Chapter - 6
Cooperative Credit Institutions

Cooperative Credit Movement over the Years - An Overview

6.01 Rural credit cooperatives in India were originally envisaged as a mechanism for pooling the resources of people with small means and providing them with access to different 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.

6.02 The history of the cooperative credit movement in India can be divided in four phases. In the First Phase (1900-30), the Cooperative Societies Act was passed (1904) and "cooperation" became a provincial subject by 1919. The major development during the Second Phase (1930-50) was the pioneering role played by RBI in guiding and supporting the cooperatives. However, even during this phase, signs of sickness in the Indian rural cooperative movement were becoming evident. The 1945 Cooperative Planning Committee had discerned these signs in the movement, finding that a large number of cooperatives were "saddled with the problem of frozen assets because of heavy overdues in repayment." Even so, also in the Third Phase (1950-90), the way forward was seen to lie in cooperative credit societies. The All India Rural Credit Survey was set up which not only recommended state partnership in terms of equity but also partnership in terms of governance and management. NABARD was also created during this phase. The Fourth Phase from 1990s onwards saw an increasing realization of the disruptive effects of intrusive state patronage and politicisation of the cooperatives, especially financial cooperatives, which resulted in poor governance and management and the consequent impairment of their financial health. A number of Committees were therefore set up to suggest reforms in the sector.

Outreach of the Cooperative Credit Sector

6.03 Of high relevance for financial inclusion of lower income people is especially the Short-term Rural Cooperative Credit Structure (STCCS) providing mainly short and medium-term credit besides other financial services.[5] At present (March 2005), the three tier STCCS consists, according to statistics of the National Federation of State Cooperative Banks (NAFSCOB), of nearly 1.09 lakh Primary Agricultural Credit Societies (PACS), 368 District Central Cooperative Banks (DCCB) with 12,858 branches and 30 State Cooperative Banks (SCB) with 953 branches or a total of 122,590 service outlets. On an average, there is one PACS for every 6 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.

[5] The Long-term Cooperative Credit Structure provides mainly long-term agriculture investments loans and consists of 20 State Cooperative Agriculture and Rural Development Banks (SCARDB) and 696 Primary Cooperative Agriculture and Rural Development Banks (PCARDB).

Performance of Rural Cooperative Credit Institutions

Primary Agricultural Credit Societies

6.04 Primary Agricultural Credit Societies, the credit institutions at the grass-root level deal directly with individual members / clients. A large proportion of PACS also serve as outlets for inputs and for the public distribution system for food and other essential items. The total membership of PACS as on 31 March 2005 aggregated to 1,274 lakh, of which, the borrowing members at 451 lakh constituted around 35% (table below). The total as well as borrowing members of PACS declined during 2004-05. Deposits and borrowings of PACS increased by 5 and 17%, respectively, as on 31 March 2005 over the previous year. The loans issued increased by 12% during 2004-05 as compared to an increase of 3.3% during 2003-04, over the previous year.

Particulars (31 March)	**PACS**		
	2003	**2004**	**2005**
No. (lakh)	1.12	1.06	1.09
Members (cr.)	12.36	13.54	12.74
Borrowers (cr.)	6.39	5.13	4.51
Owned funds (Rs. cr.)	8198	8397	9197
Deposits (Rs. cr.)	19120	18143	18976
Borrowings (Rs. cr.)	30278	34257	40429
Loans issued (Rs. cr.)	33996	35119	39212

Source : NAFSCOB

6.05 As per the data available with NAFSCOB, small and marginal farmers constitute nearly 70% of total membership of PACS at the national level, while SCs / STs constitute 34%. Wide regional variations are observed – while Western and Southern Regions have a greater proportion of SFs as members, Eastern and Central Regions have nearly half of their members belonging to SC / ST category.

6.06 The average membership per PACS (all India) is 1,171 persons as shown in the table below. Southern Region has the highest average at 2,986 persons, while Western has the lowest at 441 persons. The average borrowing membership per PACS (all-India) is 414 persons. While the Southern Region has the highest average at 944 persons, North-Eastern Region has only 91 borrowing members, on an average.

6.07 The gap between the average membership and the average borrowing membership can be presumed as the credit potential available. Viewed thus, there is a huge potential for extending credit outreach by the cooperatives, especially in the Southern Region as shown in the table below.

Sr. No.	**Region**	**Total no. of PACS**	**Total membership (no. '000)**	**Average membership / PACS**	**Total borr. membership (no. '000)**	**Average borr. membership / PACS**	**Credit potential available (no./ PACS)**
1	Central	13723	8322.68	606	6810	496	110
2	Eastern	28928	38952.94	1347	11989	414	933
3	North-Eastern	3628	3835.62	1057	330	91	966
4	Northern	16819	17084.63	1016	7191	428	588
5	Southern	15349	45832.06	2986	14484	944	2042
6	Western	30332	13378.49	441	4266	141	300
	Total	**108779**	**127406.42**	**1171**	**45070**	**414**	**757**

Source : NAFSCOB

6.08 Though the network of commercial banks and RRBs has spread rapidly and they now have nearly 50,000 branches, their reach in the countryside both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments is far less than that of cooperatives. In terms of number of agricultural credit accounts, the STCCS has 50% more accounts than the commercial banks and RRBs put together. Directly or indirectly, it covers nearly half of India's total population.

Health of Rural Credit Cooperatives

6.09 Despite the phenomenal outreach and volume of operations, the health of a very large proportion of these rural credit cooperatives has deteriorated significantly. The institutions are beset with problems like low resource base, high dependence on external sources of funding, excessive Governmental control, dual control, huge accumulated losses, imbalances, poor business diversification, low recovery, etc. Around half of the PACS, a fourth of the intermediate tier, viz., the DCCBs, and under a sixth of the State-level apex institutions, viz., the SCBs are loss-making. The accumulated losses of the system aggregate over Rs. 9,100 crore. Non-performing assets (NPA), as a percentage of loans outstanding at the level of SCBs and DCCBs, at the end of March 2006 were around 16% and 20% respectively. These institutions do not, therefore, inspire confidence among their existing and potential members, depositors, borrowers and lenders. Thus, there is a need to find ways for strengthening the cooperative movement and making it a well-managed and vibrant medium to serve the credit needs of rural India, especially the small and marginal farmers.

Need for Revival of the Cooperative Credit Institutions

6.10 Given the above indicators, there has been considerable debate on whether there is an imperative need for revival of these institutions. Herein, it may be pertinent to reiterate the following points :

6.11 In the first place, India is a country with a population of more than 100 crore, of which around 70 crore reside in a little over 6 lakh villages. As there are a little over one lakh PACS in the country, the first fact to be appreciated, therefore, is that every 6th village, on an average, has an existing cooperative credit outlet.

6.12 Secondly, although the rural credit system includes about 45,000 rural and semi urban branches of commercial banks and RRBs, if one would net out the cooperatives from the aggregate rural presence of all RFIs, the per outlet population coverage deteriorates from 1:4,393 to 1:14,893. The short point is that on grounds of outreach, cooperatives cannot be ignored.

6.13 Thirdly, the outreach is significant not merely in absolute numbers but also in terms of location of outlets. The number of PACS located in hilly terrains, deserts and other areas with poor access far exceed the number of rural branches of commercial banks and RRBs.

6.14 The same set of conclusions flow when the system is viewed in the context of its membership. Assuming an artificially low family size of 4, a back of envelope calculation shows that cooperative membership touches the lives of nearly 48 crore rural people which is more than half the aggregate rural population.

6.15 As regards number of agricultural credit accounts, the credit cooperatives have 50% more accounts than scheduled commercial banks (including RRBs). Of these, 70% are estimated to be marginal and sub-marginal farmers.

6.16 On the financial side, it is sometimes argued that in terms of deposits, rural and semi-urban branches of commercial banks have nearly six times more deposits than cooperatives. While this is true, it is also true that this is part of a historic policy infirmity which allowed cooperatives to be treated as “refinance windows” instead of incentivising them into becoming genuine thrift and credit institutions.

6.17 Coming to the assets side of the balance sheet we find that cooperatives have a 37% share in the aggregate crop loans provided by the RFIs. However, in many districts, particularly in remote, hilly and desert areas the share is upwards of 50%.

6.18 Notwithstanding a larger client base, the share of cooperatives in institutional credit is lower than that provided by the commercial banks. This is because the average loan size of cooperatives is smaller at Rs. 6,637 as compared to Rs. 31,585 of commercial banks which also confirms the claim that nearly 70% of the cooperative structure's clients are small and marginal farmers.

6.19 A little known fact is that the system has nearly 64,000 godowns. Given an appropriate policy dispensation entailing private partnership, conditions can be created for holding of crops by farmers at the ground level in these godowns while allowing them to negotiate the godown receipts in the market. A specific plan to revitalize these godowns in cooperative sector be drawn to make them the nerve centres of rural economy on a ‘kiosk’ model providing storage and financial services.

Cooperatives and the Reform Process

6.20 In the backdrop of these credentials, a look has to be taken at the reform process and what it means to the cooperative credit institutions. The financial sector reforms have been components of the overall economic reforms undertaken in a phased manner from 1991-92 by GoI. These reforms also envisaged improving the efficiency and productivity of the rural credit delivery system which in turn would accelerate the requisite credit flow to the productive sectors of the economy.

6.21 The major objectives of these reforms in the cooperative sector were :

- To make the institutions competitive by removing external constraints having a bearing on their operations,
- To improve their financial health,
- To ensure transparency in their business operations,
- To improve their profitability, *and*
- Institutional building and strengthening.

6.22 According to the Task Force on Revival of Rural Cooperative Credit Institutions (Vaidyanathan Committee), the STCCS never realized the enormous potential opened up by its vast outreach owing mainly to a “deep impairment of governance”. While they were originally visualized as member-driven, democratic, self-governing, self-reliant institutions, cooperatives have, over the years, constantly looked up to the State for several basic functions. The Task Force has described in detail how the State Governments have become the dominant shareholders, managers, regulators, supervisors and auditors of the STCCS. The concept of mutuality (with savings and credit functions going together), that provided strength to cooperatives all over the world, has been missing in India. This “borrower-driven” system is beset with conflict of interest and has led to regulatory arbitrage, recurrent losses, deposit erosion, poor portfolio quality and a loss of competitive edge for the cooperatives. The Task Force Report also recognised that there is an impasse in the laws governing cooperative banking institutions in the country as cooperation is a State subject while banking activities are regulated by a Central Act. Further, the Task Force also took cognizance of the poor quality of internal control systems, house keeping and audit in addition to professionally not qualified human resources manning the CCS.

6.23 For the revival of the STCCS, the Vaidyanathan Committee Report has suggested an implementable Action Plan with substantial financial assistance for recapitalisation subject to introduction of strict legal and institutional reforms together with technical assistance for human resource development (HRD), establishment of a common accounting system and computerisation. The implementation of the Revival Package would result in the emergence of strong and robust cooperatives with conducive legal and institutional environment for it to prosper. At the macro level, the Revival Package is expected to promote growth with social justice and greater financial inclusion. In this background, the following observations are noteworthy :

- With 127 million plus membership and 45 million plus borrowing membership, the STCCS already exceeds the combined client base of commercial banks and RRBs. With nearly 1.25 lakh outlets spread throughout the length and breadth of the country, the STCCS after implementation of the recommendations of the Vaidyanathan Committee would be adequately equipped and would be a highly appropriate mechanism to promote financial inclusion.
- Located in rural areas, governed by local community leadership and managed by the staff with roots in rural areas, the STCCS would be oriented for promoting financial inclusion more effectively.
- The CCS with large membership of small and marginal farmers would have necessary ethos to promote and encourage financial inclusion of deprived sections of the rural economy.
- With limited overheads, the CCS outlets will be an appropriate medium for encouraging financial inclusion through "no frills" savings accounts etc.
- The rural populace will be more comfortable and will easily identify culturally with the STCCS.
- Payments under various social welfare schemes of Central and State Governments for instance old age pension, Employment Guarantee Scheme (EGS), scholarships for students, etc. could be made more transparent, safe and foolproof if routed through the STCCS and the recipients could receive the assistance at their doorsteps.
- As envisaged in the Vaidyanathan Committee Report, the membership of PACS should be open to all members of the village without any restrictions. For the purpose, the existing restrictions regarding land holding etc., should be done away with. If need be, PACS could be rechristened as Primary All-purpose Credit Societies instead of Primary Agriculture Credit Societies.
- The STCCS would be an ideal instrument for promoting financial inclusion through SHGs. Many cooperatives could be transformed into SHPIs with proper sensitisation. Promotion of SHGs could, indeed, become a major component of the Business Development Plan of cooperative organisations of the STCCS.
- As the Vaidyanathan Committee is envisaging application of IT right from PACS to SCBs, the STCCS would be in a position to cope with the additional work load on account of promoting financial inclusion. This, in fact, would go a long way in improving the productivity of the credit cooperatives. With due internal controls and checks in place, PACS could ideally be developed as BCs of

DCCBs as well as for commercial banks / RRBs wherever the reform process facilitates this.

- As financial inclusion also envisages delivery of financial services at an affordable cost, the STCCS being accessible at the door step of the financially excluded sections of the society will be in a better position to render these services more effectively.
- Located in the rural areas, the STCCS units will have better knowledge of their existing and potential clients and, as such, KYC will not be a major hindrance.

Role Envisaged for Cooperatives in the Planning Process

6.24 The cooperative credit institutions are being called upon for a greater involvement in credit dispensation during successive Five Year Plans. The Working Group on Agricultural Credit, set up by the Planning Commission, for the formulation of the X Five Year Plan, had made a projection of credit flow for agriculture at Rs. 736,000 crore at 4% growth rate in agriculture GDP. Of this, the cooperative credit structure alone was required to provide during the plan period Rs. 271,000 crore from Rs.24,000 crore during the first year (2002-03) of the X Five Year Plan, on the assumption that it would maintain its share of at least 42% in the total credit purveyed. During the period 2003-04 to 2006-07, these institutions, put together, have purveyed credit to the tune of Rs. 136,229 crore for agriculture and allied activities.

Impact Envisaged Post Implementation of the Recommendations of the Task Force

6.25 The Committee concurs with the Vaidyanathan Committee's view that cooperatives are heterogeneous and exhibit wide variations in terms of method of operations, quality of governance, working results, etc. The Committee also notes that in certain areas, cooperatives have done exceedingly well. It is expected that with the implementation of the reform package as envisaged by the Vaidyanathan Committee (already 13 States have signed the MoU with GoI and NABARD, while another 5 States and 1 UT have indicated their "in principle" acceptance), the cooperatives will be able to emerge stronger.

6.26 Consequent on implementation of the Revival Package, there will be two sets of outcomes – one at the sector level and the other at the macro level. At the sector level the legal environment within which the sector functions will become more enabling and there will be institutional upgradation in terms of systems and procedures, HRD, technology, etc. This will improve the internal operational efficiency of the system leading to more robust fundamentals.

6.27 At the macro level, this process will complete the financial sector agenda in regard to capitalization of impaired entities. India embarked on its reforms in the financial sector in 1992 with the capitalization of commercial banks followed by that of RRBs. Capitalisation of the rural cooperative credit structure will bring this process to a logical completion.

6.28 The other area of impact would be on the national goal of growth with equity. As already indicated, nearly 70% of the membership of the rural credit cooperatives are small and marginal farmers. As cooperative institutions improve their health and methods of operation, the number of borrowing members as a percentage of total membership will increase, thus bringing larger number of small and marginal farmers within the cooperative fold. This will help in addressing the credit requirements of this segment of the rural population which is sometimes bypassed in the growth process. This is an important outcome in regard to financial inclusion.

Emerging Role of Cooperatives in Microfinance

6.29 The Andhra Pradesh Mutually Aided Cooperative Societies (APMACS) Act, 1995 has resulted in the creation of over 30,000 new Mutually Aided Cooperative Societies (MACS) in Andhra Pradesh. A vast majority of these are Village Organisations (VOs) of SHGs and about 800 are higher level federations of these VOs at the Mandal level (20-30 villages). All these have been formed as part of the Velugu Programme. However, about 600 MACS are independent of the Velugu Programme, and have been promoted by NGOs. These institutions are able to provide savings and credit services to their members and are fully autonomous.

6.30 The parallel Acts are also one way to federate SHGs and form community based MFIs. The founding NGO only plays a facilitating role and there are no external shareholders.

Keeping in view what has been discussed above, the Committee makes the following **recommendations** in regard to the cooperative credit institutions :

Early Implementation of Vaidyanathan Committee Revival Package

6.31 The Committee is in broad agreement with the recommendations of the Vaidyanathan Committee and suggests that all necessary steps should be taken for the early implementation of the STCCS revival package in all States. Consequent on the implementation of the Vaidyanathan Committee recommendations, the Committee hopes for the emergence of a more robust, well managed and self-reliant cooperative credit system with improved governance structures and technology applications.

Cooperatives in SHG Linkage – Need for enabling legislations

6.32 The Committee is of the view that cooperatives are a good forum for enabling financial inclusion through SHGs. This has been demonstrated in several districts such as Bidar in Karnataka, Chandrapur in Maharashtra and Mandsaur in Madhya Pradesh. The Committee notes that in certain States, legislation has been enacted, admitting SHGs as members of PACS and recommends the enactment of similar legislation in other States to enable the emergence of cooperatives as effective SHPIs. The Committee also recommends that federations of SHGs may be registered in all the States under the Cooperative Societies Act or the parallel Self Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria. NABARD may also set aside requisite funds for sensitising the cooperative movement in this regard.

Use of PACS and other Primary Cooperatives as Business Correspondents

6.33 There are a large number of PACS and primary cooperatives under the parallel Acts located in rural areas where there are no other financial services outlets. Many of these cooperatives are in districts where the DCCBs are defunct or moribund. Such PACS could provide valuable services to their members if they get access to a commercial bank. These PACS could originate credit proposals, disburse loans, collect repayments and even collect savings on behalf of the commercial bank. They could also act as payment channels. RBI has already listed Cooperatives as eligible institutions under the BF/BC Model.

6.34 In the circumstances, the Committee recommends that the Cooperatives may make use of this opportunity atleast in States which have accepted the Vaidyanathan Committee recommendations. NABARD may be asked to suggest appropriate guidelines for the purpose, subject to the approval of RBI.

Cooperatives Adopting Group Approach for Financing Excluded Groups

6.35 Micro-enterprises, in order to be successful, require larger funding which NGOs cannot provide. It will, therefore, be necessary to develop / test a new form of community based organisation other than SHGs which may be more appropriate to support members who engage in micro-enterprises. Those members of SHG who opt to graduate to micro-enterprises could be formed into JLGs or some similar organisation.

6.36 Banks may be more inclined to lend to individuals in this group based on the performance of each member in the SHG as well as on the assumption that a JLG will provide some degree of mutual guarantee. There is evidence however, that the relations of mutual trust and support which is described as affinity in a SHG tend to be weaker in a JLG. Therefore, new forms of collateral or guarantee may have to be worked out. In this regard, NABARD has already circulated the guidelines which may be adopted by banks.

6.37 Further, the use of the BF model could be thought of to organize vulnerable segments of the population into JLGs. The pilot project presently under implementation by NABARD should be sufficiently broad based to cover the role of facilitators in formation and linkage of JLGs.

Risk Mitigation - setting up of Credit Guarantee Fund

6.38 The Committee also recommends the setting up of a Credit Guarantee Fund as a risk mitigation mechanism and also for providing comfort to the banks for lending to such JLGs (akin to the Credit Guarantee Fund Scheme for Small Industries - CGFSI - available for small-scale industries - SSI - at present).