SECTION – II

CO-OPERATIVE BANKING IN INDIA

1.6 Introduction of co-operative banks

A co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Co-operative banks are often created by persons belonging to the same local or professional community or sharing a common interest. Co-operative banks generally provide their members with a wide range of banking and financial services (loans, deposits, banking accounts etc.). Co-operative banks differ from stockholder banks by their organization, their goals, their values and their governance. In most countries, they are supervised and controlled by banking authorities and have to respect prudential banking regulations, which put them at a level playing field with stockholder banks. Depending on countries, this control and supervision can be implemented directly by state entities or delegated to a co-operative federation or central body.

Co-operative banking is retail and commercial banking organized on a co-operative basis. Co-operative banking institutions take deposits and lend money in most parts of the world. Co-operative banking, includes retail banking, as carried out by credit unions, mutual savings and loan associations, building societies and co-operatives, as well as commercial banking services provided by manual organizations (such as co-operative federations) to co-operative businesses.

The structure of commercial banking is of branch-banking type; while the co-operative banking structure is a three tier federal one.

- A State Co-operative Bank works at the apex level (i.e. works at state level).
- The Central Co-operative Bank works at the Intermediate Level.
  (i.e. District Co-operative Banks ltd. works at district level)
- Primary co-operative credit societies at base level (At village level)
Even if co-operative banks organizational rules can vary according to their respective national legislations, co-operative banks share common features as follows:

**Customer-owned entities**: In a co-operative bank, the needs of the customers meet the needs of the owners, as co-operative bank members are both. As a consequence, the first aim of a co-operative bank is not to maximize profit but to provide the best possible products and services to its members. Some co-operative banks only operate with their members but most of them also admit non-member clients to benefit from their banking and financial services.

**Democratic member control**: Co-operative banks are owned and controlled by their members, who democratically elect the board of directors. Members usually have equal voting rights, according to the co-operative principle of “one person, one vote”.

**Profit allocation**: In a co-operative bank, a significant part of the yearly profit, benefits or surplus is usually allocated to constitute reserves. A part of this profit can also be distributed to the co-operative members, with legal or statutory limitations in most cases. Profit is usually allocated to members either through a patronage dividend, which is related to the use of the co-operative’s products and services by each member, or through an interest or a dividend, which is related to the number of shares subscribed by each member.

Co-operative banks are deeply rooted inside local areas and communities. They are involved in local development and contribute to the sustainable development of their communities, as their members and management board usually belong to the communities in which they exercise their activities. By increasing banking access in areas or markets where other banks are less present, farmers in rural areas, middle or low income households in urban areas - co-operative banks reduce banking exclusion and foster the economic ability of millions of people. They play an influential role on the economic growth in the countries in which they work in and increase the efficiency of the international financial system. Their specific form of enterprise, relying on the above-
mentioned principles of organization, has proven successful both in developed and developing countries.

1.7 History of co-operative banks in India

For the co-operative banks in India, co-operatives are organized groups of people and jointly managed and democratically controlled enterprises. They exist to serve their members and depositors and produce better benefits and services for them. Professionalism in co-operative banks reflects the co-existence of high level of skills and standards in performing, duties entrusted to an individual. Co-operative bank needs current and future development in information technology. It is indeed necessary for co-operative banks to devote adequate attention for maximizing their returns on every unit of resources through effective services. Co-operative banks have completed 100 years of existence in India. They play a very important role in the financial system. The co-operative banks in India form an integral part of our money market today. Therefore, a brief resume of their development should be taken into account. The history of co-operative banks goes back to the year 1904. In 1904, the co-operative credit society act was enacted to encourage co-operative movement in India. But the development of co-operative banks from 1904 to 1951 was the most disappointing one.

The first phase of co-operative bank development was the formation and regulation of co-operative society. The constitutional reforms which led to the passing of the Government of India Act in 1919 transferred the subject of “Cooperation” from Government of India to the Provincial Governments. The Government of Bombay passed the first State Co-operative Societies Act in 1925 “which not only gave the movement, its size and shape but was a pace setter of co-operative activities and stressed the basic concept of thrift, self help and mutual aid.” This marked the beginning of the second phase in the history of Co-operative Credit Institutions.

There was the general realization that urban banks have an important role to play in economic construction. This was asserted by a host of committees. The Indian Central
Banking Enquiry Committee (1931) felt that urban banks have a duty to help the small business and middle class people. The Mehta-Bhansali Committee (1939) recommended that those societies which had fulfilled the criteria of banking should be allowed to work as banks and recommended an Association for these banks. The Co-operative Planning Committee (1946) went on record to say that urban banks have been the best agencies for small people in whom Joint stock banks are not generally interested. The Rural Banking Enquiry Committee (1950), impressed by the low cost of establishment and operations recommended the establishment of such banks even in places smaller than taluka towns. The real development of co-operative banks took place only after the recommendations of All India Rural Credit Survey Committee (AIRCSC), which were made with the view to fasten the growth of co-operative banks.

The co-operative banks are expected to perform some duties, namely, extend all types of credit facilities to customers in cash and kind, advance consumption loans, extend banking facilities in rural areas, mobilize deposits, supervise the use of loans etc. The needs of co-operative bank are different. They have faced a lot of problems, which has affected the development of co-operative banks. Therefore it was necessary to study this matter.

The first study of Urban Co-operative Banks was taken up by RBI in the year 1958-59. The Report published in 1961 acknowledged the widespread and financially sound framework of urban co-operative banks; emphasized the need to establish primary urban co-operative banks in new centers and suggested that State Governments lend active support to their development. In 1963, Varde Committee recommended that such banks should be organised at all Urban Centers with a population of 1 lakh or more and not by any single community or caste. The committee introduced the concept of minimum capital requirement and the criteria of population for defining the urban centre where UCBs were incorporated.
1.8 RBI Policies for co-operative banks

The RBI appointed a high power committee in May 1999 under the chairmanship of Shri. K. Madhava Rao, Ex-Chief Secretary, Government of Andhra Pradesh to review the performance of Urban Co-operative Banks (UCBs) and to suggest necessary measures to strengthen this sector. With reference to the terms given to the committee, the committee identified five broad objectives:

- To preserve the co-operative character of UCBs
- To protect the depositors’ interest
- To reduce financial risk
- To put in place strong regulatory norms at the entry level to sustain the operational efficiency of UCBs in a competitive environment and evolve measures to strengthen the existing UCB structure particularly in the context of ever increasing number of weak banks
- To align urban banking sector with the other segments of banking sector in the context of application or prudential norms in to and removing the irritants of dual control regime
- RBI has extended the Off-Site Surveillance System (OSS) to all non-scheduled urban co-operative banks (UCBs) having deposit size of Rs. 100 Crores and above.

1.9 Types of Co-operative Banks

The co-operative banks are small-sized units which operate both in urban and non-urban centers. They finance small borrowers in industrial and trade sectors besides professional and salary classes. Regulated by the Reserve Bank of India, they are governed by the Banking Regulations Act 1949 and banking laws (co-operative societies) act, 1965. The co-operative banking structure in India is divided into following 5 components:
**Primary Co-operative Credit Society**

The primary co-operative credit society is an association of borrowers and non-borrowers residing in a particular locality. The funds of the society are derived from the share capital and deposits of members and loans from central co-operative banks. The borrowing powers of the members as well as of the society are fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, pesticides, etc.

**Central co-operative banks**

These are the federations of primary credit societies in a district and are of two types-those having a membership of primary societies only and those having a membership of societies as well as individuals. The funds of the bank consist of share capital, deposits, loans and overdrafts from state co-operative banks and joint stocks. These banks provide finance to member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint stock bank.

**State co-operative banks**

The state co-operative bank is a federation of central co-operative bank and acts as a watchdog 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 co-operative banks lend money to central co-operative banks and primary societies and not directly to the farmers.

**Land development banks**

The Land development banks are organized in 3 tiers namely; state, central, and primary level and they meet the long term credit requirements of the farmers for developmental purposes. The state land development banks oversee, the primary land development banks situated in the districts and tehsil areas in the state. They are governed both by the state government and Reserve Bank of India. Recently, the supervision of land development banks has been assumed by National Bank for Agriculture and Rural development (NABARD). The sources of funds for these banks are the debentures
subscribed by both central and state government. These banks do not accept deposits from the general public.

*Urban Co-operative Banks*

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary co-operative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centered on communities, localities, work place groups. They essentially lend to small borrowers and businesses. Today, their scope of operations has widened considerably.

The origins of the urban co-operative banking movement in India can be traced to the close of nineteenth century. Inspired by the success of the experiments related to the co-operative movement in Britain and the co-operative credit movement in Germany, such societies were set up in India. Co-operative societies are based on the principles of cooperation, mutual help, democratic decision making, and open membership. Co-operatives represented a new and alternative approach to organization as against proprietary firms, partnership firms, and joint stock companies which represent the dominant form of commercial organization. They mainly rely upon deposits from members and non-members and in case of need, they get finance from either the district central co-operative bank to which they are affiliated or from the apex co-operative bank if they work in big cities where the apex bank has its Head Office. They provide credit to small scale industrialists, salaried employees, and other urban and semi-urban residents.

1.10 Functions of co-operative banks

Co-operative banks also perform the basic banking functions of banking but they differ from commercial banks in the following respects

- Commercial banks are joint-stock companies under the companies’ act of 1956, or public sector bank under a separate act of a parliament whereas co-operative banks were established under the co-operative society’s acts of different states.
• Commercial bank structure is branch banking structure whereas co-operative banks have a three tier setup, with state co-operative bank at apex level, central / district co-operative bank at district level, and primary co-operative societies at rural level.

• Only some of the sections of banking regulation act of 1949 (fully applicable to commercial banks), are applicable to co-operative banks, resulting only in partial control by RBI of co-operative banks and

• Co-operative banks function on the principle of cooperation and not entirely on commercial parameters.

1.11 Problems of Co-operative Banks

_Duality of control system of co-operative banks_[^1][^2]

However, concerns regarding the professionalism of urban co-operative banks gave rise to the view that they should be better regulated. Large co-operative banks with paid-up share capital and reserves of Rs.1 lakh were brought under the purview of the Banking Regulation Act 1949 with effect from 1st March, 1966 and within the ambit of the Reserve Bank’s supervision. This marked the beginning of an era of duality of control over these banks. Banking related functions (viz. licensing, area of operations, interest rates etc.) were to be governed by RBI and registration, management, audit and liquidation, etc. governed by State Governments as per the provisions of respective State Acts. In 1968, UCB’s were extended the benefits of deposit insurance.

Towards the late 1960s there was debate regarding the promotion of the small scale industries. UCB’s came to be seen as important players in this context. The working group on industrial financing through Co-operative Banks, (1968 known as Damry Group) attempted to broaden the scope of activities of urban co-operative banks by recommending these banks should finance the small and cottage industries. This was reiterated by the Banking Commission in 1969.
The Madhavdas Committee (1979) evaluated the role played by urban co-operative banks in greater details and drew a roadmap for their future role recommending support from RBI and Government in the establishment of such banks in backward areas and prescribing viability standards.

The Hate Working Group (1981) desired better utilization of bank’s surplus funds and that the percentage of the Cash Reserve Ratio (CRR) & the Statutory Liquidity Ratio (SLR) of these banks should be brought at par with commercial banks, in a phased manner. While the Marathe Committee (1992) redefined the viability norms and ushered in the era of liberalization, the Madhava Rao Committee (1999) focused on consolidation, control of sickness, better professional standards in urban co-operative banks and sought to align the urban banking movement with commercial banks.

A feature of the urban banking movement has been its heterogeneous character and its uneven geographical spread with most banks concentrated in the states of Gujarat, Karnataka, Maharashtra, and Tamil Nadu. While most banks are unit banks without any branch network, some of the large banks have established their presence in many states when at their behest multi-state banking was allowed in 1985. Some of these banks are also Authorized Dealers in Foreign Exchange.
References

1. www.rbi.org.in
2. www.Banknetindia.com
10. ICBA, International Co-operative Banks Association by
    http://en.wikipedia.org/wiki/Regional_Rural_bank