CHAPTER 1

INTRODUCTION

This chapter deals with the history of co-operative movement, especially co-operative credit and the regulatory bodies that controls it. The importance of Urban Co-operative Banks is emphasized and the significance of member satisfaction is reiterated. The purpose of the study is delineated and the contribution the research aspires to the academic and practitioners’ worlds are detailed. The chapter concludes with a thesis outline where the details of the coming chapters are summarized.

1.1 THE HISTORICAL BACKGROUND

Co-operative credit, as an organized system, had its origin in Germany about the middle of the nineteenth century. Two men- Raiffeisen and Schulze- started independently about the same time to work out a system of credit on co-operative lines, the former, in the main, for poor peasants, the latter for artisans and small tradesmen (Mukherji 1917).

1.1.1 The Raiffeisen Banks of Germany

Raiffeisen (1818-1888) with whose name rural co-operative banks have become associated, began his co-operative career in the winter of 1847-48 with the foundation of a benevolent society in a small village for obtaining corn and potatoes and selling them at low prices to the poorer inhabitants. He eventually developed a loan society at Aahausen (1862) in which the fundamental co-operative idea of the collective liability of the borrowers
came into existence. Before describing the essential features of the Raiffeisen system we should have a full grasp of the meaning of personal credit which lies at the basis of the Raiffeisen system. ‘Credit’ may be briefly defined as a man’s power of borrowing. Credit in the form of a loan always requires some form of security, expressed or implied, given by the borrower to the lender, that the money borrowed will be duly repaid. This security may take various forms, like mortgage credit for immovable properties, chattel credit for movable property and personal credit when it is based on the status, position, means or character of the person seeking credit. The effort of Raiffeisen was to capitalize this personal credit by combining personal credits of the borrower.

Briefly speaking, the principles of the Raiffeisen system may be summarized as follows

1. The unlimited liability of all members for all indebtedness of their particular society.
2. Limitation of membership to one community or village, to secure mutual personal knowledge of the standing of the members.
3. Loans only for productive purposes.
4. Loans only to members.
5. Short-term credit on personal guarantee.
6. Credit for long periods with facilities for repayment by installment.
7. Absence of profit seeking: dividends, if paid, being limited.
8. All profit is carried to a permanent indivisible reserve fund, which belongs to the society as a whole.
Office holders, except the treasurer, not paid for their services.

Promotion of moral as well as material advancement of members.

1.1.2 The Schulze-Delitzsch System of Urban Banks in Germany

While Raiffeisen adapted co-operation to the needs and to the mental attitudes of the farmers, Schulze-Delitzsch devised organizations specially suited to the needs and economic character of town-dwellers. The Schulze-Delitzsch banks had, therefore, unlike the Raiffeisen banks, a large range of business in an extended area of operations: they included members of various occupations; they accumulated a considerable quantity of capital and they distributed fairly high dividends. They did not follow the principle of unpaid management; on the contrary, their management was rather costly and was conducted on strict business lines. They were based on limited liability and their business approached more closely than that of the Raiffeisen banks to banking business, properly called. There were in 1911, 952 such banks in Germany.

1.1.3 The Credit Unions of United States of America (U.S.A.)

In the United States the leading role was played by Edward A. Filene, the Boston merchant. Mr. Filene was a combination of altruist and businessman. His favourite thesis was that maintenance of mass consumer’s buying power is a social as well as economic necessity. Travelling to India in 1907 he learned of groups using a mutual aid system based on two plans devised in Germany namely that of Raiffeisen banking system and Schulze-Delitzsch system. Inspired with his discovery, Filene returned home and during the remainder of his life personally contributed over a million dollars
for the dissemination of the credit union concept in America. Enabling legislation was granted in 1909 in the state of Massachusetts and within 2 years 17 credit unions were operating in the state. In 1934, Congress enacted the federal Credit Union Law. As of 2008 in the U.S., there were over 9,000 credit unions with 89 million members comprising 43.7 percent of the economically active population. This makes U.S.A. one of the most active nations with urban co-operative banking gaining wide popularity.

1.1.4 The Early History of Growth of Primary Credit Societies in India

According to the census of 1911 agriculturists in India numbered twenty two and a half Crores and they formed 71 per cent of the total population in the whole of India including the native states. The agriculturists had to borrow for cultivation of crops, but the credit they could offer was very small. The reasons were as follow (1) the ignorance of the agriculturists; (2) their distance from the towns where the banks were situated; (3) the reluctance of the banks to extend small transactions to villages among an ignorant people; and (4) the want of sufficient knowledge regarding the substance or integrity of the borrower.

So to get credit, the Indian agriculturists were dependant on the village money lender and it was estimated by the Famine Commission of 1880 that about one-third of the land-owning class is deeply and inextricably in debt and that an equal portion is in debt, though not beyond the power of recovering themselves. A special difficulty arose from the fact that the agriculturists wanted loans for other purposes than agriculture: like wedding and other ceremonies. Also they were often forced to sell at distress prices to the money lender himself and cheated in the weighment as in the rates. The poor artisans in the village were also in a similar trap and bought raw
materials on credit from the moneylender and because of the pressing demands of the moneylender sold at cheap rates to him.

So it was a case of the Indian artisan and cultivator buying their finance dearly and selling their produce dearly while normal business sense dictates that one must buy one’s finance cheap and sell one’s produce dearly. The reason for this deplorable state of affairs is to be found in the villager’s want of thrift. It can be detailed as a want of training as to save and put by, hereditary instincts and customs of extravagance at wedding and other ceremonies which are prevalent even in these, modern days and above all, a safe place where to keep the savings. Added to it was the defects in the moneylender’s approach of (1) giving inadequate loans (2) defrauding the borrower at every turn (3) not willing to receive repayment in small installments and (4) giving loans for unproductive purposes like marriage with a view of entrapping the borrower.

Indigenous Mutual Loan Funds, named *Nidhis*, had originated in Madras about the middle of the last century when Raiffeisen and Schulze-Delitzsch were initiating the co-operative movement in Germany. But the fundamental principle namely, that of association for mutual credit is found in the indigenous “*kutthu-chittu*” system which was universal throughout the Madras Presidency. The latter system depended upon (1) association, (2) confidence and (3) honest dealing. Briefly the system was as follows- a number of men unite to subscribe periodically a small sum each; say fifty men agree to pay one thousand rupees per month for fifty months; each month fifty thousand rupees are subscribed and lots are drawn for the total sum; the winning lot takes the pool; next month the same fifty subscribe, but in drawing for the pool previous winners are excluded; this continuous for the whole fifty months till each subscriber has received fifty thousand rupees. A
further development of the system was when the promoters of the fund desired to obtain definite and increased profits for themselves, drawn from the need of the subscribers; instead, therefore, of drawing for the pool, it was put up to auction; the lowest bidder took the lowest sum below fifty thousand rupees, say forty thousand rupees, but gave a chit or promissory note for fifty thousand rupees. The difference, ten thousand rupees was divided as profit among the other members.

The first Nidhi further developed the system. About 1850, certain employees discovered they were being ruined by the usurers and determined to start a fund to give persons of fixed income a chance of borrowing at equitable rates. The first fund was a “terminating” society with a seven year’s period; each subscriber agreed to pay for 84 months, when the fund would be wound up and shares repaid. From the collection loans were granted to members at 6.25 per cent interest with penalties for delay. The loans, repayable by monthly subscriptions, were usually on mortgage and the order of granting them was determined by lot. The next step was to make the societies “permanent”. The shares were periodically and frequently issued and it was these only and not the society, which were wound up as each series matured so that subscribers were continuously coming in and going out. The essence of these societies was mutuality; it was a group of men united to help one another by a common contribution of funds which were to be lent out to members only for their sole benefit; all profits derived from the transactions were to return to members, so that all benefit; the non-borrowing members by the receipt of profits, the borrowing members by the use of the loaned capital and a portion of the profits which they had contributed to the society.

These Nidhis found their clients among a more educated and advanced class than the rural agriculturists, to whose needs their constitution
is not well adapted. They achieved a considerable degree of success (In 1903 they included some 36,000 members with a paid up capital of 75 lakhs), suggesting to the high officials the possibility of establishing true co-operatives credit societies among the Indian people.

Accordingly a committee was set up with Sir Edward Law as the president. The committee confined their attention to banking on the basis of co-operative credit because “agricultural banks” which had been so successful in improving the condition of the poorer classes in European countries rested on co-operative credit. They accordingly accepted the establishment of Co-operative Credit Societies as the object in view and considered the lines on which such societies should be worked, the privileges which should be accorded to them and the extent to which it might be advisable that they should be aided by Government funds and subjected to Government control. They embodied the result of their deliberations in the form of a draft bill.

1.1.4.1 The Co-operative Credit Societies Act of 1904

The result was the Co-operative Credit Societies Act of 1904. When Lord Curzon was the viceroy of India, the bill was passed by the Indian Legislature on the 25th of March, 1904 “to encourage thrift, self-help and co-operation among agriculturists, artisans and persons of limited means”. By this Act Local Governments were empowered to appoint Registers of co-operative credit societies, whose duty it would be to scrutinize applications for registration under the Act. Subject to the provision that any association of not less than ten persons might be registered by special order of a Local Government, the Act laid out that a society should consist of people residing in the same town or village or the same group of villages, or subject to the sanction of the Registrar, of the members of the same tribe, class or caste. Societies were classed as “rural” or “urban,” and it was laid down that four-
fifths of the members must be, in the first case, agriculturists and in the
second case, non-agriculturists. In the case of rural societies the liability was
to be unlimited, unless a departure from this rule were specially sanctioned by
the Local Government; in the case of the urban societies, liability might be
either limited or unlimited, as might be provided by bye-laws or rules made
under the Act. Limitations were placed on the interest in a society that might
be held by a single member and on the transfer of shares. Privileges included
the exemption of a member’s shares or other interests in the capital of a
society from attachment for private debts, the grant to societies of a measure
of priority over ordinary creditors in enforcing claims on crops, cattle etc and
the provision from exemption, at the discretion of the Government of India,
from income tax, stamp duties and registration fees. Provision was made for
compulsory inspection and audit by the Registrar, for compulsory dissolution
subject to appeal by the Local Government and for liquidation under a simple
procedure; finally, wide rule-making powers were conferred upon Local
Governments. The policy of the Government underlying the above provisions
had been to allow the utmost freedom to organizers in each case to start their
society on such lines as appeared to them suitable, provided that the rules
framed did not contravene the Act in any essential matter.

1.1.4.2 The Co-operative Societies Act of 1912

By 1906, 800 societies had sprung into existence. The numbers
steadily from year to year and before long the provisions of the law were
found to be in some respects faulty and in others inadequate. The need for a
free supply of capital had led to the formation of various central agencies to
finance and control the individual credit societies and the Act of 1904
provided no formal recognition of joint or central societies formed of other
societies. The distinction in treatment between rural and urban societies was
found in practice to be unnecessary and a more scientific distinction based on the nature of the liability of the members, whether limited or unlimited, was adopted in its place. There was, moreover, no provision in the old Act for any form of co-operation other than co-operative credit. To remedy these and other minor defects which experience had brought to light, a new Act was passed in 1912, which made provisions for the expansion of the movement and whose principle features were that it authorized the registration of co-operative associations for purposes other than credit, removed the former arbitrary classification of societies as urban and rural and substituted for it a scientific distinction based on the nature of the liability adopted and finally it legalized registration of unions, central banking unions and central banks. Because of the introduction of this Act, the number of co-operative societies in British India had increased by 1915 to 17,327, the number of members to 824,469 and the working capital Rs. 8,96,61,722. Under Reforms Act 1919 co-operation became a state subject.

1.1.5 The Early History Of Growth of Primary Credit Societies in Kerala

The present day Kerala State consists of the old Travancore State, the Cochin state and the Malabar province of the Madras State. Since Travancore and Cochin were free princely states, before the Montague-Chelmsford reforms of 1918 were implemented co-operative laws were passed in these states. In Cochin it was called the Cochin co-operative societies act of 1913. The Edavanakkad Service Sahakarana Bank Ltd. No.1 was the first society to be registered under this act. In 1914 in Travancore state also a co-operative society’s act was passed and Travancore Centre Co-operative Bank was the first society to be registered. It was a primary level co-operative with individuals as members. It is now apex body
called the Kerala State Co-operative Bank Ltd. In 1\textsuperscript{st} of July 1949, Travancore-Cochin State came into existence combining the erstwhile Travancore and Cochin states. In 1952, Travancore-Cochin Co-operative Societies Act was passed. In 1\textsuperscript{st} of November 1956, Kerala state was formed based on the State Reorganization act of 1956 where states were realigned according to linguistic basis. At that time in Malabar there was Madras Co-operative Societies Act 1932 and in Travancore-Cochin, Travancore-Cochin Co-operative Societies 1952 were in force. So a uniform law for the Kerala state became necessary.

1.1.5.1 The Kerala Co-operative Societies Act of 1969

The Kerala Co-operative Societies Act of 1969 came into force with effect from 15.5.1969 in order to enact a uniform law on cooperation applicable throughout the State. Consequent to its introduction, Societies with unlimited liability ceased to exist and societies with limited liability came into existence. Also, organization and control came under the Registrar of Co-operative, who is a state employee heading the Department of Co-operation.

There are essentially two types of co-operative banks giving short term credit with individuals as members (primary membership), Urban Co-operative Banks (UCBs) and Primary Agricultural Credit Societies (PACSs). UCBs are stand alone entities catering to urban population where as PACSs are part of a three-tier system catering to the rural population as shown in Figure 1.1 "*" indicates the type of banks with primary membership.
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UCBs: Urban Co-operative Banks
St CBs: State Co-operative Banks
DCCBs: District Central Co-operative Banks
PACS: Primary Agricultural Co-operative Societies
*No. in parenthesis represents the no. of banks.

Figure 1.1 Co-operative Banks of India (As at end-March 2011)
Source: RBI-The Trend and Progress of Banking (2011)

1.1.6 The Present Status of Urban Co-operative Banks in India

Reserve Bank of India (RBI), India’s central bank, has kept track of the growth of UCBs of India. There are 1645 UCBs as at end-march 2011 according to RBI’s annual report “The Trend and Progress of Banking” (2011). The position of UCBs of India is compared with the commercial banks of India in terms of the loans and advances outstanding below in
Table 1.1. The source of Information is the same. Figure No. 1.2 shows the same information as a pie diagram.

**Table 1.1 Loans and Advances- Scheduled Commercial Banks and UCBs**

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<th>Sl. No.</th>
<th>Public Sector Banks</th>
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Source: RBI-The Trend and Progress of Banking (2011) (as on end March 2011)

**Figure 1.2 Loans and Advances- Scheduled Commercial Banks and UCBs**

Source: RBI-The Trend and Progress of Banking (2011) (as on end-March 2011)

The same source, "The Trend and Progress of Banking" (2011), shows the latest state-wise distribution of UCBs and pertinent details in Table 1.2.
Table 1.2 State-wise distribution of UCBs

<table>
<thead>
<tr>
<th>State</th>
<th>Total No. of UCBs</th>
<th>Total No. of branches</th>
<th>Total No. of ATMs</th>
<th>No. of districts with UCB</th>
<th>No. of districts without UCB</th>
<th>Deposits (Rs. Cr.)</th>
<th>Loans and Advances (Rs. Cr.)</th>
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<td>2</td>
<td>22</td>
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<td>33</td>
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<tr>
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<td>2</td>
<td>8</td>
<td>10</td>
<td>369</td>
<td>120</td>
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Source: RBI-The Trend and Progress of Banking (2011) (as on end March 2011)
The total number of UCBs is 1645. The total loans and advances extended by Indian UCBs to the members is Rs. 136,341 Crores. It can be observed that in terms of the loans and advances, the two leading states are Maharashtra and Gujarat. Together, they contribute to 75.92% of the total advances extended by UCBs in India. Kerala comes in the fifth position after Karnataka and Andhra Pradesh with 2.82% of the total loans and advances.

1.1.6.1 The role of Reserve Bank of India (RBI)

There are two regulatory bodies exercising control over UCBs. RBI exercises control through the Banking Regulation Act, (BRA) 1949 and as Applicable to Co-operative Banking (AACB) 1969. Large Urban Co-operative Banks with paid up share capital and reserves of Rs 1 lakh were brought under the purview of the Act with effect from 1st March 1966 and within the ambit of the RBI’s supervision. This marked the beginning of an era of duality of control over these banks. Now RBI has a proper Urban Bank department through which audit control (regulating, supervising and developmental) is exercised over all the Urban Banks in India. Banking related functions like licensing, area of operations, interest rates etc are governed by RBI where as registration, management, audit and liquidation are governed by the respective state co-operative acts.

1.1.6.2 The Role of Registrar of Co-operatives, Kerala

The second regulatory body is the Department of Co-operatives, Kerala State. It may be noted that there is no central government’s regulatory body to control urban co-operative banks. The registrar is empowered with the right to exercise all of the powers as provided in the Kerala Co-operative Societies Act, 1969 and the Rules thereon.
The main powers are registration of co-operative societies, amendment of byelaws of co-operative societies, conduct of elections in societies, providing state aid to co-operatives, audit of co-operatives, arbitration, execution, liquidation and inspection, supervision of co-operatives. The Registrar, with the assistance of Additional Registrars, Joint Registrar, Deputy Registrars, Assistant Registrars and other subordinates perform all these functions.

Apart from the employees of Department of co-operation, about 36000 employees are working in various co-operative institutions functioning under the control of the department. Section 80 of Kerala Co-operative Societies Act has been implemented in these co-operatives fixing their salaries, service regularization etc. Welfare fund and pension schemes have been implemented in co-operatives functioning under the administrative control of Registrar of Co-operative Societies.

1.2 Importance of Urban Co-operative Banking

The Co-operative Banks of India have been vested with the vital role of extending credit facility to the weaker segments of the population by the state. As far as UCBs are concerned, its members are mainly in the priority sector defined as owners of small scale and cottage industries, small traders, self-employed people, professionals and the weaker sections of the urban community like dalits, women, handicapped etc. Thus one of the primary goals of a Co-operative Bank in India is to provide cheap and easy credit to its members. Now the question rises, whether, in the quest for bank performance and protection to depositors, it is possible to lose focus on this goal and dissatisfy the members. UCBs, as mentioned in the introductory chapter, are having primary membership only. So retention of co-operative nature in this category assumes importance.
RBI itself has identified the preservation of the co-operative nature as crucial to UCBs according to Madhav Rao Committee Report (1999). It was implicitly acknowledged that it is impossible to satisfy members without retaining this nature. In other words, emphasis on performance, depositor protection and financial system stability may result in UCBs succeeding as banks but losing their social commitment as part of the larger co-operative movement. This may even eventually transform the average successful UCB into yet another commercial bank.

This may result in the relative deprival of credit to the priority sector which has lower creditworthiness compared to the corporate world. An illustration of this phenomenon is follows. It was earlier mandatory for UCBs to have 60% of net bank credit to priority sector. The weaker sections get 25% of this priority sector lending. From 2010 onwards, by a circular of the RBI, priority sector gets only 40% on par with commercial banks. And correspondingly the weaker sections get underrepresented.

1.3 SIGNIFICANCE OF MEMBER SATISFACTION

RBI has been closely monitoring the urban bank performance all these years using objective parameters. It has basically been concentrating on the CAMELS (C-Capital Adequacy, A-Asset Quality, M-Management, E-Earnings, L-Liquidity, S-Systems and Control) rating to evaluate the performance of the UCBs, right from the time of the Report of the Working Committee on the Rating system for Urban Co-operative Banks (2002).

However it has not, as on date, looked into measuring a critical, but invisible, parameter which has a sustained effect on the long-term success of any UCB. That is the satisfaction level of the members of the Co-operative Banks. State Governments which also share responsibility for the UCBs have also not studied Member Satisfaction.
1.4 PURPOSE OF THE STUDY

The researcher endeavours to develop a robust scale to measure member satisfaction prevailing among the members of UCBs regarding their relation to and with the UCBs and hence, to measure the current level of member satisfaction prevailing among the Kerala based UCBs. Such an attempt has not been undertaken in India till date to the knowledge of the researcher after doing an exhaustive literature review.

The researcher proposes a domain for the ‘Member Satisfaction in Urban Co-operative Banks’ construct and provide definitions of its components. Following the scaling procedures recommended in the literature (Nunnally 1978; Churchill 1979; Gerbing and Anderson 1988; Clark and Watson 1995; Netemeyer et al 2003), a reliable, valid and parsimonious measure of the ‘Member Satisfaction in Urban Co-operative Banks’ construct is developed. As mentioned, the member satisfaction level currently prevailing in Kerala is assessed. Finally the impact of member profile and bank profile is studied.

1.5 THESIS OUTLINE

First chapter provides an introduction and overview of the development of the co-operative credit movement in the world in general and in India in particular. This chapter puts the entire study in a proper perspective by delineating the purpose of the research and the contribution the researcher aspires to achieve.

Second chapter presents a detailed review of the extant literature on member satisfaction and builds a conceptual model incorporating member trust, member satisfaction and organizational performance. The review helps identify the research gaps and establishes the need for this research. In this
chapter, we have delineated the content domain and provide definitions of the focal construct and its components.

Third chapter details the objectives, scaling procedures and methodology. The research design, research settings, unit of analysis, sampling frame, key informant, data collection instruments, survey procedures and measures of the constructs used in this research procedures for determination of member satisfaction level of UCBs and the impact of member and bank profiles on member satisfaction are discussed.

In chapter four, the results from the exploratory study and confirmatory study were analyzed and reported. The “Member Satisfaction in Urban Co-operative Banks” scale was finalized.

In chapter five the member satisfaction level in Kerala based UCBs is measured and the impact of member profile and bank profile on UCBs are studied.

Sixth chapter provides a discussion of the finding, suggestions, conclusions and implications of the research and its limitations.

This report is concluded with references and a set of relevant appendices.