Co-operative Banks in India

(Note-This lecture is taken from internet for teaching purpose)

In keeping with their ‘grassroots’ integration into the life and ethos of the widest sections of society, co-operative banks in India are invested with developmental goals among which financial inclusion has assumed crucial importance. These institutions play a critical role in last-mile credit delivery and in extending financial services across the length and breadth of the country through their geographic and demographic outreach.

Establishment of Co-operative Banks in India ====

The co-operative banks in India are well established financial service organization. The first legislation on cooperation was passed in 1904. In 1914, the Maclagen Committee envisaged a three tier structure of co-operative banking, viz., Primary Agricultural Credit Services (PACs) at the grass root level, Central Co-operative Banks at the district level and State Co-operative Banks at State level or Apex level. The first urban co-operative bank in India was formed nearly 100 years back in Baroda. The co-operative banks arrived in India in the beginning of 20th Century as an official effort to create a new type of institution based on the principles of co-operative organization and management, suitable for problems peculiar to Indian
conditions. These banks were conceived as substitutes for money lenders, to provide timely and adequate short-term and long-term institutional credit at reasonable rates of interest. In the formative stage, Co-operative banks were urban co-operative societies run on community basis and their lending activities were restricted to meeting credit requirements of their members. The concept of Urban Co-operative Bank was first spelt out by Mehta Bhansali Committee in 1939 which defined on Urban Co-operative Bank. Provisions of Section 5 (CCV) of Banking Regulations Act, 1949 (as applicable to Co-operative Societies) defined an Urban Co-operative Bank as a Primary Co-operative Bank other than a Primary Co-operative Society was made applicable in 1966.

**Structure of Cooperative Banking:**

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure. Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions. The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies. Long-term agricultural credit is provided by the land development banks.

**Short-Term Rural Cooperative Credit Structure:**

In rural India, there exists a three-tier short-term rural cooperative structure. Tier-I includes state cooperative banks (SCBs) at the state level; Tier-II includes central cooperative banks (CCBs) at the district level; and Tier-III includes primary agricultural credit societies (PACSs).

1. **State Cooperative Banks (SCBs):**

**Functions and Organisation:**

State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank. *State cooperative banks occupy a unique position in the cooperative credit structure because of their three important functions:*

(a) They provide a link through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,

(b) They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks. The central cooperative banks are not permitted to borrow or lend among themselves,

(c) They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.

**Capital:**

*State cooperative banks obtain their working capital from own funds, deposits, borrowings and other sources:*

(i) Own funds include share capital and various types of reserves. Major portion of the share capital is raised from member cooperative societies and the central cooperative banks, and the rest is contributed by the state government. Individual contribution to the share capital is very small;
(ii) The main source of deposits is also the cooperative societies and central cooperative banks. The remaining deposits come from individuals, local bodies and others.
(iii) Borrowings of the state cooperative banks are mainly from the Reserve Bank and the remaining from state governments and others.

**Loans and Advances:**
State cooperative banks are mainly interested in providing loans and advances to the cooperative societies. More than 98 per cent loans are granted to these societies of which about 75 per cent are for the short-period. Mostly the loans are given for agricultural purposes.

2. **Central Cooperative Banks (CCBs):**

**Functions and Organisation:**
Central cooperative banks are in the middle of the three-tier cooperative credit structure.

**Central cooperative banks are of two types:**
(a) There can be cooperative banking unions whose membership is open only to cooperative societies.
(b) There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type. The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others.

**Capital:**
The central cooperative banks raise their working capital from own funds, deposits, borrowings and other sources. In the own funds, the major portion consists of share capital contributed by cooperative societies and the state government, and the rest is made up of reserves.
Deposits largely come from individuals and cooperative societies. Some deposits are received from local bodies and others. Deposit mobilisation by the central cooperative banks varies from state to state.
For example, it is much higher in Gujarat, Punjab, Maharashtra, and Himachal Pradesh, but very low in Assam, Bihar, West Bengal and Orissa. Borrowings are mostly from the Reserve Bank and apex banks.

**Problem of Overdues:**
The most distressing feature of the functioning of the central cooperative banks is heavy and increasing overdue loans. In 1997-98, the percentage of overdues to demand at the central cooperative level was 34.

**The main causes of these overdues are:**
(a) Natural calamities such as floods, draughts, etc., affecting the repaying capacity of the borrowers;
(b) Inadequate and inefficient supervision exercised by the banks;
(c) The poor quality and management of societies and banks; (d) Absence of linking of credit with marketing;
(e) Reluctance to coercive measures; and
(f) Where coercive measures were taken, the inability of the machinery to promptly execute the decrees.

For the rehabilitation of the weak Central cooperative banks, the Central Sector Plan Scheme has been formulated under which semi financial help is given to write off the bad debts, losses and irrecoverable overdues against small and marginal farmers.

3. **Primary Agricultural Credit Societies (PACSs):**

**Functions and Organisation:**
Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments.

It serves as the last link between the ultimate borrowers, i.e., the rural people, on the one hand, and the higher agencies, i.e., Central cooperative bank, state cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member. The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of the society in case of its failure. The management of the society is under the control of an elected body.

**Capital:**

The working capital of the primary credit societies comes from their own funds, deposits, borrowings and other sources. Own funds comprise of share capital, membership fee and reserve funds. Deposits are received from both members and non-members. Borrowings are mainly from central cooperative banks.

In fact, the borrowings form the chief source of working capital of the societies. Normally, people do not deposit their savings with the cooperative societies because of poverty, low saving habits, and availability of better assets to the savers in term of rate of return and riskiness from these societies.

**Land Development Banks (LDBs) or Cooperative Agricultural and Rural Development Banks (CARDBs):**

Besides short-term credit, the agriculturists also need long-term credit for making permanent improvements in land, for repaying old debts, for purchasing agricultural machinery and other implements. Traditionally, the long-term requirements of agriculturists were mainly met by money lenders and some other agencies. But this source of credit was found defective and has been responsible for the exploitation of farmers.

Cooperative banks and commercial banks by their very nature are not in a position to provide long-term loans because their deposits are mainly demand (short-term) deposits. Thus, there was a great need for a specialised institution for supplying long-term credit to agriculturists. The establishment of land development banks now known as cooperative and rural development banks (CARDBs) is an effort in this direction.

**Structure:**

The land development banks are registered as cooperative societies, but with limited liability. **These banks have two-tier structure:**

(a) At the state level, there are state or central land development banks, now known as state cooperative agricultural and rural development banks (SCARDBs) generally one for each state. They were previously known as central land mortgage banks,

(b) At the local level, there are branches of the state land development banks or SCARDBs and primary land development banks now known as primary cooperative agricultural and rural development banks (PCARDBs).

In some states, there are no primary land development banks, but the branches of the state land development bank. In Madhya Pradesh, the state cooperative bank itself functions as the state land development bank. In other states like Andhra Pradesh, Kerala and Maharashtra, there are more than one state land development banks.
Similarly, the primary land development banks also vary organisationally in different states. At the national level, the land development banks have also formed a union, called All-India Land Development Banks’ Union.

**Capital:**
Land development banks raise their funds from share capital, reserves, deposits, loans and advances, and debentures. Debentures form the biggest source of finance. The debentures are issued by the state land development banks. They carry fixed interest, have maturity varying from 20 to 25 years, and are guaranteed by the state government. These debentures are subscribed by the co-operative banks, commercial banks, the State Bank of India and the Reserve Bank of India. Besides the ordinary debentures, the land development banks also float rural debentures for the period upto 7 years. These debentures are subscribed by farmers, panchayats, and the Reserve Bank. The Reserve Bank substantially contributes to the finance of land development banks by extending funds to the state governments for contributing to the share capital of these banks and by subscribing to ordinary and rural debentures.

**Growth:**
In India, the first cooperative land mortgage bank was organised in Jhang in Punjab in 1920. But the effective beginning was made in Madras with the establishment of a central land development bank in 1929. Later on other states also established such institutions.

**Loans and Advances:**
The land development banks or SCARDBs provide long-term loans to the agriculturists- (a) for redemption of old debt, (b) for improvement of land and methods of cultivation, (c) purchasing costly machinery, and (d) in special cases, for purchasing land. These banks grant loans against the mortgage of land and the period of loan varies from 15 to 30 years.

**Defects of Land Development Banks:**
Although numerically the land development banks have grown over the years, they have not been able to make much progress in providing long-term finance to the farmer.

The following are the factors responsible for the unsatisfactory performance of land development banks:

i. **Uneven Growth:**
There has been uneven growth of land development banks. These have shown some progress in the states like Andhra Pradesh, Tamil Nadu, Karnataka, Maharashtra, Gujrat. Other states have made very little progress. About half of the states have no land development bank.

ii. **Problem of Overdues:**
The major problem faced by the land development banks is the existence of heavy overdues. Moreover, the overdues are continuously rising over the years. In 1991-92, the percentage of the overdues of the land development banks has been put between 42 to 44 per cent. Faulty loaning policies, inadequate supervision, over-utilisation of loans, ineffective measures for recovery, willful defaulters, etc. are the main causes of unsatisfactory level of overdues. In view of the seriousness of the problem, the state governments have been advised to draw up and implement time-bound programmes for special recovery drives.

iii. **Lack of Trained Staff:**
In spite of quantitative growth of the land development banks, they have not shown much qualitative improvements in the field of granting loans largely due to inadequate technical and supervisory staff. Necessary changes in the legislation of cooperative institutions are also required if the lending activities are to be diversified for non-traditional developmental purposes and on the basis of non-landed security.

iv. **Other Defects:**
Other defects of the land development banks can be summarised below:
These banks charge very high interest rates on the loans provided by them. There is much delay and red-tapism in the granting of loans. Second loan is not advanced unless the first is not repaid. Installments and the period of loans are not fixed on the basis of the repaying capacity of the borrowers.

The procedure of receiving a loan from these banks is so complicated that the agriculturist is forced to seek help from the money lender.

Weaker sections of the rural society such as landless labourers, village artisans and marginal farmers, are generally unable to secure loans from these banks for their productive activities simply because they do not have land or adequate security to offer against loans.

Mostly loans are given for the repayment of old loans and for development purposes.

Various advantages of cooperative credit institutions are given below:

I. Alternative Credit Source:
The main objective of cooperative credit movement is to provide an effective alternative to the traditional defective credit system of the village money lender. The cooperative banks tend to protect the rural population from the clutches of money lenders. The money lenders have so far dominated the rural areas and have been exploiting the poor people by charging very high rates of interest and manipulating accounts.

II. Cheap Rural Credit:
Cooperative credit system has cheapened the rural credit both directly as well as indirectly:
(a) Directly, because the cooperative societies charge comparatively low interest rates, and
(b) Indirectly, because the presence of cooperative societies as an alternative agency has broken money lender’s monopoly, thereby enforcing him to reduce the rate of interest.

III. Productive Borrowing:
An important benefit of cooperative credit system is to bring a change in the nature of loans. Previously the cultivators used to borrow for consumption and other unproductive purposes. But, now, they mostly borrow for productive purposes. Cooperative societies discourage unproductive borrowing.

IV. Encouragement to Saving and Investment:
Cooperative credit movement has encouraged saving and investment by developing the habits of thrift among the agriculturists. Instead of hoarding money the rural people tend to deposit their savings in the cooperative or other banking institutions.

V. Improvement in Farming Methods:
Cooperative societies have also greatly helped in the introduction of better agricultural methods. Cooperative credit is available for purchasing improved seeds, chemical fertilizers, modern implements, etc. The marketing and processing societies have helped the members to purchase their inputs cheaply and sell their produce at good prices.

VI. Role of Cooperative Banks before 1969:
Till the nationalisation of major commercial banks in 1969, cooperative societies were practically the only institutional sources of rural credit. Commercial banks and other financial institutions hardly provided any credit for agricultural and other rural activities. Cooperative credit to the agriculturists as a percentage of total agricultural credit increased from 3.1 per cent in 1951-52 to 15.5 per cent in 1961-62 and further to 22.7 per cent in 1970-71. On the other hand, the agricultural credit provided by the commercial banks as a percentage of total agricultural credit remained almost negligible and fell from 0.9 percent in 1951-52 to 0.6 percent in 1961-62 and then rose to 4 per cent in 1970-71.

VII. Role of Cooperative Banks after 1969:
After the nationalisation of commercial banks in 1969, the government has adopted a multi-agency approach. Under this approach, both cooperative banks and commercial banks (including regional rural banks) are being developed to finance the rural sector.

But, this new approach also recognised the prime role to be played by the cooperative credit institutions in financing rural areas because of the following reasons:
(a) Co-operative credit societies are best suited to the socio-economic conditions of the Indian villages.
(b) A vast network of the cooperative credit societies has been built over the years throughout the length and breadth of the country. This network can neither be duplicated nor be surpassed easily.
(c) The cooperative institutions have developed intimate knowledge of the local conditions and problems of rural areas.

Major weaknesses are given below:

I. General Weaknesses of Primary Credit Societies:
Organisational and financial limitations of the primary credit societies considerably reduce their ability to provide adequate credit to the rural population.

The All India Rural Credit Review Committee pointed out the following weaknesses of the primary credit societies:
(a) Cooperative credit still constitutes a small proportion of the total borrowings of the farmers,
(b) Needs of tenants and small farmers are not fully met.
(c) More primary credit societies are financially weak and are unable to meet the production-oriented credit needs,
(d) Overdues are increasing alarmingly at all levels,
(e) Primary credit societies have not been able to provide adequate and timely credit to the borrowing farmers.

II. Inadequate Coverage:
Despite the fact that the cooperatives have now covered almost all the rural areas of the country, its rural household membership is only about 45 per cent. Thus, 55 per cent of rural households are still not covered under the cooperative credit system.

In fact, the borrowing membership of the primary credit societies is significantly low and is restricted to a few states like Maharashtra, Gujrat, Punjab, Haryana, Tamil Nadu and to relatively rich land owners.