CHAPTER FIFTH:

PROBLEMS OF CO-OPERATIVE BANKS IN MARATHWADA REGION.

5.1- CO-OPERATIVE BANKS AND RBI POLICY.
5.2- CO-OPERATIVE BANKS AND MAHARASHTRA STATE CO-OPERATIVE ACT.
5.3- MANAGEMENT AND ADMINISTRATION OF CO-OPERATIVE BANKS.
5.4- DEPOSITORS OF CO-OPERATIVE BANKS.
5.5- BARROWERS OF CO-OPERATIVE BANKS.
5.6- A ROLE POLITICS IN CO-OPERATIVE BANKS.
5.7- A ROLE OF SOCIETY IN CO-OPERATIVE BANKS.
5.8- OTHER PROBLEMS OF COOPERATIVE BANKS.
CHAPTER-V
PROBLEMS OF CO-OPERATIVE BANKS IN MARATHWADA REGION

Introduction:-

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

Towards the late 1960s there was debate regarding the promotion of the small scale industries. UCB's came to be seen as important players in this context. The working group on industrial financing through Co-operative Banks, (1968 known as Damry Group) attempted to broaden the scope of activities of urban co-operative banks by recommending these banks should finance the small and cottage industries. This was reiterated by the Banking Commission in 1969. The Madhavdas Committee (1979) evaluated the role played by urban co-operative banks in greater details and drew a roadmap for their future role recommending support from RBI and Government in the establishment of such banks in backward areas and prescribing viability standards. The Hate Working Group
(1981) desired better utilization of bank’s surplus funds and that the percentage of the Cash Reserve Ratio (CRR) & the Statutory Liquidity Ratio (SLR) of these banks should be brought at par with commercial banks, in a phased manner. While the Marathe Committee (1992) redefined the viability norms and ushered in the era of liberalization, the Madhava Rao Committee (1999) focused on consolidation, control of sickness, better professional standards in urban co-operative banks and sought to align the urban banking movement with commercial banks.

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

5.1 CO-OPERATIVE BANKS AND RBI POLICY:-

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

• To preserve the co-operative character of UCBs
• To protect the depositors’ interest
• To reduce financial risk
To put in place strong regulatory norms at the entry level to sustain the operational efficiency of UCBs in a competitive environment and evolve measures to strengthen the existing UCB structure particularly in the context of ever increasing number of weak banks.

To align urban banking sector with the other segments of banking sector in the context of application or prudential norms in to and removing the irritants of dual control regime RBI has extended the Off-Site Surveillance System (OSS) to all non-scheduled urban co-operative banks (UCBs) having deposit size of Rs. 100 Crores and above.

The advent of liberalization and globalization has seen a lot of changes in the focus of Reserve Bank of India as a regulator of the banking industry. De-regulation of interest rates and moving away from issuing operational prescriptions have been important changes. The focus has clearly shifted from micro monitoring to macro management. Supervisory role is also shifting more towards off-site surveillance rather than on-site inspections. The focus of inspection is also shifting from transaction-based exercise to risk-based supervision. In a totally de-regulated and globalised banking scenario, a strong regulatory framework would be needed. The role of regulator would be critical for:

a) Ensuring soundness of the system by fixing benchmark standards for capital adequacy and prudential norms for key performance parameters.

b) Adoption of best practices especially in areas like risk-management, provisioning, disclosures, credit delivery, etc.
c) Adoption of good corporate governance practices.

d) Creation of an institutional framework to protect the interest of depositors.

e) Regulating the entry and exit of banks including cross-border institutions.

Further, the expected integration of various intermediaries in the financial system would add a new dimension to the role of regulators. Also as the cooperative banks are expected to come under the direct regulatory control of RBI as against the dual control system in vogue, regulation and supervision of these institutions will get a new direction. Some of these issues are addressed in the recent amendment Bill to the Banking Regulation Act introduced in the Parliament.

The integration of various financial services would need a number of legislative changes to be brought about for the system to remain contemporary and competitive. The need for changes in the legislative framework has been felt in several areas and steps have been taken in respect of many of these issues, such as,

i) Abolition of SICA / BIFR setup and formation of a National Company Law Tribunal to take up industrial re-construction.

ii) Enabling legislation for sharing of credit information about borrowers among lending institutions.

Integration of the financial system would change the way we look at banking functions. The present definition of banking under Banking Regulation
Act would require changes, if banking institutions and non-banking entities are to merge into a unified financial system

While the recent enactments like amendments to Debt Recovery Tribunal (DRT) procedures and passage of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) have helped to improve the climate for recovery of bank dues, their impact is yet to be felt at the ground level. It would be necessary to give further teeth to the legislations, to ensure that recovery of dues by creditors is possible within a reasonable time. The procedure for winding up of companies and sale of assets will also have to be streamlined.

In the recent past, Corporate Debt Restructuring has evolved as an effective voluntary mechanism. This has helped the banking system to take timely corrective actions when borrowing corporate face difficulties. With the borrowers gaining confidence in the mechanism, it is expected that CDR setup would gain more prominence making NPA management somewhat easier. It is expected that the issue of giving statutory backing for CDR system will be debated in times to come.

In the emerging banking and financial environment there would be an increased need for self-regulation. This is all the more relevant in the context of the stated policy of RBI to move away from micro-management issues. Development of best practices in various areas of banks’ working would evolve through self-regulation rather than based on regulatory prescriptions.
Role of Indian Banks’ Association would become more pronounced as a self regulatory body. Development of benchmarks on risk management, corporate governance, disclosures, accounting practices, valuation of assets, customer charter, Lenders’ Liability, etc. would be areas where IBA would be required to play a more proactive role. The Association would also be required to act as a lobbyist for getting necessary legislative enactments and changes in regulatory guidelines.

HR practices and training needs of the banking personnel would assume greater importance in the coming days. Here again, common benchmarks could be evolved.

Talking about shared services, creation of common database and conducting research on contemporary issues to assess anticipated changes in the business profile and market conditions would be areas where organizations like Indian Banks’ Association are expected to play a greater role.

Evolution of Corporate Governance being adopted by banks, particularly those who have gone public, will have to meet global standards over a period of time. In future, Corporate Governance will guide the way Banks are to be run. Good Corporate Governance is not a straight jacketed formula or process.
Various Acts are applicable to co-operative banks & co-operative societies in Maharashtra.

1. The Maharashtra Co-operative Societies Act, 1960 (MCS Act) and The Maharashtra Co-operative Societies Rules, 1961 are applicable to any co-operative society registered in Maharashtra and having no branches outside Maharashtra. Many other states (Gujarat-1962, Delhi-1972, etc.) have also enacted their own State Co-operative laws. If any state does not have its own State Act, the Co-operative Societies Act, 1912 and Rules become applicable.

2. However, if a society has operations beyond one State, it is governed by a Central Act viz. the Multi-State Co-operative Societies Act, 2002 (MSCS) and its Rules.

3. Co-operative banks are also governed by the Reserve Bank of India under Banking Regulation Act, 1949 as amended by the Banking Laws (Application to Co-operative Societies) Act, 1965 and the Banking Regulation (Co-operative Societies) Rules, 1966. As per section 5A, the provisions of this Act override the ones in the MCS Act or the Rules or Bye-laws. Certain clauses of Reserve Bank of India Act, 1934 are also applicable to co-operative banks.

4. The income earned by a co-operative society is subject to income tax under the Income-tax Act, 1961 and its Rules. It may be noted the income of a
co-operative society is eligible for deduction u/s 80P of the Income-tax Act and not an exemption u/s 10. Hence, it is mandatory for all co-operative societies to file income tax return.

5. The Foreign Exchange Management Act, 1999 as well as the Service Tax rules are also applicable to co-operative banks.

6. The execution of loan and other documents are subject to rules applicable to the place where such documents are executed. Thus, for documents executed in Maharashtra, the Bombay Stamp Act (as applicable to Maharashtra) is applicable, while for documents executed in Gujarat, the Bombay Stamp Act (as applicable to Gujarat) is applicable. Both these Acts are different, though the name is the same. For certain provisions not contained in this Act, the Indian Stamp Act becomes applicable.

7. Co-operative societies are also governed by circulars, notifications and directives issued from time to time by the various departments of co-operation. Co-operative banks are further governed by circulars issued by Reserve Bank of India.

8. A society is also bound by its bye-laws. It has also to follow various accounting and assurance standards issued by the Institute of Chartered Accountants of India.

9. The 97th constitutional amendment in the Co-operative act makes it impossible for the govt. to meddle in the affairs of Co-operatives unless it has financial stakes in them. There is general acknowledgement that Iffco is a Co-operative that does not ride roughshod over the democratic
principles of management. There are thousands of democratically elected Co-operative societies composing it. The decision to gift houses were not only taken by the elected board but it was also approved by the AGM- the highest body of any Co-operative.

10. As per new norms, co-operatives having an 'A' audit class for three consecutive years would be able to park their funds in nationalised, scheduled and urban co-operative banks. To enable elected co-operative bodies to complete their five-year terms, it has been decided that their elections will be conducted only after completion of their terms, through a proposed State Co-operative Election Authority. Under new norms, it would be mandatory for an annual general meeting to appoint an auditor. Audits of co-operative bodies would be carried out by certified government auditors.

An Act further to amend the Maharashtra Co-operative Societies Act, 1960. Whereas it is expedient further to amend the Maharashtra Co-operative Societies Act 1960, for the purpose hereinafter appearing; It is hereby enacted in the Forty-seventh Year of the Republic of India:

97th Constitutional Amendments and Amendment of Co-operative act 1960:-

Salient features of the New Rules & Reforms in Co-operative Sector:

1. New election authority to be set up for Co-operative elections.

2. New additions to the criteria for disqualification of members inserted.

3. New definition of a member introduced as “Non-active members”.

257
4. "Non-active members" will be barred from voting and contesting in the elections of the society.
5. Members failing to attend general body meetings and who have no "active participation" will be termed as "non-active members";
6. Post amendment the term of Managing Committee of all societies will be equal to "FIVE YEARS", presently the Term of Managing Committee of some societies still continues to be "THREE YEARS".
7. The maximum strength a Committee can have is capped to 21 members, presently there are no such restrictions in Co-operative Law.
8. The Managing Committee will have to Co-opt two expert members, in the committee.
9. The post in the Managing Committee of a society will have two seats reserved for "Lady Member".
10. AGM of every society to be called on or before 30th September & accounts will have to be finalised and approved in the said meeting. At present the said deadline for finalizing accounts and holding AGM is fixed on or before 14th August every year.
11. Committee failing to comply with the said deadline could be debarred from being in the Managing Committee for a period of Five Years.
12. Members who have maintenance or service charges arrears pending at the end of a financial year will be deemed defaulters and will be classified as "Non-active members".
13. The Scope of Section 101 of the Maharashtra Co-operative Societies Act, 1960 has been widened.

14. Recovery Officer will now be appointed from the Office of the Registrar, Co-operative Societies, who will fix a limit within which the defaulters will have to make the payment failing which their water connection will be disconnected & their premises will be attached and auctioned, for recovering the dues.

5.3 MANAGEMENT AND ADMINISTRATION OF CO-OPERATIVE BANKS:-

Management combines ideas, processes, materials, facilities, and people to effectively provide needed services to member-owners. Management is the decision making element of the Co-operative. Broadly speaking, its role entails formulating and executing operating policies, providing good service, maintaining financial soundness, and implementing operating efficiencies to successfully meet its objects.

A successful Co-operative is viable in an economic or business sense and maintains or improves its Co-operative character or features. A Co-operative may succeed as a business, but gradually lose its Co-operative character regarding member control, serving the needs of members, and distributing net margins. Likewise, it may succeed for a while as a Co-operative, but fail as a sound business institution.

Managing a Co-operative is challenging and difficult. It involves not only managing resources and business operations, as in other businesses, but also dealing with problems stemming from the Co-operatives distinctive
characteristics. Because the Co-operatives members are both owners and patrons, special relationships and problems arise concerning member and board of director roles and responsibilities. Seemingly conflicting answers to questions arise. What’s different in managing a Co-operative from any other type of business? The answers can range from “all the difference in the world” to “none at all.” A former regional Co-operative chief executive officer offered this answer: “Decision making techniques are identical, but the Co-operative’s objectives are different; therefore, the manager’s conclusions will be different.”

5.3.1 Management and Administrative Structures:-

All members of a Co-operative Banks have one vote and this they use to elect a Board of Directors, consisting of between 5 –21 members. From within a Board an Executive Committee is constituted. The Board also appoints a Credit Committee and an Educational Committee. Alongside the Board the members elect a Supervisory committee which is merely a watchdog institution. The Supervisory Committee also appoints an auditor, that ensures the funds of the Co-operative Banks are managed properly. Each Co-operative Banks also has a statute which confers certain powers on the Board and which enables them to make policy and decide on the implementation.

NEW AMENDMENT REGARDING MANAGEMENT:

There are certain norms which are in the nature of broad guidelines leaving scope for adopting to the varying situations within the newly defined Constitutional precincts. This could lead to writs in future as aforesaid.
In the following paragraphs, we look at the mandates under Article 243ZJ and 243ZK which contain a constitutional law on these three aspects of management of Co-operative societies across the country/Co-operative Sectors. In brief:

1. **Maximum Number/Reservations:**
   a. A State, by law can lay down structure of the Board/the managing committee with in maximum of 21 numbers in which one seat must be reserved for society’s eligible member belonging to SC/ST and two seats for women members who are eligible to contest elections.
   b. Let it be understood that reservation is for the members of the concerned society at the time of holding elections, and not for a person belonging to SC/ST or women as members of public. In other words in a society of only male or female members there will be no reservations for women: The State legislature can make rules for filling up such seats or allow it to let it remain open as it may deem fit. If no woman or SC/ST member though eligible does not contest elections the seat can be filled by any other member contesting and winning.

2. **The Tenure/Casual Vacancies:**
   a. The term of office of elected members of the board and its office bearers shall be five years from the date of election and the term of office bearers shall be conterminous with the term of the board.
   b. The board may fill a casual vacancy on the board by nomination out of the same class of members in respect of which the casual vacancy has arisen, if the
term of office of the board is less than half of its original term,(impliedly that seats go vacant. If the term is more than half, it implies elections will have been held.

3. Professional management

a. The Legislature of a State must by law, make provisions for co-option of persons as additional members up to 2 persons having experience in the field of banking, management, finance or specialisation in any other field relating to the objects and activities undertaken by the co-operative society, as members of the board of such society.

b. Such co-opted professional members shall not have the right to vote in any election of the co-operative society in their capacity as such member or to be eligible to be elected as office bearers of the board:

4. ELECTIONS

a. Disregarding any law made by the Legislature of a State, the election of a board shall be conducted before the expiry of the term of the board so as to ensure that the newly elected members of the board assume office immediately on the expiry of the office of members of the outgoing board.

b. The superintendence, direction and control of the preparation of electoral rolls for, and the conduct of, all elections to a co-operative society shall vest in such an authority or body, as may be provided by the Legislature of a State, by law: Provided that the Legislature of a State may, by law, provide for the procedure and guidelines for the conduct of such elections.
c. In case of supersession of a board, the administrator appointed to manage the affairs of such co-operative society shall arrange for conduct of elections and handover the management to the elected board.

5. Supersession of managements

a. No management of a Co-operative society shall be superseded or kept under suspension for a period exceeding six months under any of the following situations:

i. Persistent default; or

ii. Negligence in the performance of duties of management or

iii. The management has committed any act prejudicial to the interests of the co-operative society or its members; or

iv. There is stalemate in the constitution or functions of the board; or

v. The authority or body as provided by the Legislature of a State, by law, under clause (2) of article 243ZK, has failed to conduct elections in accordance with the provisions of the State Act

b. Exception

The board of any such co-operative society shall not be superseded or kept under suspension where there is no Government shareholding or loan or financial assistance or any guarantee by the Government. The Housing Co-operative societies are obvious exceptions.

6. Implications for the M. C. S. Act 1960

a. The State Cabinet has reportedly drafted an Ordinance to amend the M. C. S. Act 1960 to give effect to provisions of 97 CAA expected to be in force from 16-
2-2013, the day all above provisions including several others will be in force whether the Ordinance is issued or not and the M. C. S. Act 1960 is amended or not.

b. Any of the M.C.S. Rules 1961 or any of the Bye Laws of any society having different provision shall be replaced automatically by these provisions. These documents will have to be eventually aligned to these provisions in order to avoid confusion in the minds of members and the managing committees.

c. The State Co-operative department has been caught napping. The ban on appointing administrator has made them really jittery. Coupled with that a most controversial thinking in the corridors of power is to empower these very Committees to even snatch the flat from defaulters- the other extreme.

d. Most intriguing is the lifting of ban on the Cabinet Ministers to become office bearers in the Co-operative societies.

7. Prognosis

(a) The Constitutional mandate under 97 CAA is that the State will as a constitutional obligation (not compulsion of course) seriously try to promote voluntary formation, autonomous functioning, democratic control and professional management of co-operative societies. We will have to wait and watch as to how the moves of the State live by these obligations in coming days and months.

(b) If the State is found to be wanting in that, the citizens have every right to invoke the new fundamental right of forming co-operative societies [Article (19(1) (c) of the Constitution of India as modified by 97 CAA) and approach the
High Court / Supreme Court to give necessary directions. The Citizens will have to not only shed indifference towards society management but become proactive in their approach.

(c) Since Committees are going enjoy immunity from dismissal, a safety provision would have been better for recalling such member by passing 2/3 or \( \frac{3}{4} \) majority decision. Unfortunately it is not there.

Thereof through the various committees. At an operational level or on a day-to-day basis, the Co-operative Banks might initially be managed by a volunteer clerk, but as the Co-operative Banks expands the Board might decide to hire a manager. In the Marathwada Regions Co-operative Banks, expansion has further taken place with the manager employing a receptionist and a data capture. Within the Marathwada Region the manageress's 8 functions include the following:

Every shareholder and member of the Village Financial Services Co-operative has a vote to decide on the Board. The Board, comprised of (7-11) members, normally has seven portfolios comprised an executive of three (sometimes a Chairperson; secretary and treasurer) and a marketing portfolio, an auditing and investment portfolio, loans and security. In general and as derived from the statute, the board sets policy for the co-operative. The board ensures regular audits to maintain proper financial management and control, processes loan applications through a loan committee and employs an administrator. The administrator acts as an operational manager and can employ other administrators. The functions of the administrator include some of the following tasks:
Receiving cash deposits, filing deposit slips and withdrawal slips, tally receipts and payments then record in cash book each day, keeping proper ledgers for shares and savings, managing withdrawals, reporting to the board, working with the loan committee and interacting with the link bank.

Overall, management embodies four functions—planning, organizing, motivating, and controlling. Planning determines where the organization is going and how it will get there. It sets organizational objectives and goals, forecasts the environment in which objectives must be accomplished, and determines the approach by which objectives and goals are to be accomplished. Planning is used to determine a policy and the procedures for putting it into effect. Planning usually considers several alternatives. Each should be judged on the basis of its economic or competitive effect and accompanying problems. Also, it must be consistent with Co-operative principles and the association’s objectives. Planning helps a manager shape the future of the organization rather than being caught in an endless trap of reacting only to current crises or problems. Organizing is concerned with determining the specific activities needed to accomplish the planned objectives and goals; grouping the activities into a logical pattern, framework, or structure; assigning the activities to specific positions and people; and providing means for coordinating the efforts of individuals and groups. Organizing is a bridge connecting the planned objectives to specific projects for accomplishing these objectives. Motivating concerns the people side of the organization.
Co-operatives are people-driven organizations, from the standpoint of both employees and members. Managers must have leadership skills and be effective communicators. The manager’s ability to influence members through leadership will help determine the extent to which both individuals and the entire organization accomplish their goals.

A manager spends up to 95 percent of the time communicating. Good communication is essential to coordinating the organization’s human and physical elements into an efficient and effective working unit. In controlling, management monitors the progress of planned activities. If progress is lagging, necessary adjustments are made. Controlling is the checkup part of a manager’s job.

5.3.2 Management Tools

Management uses a number of tools to carry out its functions- accounting system, control reports, security and safety, training and evaluation, incentive programs, communications, and strategic planning.

5.3.3 Accounting System

A complete and accurate accounting system is vital for effective management. It must produce several financial statements needed in planning and controlling, such as:

(1) monthly and annual balance sheets and operating statements;

(2) functional or enterprise accounts pertaining to departments or specific lines of business; and

(3) Special accounts such as patronage records, accounts receivable aging, member equity, and patron financing. An independent auditor periodically verifies...
the accuracy of the Co-operatives business records. This is especially useful to directors in performing their controlling and planning functions. It helps the board determine the extent to which the manager has followed financial policies, and evaluate how the Co-operative is accomplishing its basic objectives. The external audit is primarily a board tool.

Larger Co-operatives also use internal audit reports. The internal auditor’s primary duty is to monitor the Co-operatives accounting policy. The auditor checks the cost of prescribed procedures, including their effect on patrons and personnel, and suggests ways to prevent errors. Usually, the auditor reports to the chief accounting officer, but sometimes to the general manager or even to the board of directors. Internal audits are primarily manager tools.

5.3.4 Control Reports

Credit and inventory analysis include a monthly aging of accounts and notes receivable; selected financial and operating ratios; and a monthly accounting of selected inventories, including shrinkage reports.

5.3.5 Security and Safety

To protect the Co-operative, the board is responsible for adequately insuring employees and assets. Employees handling funds should be bonded. Facilities need to be appraised and arranged internally and fenced to minimize pilferage. The board should adopt programs to protect the health and safety of employees and patrons and measures to comply with environmental protection standards.
5.3.6 Evaluation and Training

Management will be evaluated even if the process is not formally planned. Member-owners continually evaluate their hired management in terms of how well the Co-operative is serving members. Regardless of Co-operative size, supervisory personnel are evaluated on the basis of how they perform day-to-day. In addition, business leaders, who know about or deal with the Co-operative, indirectly evaluate its management. While this type of evaluation may have a direct impact on the Co-operative, the process usually doesn’t clearly identify weaknesses so they can be corrected.

Larger Co-operatives use professional management consulting firms to assess whether the Co-operatives management structure is efficient, locate weaknesses and strengths, and suggest what types of management training are needed. A Co-operative of any size can lay a fundamental basis for evaluating its management. The essential requirement is to develop an evaluation plan and then follow it present and prospective supervisors can be encouraged to improve their management abilities by using a wide range of training resources. Co-operatives often send many of their top management staffers to commercial seminars on management or to specialized educational seminars such as the Graduate Institute of Co-operative Leadership sponsored by the University of Missouri-Columbia. Other resources are land-grant universities, banks of the Farm Credit System, regional Co-operatives, and the Federal extension service. State Co-operative councils, in conjunction with land-grant universities and Co-operatives, also offer a variety of workshops and seminars. Management Appraisal Report
Management's traditional scope concerns land (facilities and equipment), people, and capital. This is accomplished by using the management functions of planning, organizing, motivating, and controlling.

5.4 DEPOSITORS OF CO-OPERATIVE BANKS:

Opportunity to take a well-informed decision before parking their funds in these institutions. Amidst cases of Co-operative banks going bust leaving the depositors in the lurch, Reserve Banks of India is planning to put their ratings in public domain.

Termed CAMEL- short for Capital Audit Management Earning and Liquidity- the ratings system was applicable to the commercial banks. Following report of Narsimham Committee, it was adopted for the Co-operatives from 2009 onwards.

It is now being planned to disclose the CAMEL ratings of the banks to public so that depositors can take an informed decision. This was disclosed during a meeting convened by task force on Co-operative urban banks (TAFCUB) held in Nagpur on Friday.

Sources said there were plans to make information about the banks' financial status more accessible to the public. This would include making CAMEL ratings or the grades, which is a parallel system to categorize the banks, public. The general view is that grades may continue to be an internal matter but ratings may be made public, said a source. Grading, which are denoted in numbers 1 to 4, are given on the basis of parameters like capital adequacy, consistency in profits and quantum of non-performing assets. CAMEL ratings on the other hand
are denoted in alphabets, said the source. Even auditors have been asked to follow the CAMEL system while auditing the books of accounts.

Mobilisation of deposit is one of the main functions of banking business and so an important source of working fund for the bank. The District Central Co-operative Banks (DCCBs) have to increase their financial resources by way of deposit mobilisation. Deposit mobilisation is an indispensable factor to increase the source of the DCCBs to serve effectively. The importance of deposits of the Co-operative banking structure to provide satisfactory service to any programme of agricultural production and industrial manufacturing hardly needs to be over emphasized. Several committees and commissions have stressed that the DCCBs must tap deposits from urban and rural areas so that they may be able to provide funds in large amounts to primary societies for farm and non-farm development. The success of the banking greatly lies on the deposit mobilisation performance of the bank as the deposits are normally considered as a cost effective source of working fund. The bank is operating various deposit schemes such as current, savings, fixed, recurring and other special schemes to meet the varying requirement of the customers. One of the important objectives of the CCBs is the mobilisation of rural savings. It helps to expand loaning operations. The philosophy of cooperation emphasizes that Co-operative institutions should function only with the funds pooled from members and not to rely largely on external financial accommodation. The All India Rural Credit Survey Committee (1954), Mehta Committee (1960) and Banking Commission (1972) have recommended that the DCCBs could engage in the mobilisation of deposits for
improving the internal resources. Contrary to this principle, the concessional finance available to the DCCBs from the RBI made them indifferent to the function of mobilisation of deposits. To mobilize deposits, the CCBs are given some encouragement by the RBI and apex institutions such as subsidy for branch expansion, states’ participation in share capital, permitting the DCCBs to offer 1/2 per cent interest higher than the commercial banks and application of deposit insurance scheme.

5.4.1 Deposit Mix

The DCCBs, which are the backbone of Co-operative finance, must become self-sufficient and self-reliant. The All India Rural Credit Committee and the Mahajan Committee have emphasized that with a view to enhance the savings, DCCB must tap deposits from the urban areas so that adequate finance will be available for agricultural development in rural areas. The Mahajan Committee has made its observation as (1) since the interest offered by the banks on public deposits is quite attractive, the state Co-operative banks and DCCBs must offer competitive rate of interest. They must review the present rates and bring them in line with the rates prevailing in the money market. And (2) the local bodies, educational institutions, trust, etc. should be permitted to make deposits of their funds with the well managed and sound Co-operative banks. Mobilisation of deposits for a bank is as essential as oxygen for human being. In the post liberalisation scenario, the number of players in banking industry has increased considerably which developed competition in bank marketing. ‘The survival of the fittest’ has made applicable for the banks. To enhance profitability, banks take
steps to minimize the interest paid expenditure and so banks are forced to mobilise low cost deposits. In the present context bank’s efficiency is measured based on the deposit mix and on the quantum of low cost deposits in the mix. In the selected DCCB, deposits from around 40 to 60 per cent of its working funds. In the present context of competition and with the emergence of private and multinational banks, an ideal mix of deposits for the DCCBs is a must to survive. Since the interest paid on deposit forms a big burden on bank, the mobilisation of low cost deposits, like current account and savings bank deposit is the urgent need for the bank.

The deposit mix of the selected DCCB. The contribution of fixed deposits in the total mix of deposits ranges from 40.00 per cent to 77.10 per cent. The portion of current account ranges from only 3.52 per cent to 8.29 per cent and that of savings bank deposits ranges from 9.68 per cent to 22.92 per cent. The deposit portion under money at call and short notice was at a highest percentage in the year 1998-99 as 45.08 per cent and it was reduced in subsequent years. Further, it is observed that the fixed deposits cover an average of 50.47 per cent of the total deposit during the first five years i.e. from 1993-94 to 1997-98. In the year 1998-99 fixed deposits was only 40 per cent of total deposits and thereafter its contribution to total deposits was on the increasing trend and it reached the maximum of 77.10 per cent in 2002-03. The increasing trend is not advisable for the reason that, fixed deposits attract higher rate of interest and hence they are costly deposits. The trend has to be reversed.
The share of savings bank deposits in the total deposits was ranging from 9.68 per cent to 22.92 per cent during the decade of study. There is no regular increasing or decreasing trend noticed. However it is noticed that the share of saving bank deposits was higher during the first three years only. From 1996-97, savings bank deposits lost its share sizably and it was only 11.49 per cent in the year 2002-03. This trend is not healthy for the bank, because savings bank deposits provide scope to widen customer base and to increase low cost deposits. Therefore, here also the trend has to be reversed. Current account is zero interest deposit and its share to the total deposit remain the lowest i.e. an average of 5.75 per cent only during decade of study. It formed the highest share of 8.29 per cent in the year 1994-95 and it was only 4.26 per cent in the year 2002-03. The bank has to mobilise more current account in order to save the interest cost on total deposits. Current accounts provide the scope to increase business clientele for a bank. The business clientele provide more opportunities to the bank to increase the volume of business transaction. Therefore deposit under current account has to be increased.

Deposits collected under money at call and at short notice are termed as call deposit. To correct the mismatch in deposits while meeting the statutory requirements like CRR, SLR the bank resorts to call deposits. Therefore call deposits are not regular or normal deposits for a bank. Call deposits are costly and they attract interest at call money rate on day-to-day basis and hence the rate of interest will be the highest. From the table, inference derived is that, in the years 1997-98, 1998-99 and 1999-00, the call deposit share was more than one third of
total deposits which is not healthy for the bank as they were very costly deposits. Except in the year 2002-03, the call deposits were more than 20 per cent of the total deposits during the study period. This shows that the bank was unable to mobilise adequate deposits under fixed, savings and current to meet the statutory requirements and the gap was filled up through call deposits. The trend has been reversed in the year 2002-03 by bringing down its share to 7.15 per cent and it has to be further minimised and nullified to reduce the total cost of deposits. The overall inference from the table is that the deposit mix is not healthy. The fixed deposits have to be brought down to less than 50 per cent of total deposits. The savings and current accounts together must be increased to more than 50 per cent while call deposit has to be nullified. This is an ideal deposit mix for the bank to ensure profitability Therefore; the bank should adapt itself to the changed situation in search of new markets and to provide new services for existing customers to retain its market share.

5.4.2 Source-wise analysis of deposits

To mobilise deposits, the Co-operative banks depend on individual depositors as well as Co-operative societies. All the registered primary Co-operative societies have to deposit all their appropriations out of profits with the DCCB concerned. It is a statutory obligation. Thus a part of the deposits for the selected DCCB is from societies, which is considered as compulsory. Mobilisation of such deposits needs least efforts. Therefore any improvement in the deposits from societies does not reveal the real effectiveness of the bank’s efforts towards deposit mobilisation. The second source of deposit is from
individuals. This could be a voluntary source. Mobilisation of deposits under this category would be the result of continuous publicity, effective marketing management, convincing and courteous service of the bankers. The source-wise analysis of deposits will throw light on the performance of the selected DCCB on deposit mobilisation.

It is inferred from the above table table-2 that the sources of deposits of the selected DCCB are mainly from individuals. During the study period of ten years, the share of individual deposit is ranging from 69.52 per cent to 86.41 per cent, which is an average of 76.38 per cent. The percentage of deposits received from Co-operative societies to total deposits ranges from 13.59 per cent to 30.48 per cent, which is on an average of 23.62 per cent. The growth of deposits from individual as well as from Co-operative societies is similar during the study period of ten years. The growth of individual deposits has grown by nearly four times in ten years from 1993-94 to 2002-03. Similarly the deposits from Co-operative societies also have grown by nearly four times during the same period. Thus the bank is concentrating more on deposits from individuals. The deposits from Co-operative societies are also mobilised from the public by the societies. Therefore the clientele base for the bank is wide directly and indirectly through PACBs, which is essential for overall healthy business performance.

5.5 BORROWERS OF CO-OPERATIVE BANKS:-

GENERAL
As a prudential measure aimed at better risk management and avoidance of concentration of credit risk, the primary (urban) co-operative banks have been advised to fix limits on their exposure –

- To individual borrowers and group borrowers,
- To specific sectors, and towards unsecured advances and unsecured guarantees

In addition, these banks are also required to observe certain statutory and regulatory restrictions in respect of:

(i) Advances against shares, debentures and bonds

(ii) Investments in shares, debentures and bonds

Currently operative instructions on all these aspects are detailed in the following paragraphs.

**Exposure Norms**

**Exposure Ceiling to Individual/Group Borrowers**

Primary (urban) co-operative banks are required to fix, with the approval of their Board of Directors, exposure ceiling in relation to bank's capital funds. The exposure for the purpose shall comprise both credit exposure (loans and advances and investment exposure (Non SLR) as detailed at para 2.2.2(B) so that –

(i) The exposure to an individual borrower does not exceed 15 per cent of capital funds, and

(ii) The exposure to a group of borrowers does not exceed 40 per cent of capital funds.

The exercise of computing the exposure ceilings may be conducted every year after the finalisation and audit of balance sheet of the bank and the exposure
ceilings may be advised to the loan sanctioning authorities and the investment department in the bank.

In view of the linking of shareholding to lending, accretion to or reduction in the share capital after the balance sheet date, may be taken into account for determining exposure ceiling at half-yearly intervals, with the approval of their Board of Directors. Accordingly banks may, if they so desire, fix a fresh exposure limit taking into account the amount of share capital available as on 30th September. However, accretion to capital funds other than to share capital, such as half-yearly profit etc., will not be eligible for reckoning the exposure ceiling. Banks should also ensure that they do not take exposures in excess of ceiling prescribed in anticipation of infusion of capital on a future date.

Capital Funds

The "Capital Funds" for the purpose of exposure norm would comprise both Tiers I and Tier II Capital as defined in our Master Circular on Capital Adequacy.

The Exposure shall include both credit exposure (Loans and Advances) and investment exposure (non-SLR) as indicated below:

Credit Exposure:

(i) Credit exposure shall include –

(a) Funded and non-funded credit limits and underwriting and similar commitments,

(b) Facilities extended by way of equipment leasing and hire purchase financing, and
(c) Ad hoc limits sanctioned to the borrowers to meet the contingencies.

(ii) Credit exposure shall not include loans and advances granted against the security of bank's own term deposits.

(iii) The sanctioned limit or outstanding whichever is higher shall be reckoned for arriving at credit exposure limit. Further, in case of fully drawn term loans, where there is no scope of re-drawal of any portion of the sanctioned limit, banks may reckon the outstanding for arriving at credit exposure limit.

(iv) In respect of non-funded credit limit, 100 % of such limit or outstanding, whichever is higher, need be taken into account for the purpose.

(v) Consortium/Multiple Banking/Syndication

The level of individual bank's share shall be governed by single borrower / group exposure.

**Investment Exposure (Non SLR):**

Banks are allowed to invest in ‘A’ or equivalent and higher rated Commercial Papers (CPs), debentures, and bonds that are redeemable in nature. Investments in perpetual debt instruments are, however, not permitted. Banks are also allowed to invest in Units of Debt Mutual Funds and Money Market Mutual Funds.

a) Investments in non-SLR securities should be limited to 10% of a bank's total deposits as on March 31 of the previous year.

b) Investments in unlisted securities should not exceed 10% of the total non-SLR investments at any time. Where banks have already exceeded the said limit, no incremental investment in such securities will be permitted.
c) All investments as above will be subject to the prescribed prudential individual/group exposure limits.

d) All fresh investments under Non-SLR category should be classified under Held for Trading (HFT)/Available for Sale (AFS) categories only and marked to market

**Group**

The decision in regard to definition of a group is left to the perception of the banks, which are generally aware of the basic constitution of their clientele. The group to which a particular borrowing unit belongs may, therefore, be decided by the banks on the basis of relevant information available with them, the guiding principle in this regard being commonality of management and effective control.

The total of the time and demand liabilities shall have the same meaning as defined in Section 18 read with Section 56 of the Banking Regulation Act 1949, subject to the modification that 75% of the paid-up capital and reserves of a bank may be added to its time and demand liabilities.

All bills of exchange not accompanied by the official receipts of the Indian Railways or Indian Airlines Corporation or Road and Water Transport Operators, as approved by the Board of Directors of the primary co-operative bank, shall be deemed to be clean bills.

The different firms with one or more common partners engaged in the same line of business, viz. manufacturing, processing, trading activity, etc. shall
be deemed to be connected group and units coming under common ownership shall be deemed to be a single party.

**Unsecured advances** shall include clean overdrafts, loans against personal security, clean bills or Multani hundies purchased or discounted, cheques purchased and draws allowed against cheques sent for collection but shall exclude:

(i) advances backed by guarantee of the central or state governments, public sector financial institutions, banks and Deposit Insurance & Credit Guarantee Corporation;

(ii) advances against supply bills drawn on the central or state governments or state owned undertakings which are accompanied by duly authorised inspection notes or receipted challans;

(iii) advances against trust receipts;

(iv) advances against inland D/A bills drawn under letters of credit;

(v) Advances against inland D/A bills (even where such bills are not drawn under letters of credit) having a since of not exceeding 90 days;

(vi) advances granted to salaried employees against personal security, provided that the Co-operative Societies Act of the State concerned contains an obligatory provision for deduction of periodical loan installments by the employer out of the employee's salary/wages to meet the bank's claims and provided further that the bank has taken advantages of this provision in respect of each of such advances;
(vii) advances against supply bills drawn on private parties of repute and receipted
challans of public limited companies and concerns of repute and not outstanding
for more than 90 days;
(viii) advances against book debts which are not outstanding for more than 90
days;
(ix) Cheques issued by governments, public corporation and local self governing
institutions;
(x) Advances in the form of packing credit for exports;
(xi) Demand drafts purchased;
(xii) The secured portion of a partly secured advances, and
(xiii) Advances against legal assignment of contract moneys due, or to become
due.

**Concerns** in which a director of a primary co-operative bank or his relative is
interested shall mean –

(i) Proprietary concerns/ partnership firms (including Hindu Undivided Family
concerns and association of persons) in which a director of the bank or his relative
is interested as proprietor/ partner/ co-larcener;

(ii) Private/ public limited companies, where a director of the bank is a guarantor
for repayment of loans and advances granted to the company.

The 'relative' of a director of the bank shall mean any relative of a director of the
bank as indicated hereunder:

A person shall be, deemed to be relative of another, if and only if,:

(a) They are members of a Hindu Undivided Family; or
(b) They are husband and wife; or

(c) The one is related to the other in the manner indicated below:

(i) Father

(ii) Mother (including step-mother)

(iii) Son (including step-son)

(iv) Son's wife

(v) Daughter (including step-daughter)

(vi) Daughter's husband

(vii) Brother (including step-brother)

(viii) Brother's wife

(ix) Sister (including step-sister)

(x) Sister's husband

The words 'any other financial accommodation' shall include funded and non-funded credit limits and under-writings and similar commitments, as under:

(i) The funded limits shall include loans and advances by way of bills purchase/discounting, pre-shipment and post-shipment credit facilities and deferred payment guarantee limits extended for any purpose including purchase of capital equipment and acceptance limits in connection therewith sanctioned to borrowers and guarantees by issue of which a bank undertakes financial obligation to enable its constituents to acquire capital assets.

(ii) The non-funded limits shall include letters of credit, guarantees and under-writings and similar commitments.
In view of the fact that salary earner banks grant advances to salaried employees of a particular institution/group of institutions to which their membership is restricted and deductions are made from the salaries through their employers, the salary earner banks may allow such advances in excess of the limits prescribed above subject to the following conditions:

(i) The Co-operative Societies Act of the State concerned contains an obligatory provision for deduction of periodical loan installments by the employer out of employee's salaries/wages to meet bank's claims.

(ii) The bank has taken advantage of this provision in respect of each of such advance.

(iii) A general limit for such advances is fixed by the bank in terms of certain multiples of the pay packet taking into account the monthly income of the employees.

The advances granted by primary (urban) co-operative banks, other than salary earners societies, to all salaried borrowers wherein repayment is sought to be ensured through deduction from borrower's salaries as per the provisions of the State Co-operative Societies Act, should be reckoned as secured only for the purpose of computation of total unsecured advances to the members as a whole. While granting advances to the individual salaried borrowers, the banks should ensure that these advances do not exceed the maximum limit on unsecured advances as indicated in paragraph 3.1 (a).
Real Estate Sector Exposure limit

Primary (urban) co-operative banks are advised to frame, with the approval of their Board of Directors, comprehensive prudential norms relating to the ceiling on the total amount of real estate loans, keeping in view the Reserve Bank guidelines to ensure that bank credit is used for construction activity and not for activity connected with speculation in real estate subject to the following:

The total exposure to real estate including individual housing loan and commercial real estate may be limited to 15 per cent of the total deposit resources of a bank. However, the above limit may be exceeded to the extent of funds obtained for the purpose from higher financing agencies and refinance from the National Housing Bank.

Inter-bank exposure limit

Prudential inter-bank (gross) exposure limit

The total amount of deposits placed by an UCB with other banks (inter-bank) for all purposes including call money / notice money, and deposits, if any, placed for availing clearing facility, CSGL facility, currency chest facility, remittance facility and non-fund based facilities like Bank Guarantee (BG), Letter of Credit (LC), etc shall not exceed 20% of its total deposit liabilities as on March 31 of the previous year. The balances held in deposit accounts with commercial banks and in permitted scheduled UCBs and investments in Certificate of Deposits issued by commercial banks, being inter-bank exposures, will be included in this 20% limit.
Prudential inter-bank counter party limit

Within the prudential inter-bank (gross) exposure limit, deposits with any single bank should not exceed 5% of the depositing bank's total deposit liabilities as on March 31, of the previous year.

Deposits placed by non-scheduled PCBs with scheduled PCBs

Non-scheduled PCBs are permitted to place deposits with strong scheduled PCBs complying with the following norms:

(i) The bank complies with the prescribed level of CRAR.
(ii) Net NPAs of the bank are less than 7%.
(iii) The bank has not defaulted in the maintenance of CRR/SLR for the last two years.
(iv) The bank has declared net profits for the last three consecutive years.
(v) The bank complies with prudential norms on income recognition, asset classification and provisioning, exposure ceilings and loans and advances to directors.
(vi) The amount of deposits placed by a non-scheduled UCB with any scheduled UCB should not exceed 5% of the depositing bank's total deposit liabilities as on March 31 of the previous year.

Acceptance of deposits from non-scheduled UCBs by the scheduled UCBs will also be subject to the following conditions:

i) The total inter-UCB deposits accepted by a scheduled UCB should not exceed 10% of its deposit liabilities as on 31st March of the previous financial year.
ii) The rate of interest offered on such deposits should be market related.
iii) Scheduled UCBs should not, however, place deposits with other scheduled/non-scheduled UCBs.

5.6 A ROLE OF POLITICS IN CO-OPERATIVE BANKS:-

In order to cover Co-operative societies with membership from more than one province, the Government of India enacted the Multi-Unit Co-operative Societies Act 1942. This Act dealt with incorporation and winding up of Co-operative societies having jurisdiction in more than one province. A need was felt for a comprehensive Central legislation to consolidate laws governing Co-operative societies. This led to the enactment of Multi-State Co-operative Societies Act 1984 by the Parliament under Entry No 44 of the Union List of the Constitution of India.

After Independence, Co-operatives assumed a great significance in poverty removal and faster socio-economic growth. They became an integral part of the Five Year Plans. As a result they emerged as a distinct segment in Indian economy. In the First Year Plan it was specifically stated that the success of the Plan would be judged among other things, by the extent it was implemented through Co-operative organizations.

In 1958 the National Development Council (NDC) had recommended a national policy on Co-operatives. The Co-operative sector has been playing a distinct and significant role in the country’s process of socio-economic development. There has been a substantial growth of this sector in diverse areas of the economy during the past few decades. The number of all types of Co-operatives increased from 1.81 lakh in 1950-51 to 4.53 lakh in 1996-97. The total
membership of Co-operative societies increased from 1.55 crore to 20.45 crore in the same period. The Co-operatives have been operating in various areas of the economy such as credit, production, processing, marketing, input distribution, housing, dairying and textiles. In some of the areas of their activities like dairying, urban banking and housing, sugar and handlooms, the Co-operatives have achieved success to an extent but there are larger areas where they have not been so successful.

The failure of Co-operatives can be attributed to dormant membership and lack of active participation of members in the management of Co-operatives. Mounting over dues in Co-operative credit institutions, lack of mobilization of internal resources and over dependence on government assistance, lack of professional management, bureaucratic control and interference in the management, political interference and over-politicization have proved harmful to their growth. These are the areas which need to be attended to by evolving suitable legislative and policy support.

For the success of any developmental effort in the agricultural sector is to synergize with the efforts in the Co-operative sector. Development of Co-operative sector has many benefits. It will involve all sections of the society in development efforts. Co-operative sector of Indian economy has a spiritual content too when it was led by Vinoba Bhave. Co-operative sector has inbuilt democracy and only those who can demonstrate their commitment and efficiency can survive in the Co-operative elections. Nowadays most of the financial institutions in the Co-operative sector are also run on purely commercial basis. It
is here that the State intervention can make the difference. The grant, subsidies and aid meant for the poor farmers must be channeled through the Co-operative sector. Once there are enough resources in the sector in terms of money there will be increased participation by the people and will result in the all round development of the village.

Panchayat Raj institutions and Co-operative sector can bring about positive change in the rural areas. Co-operatives have extended across the entire country and there are currently estimated 230 million members nationwide. The Co-operative credit system has the largest network in the world and Co-operatives have advanced more credit in the Indian agricultural sector than commercial banks. In fertilizer production and distribution the Indian Fertilizer Co-operative commands over 35% of the market. In the production of sugar the Co-operative share of the market is over 58% and in cotton they have share of 60%. The Co-operative sector accounts for 55% of the looms in the hand-weaving sector.

Co-operative process, market and distribute 50% of the edible oil. Dairy Co-operative operating under the leadership of the National Dairy Development Board and through 15 state Co-operative milk marketing federations as now become the largest producer of milk. With the rapid growth of the Co-operative sector a supportive climate has been created for the development of Co-operatives with the opportunities for diversification.

With the efforts of National Co-operative Union of India the Central Government passed the Multi State Co-operatives Societies Act and also formulated a national Co-operative policy that provides greater autonomy to Co-
operatives. With the passage of the Insurance Act, Co-operatives have been allowed to enter into the insurance business. Insurance is a field where the immense potential of Co-operatives still remains untapped.

5.7 A ROLE OF SOCIETY IN CO-OPERATIVE BANKS:-

Since the second half of 1960s, commercial banks have been playing an important role in the socio-economic transformation of rural India. Besides actively implementing Government sponsored lending schemes, Banks have been providing direct and indirect finance to support economic activities. Mandatory lending to the priority sectors has been an important feature of Indian banking. The Narasimham committee had recommended for doing away with the present system of directed lending to priority sectors in line with liberalization in the financial system. The recommendations were, however, not accepted by the Government. In the prevailing political climate in the country any drastic change in the policy in this regard appears unlikely.

The banking system is expected to reorient its approach to rural lending. “Going Rural” could be the new market mantra. Rural market comprises 74% of the population, 41% of Middle class and 58% of disposable income. Consumer growth is taking place at a fast pace in 17113 villages with a population of more than 5000. Of these, 9989 villages are in 7 States, namely Andhra Pradesh, Bihar, Kerala, Maharashtra, Tamilnadu, Uttar Pradesh and West Bengal. Banks’ approach to the rural lending will be guided mainly by commercial considerations in future.
Commercial Banks, Co-operatives and Regional Rural Banks are the three major segments of rural financial sector in India. Rural financial system, in future has a challenging task of facing the drastic changes taking place in the banking sector, especially in the wake of economic liberalization. There is an urgent need for rural financial system to enlarge their role functions and range of services offered so as to emerge as "one stop destination for all types of credit requirements of people in rural/semi-urban centres.

Barring commercial banks, the other rural financial institutions have a weak structural base and the issue of their strengthening requires to be taken up on priority. Co-operatives will have to be made viable by infusion of capital. Bringing all Co-operative institutions under the regulatory control of RBI would help in better control and supervision over the functioning of these institutions. Similarly Regional Rural banks (RRBs) as a group need to be made structurally stronger. It would be desirable if NABARD takes the initiative to consolidate all the RRBs into a strong rural development entity.

Small Scale Industries have, over the last five decades, emerged as a major contributor to the economy, both in terms of employment generation and share in manufactured output and exports. SSIs account for 95% of the industrial units and contribute about 40% of the value addition in the manufacturing sector. There are more than 32 lack units spread all over the country producing over 7500 items and providing employment to more than 178 lack persons. The employment generation potential and favourable capital-output ratio would make small scale sector remain important for policy planners.
Removal of quantitative restrictions on a large number of items under the WTO and opening up of Indian market to greater international competition have thrown both challenges and opportunities for the SSI sector. Low capital base and weak management structure make these units vulnerable to external shocks, more easily. However the units which can adopt to the changing environment and show imagination in their business strategy will thrive in the new environment.

Instead of following the narrow definition of SSI, based on the investment in fixed assets, there is a move to look at Small and Medium Enterprises (SME) as a group for policy thrust and encouragement. For SMEs, banks should explore the option of E-banking channels to develop web-based relationship banking models, which are customer-driven and more cost-effective. Government is already considering legislation for the development of SME sector to facilitate its orderly growth.

In the next ten years, SME sector will emerge more competitive and efficient and knowledge-based industries are likely to acquire greater prominence. SMEs will be dominating in industry segments such as Pharmaceuticals, Information Technology and Biotechnology. With SME sector emerging as a vibrant sector of the Indian economy, flow of credit to this sector would go up significantly. Banks will have to sharpen their skills for meeting the financial needs of this segment. Some of the Banks may emerge as niche players in handling SME finance. Flow of credit to this Sector will be guided purely by commercial considerations as Banks will find SMEs as an attractive business proposition.
2. In recent years, there has been a considerable widening and deepening of the Indian financial system, of which banking is a significant component. With greater liberalisation, the financial system has come to play a much larger role in the allocation of resources than in the past and its role in future can be expected to be much larger than at present. The growing role of the financial sector in the allocation of resources has significant potential advantages for the efficiency with which our economy functions. Consequently, the adverse consequences of malfunction of the financial system are likely to be more severe than they used to be in the past. Hence, all our efforts today are focused at ensuring greater financial stability. Given the significance of the Indian banking system, one cannot afford to underplay the importance of a strong and resilient banking system.

3. The pre-reform period witnessed the following major regulatory constraints on the banking sector which not only distorted the efficiency of the interest rate mechanism but also adversely affected the viability and profitability of banks:

- large pre-emotions – both in terms of the statutory holding of Government securities (statutory liquidity ratio, or SLR) and cash reserve ratio (CRR); and
- complex structure of administered interest rates;

One of the major objectives of banking sector reforms in India has been to enhance efficiency and productivity, which were achieved through:

- reductions in the pre-emotions;
- de-regulation of interest rates;
-enhancement of competition through establishment of new banks in the private sector, more liberal entry of foreign banks, enhancing the role of public shareholders in nationalised banks by gradual reduction of Government shareholding in these banks and allowing foreign direct investment in the private sector banks up to 74 per cent, subject to conformity with the guidelines issued from time to time.

The cumulative effect of these measures is that banks have been accorded greater discretion in sourcing and utilisation of resources albeit in an increasingly competitive environment.

5.8 OTHER PROBLEMS OF CO-OPERATIVES BANK:

Present position and the challenges ahead

The enhanced role of the banking sector in the Indian economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on banks. Operating in this demanding environment has exposed banks to various challenges.

i) Customer service: It is no longer adequate for banks to provide only traditional banking services. Apart from providing the conventional banking services, banks have begun offering a bouquet of financial services to their clients, including cross selling of financial products. The ultimate aim is to offer a one-stop-shop for meeting varied customers' financial needs. Some banks have begun employing customer relationship management systems to not only retain the existing customers but also to attract new customers. The establishment of new private sector banks and foreign banks has rapidly changed the competitive
landscape in the Indian consumer banking industry and placed greater demands on banks to gear themselves up to meet the increasing needs of customers. For the discerning current day bank customers, it is not only relevant to offer a wide menu of services but also provide these in an increasingly efficient manner in terms of cost, time and convenience.

While banks are focusing on the methodologies of meeting the increasing demands placed on them, there are legitimate concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unorganized sector. While commercial considerations are no doubt important, banks have been bestowed with several privileges, especially of seeking public deposits on a highly leveraged basis, and consequently they should be obliged to provide banking services to all segments of the population, on equitable basis. Further, experience has shown that consumers' interests are at times not accorded full protection and their grievances are not properly attended to. Feedback received reveals recent trends of levying unreasonably high service/user charges and enhancement of user charges without proper and prior intimation. It is in this context that the Governor, Reserve Bank of India had mentioned in the Annual Policy Statement 2005-06 that RBI will take initiatives to encourage

- greater degree of financial inclusion in the country;
- setting up of a mechanism for ensuring fair treatment of consumers; and
- Effective redressed of customer grievances.
It would, therefore, be reasonable to expect banks to focus on the above aspects while designing their products for customers.

ii) Branch banking: Traditionally banks have been looking towards expansion of their branch network to increase their business. Against this background it is interesting to observe that the new private sector banks as well as the foreign banks have been able to achieve business expansion through other means. It has been realized that it might not be necessary to establish a wider brick and mortar network to reach a wider population. Banks are, therefore, examining the potential benefits that may accrue by tapping the agency arrangement route and the outsourcing route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming and hence put in place appropriate strategies and systems for managing these new risks.

Competition: With the ever increasing pace and extent of globalisation of the Indian economy and the systematic opening up of the Indian banking system to global competition, banks need to equip themselves to operate in the increasingly competitive environment. This will make it imperative for banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

iii) Technology: A few banks which have impressive branch networks have not been able to meet their customers’ expectations due to inefficiencies arising out of inadequate investment in technology and consequently faced an erosion of their market shares. The beneficiaries are those banks which have invested in technology. Another distinct advantage of use of technology is the ability to
effectively use quantitative techniques and models which can enhance the quality of their risk management systems. Recognising the benefits of modernising their technology infrastructure banks are taking the right initiatives. The challenge in this regard will be for banks to ensure that they derive maximum advantage out of their investments in technology and to avoid wasteful expenditure which might arise on account of

a. uncoordinated and piecemeal adoption of technology;
b. adoption of inappropriate/ inconsistent technology and
c. adoption of obsolete technology.

A case in point is the implementation of core banking solutions by some banks without assessing its scalability or adaptability to meet Basel II requirements.

iv) Basel II implementation: As you are aware, Basel II is the revised framework for capital adequacy for banks. Implementation of Basel II is seen as one of the significant challenges facing the banking sector in many jurisdictions. With the introduction of capital charge for market risks with effect from the year ended March 31, 2005 banks in India are compliant with all elements of Basel I. I will now outline the approach to Basel II implementation in India. Commercial banks in India will start implementing Basel II with effect from March 31, 2007. They will initially adopt the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk. After adequate skills are developed, both by the banks and also by the supervisors, some banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. Implementation of Basel
II will require more capital for banks in India due to the fact that operational risk is not captured under Basel I, and the capital charge for market risk was not prescribed until recently. Though last year has not been a very good year for banks, they are exploring all avenues for meeting the capital requirements under Basel II. The cushion available in the system, which has a CRAR of over 12 per cent now, is, however, comforting.

With a view to ensuring migration to Basel II in a non-disruptive manner, a consultative and participative approach has been adopted for both designing and implementing Basel II in India. A Steering Committee comprising senior officials from 14 banks (public, private and foreign) has been constituted wherein representation from the Indian Banks' Association and the RBI has also been ensured. The Steering Committee had formed sub-groups to address specific issues. On the basis of recommendations of the Steering Committee, draft guidelines to the banks on implementation of the New Capital Adequacy Framework have been issued. Though Basel II implementation is considered as a challenge generally, the above approach has lightened the burden on banks in India.

Notwithstanding the above, capacity building, both in banks and the regulatory bodies is a serious challenge, especially with regard to adoption of the advanced approaches. We have initiated supervisory capacity-building measures to identify the gaps and to assess as well as quantify the extent of additional capital which may be required to be maintained by such banks. The magnitude
of this task appears daunting since we have as many as 90 scheduled commercial banks in India.

v) Improving Risk Management Systems: With the increasing degree of deregulation and exposure of banks to various types of risks, efficient risk management systems have become essential. As you are aware, as a step towards further enhancing and fine-tuning risk management systems in banks, Reserve Bank has issued guidelines on asset-liability management and risk management systems in banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance Note on Operational risk management in 2005. Though Basel II focuses significantly on risks its implementation should not be seen as an end in itself. It should be seen as a medium whereby the risk management systems in banks are constantly upgraded to address the changing environment.

At the initial stages of development of the risk management systems, banks were managing each risk in isolation. The current business environment demands a more integrated approach to risk management. It is no longer sufficient to manage each risk independently or in functional silos. Enterprises worldwide are, therefore, now putting in place an integrated framework for risk management which is proactive, systematic and spans across the entire organisation. Banks in India are also moving from the individual silo system to an enterprise wide risk management system. This is placing greater demands on the risk management skills in banks and has brought to the forefront the need for capacity building. While the first milestone would be risk integration across the
entity, banks are also aware of the desirability of risk aggregation across the group both in the specific risk areas as also across the risks. Banks would be required to allocate significant resources towards this objective over the next few years.

In the Reserve Bank, we have adopted the risk based approach to supervision since 2003 and have brought about 23 banks under the fold of risk based supervision (RBS) on a pilot basis. On the basis of the feedback received from the pilot project, the RBS framework has now been reviewed. The risk based approach to supervision is also serving as a catalyst to banks’ migration to the integrated risk management systems. In view of the relevance of improved risk management systems under the changing circumstances and the larger emphasis placed on risk management systems in banks under Basel II, it is essential that the RBS stabilizes at an early date and serves as an important feedback not only to bank managements but also to RBI. However, taking into account the diversity in the Indian banking system, stabilizing the RBS as an effective supervisory mechanism will be a challenge to the RBI.

vi) Implementation of new accounting standards: Derivative activity in banks has been increasing at a brisk pace. While the risk management framework for derivative trading, which is a relatively new area for Indian banks (particularly in the more structured products), is an essential pre-requisite, the absence of clear accounting guidelines in this area is matter of significant concern. It is widely accepted that as the volume of transactions increases, which is happening in the Indian banking system, the need to upgrade the accounting framework needs no
emphasis. The World Bank’s ROSC on Accounting and Auditing in India has commented on the absence of an accounting standard which deals with recognition, measurement and disclosures pertaining to financial instruments. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting Standards on the above aspects pertaining to financial Instruments. These will be the Indian parallel to International Accounting Standards 32 and 39. The proposed Accounting Standards will be of considerable significance for financial entities and could therefore have implications for the financial sector. The formal introduction of these Accounting Standards by the ICAI is likely to take some time in view of the processes involved. In the meanwhile, the Reserve Bank is considering the need for banks and financial entities adopting the broad underlying principles of IAS 39. Since this is likely to give rise to some regulatory / prudential issues all relevant aspects are being comprehensively examined. The proposals in this regard would, as is normal, be discussed with the market participants before introduction. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank.

vii) Transparency and Disclosures: In pursuance of the Financial Sector Reforms introduced since 1991 and in order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated. The disclosure requirements broadly covered the following aspects:
- Capital adequacy
- Asset quality
- Maturity distribution of select items of assets and liabilities
- Profitability
- Country risk exposure
- Risk exposures in derivatives
- Segment reporting
- Related Party disclosures

With a view to moving closer towards international best practices including International Accounting Standards (IAS) and the disclosure requirements under Pillar 3 of Basel II, Reserve Bank has proposed enhanced disclosures which lay a greater emphasis on disclosure of certain qualitative aspects. Transparency and disclosure standards are also recognised as important constituents of a sound corporate governance mechanism. Banks are required to formulate a formal disclosure policy approved by the Board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency.

viii) Supervision of financial conglomerates: In view of increased focus on empowering supervisors to undertake consolidated supervision of bank groups and since the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision have underscored consolidated supervision as an independent principle, the Reserve Bank had introduced, as an initial step, consolidated accounting and other quantitative methods to facilitate
consolidated supervision. The components of consolidated supervision include, consolidated financial statements intended for public disclosure, consolidated prudential reports intended for supervisory assessment of risks and application of certain prudential regulations on group basis. In due course, consolidated supervision as introduced above would evolve to cover banks in mixed conglomerates, where the parent may be non-financial entities or parents may be financial entities coming under the jurisdiction of other regulators.

The financial landscape is increasingly witnessing entry of some of the bigger banks into other financial segments like merchant banking, insurance etc., which has made them financial conglomerates. Emergence of several new players with diversified presence across major segments and possibility of some of the non-banking institutions in the financial sector acquiring large enough proportions to have systemic impact make it imperative for supervision to be spread across various segments of the financial sector. In this direction, an inter-regulatory Working Group was constituted with members from RBI, SEBI and IRDA. The framework proposed by the Group will be complementary to the existing regulatory structure wherein the individual entities are regulated by the respective regulators and the identified financial conglomerates would be subjected to focussed regulatory oversight through a mechanism of inter-regulatory exchange of information. As a first step in this direction, an inter-agency Working Group on Financial Conglomerates (FC) comprising the above three supervisory bodies identified 23 FCs and a pilot process for obtaining information from these conglomerates has been initiated. The complexities involved in the supervision of financial conglomerates are a challenge not only to the Reserve Bank of India but
also to the other regulatory agencies, which need to have a close and continued coordination on an on-going basis.

ix) 'Know Your Customer' (KYC) Guidelines – Anti Money Laundering Standards: Banks were advised in 2002 to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority. These ‘Know Your Customer’ guidelines were revisited in the context of the recommendations made by the Financial Action Task Force on Anti Money Laundering standards and on Combating Financing of Terrorism. These standards have become the international benchmark for framing Anti Money Laundering and combating financing of terrorism policies by the regulatory authorities. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Detailed guidelines based on the Recommendations of the Financial Action Task Force and the paper issued on Customer Due Diligence for banks by the Basel Committee on Banking Supervision, with indicative suggestions wherever considered necessary, were issued to banks in November 2004. Banks were required to ensure that a proper policy framework on ‘Know Your Customer’ and Anti-Money Laundering measures is formulated and put in place with the approval of the Board within three months and be fully compliant with these guidelines before December 31, 2005. Compliance with the above is a significant challenge to the entire banking industry to fortify itself against misuse by anti-social persons/entities and thus project a picture of solidarity and financial integrity of the Indian banking system to the international community.
Corporate Governance: Banks are “special” as they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. In view of the above, legal prescriptions for ownership and governance of banks laid down in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time. In this context, one must remember that profit motive should not be the sole criterion for business decisions. Flow of bank finance for productive purposes must always take priority over the granting of credit for speculative investment no matter how profitable the latter may be. If bank finance flows increasingly to finance speculative activities, it will be to the detriment of real productive investment for research, development and the production of real goods/services. One might conclude that such uncontrolled flow would ultimately affect economic growth. Hence, funding of speculative activities must be subject to prudential limits, even though it might yield attractive returns. This will be a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of corporate governance. If the internal imbalances are not re-balanced immediately, the correction may evolve through external forces and may be painful and costly to all stakeholders. The focus, therefore, should be on enhancing and fortifying operation of the principles of sound corporate governance.