Business Standard

Subir Gokarn: BHAG Inclusion BHAG

The goals for financial inclusion need to be matched by the means being used

Subir Gokarn January 12, 2014 Last Updated at 21:50 IST

In their book Built to Last: Successful Habits of Visionary Companies (1994), James Collins and Jerry Porras postulated that an important characteristic of such companies was their articulation of their Big Hairy Audacious Goal, or BHAG. In contrast to the operational goals that company managements usually specify to measure their performance against, BHAG is a long-term aspiration and inspiration that they saw as an energising and motivating force for the entire organisation.

The goal of the Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, a panel chaired by Nachiket Mor that submitted its report to the Reserve Bank of India (RBI) last week, is truly a BHAG. It visualises meaningful financial access for all adult residents of India by January 2016. The building block for this is the universal electronic bank account (UEBA). This objective has to be viewed against the backdrop of the record so far. Millions of accounts have indeed been opened over the past five years, but true access in the form of practical deposit, credit, insurance and pension products is far from being realised. So, a massively disruptive strategy is absolutely necessary. Speaking of strategy, the key to success of visionary organisations is the matching of BHAG with the instruments that will be used to pursue it. Do the committee's recommendations offer this match?

Let me focus on three components of the strategy. The first relates to the institutional structure that needs to be put in place. Clearly, relying on the existing banking system to achieve BHAG is unfeasible; new mechanisms need to be created. The committee essentially recommends a number of specialised intermediary institutions to be set up. Of course, this immediately raises doubts about the two-year time frame, but that should not be the main basis of critique. The real question is whether these new institutions can do what the old ones haven't and still make reasonable money in the process.

The key new institutions are payment banks and wholesale banks. The payment banks are intended to provide very basic services - deposit taking and payout. With no credit risk being assumed, these can function with relatively low capital, allowing them to build large networks at low cost, which can be brought down further with effective use of technology. The wholesale bank concept reflects the development of a continuum across the range of financial intermediaries. These institutions will have a more pointed focus on the target segments of the inclusion strategy and will essentially provide a second tier of intermediation between the existing banking system and these segments.

Whether this will work or not is going to depend critically on two things. One, will the cost structures of these institutions be compatible with the business environment in which they operate? One obvious barrier to banks' collective difficulties in pushing inclusion is that they find it unremunerative. Profitability over the medium-to-long term is absolutely necessary. The committee's recommendations help this along by suggesting lower capital and prudential requirements, in keeping with lower risk profiles. But, beyond that, operating costs, particularly human resource costs, need to be dramatically lower than those in the traditional banking model. Two, combining low human resource costs with high technology will yield the best returns. But making this combination work is always a challenge and there clearly will be an experimental phase during which at least some of these new institutions will fail.

The second component that I want to examine is the redefinition of the priority sector lending mandate. Raising the limit from the current 40 per cent to 50 per cent may seem like an unnecessary dose of populism, but this is perhaps more than offset by three significant recommendations. One, loans to priority sector borrowers are to be completely free of price restrictions, with any subsidy that the government wants to give them being paid directly to the borrowers. Lenders can, therefore, price their loans based entirely on their risk assessments of individual borrowers. The second is to differentiate sectors and geographies by difficulties in lending. By giving more weight to loans made to the more challenging ones, more equitable lending can be hoped for. Third, reinforcing a measure that has been suggested before, the introduction of tradable certificates based on priority sector exposure will facilitate the lowest cost achievement of a system-wide priority sector target of 50 per cent.

The risk here, of course, is that the 50 per cent limit will be gleefully accepted, while efforts on the others will lag. Merely more lending, without any of the flexibilities and efficiencies that the other recommendations provide both old and new intermediaries, will do very little for inclusion, particularly in terms of bringing relatively deprived sectors and regions more firmly into the financial fold.

The third component of the strategy that I think needs to be looked at carefully is the role of technology. At one level, there is a clear recognition of the central role that it will play in the entire process. Linking customers to institutions, one institution to another and all institutions to regulatory and credit monitoring databases in a completely seamless and real-time fashion is clearly within the realm of possibility today. This requires policy and regulatory co-ordination between the financial and telecom regulators and, perhaps, others as well, which, if effectively done, will be good for BHAG.

However, there are low-hanging fruits that the current state of technology provides access to and will allow for the building block UEBA to be achieved even without the whole intermediary framework being put into place. For example, the Aadhaar number could be linked to an e-wallet, stored on the cloud, into which all government payments could be paid. This would give an immediate start to the payment banks, allowing existing and new providers of e-wallet and m-wallet and related services to bring a huge number of currently unbanked people into the financial system in a relatively short time frame.

Taken as a whole, the committee's recommendations offer a substantial and feasible strategy to achieve meaningful inclusion. Two years may be enough or not, but the first steps down the road should be taken as quickly as possible. Also, it should be emphasised that inclusion is as much a technological as a financial challenge. This will also require discontinuous change in the policymaking and regulatory framework.

The writer is director of research, Brookings India, and former deputy governor, Reserve Bank of India.
Discussions with Probir Roy on these issues are gratefully acknowledged. Views are personal