Chapter – 2

Overview of Co-operative Banks

Historical Roots - Co-Operative Banks in Europe and India:

Cooperative Movement in India

Cooperative Banking in India

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Governance: Indian Context.

Reforms in Banking sector

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UCBs – Problems and Prospects
The cooperative banking sector in Europe was created in response to the economic challenges and deprivation large swathes of the population faced in the 19th and early 20th centuries. Most continental European cooperative banks were established on the basis of the ideas of Hermann Schulze (1808–83) and Friedrich Wilhelm Raiffeisen (1818–88). Both men were moved by the poverty and misery they observed, especially during the famine of 1848, and noted that ordinary people had no access to credit, except perhaps from usurious lenders. They independently started to promote the idea of credit cooperatives during the middle of the 19th century, Schultz aiming at helping urban small business owners and artisans and Raiffeisen seeking to assist the rural poor.

The rationale was similar to the one behind current microfinance initiatives in developing countries, namely to provide people with the tools and resources to collectively and individually help themselves. From Germany the cooperative banking concept gradually spread to the rest of the continent and to the Nordic countries. In the British Isles, cooperative banks have somewhat different historical roots: building societies date back to the 18th century and were associated with a revivalist Christian movement that became popular among working class and lower middle class segments of society. UK and Irish credit unions only appeared during the second half of the 20th century and were based on US credit unions, which themselves were inspired by Canadian adaptations of the German cooperative banking concept (Hansmann, 1996).

While they were generally grassroots organizations, in many cases the
development of cooperative banking was initiated, nurtured and supported by outside forces, including governments. In France, government involvement has been very extensive throughout the history of the cooperative banking sector, the Finnish cooperative banking sector was set up in a top-down process with government support, and Portuguese agricultural credit cooperatives thank their growth since the 1970s in part to government support. In several countries, including Italy, Belgium and France, the post-Rerun Novarum social catholic movement supported the development of cooperative banks. In addition, many cooperative banks have been set up by, or with the support of, trade unions or agricultural associations and have maintained close links with these organizations.

European cooperative banks flourished because they overcame important market imperfections. Commercial banks in 19th century Europe were focused on servicing the needs of the emerging industry, wealthy individuals, and governments, and often took excessive risks with their clients’ money. Even if they wanted to, servicing poorer layers of the population ran into problems of imperfect and/or asymmetric information and difficult and/or uneconomic enforceability of (small-scale) contracts, problems which still plague rural credit markets in developing countries to this day (Hoff and Stiglitz, 1990).

As noted by Hansmann (1996), these problems gave rise to the emergence of two types of institutions: savings banks were established from 1810-1825 onwards, to overcome problems of opportunistic behavior by banks (in particular, excessive risk-taking), while cooperative banks were established from the mid-19th century onwards, to overcome
problems of opportunistic behavior by borrowers. Raiffeisen experienced such opportunistic behavior first-hand when he set up his first credit institution, which provided loans to poor people financed by funds collected from wealthy donors. The institution failed as many borrowers could not be made to repay their loans and donors lost interest.

Cooperative banks could overcome these problems because member-consumers financed the institution and were involved in its decision-making processes. Within small communities, relatively intimate knowledge of each other’s credit- and trustworthiness ensured that loans were only provided to borrowers who could be expected to repay them. The financial incentives members had to monitor each other, and the relatively small and homogenous membership base of early cooperatives ensured that peer pressure provided incentives for borrowers to repay, consistent with the analysis of Stiglitz (1990). Beyond financial incentives, social relations among members were also a contributing factor to the success of cooperatives.

**Cooperative Movement in India**

The Indian cooperative movement, like its counterparts in other countries of the world has been essentially a child of distress. Based on the recommendations of Sir Frederick Nicholson (1899) and Sir Edward Law (1901), the Cooperative Credit Societies Act was passed in 1904, paving the way for the establishment of cooperative credit societies in rural and urban areas on the patterns of Raiffeisen and Schulze Delitzch respectively. The Cooperative Societies Act of 1912 recognized the formation of non-credit societies and the central cooperative
organizations/federations. The state patronage to the cooperative movement continued even after 1947, the year in which India attained freedom. The independent India accepted the concept of planned economy and cooperative organizations were assigned an important role.

The policy of the Government towards the cooperative movement was guided by the recommendations of the Saraiya Committee, which stated that the cooperative society has an important role to play as the most suitable medium for the democratization of economic planning. Various expert committees, which examined the problem of rural credit subsequently, have come to the same conclusion, without exception, that in the Indian context, there is no alternative from the point of view of structural appropriateness, to cooperatives at the village level. The Rural Credit Survey Committee (1954), the first comprehensive enquiry into problems of rural credit, after a detailed examination of the entire gamut of issues including the social ethos of rural society, summed up its findings in the celebrated dictum that cooperation has failed, but cooperation must succeed.

Since 1950s, the cooperatives in India have made remarkable progress in the various segments of Indian economy. During the last century, the cooperative movement has entered several sectors like credit, banking, production, processing, distribution/marketing, housing, warehousing, irrigation, transport, textiles and even industries. In fact, dairy and sugar cooperatives have made India a major nation in the world with regard to milk and sugar production. Today, India can claim to have the largest network of cooperatives in the world numbering more than half a million, with a membership of more than 200 million. Of the
primary (village) level cooperatives, around 28 percent with 137 million memberships are agricultural cooperatives, dealing directly or indirectly with agricultural sector. The cooperative network in the country is rather strong covering all the villages in the country and more than 67 percent of the households have been brought under the cooperative hold. Cooperatives supply about 46 percent of the total rural credit (including agricultural credit), account for 36 percent of the total distribution of fertilizers, produce about 55 percent of the total sugar and constitute for 28 percent of the rural fair shops (distributing consumer articles). Though cooperative movement has made remarkable progress in several areas, certain glaring defects have also developed in the movement, which have been, in a way, defeating the very objectives of these institutions. The following are the unique features of Indian cooperative movement.
| TABLE 1 |
| Organizational Structure of Cooperative Credit Institutions |

<table>
<thead>
<tr>
<th>Co-operative Credit Institutions</th>
</tr>
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<tr>
<td>Rural Co-operative Credit Institutions</td>
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<tr>
<td>Short-term Structure</td>
</tr>
<tr>
<td>State Co-operative Banks (29)</td>
</tr>
<tr>
<td>District Central Co-operative Banks (367)</td>
</tr>
<tr>
<td>Primary Agricultural Credit Societies (92,000)</td>
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COOPERATIVE BANKING IN INDIA:

- Historically, Governments and policy makers have paid more attention to agricultural cooperatives and thus, the growth and development of the Indian cooperative movement is heavily tilted in favor agricultural cooperatives in general and in particular, credit cooperatives. In some areas like dairy, urban banking and sugar, the cooperatives have achieved success to an extent but there are larger areas where they have not been so successful.

- The cooperative credit movement in modern India, curiously, is a state initiated movement. The state partnership is, perhaps, the unique feature of the Indian cooperative movement. As of today, Government contribution to the share capital of primary agricultural cooperatives accounts for about 7.5 percent of the total.

- Paradoxically, the state partnership which was conceived as a measure for strengthening the cooperative institutions had paved the way for ever-increasing state control over cooperatives, their increasing officialization and politicization culminating in virtually depriving the cooperatives of their vitality as well as their democratic and autonomous character.

- Dormant membership, lack of active participation of the members in the management, lack of professionalism (and absence of corporate governance), undue political and bureaucratic intervention, have made majority of the cooperatives at the primary level almost moribund.
Understandably, this has resulted in weakening of the cooperative edifice. The upwardly transmission of the weaknesses of the primary societies have affected the capabilities of the higher level cooperative federations in so far as their usefulness to the former is concerned.

- With regard to agricultural cooperative credit structure, although the quantitative expansion has been somewhat satisfactory, the movement continues to suffer from structural defects and operational deficiencies. The acknowledged operational deficiencies of the cooperative credit structure have been (I) weak recycling of credit, (ii) poor resource mobilization, (iii) ineffective lending and (iv) poor recovery.

- The agricultural credit cooperative system in general has become rather over dependent on external support in terms of participation in share capital by Government and refinance from Government owned Financial Institutions.

Credit cooperatives are the oldest and most numerous of all the types of cooperatives in India. The cooperative credit institutions in the country may be broadly classified into urban credit cooperatives and rural credit cooperatives. There are about 2090 urban credit cooperatives and these societies together constitute for about 10 percent of the aggregate banking business and therefore regarded as an important segment of the banking system. The urban credit cooperatives are also popularly known as Urban Cooperative Banks.
The rural credit cooperatives may be further divided into short-term credit cooperatives and long-term credit cooperatives. With regard to short-term credit cooperatives, at the grass-root level there are around 92,000 Primary Agricultural Credit Societies (PACS) dealing directly with the individual borrowers. At the central level (district level) District Central Cooperative Banks (DCCB) function as a link between primary societies and State Cooperative Apex Banks (SCB). It may be mentioned that DCCB and SCB are the federal cooperatives and thus the objective is to serve the member cooperatives. As against three-tier structure of short-term credit cooperatives, the long-term cooperative credit structure has two tiers in many states with Primary Cooperative Agriculture and Rural Development Banks (PCARDB) at the primary level and State Cooperative Agriculture and Rural Development Bank at the state level. However, some states in the country have unitary structure with state level cooperative operating with through their own branches and in one state an integrated structure prevails. The organizational structure of the credit cooperatives in India is illustrated in chart I. Interestingly, under the Banking Regulation Act 1949, only State Cooperative Apex Banks, District Central Cooperative Banks and select Urban Credit Cooperatives are qualified to be called as banks in the cooperative sector. In other words, only these banks are licensed to conduct full-fledged banking business.

**Urban Cooperative Banks in India**

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative 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 around communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably.

The origins of the urban cooperative banking movement in India can be traced to the close of nineteenth century when, inspired by the success of the experiments related to the cooperative movement in Britain and the cooperative credit movement in Germany such societies were set up in India. Cooperative societies are based on the principles of cooperation, mutual help, democratic decision making and open membership. Cooperatives represented a new and alternative approach to organisation as against proprietary firms, partnership firms and joint stock companies which represent the dominant form of commercial organisation.

**The Beginnings**

The first known mutual aid society in India was probably the ‘Anyonya Sahakari Mandali’ organised in the erstwhile princely State of Baroda in 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar. Urban co-operative credit societies, in their formative phase came to be organised on a community basis to meet the consumption oriented credit needs of their members. Salary earners’ societies inculcating habits of thrift and self help played a significant role in popularising the movement, especially amongst the middle class as well as organized labour. From its origins then to today, the thrust of UCBs, historically, has been to mobilise savings from the middle and low income urban groups and purvey credit to their members - many of which belonged to weaker sections.
The enactment of Cooperative Credit Societies Act, 1904, however, gave the real impetus to the movement. The first urban cooperative credit society was registered in Canjeevaram (Kanjivaram) in the erstwhile Madras province in October, 1904. Amongst the prominent credit societies were the Pioneer Urban in Bombay (November 11, 1905), the No.1 Military Accounts Mutual Help Co-operative Credit Society in Poona (January 9, 1906), Cosmos in Poona (January 18, 1906), Gokak Urban (February 15, 1906) and Belgaum Pioneer (February 23, 1906) in the Belgaum district, the Kanakavli-Math Co-operative Credit Society and the Varavade Weavers’ Urban Credit Society (March 13, 1906) in the South Ratnagiri (now Sindhudurg) district. The most prominent amongst the early credit societies was the Bombay Urban Co-operative Credit Society, sponsored by Vithaldas Thackersey and Lallubhai Samaldas established on January 23, 1906.

The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organisation of non-credit societies. The Maclagan Committee of 1915 was appointed to review their performance and suggest measures for strengthening them. The committee observed that such institutions were eminently suited to cater to the needs of the lower and middle income strata of society and would inculcate the principles of banking amongst the middle classes. The committee also felt that the urban cooperative credit movement was more viable than agricultural credit societies. The recommendations of the Committee went a long way in establishing the urban cooperative credit movement in its own right.

In the present day context, it is of interest to recall that during the banking crisis of 1913-14, when no fewer than 57 joint stock banks collapsed, there was a flight of deposits from joint stock banks to
cooperative urban banks. Maclagan Committee chronicled this event thus:

“As a matter of fact, the crisis had a contrary effect, and in most provinces, there was a movement to withdraw deposits from non-cooperatives and place them in cooperative institutions, the distinction between two classes of security being well appreciated and a preference being given to the latter owing partly to the local character and publicity of cooperative institutions but mainly, we think, to the connection of Government with Cooperative movement”.

**Under State Purview**

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 Cooperative Societies Act in 1925 “which not only gave the movement its size and shape but was a pace setter of cooperative activities and stressed the basic concept of thrift, self help and mutual aid.” Other States followed. This marked the beginning of the second phase in the history of Cooperative 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 Cooperative 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 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 cooperative 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 Centres 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.

Inspired by the success of urban cooperative movement in Germany and Italy, in the early part of the last century, urban cooperative credit societies were organized on community basis and their lending operations were confined to meeting the consumption oriented credit needs of their members. Many urban cooperative banks, which were organized initially, were essentially credit societies but later converted themselves into urban cooperative banks. Interestingly, many urban cooperative credit societies, which were not engaged in any banking functions, also used the word .bank..

There was no well-defined concept of urban cooperative bank till 1996, when banking laws (provisions of section 5(CCV) of Banking Regulation
Act 1949) were made applicable to cooperative banks. Accordingly, an urban cooperative bank was defined as a Primary Cooperative Bank other than a primary agricultural credit society; (i) the primary object of which is the transaction of banking business, (ii) the paid up share capital and reserves of which are not less than Rs.1 lakh (0.1 Mn) and (iii) the by-laws of which do not permit admission of any other cooperative society as a member. The word primary is used to denote that the urban cooperative banks perform the role of a primary unit in a 3-tier cooperative credit structure.

Over a century old urban co-operative credit movement today, has a network of 2,084 urban co-operative banks with 7,368 branch outlets spread all over the country. The deposits and advances of urban cooperative banks constitute for about 9 and 8 percents of the aggregate deposits and advances of the banking system respectively. In so far as the growth and performance are concerned, it may be mentioned that the urban cooperative banks were a shade better than the scheduled commercial banks and public sector banks till 1999 (Ramesha K, 2001). However, it has to be recognized that the prudential standards and regulatory system prescribed for urban cooperative banks were relatively soft in comparison with those of commercial banks. This is partly on account of historical reasons and partly due to the preferential treatment of cooperative structure in general. If one benchmarks the growth and performance of urban cooperative banks with that of the banking industry (which is dominated by public sector banks) after 2000 and onwards, then the scenario undergoes a complete change.
For instance, between 2001 and 2002, although owned fund, deposits and advances of urban cooperative banks increased somewhat impressively, i.e., by 27, 15 and 14 percents respectively, the gross Non Performing Assets (NPAs % to total advances) during the same period went up from 16 to 22 percent (3). The percentage of the profit making urban cooperative banks to the total stood at 87 percent as at the end of March 31, 2002. On the whole, the performance of the urban cooperative banks particularly after 2000 has been on the decline, and a host of factors may be responsible for this which may include increasing competition, tightening prudential standards and supervision and regulatory standards, multiple control, etc. Following are the features of urban cooperative credit banks in India.

Urban cooperative banks are registered under Cooperative Societies Act of the respective state Governments. The Reserve Bank of India (Central Bank of the country) is the regulatory and supervisory authority for UCBs for their banking related operations. Managerial/Administrative aspects of UCBs continue to remain with the state Governments. The Union Government regulates the UCBs having multi-state presence and such banks are registered under Multi-state Cooperative Societies Act. Controlling of UCBs by state Government and the Central Bank of the country is generally known as duality of control.

The discernible characteristic feature of UCB structure is its heterogeneity. Nearly 50 percent of the banks are unitary in nature (with single branch banking). Heterogeneity in their size is another facet of
the UCB structure. The larger UCBs (scheduled UCBs) numbering just 51 accounts for more than 40 percent of the business from UCB sector as against 800 UCBs accounting for just 6 percent.

UCB structure is exemplified by its pronounced focus on the needs of small men and micro credit sector. The average size of the loan also works out to be relatively low and an overwhelming segment of UCBs have been able to comply with the priority sector lending targets (directive from central bank to lend to certain sectors like small enterprises, trade & business, housing etc) set by the central bank of the country.

Urban cooperative credit movement in general, and the number of UCBs in particular is concentrated in few states. Five states account for 80 percent of the total UCBs in the country and one of them accounts for as high as 32 percent of the total UCBs.

A noticeable feature of urban banking sector is its financial independence. Unlike the agricultural cooperative credit structure, the urban cooperative banks are not surviving on external assistance such as refinance support. In fact, UCBs have been supporting federal units (District Central Cooperative Banks and State Cooperative Banks) by keeping their surplus resources in the form of deposits.
Table 2.1
State Wise Financial Indications of Urban Co-Operative Banks as on 31st March 2008 (Rs. in crores)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>State</th>
<th>No. of Reporting bank</th>
<th>Share Capital</th>
<th>Reserves</th>
<th>Owned Funds</th>
<th>Deposits</th>
<th>Loans &amp; Advances</th>
<th>Working Funds</th>
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<tr>
<td>Oo 02</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>01</td>
<td>Andhra Pradesh</td>
<td>139</td>
<td>125.34</td>
<td>266.09</td>
<td>391.43</td>
<td>3541.50</td>
<td>2681.31</td>
<td>4781.96</td>
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<td>19.48</td>
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<td>135.17</td>
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<td>4.29</td>
<td>20.22</td>
<td>10.71</td>
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<td>177.67</td>
<td>92.81</td>
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<tr>
<td>Total</td>
<td></td>
<td></td>
<td>1863</td>
<td>2554.21</td>
<td>11296.48</td>
<td>13650.69</td>
<td>94068.74</td>
<td>115615.5</td>
</tr>
</tbody>
</table>

Source: Reading materials published by Gujarat state co-operative federation 12, Dec. 2008
It will be seen from table 2.1 that out of total 1863 reporting UCBs as on March 31 2008 as many as 1474 UCBs (i.e. 79.12%) UCBs are located in five states only, i.e. Maharashtra, Gujarat, Karmataka, Tamil Nadu and Andhra pradesh. The rest of the states have only 389 UCBs (i.e. 20.88%) This reveals the regional imbalance in the growth of the UCBs in India. The comparative position of the UCBs in major states of India on March 31st 2008 is also presented by pie chart in figures1.2. There were 51 scheduled UCBs as on 31st March, 2008. However there 53 scheduled UCBs as on 31/3/09

Comparative Position of the UCBs in Major States of India on March 31st 2008

From the figure it is apparent that Maharashtra stood first in development of the UCBs as it consists of 31.89 % of the total UCBs , followed by Gujarat (16.64 %) , Karnataka ( 15.83 %), Tamil Nadu ( 07.30 % ) and Andhra pradesh (07.46 %) and other stood in development of the UCBs as it consists of the 20.88% It is seen that from above figures 2.2, there was a regional imbalance of UCBs development in the country.
CHARACTERISTICS OF URBAN COOPERATIVE BANKING IN INDIA:

Cooperatives may still have an edge in identifying and serving consumer needs.

In theory, cooperatives are better able to maximize consumer surplus. Hansmann, for example, notes that inefficiencies may arise from firms seeking to satisfy the preferences of the marginal patron (to maximize sales/profits) rather than those of the average patron (which would maximize consumer surplus). In a cooperative, the one-member one-vote system will lead the firm to seek to satisfy the preferences of the median patron, who is closer to the average patron than the marginal patron is. However, in part because the median voter does not necessarily reflect average preferences, Hart and Moore (1998) find that, for consumers, cooperative ownership becomes less advantageous the more competitive a market is and more so the more uniform the membership base is.

However, these theoretical considerations are predicated on the assumption that all relevant decisions are made by the full membership base, or at least by a representative sample of members. The reality is very different (see section on corporate governance). Nevertheless, the fact that a cooperative’s clients are also its members and are involved in its decision-making, should provide it with an informational advantage over commercial banks. While size and increasing distance between members and management are likely to reduce this advantage, the remarkably high market shares some cooperative banks have in the market segments they target (e.g., farmers in France) seem to indicate that it remains in place to a significant extent.
**Cooperatives have a lower cost of capital**

Cooperative banks only need to remunerate the part of their equity that is represented by member shares (this part is henceforth referred to as the “cooperative capital”), not the often much larger intergenerational endowment (which, in accounting terms, partially appears in the books as reserves). Moreover, cooperatives do not remunerate member shares very generously (see below), and need not do so because in most cases members do not acquire shares in the first place for investment purposes. This lower cost of capital should allow cooperatives to sell their products at below-market prices, or, putting it differently, to incorporate their profits into their products.

Nevertheless, pressure has increased on cooperatives to raise their profitability to market levels. Moreover, the advantages cooperatives have thus far derived from their lower cost of capital are likely reduced by Basel II, which was introduced in the EU by the Capital Requirements Directive, on January 1, 2007. The reason is that Basel II reduces the level of capital banks need for their retail operations. As a result, the cost of capital will become a less important factor in the overall cost of providing retail financial services.

Basel II is very well applicable to Urban cooperative Banks of India also.

**Cooperatives have entrenched retail market positions and loyal customers, but depend more on those customers than other banks.**

Cooperative banks typically have strong retail market positions, especially in their target market segment. Moreover, customer members
can be expected to be more loyal than customers of a commercial bank, since the relationship they have with their cooperative is one that goes beyond a pure bank-client relationship. However, with retail markets becoming increasingly competitive, this loyalty does not imply that members will necessarily do all their banking with their cooperative. They can be members and still shop around for the best deal for individual products. In many cases, however, the cooperatives themselves cannot freely shop around for customers. Many are restricted by statute or law to a specific market segment (e.g., a region or profession). Even in the absence of such restrictions, cooperatives’ democratic nature and historic focus on a specific market segment may make it difficult for them to reach out to other market segments. Hence, cooperatives’ fate may be linked rather deterministically to the fate of the market segment they were historically set up for, and these market segments are not always flourishing. Commercial banks, on the other hand, face no such restrictions. In particular, they have more flexibility and freedom to selectively target high value added customers.

Extensive branch networks give cooperatives an important, albeit declining, comparative advantage in retail markets.

Cooperatives thank their strong and entrenched retail market positions in part to disproportionately large branch networks. Although rationalizations have occurred, often these have not been as drastic as those of commercial banks and some cooperative banks have expansion strategies that are based on a further buildup of their branch networks. As a result, in many countries the market share of cooperatives, as measured in terms of branch networks, has increased in recent years. These branch
networks are also typically spread differently than those of commercial banks.

In France, for example, commercial bank branches are mainly located in the cities, while those of cooperative banks are to a much greater extent located in the countryside. On the downside, extensive branch networks constitute a large fixed cost, which cannot easily and quickly be reduced during lean times, especially under continental European labor laws and with employees being members of the firm. In a world in which physical presence is becoming less relevant, branches also no longer provide the same degree of comparative advantage as they once did.

Cooperatives tend to have loyal employees that are close to their customers, but they may have a lower ability to pay market prices for top talent.

Employees who are members of the cooperative that employs them are likely to be relatively loyal. Involvement in decision-making (and the higher degree of job security that this typically entails) may also encourage employees to invest more in firm-specific human capital (Becht et al., 2002). Employees also tend to be close to the cooperative’s customers. Juvin (2005) notes that a cooperative’s employees and clients “speak the same language”. They are people with similar backgrounds and employees often stay in their own region for their entire career. In return for their involvement in decision-making, job security, in many cases a share in the cooperative’s profits, and the possibility to have a career in one’s own region, employees may accept to work for lower salaries. Employee loyalty also enhances a cooperative’s returns on investment in training.
Many cooperatives invest significantly in the training of their workforces, in part as a substitute to purchasing external human capital. However, the greater focus on retail activities and typically flatter pay scales than at commercial and investment banks may make it more difficult for cooperative banks, especially smaller ones, to attract top talent. This may be a handicap in developing certain lines of business, such as sophisticated financial market activities. This is one of the reasons why some cooperative groups have opted to conduct such activities through separate entities.

**A key strength of many cooperatives is their ability to mobilize and retain deposits.**

With their large branch networks, loyal customers, and overall strength in retail markets, cooperatives usually have a disproportionate share of retail deposits. This typically results in comfortable levels of liquidity, high deposit-to-loan ratios, and a tendency for cooperatives to be net lenders in interbank markets. Table 2 shows that, as of end-2004, French cooperative networks had lower loan-to-deposit ratios and higher ratios of interbank lending to interbank borrowing than large commercial banks and that all but one of the cooperative networks were net lenders on the interbank market.

**In many cases, cooperatives have a comparative disadvantage in accessing financial markets.**

Cooperatives not only have problems raising capital, they may also be less able to borrow in financial markets. Many small cooperatives lack
the expertise and scale to do so, and their retail lending may not always be suitable for securitization, syndication, or central bank refinancing.

**Cooperatives have a fundamental and increasingly relevant comparative advantage in overcoming problems of opportunistic behavior by banks.**

Hansmann argues that consumer ownership of firms can be efficient in situations characterized by problems of “lock-in” (i.e., the inability to leave a long-term relationship at low cost), risks related to long-term contracting (e.g., in life insurance), information asymmetries in favor of the firm, or other factors that give firms significant (ex-post) market power (e.g., a natural monopoly). In such cases, consumer ownership has significant benefits because it reduces the firm’s incentives to exploit these advantages. Financial products have become very complex, and financial institutions have enormous resource advantages over their retail customers.

This has led to new forms of information asymmetries and ex-post market power of the kinds listed above. Given furthermore that consumer protection laws cannot always be relied upon to fully protect consumers and provide them with cost-effective ways to seek redress, the trustworthiness of institutions has become an essential criterion in consumers’ choice of bank. Consumers want to be able to trust the advice their bank gives them and sign documents without (their lawyer) having to read the fine print.

The facts that cooperatives are owned by their clients and state publicly that they do not seek to maximize profits give them an edge in portraying trustworthiness. Cooperatives are well aware of this, and many of them
point out in their marketing that they are “different”. As a result, customers may even be willing to pay a premium for financial products provided by a cooperative bank, because the risks and monitoring costs involved are (presumed) to be less. In sum, and using John Kay’s words, cooperatives have a competitive advantage in establishing trust (Kay, 2006). However, an advantage in establishing trust does not alter the fact that trust is easy to lose. Kay observes that when mutual financial institutions become large and pursue growth and diversification, they tend to lose their trust advantage because they start to act as commercial institutions.

**Outlook**

**From a lifecycle perspective, most Indian cooperative banks have reached an advanced level of maturity.**

Their original *raison d’être* now has a reduced relevance, because improved legal and institutional frameworks have alleviated the market failures cooperatives overcame and commercial banks now generally cater to a universal clientele. The distance between management and members has increased, in part because the increasing complexity of financial services provision required a professionalization of management. This trend has been reinforced by cooperatives’ efforts to reap economies of scale and scope through mergers and through the creation of networks in which decisions are increasingly taken at the center. Some of these networks have turned into large, multistates Cooperative Banks that have little in common with the small-scale self-help organizations they descend from.
The sector’s entrenched market positions and comparative advantages are no guarantee for continued success in rapidly evolving markets that require adaptability.

The Indian banking landscape is changing rapidly. Progressing cross-border integration and new technologies are making markets more competitive and contestable. In this context, cooperatives’ branch networks may lose much of their relevance going forward. Moreover, some of the market segments that cooperatives used to focus on are declining in importance, and consumer loyalty and homogeneity are only likely to decrease further. The challenge cooperative banks face going forward is to adapt to these changing circumstances while retaining as much as possible the comparative advantages they have. In this regard, the large fixed costs related to the branch networks and the traditions of employee involvement and job security could pose particular challenges. Further consolidation and integration are seen as necessary by many within the sector not in the least to improve cooperatives’ ability to adopt new technologies. However, past experience shows that, in the process, important comparative advantages may be lost, in particular the closeness to customers that was the driving force of cooperatives’ success in the past.
GOVERNANCE : INDIAN CONTEXT

Governance in general is a systemic process for enhancing wealth generating capacity, meeting stakeholders and societal expectations. In this context, governance in banks and financial institutions (FIs) has been attracting special attention in India during the past few years for a number of reasons.

Firstly, with liberalization and globalization, the Indian economy, while on the one hand is getting more and more integrated with the global markets, on the other hand the developments outside the country are also affecting the domestic market. It is well understood that vulnerable, unstable and opaque banking and financial systems can severely disrupt macroeconomic performance of the country. It is, therefore, necessary to strengthen both supervisory and regulatory framework of the banking and financial systems.

Further, with increasing deregulation, there is need for more self regulation, in spite of the fact that the banking and financial systems all over the globe including India., are required to meet certain international benchmarks or standards as per regulation, particularly in the areas of supervision, accounting and disclosures. However, the issues are complex and merely meeting these standards would not be sufficient by themselves for stability in the long run unless there are well established governance processes permeating throughout an organization through a system of proper conduct and professional management.

In the context of governance, the Indian banking sector has a special role to play, not only because of the critical nature of the business, but
because it is a sector that has had large public ownership which is now in the process of being divested. Historically, bank has been used for government policy implementation. The differences and criticalities of the sector arise out of the following factors:

(a) In the case of banks and financial intermediaries, interests of other Stakeholders, namely the depositors, appear to be more important as compared to the other corporate.

(b) The risks in banking institutions are many for example credit risk, market risk, counter party risk, country risk, liquidity risk etc. and these have systemic implications. The East Asian crisis of the 1990s is a case in point.

**REFORMS IN BANKING SECTOR**

Under the reform process, in the post Narsimham committee scenario, ownership structures of nationalized banks are undergoing a change and the macro economic environment in which banks are required to function is also changing rapidly. In the light of both these internal and external changes, there is a need to look at governance issues in the sector on a continuing basis.

The Indian banking system had grown rapidly even before the nationalization of the fourteen major banks in 1969. However, the lending activities of the private sector banks were not directed towards the diverse productive sectors of the economy, which had the potential to contribute to economic development and growth. Moreover, banking prior to
nationalization had a strong urban bias and the banking needs of the rural economy and the poorer sections of the society were largely ignored.

The concern of the government through the 1970s and 1980s was to meet the national policy objectives using the banking system as a tool for mobilizing savings from different sections of the population and thereby accelerating the pace of investments for productive purposes. It was felt that this would be possible through nationalization of banks. Initially in 1969 and thereafter in 1980, by directing the resources of the banking industry to these selected priority sectors. Nationalisation was followed by a vast programme of branch expansion and priority sector lending.

However, over a period of time, the public sector banks which constitute about 80% of the banking activates both in terms of deposits and branch network developed certain practices which were not in conformity with efficient functioning of a commercial organization, particularly in a liberalized competitive market. The managements of these banks started looking more and more towards the government for direction and guidance not only for deciding the medium to long term action plans, but even in routine matters such as credit disbursement and branch opening etc. Even in regards to staff selection and compensation, over the years, decisions became centralized, with one size fits all approach. As a result one may say that on many occasions banks had to compromise their own commercial interests for meeting the wider national interests.

Although, theoretically the public sector banks could compete with each other, the inherent uniformity in approach on various issues, including operational areas and credit risks, there was limited scope for open competition and innovation, further, with strict regulation and exchange
control, the banking system was, by and large insulated from the global markets. Activity was more rules based rather than on the basis of initiatives of an individual bank. Further, a mix of political expediency, inefficiency due to bloated size, lack of monitoring due to absence of technology support, also contributed to the weakening of the banking system.

The external debt crisis, which surfaced in 1991, brought India close to default in meeting its international payment obligations. The balance of payment situation become almost unmanageable. The underlying fiscal crisis was acute and acceleration of rate of inflation appeared imminent. The cumulative impact of these factors had left many public sector banks under capitalized and unprofitable.

The major policy thrust was to improve the operational and allocative efficiency of the financial system as a whole by correcting many of the exogenous and structural factors affecting the performance of the financial institutions. Easing of external constraints such as administered interest rate structures and reserve requirements for banks, strengthening the financial base of the financial institutions, facilitating the entry of new institutions, exploring indirect monetary policy instruments and strengthening prudential regulations were some of the items on the agenda of the financial sector reforms.

Thus, the reform in the banking sector during the last decade, which is gathering momentum, is to enable the banks to operate more efficiently in market oriented competitive environment. However, the reforms process can be successful only through continuing efforts in strengthening the organizational framework of these banks.
A well diversified financial and banking structure that developed during the last three decades for meeting the banking and credit needs of the various sectors of the economy is facing unprecedented challenges today. At present, the banking sector is dominated by the public sector banks and unless these challenges are faced boldly by these banks and the banks themselves undergo a process of reforms through greater autonomy, they would find it difficult to survive in the competitive market; more so when competition is likely to increase from global sources as well, in the coming years.

New challenges have emerged in various forms. There is a paradigm change in use of technology by the banks. In the past, technology was being used for book keeping and accounting purposes, now it encompasses new modes of delivery channels of various products to the customers. There is also a shift from traditional delivery mechanism of brick and mortar branches to click and phenomenon, giving the customers not only easier access but wider choices of products. With the integration of financial markets all over the globe new global banking products are reshaping the balance sheets of the banks. The public sector banks would, therefore, need to change their bureaucratic character and convert themselves into more market savvy and customer friendly organizations with better understanding of the risks, which need to be managed in a market oriented environment. The strengthening of the banks would require bringing about changes on two fronts. First, through a continuing process of improving the Capital Adequacy, NPA management, tightening the systems and procedures etc. The second but more important through a simultaneous process of strengthening the management systems starting from the Board level.
The process of liberalization, globalization and privatization is leading to a greater integration of the markets and thereby diluting the role of the Government in running the organizations. Against this backdrop, there is no gainsaying that the banks will have to introduce a process of good governance which would be a precondition for sound management of banks. This in turn would require the primacy of the Board to be established. The process of good governance should emanate from the Board.

However, in certain instances where irregularities have been detected, the role of nominee directors has at tracked attention. However, it is felt in general that these nominee directors have a duty to act in the larger public interest.

This disclosure must be made on the assumption that value based governance is a dynamic concept evolving over time and constantly adapting itself to the developments in the economy and in particular the company. Cooperatives’ basic governance mechanisms were designed for small groups of people within close-knit communities, but are now being applied to large conglomerates. Just like political democracy could not be applied in the same way in large nation-states as in Greek city-states, cooperatives’ democratic governance mechanisms face problems of applicability at different scales. At present, it is by no means clear that they have been adapted to function well at the scale that many modern cooperative banks have achieved. In particular, collective action challenges appear daunting in large cooperatives.
Market forces play a lesser role in fostering good governance in cooperative banks than in joint stock corporations. Fama (1980) argues that a firm can be seen as a collection of factors of production, each facing market discipline from their own factor market. The factor shareholders contribute is risk-sharing, and since they can diversify their portfolio over many different firms, they may not be willing to engage in the management of individual firms.

In this view, management discipline is provided primarily through the market for management talent and by shareholders’ ability to express their views on the quality of management through the market for risk-bearing (capital markets). In cooperatives, however, such market discipline functions much less freely. The market for cooperative managerial talent is much less active and money-driven than its commercial equivalent. In addition, membership typically involves little financial risk, a member’s relationship with the cooperative is much broader and complex than a simple investment, and members may face conflicting interests when they are also depositors and/or borrowers.

Significant deregulation in the financial sector along with introduction of prudential norms that have been made more and more stringent over a period of time have completely altered the life of co-operative banks in general and urban co-operative banks in particular. It became inescapable for co-operative banks also to have a serious look at their governance issues in their entirety.

There is now a growing realization that a “status quo” approach in dealing with complexities of fast changing banking scenario would make the sector irrelevant and may eventually take it to oblivion.
The urban co-operative banks are battling on two fronts. The first one concerns issues that are external, like those arising out of changing economic order and globalization, the long existing issue of dual control, highly restrictive state co-operative laws, etc. The other front concerns the internal issues of governance which could be said to include the existing structure of UCBs, which does not restrict a member from being elected to the board irrespective of his/her capabilities in understanding banking, the performance of board, professional management, role of the Chief Executive, competent workforce, etc.

As for the external factors, the economic liberalization has had an all-embracing effect on all economic and commercial entities in the Country and urban cooperative banks have been no exception. The various drills that constitute what we understand as corporate governance are in the process of being internalized by the co-operative banks. But certain factors have made the process rather different for them.

It may be noted that till 1990, the growth rate in UCBs was not more than the industry average. Two factors contributed to the sudden accelerated growth of UCBs between 1992-93 and 1999-2000 as during this period their growth rate was very high.

The first one was the acceptance of the Marathe Committee’s recommendations which liberalized the rules for opening of new UCBs. The second was the deregulation of interest rates as a part of banking sector reforms ushered in by the Narasimham Committee’s Report.

While hundreds of new urban cooperative banks opened shop during the six-year period, existing UCBs also increased their branch network. Deregulation of interest rates tempted these new banks as well as most
other UCBs to offer high rates of interest to attract deposits. Thus the combination of a large number of new entities and the newfound freedom of interest rates proved to be a potent combination that invited trouble of significant proportions in the long run. Banks were posting excellent results, growth rate was much higher than the national average and for some years the glittering success made everyone oblivious of their serious shortcomings. As we all know, the first dose of prudential norms by way of asset classification and provisioning was very friendly and most of the urban banks met the requirements rather easily. But as these norms became more stringent progressively, going started becoming tougher and tougher for the urban cooperative banks. Introduction of capital adequacy norms highlighted the need for a bank having different avenues to raise capital and brought into sharp focus the limitations of co-operative banking system to have such avenues.

All this time, the urban co-operative banks did not realize the importance of the fact that globalization will make the banking progressively more complex by the day demanding a very high degree of professionalism, transparency and good corporate governance.

After the advent of financial sector reforms in India, many committees starting from Narasimham Committees I and II, the advisory committee on banking supervision headed by Sb. M. S. Verrna, the Ganguly Committee and RBI’s advisory group on corporate governance went into great detail for drawing up a roadmap for corporate governance in banks in India to meet the requirements of Basic Committee on banking supervision in this regard. Essentially the Basel Committee made banking sector specific improvements and additions to the OECD’s (Organization for Economic Cooperation and Development) principle on corporate governance that require timely accurate disclosure to be made on all
material matters regarding a corporation including financial situation, performance and ownership of the corporate. The OECD principle seeks to address the following:

(i) protect the shareholders rights (members’ rights in case of co-operatives)
(ii) protect rights of all shareholders and stakeholders as established by law and encourage active co-operation between corporation and shareholders in creating wealth and sustainability of enterprise; (iii) ensure timely and accurate disclosure.

Basel Committee included parameters like internal code of ethics, delegation of clear responsibilities and decision making authority, independent risk management and internal audit functions, special concentration on credit risk exposure, public disclosure of credit risk, etc.

Acceptance of Narasimham Committee’s recommendations, made the banks in India, for the first time to follow prudential norms, disclose non-performing assets, provisioning, and crucial operating ratios in their balance sheets. They were fine tuned to include asset liability management to monitor maturity pattern of asset & liability, movement of NPAs and details of lending to sensitive sectors etc.

In fact, the second Narasimham Committee emphasized on the need for differentiating ownership from management in order for public sector banks in particular, to get autonomy from the Government in their operations. It also emphasized the need for induction of professionals in the management and wanted major shareholders like depositors and public to be represented on the board.
The Advisory Group on Corporate Governance has strongly pitched for boards of banks to have 51% independent directors (other than full time directors and promoters). It opines that independent directors would be in a position to play their fiduciary role more effectively if they possess experience and expertise in areas related to the activities of the company. Referring to banks, the Group has said that the shareholders, particularly in public sector banks, had no say in the affairs of the banks, even in adoption of annual accounts and approval of dividends, and has recommended that RBI and Government must bring about significant changes in corporate governance mechanism adopted by banks. Recommendations of the Group are being progressively implemented.

With these macro developments in the governance scenario of the banking industry in general, we come back to the governance aspects of co-operative banks.

The sections 10, 1OA to 1OD, 12A o Banking Regulation Act, 1949 which essentially deal with appointment of- chairman, qualifications for board of directors, elections of new directors etc. in respect of banking companies are not applicable to the co-operative banks. They are governed by the co-operative societies Acts of different states on all aspects of management and governance, which are very different from those of commercial banks in terms of constitution of board and other fundamental aspects.

First and foremost, in co-operatives the governance system is democratic and is, therefore, derived from membership as against that of corporate
system where the management is controlled by majority shareholders. This itself makes co-operative system more difficult than corporate system in terms of introduction of best practices of corporate governance.

In case of cooperatives, the commitment of the management is far more complex and even unclear. Members or shareholders for whose socio-economic benefit, the co-operatives are created, by virtue of their taking active part in affairs of the co-operative and by necessarily utilizing the services of the cooperative have umbilical connection with the management. In co-operative banks, members are borrowers. Directors are elected from among them. There is no concept of independent directors which is an essential part of good corporate governance. So the question is, what does the democratic ethos of cooperative banks mean to corporate governance? It has been observed that although cooperative philosophy automatically points to transparency co-operative banks are in practice less transparent. Therefore, new regulations regarding transparency are hurting many cooperative Banks.

Elections of directors from among the members of the society may never ensure the board to be professionally competent. A board of a bank wherein majority of directors do not possess adequate knowledge of banking, finance and management would not be able to introduce and sustain best corporate Governance practices.

Another unique deviation from general governance practice that is prevalent in the co-operative banks is the complete absence of clarity of roles of the Chairman of the board and the Chief Executive of the organization. In fact, there is no demarcation of roles of board and the
executive. If this aspect of governance is sorted out, adoption of best corporate governance practices will become much easier. Corporate governance in co-operative banks would greatly improve if the system of having a truly effective audit committee is taken seriously, rather than paying only lip service to the concept.

In this context, the Kumaramangalam Birla Committee’s recommendations for corporate governance in companies are also extremely relevant in a large measure to co-operative banks. In banking context the co-operative banks would do well to strictly adopt and follow transparency and disclosure requirements, give utmost importance to off-site surveillance of RBI and institute prompt corrective action.

It may be pertinent to note that the measures taken by RBI and adopted by commercial banks over the last four years in respect of corporate governance have had a very positive effect on the health of the banks. As stated earlier, there are certain inherent difficulties in adoption of these measures in co-operative banks and it may take some more time for all of them to fall in line. However, in case of a majority of co-operative banks, changes for the better are visible. Unfortunately, in the process of enforcement of good corporate governance processes by RBI, many of the non-viable banks and those with undesirable management practices are being forced to exit, and in the absence of streamlined non-disruptive exit mechanism for these banks, a large number of better managed banks are finding it all the more difficult to adopt the required governance practices and fall in line with the progressively more stringent prudential norms that will help them align themselves with the mainstream of banking industry in the Country.
While amalgamations and mergers are a part of corporate strategies to meet the competition among companies, there has been no practice for mergers of cooperatives. Those that have taken place are few and far between. However in many countries with well established history of healthy co-operative movement, there have been large scale mergers and amalgamations among cooperative banks, primarily for creation of stronger entities that could provide better service to their members, customers and other stakeholders and at the same time be in a position to withstand competition. Such consolidations have been significant in the last 15 years, as larger entities are found to be in a better position to adopt technologies better, to increase their efficiency and become more cost effective.

The RBI has very recently announced guidelines for mergers among urban co-operative banks. These are perhaps early days and there are many questions to be answered and mindsets to be changed before there is a ready acceptance of the idea of merger being one of the routes for improvement of governance, strengthening of financials and for meeting the competition to remain in business. It is however, heartening to note that merger is not only being contemplated to save weak banks, but there are already moves by sets of two healthy banks to create a bigger, stronger and more competitive urban co-operative bank. As a thumb rule, a financially strong bank invariably follows more acceptable corporate governance practices than a weak bank. In the ultimate analysis, while extraneous factors are there as common denominator for all banks, and they are equally affected by them, internal factors of good governance make all the difference between a strong bank and a weak bank. Good corporate governance is in totality, universal in its sweep and contents.
There may be slightly different approaches to achieve the goals of good corporate governance.

After all factors like transparency, disclosure, shareholders / stakeholders interests, well defined demarcation between ownership and management are all like qualities of truth which cannot be disputed nor can anyone give any worthwhile excuse not to follow them. So if we advocate that co-operative principles of co-operatives and co-operative banks come in the way of good corporate governance, nobody will buy the argument. On the contrary, by doing so we will only be discounting the image of co-operatives.

In fact, the inherent quality of much higher corporate social responsibility that is seen in co-operative banks in much larger measure than in commercial banks will shine brightly if we can match the corporate governance practices of commercial banks. This is precisely the situation in countries like Germany. France, etc. where co-operative banks have a very respectable place in the industry and are considered financially strong and prudent entities.
CHALLENGES FOR URBAN COOPERATIVE BANKS

COOPERATIVES AND FINANCIAL STABILITY:

Prudential authorities need to be conscious of the specific risks cooperative banks face, as well as of the potential impact they may have on the banking system as a whole. The most important of these specific risks are related to the combination of the governance challenges and the constraints cooperatives face in managing their capital.

The Experience Thus Far

Cooperative banks generally have lower incentives to take on risks, and this seems to be confirmed by experience. The lack of a need to maximize profits and the absence of many of the factors that lead rational managers in commercial banks to adopt short-term horizons means that cooperative banks have lower incentives to take on risk.

Much of the available evidence is consistent with this prior. During the US savings and loans crisis, investor-owned S&Ls fared much worse than mutual S&Ls, because they had tended to pursue more speculative investment policies (Hansmann, 1996). It is also found that Cooperative banks in France and Switzerland fared generally better than commercial banks during the banking problems of the early 1990s. It’s noted that cooperatives typically have more risk-averse clients, who may prefer member shares in a cooperative over more risky assets such as stocks in Capital Market.

Cooperative banks may be more vulnerable to certain shocks, including credit quality and interest rate developments, but possibilities to manage these vulnerabilities are increasing. Old-fashioned intermediation is
cooperatives’ core business. Hence, while they may still have a bit of an edge in managing credit risk, cooperative banks typically have a lot of such risk. Moreover, the credit risks they face tend to be correlated with each other due to cooperatives’ focus on a usually in at least some ways homogenous member base.

As noted above, cooperatives’ business model also relies more on one particular source of revenues (the interest margin), which is likely to imply higher vulnerability to interest rate. Developments Overall, while cooperative banks may generally be stable, they do tend to be vulnerable to certain types of instability. Just few years bank many cooperative banks in India have had problems with nonperforming assets. However, developments in financial markets, in particular the increased opportunities to hedge against interest rate risk and securitize loan portfolios, should allow cooperatives to reduce and better manage the risks they face.

In our country India also, because of very problem two large cooperative banks such as, Madhavpura Mercantile Bank in Gujarat and Charminar Bank in Andhra Pradesh failed. Both of these banks carry with them several other small and medium cooperative banks towards failure.

Cooperative banks may have more difficulties adjusting to adverse circumstances and changing risks. The Swedish cooperative banking sector did not survive the crisis of the early 1990s in a cooperative form, and the need to restore capital was a major factor in the decision to demutualize. A cooperative’s typical business model comes with a relatively high fixed cost base. With employees involved in decision-making, it may be hard to cut these costs quickly when needed. Strong
Union affiliation makes the matter worst. In many such cooperative banks cost of employees is more than 80% of the total administrative cost.

On the positive side, employees-members may be more loyal and motivated, and therefore more determined to pull the firm through times of hardship rather than abandon it. Cooperatives’ business and depositors are also more stable, allowing them to thrive with a higher (fixed) cost base. Beyond conjunctural developments, the risk of technological change rendering the cooperatives’ branch-based strategies obsolete needs to be taken seriously. Risks have also materialized when cooperatives ventured onto unfamiliar terrain (e.g., derivatives markets).

Democratic decision-making may come at the expense of the speed and quality of decision-making needed to thrive under rapidly changing circumstances. In cooperatives in which members are routinely involved in strategic and managerial decisions, the outcome may be indecisiveness, conflict, slow adaptability, and an inability to jump on business opportunities or take tough decisions in a timely way.

**Building Empires?**

Capital and growth dynamics. Most cooperatives are designed to perpetually accumulate capital, thus building an ever-larger intergenerational endowment. At the time they were set up, a shortage of funds was typically one of the most important challenges cooperatives faced. To remedy this, mechanisms were put in place to ensure capital accumulation. As discussed above, this led to the creation of an intergenerational endowment that in most cases constitutes the bulk of a cooperative’s equity and that keeps on growing as long as the cooperative
remains profitable. Now, a century and a half after the cooperative banking movement started, in many cases the shortage of capital problem is no longer present, but the mechanisms that ensure capital accumulation remain in place. This section argues that cooperatives are caught between their capital-accumulating set-up, pressures to achieve similar profitability as commercial banks, and the already sizable equity they have built up throughout their history.

**Cooperative banks face specific challenges in managing their capital:**

- They have limited control over their cooperative capital, although over many decades this has typically been rather stable.

Since in most cooperatives members can withdraw their membership and ask to have their shares reimbursed, cooperative capital (the part of capital to which members’ shares represent a claim) is variable and cooperatives could theoretically face a “run on capital”. In practice this has not been an issue, given the buffer provided by the intergenerational endowment and considering lengthy withdrawal mechanisms and the unconditional rights that some cooperatives have to refuse redemption. In many cooperatives, there is a minimum level of capital below which redemption is refused.

- They often face binding restrictions on their pay-out policies.

At many cooperatives, there are statutory or legal restrictions that put limits on shareholder remuneration. For example, Swiss *Raiffeisen* banks are legally not allowed to pay more than 6 percent dividend on the notional value of member shares; some French cooperative banks cannot pay more than the government bond yield; *Rabobanks* do not pay dividends to members because membership is free of charge and the
Italian banking law requires that credit cooperatives add 70 percent of their annual profits to their reserves and three percent to a solidarity fund.

As far as India is concerned, The Reserve Bank of India do not permit to pay more then 15% Dividend to their Share holders.

• *They can face severe difficulties raising capital in times of need.*

Provided there is a prospect of future profits, commercial banks (Private) can always issue new shares and sell those at market price when the need to shore up equity arises. Cooperatives, by contrast, can only raise new cooperative capital by increasing their membership or by asking existing members to buy more shares. They can also issue certain kinds of securities and, in many cases, mobilize capital from their network in times of need. However, both raising new capital and tapping alternative sources of funding come with potential problems. First, members may not be well placed to provide capital when needed. They typically pay very little for their shares and buy them to gain access to the benefits the cooperative offers rather than as a financial investment (with low dividends and no potential of appreciation). As a result, they may not have any incentive to buy more than the minimum number of shares needed (a sort of “membership fee”).

The lack of diversification at small cooperatives and the high degree of overlap between their member and clients also means that in times of difficulties many members may not be in a position to provide significant amounts of fresh capital. Furthermore, in many cases there are legal and/or statutory restrictions on the total value of shares a member may hold. Second, issuing other securities is from various perspectives not as attractive as raising cooperative capital. Among other things, such
securities often require a relatively high remuneration. In both approaches, decision-making procedures to raise new capital may be cumbersome and time-consuming.

• **Even in the absence of restrictions, there may be few incentives to pay out a significant share of profits.**

Cooperatives are not at risk of seeing their share price traded at a discount because of dissatisfaction with their pay-out policies. And since shareholdership in a cooperative is not usually driven by investment considerations, members are unlikely to care enough about the level of dividends they receive to organize a “member revolt,” which may be difficult to begin with.

• **Expansionary policies can put significant pressure on cooperatives’ solvency and liquidity.**

Unless an acquisition takes the form of a merger with another cooperative, it cannot be financed through the issuance of new equity. Acquisitions and other expansion projects therefore typically have to be paid through the issuance of debt or out of a cooperative’s liquid assets, thus causing a deterioration in its balance sheet. In their view, cooperatives may have problems raising large amounts of capital quickly, but it is usually relatively easy to place new member shares with members, and this can be done at lower cost.

Many cooperative banks in India have other innovative idea and that is the mobilisation of low cost deposits by promoting more savings Accounts, more current Accounts and short term fixed deposits.
Given these circumstances, even in the absence of any restrictions or empire building aspirations, it is rational for cooperatives to accumulate large reserves by retaining earnings. The somewhat fickle nature of cooperative capital means that cooperatives’ solvency, likelihood of survival (in the absence of external support), and ability to grow all depend on having a significant buffer of reserves. They may therefore opt to maintain, on average, higher levels of capital than their commercial bank peers.

Because of large results, mergers / acquisitions, though very very few, becomes easy without the raising additional capital putting pressure on profit earning resources.

Low pay-out ratios mean that highly profitable cooperatives can enjoy rapid growth in their capital base, and therefore fast organic growth.

Capital has indeed been expanding rapidly at some Indian cooperative banks and banking groups. Because prudential regulations require banks to maintain minimum levels of capital relative to their risk-weighted assets, a bank’s ability to grow depends on its ability to increase its capital. Organic growth (i.e., growth that does not require external capital) therefore requires profits and retention of some of those profits. The link between organic capital growth, profitability and the pay-out ratio is given by the formula:

\[
\text{Capital} = \text{ROE} \times (1 - \text{POR})
\]

Where:
- \(\text{Capital}\) = growth rate of capital
- \(\text{ROE}\) = return on equity
- \(\text{POR}\) = pay-out ratio
Comparing two hypothetical banks, one cooperative and one commercial, the equation above implies that they will have the same organic growth rate if and only if their relative profitability and pay-out ratios satisfy the following equation:

$$\frac{ROE_{coop}}{ROE_{com}} = \frac{(1 - POR_{com})}{(1 - POR_{coop})}$$

For example, if a cooperative has a pay-out ratio of 10 percent and a commercial bank pays out 35 percent of its profits, the former only needs to achieve 72.2 percent of the profitability level of the latter to realize the same organic growth rate.

While a growing capital base may allow healthy organic growth, it can also lead to undesirable empire-building or forced expansion, even in the absence of attractive opportunities. When excess capital is accumulated and cannot be disposed of, over time managers are likely to be tempted or pressured to expand the business in line with the growing capital base. The temptation may originate in Board of Directors tendency to engage in empire-building, a tendency that is the subject of a rich literature.

The risks and costs of empire-building are higher when banks have entrenched Management (i.e., poorly functioning external governance mechanisms). Beyond empire-building, Management may feel pressured to expand the bank’s business when capital grows, if only to fend off outside forces (e.g., tax authorities, members, …) which may want to lay claim on the excess capital and avoid showing ROE figures that are excessively low.
Supervisory practices may play a role in this. Supervisors monitor ROE as an indication of the soundness of a financial institution. Moreover, as noted above, concern about the health of the banking system in the presence of non-profit-maximizing banks has led some supervisors to demand that cooperative banks achieve similar profitability levels as their commercial peers. Faced with a growing capital base and no means to shed excess capital, cooperative bank managers may feel they have no choice but to keep on expanding. As a result, cooperative groups may venture into businesses they are unfamiliar with, or take on challenges that their cooperative nature has difficulties coping with.

Overall, cooperatives face fundamental challenges in managing their capital / Deposits. They cannot shed excess capital, fully rely on the capital they have, or raise capital as needed, especially in times of crisis. With banking being a very capital-dependent business, this is a fundamental vulnerability.

**Asymmetric consolidation**

The tendency towards empire-building may be further reinforced by the asymmetric nature of the possibilities for consolidation between cooperative and commercial banks. Concern has been raised that cooperatives may stand in the way of the consolidation, especially those without regular ownership, can impede consolidation. Cooperatives can engage in consolidation with commercial banks, albeit mostly on an asymmetric basis.

Mergers between cooperatives and commercial banks can only happen on a mutually agreed basis and may not be appealing to commercial banks.
Neither to cooperative banks. Hostile takeovers of cooperatives are impossible.

Mergers between cooperatives can face significant obstacles. As has been illustrated by hundreds of examples over the past decade, mergers between cooperatives within a same network can normally be done, provided members approve them. However, mergers between banks belonging to different networks may be much harder, because the networks are usually governed by different laws (and by-laws) even within a single country. In addition, banks’ operations are, in many cases, closely integrated in the network, which may make it very difficult in practice for a cooperative bank to change its allegiance. This might entail changing brand name, IT systems, management systems and much more. Consolidation can in some respects be easier between networks as a whole.

Overall, cooperatives are likely to increase their market share in any consolidation wave.

**Competition Between Cooperative and Commercial Banks**

Cooperatives can follow market share-based or Deposit -based growth strategies, both of which may lead to overcapacity that may need to be resolved through retrenchment of commercial banks. Competition between cooperative and commercial banks is likely to be beneficial to consumers. In the long run, however, it may affect the structure and stability of the financial system, the impact of which is a subject of debate. Market share-based growth strategies focus on selling at lower
prices than the competition (adjusted for quality, location and everything else) and therefore accepting lower profitability.

Deposit-based growth strategies are based on relatively high organic growth rates of the capital base. Such a strategy requires significant profits because for cooperatives profits constitute the main source of fresh Deposits. As a result of these expansion strategies, competing commercial banks may face reduced profitability and transition costs and risks (e.g., costs of restructuring and closing branches). may lead to macroeconomic inefficiency, waste and overcapacity in the banking system that may take a long time to work out. However, given the higher inherent stability of cooperative banks, they find a positive overall impact of cooperative presence on overall banking system stability.

**Other Prudential Challenges and Concerns**

The third pillar of Basel II is less effective in the case of cooperative banks. The third pillar relies on extensive disclosure to ensure that banks are subject to market discipline. However, as noted above, disclosure practices (and requirements) at cooperatives are often below standards at commercial banks, especially listed ones. Also, even when disclosure is adequate, there are rarely markets that can exert effective disciplining pressure in response.

As discussed above, shareholder pressure cannot be relied upon, loyal - to some degree perhaps even captive— and insured retail depositors may not exert any effective market disciplining effect either at an early enough stage.
Contagion from cooperative to commercial banks is more likely to take the form of liquidity shocks than solvency problems.

Given their typically high levels of liquidity, cooperative banks tend to be net lenders in the interbank market. In times of stress, they are likely to cut their exposures in the interbank market, which may cause liquidity problems for other banks.

Prudential authorities may face calls to apply different standards to cooperative banks, Cooperatives’ not-for-profit statute, large membership, close involvement in local communities, retail orientation, and links to broader movements imply that they can often count on a higher level of public sympathy and political support than commercial banks.

This is only reinforced by cooperatives’ disproportionate market shares in terms of deposits and branch networks, and in rural areas where competition between banks is low to begin with. All of this may lead for pressure to “go soft” on cooperative banks, in terms or regulation as well as supervisory enforcement, and may create particular problems in case a cooperative runs into financial difficulties. In Ireland, for example, the Irish League of Credit Unions has lobbied for, and obtained, a specific regulatory and supervisory framework for credit unions that takes into account their not-for profit orientation and the volunteer nature of much its human resources.
Though in India since last few years such soft views are not taken by Reserve Bank of India but measures introduced after MMCD are much more tougher.

In some cases, risks may arise as a result of not differentiating between commercial and cooperative banks. The main area where this risk appears to exist is corporate governance. Corporate governance regulations that are tailor-made for commercial banks and fail to take into account the different nature of cooperatives may fail to address the specific risks that exist at the latter.

Given the large number of small cooperative banks, supervisory authorities sometimes rely on the apex organization for supervision. In many European countries, there are hundreds of small cooperatives, many of which have their headquarters far away from the big cities where supervisory authorities typically have most of their staff.

Individually supervising all of these small cooperatives may require a level of resources that most supervisory agencies lack. Also, full-fledged supervision might not even be necessary, given that many of the cooperative banks are not dissimilar in terms of size from branches of large commercial banks, especially in the presence of strong solidarity mechanisms.

In India many States have Apex Bank, however the entire structure needs to be changed. Present structure do not permit any direct supervision at all on member cooperative banks. Neither any reporting systems is designed for APEX BANK To guide or to come to rescue in case of need.
A well designed structure of Apex Bank can be extremely useful to small, medium and weak cooperative banks. The table will describe such possible structure.

**Current Policy Framework**

Current policy frameworks appear characterized by a lack of attention for the specific risks faced by, and related to, cooperative banks.

governance issues discussed in the document relate mainly to internal control procedures within financial institutions, rather than to external control over management. Similarly, the Basel Committee’s most recent publication on corporate governance for banking organizations (Basel Committee on Banking Supervision, 2005a) does not contain any cooperative-specific discussion.

Recent initiatives to improve corporate governance have focused on corporation and large companies. Given cooperative banks’ economic importance and large member and depositor bases, this lack of attention appears mainly the result of the absence, of corporate Governance for cooperative Banks. However since last few years the need has been recognized and now many discussions are taking place all over India.
PERFORMANCE MEASUREMENT AND DISCLOSURE PRACTICES

Background:

Financial Deregulation coupled with Technological and communication advancement has transformed the Indian financial sector, forcing paradigm shift in the way those financial industries should be managed and controlled. The driving force of change in the financial service industry, is captured by TRICKS. Which stands for

(1) Technology (2) Regulation (3) Interest rate risk, Intangible Assets (4) Customer, Competition and Confidence (5) Capital Adequacy (German spell of Capital) (6) Social objectives / Speed

The combination of TRICKS plus rational management of those forces leads to innovation. Innovation Financial Service Firms will be able to sustain and survive in such turbulent environment. This holds all the more strong and loud for the cooperative banks, which are regional and smaller in size then commercial banks, have primitive systems, methods and management skills and presently facing confidence crisis. Those banks for people of small means and small business of our economy have been playing a pivotal role in economic and social development of community. Thus it is inevitable to ensure the health of those banks and thus welfare of people.

Since banking sector reforms coupled with technology prowess have set in motion priorities of urban banks needs to be redefined. From plentiful low cost funds availability and ease of financing, stable interest rates, the era has changed to high cost of deposits due to competition and high level of NPA as well. Increased level of NPA, competition from new private
banks, poor profitability, primitive methods of management, bank failures and confidence crisis, technological investment requirements, importance of human resource, brand and customer and other intangible factors, capital adequacy, interest rate volatility have shifted priorities from social banking to commercial banking. Profitability has become a buzzword and prime mover for reasons of meeting capital adequacy, intangible and technological investment requirements.

Bankers need to recognize this fact that ‘Banks and financial services firms now operates in the turbulent financial service industry and not banking sector’ and adapt to changing environment of the Financial Service Industry to survive in long run.

**Following Weaknesses are generally found in the working of Urban Co-operative Banks.**

- Absence of systematic approach to profit planning, risk and resources management.
- Miss match in cost, yield and maturity profile of asset and liability.
- Shoddy accounting practices (income and expenses recognition, investment valuation, depreciation, NPA provisioning etc.)
- Misleading Management control systems, performance measurement and compensation system.
- Increase in level of NPA’s due to inadequate asset portfolio management.
- High deposit and lending rates.
- Unprofessional approach on credit and loan appraisal, product pricing and management of asset portfolio.
- Shrinking spreads, thinning margins, poor credits off take due to general industrial recession.
- Confidence crisis.
- Dual Regulations.
- High burden / cost of operations.
- Conflicting objectives Business V/s Societal
- Miss conceptions about cost of owned funds, deposits and borrowings.
- Inadequate technological usage and harnessing.
- Miniscule share of Para-banking, fee based banking.
• Limited area of operation and Regional presence.
• Inadequate treasury operations and management.

**Performance Measurement:**

Appropriate Strategic Planning, implementation and controlling are cardinal to survival of those banks. Banks may plan well but what determines the future is the way plans are implemented, monitored and controlled. Planning and Control are two sides of the same coin and feedback provided by control functions ensure appropriate implementation and corrective action for planning. Performance measurement hence is a very important tool to keep plans working. The turbulent environmental forces captured by TRICKS have brought paradigm change in the banks management and performance measurement, hence emphasizes the need to review the planning and control i.e. Performance Measurement and reward system of the banks. Thus, the banks need to manage and measure the performance on the following variables not only for sustainable development but also as an excellent management control and planning tools.

1. Financial
2. Capital
3. Intangible assets, (customer satisfaction, brand equity etc)
4. Human
5. Risk and Regulatory
6. Technology
7. Speed
8. Society

Arguably profit is the most comprehensive accounting measure of the performance. Prudent management of all the elements captured by TRICKS may lead to superior performance or profitability. Now the question is how the profitability is define, measured, what affects the profitability and does it capture the risk and thus risk adjusted return of bank? Return on Investment, Return of Owned Funds, Accounting net profits, operating profits. All these metrics are based on accounting
figures, which are subject to manipulation and adjustments. Accounting statements barely presents the real or economic position of the bank. Revenue recognition, Expenses recognition, depreciations, NPA, Investment, contingent liability accounting are prone to manipulations. Accounting measures are lagging indicators of performance and in this dynamic business environment the non-accounting and non-financial measures of performance, the leading indicators, are promising tools for management decisions.

Apart from above profitability measures there are other important factors which businesses need to recognize and build its competitive strengths on intangible assets as well. The economic value of the bank lies in Human resources, Brand Power or banks image, Technological skills and infrastructure, Risk Management, Branch, Capital, Regulatory, Speed, Society Costs and the Intangible assets etc. When it comes to performance measurement on all those fronts banks merely manages to know its performance on financial resource adequately. Profit the most comprehensive measure of financial performance is prone to several accounting manipulations. It ignores time value of money, risks, uncertainty of returns; it is defined ambiguously and doesn’t facilitate comparison. Accounts manipulation takes place in following three ways

a. Changing accounting method
b. Fiddling with managers estimates of costs, and
C. Shifting the period when expenses and revenues are included in results.
**Strategies for an effective Governance & Regulations of Urban Cooperative Banks**

Gujarat state occupies the second position in the development of urban cooperative banks and contributes 17.76 per cent of bank offices, 19.20 per cent of membership, 22.70 per cent of deposits and 25.92 per cent of loans and advances of the total urban banks in the country. The urban cooperative banks (UCBs) in Gujarat state have been regarded as main instruments for the growth and development of the urban and semi-urban poor. These banks are playing a vital role in the development of urban economy, such as financing the downtrodden class of urban people for the developmental activities, such as small scale industries, small business, retail trade, self employment, housing, consumption, etc. These small sectors have established the place of pride in the priority clientele groups of urban cooperative banks in Gujarat.

This paper is based on the comprehensive study on functioning of urban cooperative banks in Gujarat State undertaken by me for doctoral degree. The major observations in my study, predominantly relating to performance & deficiencies of urban cooperative banks and suggested measures and strategies recommended for the sustainable development of UCBs have been summarized are as under.

**Overview of Progress of Urban Cooperative Banks in Gujarat State:**

**Resource Mobilization:**

The urban cooperative banks in the State are self-reliant and have developed all by them due to the meticulous and uphill struggle of the altruistic cooperators involved in their development. The UCBs are financially affluent due to their well-built base of owned funds. Inspite of
problems in urban credit sector in Gujarat, especially after failure of Madhavpura Mercantile Coop Bank ltd., more than 75 percent of the UCBs in Gujarat could make sustainable progress.

Though the urban cooperative banks are small in size with limited area of operation, restricted and local individual clientele and have several boundaries to mobilize deposits, they have made a remarkable evolution in deposit mobilization. Despite of several problems and negative publicity given by the media, the growth rate of deposit mobilization ranged between 10 to 15 per cent per annum. The total deposit of urban cooperative banks in Gujarat is more than 1 2000, crores at the end of the year 2004-2005.

- **Credit Deployment**:

The loan and advances granted by UCBs in the Gujatat state have also shown increase outstandingly in absolute terms, but the growth rate of credit deployment has shown declining trend. The credit deposit ratio (CD ratio) of urban cooperative banks in the state accounted around 60 per cent in the year 2000-2001 and 55 % up to 2004-05. The main reason for declining of credit deposit ratio of urban cooperative banks was, the lack of proper planning of asset and liabilities management of the banks.

It is revealed that the major component of the loans outstanding of urban cooperative banks in the state diverted to industries and trading /business activities. These two sectors combine constituted more than 80 per cent of total loans granted by UCBs. The small-scale industries accounted for 60.54 per cent, and trading and business activities accounted 20.20 per cent of total loans in 2004-2005 compared to 51.34 per cent and 32.81 per cent, respectively in 2000-2001.
It is also found that the urban banks in different regions have concentrate their advances in particular type of business, according to the types of businesses exist in the particular area. For instance the urban cooperative banks in South Gujarat region granted more than 80 per cent of their loans to the small-scale industries, whereas the loans portfolio of the urban cooperative banks in Saurashtra region was abundantly dominated by trading and small business activities. It is also found that, some of the sectors like activities allied to agriculture, education and consumption etc., are almost neglected by all the urban banks in the state.

**Recovery Performance:**

The recovery management of urban cooperative banks has made significant improvement. It is found that the overdues of urban cooperative banks in the state came down from 11.30 per cent in 1998-99 to 7.14 per cent in 2002-03. It is noteworthy that the recovery performance of Priority and Weaker Sector advances are better than the Non-Priority sector.

**Strategies for an Effective Governance and Regulations**

The urban cooperative banks in the state have registered incredible progress in resource mobilization, credit deployment, recovery of loans, and more importantly augment in faith during the past, but currently these bank are on the mark of suspect and turn down due to the environmental and regulatory factors created by global market forces. The failing of several UCBs including Madhavpupra Urban Cooperative Bank and others have shored up the mistrust and challenge of subsistence for the UCBs in the state. The emerging trends are both challenges and opportunities. The UCBs have to rise up to the occasion,
innovate and cope with the emerging trends and challenging opportunities. To cope with the emerging situation of crises and challenges the UCBs must formulate the appropriate strategies. Some of the imperative strategies are suggested as under.

**Environmental Scanning**

The UCBs should know who are there present and potential customers. What are they? What are their saving and spending patterns? What are there needs for credit and banking services? This information input is a basic requirement for innovation and planning. The UCBs should make a survey in their area of operation and build up family profiles. These profiles will form the database for identifying potential lines of business developing appropriate new schemes and designing the required market strategy. At periodical intervals the family profiles should updated. For more transparency in MIS, urban cooperative banks should collect and maintain the detailed records of all their market segments (i.e. depositors / borrowers, sr. citizens, women, professionals, commercial organizations, business houses, industries, etc). This will help the urban cooperative banks in designing new products/ schemes according to the requirements of the existing and potential customers. It will also facilitate them for future planning and forecasting.

**Membership Coverage**

Presently most of the UCBs are reluctant to increase their membership due to some extravagant reasons. However, there is no need to offer permanent membership to the beneficiary for availing the benefits from urban banks, but for strengthening the integrity of customers with urban banks these banks must try to increase the membership. Moreover, the
UCBs being cooperatives in nature should bring into their membership fold all families, which may need their services. This should be one of their thrust areas of strategic planning.

**Marketing Approach**

Even though the most the commercial banks and all the new entrants banks are emerging as customers center, most of the UCBs operate in traditional way with old and incredibly restricted schemes of deposits, loans and other services. The urban banks in the Gujarat State must realize the need for adopting marketing approach and segment their target markets into specific categories according to the socioeconomic background of the households in their area of operation. Market segmentation is an integral part of the marketing strategy; it provides the basis for differentiating the customers’ needs and planning to meet those needs satisfactorily. The pattern of banking services to be marketed should be need-specific, and oriented to the specific social and economic needs of the various categories of the customers. The urban banks should organize the systematic customers awareness campaigns, initiate other promotional activities, and make them aware about the banking services.

**Innovative Banking**

Analyzing the emerging needs of the households in the area of operation of UCBs, and the characteristics of the various market segments, novel schemes of loan, advances and other services may be designed for meeting the identified needs. The schemes may include (a) special schemes of deposits, advances and other specialized services for ladies, senior citizens, students; professionals etc. (b) value addition in existing schemes and services; (C) loans for agriculture and activities allied to
agriculture (d) dealing with foreign exchange, investment banking and stock exchange business. These type of term services not only assist the banks but also help the customers and in turn contribute to the development of equipment manufacturing industries, marketing and consumer durable industries.

**Portfolio Management**

It is another growing line of new business. in the present epoch of sluggish industrial sector, crises and suspicion in investment opportunities, the customers particularly In urban areas need proper advice and assistance for buying and selling their securities. The urban banks may undertake portfolio management for individual customers, charging them a fix fee for these services.

**Consolidation**

Small unitary banks may find it difficult to cope with emerging trends. Hence it is desirable for small urban banks in a city to merge and integrate into one or two big banks with branches spread over the city. It is also possible that the urban banks located in different places can start special types of services jointly like credit card, debit card, portfolio management, forex business etc.

For balancing the imbalance of funds of urban cooperative banks, it is suggested that Apex urban cooperative banks at the state level in the state, which have a network of urban cooperative banks and an All India Bank of the urban cooperative banks should be set-up. This will not only provide the much needed organizational and financial collaboration and solidarity amongst the urban cooperative credit institutions but also act as the fund balancing center of urban cooperative bank at the national level.
The urban cooperative banks must expand their branch network in the other parts of the state, particularly in unbanked area and upgrade themselves with all the latest technology to render prompt and efficient service to their clients.

**Professional Management**

Innovative banking, development of new schemes, and the management of new lines of business call for well educated and trained managers and supporting personnel. Proper recruitment, placement and working conditions including facilities and motivational factors help the personal to work effectively. Training is essential for all the personnel to update themselves with the latest developments in respective fields, develop expertise to manage the new banking services prudently and efficiently. The training needs and the manpower needs may be identified and the need based training and executive development programme may be identified and the need-based training and executive development programme may be launched by the federation of urban coop. Banks in collaboration with the training institutes, like VMNICOM, Pune, NICM, Gandhinagar etc.

**Monitoring and Control**

Every urban cooperative bank should prepare a business development plan through participation of its members based on its inputs, potentially of business and with a major thrust to the priority sector lending. While preparing their credit plans for their branches, the urban cooperative banks should make adequate and proportionate credit provisions for different sectors, such as allied agricultural activities, small scale industries, trading activities, etc.
There should be a strict monitoring of its performance by an independent committee. If any performance gap arises, then a reporting variance should - monitored to remove the performance gap.

**Regulatory Reforms**

The UCBs should be allowed to open deposit accounts of educational institutions, public undertaking, panchayats, municipal authorities etc. This will help the urban banks to mobilize more resource and also to the depositors in getting a higher rate of interest on their deposits. The role, responsibility and accountability of the directors of UCBs must be redefined in the cooperative societies act and the system should be introduced to monitor the role of directors.

All UCBs should be permitted to deal in Foreign Exchange, to float Mutual Fund Schemes and Inter-bank participation certificates schemes, Merchant Banking and Stock Invest Scheme etc.

The existing mechanism provided in the Gujarat State Cooperative Societies Act is not functioning effectively due to operational delays involved. The commercial banks enjoy the benefit of Debt. Recovery Act for speedy disposal of recovery cases. It is also to be noted that the recovery system in Maharashtra state is working effectively, where there is an independent quasi-judicial machinery parallel to the cooperative courts presided over by the officers of the Registrar of Cooperative Societies, who work in associate with state federation. Hence, It is suggested that the UCBs In Gujarat should adopt the Maharashtra Pattern of debt. recovery.
The working of the urban cooperative banks would need to be strengthened by undertaking legal reforms, which encompass change in the existing Gujarat State Cooperative Societies Act, 1960, and introduction of new enactments. At the national level also there is a need to modify the Banking Regulation Act and other related laws so that the UCBs can function freely as other commercial banks. The Debt Recovery Tribunal should be set up at the state level especially for the cooperative banks. In addition to the section 159 of Gujarat State Cooperative Societies Act for recovery, the securitisation act also may strictly be followed by the UCBs so that recovery process may help the bank to regain the public confidence.

The policy makers as well as bankers should not intensify themselves on target oriented lending on quantitative manner. The role of the UCBs in financing the priority and weaker sectors should also be evaluated as per cooperative principles and values followed by them.

**Yield Planning**

The urban cooperative banks in the state have to step up their non-interest income (Nil) and reduce their non-interest expenses (NIE). This will correspondingly reduce the non-interest load (NIL). So, these banks should develop a new package of incentive oriented and economically viable schemes to increase their non-interest incomes (Nil). At the same time, these urban cooperative banks’ personnel should become cost and productivity conscious. For the same, each urban cooperative bank should evolve a time bound result oriented monitoring mechanism of controlling the non-interest expenses. Thus, increasing interest surplus and reducing the non-interest load can enhance the profitability of the urban cooperative banks.
The UCBs, particularly in South Gujarat region must try to diversify the lending portfolio in different sectors, whereas, the urban cooperative banks in Saurashtra region must reduce their non interest expenses and also try to recover their overdue as early as possible.

The urban banks in the state must try to increase their non-fund based (fee based) services and generate more non-interest income. The composition of deposit mix should be changed are these banks must try to increase the share of low cost deposits (i.e. current and saving deposits). So as to enable them to increase interest surplus, profit margin and profitability.

**Building of Public Confidence:**

The bankers and Cooperative leaders should decide the strategies to regain the public confidence, by organizing campaigns, seminars, workshop and positive publicity and highlight the achievements, values and ethics of the cooperative sector in general and urban cooperative banks in particular. This Is the most needed input for the cooperative banks than any others.

**Growth And Development Of the UCB in Gujarat.**

Gujarat holds second position in the development of the UCBs in India and is known as the “Mother Land” of the co-operative as the first co-operative body of India was formed in 1889 in Baroda named “ANYONYA SAHKARI MANDLI” Similarly the first registered UCBs of India named “THE SURAT PEOPLE’S CO-OPERATIVE BANK LTD.” was established in Surat city of Gujarat on March 1922. That was
the dawn of Co-operative banking. Inspired by the success of this bank, similar UCBs developed very fast in other parts of Gujarat state. By the year Ended 31st March 2004, out of 2105 UCBs of India 351 UCBs alone provided service in Gujarat having network of about 736 branches spread over 18 district of the state. The progress of the UCBs in Gujarat is shown by the following table.
Table 2.2  
Progress of the UCBs in Gujarat (Rs in Crores)

<table>
<thead>
<tr>
<th></th>
<th>30/06/2002</th>
<th>31/03/2003</th>
<th>31/03/2004</th>
<th>31/03/2005</th>
<th>31/03/2006</th>
<th>31/03/2007</th>
<th>31/03/2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No of Banks</td>
<td>321</td>
<td>330</td>
<td>341</td>
<td>350</td>
<td>351</td>
<td>351</td>
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<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>103</td>
<td>107</td>
<td>109</td>
<td>110</td>
<td>110</td>
</tr>
<tr>
<td>2</td>
<td>No of Branches</td>
<td>5</td>
<td>708</td>
<td>728</td>
<td>800</td>
<td>762</td>
<td>779</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>115</td>
<td>118</td>
<td>130</td>
<td>124</td>
<td>127</td>
</tr>
<tr>
<td>3</td>
<td>Deposits</td>
<td>9948</td>
<td>13276</td>
<td>16703</td>
<td>17791</td>
<td>16506</td>
<td>16345</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>133</td>
<td>168</td>
<td>179</td>
<td>166</td>
<td>164</td>
</tr>
<tr>
<td>4</td>
<td>Share Capital</td>
<td>251</td>
<td>304</td>
<td>363</td>
<td>418</td>
<td>436</td>
<td>451</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>121</td>
<td>145</td>
<td>167</td>
<td>174</td>
<td>180</td>
</tr>
<tr>
<td>5</td>
<td>Reserves</td>
<td>1486</td>
<td>1832</td>
<td>2271</td>
<td>2487</td>
<td>2968</td>
<td>3332</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>123</td>
<td>153</td>
<td>167</td>
<td>200</td>
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<td>6</td>
<td>Working Capital</td>
<td>13179</td>
<td>17218</td>
<td>21110</td>
<td>23520</td>
<td>21633</td>
<td>22833</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>131</td>
<td>160</td>
<td>178</td>
<td>164</td>
<td>173</td>
</tr>
<tr>
<td>7</td>
<td>Advances</td>
<td>6623</td>
<td>8446</td>
<td>10468</td>
<td>11864</td>
<td>11004</td>
<td>11304</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>128</td>
<td>158</td>
<td>179</td>
<td>166</td>
<td>171</td>
</tr>
<tr>
<td>8</td>
<td>Profit</td>
<td>221</td>
<td>238</td>
<td>294</td>
<td>273</td>
<td>241</td>
<td>213</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>108</td>
<td>133</td>
<td>124</td>
<td>109</td>
<td>96</td>
</tr>
<tr>
<td>9</td>
<td>No of Members</td>
<td>2812687</td>
<td>2998011</td>
<td>3242829</td>
<td>3303662</td>
<td>3245699</td>
<td>3321357</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>100</td>
<td>107</td>
<td>115</td>
<td>117</td>
<td>115</td>
<td>118</td>
</tr>
<tr>
<td>10</td>
<td>No of Depositors</td>
<td>N.A</td>
<td>9746161</td>
<td>11009558</td>
<td>11634435</td>
<td>10998814</td>
<td>10641234</td>
</tr>
<tr>
<td>11</td>
<td>No of Borrowers</td>
<td>N.A</td>
<td>926804</td>
<td>997619</td>
<td>1091005</td>
<td>100603</td>
<td>935198</td>
</tr>
<tr>
<td>12</td>
<td>No of Staff Members</td>
<td>N.A</td>
<td>16457</td>
<td>17393</td>
<td>17473</td>
<td>17190</td>
<td>16692</td>
</tr>
</tbody>
</table>

Source :-
2. Base year 1998

It is apparent from the table 2.2 that UCBs in Gujarat have recorded commendable achievement in the banking sectors There are 51 Schedule UCBs by the end of March 2007, 11 of them were registered in Gujarat itself having deposits of more than 100 crores.

In addition 18 Mahila UCBs were worked in the year ended 31st March 2004 and 19 Mahila UCBs are working in the year ended 31st March 2008 by only women.

But at the same time the development of the UCBs also marked regional imbalance in Gujarat out of 351 UCBs about 195 UCBs are located in
four district and 92 UCBs are located in five district while only 64 UCBs are located in remaining district further more 245 UCBs are located in only 6 district. These are Ahmedabad, Kheda, Baroda, Mehsana, Surat and Panchmahal. Details are shown in the table 2.3.
### Table 2.3
District-wise Statistical Data of Urban Co-operative Banks as on 31-3-08 (Rs. In lakhs)

<table>
<thead>
<tr>
<th>District</th>
<th>Total Banks</th>
<th>Paid-up Share Capital</th>
<th>Deposits</th>
<th>Reserve &amp; Others Funds</th>
<th>Advances</th>
<th>Investments</th>
<th>Working Capital</th>
<th>Profits</th>
<th>No. of Members</th>
<th>No. of Depositors</th>
<th>No. of Borrowers</th>
<th>No. of Staff</th>
<th>No. of Branches</th>
<th>Reporting Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahmedabad</td>
<td>74</td>
<td>11123.5</td>
<td>498354.39</td>
<td>280636.93</td>
<td>377942.11</td>
<td>231582.12</td>
<td>742458.15</td>
<td>5059.21</td>
<td>583421</td>
<td>2447335</td>
<td>173112</td>
<td>4201</td>
<td>245</td>
<td>63</td>
</tr>
<tr>
<td>Kheda</td>
<td>48</td>
<td>2464.65</td>
<td>98323.77</td>
<td>29851.95</td>
<td>6116.6</td>
<td>52871.52</td>
<td>146100.18</td>
<td>601.07</td>
<td>310679</td>
<td>821657</td>
<td>68781</td>
<td>1062</td>
<td>24</td>
<td>43</td>
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<tr>
<td>Baroda</td>
<td>38</td>
<td>3688.59</td>
<td>115188.68</td>
<td>23269.92</td>
<td>74931.3</td>
<td>54124.81</td>
<td>138743.9</td>
<td>1454.73</td>
<td>340653</td>
<td>970257</td>
<td>85602</td>
<td>1437</td>
<td>79</td>
<td>33</td>
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<tr>
<td>Mehsana</td>
<td>35</td>
<td>5129.2</td>
<td>147623.92</td>
<td>24880.46</td>
<td>87270.05</td>
<td>85765.21</td>
<td>199455.33</td>
<td>1683.03</td>
<td>302864</td>
<td>1138317</td>
<td>64092</td>
<td>1268</td>
<td>79</td>
<td>33</td>
</tr>
<tr>
<td>Surat</td>
<td>30</td>
<td>6429.90</td>
<td>232327.79</td>
<td>44982.71</td>
<td>115365.53</td>
<td>146223.24</td>
<td>307250.58</td>
<td>4514.72</td>
<td>323027</td>
<td>1263208</td>
<td>70091</td>
<td>2276</td>
<td>95</td>
<td>28</td>
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<tr>
<td>Panchmahal</td>
<td>20</td>
<td>1836.64</td>
<td>47245.21</td>
<td>8265.88</td>
<td>25470.44</td>
<td>28893.12</td>
<td>66562.33</td>
<td>430.85</td>
<td>147255</td>
<td>424260</td>
<td>45203</td>
<td>487</td>
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<td>Sabarkantha</td>
<td>16</td>
<td>802.7</td>
<td>33746.04</td>
<td>6329.43</td>
<td>18160.75</td>
<td>20577.97</td>
<td>44908.77</td>
<td>535.26</td>
<td>115165</td>
<td>382317</td>
<td>33692</td>
<td>419</td>
<td>9</td>
<td>15</td>
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<tr>
<td>Bhavnagar</td>
<td>13</td>
<td>1488.51</td>
<td>42593.14</td>
<td>10040.46</td>
<td>24178.35</td>
<td>19079.58</td>
<td>65656.99</td>
<td>523.78</td>
<td>118493</td>
<td>428646</td>
<td>44956</td>
<td>511</td>
<td>14</td>
<td>11</td>
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<tr>
<td>Rajkot</td>
<td>13</td>
<td>2935.34</td>
<td>177656.83</td>
<td>38962.21</td>
<td>96101.84</td>
<td>92084.7</td>
<td>233535.97</td>
<td>2212.23</td>
<td>392841</td>
<td>979400</td>
<td>68866</td>
<td>1181</td>
<td>60</td>
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<tr>
<td>Junagadh</td>
<td>10</td>
<td>701.11</td>
<td>18020.28</td>
<td>2831.58</td>
<td>9981.11</td>
<td>10510.98</td>
<td>22444.67</td>
<td>177.1</td>
<td>114725</td>
<td>147579</td>
<td>18875</td>
<td>332</td>
<td>8</td>
<td>10</td>
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<tr>
<td>Bharuch</td>
<td>10</td>
<td>757.81</td>
<td>25505.73</td>
<td>4737.61</td>
<td>14495.08</td>
<td>8653.04</td>
<td>36025.09</td>
<td>241.8</td>
<td>80188</td>
<td>181475</td>
<td>19108</td>
<td>414</td>
<td>25</td>
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<td>Banaskantha</td>
<td>9</td>
<td>428.87</td>
<td>15893.86</td>
<td>2493.33</td>
<td>9688.73</td>
<td>8797.71</td>
<td>22319.87</td>
<td>110.88</td>
<td>42823</td>
<td>185767</td>
<td>18418</td>
<td>297</td>
<td>17</td>
<td>9</td>
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<tr>
<td>Amreli</td>
<td>7</td>
<td>379.61</td>
<td>7208.92</td>
<td>1452.32</td>
<td>4563.13</td>
<td>4487.65</td>
<td>10108.58</td>
<td>116.03</td>
<td>25748</td>
<td>52295</td>
<td>20010</td>
<td>124</td>
<td>0</td>
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<tr>
<td>Surendranagar</td>
<td>6</td>
<td>793.41</td>
<td>24578.55</td>
<td>4376.21</td>
<td>13593.16</td>
<td>10514.89</td>
<td>31809.54</td>
<td>134.19</td>
<td>128783</td>
<td>204135</td>
<td>20890</td>
<td>410</td>
<td>14</td>
<td>4</td>
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<tr>
<td>Jamnagar</td>
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<td>27602.66</td>
<td>6734.8</td>
<td>10799.43</td>
<td>17711.63</td>
<td>37563.76</td>
<td>680.49</td>
<td>36376</td>
<td>156848</td>
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<td>328</td>
<td>17</td>
<td>6</td>
</tr>
<tr>
<td>Kutch</td>
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<td>15344.8</td>
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<td>235</td>
<td>10</td>
<td>6</td>
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<tr>
<td>Valsad</td>
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<td>7778.36</td>
<td>19202.08</td>
<td>17565.35</td>
<td>50342.77</td>
<td>437.05</td>
<td>109330</td>
<td>278429</td>
<td>25525</td>
<td>411</td>
<td>23</td>
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<td>Gandhinagar</td>
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<td>485.92</td>
<td>8256.69</td>
<td>1817.54</td>
<td>4280.87</td>
<td>6596.17</td>
<td>12020.82</td>
<td>145.92</td>
<td>48446</td>
<td>91905</td>
<td>4398</td>
<td>145</td>
<td>5</td>
<td>5</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>351</strong></td>
<td><strong>42488.88</strong></td>
<td><strong>1589375.37</strong></td>
<td><strong>505239.82</strong></td>
<td><strong>982537.36</strong></td>
<td><strong>835776.59</strong></td>
<td><strong>2208694.44</strong></td>
<td><strong>20095.9</strong></td>
<td><strong>3251276</strong></td>
<td><strong>10287650</strong></td>
<td><strong>804860</strong></td>
<td><strong>15538</strong></td>
<td><strong>736</strong></td>
<td><strong>319</strong></td>
</tr>
</tbody>
</table>

**Source:** Statistical hand book- 2008 No.10 and 11.
Role of the UCBs in the Indian Banking System:

The performance of the co-operative banking sector as a whole has attracted attention in recent year. Today they have become an important constituent of the Indian financial system and cover a large segment of society because of their prompt and personalized service. They take the responsibility of covering the unmonitored sector neglected by commercial banks and most priority is given by UCBS to small and medium enterprise UCBs provide service with no bars of caste religion etc. and thus spread the feeling of “Unity of diversity”. Some UCBs operate beyond their state of registration and are governed by the Multi state Co-operative Act 1984. They are not responsible only to employees and societies. The UCBs bears some responsibility in the following ways.

A. Service on Behalf of Customers:-
1. Provide facility regarding opening current, saving and fixed deposit accounts and collect deposits.
2. Issue draft, letter of credit and discount bill on a low rate of commission.
3. Provide services of automatic teller machine mobile banking and depository participants and do immediate transfer of money.
4. Computerized bank passbook issued to customers.
5. Received complaint of customers and solve it as early as possible
6. Provide self deposit vault facilities
7. Advances are given to small scale and medium enterprise and cottage industries.
8. Advances against properties, jewelry, govt. securities, life policy and new or old vehicles.

**B. Service on Behalf of Employees :-**

1. Provide medical facilities and educational facilities.
2. Provide various types of allowances.
3. Maintain various types of funds like staff provident fund bonus fund etc.
4. Conduct training programs for new employees and refresher programs for old employees and organize a seminar and the conferences to update their knowledge.
5. Special education reward is given to employees children for highest percentage.

**C. On Behalf of Society :-**

1. Provide donation to educational institutions charitable institutions and hospitals etc.
2. Advances to the weaker sections of the societies to be self-sufficient.
3. Helping to the people at the time of natural calamity like earthquake, flood, drought.
4. Sustain and generate gainful employment.
5. Equal distribution of credit structure by branch expansion particularly in areas which are not covered by the banking system.

**Evaluation Of The Role Of The UCBS :-**
It can be said that because of their noble objectives; functions and philanthropic attitude towards clients and society, the UCBs in spite of being a small segment of the co-operative banking sector, have proved themselves a vital role of the Indian banking system. The committee on co-operative movement appointed by the Government of Tamil Nadu in February, 1968, under the chairmanship of Shri K. Santhanam –has made the following observation:

“The non agricultural credit societies have been significantly successful in attracting deposits and promoting thrift..........This sector of the movement has grown voluntarily without special encouragement from the state. The urban banks in the state have recorded a steady progress over the years. As observed by the co-operative planning committee (1946), urban banks have proved to be the best suited agencies for which joint stock banks are not generally interested.”

Thus it can be stated that though organized on a small scale primarily to meet the need of the poor or weaker sections of society, the urban banks have proved that they occupy a key position in semi-urban and urban areas so far as the national banking structure is concerned.

Problems & Prospects Of UCBs :-

UCBs were setup with the objective of promoting saving habits amongst the middle-income group of the urban population 2004 is golden jubilee of urban co-operative banks celebrated by govt. of Gujarat. During the 100 years of their inception they have attracted considerable attention and large
number of them has shown creditable performance but fair number of them have simultaneously shown discernible signs of weakness too because of the problems they could not overcame some important factors, Which are barriers to the progress of the UCBs are as given below.

1. **Dual Control** :- A major problem faced by UCBs is the duality of control by the State Government and the RBI. The UCBs are supervised by RBI and also issued for license while regarding administrations like, registration, administration constitution and administration and selection etc. This had negative impact on the functioning of the UCBs. Duality in command hampers effective supervision. The Narsimhan committee suggests removing dual control system which is affected to UCBs. High power Committee also.

2. **Limited Area of Operations** :- The UCBs have to function within restricted framework in the context of mobilization of deposits. The need for heavy industrial advances and trade finance for industrial units as well as for commercial enterprises is here but the UCBs are not able to meet with it is they have to serve as per the RBI directives. But to survive in the competitive world the UCBs should enhance their area of operation and start providing loans as per local needs.

3. **Violation of Prudential Financial Norms** :- It is found that many UCBs violate norms governing advances. Top officials of the banks receive loans without documents. The failure of Visangar Co-operative Bank (Mehsana) and Madhavpura Mercantile Co-operative Bank (A’bad) are the example of violation of prudential norms. The UCBs must adopt a
system of internal audit and inspection of branches and department, the RBI should follow strict supervision and to stop such malpractices.

4. Poor Management : - The necessity of the financial institution has a good corporate financial management and articles. The Madhavrav committee insisted to appoint two directors who are professional or experience persons. But in UCBs directors are politician or illiterate. Due to this reasons management of the UCBs are poor. The RBI advise to directors about it by letter dated 05-04-2002

5. Poor Quality Services : -The services of the UCBs are not significant enough in terms of quality and have failed to attract deposits from individuals and institutions other than the co-operative sectors. Hence they should try to improve the quality of services by providing required facilities like waiting space; customer information counter, complain box, banking information chart, easy accessibility to higher officials at the banking promises ect. At the same time they should maintain good customer relations and keep positive attitude towards customer. Besides this; they should start providing door to door services.

6. Lack of Modernization :- In today’s world of technological advancement, still manual form of work followed in some of the UCBs which cause delay and increase operational cost. Most of the UCBs failed to provide service through use of modern technology except some UCBs. It has become inevitable now on part of the UCBs to have computerized system of banking and adopt latest banking technique like ATM, Credit Card, Internet Banking, Branch Banking, Tele Banking etc.
7. **Increasing Overdoes**: The UCBs suffer dangerously. Low or weak quality of loans, assets, and highly unsatisfactory recovery of loans, which enhance the proportion of overdue. Due to this situation, UCBs must develop a separate recovery department for quick recoveries.

8. **Political Interference**: Political interference in the affairs of the UCBs leads to faulty lending and poor recovery. It compels banks to provide loans to parties whose repaying capacity is doubtful. Visanagar co-operative bank is an example of this situation. Though banks take legal action against defaulters, it often interferes by preventing legal action. Hence, political interference damages UCBs' administration.

9. **Staff Problems and Prospects**: The UCBs have not trained and professional staff. The UCBs do not select staff on a professional basis. External pressures are a cause of untrained and low-standard staff which directly affect quality work. At least, the appointment of a chief executive officer (like a Manager or Managing Director) should be made on professional lines and provide training to untrained or fresh staff members or employees.

10. **Some Other Problems of UCBs are as under**: Low capital adequacy ratio etc.
II. Lack of transparency in financial statement.

III. The Balance sheet of most of UCBs are not finalized in time due to non-completion of audit purpose.

IV. Lack of planning and co-ordination.

V. Lack of standardization in data reported by ratio etc.

**UCBS – Recent Regulatory Measures : -**

The schedule and other similar UCBs have increased the need for a greater role of the RBI as a regulator of the UCBs. Hence, the RBI has announced a series of measures for the UCBs by day to day relating to monetary and credit policy statement. The salient feature of these measures of this regulation of UCBs is as under.

I. **Lending Stock Market : -**

The RBI had put restriction on lending by the UCBs against security of stocks. The UCBs have been advised to unwind existing lending to stockbrokers or direct investment in shares on contracted dates.

II. **Inter UCBs Term Deposits: -**

The UCBSs were advised not to increase their deposits with other UCBs and ordered to unwind the outstanding deposits with other UCBs as on 14\textsuperscript{th} April 2001 before ended of june 2002. However shri Anant Giti committee the schedule UCB accepts deposit from non schedule UCBs. The RBI imposed some condition regarding it by circular date 17\textsuperscript{th} 2003.
III. **Gold Loans and Small Loans**: -

Gold loans and small loans up to Rs. 100000.00 given by primary Urban Co-operative Banks will no more be exempted from the 90 day NPA norms. The RBI recently issued a notification for chief executive officers (CEOs) of all primary UCBs stating that it has been decided that 90 day loan impairment norm will be applicable even in case of gold loans and small loans up to Rs.100000.00 In May 2003 RBI said to CEOs of all primary UCBs to classify an assets as non-performing if the interest and/or of installment of principal amounts remain overdue for period of more than 90 days, with effect from March 31, 2004.

IV. **Maintenance of Statutory Liquidity Ratio (SLR)** :-

The UCBs are required to maintain their statutory liquidity ratio equivalent to 25% of net Demand and Time Liabilities. (NDTL) They can maintain it in the form of investments in government and other approved securities or as deposits with State Co-operative or Central Co-operative Banks. But with effect from April 01,2003 all scheduled UCBs would need to maintain their entire SLR investment of 25% of NDTL only in government and other approved securities and that compliance with cash Reserve Ratio (CRR) requirements on par with scheduled commercial Banks would be prescribed in due course.
V. Capital Adequacy Norms:

The concept of capital to risk assets ratio (CRA) or capital adequacy ratio (CAR) has been made applicable on urban co-operative banks wide effect from 31-03-2002. The RBI accepted the recommendation made by High power Committee (HPC) in this regard and decided to implement (CAR) norms to urban co-operative banks in a phased manner wide effect from 31st March, 2002 over a period of three years as indicated below.

<table>
<thead>
<tr>
<th>As on</th>
<th>Scheduled with Co-operative banks</th>
<th>Non-Scheduled Urban Co-op. Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-03-02</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>31-03-03</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>31.03-04</td>
<td>As applicable to commercial banks</td>
<td>9%</td>
</tr>
<tr>
<td>31-03-05</td>
<td>As applicable to commercial banks</td>
<td>As applicable to commercial banks</td>
</tr>
</tbody>
</table>

VI. New Grades System:

The Reserve Bank of India vide its circular dated 5th April, 2003 introduced new system of awarding grade to UCBs i.e. Grade I,II,III,& IV and dispensed with earlier nomenclature of classifying UCBs a weak and sick bank. These grades are to be awarded by RBI based on the review carried through statutory returns/statements submitted by urban co-operative banks or statutory inspections scrutiny of books of accounts of UCBs conduct.
Looking at the progress of the UCBs it can be said that they have expended by leaps and Bounds and increased their business over the last few decades. A walk down the streets of Mumbai, Ahmedabad, Hyderabad, Surat etc. reveals how widely they have spread their tentacle across the nation. Every nook and corner displays the hoarding of the office of one or the other UCB. But an increasing number of failures of the UCBs have spolied the image of the UCBs and shaken the faith of their depositors and investors. The scam of Madhapura Mercantile Co-operative Bank (MMCB) of Ahmedabad, Krushi Co-operative Bank of Hyderabad and Visanagar Nagrik Sahkari Bank (Mehsana Dist.) have brought into the fact that loopholes exist within the banking system itself and the RBI failed to perform its duties as a banking regulators. In the case of Krushi bank, it was found that the Chairman and the Vice Chairman got loans from the bank without any collateral and the funds were siphoned off for other purposes. Similarly in MMCB lending norms were violated and crores of rupees were given to Mr. Ketan Parekh violating norms of the bank. In case of Visangar Sahakari Bank, it was found that the chairman and his relatives got loans from bank without any proper documents and guarantors. Free entry of private financial institutions has also led to a threat to their existence. In spite of these problems, with regard to the future of these banks it can be said that the UCBs will continue to be promoters of mass banking as distinguished form class banking usually practiced by commercial banks. The future of UCBs is much better due to their numerous distinctive such as-

**Future Of The UCBSS :-**
(a) Close familiarity with the members
(b) Local feel
(c) Democratic management
(d) Personalized service
(e) Compactness in the area of operation
(f) Close supervision over the end use of credit
(g) Prompt recovery of dues from member borrowers.

But both the RBI and the UCBs should try to maintain this distinctive identity of the UCBs and take care to waive scandals or scams. In order to achieve this goal, the RBI should take measures to strengthen the regulatory framework for the co-operative sector, lay down clear cut guidelines for their management structure and should enforce further prudential standards in respect of access to uncollateralized funds and lending against volatile assets. Simultaneously, the UCBs should try to compete with private financial institutions and commercial banks within their limits. Their main inclination should be towards customer’s satisfaction. They should introduce a “Customer Day” on which customer’s can meet and discuss with the Board of Directors their problems. They should also try to reach to the customers by providing door-to-door services. They should open a separate wing for publicity and advertisement of existing well as new schemes of deposits loans and other services provided by them. Simultaneously they should try to enhance their deposits and advances by providing quality services. For enhancing deposits, they should introduce children savings and youth savings centers in schools and colleges respectively and provide knowledge about the benefit of savings. All UCBs should introduce mobile vans for
handicapped and illiterate people. Similarly for enhancing advances, they should do market research and start loaning according to the local needs; keep less margin of profit on advances; provide a guideline about the procedure of advances to the general public so that they would not procedure of advancing loans; etc.. Such comprehensive attempts will help the UCBs in enhancing the banking business in limited areas only.

In short, the UCBs must come into their own to take the future head on. It’s time for them to think strategically and focus on the opportunities in terms of market, products and customers. It requires a vision about which their future customers are going to be what they will need; who their competitors will be and what their disadvantages mean for the UCBs; etc. They should be ready to make changes in their policy as per the demands and competition. They should consider diversification of business product and must upgrade their skills and technology to provide efficient and affordable services. At evolve a systematic approach towards human resource development in many areas like manpower planning, recruitment, placement and leadership development for motivating staff and increasing productivity. In short UCBs should pay attention to human resources development and evolve a systematic approach toward human resource development in many areas. They should focus on the opportunities in terms of market, products and customers. They also focus on need of customers should be removed disadvantages of management and administration.
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