

CHAPTER III

CO-OPERATIVE URBAN BANKS

INTRODUCTION :

The process of development is to be accelerated by the banking institutions in the country and it all depends to a great extent how they orient their lending policies that would ignite the spark of development. The Urban Co-operative Banks in the country have demonstrated that they are successful business institutions in the co-operative sector.

As banking is an important instrument for the economic development of a developing country like India, the primary objective of Indian Economic Policy is economic growth with social justice. This involves balanced growth, prevention of concentration of economic power, direction of the flow of resources towards under-developed regions and economically weaker sections of people, development of entrepreneurship among them, promotion of employment opportunities and improvement in the quality life of people.

DEFINITION OF CO-OPERATIVE BANKING :

1. Devine defined a Co-operative bank as, " a mutual society formed, composed and governed by working people themselves, for encouraging regular saving and granting small loans on easy terms of interest and repayment." ¹
2. Sonnichen defined, " mutual or co-operative credit, as its name indicates, consists of a number of individuals who join together to pool their surplus savings with the purpose of eliminating the profits of the banker or money lender. " ²

3. N. Baron defined co-operative bank as " a bank formed by co-operative and labour organisation for the purpose of accumulating their collective funds and the savings of their individual members; it manages their financial interests, grants credit to co-operative and labour enterprises, and helps to satisfy the needs for personal credit of their individual members; the banks' surpluses are distributed between shareholders, depositors, and borrowers or placed to reserves. " 3
4. The Banking Committee of the I C A had formulated a set of principles to serve as a criterion for the admission of co-operative banks into I C A. The banks which are eligible for admission have to conform to the following principles :- " The task of a co-operative bank is to develop co-operative enterprise in all its forms, its capital must not yield more than a statutory limited rate of interest, any further net profits being utilized for reserves or otherwise in their collective interest. The state may take part in the organisation of these banks, but the co-operative movement must be adequately represented on the governing body. If the bank is organised as a limited company, the majority of its shares must be in the hands of the co-operative movement and the trade unions. " 4
5. Henry Wolff defined co-operative banking as, " an agency which is in a position to deal with small man on his own terms, accepting the security he has and without drawing the protection of the rich. " 5

From the above definitions it is clear that co-operative banks are organised voluntarily by people who could save their money

with the bank. The primary motive of a co-operative bank is to encourage savings. In other words the basis of co-operation namely ' Thrift and selfhelp ' is the motto of co-operative banks. Members join the co-operative bank to get small loans. Such loans are given out of the savings collected from among the members.

According to the Banking Regulation Act 1949 (as applicable to co-operative societies) a co-operative institution with a share capital and Reserves of Rs. 1 lakh and above is eligible to become a co-operative bank.

OBJECTIVES OF CO-OPERATIVE BANKS :

The American co-operator, Herbert Myrick, in his book ' Co-operative Finance ' mentioned the following purposes of co-operative banks :-

1. To induce the people to join it as members and shareholders, if only in a small way-labour or effort.
2. To encourage them to save money and deposit their savings in their own bank - capital accumulated.
3. To safely loan these savings and the bank's credit to the bank's members or customers within the local territory of the bank, for wisely productive purposes wise-use.
4. To enable the people themselves to create efficient management of their bank.
5. To borrow funds from the members or others to be utilized for loans to members for useful purposes.
6. To act as an agent for the joint purposes of domestic and other requirements of members.
7. To encourage thrift, selfhelp and co-operation among the members.

8. To undertake collection of bills drawn, accepted or endorsed by members and constituents and to discount cheques and bills of approved members subject to rules and bye-laws in this behalf.
9. To arrange for the safe custody of valuables and discounts of members and constituents.
10. To provide other facilities as provided by Commercial Banks etc.

CO-OPERATIVE BANKING STRUCTURE :

Since the credit sector is "the Prince of Denmark" in the whole apparatus of the co-operative movement, it merits the pride of place in the present study of co-operation. The co-operative banking structure is pyramidal or federal in character. At the base, that is, at the village level, there is a primary credit society upon which the whole edifice of co-operative credit is based. These societies are federated at the district level into a central society called the central co-operative bank. At the state level, the district banks are federated into an apex bank. The apex or state co-operative bank in its turn is closely linked with the National Bank for Agriculture and Rural Development, which provides considerable financial assistance to co-operative credit structure. This is the set-up in regard to short-term financing. The urban co-operatives, however, do not exactly fit into this federal structure. The long-term credit structure at the moment consists of two tiers; there are primary land mortgage banks at the base and central land mortgage banks at the top. In some states central land development banks operate through their branches. These are,

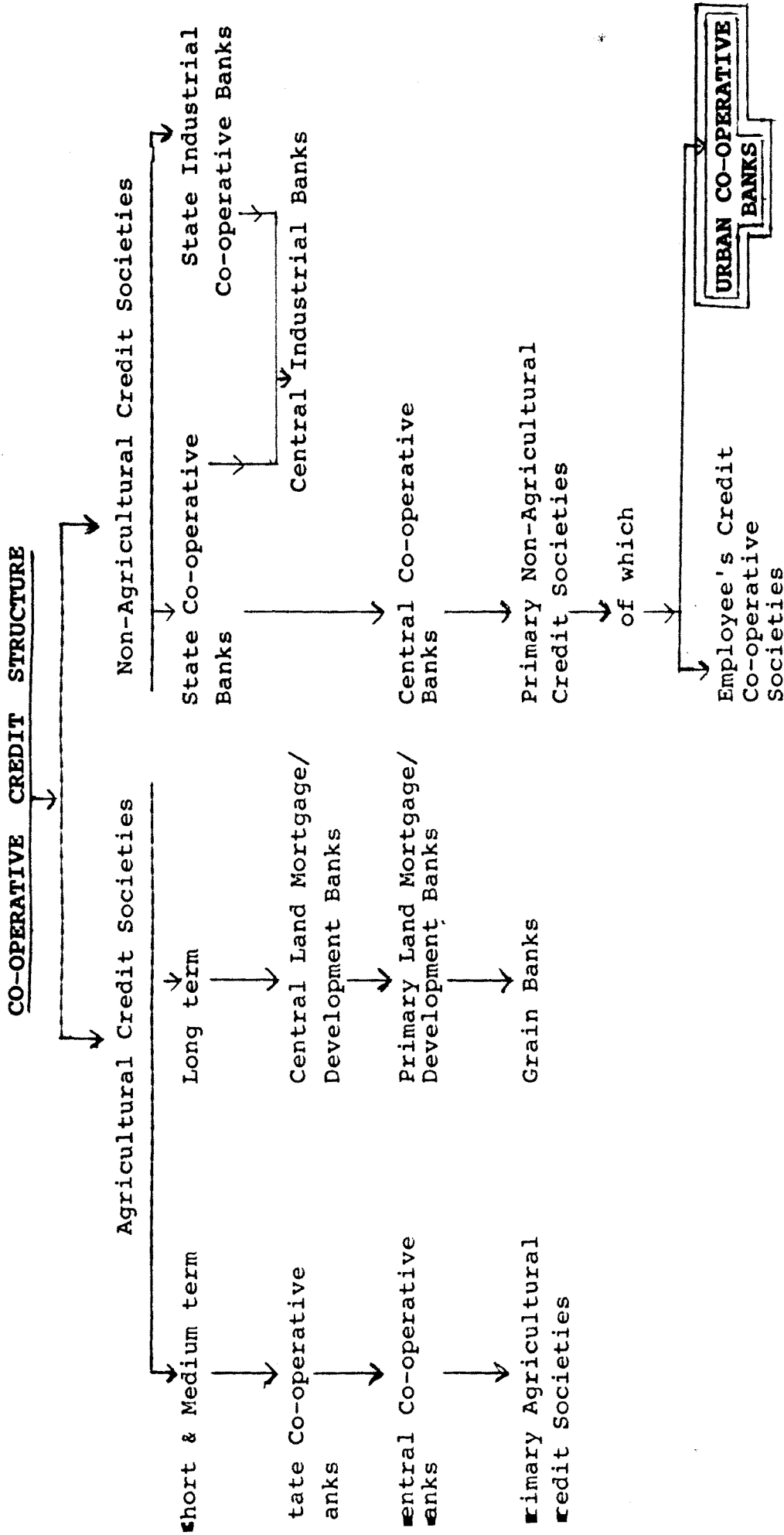
in the addition, a few industrial banks operating at the state or district level.

It is a merit of this set-up that, though the institutions at the different levels are connected with each other by the bond of affiliation, they are, in financial and legal terms, district entities, each serving a set of specific purposes which justify its existence as an independent unit. Together, these institutions constitute an effective machinery functioning as balancing centres within the movement and supplementing the internal financial resources by borrowing from outside. Accordingly, they assist in supplying agricultural credit in the volume required, supervising its use and effecting its recovery on due dates. At the same time, the fact that the structure is federal in character and that the institutions at the different levels are independent legal entities also implies that the strength of the chain depends upon the strength of each of the links. The chart No3.1 shows the said structure.

CO-OPERATIVE CREDIT STRUCTURE :

A study Group of the National Credit Council presided over by Dr. D.R. Gadgil, has stated : " The co-operative banking system is an integrated one and, because of its three-tier structure, has been enabled to extend credit to agriculturists, artisans and small men in general. The three-tier system also allows a rationalised flow of resources from the metropolitan centres to the villages and combines this with fairly low costs of operations." ⁶

Chart 3.1



NEED FOR URBAN BANKING :

The need for urban co-operative banking arises from the fact that joint stock banks are not interesting in providing credit to the urban middle class. This is because it is not advantageous for joint stock banks in developing the business of small loans on account of the high cost of advancing and recovering them. Further, as joint stock banks are not likely to have under ordinary circumstances full and intimate knowledge of the standing and resources of persons of moderate means, they will not advance loans on personal security. In these circumstances the man with limited means in urban areas would be driven to money lenders or similar agencies to obtain loans at exorbitant rate of interest. In this connection the following observations of W. K. H. Campbell are significant.

" A very little investigation of the condition of the salary-earning class is frequently enough to reveal that, when sudden emergencies arise which make an unexpected demand on their fixed salaries, they have to borrow, that they are heavily, and in most cases, hopelessly indebted." ⁷

The need for urban co-operative banks as an ideal institution, to meet the credit and banking requirements of men of small means was first pointed by the Maclagan Committee in 1915. In 1931, the Indian Central Banking Enquiry Committee highlighted the role of urban co-operative banks to meet the credit needs of small traders, small entrepreneurs and middle classes. The Co-operative Planning Committee in 1946 observed that, " Urban Banks would be the most suitable agency for serving the credit needs for classes like traders, artisans, factory workers, technicians and skilled workmen like carpenter, black-smith etc." ⁸

Besides, protecting the middle classes and men of modest means from the clutches of the money lenders, the movement provides the frugal section of the community an opportunity of investing their savings and thus help the hard pressed people tide over the period of stress and strain.

The need for priority sector financing by the urban banks, more so in Southern India, hardly needs to be emphasised. One of the somewhat undesirable features in the lending operations of urban co-operative banks in this region is the marked security-orientedness and the preponderance of loans and advances against gold ornaments and real estate. It is time that the banks in these states should shed the traditional approach in their lending and initiate measures for diversification of their lending and increasingly take up financing for productive purposes, particularly to those belonging to cottage and small scale industrial sector.

There should be a visible shift in the emphasis from credit worthiness of the purpose and the banks should be guided by the need and viability of the project, while extending credit. Many banks in the Southern region contend that although the advances are granted against gold ornaments and immovable property, they are ultimately used for productive purposes. There is, however, not adequate evidence to indicate that these are production-oriented lendings. Inclusion of such advances as priority sector lending in the statements sent to Reserve Bank does not therefore, reflect a true picture of the performance of banks in lending to these sectors. Most of the banks grant advances for retail trade or business, etc., by

way of fixed loans, repayable in instalments. Such credit facilities are normally required to be granted on a cash credit basis to ensure that the funds are utilised for business purposes and should be backed by receipt of stock statements, periodical verification of stocks, etc. It is therefore, imperative that urban banks should alter the pattern of lending to meet genuine banking needs for productive purposes with emphasis on weak and under-privileged sections of the society.

ORIGIN AND DEVELOPMENT :

The urban co-operative credit movement originated in Germany when Herman Schultz started such societies for the benefit of artisans in the cities. In Italy, the credit of starting such societies goes to Luigi Luzzatti. Encouraged by the success of the urban credit institutions in these countries, social workers in India began to think in terms of co-operation as a means of bringing succour to the middle classes as early as the close of the 19th century. The first urban credit society saw the light of the day in 1889 when a mutual aid society was registered at Baroda. Little attention was, however, paid to the development of the urban credit movement until the Maclagan Committee drew attention to its potential. The failure of the Swadeshi joint stock banks created an opportunity for co-operative banking to develop as a medium for mobilising the savings of persons of modest means and helping those whom financial distress caused by high living costs and unemployment had driven into the clutches of money lenders. The inter-war period did not affect the urban credit movement as adversely as it affected the agricultural credit

movement. This might be due to the fact that during depression the fall in urban incomes was not as steep as the fall in the rural incomes. Another contributory factor to the stability of the movement in urban area was the comparatively high standard of the managerial efficiency available in urban areas which urban co-operatives could afford on account of their larger resources.

The progress of urban co-operative credit societies and banks can be assessed from the following observations of the Reserve Bank made in purview of the Co-operative Movement in India, 1939 - 40. "Urban Credit Societies and banks are the most important feature of the urban co-operative movement in India, and make-up to the some extent for the absence of joint stock banking facilities in the smallest towns. Urban co-operative credit societies and banks occupy a prominent place among the agencies supplying the credit needs of people residing in urban areas. They advance loans mostly to the small traders, artisans, and salary earners on personal security as well as against gold, silver and produce." ⁹

DEFINITION OF URBAN BANKS :

Till the introduction of the Banking Regulation Act 1949 (As applicable to Co-operative Societies) from 1st March 1966. no clear cut definition was given for urban banks. Before this period various criteria were laid in various states. There was no uniformity in their operations. This resulted in greater confusion in getting reliable statistics on urban banks.

Before the year 1938 all the urban banks were included under the category of non-agricultural credit societies. This included salary earners' societies and credit societies organised by special category of people. Lack of proper definition led to serious confusion. The Varde Committee (1963) had pointed out that, "the statistics available regarding urban banks were subject to several limitations, the principal among them being the ambiguity and lack of uniformity of definition of the term "Urban Bank". As a result very few states collected separate statistics for such institutions and it was difficult to analyse their progress or problems. The term 'Bank' was used loosely in some states and gave a misleading picture to the public as some societies named did not undertake regular banking activities. On the other hand certain co-operatives were carrying on regular banking activities, but designated as credit societies. This, as, to some extent, stood in the way of attracting the confidence of the people and thereby hampered the further development of banks." 10

Prior to 1938, there was no difference between an urban credit society and an urban bank. Any urban credit society was designated as an urban bank in Madras (Tamil Nadu), if it possessed Rs. 20,000 as working capital and maintained fluid resources according to a standard prescribed by the Registrar, while in Bombay (Maharashtra), an urban credit society can be styled as an urban bank upto 1938, if it had Rs. 50,000 as working capital, but since 1938, it was those urban credit societies which did banking business as defined by Section 277(f) of the Indian Companies Act, 1913 (which was later

Section 5 (1) (b) of the Banking Companies Act 1949) then inforce and accepted deposits of money on current account or otherwise, subject to withdrawal by means of cheques, draft or order and had had a paid-up capital of not less than Rs.20,000 that were allowed to style themselves, as 'banks'. This was in accordance with the recomondation of Bhansali Mehta Committee Report. The definition adopted in Madras were loose under which all salary earners' societies or other non-agricultural credit societies could be categorised as urban banks provided they had Rs. 20,000 as working capital and maintained fluid resources. So the need to have a uniform definition was felt. The Varde Committee felt that, " It would be advantageous to adopt a uniform definition of urban banks so that they could be easily distinguished from other credit societies. This would facilitate the comparison of their position in different states, implimentation of a national policy for the development of such institutions and maintenance of a separate watch on their progress". ¹¹

The R.B.I. Survey on Urban a Banks said that, " In view of the importance of these institutions, it will be advantageous to adopt a uniform definition by which urban banks can be easily distinguished from other credit societies. It would appear that this definition should include the following features :-

1. Minimum paid-up capital, e.g., Rs. 20,000
2. Provision of important banking facilities such as withdrawal deposits by cheques, remittance of funds, etc., and
3. Maintenance of fluid resources according to the standards prescribed.

The Study Group on Credit Co-operatives in the Non-Agricultural sector has recommended that the definition of an urban co-operative bank should include the following features ;¹²

- a. a credit co-operative registered under the State Co-operative Societies Act in urban or semi-urban areas ;
- b. a minimum paid-up capital of Rs.50,000 ; and
- c. provision of banking facilities, e.g., accepting for the purpose of lending or investment of deposits from members and non-members repayable on demand or otherwise, and withdrawal by cheque, draft, order, etc.

The battle on the definition came to an end after passing of the Banking Regulation Act, 1949 (as applicable to Co-operative Societies) from 1st March 1966. All the urban banks which had a paid-up share capital and reserve of Rs.1 lakh were classified as 'Primary Co-operative Banks'. Under the provisions of the Act, the banks were required to apply the Reserve Bank for licence to carry on banking business, to seek prior permission of the Bank for opening new offices, to maintain certain minimum cash reserves and liquid assets, to submit returns prescribed under the rules framed under the Act. In regard to the issue of licence, while the co-operative societies which carried on banking business at the commencement of the Act in 1st March 1966, were allowed to function as Banks, till a licence was refused to them. The urban banks coming under the purview of the Act were subjected to statutory inspection by R.B.I. either directly or through their respective State Co-operative Banks.

OBJECTS :

The principal objects of the urban banks are :¹³

1. to attract deposits from members as well as non-members,
2. to advance loans to members,
3. to act as the agent for the joint purchase of domestic and other requirements of the members,
4. to undertake collection of bills, accepted or endorsed by members,
5. to arrange for the safe custody of valuable documents of members,
6. to provide other facilities as provided by commercial banks,
7. to encourage thrift, self-help and co-operation among the members.

FUNCTIONS OF URBAN BANKS :

1. One of the main functions of Urban Co-operative Banks is accepting various kinds of deposits from members and non-members.
2. The second function of the Urban Banks is to lend to members for various useful purposes. Loans are given to the non-members on the security of their deposits.
3. The Urban Banks may undertake to purchase for and supply essential consumer goods to their members on agency basis, but this is not generally done.
4. These banks collect the bills and cheques of their members and approved constituents. They may effect receipt and payments on behalf of members and constituents.
5. Some agency services are also performed by the Urban Banks. They also undertake discounting bills.

To sum up, the principal functions of Urban Banks are to promote thrift by attracting various kinds of deposits from the members and non-members and to advance loans on personal security or on mortgage of house or landed property, on pledge of gold and silver, produce merchandise, government securities, fixed deposits, receipts, life insurance policies, bank debentures etc. In spite of all these, Urban Banks also play the important role in respect of the following ¹⁴;

1. First and foremost, they can organize and bring together middle and working classes in urban and semi-urban areas and inculcate in them the habits of thrift and self-help and acquaint them with the elements of ordinary banking principles.
2. The mobilization of savings by urban co-operative banks and the consequent drawing of urban resources into the Apex and Central Co-operative Banks which are in need of funds to finance the rural, industrial and other functional co-operatives can contribute to general economic development.
3. By providing credit on reasonable terms to the middle classes, they can rescue them from the exploitation of money lenders and other unscrupulous agencies, which is particularly important in the context of rising prices and cost of living. This has consequent effects also on non-co-operative lendings.
4. By financing individual industrialists and artisans working in urban areas, they can make a significant contribution to industrial development.
5. They can make certain essential banking facilities such as remittance of funds etc., available ~~in areas which may not~~

- be considered suitable for commercial banking and persons who may not be able to get such facilities from commercial banks; and
6. They can provide intelligent, experienced and active leadership to the co-operative movement including the Central and Apex Co-operative Banks which, in view of their federal character, draw their directors from members institutions.

SIGNIFICANCE OF URBAN BANKS :

Urban Co-operative Banks are as old as the Agricultural Credit Co-operatives. While the agricultural credit co-operatives have been organised with an aim of releasing the farmers from the hold of the money lenders, the urban banks have been organised to help the middle class and weaker sections of the urban community. As the problem of rural indebtedness was considered to be the major issue, the government gave importance to the organisation of agricultural credit co-operatives. Financial assistance and managerial helps were provided to the agricultural credit co-operatives on a large scale. But the urban co-operative banks were not given such an encouragement by the government. The urban banks were expected to grow on their own accord. Such circumstance posed both a challenge and an opportunity for the urban banks to grow and stand as voluntary and self-reliant institutions. Less interference of the government made the urban banks to develop their own leadership and managerial competence. In the case of resource mobilisation also, to this date, they depend on their own resources and dependence on government or other financing agencies has been kept to the lowest minimum.

The importance of urban banks in helping the urban community has been pointed out by the Report of the Study Group on Credit Co-operatives in the Non-Agricultural Sector (Varde Committee) as follows : " Non-Agricultural Credit Societies cater to the banking and credit requirements of the urban middle class, e.g., the small trader or businessman, the artisan or factory worker, the salaried person with a united fixed income in urban or semi-urban areas. While, as a class, they may be in a position to collect and invest a certain amount of savings over a period of years, they may also from time to time have demands on them which require them to take small loans. Such loans may be needed for what could be described as productive purposes, such as the acquiring or building or repairing of a house, the education of children or the setting-up or advancing of a business or a trade. Loans may also be required for meeting recognized social obligations connected with marriages, funerals or religious ceremonies and for the redemption of old debts ". ¹⁵

As institutional agencies like commercial banks did not come forward to help the urban middle class and weaker sections, it was felt to organise urban co-operative banks. This was aptly pointed out by the Co-operative Planning Committee as follows: " Joint stock banks are not interested in developing the business of small loans, because the cost of advancing and recovering them is high. Further, as joint stock banks are not likely to have under ordinary circumstances full and intimate knowledge of the standing and resources of persons of moderate means, they will not advance loans on personal security. On the other hand, there are, in urban areas, numerous persons of

small means, like traders, merchants, artisans, factory workers, street bankers, motor and gharry drivers, who resort to money lenders and similar agencies for small loans and obtain them at high rates of interest. Ex-servicemen like technicians and skilled workmen like carpenters, black-smiths, machanics etc., will also require credit for setting-up their own business in small work-shops. Co-operative banks qualify by eastablishing personal and intimate relationship with people of this class as the most suitable agencies for serving their credit needs". 16

As the urban middle class have been under the grip of money lenders, agencies like urban co-operative banks can give relief to such population. Small traders, businessmen, artisans and self-employed people can also improve their income by means of getting loans for production purposes. Unemployment in urban areas could be reduced by means of encouraging self-employment schemes. The urban banks are ideal agencies for such purposes. As they keep close contact with them, it is possible to supervise the utilisation of loans.

Another area left out is the encouragement of small-scale industries. The role of the urban banks in encouraging such industries is very responsible and their need is felt very much. The criticism that urban banks are lending for consumption purposes could be nullified by investing part of their money on small-scale industries.

Urban banks do good to the society not only by means of lending the urban population but also by means of encouraging the urban middle and lower class to save money. As they may not like to keep deposit accounts with other banks for their small amounts, they can have deposit accounts with their urban banks.

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