of needed services. The KGFS experience introduces new financial inclusion ideas that deserve further consideration in India and around the world.





## Annex

PRODUCT	FEATURES	COST TO CLIENT*
<b>PLAN</b>		
Money Market Mutual Fund (MMMF)	<p>Investment in an MMMF, for short-term liquidity management. Underlying investments are mostly treasury bills of short maturity.</p> <p>No minimum investment amount.</p> <p>Redemptions can be encashed, with one-day notification, but a short-term credit facility allows for immediate access to liquidity as well.</p> <p>Maximum transaction size is INR 50,000.</p>	Nil
International Remittances	<p>In-bound remittances through Western Union Money Transfer can be encashed at KGFS branches.</p> <p>Clients (beneficiaries of the remittance) submit a unique Money Transfer Control Number (MTCN) at the branch along with other details, to receive cash.</p> <p>Maximum cash that can be received per transaction per day is INR 50,000.</p> <p>Client is entitled to 12 transactions per year.</p>	Nil, sender bears expense
Jewel Loan	<p>Secured loan to individuals with gold jewelry as security. Valued and kept securely by KGFS.</p> <p>Maximum loan size is INR 50,000.</p> <p>Bullet repayment within one year.</p>	23% APR
Joint Liability Group (JLG) Loan	<p>Individual loan backed by group guarantee from a homogenous group of five clients.</p> <p>Maximum loan size of INR 15,000 in the first cycle, with an increment of Rs. 5,000 in subsequent cycles (up to a maximum of INR 25,000).</p> <p>Repayment is to be done in weekly installments over 50 weeks.</p>	21.5% APR
Emergency Loan	<p>Unsecured individual loan to all clients who have successfully repaid first cycle of JLG.</p> <p>Maximum loan size is INR 2,000.</p> <p>Bullet repayment within one month.</p>	24.50% APR
<b>GROW</b>		
Enterprise Loan	<p>Unsecured loan to individual retailers backed by a third-party guarantee.</p> <p>Maximum loan size is INR 50,000.</p> <p>Repayment can be done weekly/fortnightly/monthly, over a tenure ranging from 6 to 24 months.</p>	APR ranges from 24.1% to 24.6%
Education Loan	<p>Unsecured individual loan for financing higher education, backed by a third-party guarantee.</p> <p>Maximum loan size is INR 25,000.</p> <p>Repayment in monthly installments over 12 months.</p> <p>Loan is given to family member/guardian of the student.</p>	24% APR

\*All annual percentage rates (APRs) as of December 2011.

## Annex, continued

PRODUCT	FEATURES	COST TO CLIENT*
Livestock Loan	<p>Unsecured loan to clients already engaged in dairying activity to expand their activities through purchase of cattle.</p> <p>Maximum loan size is INR 25,000.</p> <p>Clients need to hypothecate existing as well as new cattle to KGFS.</p> <p>Clients need to get existing as well as new cattle insured under Livestock Insurance.</p> <p>Repayment in fortnightly/monthly installments over a maximum tenure of 24 months.</p>	24% APR
Housing Loan	<p>Secured loan for financing construction of a new house.</p> <p>Maximum loan size is INR 100,000 disbursed in four tranches, each not exceeding INR 25,000, and set based on client income.</p> <p>Collateral is the original land title of the same land on which the house is being built.</p> <p>Repayment is in monthly installments, over a maximum tenure of 36 months.</p>	21% APR
<b>PROTECT</b>		
Personal Accident Insurance	<p>Insurance to cover death or disability due to accident.</p> <p>All KGFS clients 18–59 years are eligible.</p> <p>Tenure of the policy is one year, renewable every year.</p> <p>The sum assured varies from INR 100,000 to Rs 300,000 in multiples of Rs 100,000.</p>	Premium is INR 55 per INR 100,000 of cover
Term Life Insurance	<p>Insurance to cover death of person; indemnifies the loss of income.</p> <p>All KGFS clients 18–59 years are eligible.</p> <p>Tenure of the policy is one year, renewable every year.</p> <p>The sum assured varies from INR 25,000 to INR 2,50,000 in multiples of INR 25,000.</p>	Premiums vary from INR 162 to INR 1,458 per INR 100,000 depending on age of person
Shopkeeper's Policy	<p>Insurance to protect loss of income of KGFS retailer loan clients due to destruction of shop.</p> <p>The cover is for the business locations against fire and allied perils and burglary.</p> <p>The sum assured varies from INR 12,500 to INR 25,000, depending on value of the building contents (which range from INR 50,000 to INR 100,000).</p> <p>Payouts are based on loss estimates subject to maximum limit of the sum assured.</p> <p>Tenure of the policy is one year, renewable every year.</p>	Premiums range from INR 215 to INR 430
Livestock Insurance	<p>Insurance to cover death of cattle owned by KGFS clients (only for dairy purposes), up to 85% of market value of cattle or client declared value, whichever is lower.</p> <p>Cover ranges from INR 8,000 to INR 40,000.</p> <p>Age limits for the cattle is specified, and this needs to be confirmed by a veterinary doctor.</p> <p>Tenure of the policy is one year.</p>	3.88% of sum insured + Service Tax

\*All annual percentage rates (APRs) as of December 2011.

PRODUCT	FEATURES	COST TO CLIENT*
<b>DIVERSIFY</b>		
National Pension Scheme-Lite (NPS-Lite)	<p>This pension product regulated by India's pension regulator can be offered at KGFS branches (because KGFS is an authorized subaggregator for NPS-Lite).</p> <hr/> <p>KGFS clients register to obtain their permanent retirement account number (PRAN) and open their account at KGFS to build a corpus for their retirement years.</p> <hr/> <p>Up to 12 transactions per year are free.</p> <hr/> <p>Contributions by clients get invested by chosen pension fund managers.</p> <hr/> <p>Once client passes 60 years of age, he/she can withdraw up to 60% of the corpus as a lump sum and purchase an annuity with the remaining 40% (which the client would receive as monthly pension until age 70).</p> <hr/> <p>Clients working in the informal sector can also avail the central government's Swavalamban scheme (in which government will contribute INR 1,000 to every subscriber's annual contribution between INR 1000 and INR 12,000 for the next four financial years starting 2010–2011).</p>	<p>Registration fee of INR 35</p> <p>Annual maintenance charge of INR 70</p>
Gold Investment	<p>Loan scheme to buy gold coins by making payments in installments and receiving physical delivery of gold at the end of tenure.</p> <hr/> <p>Gold price is fixed as of the date of availing the product.</p> <hr/> <p>Gold coins are available in weights ranging from 4 grams to 10 grams.</p> <hr/> <p>Maximum loan size is INR 50,000.</p> <hr/> <p>Payments can be made in weekly/monthly installments for up to one year.</p>	23% APR

\*All annual percentage rates (APRs) as of December 2011.



## Reference

Bauchet, Jonthan, Cristobal Marshall, Laura Starita, Jeanette Thomas, and Anna Yalouris. 2011. "Latest Findings from Randomized Evaluations of Microfinance." Forum 2. Washington, D.C.: CGAP, Abdul Latif Jameel Poverty Action Lab, Financial Access Initiative, and Innovations for Poverty Action, December.





