Financial inclusion should go beyond Jan Dhan: Why NBFCs should play the lead role

By VP Nandakumar

The cause of financial inclusion has received a shot in the arm with the Prime Minister's Jan Dhan Yojana. Launched on 28 August with a target of opening 7.5 crore bank accounts by 26 January 2015, the scheme has already crossed the five crore milestone.

The key difference is that beneficiaries now get a bank account with bells and whistles — extra benefits like life and accident insurance cover, a five thousand rupee overdraft facility — unlike the no-frills account promoted earlier.

Insurance and overdraft facilities will be costly but worth it if compensated by better targeting of subsidies. The Indian welfare system directs a huge amount of money at the poor through subsidies on food and fuel but a good part is lost in the transmission.

A recent study by the Planning Commission's Independent Evaluation Office estimated that the government spends Rs 3.65 to deliver one rupee worth of foodgrain. Moreover, half the quantity does not reach the intended beneficiary.

A system of direct transfer of benefits through functional bank accounts would surely eliminate this wastage. But, as financial inclusion is often billed as an antidote to deprivation, the question must still be asked, will this latest edition do any better in helping beneficiaries out of poverty?

Broadly speaking, there are two diverging approaches to poverty eradication. The first is focused solely on the outcome. The government intervenes to deliver an outcome deemed desirable, be it jobs for the jobless, food for the hungry, income for those with no earnings, or bank accounts for the financially excluded. Certainly, beneficiaries are better off than before but a price is paid in the dependence it creates, making it unsustainable in the long run.

The second approach focuses on the processes leading up to the outcome. The objective is to have people stand on their own feet without artificial support. Gains are delivered over the long term, often after some initial, short-term pains. No developmental activity can deliver permanent gains when reduced to people passively accepting a stream of benefits flowing into their laps. Therefore, this approach is necessarily about inclusion in the wealth creation process, say, by upgrading skills and employability, or through self-employment and (micro) entrepreneurship.

Where would the Jan Dhan Yojana fit within this "outcome focused" versus "process focused" paradigm? To the government, it's about improving efficiency and squeezing out waste for lasting gains and is no doubt a process. To the beneficiary, however, it is outcome focused and therefore would hold only slender potential for a truly transformative impact.

Redraw the architecture

While the financial services sector has limited role in upgrading skills and employability, inclusion in the wealth creation process through self-employment and micro-entrepreneurship is right up its territory. Giving the poor easy access to small ticket, short duration loans is a necessary component of financial inclusion. And yet, if the quest has fallen well short of its goals, it's because we rely too much on commercial banks.

About 65 percent of a typical bank's operating cost is taken up by manpower costs, and PSU banks spend three times or more per employee than NBFCs. Technology can cut costs but loans to the poor demand high levels of human involvement. Besides, banks lack the last mile reach of the NBFCs, so getting through to beneficiaries is difficult. Extending last mile reach to service low value customers in a high cost set-up is unviable. Given these constraints, it's no surprise that commercial banks have fallen behind and need constant prodding by regulators.

The way out is to co-opt players who can operate profitably at low costs. With lower costs, break-even is attained earlier. Once viability is assured, the activity becomes self-sustaining. That's why NBFCs would be the safer bet when pushing for inclusion while banks are better off in a supporting role, extending low cost funds or channelling their own priority sector commitments to NBFCs. Eventually, customers won over from the unorganized sector by NBFCs will move up the value chain. Thus, NBFCs complement the banks, leaving them free to focus on their core competencies.

Won't the higher interest rates of NBFCs burden the poor? The belief that the poor are best served when credit flows at subsidized interest rates is actually a fallacy. It has been shown over and over that what the poor need is ready availability of small ticket loans with minimum procedural hassles.

To the starving, the simple dal chawal is worth more than the rasgulla that follows a hearty meal. Moreover, the comparison with banks has little meaning to those with no access to banks and who depend on moneylenders.

For the record, India's NBFCs have excelled at innovation, consistently doing well in areas banks had shirked from, e.g. housing and truck finance, gold loans. This success did not come easy given the unwelcoming policy environment. What the outcome would have been under a more benign setting can only be guessed at.

A hint lies in our aviation and telecom sectors. Air travel in India was for long the preserve of the elite. It took the entry of a low-cost carrier like Air Deccan to take it to the masses. In the space of a decade, India's private telecom players made mobile telephony inclusive and affordable to common people. Likewise, given the chance, India's NBFCs can potentially rewrite the rules of the financial inclusion game.

The author is MD & CEO of Manappuram Finance Ltd.