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2 and 3 Tier Structure of Co-operative Credit (CC) in India: Current Status, Issues and Challenges

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***Abstract* - Co-operative banks in India have come a long way since the enactment of the Agricultural Credit Co-operative Societies Act in 1904. The century old co-operative banking structure is viewed as an important instrument of ba62nking access to the rural masses and thus a vehicle for democratization of the Indian financial system. Co-operative Banking is an agency which, in the words of Henry Wolff , "is in a position to deal with small man on its terms, accepting his security he has and without drawing on the protection of the rich, that the agency must not be channel for pouring charity or subsidizing the small man out of the public funds, instead, the material help must be backed by moral improvement and strengthening of the fiber". Today, short term co-operative credit structure has 32 state co-operative banks and 371 district central co-operative banks operating through 14907 branches. There were 92,996 Primary Agricultural Credit Societies (PACS) as on March 31, 2014 at the grass root level catering to the credit requirements of the members but also providing several non-financial services like input supply, storage and marketing of produce, supply of consumer goods, etc. The journey has not been smooth for the co-operative banking structure. This analysis has been made based on the various data given by Reserve Bank of India (RBI) to trace out the current trend of the co-operative credit institutions also includes the issues and challenges of the two and three tier credit structure of co-operative credit.**
***Keywords:* Co-operative Credit, Co-operative Bank, NPA, two and three tier structure**

I. INTRODUCTION

Co-operative banks in India have come a long way since the enactment of the Agricultural Credit Co-operative Societies Act in 1904. The century old co-operative banking structure is viewed as an important instrument of banking access to the rural masses and thus a vehicle for democratization of the Indian financial system. Co-operative banks mobilize deposits and purvey agricultural and rural credit with a wider outreach. They have also been an important instrument for various development schemes, particularly subsidy based programmes for the poor. The co-operative banking structure in India comprises urban co-operative banks and rural co-operative credit institutions (Abdul Kuddus & Zakir Hussian)

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II. REVIEW OF LITERATURE

Co-operative credit practices came into existence essentially as an institutional mechanism to provide credit to farmers at affordable cost and address the twin issues of rural indebtedness and poverty. With its phenomenal growth in outreach and volume of business, rural credit co-operatives have a unique position in the rural credit delivery system. Through the short and long-term structures, they continue to play a crucial role in dispensation of credit for increasing productivity, providing food security, generating employment opportunities in rural areas and ensuring social and economic justice to the poor and vulnerable. Several committees, from the All India Rural Credit Survey Committee to the Vaidyanathan Committee have stressed the relevance and importance of co-operative credit societies to the development of agriculture and rural economy (Rajagopalan S).

Banks and financial institutions have played a major role in the economic development of the county and most of the credit-related schemes of the government to uplift the rural poor and agricultural community, under privileged sections have been implemented and operated through co-operative banking sector (Periyasamy P & Umamaheswari C).

To provide adequate and timely support from the banking system to the famers for their cultivation needs including purchase of all inputs in a flexible and cost-effective manner, Kisan Credit Card (KCC) scheme was introduced. In this line, co-operative banks accounted for maximum share in the issue of KCC (66.2%) followed y commercial banks (27%) and (Regional Rural Banks (RRBs) 6.8 %. (Selvaraju P).

III. CO-OPERATIVE CREDIT (CC): CURRENT STATUS

Today, short term co-operative credit structure has 32 state co-operative banks and 371 district central co-operative banks operating through 14907 branches. There were

92,996 Primary Agricultural Credit Societies (PACS) as on March 31, 2014 at the grass root level catering to the credit requirements of the members but also providing several non-financial services like input supply, storage and marketing of produce, supply of consumer goods, etc. The journey has not been smooth for the co-operative banking structure. There were legal, structural and organizational rigidities which created conflicts and challenges in the functioning of co-operatives.

Reserve Bank of India (RBI) as regulator of banks is mandated to maintain a sound and stable banking system. Since banks are highly leveraged entities and accept unrestricted amount of uncollateralized public deposits, it is important to ensure that banks operate on sound lines, are well regulated and supervised and public faith in these institutions are sustained.

Economic and financial reforms initiated in early 1990's were focused mainly on commercial banks which have pan-India and international operations. Co-operative banks were kept outside the reforms since these banks had limited area of operations, simple banking products, low volume of business and insignificant share in the total assets and liabilities of the Indian banking system. The regulatory regime continued to be less rigorous for the co-operative banks (Gandhi R). Capital adequacy and other prudential norms were not applied to co-operative banks. However, as commercial banks continued to make significant strides in expansion of business, product diversification and technology adoption, weaknesses in the co-operative system became more and more conspicuous and posed a threat to their survival. Particularly, the relevance and existence of co-operative banks came into question since a large number of state and central co-operative banks were operating without banking license even after 40 years from the date of bringing them in the ambit of Banking Regulation Act.

A major initiative for reforming the short term co-operative credit system (STCCS) came from the Government of India when it constituted a Task Force in August 2004 to suggest an action plan for reviving rural co-operative credit institutions and legal measures necessary for facilitating this process . The Task Force, chaired by Prof. A. Vaidyanathan has recommended that any financial restructuring without addressing the root causes of the weaknesses of the system would not result in its sustained revival. The Task Force made several suggestions including a financial package for cleaning up the balance sheets of STCCS, legal and institutional reforms necessary for co-operatives to function as democratic institutions (Vaidyanathan V). One of the major recommendations was on capital adequacy norms for the three tiers of STCCS (NABARD). The Short –term Co-operative Credit Structure is federal in character uniformly in all the States in the country (Bal Ram Jakhar & Dwivedi RC)

IV. REGULATORY INITIATIVES

The Committee on Financial Sector Assessment recommended that all banks should obtain a license before March 31, 2012 and those who failed to obtain a license should be phased out of a co-operative space in a non-disruptive manner. 25 State Governments signed the (Memorandum of Understanding) MoU for the financial assistance under the Government of India Revival Package for STCCS announced as per the recommendations of the Task Force. Reserve Bank, as a major policy measure, relaxed the licensing norms for state and central co-operative banks. The twin initiatives resulted in licensing of a large number of banks starting from 2008 (RBI).

TABLE I POSITION OF STATE CO-OP. BANKS AND CENTRAL CO-OP. BANKS

Position as on	State Co-op. Banks			Central Co-op. Banks		
	Licensed	Unlicensed	Total	Licensed	Unlicensed	Total
31.3.2006	13	18	31	73	298	371
31.3.2009	14	17	31	75	296	371
31.3.2010	22	9	31	176	195	371
31.3.2011	24	7	31	221	150	371
31.3.2012	30	1	31	329	42	371
31.6.2013	31	1^	32	348	23	371
As on date	32	1*	33	349	22	371

^ Jharkhand StCB licensed on 26.8.2013

* Telangana State Co-operative Bank commenced operations on 1.4.2015

The position of Capital to Risk Assets Ratio CRAR in respect of state and central co-operative banks as on March 31, 2013 revealed that 23 out of 31 state co-operative banks (StCBs) and 278 out of 371 central co-operative banks (CCBs) had CRAR above 7%. Six StCBs and 48 CCBs had CRAR between 4% and 7% (Abdul Kuddus & Zakir Hussian). The RBI felt that the time was appropriate to introduce Basel I capital adequacy framework to these banks. Hence, the banks were placed under phased implementation of Basel I norms with a target of 7% CRAR by March 31, 2015 and 9% CRAR by March 31, 2017. The banks were allowed to raise the additional capital resources through Long Term (Subordinated) Deposits and Innovative Perpetual Debt Instruments. As on March 31, 2015, 30 StCBs and 301 CCBs had CRAR of 7% or above.

Pursuant to the Banking Laws (Amendment) Act 2012, CRR to be maintained by non-scheduled StCBs and CCBs and SLR to be maintained by all StCBs and DCCBs were brought on par with commercial banks from the fortnight beginning July 12, 2014. Eligible assets for SLR were also brought on par. With a view to enabling the banks to meet the revised requirements, a roadmap was provided to phase out the existing SLR term deposits by March 31, 2017(RBI).

Regulatory functions related to urban and rural co-operative banks have been brought under a single department within RBI with effect from October 1, 2014. Erstwhile Urban Banks Department was bifurcated and rechristened as Department of Co-operative Bank Regulation (DCBR) and Department of Co-operative Bank Supervision (DCBS). While supervision of UCBs is vested with DCBS, supervisory functions in respect of StCBs and CCBs remain with NABARD. The new arrangement is aimed at achieving synergy and harmonization in regulation of co-operative banks without losing sight of the structural differences in rural and urban co-operative credit systems.

Some of the recent policies aimed at harmonization of regulation of co-operative banks are related to increase in gold loan bullet repayment limit from ` One lakh to ` Two lakh, guidelines on opening of branches / extension counters by state co-operative banks, issue of Automated Teller Machine (ATM) / Debit cards, guidelines on setting up mobile / off-site ATMs and internet banking and permission to StCBs / DCCBs for investment in Market Infrastructure Companies like National Payments Corporation of India NPCI, Clearing Corporation of India Ltd (CCIL), etc. With a view to speeding up approvals, the delegation of authority powers has given to Regional Offices in most of these areas.

V. FINANCIAL PERFORMANCE OF STATE AND CENTRAL CO-OPERATIVE BANKS

Today the StCBs and DCCBs display a reasonable financial strength. Their combined capital and reserves stood at Rs.20.1 thousand crores for the StCBs and Rs.51.04 thousand crores for the DCCBs as on March 31, 2015. The combined balance sheet, as on March 31, 2015, of all state co-operative banks stood at Rs.1.98 lakh crore and that of the district central co-operative banks at Rs.4.06 lakh crore. Their Gross Non-Performing Assets (GNPA) stood at 4.8% and 9.1% respectively as on March 31, 2015. Their combined Net Profits were Rs.1,005 crore and Rs.793 crore respectively (Selvaraju P).

A. State Co-operative Banks

TABLE II COMPOSITION OF LIABILITIES AND ASSETS OF AS ON 31 MARCH 2012, 2013, 2014 AND 2015 (RS.IN CRORE)

Sr. No.	Item	As on March 31				Growth Rate		
		2011-12	2012-13	2013-14	2014-15	2012-13	2013-14	2014-15
1	2	3	4	5	6	7	8	9
Liabilities								
1	Capital	3508.47	3053.59	4537.67	5164.53	-12.97	48.60	13.81
2	Reserves	11823.68	12331.13	11147.76	14845.63	4.29	-9.60	33.17
3	Deposits	86428.84	94516.14	104207.43	102591.87	9.36	10.25	-1.55
4	Borrowings	43424.04	50947.50	60938.92	68413.44	17.33	19.61	12.27
5	Other Liabilities	7564.23	7445.42	6752.64	6838.11	-1.57	-9.30	1.27
Total Liabilities		152749.26	168293.78	187584.42	197853.58	10.18	11.46	5.47
Assets								
1	Cash & Bank balances	7835.78	8729.02	18286.26	6469.95	11.40	109.49	-64.62
2	Investments	58427.32	59389.3	61880.15	69592.96	1.65	4.19	12.46
3	Loans and Advances	77675.09	93257.94	103116.68	114221.84	20.06	10.57	10.77
4	Other Assets	8811.07	6917.51	4301.33	7569.13	-21.49	-37.82	75.97
Total Assets		152749.26	168293.78	187584.42	197853.58	10.18	11.46	5.47

B. District Central Co-operative Banks(DCCBs)

Asset qualities of StCBs / DCCBs have improved over the last three years as may be seen from the fall in the percentage of NPAs between 2013 and 2015. However, the percentage of recovery to demand is a concern since it is showing a declining trend. There are wide variations region-wise too. In 2014, NPAs of StCBs varied between 1.93% in northern region and 17.12% in north-eastern region. In respect of CCBs, it was 5.27% in northern region and 10.98% in eastern region. During the same year, percentage of recovery to demand was 97.9 in northern regions and 49.10 in north-eastern regions for StCBs. Recovery to demand was 83.16% in northern region and 67.23% in eastern region in respect of CCBs (Amrit R. Patel).

TABLE III COMPOSITION OF LIABILITIES AND ASSETS OF AS ON 31 MARCH 2012, 2013, 2014 AND 2015 (RS. IN CRORE)

Sr. No.	Item	As on March 31				Growth Rate		
		2011-12	2012-13	2013-14	2014-15	2012-13	2013-14	2014-15
1	2	3	4	5	6	7	8	9
Liabilities								
1	Capital	8913.85	9700.84	11147.76	12942.53	8.83	14.9	16.10
2	Reserves	24785.29	30299.71	29044.59	38102.41	22.25	-4.14	31.19
3	Deposits	187770.03	208218.15	235920.76	257563.83	10.89	13.3	9.17
4	Borrowings	53924.39	64968.09	72776.30	80199.64	20.48	12.0	10.20
5	Other Liabilities	19817.32	21281.93	15139.04	16917.15	7.39	-28.86	11.75
Total Liabilities		295210.90	334468.72	364028.45	405725.56	13.3	8.84	11.45
Assets								
1	Cash & Bank balances	21028.96	19214.98	22974.75	21842.77	-8.63	19.57	-4.93
2	Investments	93869.59	104090.60	121593.49	137741.44	10.89	16.82	13.28
3	Loans and Advances	157184.4	183969.57	202672.62	219197.92	17.04	10.17	8.15
4	Other Assets	23127.98	27193.57	16787.59	26943.43	17.58	-38.27	60.50
Total Assets		295210.90	334468.72	364028.45	405725.56	13.3	8.84	11.45

TABLE III STATE CO-OPERATIVE BANKS

Year	CRAR %				
	< 4	4 to <7	7 to <9	9 & above	Total
2012-13	2	6	7	17	32
2013-14	0	6	7	19	32
2014-15	2	0	11	19	32

TABLE IV CENTRAL CO-OPERATIVE BANKS CRAR- 2012-13, 2013-14 AND 2014-15

Year	CRAR %				
	< 4	4 to <7	7 to <9	9 & above	Total
2012-13	45	47	70	208	370
2013-14	24	45	77	222	368
2014-15	43	27	93	208	371

VI. ISSUES AND CHALLENGES

1. Some of the major issues to be addressed by the co-operative banking sector relate to governance, management, sound capital base, technology, risk management and frauds. The format has prescribed fit and proper criteria for Chief Executive Officers of StCBs and CCBs. The Constitution (97th Amendment) Act mandates appointment of at least two professional directors in the Boards of co-operative banks (Sharma V.K). The Act has also covered other issues aimed at improving governance and autonomous functioning of co-operative societies such as engagement of professionally qualified auditors, tenure of Board, conditions for supersession of Board, active participation of members in annual general meetings, etc. Implementation of these directions in their true spirit is critical for ensuring good governance and management practices (ISSC).
2. The Constitution (97th Amendment) Act requires that audit of a co-operative society to be conducted by qualified auditors or auditing firm to be appointed from the panel prepared by the State Government. National Bank for Agriculture and Rural Development (NABARD) has requested Registrar of Co-operative Societies (RCS) of all states to provide chartered accountants for conducting statutory audit of StCBs / DCCBs. It comes across large divergence between audited financial parameters and that assessed by NABARD, particularly in respect of reporting of NPAs and provisioning. Since audited financial statements are relied upon for granting various regulatory approvals and assessing compliance standards, quality of statutory audit needs to be improved. For achieving this, RBI has planned to conduct workshops / seminars for statutory auditors to familiarise them with the instructions. RBI will be taking the help of Institute of Chartered Accountants for preparing a standard audit report format for co-operative banks (Deepali Pant Joshi).
3. Co-operative banks should improve their bottom line through internal accruals without relying on frequent bouts of capital infusion by the government (Gandhi.R). They should review their pricing policies on deposits and loans, appraisal systems, recovery procedures, major expenditure items and devise suitable action plan to plug leakages and augment income. Implementation of effective loan appraisal policies at the approval stage will ease the pressure on recoveries at a later date and help to curtail expenditure on litigations. Continuous monitoring of loan accounts with give signals on creeping sickness and

delinquencies and effective steps aimed at recovery at an early stage will prevent deterioration of asset quality. Further, higher provisioning towards NPAs severely erodes profitability. Banks should look for more fee-based activities to supplement their earnings.

4. Another area of persistent and serious concern to us and NABARD is that co-operative banks are unable to prevent frauds. Most of the times, the frauds have been perpetrated by or in collusion with the banks' own staff. As on March 31, 2015, state and central co-operative banks have 2589 cases of frauds with outstanding amount of Rs.877.7 crore. If the banks are unsuccessful in recovering the amount, the losses have to be absorbed by them. Co-operative banks need to think whether frauds are really non-preventable.
5. Technology adoption is an imperative in today's banking. Implementation of CBS in StCBs and DCCBs which was started in 2012 has been completed in all 32 StCBs and 347 licensed DCCBs. These banks can now offer RTGS and NEFT facilities to their customers through direct or sub-membership route and also participate in Direct Benefit Transfer Scheme. RBI has already circulated the criteria for offering mobile and internet banking facilities by these banks. Since the technology brings its own risks, co-operative banks should have proper risk assessment and risk mitigation policies in place. Sound internal control system is critical to prevent frauds, data integrity and leakage of customer information. Banks should develop wherewithal to handle the liabilities that would devolve on them due to failures in internal controls. Any lapses on this count will not only impose cost in terms of money but also loss of customers' faith.
6. Rural co-operatives have enormous potential to deliver financial inclusion to remote locations leveraging technology. NABARD extends support to co-operative banks in implementing the technology assisted banking platform and setting up Financial Literacy Centres and Common Service Centres with (Information and Communication Technology (ICT)-enabled kiosks to create awareness and demand for products and services. Financial assistance is provided from Financial Inclusion Fund for implementation of CBS in co-operative banks, data migration from PACS to DCCBs, issue of RuPay and Kisan Credit Card (KCC) cards and meeting expenditure towards micro-ATMs and the Point of Sale (POS) terminals. Co-operative banks should join hands with NABARD to reach financial products and services to the unserved.
7. Implementation of mobile and internet banking will facilitate anywhere banking without any necessity for the customers to visit banks' premises. Since physical interactions with customers will be limited or nil, banks should pay attention to adequate (Know Your Customer) KYC checks. Proper care should be taken at the time of engaging the services of third party service providers for managing the (Information Technology) IT systems and outsourcing database management activities.
8. With the adoption of technology and liberalisation of regulatory policies, co-operative banks are foraying into new business activities where they have no familiarity. Training and capacity building assumes importance in the present context. Adequate training should be imparted to people at all levels including employees, Board of Directors and auditors to improve productivity, efficiency and professionalism. Co-operative banks should make use of financial assistance for capacity building provided by NABARD from Co-operative Development Fund and under Scheme of Financial Assistance for Training of Co-operative Banks Personnel (SOFTCOB). Co-operative banks may avail of training facilities available in the training establishments of RBI, NABARD and various co-operative training institutions.
9. Today's customers have more awareness about their rights and demand transparency in the banking system. Leveraging the technology, every co-operative bank should provide on its website where customer can access information about products, procedures, forms, fees / charges, annual reports, etc. Customers should have the facility to communicate to the bank through e-mails. Transparency will improve confidence of customers, bank's image and reduce complaints.
10. Co-operative banks are now functioning in a highly competitive environment. Entry of more players in the banking arena and technology has increased options to customers and banks have both opportunities to grow and challenges for survival. Co-operative banks with their intimate knowledge of customers and familiarity with the area of operation can attract new customers and retain the existing clientele with their unique selling proposition. However, this can be achieved only with suitable changes in outlook, processes, business model and strategy.

VII. CONCLUDING REMARKS

Co-operative credit delivery has played in an important role in accelerating the process and progress of financial services in the society at all levels in town as well as rural areas. Co-operatives provide credit needs to people those are neglected by the commercial banks and other financial institutions. Co-operative credit mechanism can promote healthy financial services to masses with a value driven. The existing system of co-operative banks can be revamped with modernization and digitalization to promote healthy and value-oriented financial services in India.

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