DEVELOPMENT IN COOPERATIVE BANKING AND
FINANCIAL INCLUSION

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ABSTRACT

The financial position of Urban Cooperative banks showed a varied performance in terms of important indicators such as profitability and non-performing assets. The net profits of UCB’s also reduced due to the slowdown of the Indian Economy, but there asset quality showed good performance which helped in the strengthening prudential norms and regulations.

Financial Inclusion though says, to provide access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections at an affordable cost from mainstream financial institution, though succeeded in achieving some milestones like opening of no frill account, relaxation of KYC norms for small account holders, engaging business correspondents for providing financial services, upgrading technology, for delivery of social welfare schemes providing Direct benefit transfer etc., but has a long way to go in adopting an integrated approach for financial education, issue of new bank licenses, review of the cash management practices and so on.

Keywords: Cooperative Banking; Financial Inclusion

INTRODUCTION

The cooperative banking system forms an integral part of Indian Financial system. It comprises urban cooperative banks and rural cooperative credit institutions. Urban Cooperative banks have a single tier structure whereas rural cooperatives have a two or three tier structure.

The single tier Urban Cooperative Banks (UCB’s) also referred to as primary cooperative banks-play an important role in meeting the growing credit needs of urban and semi-urban areas of the country. The UCB’s which grew rapidly in the early 1990’s showed certain weaknesses arising out of lack of sound corporate governance, unethical lending, comparatively high levels of non-performing loans & their inability to operate in a liberalized environment. Accordingly, some of the weak UCB’s have been either liquidated or merged with other banks.

Cooperative banks in India are more than 100 years old. The banks came into existence with the enactment of the Agricultural Credit Cooperative Societies Act in 1904. Cooperative banks operate mainly for the benefit of rural areas, particularly the agricultural sector. Cooperative banks mobilize deposits and supply agricultural and rural credit with a wider outreach. They are the main source of institutional credit to the farmers. Cooperative banks are primarily responsible for breaking the monopoly of moneylenders in providing the credit.
to agriculturists. They have also been an important instrument for various development schemes, particularly subsidy based programmes for the poor. Cooperative banks operate for non agricultural sector but their role is small.

Though much smaller as compared to scheduled commercial banks, cooperative banks constitute an important segment of the Indian banking system. They have an extensive branch network and reach out to people in remote areas. They have traditionally played an important role in creating banking habits among the lower and middle income groups and in strengthening rural credit delivery system. Urban Cooperative banks play an important role in meeting the growing credit needs of the urban and semi-urban areas. UCB’s mobilize savings from the middle and lower income groups and provides credit to small borrowers including weaker sections of the society. Scheduled UCB’s are under closer regulatory and supervisory framework of the Reserve Bank of India. Unfortunately, financial reforms have not impacted the functioning of cooperative banks. The financial reforms process initiated in 1991 has tried to achieve regulatory convergence among various financial intermediaries in view of their systematic importance. Therefore the basic objectives and instruments of reforms for cooperative banks have been the same as for State Cooperative Banks (SCB’s). However given the special characteristics of cooperative banks, they have been extended certain dispensations in terms of pace and sequencing of reforms. UCB’s have grown rapidly since the early 1990. During the phase of rapid expansion, however the sector showed certain weaknesses arising out of

1. Lack of sound corporate governance.
2. Unethical lending
3. Comparatively high level of loan defaults.
4. Inability to operate in a liberalized and competitive environment.

The RBI therefore has been striving to harness the growth of UCB’s with appropriate application of prudential regulation and supervision to safeguard the interest of depositors. Keeping in view the weak financial position of many UCB’s the RBI has undertaken a serious of measures directed towards strengthening of the UCB’s. Since 1993, the UCB’s have been advised to adhere to the prudential norms which include the following:

1. Applying capital adequacy standards
2. Prescribing an asset-liability management framework
3. Enhancing the proportion of holding of government and other approved securities for the purpose of (SLR) stipulation
4. Restriction on bank finance against the security of corporate shares and debentures.
5. Limiting the exposure to capital market Investments.
Scheduled bank has 25 Multistate and 26 Single State banks.
Non Scheduled bank has 21 Multistate and 1534 Single State banks.

**Abbreviations:** DCCB’s-District Central Cooperative Banks, PAC’s-Primary Agricultural Credit Societies, StCB’s-State Cooperative Banks, PCARDB’s-Primary Cooperative Agriculture and Rural Development banks, SCARDB’s-State Cooperative Agriculture and Rural Development Banks

**Performance of Urban Cooperative Banks**

**Further consolidation of UCB sector**

The RBI adopted a multi layered regulatory and supervisory strategy aimed at the merger amalgamation of viable UCB’s and the exit of unviable ones for the revival of the sector. As a result the total no of UCB’s at the end of 2013 stood at 1606 as against 1618 in March 2012.

**Tier II UCB’s dominate the business operations of UCB’s**

There has been a stable growth in the B/S of UCB’s were classified into Tier I & Tier II categories based on their deposit base. In recent years Tier II banks, which have a larger deposit base and wider geographical presence, have been grown considerably in terms of both number and asset size.

**Improvement in the financial strength of UCB’s**

The RBI discontinued the erstwhile classification of UCB’s into different grades for regulating & supervisory purposes with the introduction of CAMELS (capital adequacy, asset quality, management, earnings, liquidity, systems & control) rating model to gauge the financial soundness of UCB’s. Under the new camels rating model, a composite rating of A/B/C/D/ in decreasing order of performance is given to a bank, based on the weighted average rating of individual components of camel rating model.
Further increase in asset concentration within the UCB sector in 2012-2013

There has been an increase in asset concentration within the UCB sector in recent years, partly as an outcome of consolidation. The no of UCB’s with an asset size of more than 102 billion increased sharply between 2008 and 2013. Notably the percentage share of such UCB’s in the total assets of UCB sector increased from about 37 to 50% during the period.

Asset growth of UCB’s remained stable in 2012-2013

The assets of UCB’s increased by 11.4% in 2012-2013. There was some moderation in their credit growth owing to sluggish demand in the economy.

Scheduled UCB’s account for nearly half of total assets of UCB’s

Schedule UCB’s are banks included in the second schedule of the RBI Act 1934 and include banks that have paid up capital and reserves of less than 0.5m and which carry out their business in the interest of depositors to the satisfaction of the RBI. At the end of March 2013, there were 51 scheduled UCB’s which had a share of nearly half of the total assets of UCB’s.

CD Ratio of UCB’s contained to be lower than SCB’s

Although the Credit-Dropit (CD) ratio of UCB’s hovered in the vicinity of the preceding year, the ratio continued to be lower than that of SCB’s. However the investment deposits ratio was higher for UCB’s than it was for SCB’s primarily due to deposits of the former with StCB’s and DCCB’s as alluded earlier.

Profitability indicators of UCB’s remained stable in 2012-2013

UCB’s net profits witnessed a moderation during 2012-13. There was a sharp increase in both their interest and non-interest income. However UCB’s total expenditure also rose during the year due to pick up in the interest component of expenditure.

Sustained improvement in the asset quality of UCB’s

The asset quality of UCB’s has witnessed sustained improvement in recent years. The gross NPA’s of UCB’s exhibited a decline in absolute terms as well as percent to total advances in 2012-13 vis-a-vis 2011-12.

Increase in Provisioning Coverage Ratio (PCR) for UCB’s

Provisions for NPA’s of UCB’s have increased over the years.

<table>
<thead>
<tr>
<th>Year</th>
<th>PCR</th>
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<tr>
<td>2008-09</td>
<td>60%</td>
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<tr>
<td>2009-10</td>
<td>70%</td>
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<tr>
<td>2012-13</td>
<td>78%</td>
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About 88% of UCB’s reported CRAR (Capital to Risk Weighted Assets Ratio) above the statutory minimum in 2012-13

The CRAR was above the statutory minimum of 9% at the end of March 2013 with respect to 1415 UCB’s. 191 UCB’s both scheduled and non-scheduled reported CRAR below the statutory minimum as at March end 2013. Among scheduled UCB’s 4 had a negative CRAR.
Credit to small enterprises and housing dominated priority sector advances by UCB’s in 2012-13

The credit to small enterprises and housing accounted for nearly 1/3rd of the total credit of these institutions in 2012-13. These institutions primarily cater to the requirement of urban consumers which explains the predominance of the two sectors in the UCB’s portfolio.

Increase in the provision of credit to weaker sections by UCB’s

Small enterprises, housing loans and micro credit are the 3 major constituents in terms of priority in providing credit to weaker sections by UCB’s. The aggregate credit to weaker sections by UCB’s has increased in 2012-13 as compared to 2011-12.

Concentration of banking business of UCB’s continued to be in the western region

The banking business of UCB’s comprising of deposits plus advances continued to be concentrated largely in the western region, followed by the southern region. These two regions together with 27% of the total districts in India accounted for about 91% of total banking business of UCB’s.

So from the above discussion we can rightly conclude that:

1. UCB’s exhibited improvements in the asset quality, moderation in profitability, however capital adequacy of some institutions remains a concern.
2. Under short term cooperatives the financial performance of State Cooperative banks and District Central Cooperative Banks exhibited improvements however PACS continued to be affected by financial weaknesses.
3. Financial soundness of long term cooperatives continued to be fragile.

Financial Inclusion

Before we look on financial inclusion, we will first see RBI panels 2016 vision with focus on Financial Inclusion.

1. Every adult Indian to have a universal electronic bank account.
2. Every resident would have access to an electronic payment system within 15 minutes of walking distance and it would allow resident to deposit and withdraw cash.
3. Each household would have access to suitable investment and deposit product providers at reasonable charges.
4. Each household would have access to formally regulated lenders.
5. Each household and business will have access to insurance and risk management product.
6. Each low income household and business would have a legally protected right to be offered only suitable financial services.

Financial Inclusion has been a much debated subject for several years now and over the last few years, it has gained a lot of momentum. The issue has been a subject of discussion and development of various financial services industries-banking, capital markets, mutual funds insurance and pension funds.

The RBI plans its developmental initiatives over the next few quarters on five pillars one important pillar being Financial Inclusion i.e expanding access to finance to small and
medium enterprises, the unorganized sector, the poor and remote and underserved areas of
the country through technology, new business practices and new organizational structures.
i.e we need Financial Inclusion. Taking into account their seasonal inflow of income to the
workers and labourers from agricultural operations, migration from one place to another
place, seasonal & irregular availability of work and income, the existing financial system
needs to be designed to suit their requirements and to be more responsive to their needs.
The mainstream financial institutions like banks have an important role to play in their effort not
as a social obligation but as a pure business proposition.

In short we can say that Financial Inclusion is nothing but connecting people with the
banking system, and not just credit. Financial Inclusion is mainly in two ways:

1. One is exclusion from the payment system i.e not having access to a bank account.

2. Second type of exclusion is from formal credit markets requiring the excluded to
   approach informal and exploitative markets.

Rajaram committee which first studied the issue of Financial Inclusion in depth have defined
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 at an affordable
cost from mainstream financial institution.

Need for Financial Inclusion: Financial Inclusion and higher penetration of the formal
banking system into the unbanked areas in the country will not only help in preventing
investors from being lured by illegitimate collective investment schemes across the country.
In the absence of the formal system, investors often fall for such products that collect money
from them and thereby risk their life savings.

What Needs to be Done: While providing bank accounts to all adult individuals in the
country is a dire need, various sectors in the financial services space have seen varied
initiatives. While financial sector regulators RBI & SEBI have been running programmes on
financial inclusion, the RBI panel chaired by Nachiket More has set a target to provide every
adult Indian with a bank account in the next three years. It even proposed the creation of ten
special category banks, including payment bank that would cater to small businesses and low
income households with a relaxed entry level capital requirement of Rs. 50/-crores. It has
also been proposed the formation of WHOLESALE BANKS which can be permitted to
accept deposits of over Rs 5 crores. However it is to be noted that there is unanimity on the
fact that financial inclusion is the need of the hour and RBI will have to be quick to take a
decision on the manner it wants to push financial inclusion.

Achievements so far
The government is successful in the implementation of the following activities so far:

Openings of No-Frills A/C’s
No frills account means nil or very low min balance to be maintained to make such account
accessible to vast sections of the population.

Engaging Business Correspondents
It was in January 2006, the RBI permitted banks to engage Business Facilitators (BF’st)and
Business Correspondents (BC’s) as intermediaries for providing financial and banking
services.

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Use of Technology

Banks especially Commercial Banks are advised to implement CBS so as to enable them effective use of ICT to provide door step banking services through BC Model, wherein the accounts can be operated by even illiterate customers by using biometrics thus ensuring the security of transactions and enhancing the confidence in the banking system.

Relaxation in the KYC Norms

It is to be noted that KYC requirement for opening bank accounts were relaxed for small accounts in August 2005, thereby simplifying procedure. To facilitate of easy opening of accounts especially for small customers, KYC guidelines have been simplified to such an extent that small accounts can be opened without any documentation by just giving a self certification in the presence of bank officials. Aadhar i.e Unique Identification Number being issued to all citizens of India to be used as one of the eligible document for meeting the KYC requirement for opening a Bank Account.

Simplified branch authorization

To address the issue of uneven spread of bank branches in December 2009 domestic scheduled commercial banks were permitted to freely open branches in Tier III and Tier VI centres with population of less than 50000 under general permission. Now even branch authorization has been relaxed to the extent that banks do not require prior permission to open branches even in Tier I centres, subject to reporting.

Opening of Branches in Unbanked Rural Areas

To further step up the opening of branches in rural areas, banks have been mandated to open at least 25% of branches in Unbanked Rural Areas.

Roadmap for providing banking services in unbanked villages with population more than 2000

With Financial Inclusion gaining increasing recognition as a business opportunity and with all banks geared to increase presence we adopted a phase wise approach to provide banking services in all unbanked villages in the country.

Direct Benefit Transfer

The introduction of Direct Benefit Transfer validating identity through Aadhar will facilitate delivery of Social Welfare benefits by direct credit to the bank accounts of beneficiaries.

Financial Literacy

The banks have adopted an integrated approach where financial inclusion and financial literacy go hand in hand. Through financial literacy and education, banks disseminate information on general banking concepts to diverse target groups, including school and college students, women, rural and urban poor, pensioners and senior citizens to enable them to make financial decisions.

New Bank Licenses

To ensure that the banking system grows in size and sophistication to meet the needs of the modern economy and for improving access to banking services, RBI is in the process of evaluation of New Bank Licenses. These new banks is expected to bring new technology, new business and delivery models which would speed up financial services in the rural areas.
Financial Inclusion will work on the ACTA Model A/C’s Cash in Cash out, transactions and adjacencies which will help to build a revenue stream.

CONCLUSION

Apart from what we had discussed about Financial Inclusion so far it cannot be achieved without the active involvement of RBI, All financial Regulators, Banks, Government, NGO’s and Civil Societies. Banks alone will not be able to achieve this unless an entire support system participates in the mission. All the stakeholders need to join hands and make it possible. Governments, IT companies providing solutions and the public at large would bring a decisive metamorphosis in Indian Banking.

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