27

SIR PURSHOTAMDAS THAKURDAS MEMORIAL LECTURE

Shri Nandan Nilekani
Chairman
Unique Identification Authority of India
Government of India
New Delhi

Indian Institute of Banking & Finance
An ISO 9001 : 2008 Certified Organisation

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About Sir Purshotamdas Thakurdas

Sir Purshotamdas Thakurdas or Sir P. T. as he was popularly known was a very distinguished and eminent businessman of India who took a keen and active interest in the economic life of the country before and after independence.

Sir P. T. was indeed, a severe critic of the policies followed by the British Government but his views, though dissenting and differing from the Government's policies, were greatly appreciated and even valued by the then British Government as he was very constructive in his approach to the problems. Sir P. T. was associated with several committees and commissions appointed by the Government of India.

Sir P. T. was a firm believer in the logic and philosophy of free enterprise and believed in the free forces of market mechanism to bring about the rational allocation of scarce resources in the economy to promote growth and development. However, he was not dogmatic about the virtues of free enterprise or market mechanisms. He had accepted the inevitability of State intervention at a certain stage of development in the country, as a necessary policy instrument to promote growth keeping in view the imbalances in the nature of the under developed economy. This has been reflected in the famous book "Bombay Plan" published as early as in 1944. This remarkable document was drawn up by a group of distinguished persons belonging to the private sector and this document took a much broader view of the development process than one would expect from the persons having faith in the market economy. The document clearly stated that **"no development of the kind we have**

proposed will be possible except on the basis of a central directing authority which enjoys sufficient popular support and possesses requisite powers and jurisdiction". This reflected the farsightedness of the authors of the Bombay Plan.

Sir P. T. was closely associated with the Indian Banking Industry having worked as a member on the Board of Directors of the then Imperial Bank of India and also on the Central Board of the Reserve Bank of India since its inception in 1935.

Sir P. T. was a very powerful and influential member on the Board of the Reserve Bank of India. He was a prominent member of the Central Banking Enquiry Committee and Chairman of the Rural Banking Enquiry Committee.

In the formative years of the Reserve Bank of India Sir P. T. played an outstanding role and he was considered to be **"both a driving force and a restraining influence"** during the deliberations in the Board Room of the Reserve Bank of India more particularly in matters pertaining to the rights of the Reserve Bank of India and its autonomous functioning vis-à-vis the Government.

Sir P. T. was greatly interested in the problems of money, banking, finance and exchange rates. Sir P. T. was associated with the Indian Institute of Banking & Finance (Formerly Indian Institute of Bankers) as its founding member and served on the Council of the Institute till his death on 4th July 1961.

27th Sir Purshotamdas Thakurdas Memorial Lecture

The Goal of Financial Inclusion -- Have We Reached The Tipping Point?

Shri Nandan Nilekani
Chairman
Unique Identification Authority of India
Government of India
New Delhi

SBI Auditorium, Mumbai
9th December, 2010

The Goal of Financial Inclusion -- Have We Reached The Tipping Point?

Nandan Nilekani

It's quite an honour to be here. I thank the organizers for the opportunity to speak in the memory of Sir Purushotamdas Thakurdas, someone who was among the leading lights of Indian industry, and also played an enormously influential role in the rise of our financial institutions.

Financial inclusion has recently become something of a buzzword, publicized as an explicit goal for governments as well as for our major banks. Nevertheless, this is not a new objective. Providing broad-based financial services in India has been a clear part of our mandate since independence, and the government has since gradually chipped away at the barriers that have constrained access to banking for the ordinary individual, the poor and the marginalized.

There is nevertheless, a real difference between the financial inclusion efforts of the past and what is happening now. Till date, the growth of financial services was largely driven by a push from the government and by banks. Banks responded to expansionary mandates to establish branches across rural India, and provide financial services even in hard to reach parts of the country. Today however, we are also witnessing an unprecedented burst of demand for financial services. As economic growth has taken off, the demand for a bank account has become much more pervasive across India's income groups and communities.

As demand has surged, we are witnessing innovations within the market and in government policy, that brings us to a tipping point. I believe the resulting transition in the next five years will permanently change the scale, and the shape of financial services in India.

Early years

My friend and marketing consultant Rama Bijapurkar often points out that we Indians are a very money-minded people – 'Lakshmi, the goddess of wealth, ranks high on our pantheon of gods,' she notes, 'We revere her in festivals across the country.' The transaction of money – the depositing of it, the lending of it, and so on through indigenous banks, was familiar throughout India well before the British. In the Laws of Manu, 'lending money' was considered one of only four 'honest callings.' This was culturally very different from say medieval Europe, where the church forbade lending money on interest. While in Europe of the time people who lent money were regarded as disreputable Shylocks, in India the indigenous bankers and lenders – such as Manohardas, Gulabrai and the Jagat Seths – were highly respected.

The arrival of the British however warped many institutional systems in India, and banking was no exception. Just as road-building and rail became largely dedicated to enabling imperial trade and the movement of goods to India's port cities, banks prioritised trading and business transactions, and were concentrated in urban areas. From the establishment of the first banks – the Bank of Hindustan and the Bengal Bank – the differences were clear.

This urban, commercial tilt remained true of India's banks well after independence. Banking services availed by the common people were primarily informal sources such as chit funds and moneylenders. The lack of easy financial access meant the absence of a 'banking habit' among ordinary people, which was obvious in how our parents' generation saved money and accumulated assets – they stored wealth not as money in bank accounts, but as gold jewellery and cash in locked armoires.

Three nationalizations

The state has battled this imbalance in financial access over the last five decades. Post-independence, the state nationalized the Imperial Bank of India in 1955 to form the State Bank of India, with the hope that the state's mandate of universal access would lend banking a more inclusive focus.

In July 1969, then Prime Minister Indira Gandhi made bank nationalization an important part of her strategy to build broad appeal, and expand key services to the poor. 14 banks were nationalized. And in April 1980, India underwent another wave of nationalization, bringing more than 90% of India's banking activity into the public sector.

The RBI has called the 1969 bank nationalization 'the defining economic event of not just the 1960s but of the next few decades.' I wouldn't disagree. The rise of the public sector banks, and the 1:4 expansion policy which mandated four branches in unbanked areas for every new urban bank branch completely transformed India's financial landscape. Over 50,000 new bank branches were opened across India in the ensuing three and a half decades, bringing institutional banking to millions of ordinary people.

Changing attitudes

India's policy efforts have often been criticised as overly slow and cautious. But this approach has had its advantages. India was able to build the institutions that eventually allowed market growth to take off without substantial crisis.

In banking in particular, this caution has had some admirable results. Bank nationalization, and the efforts to spread banking services created an expansive banking infrastructure, which made substantial inroads into rural India. The banking reforms that finally took place built on the foundations of these previous efforts. the state-led policies also had a long-term impact on our attitude towards the role of banks : we embraced the idea that banking must incorporate inclusion as part of its core mandate, and that banking services should be easily available to the poor.

The era of deregulation

The eventual 1993 RBI guidelines encouraged the rise of young, private banks, as well as a new focus on 'modern infrastructure'. With these banks, we saw the emergence of an agile and IT-enabled approach to banking : where banks functioned as automated, networked entities.

The rise of competition also encouraged new private players as well as older public sector banks to experiment with remote service delivery, the use of smart cards and other efforts to reach customers in the most efficient ways possible. In addition, technological advances such as core banking, the use of ATMs and telecom connectivity brought convenience for bank customers, with anytime, anywhere financial access.

Considering the progress and the many innovations we are now witnessing, the continued lack of penetration of bank services especially in rural India, seems baffling. Fully 40% of rural Indians lack bank accounts – a number that rises among marginalized communities. This exclusion is debilitating for the poor, whose small, volatile incomes makes financial access all the more important for savings, and to insure themselves against crisis.

In the last decade, we have seen access to basic services become a priority in government policies. Since the 1999 telecom policy opened up the sector, the penetration of mobile phones in India exploded, from less than five million connections in 1997 to over 700 million today. But we have yet to see comparable growth in the similarly essential service of banking.

'Can we reach finance to people in a meaningful way?'

A visit to an Indian village indicates a fundamental challenge we face in expanding banking services – the disconnect that exists between current bank models and the needs of the ordinary, rural Indian. Our Aadhaar team, on rural visits, found that many Indians viewed banking as an alien, difficult experience. Even when they had accounts, they rarely used them. The bank was usually far away, requiring travel in a bus and the foregoing of a day's income if the person was a daily wage earner. There was little the person could do if they needed money immediately, in case of a financial emergency.

And once there, the bank required the often illiterate customer to fill a bewildering number of forms, and also required documentation that the person did not have.

Clearly a banking model which has been tailored for the educated and urban population is now trying to cater to the needs of our vast rural country. In this setting, it quickly reveals its weaknesses. The average bank deposit in rural India is one-tenth that of urban India. When catering to the poor individual, the bank faces a customer who prefers to make numerous, very small transactions, which vastly increases costs for the bank, with little additional benefit in deposit value. The result is that banks don't treat poor, rural market as a priority – every additional customer becomes a source of additional expense rather than profit.

Reworking our approaches

D. Subbarao, the RBI governor, has pointed out the need for us to build additional bridges between the ordinary villager and the banks as they now exist. There have some interesting experiments in this direction to make banking services more accessible to the poor, through business correspondents located within the village, and by enabling people to make remote transactions.

The objective of these steps is to shift our banking approach from a low-volume, high-cost model, to a high volume, low cost model, where large numbers of small transactions become profitable to banks, mirroring the pattern of growth in telecom. However, this goal remains strait jacketed by basic weaknesses. Fulfilling Know Your Customer norms remain a hard-to-surmount challenge for banks. Many of the poor lack the basic documentation they need to open a bank account, including a proof of identity and proof of address.

The lack of easily verifiable identity also limits the online and mobile banking services that can be delivered to the poor. Banks have tried to address this through remote authentication devices employed by village-based agents and BCs, who use smart cards to remotely verify their customers before allowing transactions. These verification systems however have remained proprietary to particular banks, limiting large-scale expansion. If such an approach existed in telecom, it would have been akin to allowing phone calls only say, between BSNL subscribers!

The pieces of financial inclusion are now in place

Much of what is necessary to enable financial inclusion in India is already in place, with technological advances coming powerfully together with policy efforts. The RBI for example, recently expanded the definition of the business correspondents who can serve as the final link between the villagers and a bank. Now, self-help groups, kirana stores, post-offices as well as for-profit entities can function as BCs, creating the potential for a denser and more accessible bank network. The spread of core banking systems means the technology for anywhere banking is in place. The no-frills bank account, with limited KYC norms and which allows a zero balance has become a widely accepted service solution for the poor.

In addition, the large, expanding base of mobile phone connections has put in place the infrastructure necessary for delivering financial services remotely and through BCs to the poor. There are also multiple mobile end-devices now in use by banks that can verify bank customers through smart-cards or fingerprinting. And finally with the NPCI, we have since 2008 what is an umbrella payment authority.

Urgency in enabling access

The infrastructure for financial inclusion has come of age at the right time. India's growth has come with a radical transformation in what people aspire to achieve across income groups and communities. Previous generations had little opportunity to change the circumstances they were born into, as access to education and jobs was difficult. But in the last two decades, economic and social mobility has become a real possibility in India, and hundreds are moving across the country, to our cities and towns every day in search of opportunities – for city lights and fighting chances.

These changes mean that filling in the missing pieces that limit access to services such as finance is even more urgent. This is where the unique identity number comes in.

Connecting the dots : the unique identity number

The power of the number stems from how it serves as a universal identity infrastructure. The Aadhaar number substantially reduces the risks inherent within the BC network – it enables the bank to easily and instantly verify an individual's identity, directly or through the BC using the Aadhaar number, before they open an account, or prior to a transaction. The person can verify their identity through a number of means – through biometrics for maximum security, as well as through their demographic information, or using a PIN number.

Such verification can take place anywhere in India and through any device since the Aadhaar number and individual details are stored in a central database. The mobility it offers is unsurpassed, and it gives the poor same financial portability urban India has long had with ATMs and core banking services.

In addition, Aadhaar number verification opens up the possibility of self-service in banking transactions through a mobile phone. We can realistically consider a near-cashless economy in our villages, where individuals electronically transfer money to bank accounts with the help of mobile phones and BCs.

The open architecture the Aadhaar number offers – enabling transactions through any device, any BC, anywhere in the country – brings down the remaining barriers towards building highly scalable financial services for the poor.

The number thus serves as the glue that ties our various efforts in financial inclusion together. It enables a financial inclusion strategy that is low-cost, easily scaled, and adapted to the behaviour of the poor. It enables banks to earn transaction fees on remote and BC-enabled transactions, making high-volume micro-transactions viable. It helps even the poorest to build a credit history, lowering the risk for banks in this market. And it gives millions more the opportunity to save, make investments, and use products such as micro-insurance.

Building towards growth

A significant difference between the efforts in financial inclusion today and what came before, is that now there is not just a growing supply of financial services, but also immense demand for it. Over the last decade, policy shifts as well as market trends have created widespread awareness of how valuable a bank account can be.

A new generation of welfare initiatives such as the NREGA and the JSY are offering the poor cash benefits and incentives, which are paid to them through bank accounts and post office savings accounts. Another factor driving demand for bank accounts is the millions of people who have left villages and now remit money back home. Unofficial estimates put the cash travelling through informal remittance corridors, from towns to rural hutments, at thousands of crores.

Changes in the local rural economy have also increased the cash circulating within villages, and the consequent demand for bank accounts. Many agricultural labourers who were once paid in kind for their work – in the form of food and clothes – are now paid in daily wages.

Perhaps nothing exemplifies the change in attitude towards investments and savings in rural India better than the change in status for the buffalo. Across north India in particular, the buffalo has been a prized asset, and the rich indicated their status through the number of the animals they owned. In recent years however, the regard for the buffalo has fallen – it is increasingly seen as an expensive investment, one with low returns, illiquid compared to money and houses, and difficult to sell when an immediate need arises.

The untapped potential

India's financial depth today is substantially lower than other Asian countries including Thailand, Korea, China and Malaysia. I believe that a pro-poor approach towards financial inclusion will consequently trigger a growth curve similar to what we witnessed in the telecom sector. The Aadhaar number would bring to our financial inclusion approach the same features that drove rapid telecom expansion – geographical mobility in services, the dominance of low-cost, high volume micro-transactions, negligible upfront costs, and a dense, easily accessible network of agents retailing the service.

Within the UIDAI, we are already seeing massive demand for bank accounts among people enrolling for Aadhaar numbers – fully 80% of people enrolling for the number want bank accounts. If we are able to provide every such person with a bank account, financial access will simply explode in India. Considering the pace of enrolments for the Aadhaar number, it is a very real possibility that the number of bank accounts we issue in the next four years will exceed the number of accounts banks have issued since India's independence.

The great transformation

In the last decade, we have witnessed a decisive breaking away from what economists used to call the 'culture of poverty' in India – the beaten-down, no-way-out circumstances of India's marginalized and its poor.

While we still have hundreds of millions in poverty, their environment and the tools available to them are changing fast. We are building services and products to cater to the poor – accessible consumer goods, decentralized governance infrastructure, low-cost solutions in lighting, water supply, transportation, and so on. At the same time expanded information services as well as telecom and financial access are connecting the poor more closely to our markets.

They say fortune is all about timing, and India has been incredibly fortunate that our growth is happening at a time when we have the technological tools to transform service access – in welfare, telecom, and increasingly, finance. We now have the chance to build services that are efficient and truly innovative – 'made in India' solutions. Our success in building these solutions will enable us to not just meet the expectations for India's growth, but substantially surpass them.

About the Speaker

Shri Nandan Nilekani is the Chairman of the Unique Identification Authority of India (UIDAI) in the rank of Union Cabinet Minister, which aims to provide a unique identification number for all residents of India.

Shri Nandan Nilekani was most recently the Co-Chairman of the Board of Directors of Infosys Technologies Limited, which he co-founded in 1981. He was serving as Director on the Company's Board since its inception to July 2009. He has held various posts at Infosys, including Chief Executive Officer and Managing Director, President, and Chief Operating Officer.

Shri Nandan Nilekani co-founded India's National Association of Software and Service Companies (NASSCOM) as well as the Bengaluru chapter of the IndUS Entrepreneurs (TiE). He is a member of the Board of Governors of the Indian Council for Research on International Economic Relations (ICRIER) and the President of NCAER (the premier, independent, applied economics research Institute in India).

Born in Bengaluru, Shri Nandan Nilekani received his Bachelor's Degree in Electrical Engineering from the Indian Institute of Technology, Bombay. He was named the Corporate Citizen of the Year at the Asia

Business Leaders Award (2004) organized by CNBC. In 2005, he received the prestigious Joseph Schumpeter Prize for innovative services in economy, economic sciences and politics.

In 2006, he was awarded one of India's highest civilian honours, the Padma Bhushan and was also named Businessman of the Year by Forbes Asia. Time magazine listed him as one of the 100 most influential people in the world in 2006 and 2009. He is the author of 'Imagining India', which was one of the finalists for the FT-Goldman Sachs Book Award for the year 2009.

Previous Lectures

Sr. No.	Year	Name of the speakers	Title of the lecture
1.	1981	Shri L. K. Jha	Supply-side Economics
2.	1982	Shri K. N. Raj	The Global Slump and 'Rules of the Game'
3.	1983	Mr. Dragoslav Arvamovic	International Financial Co-operation : Problems and Prospects
4.	1984	Shri Amiya Kumar Bagchi	The Economics of Business and Business of Economics
5.	1985	Mr. Alexandre Lamfalussy	Structural Changes in International Financial Markets
6.	1986	Shri Sukhamoy Chakravarty	Report of the Committee to review the working of the Monetary System & Re-examination
7.	1987	Shri Jagdish Bhagwati	Indian Economic Performance and Policy Design
8.	1988	Shri A. M. Khusro	Management of Indian Economy Macro-economic and Sectoral Policies
9.	1989	Shri M. S. Gore	India and the Concept of Nation State
10.	1990	Shri A. Vaidyanathan	Cottage and Small Industries in India-Policy and Performance
11.	1991	Shri M. Narasimham	Financial Sector Reforms
12.	1993	Dr. I. G. Patel	Some Reflections of Financial Liberalisation
13.	1994	Dr. Arjun Sengupta	The Financial Sector and Reforms in India
14.	1995	Dr. Shanker Acharya	The Economic Consequences of Economic Reforms
15.	1996	Dr. Parthasarathi Shome	Fiscal Policy in 1990s : Needed Reforms and Ramifications for the Financial Sector

Previous Lectures

Sr. No.	Year	Name of the speakers	Title of the lecture
16.	1998	Shri S. S. Tarapore	Need for Second Generation Banking Sector Reforms
17.	1999	Dr. R. A. Mashelkar	Resurgence of Innovative India : The Challenges and Strategy
18.	2000	Dr. C. Rangarajan	Capital Flows : Another Look
19.	2001	Shri P. Chidambaram	Economic Reforms - Reappraising the Past; Lessons for the Future
20.	2003	Shri N. R. Narayana Murthy	Reinventing Banking in India
21.	2004	Dr. Richard C. Levin	Patents in Global Perspective
22.	2005	Dr. Montek Singh Ahluwalia	Globalisation and India - Challenges and Opportunities
23.	2006	Dr. Guillermo Ortiz	Growth and stability in Latin America and Asia
24.	2007	Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz	Managing Financial liberalisation and its Challenges : Implications for Emerging Economies
25.	2008	Dr. Ashok K. Lahiri	Indian Financial Reforms : National Priorities amidst an International Crisis
26.	2009	Dr. Vijay Kelkar	On Strategies for Disinvestment and Privatisation

NOTES

About the institute

Indian Institute of Banking & Finance (IIBF), formerly The Indian Institute of Bankers, established in 1928 is a professional body of banks, financial institutions and their employees in India. During its 82 years of service, IIBF has emerged as a premier institute in banking and finance education for those employed in the sector, aiming for professional excellence. Since inception, the Institute has awarded over 5 Lac banking and finance qualifications, *viz.,* JAIIB, CAIIB, Diplomas and Certificates in specialized areas. The pedagogy of Distance Learning offered by the Institute comprises (I) publishing specific courseware for each paper / examination; (ii) publishing work books; (iii) holding tutorials through accredited institutions; (iv) organizing contact classes; (v) conducting virtual classes; (vi) offering e-learning through portal; (vii) organising campus training for selected courses, etc. For details please visit : **www.iibf.org.in**.

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