

Research Paper



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ISSUES OF URBAN CO-OPERATIVE BANKS IN INDIA



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Brief History of Urban Cooperative Banks in India

The Co operative banks in India started functioning almost 100 years ago. The origins of the urban cooperative banking movement in India can be traced to the close of nineteenth century when, inspired by the success of the experiments related to the cooperative movement in Britain and the cooperative credit movement in Germany such societies were set up in India. India adopted Raiffeisen model of rural credit cooperatives in the beginning of this century to combat the problems of usury and indebtedness of farmers and to rejuvenate the then stagnant rural economy. From that stage, the cooperative movement in India came a long way, mainly through the efforts and contribution of cooperators, Governments and members.

The first known mutual aid society in India was probably the 'Anyonya Sahakari Mandali' organised in the erstwhile princely State of Baroda in 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar. Urban co-operative credit societies, in their formative phase came to be organised on a community basis to meet the consumption oriented credit needs of their members. Salary earners' societies inculcating habits of thrift and self help played a significant role in popularising the movement, especially amongst the middle class as well as organized labour. From its origins then to today, the thrust of UCBs, historically, has been to mobilise savings from the middle and low income urban groups and purvey credit to their members - many of which belonged to weaker sections. Cooperative societies

are based on the principles of cooperation, - mutual help, democratic decision making and open membership.

Structure of UCBs

The cooperative bank are compactly located in five states, - Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. The short term credit structure specializing in production credit is functioning with 3-tier structure – State Co-operative Banks (SCBs) at apex level, District Central Co-operative Banks (DCCBs) at district level and Primary Agricultural Credit Society at grassroot level in 15 States and with 2-tier structure -without DCCBs in 12 States/Union Territories.

Duality of Control

Co operative Banks in India are registered under the Co-operative Societies Act. The cooperative bank is also regulated by the RBI. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

Role

When it comes to the allocation of credit, private and public sector banks generally tend to rely on hard information to make their decisions. This creates a major impediment for small borrowers. The cooperative banks help bridge this gap as they rely more on soft information and focus on relationship based lending.

Issues in India

Capital

Capital, in a broader sense is the owned funds consisting of share capital and reserves. Reserves represent profit earned over the years that have not been distributed to shareholders and retained in the

business. The accumulation of such retained reserves reflects financial soundness, stability and growth of banks. The capital base of cooperative credit and banking institutions increases steadily with the growth in business as it is linked to loans and borrowers are compulsorily required to contribute to the share capital certain percentage of loans ranging from 2.5% to 10%. This system is quite different from Commercial Banks, both public and private sector banks, who raise capital from Government and market by public issues. Capital is one of the major indicators of the financial strength of an enterprise. For a banking institution, capital covers risk of losses apart from reposing confidence of the depositors and other creditors. Borrowing power of a financial cooperative is linked to net worth as stipulated in the Law. Net worth here means equity plus reserves minus accumulated losses. Cooperative banks in India, other than Urban Cooperative Banks, besides raising share capital from members, which is linked to loans, also receive equity contribution from the Government as a matter of State policy. Such capital held by State Governments in the cooperative banking structure ranges from 10% to 20%. In any case, in the context of new economic policy and financial sector reforms, Government support by way of additional capital is not likely to forthcome to cooperative banks in any significant manner in the coming years.

Capitalisation

Cooperatives have share linking norm in terms of which the borrowing members are required to take up a certain percentage of loans towards share capital. While the banks would like to augment capital by increasing this ratio of capital to loan, the borrower may not be interested in increasing the rate of linkage as it would put additional burden on him and render the loan less attractive. Also, there is 'nil' or inadequate return on such capital. Because of low level of profitability, majority of the banks have not been paying dividend on share capital. There is no equity contribution to Urban Coop. Banks by the Government and they raise their equity entirely from members. As compared to public and private sector banks, the shares of cooperatives neither appreciate in value nor they

are traded in the secondary market. Also, they are constrained to raise capital through the primary market. These are the bottlenecks for augmenting capital by cooperatives. Cooperative Banks have not made any significant attempt for capitalization and most of them continue the age old practice of raising equity from members in relation to the borrowing. One reason for this could be non-application of capital adequacy norm. They may soon realise the inadequacy of capital with application of international standards.

Recapitalisation

Cooperatives, in keeping with their principles, have been operating as service sector institutions. There was no seriousness on their part to work as economic enterprises. They were subjected to several controls and restrictions by monetary / refinancing authorities and Government. The cooperatives were put to a disadvantage and suffered liquidity problems as Government support in relation to volume of loans waived was not provided for fully and that, further, there was considerable delay even in the settlement and release of dues. More than anything, implementation of this populist scheme resulted in vitiating the recovery climate which even otherwise was not so good. These, coupled with the application of provisioning norms for NPAs have resulted in substantial losses to cooperative banks. Hence, cooperatives have been pleading with the Government for funding support as one time measure to cover losses by recapitalisation on the lines of support extended to public sector banks.

Prudential Norms

As a follow-up of the financial sector Reforms Committee recommendations, prudential norms involving income recognition, asset classification, provisioning, valuation of investments and capital adequacy were introduced to various banks in India beginning from 1992-93 as under: The capital adequacy norms have not been made applicable to cooperative banks (including UCBs) and Regional Rural Banks so far. With a view to preparing the Balance Sheet and Profit & Loss Account and reflecting bank's actual financial health, a proper system for recognition of income, classification of assets and provisioning on a prudential basis was

found to be essential. While the norms for income recognition is based on record of recovery (realised income), the classification of assets has to be done on the basis of objective criteria which would ensure a uniform and consistent application of norms. It would be necessary that the provisions are made on the basis of classification of assets into 4 different categories viz., standard, sub-standard, doubtful and loss.

Demutualisation

For a successful and profitable cooperative bank, there are quite a few of them even in India, raising capital from market besides member-holdings, is not going to be a major problem. But how it is going to be beneficial to the general public or the corporate sector by holding on to the cooperative principles of one-member-one-vote and limited returns? We want access to capital market and at the same time do not wish to give up or dilute the cooperative principles. Unfortunately, 'self-help' and 'mutual help' aspects in cooperatives are not strong enough to raise capital from members more than what is mandatorily necessary. Like in a credit cooperative, equity holding by member in certain ratio is essential for loan availment. If option is given, borrowing member may not opt for holding any additional shares except perhaps what is essential for membership. 'Mutuality' in cooperatives is a major casualty which will also act as a major constraint for augmenting capital through members. Cooperative bank with long standing and popular by its services can successfully raise capital from the market through innovative capital instruments - shares or otherwise - even without voting rights provided the bank is able to repose investors confidence about reasonable safety of investment and return on capital. Without resorting to demutualization as to members' rights and ownership, cooperative banks will also have to evolve measures for member loyalty and mutuality.

Governance

Providing service was the main concern and not the financial results and viability. Good governance & professionalism by and large are much below the required standards. A large number of banking institutions are not financially viable though they continue to perform the routine

functions of retailing credit without accountability. Members of the Board of Management of the banks elected democratically by members are not necessarily professionals. There is no possibility of any systems change in this regard without violation or dilution of the basic cooperative principle. Elected members of the Board need orientation for performing the tasks of policy making in an effective manner. Such orientation and educational programmes are not organised on a regular and continuing basis. The paid management of the banks - top and middle level management - also lack professionalism to understand and operate in a fast changing financial market and to evolve innovations in their operations due to faulty HRMD practices followed by them. Good governance should be result-oriented and serve the members economic interests. Improvement in the quality of governance is, therefore, a prerequisite for realising favourable impact of any capitalization measures.

Relations with Governments

In India, "Cooperation" is a State subject whereas "Banking" is with federal Government. Laws governing the management and operations of the cooperative financial institutions are therefore not uniform. There are several restrictive provisions in these laws hindering the operations and management functions. Government control over institutions is excessive and interference is unwarranted. Very often, elected Boards / Managements are superseded not for reasons of mismanagement or violation of law but on political consideration. Apex level financial institutions invariably are managed at the top level not by professionals but by deputed Government officers. Central Government's support or control is not always direct. It is through the Central Bank by way of banking regulations or as a part of monetary policy and through public sector financial institutions on which the cooperative banks depend for funding / refinance. Cooperatives over the last few years have been demanding amendments in the cooperative laws for their autonomy. The issue has evoked a national debate and pressures are mounting on the Governments for amendments in the laws. Economic liberalisation and reforms have no meaning without functional autonomy.

Suggestions

After diagnosing the malady, it is necessary to evolve solutions to remedy the situation. The following aspects need to be addressed in order to improve the efficiency of cooperative banks:

1 Cooperative financial enterprises should raise funds through deposits and other financial market instruments in order to be self-reliant and for flexibility in their operations. 2 Cooperative banks should develop and introduce such service products, without involvement of funds. If income level and profitability goes up by noncredit business operations, capital base will be strengthened by retained earnings - Reserves. 3 Immediate task is to bring about perceptible improvement in the quality of assets and bring down NPAs. 4 Supervision and control mechanism needs to be strengthened and streamlined. 5 Cooperative credit and banking enterprises need to be professionalized for improving competitive strength and operational efficiency. Corporate Governance is missing due to lack of professionalism. 6 Excessive Government control and interference in the management of financial cooperatives needs elimination by

comprehensive amendments in the concerned cooperative Laws. 7 Improve the transparency of information and in turn use depositors effectively as a market discipline tool. 8 Address the issue of dual regulation by ideally allocating regulatory authority to a single regulator or clearly specify the regulatory domains and responsibilities. 9 Minimize political interference. 10 Lastly, to enhance the financial base and for capital augmentation to meet fully the international standards, innovative capital instruments are essential.

Conclusion

Apart from presenting the status of our Banking Cooperatives, highlighting their problems of capital inadequacy, growing NPAs, lack of professionalism in the management, etc. and making a few broad suggestions, there are hardly any innovative practices which can be shared with other successful Cooperative Banks. Cooperative banks act as a very important channel for credit allocation to the small borrowers. Thus, improving their functioning through a better regulatory structure can provide further impetus to economic growth and poverty alleviation.

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