CHAPTER I

INTRODUCTION
INTRODUCTION

1.1 Co-operatives – Concept and Concern:

The Rural Credit Survey Committee (1954), the first comprehensive inquiry into problems of rural credit, after a detailed examination of the entire gamut of issues including the social ethos of rural society, summed up its findings in the celebrated dictum that “cooperation has failed, but cooperation must succeed”. Cooperation in India was introduced by the government as a policy, which later turned into movement, mainly to combat rural indebtedness of the downtrodden.

Cooperation has been called an economic miracle of the Nineteenth Century. It has been perceived as a superior alternative to capitalism, socialism and communism because it is said to remove the defects of these systems while retaining their advantages. It has also been regarded as a corrective to Statism. On the face of it, the principles of cooperation such as equality of members, one man one vote and ownership of business by workers, customers or members, have attracted many people towards the co-operatives.

In the new millennium, the co-operatives have to play a pivotal role and act as agencies of economic growth, creating wealth and employment especially in the rural areas. The co-operatives have inherent advantages in tackling the problems of poverty alleviation,
food security and employment generation. Co-operatives are also considered to have immense potential to deliver goods and services in areas where both the state and the private sector have failed.5

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.6 Some of the problems of typical co-operatives today are: the multi-purpose vertical federal structure, concentration and centralization, state-sponsorship and state-dependence, top-to-bottom approach, outside leadership, lack of spontaneity, failure to serve the neediest social strata, commercialization, agent-status, consumerism, power politics and corruption.7

Internal and structural weaknesses of co-operatives, wide regional imbalances combined with lack of proper policy support had neutralized their positive impact. This had necessitated the need for a clear-cut National Policy on co-operatives. The objectives and salient features of the comprehensive National Policy on Co-operatives (April 2002), announced by Government of India is as follows. Co-operatives would be provided necessary support, encouragement and assistance so as to ensure that they work as autonomous, self-reliant and democratically managed institutions accountable to

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their members and make a significant contribution to the national economy.

The policy aims at ensuring the functions of co-operatives based on the Manchester Declaration of International Co-operative Alliance 1995 (Voluntary and open membership, democratic member control, members' economic participation, autonomy and independence, education, training and information, cooperation among co-operatives and concern for community).  

1.2 Role of Institutional Credit to Agriculture in India:

Agriculture sector is the backbone of Indian Economy and it has to be competitive in the backdrop of globalization and consequent reforms. The government has emphasized an added priority for agriculture in the coming years. The overall growth rate of about 9 per cent proposed in the 11th five year plan (2007-2012) can be achieved only if agriculture growth is maintained around four per cent while the current rate is only 2.7 per cent. In this context, it is high time to revamp the institutional credit for agriculture particularly the investment credit so as to meet the global and domestic challenges.  

Clearly, credit requirement has increased manifold in rural India since independence owing to endurance of the 'agricultural and rural development' to be one of the main objectives of economic planning. To make this increasing requirement fulfilled, multi-agency approach to

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rural credit has been adopted. As a result of this approach various formal agencies have entered the field of rural credit till the date.¹⁰

Credit has been considered not only one of the critical inputs in agriculture, but also an effective means of economic transformation. A large number of agencies, including Co-operatives, Regional Rural Banks, Commercial Banks, Non-Banking Financial Institutions, Self-Help Groups (SHGs) and well spread informal credit outlets together represent Indian rural credit delivery system. These networks, apart from working as financial intermediaries, also play a key developmental role in the economy.¹¹

### Table 1.1
Credit Flow to Agriculture from Different Sources in India

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Non-Institutional</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money Lenders</td>
<td>92.7</td>
<td>81.3</td>
<td>68.3</td>
<td>36.8</td>
<td>33.7</td>
<td>38.9</td>
</tr>
<tr>
<td>Money Lenders</td>
<td>69.7</td>
<td>49.2</td>
<td>36.1</td>
<td>16.1</td>
<td>17.5</td>
<td>26.8</td>
</tr>
<tr>
<td>Traders</td>
<td>5.5</td>
<td>8.8</td>
<td>8.4</td>
<td>3.2</td>
<td>2.2</td>
<td>--</td>
</tr>
<tr>
<td>Traders</td>
<td>14.2</td>
<td>8.8</td>
<td>13.1</td>
<td>8.7</td>
<td>4.6</td>
<td>--</td>
</tr>
<tr>
<td>Relatives/Friends</td>
<td>3.3</td>
<td>14.5</td>
<td>10.7</td>
<td>8.8</td>
<td>6.3</td>
<td>--</td>
</tr>
<tr>
<td>Landlords and Others</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>3.1</td>
<td>--</td>
</tr>
<tr>
<td><strong>B. Institutional</strong></td>
<td>7.3</td>
<td>18.7</td>
<td>31.7</td>
<td>63.2</td>
<td>66.3</td>
<td>61.1</td>
</tr>
<tr>
<td>Government, etc.,</td>
<td>3.1</td>
<td>15.5</td>
<td>7.1</td>
<td>3.9</td>
<td>5.7</td>
<td>--</td>
</tr>
<tr>
<td>Co-operative Society/Bank</td>
<td>3.3</td>
<td>2.6</td>
<td>22.0</td>
<td>29.8</td>
<td>23.6</td>
<td>30.2</td>
</tr>
<tr>
<td>Commercial Banks, etc.</td>
<td>0.9</td>
<td>0.6</td>
<td>2.4</td>
<td>28.8</td>
<td>35.2</td>
<td>26.3</td>
</tr>
<tr>
<td>Others</td>
<td>--</td>
<td>--</td>
<td>0.2</td>
<td>0.7</td>
<td>1.8</td>
<td>--</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: All India Debt and Investment surveys (AIDIS, 2002).

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Institutional credit to agriculture witnessed a remarkable growth after nationalization, but still a large number of rural populations especially the marginal farmers are out of reach of institutional credit and depend upon informal sources for their credit requirements. All-India Debt and Investment Survey (AIDIS) 2002, which provide the magnitude of the dependence of rural farmers on different sources for
their credit requirements, reveal that the share of non-institutional sources in credit supply to agriculture has declined from about 92.7% in 1951 to about 38.9% in 2002 (table 1.1). This shows that still informal sources have an important place in agriculture credit market and institutional sources are unable to provide adequate credit to the farmers and in this situation the farmers are left with no alternatives but to move to the unorganized market.

The important informal sources are professional moneylenders, landlords, input suppliers, commission agents and also the large farmers. These sources especially the moneylenders have a great hold on farmers. They particularly small and marginal farmers do feel it convenient to borrow from these informal sources as they can obtain money from them at any time and even without any security.

According to Situation Assessment Survey of Farmers (ASFs), conducted by NSSO (National Sample Survey Organization) (2003), moneylenders are the second important source of credit to farmers, contributing about 26% of the total outstanding loans followed by the banks. These informal sources charge exorbitant rate of interest, exploit them and also sometimes grab the land of the debt stricken farmers.12

Table 1.2
Farm Credit Disbursements by Co-operatives, Commercial Banks & Regional Rural Banks in India ($ in Million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Co-op. Banks</th>
<th>Com. Banks</th>
<th>RRBs</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>235,240</td>
<td>335,870</td>
<td>48,540</td>
<td>800</td>
<td>620,450</td>
</tr>
<tr>
<td></td>
<td>(37.91)</td>
<td>(54.13)</td>
<td>(7.82)</td>
<td>(0.14)</td>
<td>(100)</td>
</tr>
<tr>
<td>2002-03</td>
<td>236,360</td>
<td>397,740</td>
<td>60,700</td>
<td>800</td>
<td>695,600</td>
</tr>
<tr>
<td></td>
<td>(34.00)</td>
<td>(57.18)</td>
<td>(8.72)</td>
<td>(0.10)</td>
<td>(100)</td>
</tr>
<tr>
<td>2003-04</td>
<td>268,750</td>
<td>524,410</td>
<td>75,810</td>
<td>840</td>
<td>869,810</td>
</tr>
<tr>
<td></td>
<td>(30.91)</td>
<td>(60.29)</td>
<td>(8.71)</td>
<td>(0.09)</td>
<td>(100)</td>
</tr>
<tr>
<td>2004-05</td>
<td>312,310</td>
<td>814,810</td>
<td>124,040</td>
<td>1,930</td>
<td>1,253,090</td>
</tr>
<tr>
<td></td>
<td>(24.92)</td>
<td>(65.02)</td>
<td>(9.15)</td>
<td>(0.15)</td>
<td>(100)</td>
</tr>
<tr>
<td>2005-06*</td>
<td>372,520</td>
<td>1,061,520</td>
<td>140,760</td>
<td>NA</td>
<td>1,574,800</td>
</tr>
<tr>
<td></td>
<td>(23.65)</td>
<td>(67.41)</td>
<td>(8.94)</td>
<td></td>
<td>(100)</td>
</tr>
<tr>
<td>Total</td>
<td>1,425,180</td>
<td>3,134,350</td>
<td>449,850</td>
<td>4,370</td>
<td>5,013,750</td>
</tr>
<tr>
<td>Share</td>
<td>(28.42)</td>
<td>(62.52)</td>
<td>(8.97)</td>
<td>(0.09)</td>
<td>(100)</td>
</tr>
</tbody>
</table>

Figures in bracket indicate % share to total
N.A: Not Available
*Provisional figures

Chart 1.3
Farm Credit Disbursements by Co-operatives, Commercial Banks & Regional Rural Banks in India
(Total Share)
The share of co-operatives in the total disbursements of short-term and long-term credit progressively declined from 37.91% in 2001-02 to 23.65% in 2005-06, whereas that of commercial banks recorded progressive increase from 54.13% to 67.41% during the corresponding years. RRBs accounted for 7.82% in 2001-02, which progressively rose to 9.91% in 2004-05, but it declined by one percentage in the following year.13 Since the RBI (Reserve Bank of India) policy (1998) of priority sector lending is related to the level of net bank advances and in turn to the level of bank deposits of banks, the policy of RBI played the primary role in determining the flow of institutional finance to agriculture.14

The NABARD (National Bank for Agriculture and Rural Development) deals with policy, planning and operational aspects in flow of credit for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts and allied economic activities in rural areas. As an apex Institution in rural credit structure, NABARD provides refinance facilities to various financial institutions which provide loans to agriculture and rural areas.15 NABARD has been giving lot of emphasis to the viability of various rural financial institutions for bringing development in the rural areas.

Among various alternatives, Development Action Plans (DAPs) have been considered one of the suitable mechanism through which viability of rural institutions could be analyzed and planned. Keeping the viability in mind, almost all the rural banking institutions have

signed the Memorandum of Understanding (MOU) and have been preparing the DAPs since 1993-94. Through the DAP, banks have been able to prepare specific plans of their institutions by considering their strengths and weakness etc.16

1.3 Origin and Growth of Co-operative Credit Institutions in India:

It is an open secret that, co-operative movement is gearing towards twenty first century and nearing a century old in India since it gained momentum through the passing of the Co-operative Societies Act in 1904, with a view of providing funds to “Agriculturists for agricultural operations and allied sectors at the lowest lending rate of interest”. Moreover, it is aimed at protecting rural farming communities from the clutches of moneylenders. Furthermore, co-operative finance is the cheapest, accessible, manageable and best source of rural credit supply with incomparable low rate of interest.17

Co-operative banks in India are registered under the Co-operative Societies Act. The co-operative bank is also regulated by the RBI. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.18 The co-operative banking system aims at mobilization of savings from the middle-income groups and provides credit requirement to the middle and economically weaker sections of the society. Thus, it occupies an important position in the financial system of the economy.19

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The Vaidyanathan Committee (2004)\textsuperscript{20} divided the rural co-operative credit movement into four phases:

\begin{itemize}
  \item 1900-30, the Co-operative Society Act 1904 was passed and cooperation became a provincial subject by 1919.
  \item 1930-50, signs of sickness in Indian rural co-operative movement were becoming evident. RBI was set up in 1935 and played a pioneering role in supporting the co-operatives.
  \item 1950-90, The All India Rural Credit Survey (1954) recommended state partnership and GOI's (Government of India) 1989 loan waiver scheme set an unhealthy precedent. Co-operatives were used by states to channel its' development schemes. Commercial Banks (1969) & RRBs (1975) entered rural areas. NABARD was set up in 1982.
  \item The fourth phase from 1990's onward was a period of reforms/liberalization and saw an increasing realization of the disruptive of state interference and politicization of co-operatives. A number of committees were set up to suggest reforms in this sector.\textsuperscript{21}
\end{itemize}

In a developing country like India with huge deficits in terms of quality and quantity, the state has to shoulder the primary responsibility of providing credit through co-operatives. Considering the low living standards of common man, incomplete and imperfect markets and other socio political considerations it is the primary duty of the government to ensure that its citizens have easy access to co-operative credit.\textsuperscript{22} Capital deficiency is one of the causes for underdevelopment and backwardness in developing countries.

\textsuperscript{21} Mallika Kumar, "Rural Co-operative Credit", \textit{Yojana}, Vol.51, Sep, 2007, P.52.
Capital formation has three important stages: saving, financing and investment. Financial institutions in general and banking sector in particular play a strategic role in the financing stage of capital formation. In the banking sector, co-operative banks undertake the responsibility of mobilizing the scarce savings of the community and canalizing these savings for purpose of productive investment in the economy.23

Co-operatives form the major component of the institutional rural credit system in our country, the other components being commercial banks and Regional Rural Banks. Co-operatives offer short-term and long-term credit through two separate channels whereas the other two agencies offer all types of credit without separate channels. The evolution of long-term and short-term co-operative structures has distinct historic antecedents.24

The Co-operative Banks in India started functioning almost hundred years ago. The co-operative bank is an important constituent of the Indian financial system. Some Co-operative Banks in India are more forward than many of the State and Private Sector Banks. According to National Federation of Urban Co-operative Banks and Credit Societies Ltd., (NACUB) the total deposits and lendings of Co-operative Banks in India are much more than the old Private Sector Banks and also the New Private Sector Banks.25


### Table 1.3
Performance of Rural Co-operative Banks in India
(as on March 2006)
(Amount ₹ in 000 Million)

<table>
<thead>
<tr>
<th>Sl. NO</th>
<th>Particulars</th>
<th>SCBs</th>
<th>DCCBs</th>
<th>PACSs</th>
<th>SCARDBs</th>
<th>PCARDBs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>No. of Co-operative Banks</td>
<td>31</td>
<td>366</td>
<td>1,06384</td>
<td>20</td>
<td>696</td>
<td>1,07,497</td>
</tr>
</tbody>
</table>

2. Balance Sheet Indicators

<table>
<thead>
<tr>
<th></th>
<th>SCBs</th>
<th>DCCBs</th>
<th>PACSs</th>
<th>SCARDBs</th>
<th>PCARDBs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Owned Fund</td>
<td>105.45</td>
<td>234.50</td>
<td>92.92</td>
<td>33.52</td>
<td>33.80</td>
<td>500.19</td>
</tr>
<tr>
<td>ii) Deposits</td>
<td>454.05</td>
<td>875.32</td>
<td>195.61</td>
<td>6.36</td>
<td>3.82</td>
<td>1,535.16</td>
</tr>
<tr>
<td>iii) Borrowings</td>
<td>169.89</td>
<td>242.17</td>
<td>410.18</td>
<td>170.75</td>
<td>130.66</td>
<td>1,123.65</td>
</tr>
<tr>
<td>iv) Loans and Advances Issued</td>
<td>482.60</td>
<td>735.83</td>
<td>429.20</td>
<td>29.07</td>
<td>22.54</td>
<td>1,699.24</td>
</tr>
<tr>
<td>v) Loans and Advances Outstanding</td>
<td>396.84</td>
<td>792.02</td>
<td>517.79</td>
<td>177.13</td>
<td>127.40</td>
<td>2,011.18</td>
</tr>
<tr>
<td>vi) Total Liabilities/Assets</td>
<td>764.81</td>
<td>1,430.90</td>
<td>733.87</td>
<td>246.04</td>
<td>213.65</td>
<td>3,389.27</td>
</tr>
</tbody>
</table>

3. Financial Performance

<table>
<thead>
<tr>
<th></th>
<th>SCBs</th>
<th>DCCBs</th>
<th>PACSs</th>
<th>SCARDBs</th>
<th>PCARDBs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Institutions in Profit</td>
<td>27</td>
<td>278</td>
<td>44,321</td>
<td>11</td>
<td>331</td>
<td>44,968</td>
</tr>
<tr>
<td>ii) Institutions in Loss</td>
<td>4.08</td>
<td>11.16</td>
<td>10.64</td>
<td>3.35</td>
<td>3.28</td>
<td>32.51</td>
</tr>
</tbody>
</table>

4. Non-Performing Assets

<table>
<thead>
<tr>
<th></th>
<th>SCBs</th>
<th>DCCBs</th>
<th>PACSs</th>
<th>SCARDBs</th>
<th>PCARDBs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Amount</td>
<td>63.60</td>
<td>157.12</td>
<td>154.76</td>
<td>57.86</td>
<td>45.54</td>
<td>478.88</td>
</tr>
<tr>
<td>ii) As Percentage of Loans Outstanding</td>
<td>16.0</td>
<td>19.8</td>
<td>30.4</td>
<td>32.7</td>
<td>35.4</td>
<td>23.8</td>
</tr>
<tr>
<td>iii) Recovery of Loans to Demand (%)</td>
<td>87</td>
<td>69</td>
<td>62.1</td>
<td>47</td>
<td>48</td>
<td>--</td>
</tr>
</tbody>
</table>

Source: Trend and Progress of Banking in India 2006-07.
NA: Not Available.
A whole profile of performance of Rural Co-operative System in India is presented in table 1.3. It is clearly indicated in the table that their financial performance is getting worse as the number of loss made units are significantly more than the number of profit making units. During 2005-06, the Rural Co-operative Bank institutions were making an overall loss of ₹2,710 million. While the upper-tier of the both short-term and long-term structure made profit, the lower-tier i.e., Primary Agricultural Credit Societies (PACSs) and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) made losses. Both the tiers of the long term co-operative structure have the higher Non Performing Assets (NPAs) as percentage of loan outstanding and also the lower percentage of recovery of loans. In the short term co-operative structure lower tier has the highest NPAs with lowest recovery performance.26

1.4 Organization of Co-operative Credit Structure in India:

The co-operative banking structure in India comprises two main components, viz., Urban Co-operative Banks and Rural Co-operative Credit Institutions. While Urban Co-operative Banks have a single tier structure, Rural Co-operatives have a complex structure. Rural Co-operative Credit Institutions have two distinct structures, viz., the Short-Term Co-operative Credit Structure (STCCS) and Long-Term Co-operative Credit Structure (LTCCS). Within the STCCS, Primary Agricultural Credit Societies (PACS) at the village level, while District Central Co-operative Banks (DCCBs) are placed at the intermediate level and the State Co-operative Banks (SCBs) at the apex level. The STCCS mostly provide crop and other working capital loans primarily for a short period to farmers and rural artisans.

The long-term structure of Rural Co-operatives comprises State Co-operative Agriculture and Rural Development Banks (SCARDBs) at the State Level, and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) at the decentralized district or block level. These institutions focus on providing typically medium to long-term loans for making investments in agriculture, rural industries and housing.27

Chart 1.4
Organizational Structure of Co-operative Credit Institutions in India 28

The organizational structure of co-operative credit institutions as shown in the above diagram is of a federal type of structure. Each lower entity is federated into higher one. In this federal structure money flows from the apex bank to the central banks and from central banks to the rural societies and from them to the individual.

borrowers. Sources of capital for each entity consist of own capital (share capital and reserves), deposits and borrowings. Borrowing is made from Government, RBI and higher co-operative institutions and others. Most of the resources of each institution are utilized in granting loans to the constituting members. Higher institution not only provides refinance to the lower institutions but also supervises and advises them.29

The structure of rural credit shows a great deal of variation over the country. At present, in 15 states there are three-tiered and in 12 States/Union Territories (UTs) there are two tiered short credit structures. As far as Long-Term (LT) credit structures are concerned in eleven states there are the two tiered structures and in 8 states there exists a single tiered structure. In some states Long Term (LT) and Short-Term (ST) credit structures are integrated. The generic name for PCARDBs and SCARDBs are the Land Development Banks (LDBs) and are constituents of LT credit structure.

These institutions differ from state to state and are broadly of four types.

1. Unitary structures where SCARDBs operate at the state level through their branches and have individuals as members. Such type of societies is found in Bihar, Uttar Pradesh, Maharashtra, Gujarat, Tripura, Jammu and Kashmir, and in the Union Territory (UT) of Pondicherry.

2. Federal structure with SCARDB at the state level and federated societies (PCARDBs) at the primary level exist in states like Tamil Nadu, Karnataka, Kerala, Orissa, Punjab, Haryana, Rajasthan and Madhya Pradesh.

3. Mixed structure of type 1 and 2 above is seen in Himachal Pradesh, Assam and West Bengal.

4. In the states like Delhi, Andhra Pradesh, Goa, North Eastern (NE) states and in Union Territory (UT) of Daman and Diu, there are no separate LDBs. The SCBs undertake long term credit activities.

According to the task force on Revitalization of Co-operative Credit (2004), two trends are seen with regard to rural credit by the commercial banking sector. Firstly, the branch rationalization programme has resulted in decline in the number of rural branches. Secondly, through most of the banks meet the priority sector target set by the RBI; they have moved towards larger customers. For instance, the average size of direct loan to agriculture by commercial banks was ₹13,500 in 1997. This has increased to ₹30,585 in 2002-03, whereas, the average size of loan of the PACSs is merely ₹6,640 per borrower.

Today, India's Co-operative Credit Structure (CCS), with over 13 crore members (including six crore borrowers), constitutes one of the largest rural financial systems in the world. Over one lakh Primary Agriculture Credit Societies (PACS) can, in many ways, be regarded as the veritable bedrock of India's rural economy. Directly or indirectly, it covers nearly half of India's total population.30

The Co-operative Credit System of India has the largest network in the world and co-operatives have advanced more credit in the Indian agricultural sector than that of commercial banks.31 Thus, the small quantum of loan demanded by the rural borrowers, the high

administrative costs of these loans apart from a high risk of default make these loans economically nonviable. Hence, this sector has to be increasingly served by the co-operative and other rural credit institutions.\textsuperscript{32} Considering that the upper tier co-operatives largely depend on the primaries for their business, it can be said that the structure stands on very weak foundations. Current profits or losses could be misleading, especially since some of the institutions that are making current profits could have heavy accumulated losses and that all of them may not have made the required provisions against their NPAs.\textsuperscript{33}

1.5 Problems of Co-operative Credit Institutions in India:

Co-operative banks are under considerable pressure causing decline in productivity and efficiency, low profitability, un-remunerative direct investment, deterioration in the quality of portfolio, inadequacy of capital, inadequacy of loan provision, large scale loan waiver, duplication of infrastructure, over staffing, management weaknesses etc. These constraints may considerably influence institutional finance for priority sector in the long run.\textsuperscript{34}

Non-Performing Assets have various implications on profitability, liquidity and solvency of the banks. In spite of the various measures taken by banks, Non Performing Assets have been at a high level in co-operative banks.\textsuperscript{35} Due to financial impairment, the

Co-operative Credit Structure is steadily losing its ability to meet the rapidly growing credit needs of agriculture.\textsuperscript{36}

The regional distribution of co-operative credit is highly uneven. In general, the agriculturally advanced states account for a disproportionately large share of co-operative credit. During 2002-03, seventy eight per cent of the total short term credit of co-operatives was accounted for by the northern, western and southern regions of India and seven states (Andhra Pradesh, Gujarat, Haryana, Maharashtra, Kerala, Punjab and Tamil Nadu) received as much as seventy per cent of the loans advanced by the PACSs.\textsuperscript{37}

A desire to provide multi-term credit and multi-functional services motivated the government of Andhra Pradesh to integrate both the structures. Accordingly, the process of integration at primary level was implemented in 1987 and at the apex level in 1994. To begin with the results in terms of membership, share capital, credit off-take, etc. seem impressive but failed to maintain momentum. With addition of long-term credit, workload at delivery point, i.e., Primary Agricultural Co-operative Societies (PACSs) has gone up leading to decline in advances, lapses in supervision, and poor recovery.\textsuperscript{38}

Corporate governance especially in the co-operative sector has come into sharp focus because more and more co-operative banks in India, both in urban and rural areas, have experienced grave problems in recent times, which has in a way threatened the profile and identify

of the entire co-operative system. The Vyas Committee (2004) on flow of credit to agriculture had recognized the inefficiencies posed by the three-tire structure in the rural co-operative credit institutions. It pointed out that “in the three-tire co-operative credit structure, each tier adds its costs and margins to the interest rates and ultimately, the borrower gets credit at a relatively higher rate of interest”.

Several committees have gone into the question of reorganizing the co-operative credit structure in the country. Recently, the Task Force on Restructuring of Co-operative Credit Institutions (2004) underlined the need to eliminate state governments’ interference in the functioning of co-operatives. It recommended a revival package of about ₹15,000 crore for retiring the share capital contributed to co-operative societies by state governments and for cleaning up their balance sheets.

1.6 Impact of Reforms on Co-operative Banks in India:

As the country was facing a serious economic crisis due to critical balance of payments situation, the government of India decided to initiate measures to stabilize the economy and simultaneously to introduce structural reforms in the banking system. The main motive of these structural reforms was to enhancing the productivity and the operational efficiency of the banks as well as the economy as a whole and increasing global competitiveness in the years to come.

Financial sector reforms are also formulated against the backdrop of the process of globalization of finance. Indian economy

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integrates itself more closely with the international economy. Indian financial and banking system would increasingly be drawn into the dynamics of international finance.\textsuperscript{43} The Banking Sector Reforms introduced during the 1990's as part of the overall economic reforms essentially aimed at making the financial institutions efficient and vibrant while meeting the credit needs of its clients (Rangarajan:1998).

Based on the recommendations of the Narasimham Committee Report (1991), the banking sector in India has witnessed significant changes by way of downsizing bank branches and staff, rationalizing prudential norms - reduced Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR), rising Credit-Deposit Ratio (CDR), increase in the number of Private and Foreign Banks and (partial) deregulation of interest rates.\textsuperscript{44} The report of the Committee on Banking Sector Reforms (CBSR, 1998) provides a framework for the second phase of reforms in the banking system.

The broad features of the on-going banking reforms is that; gradual removal of preemptions (reduction in CRR and SLR) deregulation of interest rates, tightening of prudential standards, competition and transparency, improving the quality of supervision, partial removal of selective credit controls, assistance to banks in debt recovery and reforms in money and forex markets.\textsuperscript{45}

Credit flows through the co-operatives in rural India and their sustainability, viability and operational efficiency have become the major focus of attention of various policy-makers in the era of

financial sector reforms. Although reforms in the banking sector were initiated in commercial banks much earlier (beginning 1991-92) the reform process in the co-operatives have taken a longer time to get started.

It was because of the need for generating a consensus among various state governments, which govern and control the Co-operative Credit Institutions and to balance the interests of many diversified groups. However, a few major reforms, as indicated by Subramanyam (1999), have been introduced in the Co-operative Credit System. Despite these reforms, the co-operatives are still too weak to face the market forces. The weakness of co-operative banking lies at the primary level.

According to Subrahmanyam (1999), the major reforms/steps initiated during the period from 1991-92 to 1997-98 are:

a. Relaxation in branch expansion policy.
b. Liberalization and relaxation in Credit Authorization Scheme.
c. Permission to SCBs to introduce STOCKINVEST and Currency Chest Branches.
d. Some additional scheme to SCBs under National Level Consortium arrangement for financing.
e. A policy decision to permit SCBs on case by case to subscribe to the Public Sector Bonds.
f. Assistance to SCBs from Co-operative Development Fund by NABARD to ensure proper Management Information System and to conduct research studies.
g. Deregulated interest rates on advances and deposits by SCBs/DCCBs.
h. Preparation of Development Action Plans and entering into MOUs at the instance of NABARD.
i. Applicability of prudential norms to SCBs/DCCBs.
j. Relaxation in extending finance to individuals with a view to provide avenues for broader deployment of the resources.46

Keeping in view the RBI's goal to have consistency and harmony with international standards it has been decided that at a minimum, all banks in India will adopt Standardized Approach for Credit Risk and Basic Indicator Approach for Operational Risk with effect from March 31, 2007. After adequate skills are developed some banks may be allowed to migrate to Internal Rating Based (IRB) approach after obtaining the specific approval of the RBI.

RBI has indicated that the risk weights applicable for various rating categories of Credit Rating Information Services of India Limited (CRISIL) and Internet Content Rating Agency (ICRA). These risk weights were derived based on the mapping of CRISIL/ICRA ratings to Standard and Poor's (S&P). A risk weight of 150% would be applicable for Better Business Bureau ratings (BBB Rating) of CRISIL/ICRA. However, the regulatory definition of default (Probability of Default (PD)/Non-Performing Asset) was more liberal than the 90 days overdue rule in the past.

The RBI has adopted a consultative approach to implement Basel-II Norms for Indian banking industry. A Steering Committee comprising of senior officials from 14 banks has been constituted where Indian Bank's Association is also represented. On the basis of the inputs received from the Steering Committee "Draft' guidelines for

implementation of Basel-II in India have been prepared by Reserve Bank and has requested banks to study these guidelines and furnish their feedback.47

The RBI has directed the State Co-operative Banks to adopt prudential norms interms of income recognition, asset classification and provisioning for bad and doubtful debts. Prudential Norms also includes, capital adequacy norms and these norms have been fixed at 8% of the capital risk weighted assets. The Co-operative Banking Sector has been asked by RBI to adopt Prudential Norms by March 31st, 2000. Adoption of Prudential Norms by Co-operative Banking Sector would imply considerable improvement in their financial health, reduction of loan overdues and greater mobilization of deposits in the coming years.48

In order to strengthen the capital base of banks and in keeping with the recommendations made by the Basle Committee on Banking Regulations and supervisory practices (BCBR), the RBI has introduced Capital to Risk Weighted Assets Ratio (CRAR) system for commercial banks (including foreign banks) in India as a capital adequacy measure way back in 1993.

The fundamental objectives that underlay behind this principle are, firstly, that the framework should serve to strengthen the soundness and stability of the banking system and secondly that the framework should be fair and have a high degree of consistency in its application to banks operating at different levels. The prudential norms relating to capital adequacy was not made applicable

simultaneously to Urban Co-operative Banks due to certain statutory constraints faced by them. The capital adequacy norms are also applicable to Central Co-operative Banks and comply from the year 2002-03 onwards.\(^{49}\)

However, co-operative reforms encompassing legal and administrative aspects have not taken place in India. This is on account of multiplicity of controls (administrative aspects including registration are under State Co-operative Acts whereas financial supervision and regulation is with the Central Bank of the country). The impact of the extension of prudential standards to co-operative banks has resulted in an increased intervention by the regulator and the government in the name of the financial regulation/supervision.\(^{50}\)

Recovery performance of agricultural advances especially in the post-reform period had significantly improved in commercial banks, RRBs and DCCBs lending. Only the recovery performance of PCARDBs continued to decline. The major attributes opined by respondents to the poor level of recovery performance include the announcement of debt-relief schemes by the government, miss utilization of loans by borrowers and willful default of borrowers for various reasons. Some of these problems improved in the 1990s and as a result recovery performance of banks showed improvement.\(^{51}\)

The lower or negative net profits (Co-operative Banks) are a result of the enforcement of Asset Classification and Prudential Norms which have forced the banks to make larger provisions for their Non

\(^{50}\)Ramesha, K, Op. Cit, P.5.  
The financial sector reforms have accorded greater flexibility to co-operatives to invest in non-target avenues like shares and debentures of corporate, units of mutual funds, bonds of public sector undertakings, etc.³³

In recent years, with the extension of capital adequacy and asset classification norms, the share capital and own funds have assumed greater significance in the Co-operative Credit Institutions (CCIs). In the CCIs, the share capital is raised by linking the share holding with borrowing. At present, the borrowers have to contribute anywhere between 5 to 10 per cent of the borrowed amount as share capital.⁵⁴

After nearly two years of the reform process for financial co-operatives, one of the key lessons that have emerged is that the lack of a Common Accounting System (CAS) and ineffective audit procedures over the years have resulted in a chaotic financial picture.

Lacking appropriate accounting for Non-Performing Assets (NPAs), no accounting for depreciation and other similar problems have made it impossible to determine the correct aggregate financial status of the co-operative credit system. In some cases the accounts have been found to be incorrect by as much as 90% of the total size of the balance sheet of a primary co-operative. As a result, the initial focus of the reform programme has been on using the new Common Accounting System to calculate a corrected figure for accumulated losses so that recapitalization can be expedited. Once this has been completed, possibly by end-March 2009, it will become easier to
determine the true financial position of the DCCBs to facilitate, in turn, their capitalization.55

1.7 Restructuring of Co-operatives - Vaidyanathan Committee Recommendations (2004):

The Government of India has felt that the need to revamp the three tier co-operative banking network and constituted the committee to “Restructure and Revitalize the Co-operative Banks”, under the Chairmanship of Professor Vaidyanathan. This Committee is also popularly known as the Vaidyanathan Committee (2004).

The Vaidyanathan Committee has, therefore, recommended the implementation of a revival package covering three broad areas:

1.7.1 Financial Assistance:

The Co-operative Banks and PACS shall be provided financial assistance under a revival package so as to make them strong to serve the credit needs of the rural people, particularly the small and marginal farmers. Such revival package shall include assistance to wipe out accumulated losses also. The financial package shall also increase the capital base of the banks/societies and reduce the government share of equity to 25% of the total subscribed share capital of the society. Cost of training and capacity building to improve the financial management skills of the staff and board of directors is also envisaged. Financial support shall be made available for installation of uniform accounting and monitoring systems and computerization of PACS.

1.7.2 **Legal and Institutional Reforms:**
- Full membership rights to all users, including depositors.
- Wider access to all institutions for borrowing and investment.
- Ensuring elections before end of tenure of Boards.
- Exit of State equity and consequent withdrawal from Boards.
- Empowering RBI to directly exercise full regulatory authority in financial matters.

1.7.3 **Measures to Improve Quality of Management:**
- Co-option of professionals on Boards.
- Reduction of State intervention in administrative and financial affairs.
- Limited powers of State to supersede Boards.
- Introduction of Prudential norms and audit by Chartered Accountants (CAs).

The Government of India has accepted the Vaidyanathan Committee recommendations and rolled out the programme for Revival of the Co-operative Credit Structure. NABARD is the nodal implementing agency for the programme. By April 2008, 19 states had accepted the package and commenced implementation.\(^{56}\)

1.8 **District Central Co-operative Banks (DCCBs) : A Special Mention**

When the first Co-operative Credit Societies Act was passed in 1904, there was no provision for the formation of DCCBs. But the Act 1912 permitted the organization of higher level federal societies. Before passing this Act of 1912, some Central Co-operative Banks had been established to cater to the financial needs of the primary societies.

They were registered as PACS but were working as Central Co-operative Banks. However with the passing of the Co-operative Societies Act in 1912, District Central Co-operative Banks came to be established on a large scale in the country. The period from 1906 to 1918 may be called as the period of origin of the District Central Co-operative Banks in the country.57

The National Bank for Agriculture and Rural Development Act, 1981, provided the following definition of a Central Co-operative Bank: “Central Co-operative Bank means the principal co-operative society in a district of a state, the primary object of which is the financing of other co-operative societies in that district, provided that in addition to such principal society in a district or where there is no such principal society in a district, the State Government may declare any one or more co-operative societies carrying on the business of financing other co-operative societies in that district to be Central Co-operative Bank”.58

Central Co-operative Banks are the middle wing of the three-tier co-operative credit structure. These are of three types:
1) Banks with membership confined to individuals.
2) Banks with membership exclusively confined to primary credit societies; this is the best type from the co-operative angle.
3) A mixed type with individuals and societies as members.

The Central Co-operative Banks are Federations of Primary Agricultural Credit Societies in a particular district. Hence they are called District Central Co-operative Banks.59

All India Rural Credit Survey was conducted by Prof. A.D. Gorwala in 1951. As per the suggestions of this committee the present three tier structure of co-operative banking came into existence. Primary Agricultural Co-operative Society at village level followed by District Central Co-operative Bank at district level and State Co-operative Bank at the apex level. This committee recommended that all types of co-operative institutions should be members of DCCB and they should invest their funds in this bank. Bank has strictly followed the recommendations of this committee in order to strengthen the co-operative movement in the district.60

Central Co-operative Banks are the federation of all types of co-operative functioning in their area of operations, their main objective being to arrange the supply of finance to their constituents. In the present stage of development of the co-operative structure, in which the primary societies are not strong to meet the credit requirements of their members, Central Co-operative Banks play a crucial role by arranging a regular flow of credit to the primaries. They also supervise the working of credit societies and ensure a satisfactory implementation of recognized credit policies.61

For a short-term rural co-operative credit institution, like Central Co-operative Bank, sources of funds can be categorized as the owned

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funds and the borrowed funds. The paid-up share capital contributed by the members of the bank and the reserves created out of profit can collectively be termed as owned funds, whereas the borrowed funds constitute the deposits from public and borrowings or loans from higher financial agencies, the other equally important aspect in the deployment of these resources. The funds of a short-term co-operative credit institution are channelized into loans for seasonal agricultural operations and medium-term agriculture investment as their prime responsibility. The high yield non-farm sector advancing is also getting popular, since the initiation of liberalization and diversification in these banks. 62

1.8.1 Role and Functions of DCCBs:

The District Central Co-operative Banks play multiple roles. Some of these are discussed below:

1.8.1.1 Banking Entity:

The DCCBs are banking entities recognized by the Reserve Bank of India under the Banking Regulations Act. They accept deposits from general public and provide loans to individuals and institutions including primary co-operative societies. They are governed by the various regulations stipulated by the Reserve Bank of India from time to time. Special provisions have been incorporated in the Banking Regulations Act 1949 considering the special nature of their ownership, development role etc.

1.8.1.2 Role of DCCBs in Co-operative Movement:

One of the most important functions of the District Central Co-operative Banks is to provide financial support to the Primary Co-operative Societies that are affiliated to it in the district. These societies belong to highly diverse categories like the Primary Agricultural Credit Societies, the Producers Co-operative Societies, Handloom and Handicrafts Co-operative Societies, Salary Earners’ Co-operative Societies Consumers’ Co-operative Societies, Primary Urban Co-operative Banks, etc. However, one of the most important role of the District Central Co-operative Bank is to support and develop the Primary Agricultural Credit Societies.

The officials of the DCCB inspect the PACS affiliated to them periodically. The main source of funds for the PACS is the DCCB and the lending programme of PACS is regularly supervised by the supervisors of the DCCBs. Among the most important line of credit provided by the DCCB to PACS is that for providing production loans for crops to members of PACS. Many PACSs also undertake multiple activities like sale of fertilizers and other agricultural inputs and several Acts as distributors of ration items under the Public Distribution System (PDS). The financial assistance for such activities and other loans provided to members are also sourced from the DCCBs as the PACS usually do not have major resource base of their own.

The important source of own resources of the PACS is the deposits placed with it by the members. A specified percentage of such deposits collected by PACS are kept with the DCCBs as reserve deposits to protect the interest of the member depositors. The DCCBs also provide capacity building support to PACS. They conduct training
programmes for secretaries and directors of the board of the PACS. Periodical seminars are also conducted to update the staff and members of PACS on important developments affecting them.

1.8.1.3 Role of DCCBs in Agricultural Lending:

Historically, the DCCBs have been considered as the most important financial institution to support the short term credit requirements of the agricultural sector. These loans include both production loans and marketing loans are provided to the members. Usually the production loans are provided on the basis of the “Scale of Finance” which is fixed for each major agricultural crop in the district. The scale of finance is computed by taking the total cost of production of the crop based on average price of inputs, including labour. The yield and market value of the output are also computed and the credit required per hectare for raising the crop is determined. The scale of finance is fixed by a committee called the “District Level Technical Committee (DLTC)” and the DCCB is the convener of this committee. The members of the DLTC include the representatives of the agricultural department, banks, NABARD etc.63

The DCCBs grant loans and advances to the rural dwellers both for agricultural and non-agricultural purpose, but the infrastructure aids are totally neglected by them. The agricultural produces must reach the final users in time and the infrastructure conditions facilitate such functions effectively. As the aiding infrastructure aspects are not covered in many agricultural, fisheries and non-agricultural loans and advances, DCCBs could not operate successfully to penetrate through the challenges.64

The Central Co-operative Banks have usually been dependent upon NABARD for

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63 RBI College of Agricultural Banking, *On Cit.* PP.3-4.
borrowings under various schemes. Due to the upcoming low subsidy economic scenario, the cost of borrowings increased.\textsuperscript{65}

\textbf{1.9 Need for the Study:}

Financial inclusion as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. Impressive Network and its spread to the rural poor, the RSTCCS (Rural Short-term Co-operative Credit Structure) could play an important role in enhancing financial inclusion in India. DCCBs play a predominant role to fulfill this gap. The present study is intended to appraise the financial performance of the DCCBs in India and vis-à-vis the selected DCCB of Guntur, Andhra Pradesh, with particular reference to finance.

\textbf{1.10 Organization of the Study:}

The first chapter deals with the introduction, genesis, organization structure and trends of co-operative credit in India. The second chapter deals with the objectives, methodology and review of literature of the study. The third chapter deals with the financial status and performance of District Central Co-operative Banks (DCCBS) in India and Andhra Pradesh - An Appraisal. In the forth chapter an attempt is made to present a profile of the study area and the basic working trends of the study Bank (GDCCB). An appraisal of the financial performance of the GDCCB – A CAMEL Analysis was attempted in chapter five. In the sixth chapter management of Credit Risk and Non Performing Assets (NPAs) of the GDCCB was undertaken. Finally Conclusions and Suggestions are presented in the Seventh Chapter.