

## Quadrant II - Notes

**Course Code: UCOD112**

**Module Name: Co-operative banks - structure. Co-operative banks and rural credit, Functions, Problems and remedial measures.**

### **CO-OPERATIVE BANKING IN INDIA:**

In the general sense, the term "co-operation" means, the idea of "living together and working together". Co-operation is a form of business organisation. It is the only system of voluntary organisation suitable for poorer people. In this system, the persons voluntarily associate together as human beings on a basis of equality, for the promotion of their economic interests.

Thus, the co-operative bank can be defined as, "an institution established on the co-operative principles and engaged in the normal banking business of accepting deposits from the public for the purpose of lending and repay it on demand or otherwise"

Cooperative institutions occupy an important position in the Indian financial system. Cooperatives were the first formal institutions developed to provide credit facilities to rural areas of India. Until now, cooperative institutions have been a key instrument of financial service to rural areas. The Urban cooperative banks also have been an important channel of financial service for the middle and low income sections in the semi-urban and urban areas

Co-operative Banks in India are registered under the Co-operative Societies Act. They are regulated by the RBI. Co-operative Banks are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

### **STRUCTURE OF CO-OPERATIVE BANK:**

The Co-operative Banks in India includes the following two main types:

1. Urban Co-operative Banks
2. Rural Co-operative Banks

**Urban cooperative banks:** Urban cooperative banks, also referred to as primary co-operative banks, play an important role meeting the growing credit needs of urban and semi-urban areas of the country. They mobilise Savings from the middle and lower income groups and provide credit to small borrowers, including weaker sections of the society. Urban Co-operative banks are small sized cooperatively organized banking units which operate in metropolitan, urban and semi-urban canters to cater mainly to the needs of small borrowers, viz. owners of small scale industrial units, retail traders, professional and salaries classes.

**Rural Co-operatives:** Rural Cooperative Banking plays an important role in meeting the growing credit needs of rural population of India. It provides institutional credit to the agricultural and rural sector. The inadequacy of rural credit engaged the attention of RBI and Government throughout the 1950s and 1960s. One important feature of providing agriculture credit in India has been the existence of the widespread network of rural financial institutions. The rural credit structure consists of many types of financial institutions as large scale branch expansion was undertaken to create a strong institution based in rural area. It has served as an important instrument of credit delivery in rural and agricultural areas. The separate structure of rural Cooperative sector for long-term and short-term has enabled these institutions to develop a specialized institution for rural credit delivery. The volume of credit flowing through these institutions has increased. The Rural Co-operative structure has traditionally been bifurcated into two parallel wings, i.e.

1. Short-term Rural Co-operatives
2. Long-term Rural Co-operatives

**1. Short-term Rural Co-operatives:** Since inception, cooperatives have made available institutional credit at affordable cost particularly to the agricultural sector. The Short-term Rural Cooperative Credit Structure (STCCS) provides mainly short term and medium-term production credit besides other financial services. At present, there are nearly 92,432 Primary Agricultural Credit Societies (PACS), 371 District Central Cooperative Banks (DCCB) with 13,233 branches and 32 State Cooperative Banks (SCB) with 992 branches. On an average, there is one PACS for every 8 villages. These societies have a total membership of more than 120 million rural making it one of the largest rural financial systems in the world. 60% of population

still depends upon the agricultural income.

In India, the structure of commercial banking is based on branch banking system. But the organization of Short-term Co-operatives is pyramidal is based in nature. It has a three-tier structure that is, the **primary societies** are functioning in the various towns and villages, the **Central Banks** at the district headquarters and the state co-operative banks at the state capitals forming the apex of the system. The Reserve Bank of India assist the co-operative structure by providing concessional finance through NABARD in the form of General Lines of Credit for lending to agricultural activities. Thus, the whole system is integrated with the Banking structure of the country.

Let us discuss about these institutions one by one:

1. **The Primary Agricultural Credit Societies:** Basically, a primary society is an association of borrowers and non-borrowers residing in a particular locality and taking interest in the business affairs of one another. As membership is practically open to all inhabitants of a locality, people of different status are brought together into the common organization. The affairs of those organization are managed by honorary secretaries and presidents assisted by boards of directors, all these officials being elected from amongst the shareholders on the principle 'of one man, one vote. Most of the societies are organized and working on the principle of unlimited liability. The society may be started with ten or more persons of a village. Primary Agricultural Credit Societies are established on this basis. Thus, they are the credit institutions at the grass-root level deal directly with individual members or clients. Primary Agricultural Credit Societies is the foundation of the co-operative credit system on which the superstructure of the short-term co-operative credit system rests. It deals directly with individual farmers, provide short and medium term credit, supply agricultural inputs, distribute consume articles and also arrange for the marketing of products of its members through a co-operative marketing societies. These societies form the basic unit of co-operative credit system in India. These credit societies can extend loans to its members only for the purpose of agriculture connected activities. The success of the co-operative credit movement depends largely on the strength of these village level societies.

2. **Central Co-operative Banks:** A Central Co-operative Bank is a federation of primary societies in a specified area. Where membership of a Central Co-operative Bank (CCB) is restricted to primary societies only, it is known as a 'banking union'. Nowadays, individuals are also admitted as members of almost all CCBs. They are generally situated at the headquarters of district and have on their boards of management, individuals of sufficient effect and business capacity in addition to representatives of primary societies. The CCBs form an important part in the short term structure of co-operative credit institutions.
3. **State Co-operative Banks:** At the top of the co-operative banking, there are State Co banks are also more suitably equipped to serve as channel between the co-operative movement and the joint stock banks. The constitution of these banks differs from one another, but generally speaking, their membership comprises of representative of central Banks as well as individual shareholders. A logical development of these banks would have been the establishment of all-India Co-operative bank. But there is no such institution, although the Indian state co-operative bank Association has been coordinating their activities and performing certain services to all these banks. NABARD maintains contact with the State co-operative Banks. In addition to offering them rediscount facilities, collects and disseminates useful information regarding co-operative movement. In simple terms, it is a federation of central co-operative bank and acts as a regulator of the co-operative banking structure in the state. Its funds are obtained from share capital, deposits, loans and overdrafts from the Reserve Bank of India. The state cooperative banks lend money to central co-operative banks and primary societies and not directly to the farmers.

**2. Long-Term Rural Co-operatives:** The long-term rural co-operative provide typically medium and long-term loans for making investments in agriculture, rural industries and, in the recent period, housing. Generally, these co- operatives have two tiers, i.e. State Co-operative Agriculture and Development Banks (SCARBDS) at the state level and Primary Co-operative Agriculture and Rural Development Banks (PCARBDS) at the taluka or tehsil level. PCARBDS are affiliated to the SCARBDS.

However, some States have a unitary structure with the state level banks operating through their own branches.

1. **State Co-operative Agriculture and Development Banks (SCARBDs):**

State Co-operative Agriculture and Development Banks constitute the upper-tier of long term co-operative credit structure. Though long term credit co-operatives have been allowed to access public deposits under certain conditions, such deposits constitute a relatively small proportion of their total liabilities. They are mostly dependent on borrowings for on-lending. The main objective of the Co-operative State Agriculture and Rural Development bank is to finance primary agriculture and rural development banks.

2. **Primary Co-operative Agriculture and Rural Development Banks (PCARDBs):**

Primary Co-operative Agriculture and Rural Development Banks is the lowest layer of long term credit co-operatives. It is primarily dependent on the borrowings for their lending business. They provide credit for developmental purposes like minor irrigation, cultivation of plantation crops and for diversified purposes like poultry, dairying and sericulture on schematic basis. They get requisite financial assistance from the Cooperative State Agriculture and Rural Development Bank. In order to widen their scope of lending to compete with other financial agencies, the primary cooperative agriculture and rural development banks have been permitted to finance artisans, craftsmen and small scale entrepreneurs.

### **Rural Credit:**

Any loan taken for agricultural purposes or small home businesses across the rural areas in India is known as a rural credit.

Rural credit is necessary for the following reasons –

- The incubation period in agriculture is significant, which means that the period from sowing the crop to selling the produce is vast. Therefore, rural credit helps farmers with their livelihood until the crops are ready for sale in the market.
- The credit can help farmers acquire seeds, tools, fertilisers and more, which are essential parts of their trade.

- Another valid reason for availing rural credit is to mitigate personal expenses, such as marriage, religious functions, death and more. Additionally, such financial assistance can also aid in repaying outstanding debts.

## **Functions of Cooperative Banks**

- It provides financial assistance to people with small means and protects them from the latches of money lenders providing loans and other services at a higher rate at the expense of the needy.
- It supervises and guides affiliated societies.
- Rural financing- It provides financing to rural sectors like cattle farming, crop farming, hatching, etc. at comparatively lower rates.
- Urban financing- it provides financing for small scale industries, personal finance, home finance, etc.
- It mobilises funds from its members and provides interest on the invested capital.

## **Problems faced in the Indian Cooperative Banking System:**

**Small capital base:** Cooperative banks have a small capital base as it can start with a capital base of 25 lakhs, making it difficult for them to account a portion of such capital as their working capital and raising working capital has been a major hurdle for almost all cooperative banks.

**Political interference:** Politicians use them to increase their vote bank and usually get their representatives elected over the board of directors in order to gain undue advantages like sanctioning of loans which later gets written off.

**RBI Supervision:** The supervision of RBI is not as stringent on cooperative banks as compared to commercial banks. RBI inspects the books of these banks only once a year.

**Dual control:** Cooperative banks are controlled under the dual system, i.e. by RBI and by their respective State government which poses a problem in coordination and management.

**Professional management and technological advancement:** Cooperative banks are often reluctant to adopt new technologies like computerised data management. Professional management in the banks is often missing due to lack of training of personnel because of lack of funds.

**Dependence of finance:** Cooperative banks depend heavily on RBI, NABARD and the government for refinancing facilities. It depends on the government for capital rather than on its members.

**Overdue loans:** Overdue loans of cooperative banks are increasing yearly, restricting the recycling of funds which in turn affects the lending and borrowing capacity of the bank.

## **Measures to be taken:**

PMC Bank is not the first case of failure of the cooperative banking system in India. The Madhavpura Cooperative Bank scam in 2001-02 was a clear signal to bring certain changes in the regulatory and supervisory structure of cooperative banks. But no heed was given at that time. Since then, urban cooperative banks are failing with alarming regularity. Their numbers fell from 1,926 in 2004 to 1,551 in 2018, as per RBI data. These issues need to be addressed and remedied if the Government wants the public to place their trust in the country's banking system.

In 2015, an RBI panel under R. Gandhi, a former deputy governor at the Central bank, had proposed several governance reforms for the cooperative banking sector, some of which are as follows:

- Greater control and supervision of RBI upon the cooperative banks.
- These banks and other financial institutions should be professionally managed, which means that the board of directors should be delegated power similar to those delegated under commercial banks. Board of directors should be able to conduct an independent assessment and supervise the bank's functioning. They should be able to question the shareholder's representation.
- The committee also recommended certain changes in Banking Regulation Act, 1949, so as to increase the ambit of power of RBI to wind up and liquidate banks without involving other regulators under the cooperative societies' laws.
- Conversion of UCBs into small finance banks by RBI should be allowed subject to fulfilment of certain conditions.
- Creation of umbrella organisation for supervising and coordinating the activities of all cooperatives. Such an organisation should be over and above the board of directors and should be reporting directly to RBI so as to bring it under better control.