Deepali Pant Joshi: Strengthening and revitalising rural cooperative credit delivery system

Speech by Dr Deepali Pant Joshi, Executive Director of the Reserve Bank of India, at the National Meet of CEOs of State Cooperative Banks, Mumbai, 21 March 2014.

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1. I am extremely happy to be with you today and thank Dr. Harsh Kumar Bhanwala, Chairman, NABARD and the organizers of this National Meet of State Cooperative Banks for inviting me to share the Reserve Bank's perspectives.

2. Since inception the Indian Cooperative movement was initiated by the Government to align the rural credit system with the objectives of development planning. The RBI played an important role. The RBI's concern and involvement in the sphere of rural credit stemmed from its very statute of incorporation. Specific provisions were made in the Reserve Bank of India Act 1934 for the establishment of an Agricultural Credit Department and for extending refinance facilities to the cooperatives. RBI laid emphasis on strengthening and ensuring viable provincial cooperative bank, central cooperative banks, marketing societies and primary agricultural credit societies in each province for seasonal agricultural operations.

Role of cooperatives

3. The cooperative movement in the country, originated as a measure against rural poverty, agrarian disturbances in 1875 in the Deccan against moneylenders led to the enactment of Taccavi legislation in 1892. Sir Frederick Nicholson recommended the establishment of cooperative societies on the Raiffeisen model popular in Germany. Thus, cooperatives as people's institutions have a long legacy and a rich tradition in India. The founders of Planning in India considered cooperation an instrument of economic development combining the advantages of private ownership with public good.

4. Rural credit cooperatives in India were originally envisaged as a mechanism for pooling the resources of people with small means and providing them access to cheap and cost-effective financial services. Democratic in features, the movement was also an effective instrument for development of degraded waste lands, increasing productivity, providing food security, generating employment opportunities in rural areas and ensuring social and economic justice to the poor and vulnerable. In light of this, the cooperatives occupy an important position in the Indian financial system.

Cooperatives were the first formal institutions to be conceived and developed to purvey credit to rural India and have been a key instrument of credit delivery to enable farmers to meet their production needs and so increase production and productivity in the rural areas.

Evolution of cooperatives in India

5. ***In the first Phase (1900–1930)***, the cooperative movement originated due to the initiative of the colonial government in the early 20th century. The idea of establishing cooperatives of the type that worked successfully in Germany was mooted in the late 19th century. These cooperatives were seen as a means to liberate the poor farmers from the clutches of usurious money-lenders. The Government passed the Cooperative Societies Act in 1904 followed by a more comprehensive Cooperative Societies Act later in 1912. In 1915, the Maclagan Committee advocated that "there should be one cooperative for every village and every village should be covered by a cooperative." The Royal Commission made the observation "if cooperation fails, there will fail the best hope of rural India".

6. ***In the second Phase (1930–1950)***, by virtue of the provisions of the RBI Act, the Reserve Bank was given a mandate to closely associate with matters relating to rural credit and banking. RBI Act provided for both the establishment of an Agricultural Credit Department in the bank and extension of refinance facilities to the cooperative credit system. RBI introduced credit facilities to provincial cooperative banks for seasonal agricultural operations and marketing of crops from 1942.

7. ***In the third Phase (1950–1990)***, a major initiative for pursuit of the mandate given to the Reserve Bank was taken with sponsoring of All India Rural Credit Survey in 1951–52. The study recommended an integrated approach to cooperative credit and emphasized the need for viable credit cooperative societies by expanding their area of operation, encouraging rural savings and diversifying business. The Committee also recommended government participation in the share capital of the cooperatives. The National Commission on Agriculture (1976) recommended setting up of Farmers Service Cooperative Societies with the active collaboration of the nationalized banks. The involvement of commercial banks was institutionalized through nationalization of major commercial banks in 1969, causing unprecedented penetration of commercial banks in the rural sector. The State has used co-operatives to channel its development schemes, particularly subsidy-based programs for the poor. As these institutions have a wide reach in the rural areas and also deal with finances, the choice was natural.

8. By 1982, to consolidate the various arrangements made by the RBI to promote / supervise institutions and channel credit to rural areas, NABARD was established based on the recommendation of the CRAFICARD (Sivaraman Committee 1981). The Agriculture Credit Review Committee (Khusro Committee, 1989) stressed the importance of encouraging members' thrift and savings for the cooperatives. It also emphasized the need for better business planning at the local level and for strategies to enable cooperatives to be self-sustaining. To this end, the Committee was in favor of serving non-members, if it made business sense. The 1990s witnessed more concerted attempts by both the government and non-official organisations and cooperators, to explore ways to revitalize the cooperatives.

9**. *In the Fourth Phase (1990s and onwards)***, there has been an increasing realization of the deleterious impact of intrusive State patronage, politicization, and the consequent impairment of the role of cooperatives in general, and of credit cooperatives in particular, leading to a quest for reviving and revitalizing the cooperative movement. Several Committees were set up to suggest cooperative sector reforms during this period.

Short Term Cooperative Credit Structure (STCCS)

10. Since inception, cooperatives have made available institutional credit at affordable cost particularly to the agricultural sector. The Short-term Rural Cooperative Credit Structure (STCCS) provides mainly short term and medium-term production credit besides other financial services. At present, there are nearly 92,432 Primary Agricultural Credit Societies (PACS), 371 District Central Cooperative Banks (DCCB) with 13,233 branches and 32 State Cooperative Banks (SCB) with 992 branches. On an average, there is one PACS for every 8 villages. These societies have a total membership of more than 120 million rural people making it one of the largest rural financial systems in the world. 60% of population still depends upon the agricultural income.

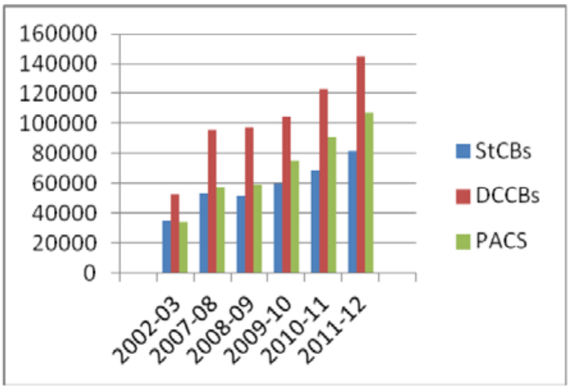
Performance of rural cooperative banks in extension of agriculture credit

11. Institutional lending to agriculture and allied activities has recorded a significant growth during the last two decades due to the aggressive policy of the government in expanding credit to agriculture. The following figure depicts the growth in agricultural credit distributed by the STCCS:

Performance of STCCS under agricultural Credit

(Rs. in crore)

Years	StCBs	DCCBs	PACS
2002-03	35052	52820	33996
2007-08	53314	95974	57642
2008-09	51866	97207	58787
2009-10	59784	104997	74938
2010-11	68481	122795	91304
2011-12	81523	144761	107300



12. Lending by cooperative credit institutions grew much faster than that by other banks during the 1990s. Thereafter, their share has been declining since 2007–08. Despite this fall, cooperatives clearly remain the major source of agricultural credit to small and medium farmers in terms of the number of borrowers and size of individual loans.

Agricultural Loans Disbursed during the Year (Rs. in crore)						
Agency	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Coops.	42,480 (18)	48,258 (19)	46,192 (15)	63,497 (17)	78,121 (17)	87,963 (17)
RRBs	20,435 (9)	25,312 (10)	26,765 (9)	35,217 (9)	44,293 (9)	54,450 (11)
CBs	1,66,485 (73)	1,81,088 (71)	2,28,951 (76)	2,85,800 (74)	3,45,877 (74)	3,68,616 (72)
Total	**2,29,400**	**2,54,658**	**3,01,908**	**3,84,514**	**4,68,291**	**5,11,029**
Figures in brackets indicate percentage share of different agencies to total agricultural credit						

Problems of cooperatives

13. Despite the phenomenal outreach and volume of operations, the health of a very large proportion of rural credit cooperatives has deteriorated significantly. The institutions are beset with problems like poor governance infrastructural weaknesses, operational inefficiencies and the consequent impairment of their financial health. Several factors such as low borrowing membership, low resource base, lack of democratization and professionalism, high incidence of overdues and almost stagnant recovery performance have led to the deterioration in the financial soundness of cooperatives. There is an urgent need to find ways for strengthening the cooperative movement to meet the credit needs of rural India, especially the resource-poor and resource-less poor farmers. The revitalization and strengthening of cooperative institutions at all levels should therefore be considered not only desirable but expedient. The thrust has to be four-fold, financial, operational, organizational and systemic.

Poor governance

14. Cooperatives operate within the legal framework formulated by state governments. However, compliance with the legal provisions of the State Cooperative Societies Acts has not been ensured. Governance, connected lending, transparency in grant of loans, audit, internal checks and control, recovery of dues, recruitment of qualified persons are issues trammeling the efficient functioning of cooperatives.

15. As dominant share holders, state governments interference in the management of cooperatives. Supervision and guidance by the elected Boards is lax. Delay in conduct of elections, frequent supersession of the Boards, lack of participation by members in the management and decision-making process have impaired functioning of cooperatives on sound business lines. In the absence of professional management, accountability and uncertain tenures, the Board members are not able to provide dynamic leadership to the organization. Restoring and strengthening autonomy, mutual help and self governance are the cornerstone of the cooperatives.

Absence of prudent interest rate policies

16. Cooperatives have access to huge deposits from public but there is no system to ensure prudent deployment of these funds. They have not taken advantage of the freedom given to them to decide on the interest rates on deposits and advances. While deposits are accepted at unsustainably higher rates, loan pricing is done in imprudent manner without factoring in cost of funds. Many cooperatives are unable to generate enough revenue or surplus to sustain their operations and boost capital formation on account of very thin or negative margins. As a result, there are frequent demands for recapitalization which causes pressure on the limited resources of governments which could have been used for productive investments benefitting the society in large.

Lack of HR policies and professionalism

17. The quality of human resources is an important determinant of the success of any organization. This aspect, however, has not received due importance in the cooperative institutions. The cooperative banks are headed by a committee of elected members who are not professionals and do not possess sound knowledge in banking functions. The Committee takes crucial business decisions involving sanction of loans, investments, interest rates on deposits and loans, etc. which require a minimum degree of skill and expertise. Often, the role of Chief Executive Officers in these areas is minimal.

18. Cooperatives do not have well defined capacity building and HR policies in crucial areas like recruitment, placement, training, career progression, succession planning, etc. Recruitments are done without any objective and systematic manpower assessment. All these have led to inefficiency and lower productivity. Though there is a system of training in place in many cooperative banks, there is no need-assessment to align training with the current and future staff requirements. Training programs should be designed to achieve skill upgradation in areas related to audit and expenditure, management and aptitude development. It is also necessary to keep the staff sufficiently motivated through periodic job rotation, job enrichment and recognition of performance.

Poor recovery performance

19. Frequent loan waiver announcements by governments aimed to garner electoral support have vitiated the credit discipline among the borrowers and affected the recovery atmosphere. The resultant weak finances, growing NPAs and poor resource base have contributed to the declining performance of the cooperatives, particularly at the grass root level. Since these grass root institutions depend on liquidity support from higher financing

agencies like State and Central Cooperative Banks, non-payment of dues impairs the financial health of the entire chain.

Inadequate internal control and audit

20. Cooperatives do not pay attention to implementation of adequate and foolproof internal checks and control. Balancing of books and reconciliation of entries are in arrears for unduly long periods. As a result, there is frequent incidence of frauds involving the staff who game the system. Very often, these cases are held up due to protracted litigation in Courts of law and the guilty are not brought to book .There is absence of effective audit mechanism. There are delays in the conduct of audits and submission of reports. Quality of audit leaves much to be desired in as much as it fails to address the gaps in the systems and processes and improve efficiency of operations of the cooperatives.

Lack of member participation

21. The cooperative structure should be member-driven. However, members having a voting right do not take active part or show interest in the affairs of the cooperatives since the control and management is vested in a few members .Besides, depositors, whose money is intermediated by the cooperatives, have no voting right or any say in the management.

Not keeping pace with changes

22. Cooperatives have been unable to adapt themselves to the rapid pace of changes in the financial sector. Cooperatives have lagged behind in designing of new products and services and in adoption of technology and advanced management practices that have changed the face of financial sector in the post economic-liberalization era. As a result, they are unable to cope with the stiff competition posed by other banks in rural finance and retain their market share.

Duality of control

23. Under the Constitution, ‘Cooperation’ is a state subject governed by the respective State Cooperative Societies Acts. Registration, incorporation, management, election, and audit are governed by the State Acts. Some aspects relating to banking activities are regulated and supervised by the Reserve Bank of India / NABARD under the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies). There is an urgent need to remove the overlapping controls and endowing functional autonomy and operational freedom to cooperatives. Banking functions should be brought completely under the Banking Regulation Act. The provisions of the Banking Regulation Act should override the provisions of the State Acts/bye-laws/rules which run counter to it. This will lead to clear demarcation of the areas of activities of cooperative banks.

Need for revival of the cooperative credit institutions

24. It is pertinent to mention that in the first place, India is a country with a population of more than 110 crore, of which around 70 crore reside in a little over 6 lakh villages. As there are a little over ninety two thousand PACS in the country, every 8th village, on an average, has an existing cooperative credit outlet. It is in this context that the role of cooperatives assumes importance. A number of Committees were set up to suggest reforms in the sector. Based on the recommendations of the Vaidyanathan Committee, the Government of India rolled out in January 2006, a package for revival of the Short-Term Rural Co-operative Credit Structure. The Task Force also suggested wide-ranging reforms in the governance and management of STCCS including crucial amendments to the respective State Cooperative Societies Acts

that were to precede the recommended one-time capitalization jointly by the Central government, the state governments and the STCCS of the state itself.

25. Twenty-five state governments signed the MoU with Government of India and NABARD to participate in and implement the package. As on December 2012, 21 states had amended the respective State Cooperative Societies Act. An amount of Rs. 9,002 crore was released by NABARD as the Government of India's share, while the state government released Rs. 856 crore as their share for recapitalisation of 53,202 eligible PACS in 17 States. Recapitalisation assistance could not be released in many cases as the states did not complete all the necessary benchmark activities within the stipulated period.

Licensing of rural cooperative banks

26. The Committee on Financial Sector Assessment set up by the Government of India in September 2006, under the Chairmanship of Dr. Rakesh Mohan, looked into the financial health of all the banks including the cooperative banks and made recommendations for improvement of financial health and systems for attaining and maintaining financial stability. A major recommendation of the Committee was to prohibit unlicensed banks from functioning beyond March 2012.

27. As there were a large number of cooperative banks (17 out of 31 State Cooperative Banks and 296 out of 371 District Central Cooperative banks) functioning without license, the Reserve Bank of India relaxed the licensing norms to grant license to these banks. The relaxed norms were

i) Capital to Risk-weighted Assets Ratio (CRAR) – Minimum 4 %, and

ii) Compliance with CRR and SLR for the last one year (default on one or two occasions were permitted).

Consequent upon relaxation of licensing norms, 50 banks qualified for issue of license reducing the number of unlicensed banks from 73 as on February 29, 2012 to 43 as on March 31, 2012 and further to 23 as on June 30, 2013.

Progress in licensing of State and Central Cooperative Banks

Position as on	StCBs			DCCBs		
	Licensed	Unlicensed	Total	Licensed	Unlicensed	Total
31 March 2006	13	18	31	73	298	371
31 March 2009	**14**	**17**	**31**	**75**	**296**	**371**
31 March 2012	30	01	31	329	42	371
30 September 2012	31	-	31	330	41	371
30 November 2012	**31**	**-**	**31**	**345**	**26**	**371**
31 March 2013	**31**	**-**	**31**	**348**	**23**	**371**
31 December 2013	**32***	**-**	**32**	**348**	**23**	**371**

* The Jharkhand State Coop. Bank was issued license on 26 August 2013

Recent policy initiatives

Implementation of core banking solution

28. The Reserve Bank of India has granted permission to StCBs and CCBs to participate in the payment system and offer RTGS/ECS/NEFT facilities to their customers/members. Since IT infrastructure is the prerequisite for offering these services, Core Banking Solution (CBS) is being implemented in StCBs and CCBs. Several banks have joined the NABARD assisted

project and made significant progress in implementation of CBS. Some banks have undertaken implementation of CBS on their own. Full implementation is expected to be achieved by March 31, 2014.

Progress in implementation of CBS as at January 31, 2014

No of banks		CBS completed		CBS in progress		Yet to commence	
StCBs	DCCBs	StCBs	DCCBs	StCBs	DCCBs	StCBs	DCCBs
32	**371**	28	294	4	55	-	22

Prudential norms on capital adequacy

29. Rural cooperative banks have been kept out of Capital to Risk-Weighted Assets Ratio (CRAR) framework for a long time on the grounds that there is an in-built accretion to capital every time a loan is availed of by a member. In view of the high level of default characterizing the STCCS and the risk posed by higher concentration of loan portfolios of these banks in a single sector with defined areas of operation, the Vaidyanathan Task Force recommended for bringing all tiers of the STCCS under the CRAR framework. The Reserve Bank of India recently reviewed the position of CRAR in StCBs and CCBs and has introduced the minimum CRAR requirement for these banks. A roadmap has been laid down for achieving CRAR of 7% by March 31, 2015 and 9% by March 31, 2017.

30. Since these banks have limited avenues of mobilizing additional capital resources, permission has been granted for issue of Long Term (Subordinated) Deposits and Innovative Perpetual Debt Instruments. State / Central Co-operative Banks (StCBs / CCBs) are now allowed to issue Long Term (Subordinated) Deposits (LTD) with the prior permission of the respective Registrar (RCS) granted in consultation with the Reserve Bank. LTD can be issued to members and non-members, including those outside the area of operations of the StCBs / CCBs concerned. There is no prohibition on existing shareholders subscribing to LTD. The amounts raised through LTD will be eligible to be treated as lower Tier II capital, subject to certain conditions.

31. State / Central Co-operative Banks are also allowed to issue Innovative Perpetual Debt Instruments (Innovative Instruments). The instruments may be issued as bonds or debentures to qualify for inclusion as Tier I Capital for capital adequacy purposes. Banks are required to obtain prior approval of the Reserve Bank of India, on a case-by-case basis, for issue of innovative instruments. Innovative instruments shall not exceed 15 per cent of total Tier I capital. Innovative instruments in excess of the above limits shall be eligible for inclusion under Tier II, subject to limits prescribed for Tier II capital. However, investors' rights and obligations would remain unchanged.

Membership of credit information companies

32. Under the Credit Information Companies (Regulation) Act, 2005, all co-operative banks are credit institutions and every credit institution has to be a member of at least one Credit Information Company (CIC). State and Central cooperative banks are required to take membership of at least one CIC. In developing economies, lending, especially to retail, has been made possible by credit information companies, which perform the vital task of collating and distributing reliable credit information to the specified users. Reports from CICs contain information about the payment behaviour of consumers and commercial entities, including data on timely fulfillment of or delinquency in meeting the financial obligations. It helps credit institutions in making an informed decision about a credit applicant.

State cooperative banks – guiding role

33. State Cooperative Banks are the apex level institutions in the federal structure of STCCS. They accept huge deposits from the affiliated / member societies and also from non-members. They provide liquidity support and financial accommodation to the member societies down the chain. Large volume of funds in the form of governmental assistance under various welfare and subsidy schemes, grants and refinance from higher refinance agencies are channeled through state cooperative banks to the lower tier institutions. Hence, it is the responsibility of the state cooperative banks to provide guidance and direction to the member societies and ensure that the valuable resources are not frittered away and diverted to investments in risky assets. Weaknesses in lower tier institutions would eventually move up the chain and bring down the entire edifice of the federal cooperative credit structure. Even strong state cooperative banks would face threat to their survival if the structural weaknesses are not addressed in a timely manner.

34. State cooperative banks have a larger role in the development of the state economy. They should rise above the self-interest and work for serving the economic interests of the society at large. It need not be emphasized that these banks should keep their own house in order and conduct themselves with unquestionable integrity and social responsibility.

Way forward

35. Cooperatives have inherent advantages as member-owned and member-controlled institutions. Successive governments have acknowledged their role in improving the productivity and eradication of poverty among the rural masses and contribution to development of rural economy and provided support and assistance as a part of State-promoted policies. However, cooperatives have to make sustained efforts to address the constraints and inadequacies discussed above.

36. To sum up, cooperatives should practice good corporate governance and social responsibility. These institutions should be purely “member-driven” keeping the principle of cooperation in letter and spirit. Professionalism should be introduced in staffing and adequate training opportunities should be provided to the employees of cooperatives for skill upgradation. They should frame sound and prudent policies for loans and investments and conduct themselves in the larger interests of the depositors and the general public. Cooperatives should overcome their inertia and resistance to change and emerge as technology-driven, well-managed institutions to inspire confidence in the public and secure their survival.

Thank you for a patient hearing.