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Financial Sector Reforms: The Way to Socio-Economic Inclusion

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ABSTRACT

The immediate question, of course, is whether we need a new generation reforms at all. There are two ways of answering this. First on the retail side, financial services are not reaching the majority of Indians. The single most frequently used source of loans for the median Indian household is still the moneylender. Second on the wholesale side, the financial sector is not able to meet the scale or sophistication of the needs of large corporate India, as well as of public infrastructure, and does not penetrate deeply enough to meet the needs of small and medium-sized enterprises in much of the country. The negligence of credit to priority sectors called for nationalization of commercial banks in1969. The broad aims of nationalization were "to control the heights of the economy and meet progressively and serve better the needs of the development of the economy in conformity with the national policy and objectives. The period after 1964 was aptly described as the phase of innovative banking or revolutionary phase. To do away with the persistent deficiencies of the banking system, the scheme of social control was introduced in 1967. The starting point for a vibrant ecosystem for financial inclusion is to ensure that the organizational structure supports and creates institutions that can reach the poor.

Keywords: *Big bang approach , Rural Internet Kiosks, Virtual banking, Universal Banking, social control***.**

1. INTRODUCTION

It was not everyone who could take up the banking business. Only men belonging to the Vaishya caste could take up the money-lending profession. When a creditor sued the debtor for recovery of money, it was the duty of king to ensure that the creditor got back his money. Manu permitted the king to employ all means, fair or fouls, to recover the dues, e.g., torturous punishment like killing the debtor's wife, children and cattle, or obstructing his movements. Manu held the view that a defaulter could not absolve himself of his debt burden even by his death. Chanakya said that sons should pay with interest the debt of a deceased person or co-debtors or sureties. As regards the responsibility of a spouse to pay for the debts incurred, wife was exempted from the debt burden of her husband if she had not given her assent to his borrowings. However, the debt incurred by a wife, her husband was liable for repayment. Perhaps, this was the background in which one of the committees on rural indebtedness concluded that the 'the Indian farmer is born in debt, lives in debt and dies in debt' (Reddy, 2002: 65). The role of interest rates was explicitly recognized and they were prescribed by almost all Hindu law givers – Manu, Vasistha, Yajnavalkya, Gautama, and Kautilya. A common base number was 15 per cent per annum – what the banker- economist Dr. Thingalaya calls the Hindu rate of interest. According to Manu and Vaisistha, the interest rates were not to vary depending on the risk involved or the purpose for which the money was borrowed. But, they were directly linked to the caste classification of the borrowers. Brahmin was to be charged two per cent, Kashtriya three per cent, Vaishya four per cent and Shudra five per cent per month. However, according to the system proposed by Chanakya, interest rate structure was risk-weighted since the rate of interest increased with the risk involved in the borrower's business (Reddy, 2002: 66).

An efficient, articulate and developed financial system is indispensable for the rapid growth and thereby inclusion of the excluded section and sectors of the society and economy of any country. The process of economic development is invariably accompanied by a corresponding and parallel growth of the financial organizations. Before nationalization of banks in 1969, it was large scale industries, large borrowers, established business houses, have access to bank credit while the priority sectors such as the small scale industries, small borrowers, agriculture and exports were not receiving their due share. The negligence of credit to priority sectors called for revolutionary changes in the structure, operation policies and practices of commercial banks in India during 1964-90. The period after 1964 was aptly described as the phase of innovative banking or revolutionary phase. The control of major banks by the established and leading business houses was yet another weak element of the banking system. To do away with the persistent deficiencies of the banking system, the scheme of social control was introduced in 1967. The main elements of social control were: organizational changes, National Credit Council, and Agricultural Finance Corporation Ltd. National Credit Council was set up in December 1967 with the following objectives:

a. To assess the demand for bank credit from the various sectors of the economy;
b. To determine priorities for the grant of loans and advances or for investment having regard to the availability of resources and the requirements of the priority sectors, particularly in agriculture, small scale industries and export;
c. To co-ordinate lending and investment policies between co-operative and commercial banks and specialized agencies to ensues the optimum and efficient use of the overall resources; and

d. To consider other allied issues as may be referred to it by the Chairman or the Vice Chairman of the Council.

In the years from the 1967 to 1969, the main objectives of the social control was "achieving a wider spread of bank credit, prevent its misuse, directing large volume of credit flow to priority sectors and making it a more effective instrument of development." It was the purpose of the social control to achieve a much greater participation of credit by the underprivileged. This made the case for nationalization of commercial banks.

In 1969, Indira Gandhi took the major steps of the nationalization of banks. The broad aims of nationalization were: "To control the heights of the economy and meet progressively and serve better the needs of the development of the economy, and to promote the welfare the people in conformity with national policy and objectives." During the era of post nationalization, Indian commercial banking shifted from "class banking" to "mass banking" (Pal, 2009:30-32)

The crisis that developed in the Indian Banking System towards the end of the eighties is coincided with the economic crisis faced by the Government in the same period. In the aftermath of the reforms in the economic front, government undertook comprehensive reforms in the financial and banking sector. The financial sector reforms, which were introduced from 1991 onwards, were aimed at transforming the credit institutions into organizationally strong, financially viable and operationally efficient units. The measures introduced include reduction in budgetary support, preparation of Development Action Plans; prudential norms relating to income recognition, asset classification for Regional Rural Banks, and co-operative banks were some of the other measures. The organization of the Indian financial system since the mid eighties in general and the launching of the new economic policy in 1991 in particular have been characterized by profound transformation. The fundamental philosophy of the development process in India shifted from state regulated economy to free market economy and the consequent liberalization, deregulation, and globalization of the economy. Major economic policy changes such as macroeconomic stabilization, relicensing of industries, trade liberalization, currency reforms, reduction in subsidies, financial sector, capital market, banking reforms, privatization, disinvestment in public sector units, tax reforms and company law reforms in terms of simplifications and debureaucratisation, were gradually implemented, and they have had far reaching impact on the structure of the corporate industrial sector in India. The Narshimham Committee II had examined the second generation reforms in terms of three broad interrelated issues: (i) action that should be taken to strengthen the foundation of the banking system, (ii) streamlining procedures, upgrading technology, and human resource development, and (iii) structural changes in system. These cover the aspects of banking policy, institutional, supervisory and legislative dimensions (Khan, 2007: 2.23).

During the reform period, several policy initiatives have been taken to advance rural banking. These include additional capital contribution to National Bank for Agriculture and Rural Development (NABARD) by Reserve Bank of India (RBI), and the Government of India, recapitalization and restructuring of Regional Rural Banks (RRBs), simplification of lending procedures as per the Gupta Committee recommendations, preparation of special credit plans by public sector banks and launching or Credit Cards. Finally, a scheme linking self-help groups with banks has been launched under the aegis of NABARD to augment resources of micro-credit institutions. These initiatives have enabled the growth of a very wide network of rural financial institution, counter the dominance of moneylenders, aided the modernization of rural economies and implementation of anti-poverty and self-employment programmes. (Reddy, 2002: 69).

2. NEED FOR REFORMS

The immediate question, of course, is whether we need a new generation reforms at all. There are two ways of answering this:

2.1 On The Retail Side

Financial services are not reaching the majority of Indians. The single most frequently used source of loans for the median Indian household is still the moneylender.

2.2 On The Wholesale Side

The financial sector is not able to meet the scale or sophistication of the needs of large corporate India, as well as of public infrastructure, and does not penetrate deeply enough to meet the needs of small and medium-sized enterprises in much of the country.

Financial sector reforms have an enormous multiplier effect on inclusion and economic growth. It is both a moral and an economic imperative! There are thus at least three reasons for financial sector reform: (i) to include more Indian in the growth process; (ii) to foster growth itself; (iii) to improve financial stability; flexibility; resilience, and thus protect the economy against the kind of turbulence that has affected emerging markets in the past, and is affecting industrial countries today.

We need a new paradigm in the financial sector. Such a paradigm should recognize that efficiency, innovation, and value for money are as important for the poor as it is for our new Indian multinationals, and these will come from deregulation, new entry and competition. The role of the government is not to take on the tasks that should legitimately be delegated to the private sector, but to create an enabling environment by building sound infrastructure.

How do macroeconomic policies fit into the game plan for financial sector reforms? There are deep, two way links between macroeconomic management and financial sector development. Disciplined and predictable monetary, fiscal and debt management policies continue the crucial foundation for further progress in financial sector reforms and the effective functioning of financial market. At the same time, a well functioning financial system is essential for macroeconomic stability, and can be particularly helpful in reducing the secondary effects of various shocks that inevitably hit any economy. A well functioning financial system is also relevant for the implementation of macro policy. In its absence, monetary policy, for instance has to use considerably less effective instruments to stabilize economic activity and inflation.

An important development in the formal segment of the rural financial markets is the growing significance of non-banking financial companies, in particular, in hire purchase and leasing operations. The present banking system does not generally encourage financing transactions of this nature. However, a few non-banking financial companies do provide indirect finance for such purpose. They also finance traders of agricultural inputs and output. The non-banking financial companies have only recently been brought under the regulatory regime of RBI. While their importance is recognized in financing diversified rural agriculture, its extent and scope of their operations have not been adequately researched (Reddy, 2002: 70).

3. BANKING SECTOR REFORMS AND INCLUSION

The Indian financial system in the pre-reform period, i.e., up to the end of 1980s, essentially catered to the needs of planned development in a mixed economy framework where the government sector had a dominant role in economic activity (Rangarajan, 2007). During socialist-democratic era of the 1960s to 1980s, India nationalized most of its banks. This culminated with the balance of payment crisis of the Indian economy where India had to airlift gold to International Monetary Fund (IMF) to loan money to meet its financial obligations. This event called into question the previous banking policies of India and triggered the era of liberalization in India in 1991. Given that rigidities and weakness had made serious inroads into the banking system by the late 1980s. Furthermore, a complex structure of administered interest rates prevailed, guided more by social priorities, necessitating cross subsidization to sustain commercial viability of institutions. These not only distorted the interest rate mechanism but also adversely affected financial market development. All the signs of 'financial repression' were found in the system. The decline of the Bretton Woods system in the 1970s provided a trigger for financial liberalization in both advanced and emerging markets. Several countries adopted a 'big bang' approach[1] to liberalization, while others pursued a more cautious or 'gradualist' approach (Rangarajan, 2007). The Government of India, post crisis, took several steps to remodel the country's financial system (some claim that these reforms were influenced by the International Monetary Fund (IMF) and the World Bank as part of their loan conditionality to India in 1991). The banking sector, handling 80 per cent of the flow of the money in the economy, needed serious reform to make it internationally reputable, accelerate the pace of reforms and develop it into a constructive usher of an efficient, vibrant and competitive economy by adequately supporting the country's financial needs. In the light of these requirements, two expert Committees were set up in 1990s under the chairmanship of M. Narsimham (an ex-RBI Governor). They submitted their recommendations in the 1990 and 1998. Subsequently, the first one widely came to be known as the Narsimham Committee I (1991) and the second one as the Narsimham Committee II (1998). The Narsimham Committee I (Committee on the Financial System) was appointed by Manmohan Singh as India's finance Minister on August 14. 1991 focused on arresting the qualitative deterioration in the functioning of financial system (Tenth Five Year Plan, 64). The purpose of the Narsimham Committee I was to study all aspects related to the structure, organization, functions, and procedures of the financial systems and to recommend improvements in their efficiency and productivity. The Narsimham Committee II (Committee on Banking Sector Reforms) was appointed by P. Chidambaram as Finance Minister in December 1997 offered recommendations on the strengthening of the banking system within the framework of purposive regulation and a strong and legal effective system (Tenth Five Year Plan, 64).

The purpose of the Narsimham Committee II was tasked with the progress review of the implementation of the banking reforms since 1992 with the aim of the further strengthening of the financial institution of India. It focused on size of banks, capital adequacy ratio norms, recapitalization of banks, prudential accountancy norms for banks, asset liabilities management system, stronger banking system, risk management guidelines, disclosure norms, technological developments in banking, revival of weak banks among other things.

India is a nation with over 300 million poor people, a number that has barely declined over the last three decades of development. The composition of the poor has been changing and rural poverty is getting concentrated in agricultural labour and artisanal households and urban poverty in casual labour households. Agricultural labour households accounted for 41 per cent of rural poor in 1993–94 as well as in 2004–05. The share of self employed in agriculture among the rural poor had fallen from 32 per cent to 21.6 per cent. Casual labour households accounted for 62.6 per cent in 1993–94 in urban areas and 56.5 per cent in 2004–05. (Eleventh Five Year Plan, 2007-2012: 79). In the small town of Chamba in Himachal Pradesh, over 500 artisans make sturdy and beautifully designed leather footwear. They sit inside homes or in tiny shops making one pair of chappals in approximately two hours. They earn Rs 30 per pair; each pair retails for anything between Rs 100 and Rs 500. At one time, Chamba made footwear for the entire Punjab. Chamba chappals have long been known for their durability and exclusive designs, many of which are now being developed and sold by big footwear manufacturers at exorbitant prices. These chappals have tremendous export potential and can take the domestic market by storm. Yet, in the absence of proper advertising and market linkages, the Chamba artisans are finding it increasingly difficult to make ends meet. Similarly, the bamboo products developed in North East India—in Meghalaya, Tripura, Manipur, Mizoram, even Assam, and Siliguri and Jalpaiguri (both in West Bengal)—have tremendous export potential. The range of products varies from picnic baskets to furniture, dinner sets, and even furnishing material (Eleventh Five Year Plan, 2007-2012: 79). India's poor, many of who work as agricultural and unskilled/semi-skilled wage labourers, micro-entrepreneurs and low salaried worker, are largely excluded from the financial system. The rich-poor divide has replaced the conventional rural-urban divide in access to financial services, as measured by the distribution of savings accounts. Most arguments for nationalizing banks were based on the premise that profit maximizing bankers do not necessarily deliver credit where the social returns are the highest. The broad aims of nationalization were "to control the heights of the economy and meet progressively and serve better the needs of the development of the economy in conformity with the national policy and objectives (Clayton: 95)." The Indian government, when nationalizing all the larger Indian banks in 1969, argued that banking was inspired by a" larger social purpose" and must "sub serve national priorities and objectives such as rapid growth in agriculture, small industry and exports." An important rationale for the nationalization of banks were to direct credit towards sectors government that were underserved, including small scale industry, as well as agriculture and backward areas.

In 1977 the government passed a regulation which required both public and private banks to open four branches in unbanked locations for every branch they opened in banked locations. This regulation was repealed in 1990, though the Reserve Bank of India still maintained some authority of bank branch openings. Branching as a strategy to improve inclusion itself seems to have reached diminishing returns. The poor have no more access in the richly branched urban areas. Inclusion has to be more than opening up more branches. The broad strategy for expanding the reach of the financial system had mixed results. The strategy relied primarily on expanding branching into rural areas, setting up special purpose government sponsored institutions (such as RRBs and Co-operatives) and setting targets for credit to the broad categories of the excluded).

Indeed, the prominent lender to the poor is still the moneylender, in part because he is flexible, does not need documentation, is prompt, and can respond to his client's emergency needs very well. Structural problems in the rural financial system remain. There still exist a substantial gap between the demand (leave alone the 'need') and the supply of agricultural credit. The increasing credit needs of the fast growing rural non-farm sector have also to be factored in. It is farmers holding more than 5 acres of land who dominate cooperative membership; consequently, they also corner the bulk of agriculture credit from commercial banks. Small and marginal farmers are denied access to credit. It has been estimated that over half their credit needs are met by non-institutional sources. Inevitably, they pay usurious interest rates. This could well be one of the factors contributing to distress of ryots manifested most tragically in suicides in states like Andhra Pradesh, Karnataka and Maharashtra (Kannan). Credit is one such service which must be made available on time and must be at the lowest possible cost. Perversely, we have allowed interest rates to be raised to make rural financial institutions viable. The result is that while some institutions are profitable, most borrowers are broke. The more enduring ways lie elsewhere in reducing transaction and risk costs, in improving productivity and in better recovery.

4. BROADENING ACCESS TO FINANCE

The formal credit has a tendency to flow more easily to agriculturally developed regions and to relatively richer farmers leaving backward regions and small farmers to be largely served by the informal market. This phenomenon is generally explained by four factors viz; poor resource endowment features of the borrowers, poor personal factor (education, social contact etc.) under development of a region and high transaction costs (Reddy, 2002: 74). The Reserve Bank of India (RBI) has a mandate to be closely involved in matters relating to rural credit and banking by virtue of the provision of Section 54 of the RBI act. The major initiative in pursuance of this mandate was taken with sponsoring of the All India Rural Credit Survey in 1951-52. This study made agecy-wise estimates of rural indebtedness and observed that cooperation has failed but it must succeed. This is the origin of the policy of extending formal credit through institutions while viewing local, traditional and informal agencies as indulging in usury. In the first stage, therefore, efforts were concentrated on developing and strengthening co-operative credit structures. While enacting the State Bank of India (SBI) Act in 1955, the objective was started to be the extension of banking facilities on a large scale, more particularly, in rural and semi-urban areas (Reddy, 2002: 67). In 1969, 14 major commercial banks were nationalized and the objective, inter alia, was to 'control the heights of economy'. The nationalized banks thus became important instruments for the advancement of the rural banking in addition to cooperative and SBI. The next step to supplement the efforts of co-operatives and commercial banks was the establishment of Regional Rural Banks (RRBs) in 1975 in different states, with equity participation from commercial banks, central and state governments.

In India, the general attitude to trade especially in agriculture has been to favour elimination of middlemen or ensure that middlemen functions are carried out by public sector or cooperatives in name, but public sector in reality. However, experience has shown that public sector as middleman also utilizes some middlemen and in any case has not been cost effective. This underscores the need to regulate middlemen in order to make them more efficient, competitive and accountable. It is necessary to move to a situation where an efficient system of market intermediaries is created in agriculture sector.

The current regime of subsidized credit does not tackle the major problems of agriculture, viz., uncertainty. Uncertainty of weather may be alleviated by insurance-mechanisms but unfortunately the experience so far, with what has essentially been insurance of credit to agriculture, has not been encouraging. Commercialization of agriculture can progress only when institutional arrangements such as insurance penetrate deep within the agriculture sector. In the financial world, it is recognized that there are certain uncertainties and hence financial participants are encouraged to devise mechanisms for hedging. Similarly, modern agriculture too will have to have a mechanism by which farmers are able to hedge risks. This is possible only if there are proper institutional mechanisms and incentives to hedge (Reddy, 2002: 220-221).

By 1982, to consolidate the various arrangements made by RBI to promote/supervise institutions and to augment credit to rural areas, the National Bank for Agriculture and Rural Development (NABARD) was established. Though several efforts were made to increase the flow of institutional credit for agricultural and rural credit, there were mismatches between credit and production. It was felt that with the establishment of large network of branches, a system could be adopted to assign specific areas to each branch by which it can concentrate on focused lending and contribute to the development of the particular area. With a view to implementing this approach, RBI introduced a scheme of 'Service Area Approach' for commercial banks. To further supplement the institutional mechanism, the concept of 'Local Area Banks' was taken up in 1996-97(Reddy, 2002: 67). Any comprehensive and sustainable response to addressing issues of financial inclusion must necessarily factor in the role of the market. This is because efficiency, innovation and cost effectiveness are keys to serving the financial needs of the poor. The financial sector does not ignore the poor because of biases, but because the transaction cost to serve the poor is very high. Initiatives that reduce these costs will allow service providers to begin thinking of financial services for the poor as a business opportunity and not as an act of charity. A new strategy for increasing access to financial services will require the creation of a vibrant ecosystem that supports financial inclusion. This calls for changes on several fronts (Planning Commission, 2009:58).

5. STRATEGY FOR INCLUSION

Inclusion has certainly been a public policy objective in the area of banking and it is undeniable that public sector banks have played pivotal role in this area. Public sector banks account for 88 per cent of all commercial bank branches in India and in rural areas the proportion rises to 95 per cent (Planning Commission,2009:86-87).

The starting point for a vibrant ecosystem for financial inclusion is to ensure that the organizational structure supports and creates institutions that can reach the poor. Financial inclusion poses policy challenges on a scale and with an urgency that is unique for developing countries, which house more than 90 per cent of the world's unbanked population. Developed countries policy makers have recognized that there are complex and multi-dimensional factors that contribute to financial exclusion and therefore require a comprehensive variety of providers, products and technologies that best suits the socio-economic, political, cultural and geographical conditions in these countries. Financial inclusion is not only credit and number of bank accounts held by the weaker sections, but providing wide range of financial services, including saving accounts, insurance and remittance products at an affordable cost to the vast sections of disadvantaged and low income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. There is now genuine and wide spread recognition about the adverse social consequences of rising inequalities in the recent high growth phase, which do not seem to be mitigated through the so called "trickle down mechanism (Pal, 2011: 80)." Realizing these facts one of the Committees recommends a two pronged approach – first, to facilitate the creation of small finance banks, and second, to strengthen the linkages between large and small financial institutions. Both measures should be pursued with equal vigour. There is a growing consensus around the world that small business/farmer credit is best delivered by local small private or voluntary institutions, especially if standardized credit information is limited. Experiences in U.S, Europe, the Philippines, and other countries in the creation of small and local financial institutions are a case in point. These institutions should be 'local' because someone who is part of the locality has much better information on who is creditworthy than someone who is either posted temporarily from a city, or someone who takes the bus everyday from the nearest town. Besides, local, small, private or voluntary institutions have the low cost structure and low staffing cost (because their local hires will be paid at local wage rates instead of at city rates) that allow small loans to be profitable (Planning Commission,2009:59).

Large banks do not have the decentralized loan making authority, the local knowledge, the incentives (in the case of public sector banks), or the low cost structures to make local loans. This is not to say that large banks have no role in financial inclusion – they do have an important direct role in offering 'commoditized' products such as checking accounts, where scale economies can be brought to bear, and an indirect role through local partners in offering customized products. Hence recommendation of a two-track approach that involves the creation and promotion of small finance banks as well as the strengthening of linkages between large banks and small local entities to facilitate the retailing of large banks' financial products to small clients (Planning Commission,2009:59).

Another channel to create an inclusive financial architecture is to create strong linkages between large institutions and local entities to bring the existing large banks closer to the poor. This is certainly the trend to reach the poor, as evidenced by the increasing use of credit-scoring and technology by large banks to reach remote areas. To facilitate this, in India, the business correspondent legislation is particularly laudable given its good potential for combining the scale economies and diversification that large banks bring with the local knowledge and low cost outreach provided by business correspondents (Planning Commission,2009:62).

More market friendly approach is advocated. The role of public intervention must change to focus more closely on the excluded. The basic cause for financial exclusion, often missed, lacking in social concerns. For instance, a small farmer was to pay an interest rate of 12 per cent while a highly rated corporate entity could raise money from banks at 6 per cent. The experience with the linkages of the banks with the Micro Finance Institutions and Self-Help Groups clearly demonstrate that poor are bankable (Pal, 2011: 81). Important policy actions are required in the following areas:

5.1 Priority Sector Lending Framework

The priority sector lending framework has historically had at least two, not mutually exclusive, objective. One is to channel resources to areas that were deemed national priorities, and the other is to foster inclusion. Keeping in view the growing importance of rural to urban migration and the growing share of the urban poor, consideration should be given to including then in the overall agricultural share. The RBI has proposed a scheme, which with a few modifications could prove very attractive in facilitating flows to the priority sector. The inter-bank participation certificates are a form of securitization of loans through which a bank buys the assets of another bank for a stipulated period.

5.2 Interest Rates

It is necessary to deregulate interest rate in order to unlock funds to activities that are commercially unviable and therefore denied credit. In general, the true cost of small loans is very high. The approach thus far has been to deregulate interest rates for certain activities in order to stimulate credit provision. The committee recognized that weaker sections are liable to exploitation. But driving them away from banks via interest rate ceilings into the hands of moneylender is no solution. Instead, it proposes the following safeguards. A liberalized interest rate regime should be accompanied by a transparent way of communicating to borrowers up front what the all-in cost of a loan will be (a simple number which reflects the effective interest rate they are being charged when all fees are included), public disclosure of margins on loans to the priority sector relative to reasonable cost benchmarks, and an effective system for tackling consumer grievances. However, the most important check will be that loans with interest rates that meet a 'reasonable margin' test imposed by the regulator based on prevailing cost will get priority sector lending certificates, which they can sell for an extra margin (Planning Commission,2009:68).

The committee believes that well targeted subsidies provided directly to the poor are a more useful option than subsidies to financial entities for provision of services. An alternative would be to have those who provide financial services in underserved areas (such as direct agriculture and the weaker section category) obtain certificates based on creating accounts or other services in underserved areas, and allow these certificates to be traded, much like Priority Sector Lending Certificates (PSLC) (Planning Commission,2009:68).

The technology can play a major role in reducing the transaction and operation cost of serving the poor. Transaction and operation costs consist of front-end costs, network costs and back-end operation costs. The telecom network in India is rapidly evolving. The banks need to move towards leveraging this network and design their networks afresh to expand operations, reduce costs and increase reliability of their operations. The front-end cost continues to be the dominant costs for banks. The use of ATMs has significantly reduced front-end costs but they are still too high. Banks need to promote lower cost indigenous ATM technologies, especially for rural areas. On the other hand, internet banking transactions have zero front-end cost for the banks; efforts have to be made to make this preferred mode of transactions for large corporations. Its extension to small medium enterprises may have much larger impact. Rural Internet Kiosks[2] can be used by all rural businesses to carry out such transactions. Mobile banking is perhaps the most promising front-end technology for facilitating financial inclusion in India, especially for individual customers (Planning Commission, 2009: 68-71). The kind of technology-led process is leading us to what has been described as virtual banking[3]. The benefits such virtual banking services are manifold. First, it confers the advantage of a lower cost of handling a transaction. Second, the lower cost of operating branch network along with reduced staff costs leads to cost efficiency. Third, it allows the possibility of improved quality and enlarged range of services being available to the customer more rapidly and accurately at his convenience. It may not be feasible to deny these facilities to excluded section of the society, since if banks do not provide them, some more non-banks will do it. Further, technology can be significantly leveraged for acquiring customers. Banking correspondents (BC) with Internet Kiosks at villages as well as BCs armed with mobile phones with back-end interface (e.g., the kirana shop) has to be used extensively. A unique ID for each citizen would help accelerate this. Besides improvement in infrastructure, the committee believes that a significant investment in financial literacy is required if the poor are to make effective use of various initiatives to foster financial inclusion (Planning Commission, 2009: 68-71). Banks are also becoming what are called universal banks[4] and are already providing a range of financial services such as investments, merchant banking and even insurance products. Similarly, non-banks are also undertaking bank like activities. At present in India, these are mostly confined to urban areas and well off family but they will sooner than later spread to rural area and excluded section of the society.

It is clear that significance progress has been made since independence, in expanding bank branches and banking habits in the rural areas and among excluded section of the society, through a variety of institutional innovations. In the past, the major instruments of public policy were co-operatives and public sector banking systems. However, with the diversification of ownership of public sector banks and overall thrust of financial sector reforms, a review of institutional arrangements, mainly in the incentive framework for credit delivery appears necessary. Further, there are new institutions and new forms of financial intermediation that are emerging – be it mutual funds or more important for rural areas, non-banking finance companies. Any approach to rural development should consider capturing, at least the activities of non-banking financial companies as part of formal rural financial markets (Reddy, 2002: 78).

Commercial banks are being reformed in accordance with the recommendations of the Narshimham Committee. The RRBs are being recapitalized. These efforts in regard to banks would presumably recognize the trends in providing financial services to enable them to exercise necessary flexibility and dynamism that is warranted by a fast changing world. Similarly, the future role of NABARD could be addressed because the organizational set up, funding, and activities will have to reflect the basic logic of the financial sector reforms, viz., changing the role of owner, regulator, refinancing, subsidized credit, government funding and co-operatives (Reddy, 2002: 78). There is an increasing recognition of the fact that the spread of literacy and generation of growth impulses in the rural sector would be very significant factors in enhancing effective supply and reducing the true cost of rural credit. More specifically, the spread of financial literacy, banking technology and trickle down of urban financial products to rural areas would help excluded section to enjoy the benefit of growth and development of economy and society.

NOTES

1. Big bang approach is that type of approach where instant changeover takes place. When everybody associated with the new system moves to the fully functioning new system on a given date. When a new system needs to be implemented in an organization, there are three different ways to adopt this new system: The big bang approach, phased approach and parallel approach. In case of parallel approach the old and the new system are running parallel, so all the users can get used to the new system, and meanwhile do their work using the old system. Phased approach means that the approach will happen in several phases, so after each phase the system is a little nearer to be fully adopted. With the big bang approach, the switch between using the old system and using the new system happens at one single date, the so called instant changeover of the system. Everybody starts to use the new system at the same date and the old system will not be used anymore from that moment on. The big bang approach type is riskier than other approach types because there are fewer learning opportunities incorporated in the approach, so quite some preparation is needed to get to the big bang.

2. The Rural Internet Kiosks (RIK) is a blueprint for self-power and sustainable social enterprise. The internet kiosk is a self-contained, solar powered hub designed to sit safely in a public space. It consists of a flat-packed outer shell, has 3 computer terminals and one mobile telephone and charging terminal. It also has an electronically lit sign board for easy recognition, and to form an advertising space.

The unit provides Internet and ICT access to the community in which it is placed regardless of infrastructure. It is interested in what ways social enterprise was being used to advance digital inclusion in poorer areas of the world.

3. Virtual banking is internet based financial institution that offers deposit and withdrawal facilities, and other banking services, through automated teller machines or other devices, without having physical (brick and mortar) walk-in premises.

4. The phenomenon of Universal Banking as a distinct concept, as different from Narrow Banking came to the forefront in the Indian context with the Narsiham Committee (1998) and later the Khan Committee (1998) reports recommending consolidation of the banking industry through mergers and integration of financial activities. By the mid 1990s, all the restrictions on project financing were removed and banks were allowed to undertake several in-house activities. Reforms in the insurance sector in the late 1990s and opening up of this field to private and foreign players also resulted in permitting banks to undertake the sale of insurance products. At present, only an 'arm's length relationship between a bank and an insurance entity has been allowed by the regulatory authority, i.e., Insurance Regulatory and Development Authority (IRDA). As per the World Bank, "In Universal Banking, large banks operate extensive network of branches, provided many different services, hold several claims on firms (including equity and debt) and participate directly in the Corporate Governance of firms that rely on the banks for funding or as insurance underwriters"

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