

# Convocation Address

*Raghuram G Rajan*

Shri Achintan Bhattacharya, Shri Uday Kotak, distinguished bankers, distinguished faculty and staff of the institution, proud parents, and, all you happy graduating students, and of course, my friends in the Press.

First of all let me repeat my congratulations for your success and I hope you will take the time today to thank the faculty who have taught you, and your parents and families who have supported you on the way. Clearly, your will, your determination, your drive to succeed; is all because of you and from you. Your success, not just here, but later on in life, would be a function of these, and far more, of the people who helped you, the schools and the institutions that nurtured you along the way, and, of course, the plain simple luck. So, remember that in many ways you are the product of many forces; let me emphasize that you are a product of your own will and congratulations for having come this far.

Before me, you heard one of the truly great entrepreneurs in India, Mr Uday Kotak who built a great institution right from a simple task of buying at 6 per cent and selling at 16 per cent. That sounds very simple. Right? Anybody can do it. But it requires a business mind of the quality of Uday's to recognize the opportunity to transform it into a money making enterprise and then to transform that money making enterprise into a strong and a healthy, successful bank. I am glad to say that we, the Reserve Bank of India gave Uday a license many years ago and I am glad that you know in some ways, a message I took away from what he was saying.

**In a developing country like ours, there are so many inefficiencies and so many low lying fruits, which makes it fairly easy to make money with integrity, with honesty, and by doing business the right way.**

I thought, you saw today an example of how it can be done.

He gave you three principles – the first is, *prudence*. In the financial sector prudence is important. You want to be aggressive in some places; you have to take risks; you can't sit and raise deposits and invest in treasury bills, but you have to know how

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far to go. That's the key in risk management. In risk management some of you may have learnt, or must have learnt about volatility, tail risk, about betas, gammas, thetas, the whole works; but ultimately, risk management boils down to taking risks you understand and being relatively cautious, don't test the limits and stay within the limits. I think, Uday gave you a sense that is at the core of running a good bank.

The second part of it is keep it *simple* – if it gets overly complicated; if it is tough that you do not understand, it can take you over. I always tell bank boards "if you do not understand it, then do not do it". Unfortunately, too many of them don't want to acknowledge that they don't understand and feel scared about saying, "Hey, what is that Asian option on top of a Turkish option". So, the second principle is – *keep it simple*.

Third, I think which is very important and you saw today is, *humility*. Here is a man who created value which is in stock markets, see in the tens of thousands of crores, even lakh of crores, and he has created thousands of jobs but you know he dismisses it all and says "I bought it at 6 per cent and lent at 16 per cent", the point is that you know that in being big is you have to recognize the limits – that's prudence but also do not get carried away by your success; and that is always the danger in finance.

You think you have the Midas touch because you made money in the past and, therefore, things will continue the same way. But competition comes in, the environment changes. This may be the problem with many investment managers who made money for a little while and think they can pile on more and more into that kind of trade because it was worth for a little while. But everybody recognizes that trade becomes crowded and soon there is no money to be made and then you start losing money. So, be humble about capabilities, don't suddenly think you know everything and there is no risk because, when you do that it comes back to you. AIG, during the crisis, was an example of this, writing guarantees upon guarantees which seemed to be making money; of course, guarantees don't get invoked until things turn sour, but when it turns sour, it can turn bad very fast and they recognized it.

I see there are two more things that Uday left out and, perhaps, this was because of his humility. *One is skin in the game*. You have to be invested in what you are doing, to do a really good job. So if you have significant skin in the game, you have a reason, an incentive to make sure it works right. Now, skin in the game can sometimes come from owning equity, can sometimes come from being invested in the institution, by recognizing that you are a part of the institution and you want to make it succeed the various forms of skin in the game, the skin in the game is extremely important.

And the last, I think which we see again and again in India today is, *integrity*. You need to have a basic core of integrity to run business well and I think, going forward,

this will become increasingly true. Of course, we have seen the elections; the run up to the elections was all about discussion about integrity.

**I think this is a sign of a maturing economy, we are becoming from an economy where rules were for the other persons to follow, to an economy where, because it is complex and is large, we all need a basic set of rules, we all abide by and everybody has to understand what those rules are and how it works.**

Now, having talked little bit about tools, let me talk little bit about challenges that you will face. I can exhort from here, you know, be good, be nice, be kind, etc. etc. The question is - in the real world the choice is rarely black and white; if it was so easy; we won't have to debate these issues. Often the choices are shades of gray. So how do you know when to bend and when to stand firm? That's the difficulty you will face when you go into real business life. You can choose one extreme which is, follow the rules, be rigid, that is what people say is, bureaucratic. You feel you are doing a job; you feel you are staying by the rule, but, of course, sometimes being bureaucratic is being inhuman. There are cases where the rules and laws are irrational, they don't make sense. How do you react in situations when you are confronted by the rule which is different from the human situation that you see in front of you? Many of you will confront that. That is one extreme. The other extreme is you can be flexible, such as 'everything goes; little from me also on the way', you can be capricious, you can be corrupt, and that's another extreme.

**How do you choose extreme flexibility, extreme rule, and rule based pro-jumps?**

I am simplifying things; of course, things are more complicated than this.

One of the things I have found to help me is to figure out your core attributes, what are the issues that you will not compromise on. For example, it could be integrity, it could be compassion, in a situation where you can be compassionate, good, try and be compassionate; it could be duty: to your institution and to the country.

**So, there are a set of attributes which will define what you will not compromise on what is core to you. And when you look at an action, value it against that core, ask yourself - "does it compromise the core or does it not?" And if you think that action is worthwhile and it does not compromise with your core, then do anything you can to make it happen.**

If the rules are there and the rules don't make sense, see how you can change the rules, if the law does not make sense, see how you can change the law, I am not advocating that you break the law, but certainly see how you can change the law.

The point is, once you are convinced about something, it is in a sense your duty to go and accomplish it, and that is the best way you can have influence in the world.

Let me turn finally to some of the problems with finance that Uday talked about. We have many challenges coming and he spelt out the gap between what the real sector, firms, households, and the common man in this country want from finance and what finance is able to provide right now; for examples, we have enormous infrastructure needs coming in the next few years, enormous – truly mind boggling; but our capacity to finance those has to be upgraded. We can do it but we have a long way to go. Many of the entities that are capable of financing infrastructure are still dealing with the bad loans that have emerged from the past financing of infrastructure, so it is extremely important for them to clean up their balance sheets.

**Now, at the Reserve Bank, because we are the regulator, we keep hearing corporations and banks come to us with, "give us some forbearance, and don't call it bad loans" even though it has not paid for 3 years, "allow us to postpone recognition", this is a wrong way to go about it. Postponing recognition will not help; if it's not paying today it won't pay tomorrow.**

The best thing to do is to make sure the asset itself becomes viable, focus on putting the asset back on stream which means create payment structure which can actually pay or create a management structure that will actually manage it properly or create an alternative use of the asset which makes sure that it generates value. Focus on putting the asset back on track. Once you focus on putting the asset back on track, the rest is accounting treatment that can be dealt with. But don't keep postponing the recognition of the problem by saying, "you know, give me some forbearance; treat this as a performing asset even though it is not paying" etc. I believe if we clean up our act and balance sheets, the markets will be willing to provide finance to the institutions that have straight balance sheets and thereby create the space for financing to go forward. So, let us not try to find artificial fixes. Let us go about fixing it the right way. It is hard. I am not in any way telling any of our banker friends who are working very hard at this point to deal with some of these problems, that this is an easy job. But I think at times of stress, to quote an expression we distinguish the men from the boys and women from the girls, the truly good bankers will figure out ways to put the balance sheets back on track and in turn the banks back on track.

Borrowing at 6 per cent and lending at 8 or lending at 10 per cent, with nims of three and four is easy. But it is when the bad loans start hitting and you have to clean up the balance sheets that in fact you have to rise to the task, you have to clean up the balance sheets, you have to clean up expenses, you have to bring down cost and that is the way to do it.

The second aspect of finance I want to touch upon which Uday talked about was access.

**It is a shame that so many people in our country don't have access. We have to find a way around this. We have to give people good savings products, we have to give them good investment products, we have to give our small and medium enterprises access to low cost financing so that they can create the many jobs that we need.**

But in this, and here I am looking inwards, into regulatory process, we have to look at what regulations make sense and what regulations don't make sense. I have to mention that a senior official from the RBI just retired went to Hyderabad and tried to open a bank account and could not because he could not fulfill KYC norms. If a senior official from the RBI cannot open a bank account, there is something wrong in the system. We have to figure out a better way. I am not saying KYC norms are bad, but, if it becomes a bureaucratic end in itself and prevents us from expanding access, even while not doing so much to keep out the crooks from the system, the fly by night operators who open bank accounts and steal your money on line and so on, we have to re-exam. The point is, can we do this better? Not without compromise on security, while allowing ease of access. That is something we need to think about. These are the kind of things where we have to be innovative that it may seem simple. It is the kind of problem Uday would point out how is it that we cannot get people to sign up to bank accounts without the huge amount of bureaucratic hurdles. This is not for people who have stayed in a place for a long time in a fixed address; these are for people who migrate. RBI Officer goes from Bombay to Hyderabad and finds that he is locked out of the system. These are the kind of challenges.

I said low hanging fruits, seems low hanging but the once you go into it, there are more complications. Yes we need to keep bank accounts safe and secure and prevent fly by night operators not to come in. But at the same time if you raise the herd so high that you keep genuine people from coming in, like a genuine labourer who is a migrant labourer, from getting a bank account then we are also doing some harm. Can we balance the good and the harm? Can we perhaps even think about taking some risk? Yes, we will have one in one hundred thousand accounts which turn out to be really bad and the KYC was not adequate. But on the other hand it gives us a thousand from that hundred thousand migrants who get accounts, is the tradeoff appropriate? So this is the kind of risk management you learnt about. Business is always for managing risks and about trade-offs. There are no extremes. You have to take some risks, you cannot make money safely. Uday could do it in a first few days and then he got competition and then it became harder, right? So you have to take the risk but you have to balance against the benefits. There is you know an adage in finance that you should have learnt that there is no return without risk. That applies as much for regulation as it does

for business. So we in the regulatory side have to think of how we can make the system work better to provide the financing, which of course, you know, our bankers will provide but we can set the regulatory structure that allows them the ability to do that and we have to keep looking inwards to see what we are doing right and what we are doing wrong.

I have spoken enough, I know you are now tired of speeches, so let me just say I wish you all great success in your careers and good luck in days to come.

Thank you again.