Chapter 1

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The role of banks in India has continued to be an evolving one undergoing changes in response to the emerging economic environment. Prior to nationalization, the banks had developed a powerful trend in the direction of giving credit only to big business houses & large scale industries and helped financially only those individuals who were rich & prosperous.

The scheme of social control adopted in 1967 and the enactment of Banking Laws (Amendment) Act of 1969 constituted a major change in the Indian banking policy and due to this, different types of banks have came into existence in last many years & they are classified as Central Bank, Public Sector Banks, Private Sector Banks, Regional Rural Banks and Co-operative Banks etc. With the nationalization of major Banks in 1969, the main objective of banks has changed to sub-serve the society at large rather than just to serve private interest. For this purpose various Co-operative banks were established in different states under Co-operative societies Act, 1912.

After 1969, Co-operative banks have enlarged their coverage to the neglected sectors of the economy. Thus Co-operative banks have emerged as active agent for social and economic change. In order to bring allocation of credit in consistent with the plan priorities the concept of Priority Sector Lending was evolved. Priority Sectors are the sectors which are entitled to financial facilities in preference to others. This concept has also been reviewed by the Government of India and Reserve Bank from time to time and the banks have been directed to channelize their lending accordingly.

This chapter is divided into two sections:- Section-1 includes introduction of Cooperative banks. Section-2 includes introduction of Priority Sector Lending.
SECTION - I

General Profile of Cooperative Banks

Cooperative Banks, the components of the Indian banking organisation, originated in India with the enactment of the Cooperative Credit Societies Act of 1904 which provided for the formation of cooperative credit societies. Under the Act of 1904, a number of cooperative credit societies were started. Owing to the increasing demand of cooperative credit, a new Act was passed in 1912, which provided for the establishment of cooperative central banks by a union of primary credit societies or by a union of primary credit societies and that of individuals. The chief functions of these banks were:

- Attracting deposits from non-agriculturists.
- Using excess funds of some societies temporarily to make up for shortage in other.
- To supervise and guide the affiliated societies.

In 1914, the Maclagan Committee was appointed to examine the cooperative movement and to make recommendations regarding the improvement of the movement. It recommended the establishment of a State Cooperative Apex Bank. On this recommendation a Central Cooperative Bank was established in Bombay. Although these may be considered as the early beginnings in the direction of establishing cooperative banks to meet the financial needs of agriculturists, the movement received momentum only after the Second World War.

Cooperative Banking in India is federal in its structure. At the lower rung, there are primary credit societies, then there are the central cooperative banks and at the top there are the Provincial Cooperative Banks or State Cooperative Banks, otherwise known as "Apex" banks.

**Primary Credit Societies** - The primary credit societies constitutes the lower most rung of the cooperative banking. Their main function is lending money to villagers on easier terms. They have their own funds supplemented by funds drawn from the Central Cooperative Banks through the banking union where such unions exist. The
Banking unions are federations of primary societies and they act as either 'coordinating unions' or 'supervisory unions' between primary societies and central cooperative banks.

**Central Cooperative Banks** - The central cooperative banks are independent units in as much as the provincial cooperative banks have no powers to control or to supervise the affairs of central banks. The central cooperative banks draw their funds from share capital, deposits, loan from the state cooperative banks and where the state cooperative banks do not exist, from the Reserve Bank and other commercial banks. The main function of the central banks is to finance the primary credit societies. In addition to this, they carry on commercial banking services like acceptance of deposits, giving of loans and advances, fixed deposits receipts, collecting of bills and selling securities etc.

**State Cooperative Apex Banks** - Sate cooperative banks means the principal society in a state which is registered or deemed to be registered under the Government Societies Act 1912, or any other law for the time being in force in India relating to cooperative societies and the primary objective of which is the financing of the other societies in the state which are registered or deemed to be registered. The apex banks obtain their funds from share capital, deposits, loans from commercial banks, the Reserve Bank of India and the Government. The principal function of the state banks is to assist the central banks and to balance excess and deficiencies in the resources of central banks. Central banks are acting as intermediaries between the state banks and primary societies. Of course, in the absence of the central bank, the state cooperative bank may act as a central bank and in that case its connection with the primary societies will be direct.

**Cooperative Credit Structure**

An important segment of the organized sector of Indian Banking is Cooperative Banking. The segment is represented by a group of societies registered under the Acts of the State relating to Cooperative Societies.

Problem of Rural Credit i.e. agriculture credit has been a matter of concern from a very long time. Even the British realized the peculiar difficulties of agriculture credit
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between 1860-1880 and enacted the Land Improvement Loans Act of 1883. Another landmark in the development of rural credit was NICHOLSON’S famous report which contained his prescription i.e. Cooperatives. The Cooperative Banking system was ushered in by the cooperative societies Act of 1904. A large number of cooperative societies were established under this ACT. Subsequently in 1912 the Cooperative Societies Act was passed for facilitating the establishment of new organizations for supervision, auditing and supply of cooperative credit. The Bombay Committee with Sir Janardan Madan as the Chairman, in 1931 and the Agriculture Finance Sub-Committee in 1944, showed the way for further development, and by 1949 a system of agriculture cooperative credit was brought into being “under this scheme, the short-term and medium term credit has been organized on federal lines with the agriculture primary societies as the base, the district bank as the federal organization at the intermediate level, and the State Cooperative Banks as the Apex Institutions. Banking companies Act 1949 was extended to certain cooperative societies in terms of the Banking Laws (Application to Societies) Act, 1965 with effect from March 1, 1966. The date on which this Act came into force, those State Cooperative Banks, Central Cooperative Banks and Primary Agricultural Societies which were having paid up capital and reserves of not less than one lakh were brought within the regulatory framework of the Reserve Bank. Accordingly the name of banking act was changed into Banking Regulation Act. The number of licensed cooperative banks coming under the purview of the Banking Regulation Act, as on June 30, 1996, comprised 28 State Coop. Banks, 352 Central Cooperative Banks and 92194 Primary Agriculture Credit Societies.
Table 1.1 Co-operative credit structure

Co-operative credit structure

Agriculture & Non-agriculture Credit

- Short term credit & Long term credit
  - Urban co-op. banks

Long term credit for
- Non-agriculture
  - State co-op. bank
  - Primary co-op. Agriculture
  - or HARCO bank
  - & rural development banks
    - (SCB)
    - (PARDBS)
  - District Central co-op. Bank
    - (DCCB)
  - Primary Agriculture
    - Salary Earners/
  - Co-op.credit
    - Employees
  - Co-op. thrift
    - Societies (PACS)
    - & Credit Society
  - Farmers
State Cooperative Banks (SCBs)

SCBs are the upper most rung of a three tier cooperative credit structure. There is a State Cooperative Bank in every State. SCBs provide a link through which the RBI provides credit facilities to the cooperatives, finance, control and supervise the CCBs and through them primary societies. SCBs provide a link between Indian Money Market & cooperative sector; they also function as commercial banks.

Central Cooperative Banks (CCBs)-CCBs are the middle rung units which are of two types:

- **Cooperative Banking Unit**: Whose membership is open only to Coop. Societies, they exist in Haryana, Punjab, Rajasthan, Orissa & Kerala.

- **Mixed central coop. Banks**: whose membership is open to both individuals & Cooperative Societies. The CCBs in the remaining States are of this type. It provides credit facilities to primary credit societies without any security.

Primary Agricultural Credit Societies (PACS):

The PACS form the base of the federal cooperative credit structure. These are village level institutions which directly deal with rural masses by providing short & medium term credit, distributing agricultural inputs like fertilizers & seeds etc. They are the link between the rural borrowers & the upper tiers of cooperative movement. A PACS can be organized according to the provisions of the act with 10 or more person of village.

In the manner of doing business, Cooperative banks are similar to that of Commercial banks but in matters of organization & management they are very different from them. The Main points of difference are:-
Table 1.2 Difference Between Cooperative Banks and Commercial Banks

<table>
<thead>
<tr>
<th>COOPERATIVE BANKS</th>
<th>COMMERCIAL BANKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisation in three-tiers-Primary Coop. at local level, Central Coop. Banks at district level &amp; Apex Bank at State Level.</td>
<td>All branches under control of one Central / Head office with different levels of administrative offices functioning as the extended arms of H.O./ Co.</td>
</tr>
<tr>
<td>Resources are limited, heavy dependence on external borrowings, mainly from NABARD.</td>
<td>Resources are large, mostly from Deposits.</td>
</tr>
<tr>
<td>Range of Services &amp; branch Spread and network is limited.</td>
<td>Wide range of services and wide branch spread / network.</td>
</tr>
<tr>
<td>Predominantly agriculture oriented.</td>
<td>Urban oriented.</td>
</tr>
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Functions of Harco Bank:-

Agriculture Credit Section:

- Short Term Agriculture loan to Central Cooperative Banks for financing the members of Primary Agricultural Credit Societies.

- Medium Term Agriculture and Medium Term Conversion loans to Central Cooperative Banks for financing the members of Primary Agricultural Credit Societies.

- Cash Credit Limit to HAFED and State Co-operative Agriculture Rural development bank.
Non Agriculture Credit Section-

- Financing of Cooperative Sugar Mills.

- Short Term Non – Agricultural Loans to Central Cooperative Banks for financing the members of Primary Agricultural Credit Societies.

- Loans to Boards & other Apex Cooperative Institutions

Banking -

- Mobilisation and Management of funds.

- Preparation & submission of statutory reports to Reserve Bank of India/ National Bank of Agriculture And Rural Development.

- Maintenance of Statutory Liquidity Ratio & Capital Reserve Ratio.

- Remittance of funds between Commercial banks / Central Cooperative Banks.

- Implementation of guidelines of Reserve Bank of India/ National Bank of Agriculture and Rural Development (NABARD) relating to deposit mobilization.

Planning & Monitoring section-

- Calculation & compilation of data of Central Cooperative Banks/ Primary Agricultural Credit Societies.

- Setting up of targets of loans, deposits, recoveries etc. & monitoring thereof.

- Implementation of procedures & guidelines.

- Management information System (MIS).

- Budgeting & deployment of funds.

- Propaganda & publicity of achievements of the Bank.
Non Farm Finance Section -

- To process & accord approval of integrated loans cases sent by Central Cooperative Banks under NFF, SRTO scheme whose project cost is above Rs. 50,000 /-.
- To provide re-finance to Central Cooperative Banks for financing under above scheme as well as IRDP & subsequently claims reimbursement from NABARD.
- To compile & prepare the statements showing advances made by CCBs under NFF, Farm Sector, SRTO etc. as well as recovery statements of transport societies.

Administration Section -

- Recruitments/ posting / training to staff.
- Payments of salaries/ wages and other bills of the staff.
- Purchase/ maintenance of vehicles, building, furniture and fixture.
- Loans to staff.

General Section –

- Audit Inspection, Concurrent audit etc.

Computer Section-

- Computer work allotted by Apex Bank.

Staff Training College-

- To impart training to middle level functionaries of Central Cooperative Banks/ Urban Cooperative Banks/ Apex Bank.

Construction Cell –

- Construction and repair work of the Bank Building.
SECTION- II

Priority Sector Lending

It has been in the post 1969 period that priority sector lending and social banking concepts have been crystallized and adopted for the purpose of credit deployment. The term ‘priority sector’ indicates those activities which have national importance and have been assigned priority for development. Hence, the adoption of priority sector concept for the purpose of bank lending reflects the effort to synchronize the lending activities of each bank with the national priorities. These sectors, in particular agriculture, small industries and other small businesses were the neglected sectors and for the purpose of bank credit, they have been categorized as priority sector. The priority sector advances have undergone several changes, since then, several new areas and sectors have being brought within the purview of this sector. While there has been continuous demand to include new areas such as infrastructure within the ambit of priority sector, there have also been suggestions that the focus on the needy sectors of economy and weaker sections of the society is getting lost because of such inclusions. A need has therefore, been felt to review the concept and the segments of priority sector. Consequently, in paragraph 89 of the Annual Policy Statement of Reserve bank of India for the year 2005 - 2006, it was stated that prescriptions relating to priority sector lending have been modified from time to time and generally, the eligibility criteria have been enlarged to include several new areas. In December 2004, it was decided that direct advances to priority sector will be encouraged, thus beginning a phased withdrawal of eligibility in special bonds of specified institutions. At the second meeting of the national credit council in July 1968, the priority sector was defined to include only two activities, agriculture and small scale industries. A list indicating the type of advances which would be eligible for compliance with the lending targets for these sectors was sent by RBI to the banks. For small scale industries, no separate guidelines were issued, but it was indicated that direct loans granted to road transport operators would qualify for compliance with lending targets along with small scale industries (Ramesh k, 1998 ). Financing of industrial estate was also to be included under small scale industries. Over a period of two decades, the composition of priority sector has undergone some modification in the activities
covered, such as the addition of housing for weaker sections and pure consumption loans under the priority sector. Economic Reforms in the real sectors of an economy fail to realize their full potential without a parallel reform in the financial sector. The financial sector reforms refer to a general improvement in the functioning and efficiency of the financial system as a whole and the removal of impediments to its long term developments. As a result of financial sector reforms, there is a shift in the focus from quantitative to qualitative growth and Indian banking should be subjected to rigorous prudential norms of operations and competitive environment. (Mujumdar NA, 2001), the deregulation, the vital component of the financial sector reforms, has increased the overall profitability of the banking industry & analyzed the Indian financial system comprising the commercial banks, the financial institutions and the capital markets. He concluded that Indian banking has undergone a very rapid transformation in the past three decades. There is a sea change in the Indian banking sector in the post financial sector reforms. The scope and extent of priority sector lending has undergone a significant change in the post-reform period with several new areas and sectors being brought under its purview while there had been demands to include new areas, such as infrastructure, within the ambit of priority sector, there is apprehension that it will dilute the definition of the priority sector with the focus on the needy sectors of the economy and weaker section of society getting completely lost. Against this background, an internal working group was set up in the Reserve Bank (Chairman: Shri C.S. Murthy) to examine the need for continuance of priority sector lending prescriptions, review the existing policy on priority sector lending, including the segments constituting the priority sector targets and sub-targets and to recommend changes, if any, required in this regard. Based on the draft technical paper submitted by the internal working group and the feedback received thereon, the guidelines were revised. The sectors of the economy that impact large segments of the population, the weaker section and the sectors which are employment-intensive such as agriculture and micro and small enterprises, have been retained as priority sector in the revised guidelines, which came into effect from 30 April, 2007. Agriculture, small enterprises, micro credit, retail trade, education loans and housing loans up to 20 lakh are the broad categories included in the priority sector. In the old days, poor people borrowed money from indigenous banks to fulfill their needs. But as the time passed, banking as an institution, dealing with lending and collection of money came into
existence. This type of banking is called simple banking. According to the changing requirements of time, simple banking transformed itself into commercial banking (Gujral N, 2003). Commercial banking, itself, has undergone numerous changes all over the world, during the last five decades. Now, the present day banking does not restrict itself to traditional deposit collection and money lending, encompassing a wide sphere of financial activity; lending still remains the primary activity. Most credit needs of the society, for carrying commercial activities are fulfilled by the banks (Purwar K A, 2003). The conventional credit from the banking system to the commercial sector comprises bank loans and advances in the form of term loans, demand loans, cash credit, overdrafts, inland and foreign bills purchased and discounted as well as investments in instruments issued by non-government sector. But lending is not an easy task for the banks because it creates a big problem for the banks which is called non-performing assets (Chhimpa J, 2002). Non-performing asset generally refers to those assets which cease to provide any return to the bank. In the present time, NPAs is a big problem for the banks as it has ever been a major concern for the bank promoters and government. But efficient banks have no need to frighten from the NPAs because they can find some other sources of income to match these NPAs in the era of LPG. The cooperative banks have been rural oriented and till 1969 were financing agriculture and allied activities. But after the nationalization of major Indian commercial banks, the concept of 'Priority Sector' was evolved which include the segment like:

- Agriculture
- Small scale industries (including setting up of industrial estates)
- Small road and water transport operators (owning up to 10 vehicles)
- Small business (Original cost of equipment used for business not to exceed Rs. 20 lakh)
- Retail trade (advances to private retail traders up to Rs 10 lakh)
- Professional and self employed persons
- State sponsored organisations for Scheduled Castes/ Schedules Tribes
- Education
- Housing [both direct and indirect] loans up to Rs. 5 lakhs (direct loans up to Rs. 10 lakh in urban/ metropolitan areas), Loans up to Rs. 1 lakh and Rs. 2 lakh
for repairing of houses in rural/semi-urban and urban areas respectively]

- Consumption loans (under the consumption credit scheme for weaker sections)
- Micro-credit provided by banks either directly or through any intermediary; Loans to self-help groups (SHGs)/Non-Government Organisation (NGOs) for on-lending to SHGs
- Loans to the software industry
- Loans to specified industries in the food and agro-processing sector having investment in plant and machinery upto Rs. 5 crore
- Investment by banks in venture capital

After 1969 co-operative banks have enlarged their coverage to all the segments of priority sector and even to the segments of weaker sections which include small and marginal farmers with land holding upto five acres, land-less labourers, tenant farmers and share croppers, village and cottage industries, beneficiaries belonging to SC&ST categories, beneficiaries of Integrated Rural Development Program, differential rate of interest beneficiaries. The assistance to these sections will be of no use unless it is ensured that the recipient utilises the assistance for productive purposes and generates sufficient income to repay the loans and to improve their standard of living.

As the scheme has been in operation for more than four decades and the Co-operative banks are one of the largest lenders in this sector, the researcher has sought to do an empirical evaluation of Priority Sector Lending (PSL) of the Haryana Co-operative bank (HARCO). In this study the researcher has analysed the involvement of the HARCO Bank in PSL, evaluated the extent of success, identified the problems associated therewith and the methods to improve the effectiveness of the scheme. It will lead to increase in the extent of the PSL in Haryana by removing various obstacles and will result in improvement in the standard of living of the weaker sections of the society.
References