CHAPTER II

THEORETICAL FRAMEWORK

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2.1 INTRODUCTION

The main object of this chapter to be acquainted with the concept related to the subject selected for research work. Therefore, under this chapter necessary concepts and terms related to the subject matter are covered.

As this study is on urban co-operative credit societies, the concepts such as cooperation, banks, banking, co-operative banking structure and urban co-operative credit society considered in this chapter.

2.2 CONCEPT OF CO-OPERATION

2.2.1 CO-OPERATION – THE ORIGIN AND DEVELOPMENT

Cooperation is much older as the human civilization. Formation of social groups is the outcome of reflexive cooperation. The lives of ant, bees, wasp, lions, etc. provide the best example of instinctive cooperation. The practice of instinctive cooperation has contributed to the development of human race more then any other factor. Right from the hunting age up to the present day the progress and development of human beings, in any spheres, social, economic, religions and political marked by sense of thing and living together. In India throughout the ages, the people and communities worked on an informal co-operative basis with regard to their religions, social, economic and cultural life.

As has been rightly pointed out in Rig-Veda "May you all have common purpose, May your hearts is in union, may you all be the same mind, so you can do the work efficiently well." In other words co-operation means to work together to achieve common purpose. However, co-operation in the true sense is new economic philosophy developed agents inequality from the society in modern times co-operation promotes voluntary associations of individuals having common needs who combine towards the achievement of common economic ends.

2.2.2 DEFINITIONS OF CO-OPERATION

1) Dr. C. R. Fay -

"An association for the purpose of joint trading origination among the weak and conducted always in an unselfish spirit on such terms that all who are prepared to assume the duties of membership may share in its rewards, in proportion to the degree in which they make use of their association."

2) Mr. Calvert –

"A form of organization wherein the persons voluntarily associate together as human being on a basis of equality for the promotion of economic interest of themselves."

3) Prof. V. L. Mehta –

"Co-operation is self-help as well as mutual help. It is a joint association or enterprise of those who are not financially strong and are unable to stand on their own legs and therefore, come together not with a view to get profit but to overcome disability arising out of wants of adequate financial resources and thus better their economic conditions."

From the above definitions, it is clear that a co-operative society is a voluntary and democratic association of persons with common economic need working on basis of equality self-help and mutual-help.

2.2.3 FEATURES OF CO-OPERATION

In the light of the above definitions the chief features of co-operative organization may listed as under

1) An Association of Persons

A co-operative society is an association of several persons like a joint stock company. The persons who associate together contribute capital in the shape of shares. In co-operative, it is man that counts much, not money. More emphasis is give on man not on capital that he contributes.

2) A Business Enterprise

A co-operative society is not a charitable enterprise. It is a form of business organization coupled with profit and risk. The members or shareholders in the society posses a common interest and have common need to society.

3) A Voluntary Organization

The element of coercion is absent in a co-operative organization. Admission and retirement of member in the society is voluntary.

4) A Democratic Association

A co-operative society managed democratically. Every member has one and only vote to exercise irrespective of the number of shares held by him.

5) The Motto is to serve rather than to earn

Although the element of profit attached to a co-operative society, the main aim of the co-operative society is service. The provision of maximum service is the prime objective of co-operative.

6) Key-note of co-operation is mutual help

The key note of co-operation is mutual help and self-help and its slogan is "each for all and all for each."

7) The basis is equality and equity

One of the important features of co-operative enterprise is equity and equality. Its members placed based on equality, irrespective of their differences in race, religions, color, creed, social states, political standing and financial position.

The distinctive feature of co-operative society is that the surplus or profit distributed not according to share holding but according to the proportion of business operations transacted by the members during the given period.

8) Aims at socio-economic change

The co-operative movement aims at a socio- economic change through peaceful means. It becomes a part of our socio-economic movement.

9) Service to community

The important feature of co-operative enterprise is not only to serve its members for economic up-liftment but also to service the community at large.

2.2.4 PRINCIPLES OF CO-OPERATION

1) Voluntary and Open Membership:

Co-operatives are voluntary organizations, open to all persons who use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2) Democratic Member Control:

Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives, members have equaled voting rights (one member, one vote) and co-operatives at other levels organized in a democratic manner.

3) Member Economic Participation:

Members contribute equitably to and democratically control the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible, benefiting members in proportion to their transactions with the co-operative and supporting other activities approved by the members.

4) Autonomy and Independence:

Co-operatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments or raise capital from external sources they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5) Education, Training and Information:

Co-operatives provide education and training for their members, elected representatives, managers and employees so that they can contribute effectively to the development of their co-operatives. They inform the general public particularly young people and opinion leaders about the nature and benefits of co-operation.

6) Co-operation among Co-operatives:

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, regional, national and international structures.

7) Concern for Community:

Co-operatives work for the sustainable development of their communities through policies approved by their members.

2.2.5 CO-OPERATIVE MOVEMENT AT A GLANCE

I. Co-operative Movement in the World

The earliest co-operatives were set-up among the weavers, in other words workers in cottage industries, who were the first and the hardest hit by the development of the mercantile economy and the industrial revolution.

So the weavers, in order to gain access to the market in the tools of their trade or to the market in foodstuffs set up the first co-operative in Scotland (Fenwick, 1761; Govan, 1777 ; Darvel, 1840), in France (Lyons, 1835), in England (Rochdale, 1844) and in Germany (Chemnitz, 1845).

Though co-operation and mutual enterprise has been an essence of human-society ever since it evolved, the real co-operative movement can credited to the Rochdale Pioneers who established a co-operative consumer store in North England. This store can be called as the first in the co-operative consumer movement.

The "Rochdale Pioneers", made their first aim to establish co-operatives where the members would not only be their own merchants but also their own producers and their own employers.

Around this time, the co-operative movement was more at a utilitarian level. The concept though old, was just being implemented and was growing slowly. Many great thinkers, far-sighted men and visionaries were applying their minds to find practical solutions to the new problems and to work out better systems of social organization.

In Great Britain Robert Owen (1771-1858) conceived and set up self-contained semi-agricultural, semi-industrial communities.

Dr. William King (1758-1865) helped to spread Owen's doctrine; his ideas were more reasonable than Owen has been and achieved more results.

In France Charles Fourier (1722-1837), a commercial clerk, published in 1822 his main work, a Treatise on Domestic Agricultural Association. This could be one of the first works on co-operation.

In France Saint-Simon (1760-1865) worked on various theories of "associations".

However, it was Proudhon (1796-1865) who advocated mutual aid and "free credit" free access to the money market and Buchez (1796-1865) who championed the idea of inalienable collective capital and workers' production co-operative societies.

Schulze-Delitzsch (1808-1883) was the apostle of urban credit co-operatives and co-operatives in handicrafts, while F.W. Raiffeisen (1818-1888) did the same for rural credit co-operatives.

Though all these visionaries had articulated the philosophy of co-operation it was not until the World-War II that an Authoritative Commission appointed by the International Co-operative Alliance.

This Commission formulated or rather formalized the principles of co-operation. They are,

1. *Voluntary and open membership*
2. *Democratic Management*
3. *Limited interest on capital*
4. *Patronage dividend in proportion of members' transactions*
5. *Education and Training and*
6. *Co-operation among co-operatives*

There have been also other principles like the principles of political neutrality, correct weight and measures, purity of goods and thrift, which also taken into consideration.

The Manchester Congress has reformulated these principles recently in 1995 and now the principles of co-operation are as follows:

1. *Voluntary and Open Membership*
2. *Democratic Member Control*
3. *Member Economic Participation*
4. *Autonomy and Independence*
5. *Education, Training and Information*
6. *Co-operation among Co-operatives*
7. *Concern for Community*

The seventh Principle added at the Manchester Congress in 1995.

II. Co-operative Movement in India

Co-operation occupies an important place in the Indian economy. Perhaps no other country in the world is the co-operative movement as large and as diverse as it is India. There is almost no sector left untouched by the co-operative movement.

The main areas of operation of co-operatives in India are as under.

1. Agricultural Credit
2. Agricultural supplies
3. Agricultural Marketing
4. Agricultural Processing
5. Functional co-operatives in the fields like dairy, poultry, fisheries, fruits, vegetables etc.
6. Industrial co-operatives
7. Public Distribution of essential commodities through consumer co-operatives
8. Urban credit Co-operatives
9. Housing co-operatives

Co-operative movement in India is the result of a deliberate policy of the state and vigorously pursued through formation of an elaborate governing infrastructure. The successive Five-year plans looked upon the co-operation movement as the balancing sector between public sector and the private sector.

In addition, the success is evident. Almost 50 percent of the total sugar production in India contributed by sugar co-operatives and over 60 percent of the total fertilizer distribution in the country handled by the co-operatives. The consumer co-operatives are slowly becoming the backbone of the public distribution system and the marketing co-operatives are handling agricultural produce with an astounding growth rate.

The National Co-operative Development Corporation (NCDC), a statutory body set up in 1963 by the Union ministry of Civil Supplies and Co-operation, to promote the co-operative movement in India.

Further, there is the Indian Farmers Fertilizer Co-operative LTD (IFFCO), which has been successful in setting up an effective marketing network in most of the states for selling modern farming technology instead of fertilizers alone. The operations of IFFCO handled through its more than 30,000 member co-operatives.

The National Agricultural Co-operative Marketing Federation (NAFED) has over 5000 marketing societies. These societies operate at the local wholesale market level and handle agricultural produce. Thus, the farmers have a market for their produce right at their doorstep. A market, which assures the farmers reasonable returns and guaranteed payments.

All these Federations are acting like the spokespersons of member co-operatives and are doing liaisioning work between the co-operatives and the Government.

In India we find that the states of Maharashtra and Gujarat are well developed. Whereas the states of Andhra Pradesh, Rajasthan and Karnataka have shown remarkable progress in the co-operative movement and there is a vast potential for the development of co-operative in the remaining states.

Co-operatives today are committed to securing an improvement in the quality of life of a vast majority of Indian people.

III. Co-operative Movement in Maharashtra

Maharashtra is one of the major States of India. It is also the most urbanized and industrialized State.

Co-operative movement is widespread and has a long history in Maharashtra and even today, it plays an important role in the economy of Maharashtra. The genesis of the co-operative movement in Maharashtra can be divided into six stages.

1. The pre-co-operative stage (1870-1903)

With the Deccan Agriculturists' Relief Act, The land Improvement Loan Act 1883 and the Agricultural Loans Act, the Nicholson Report.

2. The Initial Stage (1904-1911)

From the Agricultural Credit Co-operative Societies Act 1904 to the creation of the Bombay Central Co-operative bank.

3. The Evolution Stage (1912 to 1924)

After the Co-operative societies Act of 1912, the movement passed through a new phase of re-organization: formation of co-operative financing agencies, formulation of co-operative educational schemes and organization of non-credit societies.

4. The Stagnation Stage (1925-1947)

The enactment in 1925 of the Bombay Co-operative Societies Act widened the cope of the movement in the Bombay province both horizontally as well as vertically. The Bombay Co-operative Insurance Society established in the year 1930. In the same year, the Co-operative Land Mortgage Bank also formed for long term financing for redemption of debts, land improvement and purchase of land.

5. The Growth Stage (1948-1961)

There was an all-round progress during these two decades after India attained Independence from the British Rule.

The movement diversified especially in the rural area where sugarcane was grown. The agriculturists pursued this concept of self-help and made the best use of the credit facilities given to them for augmenting the production. Examples like the Pravaranagar Sugar Co-operative inspired many to organize co-operatives in the sugar sector with long-term goals in mind. Significant attitudinal changes had occurred at the grass root level.

This was also the period of emergence of rural leadership through co-operative movement.

The Apex Bank also started to strengthen its organization and the working of the secondary level central financing agencies. This was also the period where the institutional foundation was strengthened.

6. The Diversification Stage (1962 onwards)

Expansion, accompanied by extensive vertical and horizontal diversification embraced all fields of socio-economic activity with gains varying from 2 to 6 times.

The State government initiated policies and programs to strengthen the co-operative effort. Some of the noteworthy features of the movement during this period were the increased mobilization of resources, strengthening the co-operative effort in the sphere of agricultural production and the building of rural leadership.

The State Co-operative Bank also built up the necessary strength to provide support to the government programs of intensive production and procurement of food grains, financing of sugar factories and other new industries in the co-operative sector.

The co-operatives have helped the rural economy of Maharashtra tremendously. It has been able to groom grass root level leadership and bring about peaceful socio-economic changes and help institutionalize the rural economy to a considerable extent.

The following table shows the progress of the Co-operative Movement in Maharashtra.

Table 2.1

Progress of co-operative movement in Maharashtra

No.	Type of Co-op	1961	1981	1991	1996	1997	2003
1	Apex & Central Agri/ Non Agri Credit	39	31	34	34	34	34
2	Primary Agri Credit	21,400	18,577	19,565	20,137	19,068	20,839
3	Non-Agri Credit	1,630	5,474	11,291	17,671	10,359	25,107
4	Marketing Co-ops	344	423	931	1,044	985	1,252
5.	Industrial Co-ops (Including Sugar factories, spinning mills etc.)	4,306	14,327	28,954	41,985	41,985	40,171
6.	Service co-ops (consumer stores/ Housing etc)	3,846	21,915	43,845	58,218	64,354	85,243

(Source – www.mah.nic.in/sahakaar)

This Table gives an idea about the progress of the co-operative movement in Maharashtra over the years.

2.2.6 THE CO-OPERATIVE SOCIETY

Introduction

Sole proprietorship, partnership and joint stock Company are the different forms of business organisation. There are differences among them in respect of their formation, operation, capital contribution as well as liabilities; one common similarity is that they all engage in business activities to earn profit. Without profit, it is impossible for them to survive and grow. However, there are certain organizations that undertake business activities with the prime objective of providing service to the members. Although some amount of profit is essential to survive in the market, their main intention is not to generate profit and grow. They pool available resources from the members, utilize the same in the best possible manner and the benefits are shared by the members. These organizations are termed as co-operative societies.

Meaning of Co-operative Society

The term co-operation derived from the Latin word co-operari, where the word co means 'with' and *operari* means 'to work'. Thus, co-operation means working together. Therefore, those who want to work together with some common economic objective can form a society, which is termed as "co-operative society". It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help as well as mutual help. The main objective is to provide support to the members. Nobody joins a co-operative society to earn profit. People come forward as a group, pool their individual resources, utilize them in the best possible manner, and derive some common benefit out of it.

Types of Co-operative Societies

Although all types of co-operative societies work on the same principle, they differ with regard to the nature of activities they perform. Followings are different types of co-operative societies that exist in our country.

1. Consumers' Co-operative Society: These societies are formed to protect the interest of general consumers by making consumer goods available at a reasonable price. They buy goods directly from the producers or manufacturers and thereby eliminate the intermediaries in the process of distribution. Kendriya Bhandar, Apna Bazar and Sahkari Bhandar are examples of consumers' co-operative society.

2. Producers' Co-operative Society: These societies are formed to protect the interest of small producers by making available items of their need for production like raw materials, tools and equipments, machinery, etc. Handloom societies like APPCO. Bayanika, Haryana Handloom, etc., are examples of producers' co-operative society.

3. Co-operative Marketing Society: Small producers and manufacturers who find it difficult to sell their products individually form this society. The society collects the products from the individual members and takes the responsibility of selling those products in the market. Gujarat Co-operative Milk Marketing Federation that sells AMUL milk products is an example of marketing co-operative society.

4. Co-operative Credit Society: These societies formed to provide financial support to the members. The society accepts deposits from members and grants them loans at reasonable rates of interest in times of need. Village Service Co-operative Society, Urban Co-operative Banks and Urban Co-operative Credit Societies are examples of co-operative credit society.

5. Co-operative Farming Society: These societies formed by small farmers to work jointly and thereby enjoy the benefits of large-scale farming. Lift-irrigation co-operative societies and *pani-panchayats* are some of the examples of co-operative farming society.

6. Housing Co-operative Society: These societies formed to provide residential houses to members. They purchase land, develop it, construct houses or flats, and allot the same to members. Some societies also provide loans at low rate of interest to members to construct their own houses. The Employees Housing Societies and Metropolitan Housing Co-operative Society are examples of housing co-operative society

Advantages of Co-operative Society

A co-operative form of business organisation has the following advantages:

i. Easy Formation: Formation of a co-operative society is very easy as compare to a joint stock company. Any ten adults can voluntarily form an association and get it registered with the Registrar of Co-operative Societies.

ii. Open Membership: Persons having common interest can form a co-operative society. Any competent person can become a member at any time he/she likes and can leave the society at will.

iii. Democratic Control: A co-operative society managed in a democratic manner. The members cast their vote to elect their representatives to form a committee that looks after the day-to-day administration. This committee is accountable to all the members of the society.

iv. Limited Liability: The liability of members of a co-operative society is limited to the extent of capital contributed by them. Unlike sole proprietors and partners, the personal properties of members of the co-operative societies are free from any kind of risk because of business liabilities.

v. Elimination of Middlemen's Profit: Through co-operatives, the members or consumers control their own supplies and thus, intermediaries' profit eliminated.

vi. State Assistance: Both Central and State governments provide all kinds of help to the societies. Such help may be provided in the form of capital contribution, loans at low rates of interest, exemption in tax, subsidies in repayment of loans, etc.

vii. Stable Life: A co-operative society has a stable life and it continues to exist for a long period. Its existence not affected by the death, insolvency, lunacy or resignation of any of its members.

Limitations of Co–operative Society

Besides the above advantages, the co-operative form of business organisation also suffers from various limitations. Let us learn these limitations.

i. Limited Capital: The amount of capital that a co-operative society can raise from its member is very limited because the membership generally confined to a particular section of the society. Again, due to low rate of return the members do not invest more capital. Government's assistance is often inadequate for most of the co-operative societies.

ii. Problems in Management: - Generally, it seen that co-operative societies do not function efficiently due to lack of managerial talent. The members or their elected representatives are not experienced enough to manage the society. Again, because of limited capital they are not able to get the benefits of professional management.

iii. Lack of Motivation: Every co-operative society formed to render service to its members rather than to earn profit. This does not provide enough motivation to the members to put in their best effort and manage the society efficiently.

iv. Lack of Co-operation: The co-operative societies formed with the idea of mutual co-operation. However, it often seen that there is a lot of friction between the members because of personality differences, ego clash, etc. The selfish attitude of members may sometimes bring an end to the society.

v. Dependence on Government: The inadequacy of capital and various other limitations make co-operative societies dependant on the government for support and patronage in terms of grants, loans subsidies, etc. Due to this, the government sometimes directly interferes in the management of the society and audits their annual accounts.

2.3 CONCEPT OF BANKING

2.3.1 BANKING – THE ORIGIN AND DEVELOPMENT

There is conflict among economists about the origin of the word "Bank". There are two opinions or viewpoints about the origin of word bank. According to first opinion, the word bank derived from German word "Banc" which implies Joint Stock Firm. Since the Germans influenced and dominated a great part of Italy, it believed that the Italians used the word "Banc" or "Banco" implying that accumulation of money with a Joint Stock Firm. This German word "Banc" which with the passage of time came know as "Bank".

According to other opinion, the word bank has derived from the Latin word "Banque" or "Bancus" which means a bench upon which the mediaeval European moneylenders and money chargers used to display their coins.

Evolution of Banking in Europe –

The business of banking is as old as human civilization. The banking activities although in rudimentary form, did exist and undertaken by early Babylonians and other civilizations much before Christ. The Babylonians had developed a banking system as early as 2000 B. C. The Babylonians used their temples as banks.

In Rome and Greek countries, the development of banking system also can be seen. The Greek peoples also their temples as center of money lending transactions. The great temples of Ephesus and of Delphi regarded to be the most powerful of Greek banking institutions. Banking was a flourishing and prosperous business in Athens. In Rome, the bankers called as Tabernoe Argentarioe. The functions undertaken by Roman bankers were more or less similar to modern banking such as valuation and exchange of money. All this shows that there was a developed banking system in Europe in the ancient times.

Although banking was mostly confined to private individuals in the early periods, many countries established public or national banks for two reasons. Firstly, to facilitate and promote trade and commerce. Secondly, to serve the Government. 'The Bank of Venice', established in 1157 (in Italy) regarded to be the first public sector banking institution. In 1401, a public bank was established in Barcelona (in Spain) viz., 'The Bank of Barcelona'. 'Bank of Geneva' was established in 1407 followed by 'The Bank of Amsterdam' (in Netherlands) in1609. It will not be out of place to mention here that most of the European banks now in existence formed on the mode of 'The Bank of Amsterdam'. All these banks accepted deposits that could be withdrawn on demand or could be transfer from the account of one individual to another.

The development of the business of banking in England owes its origin to the London Goldsmiths. In the 17^{th} century, the goldsmiths in England had their own their safe vaults. They used to receive their customer's valuables such as gold and silver for safe custody and issue receipts acknowledging undertaking to return the valuables and money to the depositor or bearer on demand. At this stage, it discovered that these valuables with goldsmiths could server as medium of exchange. The merchants and wealthy people who had deposited their valuables with goldsmiths could pay off their debt simply by endorsing the deposit receipt in favor of the creditors. In this way, the valuables automatically transferred from one person to another even though they remained in the safe custody of the goldsmiths.

It soon discovered that there was no need for endorsing the entire deposit receipt in favor of the creditors. A customer, whose valuables were in safe custody of goldsmith, could issue a letter to his goldsmith instructing him to transfer a certain portion of his valuables to another person. The modern system of payment through cheques obviously owes its origin to this practice of transfer of specific portion of valuables.

The goldsmiths also realized that their customers demanded a certain portion of the valuables deposited with them every day. Since much of the valuables deposited remained idle with the goldsmiths, they soon realized that they could issue more deposit receipts than the actual valuables with them, to meet the credit needs of some persons and started charging interest on them. Thus, it can see that goldsmiths laid the seeds of modern banking.

Although the goldsmiths laid the foundation of modern banking in England, the business of goldsmiths suffered a great setback in 1672. Charles II who had borrowed heavily from the goldsmiths refused to repay his debts; as a result, the goldsmiths were ruined. The role of goldsmiths as bankers eclipsed and they broke with their clients. However, this proved to be a turning point in the history of English banking and led to the growth of private banking and the established of 'Bank of England' in 1694. Various privileges granted to this bank. In 1708, an act passed prohibiting any other Joint Stock Bank from issuing notes and confining this privilege to private bankers with not more than six partners. In 1826, an act passed which allowed banks to start with unlimited liability. After 1858, Joint Stock Banks in England.

Evolution of Banking in India –

Although commercial banking of the western type is of recent origin in India it is a well-known fact that a system of banking suited to her requirements was in force in India science, 500 B.C. banking was popular and money lending was a common practice with ancient people in India. The ancient Hindu scriptures refer to the money lending activities, which existed during the Vedic period. The puranas and smritis have mentioned about money lending. References regarding banking practices in ancient India found in Manusmriti and Kautilya's Arthashastra. India possessed a system of banking which admirably fulfilled her requirements and proved very beneficial to her. Hindus came into use in India from the 12th century. J.

J. B. Tavernier, the famous French traveler states that in the 17th century almost every village had a moneychanger called 'Shroff' who acted as a banker. Banking in those days largely meant money lending. There was a lack of a well-organized banking system in the early period. The modern banking is essentially an impact of west. Banking on modern lines bean in India in the 18th century when the Agency Houses were established by English traders for financing trade. These Agency Houses functioned as trading concerns as well as commercial banks to cater to the needs of the colonial economy and established in the port cities of Bombay (Mumbai), Calcutta (Kolkata) and Madras (Chennai). Thereafter, the European traders established several Joint Stock Banks on unlimited liability basis. The first such type of bank established in 1770 viz., 'Hindustan Bank'. However, this bank had to be closed down in 1832 when its parent Agency House becomes bankrupt. Many other banks during the crisis of 1829-33 failed due to reckless speculation and mismanagement. Combination of banking with other kinds of business such as industry and commerce was also responsible for the collapse of many banks. The three 'Presidency Banks' were established in the first half of the 19th century viz., 'Bank of Bengal' in 1804, 'Bank of Bombay' in 1840 and 'Bank of Madras' in 1843. In 1960, an Act passed permitting the establishment of banks on 'Limited Liability' basis. Although the progress of banking in India was very slow up to 1865, it steadily grew after 1920 with the passing of the Imperial Bank of India Act to constitute the Imperial Bank of India', amalgamating the three Presidency Banks into a single bank. The Imperial Bank, the biggest commercial bank, functioned partly as the Central Bank and partly as a commercial bank from 1921 to 1935. In 1935 the 'Reserve bank of India' was established and as a result the central banking functions were taken away from the Imperial Bank.

After independence, there was a complete change in the banking scene in India. This change occurred of the passing of the 'Banking Regulation Act,' in 1949. The Act considered a landmark in the history of commercial banking in India. The Imperial Bank nationalized in 1955 to constitute the 'State Bank of India'. The pattern of the banking scene has changed considerably during the last four decades and the system as a whole has recorded rapid progress.

2.3.2 BANKING – DEFINITIONS

1) H. L. Hart -

"A banker is one who in the ordinary course of his business honors cheques drawn upon him by persons from and for whom he receives money on current account."

2) Sayers –

"Banks are institution whose debts-usually referred to as bank deposits – are commonly accepted in final settlement of other people's debts."

3) Banking Regulation Act, 1949 –

"Accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise."

From the above definitions, it is clear that a bank is an institution dealing in money and credit. It is an institution, which receives money as deposited and lends money as credit. Thus, a banker may be defined "a dealer in money" or "a dealer in credit."

2.3.3 FUNCTIONS OF BANK

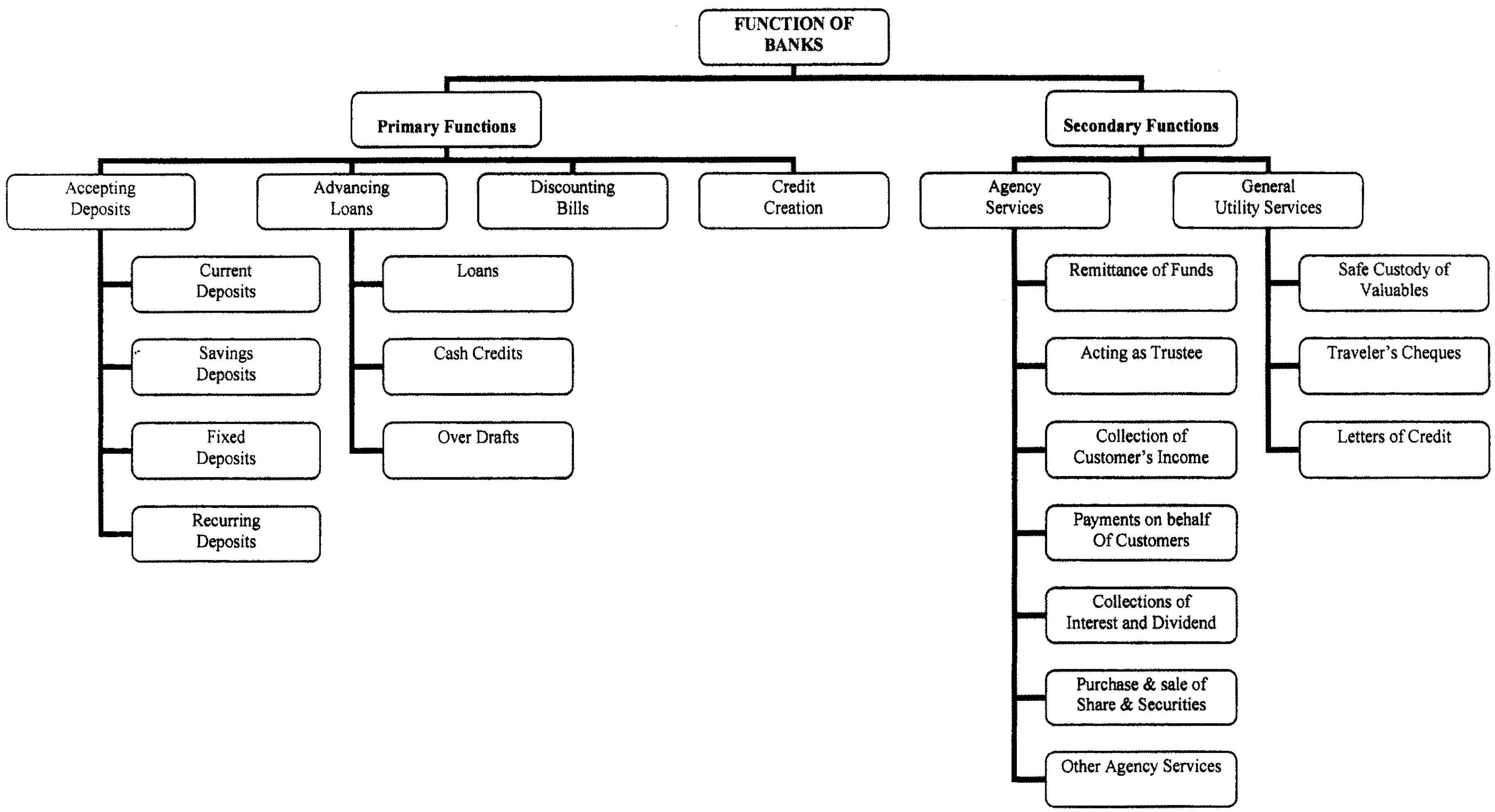
The banking is an evolutionary concept and the functions of banks have evolved over time in response to changing conditions. The evolutionary nature of bank keeps the functions also evolved ones. Taking into account the diverse, varied and ever-expanding activities undertaken by a bank, here the functions of banks can broadly classify into two heads viz., Primary Functions and Secondary Functions.

I] Primary Functions or Banking Functions

These are fundamental functions of a bank and include the following four functions.

1) Acceptance of Deposits
2) Advancing of Loans
3) Discounting of Bills of Exchange
4) Creation of Credit

Chart 2.1
Functions of Banks



1) Acceptance of Deposits:-

Accepting deposits from the public is the primary and basic function of a bank. In fact, the banking business has its origin in this function. Safety of saving is a major concern from most people, so they deposit their money in banks for safekeeping. The bank not only protects the deposits of the people but also pays interest on deposits so collected. Besides, the banks provide the depositors with a convenient method for transferring their funds by cheques. The business of banking depends on its capacity to attract deposits from the people at large. The deposits accepted by banks can be categorized as under.

A) Current Deposits –

Current deposit is also known as Demand Deposit or Current Account. Current Account general opened by people engaged in trade and business, Joint Stock Companies and Institutions who made daily payments and receive daily money. There are no restrictions on the number of withdrawals of money on this account. The bank generally does not pay interest on current account. The bank offers several facilities on this account such as, cheque facility, overdraft facility, etc. however bank levies certain charges on the customer for the services rendered by bank.

B) Saving Deposits –

This is the second type of deposit that banks offers for collecting the savings of people of small means, generally, people with fixed salaries. The chief object of saving deposit is to encourage the habit of thrift among people with low incomes. There are no restrictions on the amount to be deposit in this account but there are restrictions on withdrawals of money from the account. Bank pays interest on saving bank account but rate of interest on saving bank account is very low i.e. only 3.5%.

C) Fixed Deposits –

Fixed deposits are also known as Time deposit or Term deposit. Fixed deposits cannot withdraw before the expiry of the term period. Hence, banks can freely make use of such deposits for a fixed period for granting loans and advances. Therefore, the banks offers higher rate of interest on fixed deposits. Depositor cannot withdraw the amount deposited by him before the maturity period, if he intended to do so, the interest on such a fixed deposit reckoned at one per cent less than the rate applicable to the period for which the deposit has already run. The bank also allows the customers to borrow the amount required against the security of his fixed deposit at a rate of interest which usually two per cent higher than the rate payable on the deposit.

D) Recurring Deposits –

In order to inculcate the saving habit on a regular basis, the scheme of recurring deposits has been started by the banks. A depositor opens an account and has to deposit a fixed amount every month for a period selected by him. The rate of interest on these deposit are almost equal to the rates of interest of fixed deposits. Depositor can borrow loan on recurring deposit up to 75% of the amount in the account at the rate of interest in vogue. Besides, if the customer intended to withdraw the total accumulated amount in the account before the due date he can do so.

2) Advancing of Loans

The second major function of a commercial bank is the landing of money. The money that is received by the money that is received by the way of deposits from the customers is not kept idle in the cash box but is utilized for granting loans and advances to the needy borrowers. Lending of money is an important function of a bank from the point of view of its earnings. This function of lending of money is important also for the economy as a whole and for industry and commerce in particular. This is because the lending operations of banks involves the creations of credit which in turn facilities the financing of industry and commerce.

Before granting loans and advances to the borrowers, the bank satisfies itself fully about creditworthiness. This is why a bank lends money against the personal security of the borrowers or against the security of moveable and immoveable proprieties. Generally, banks grant loans and advances to the borrowers in the following three forms:

A) Loans –

When a banker makes an advance in a lump-sump for definite period of time it called as loan. The loan money credited to the deposit account of the borrower. However, borrowers can either withdrawn full amount a part of amount of loan as per his requirements. Interest charged on the total amount of the loan granted, irrespective of the fact that how much amount withdrawn by borrower. The loan account is repayable in lump sum on the due date or in installments as agreed. There are different types of loans such as, term loans, participation loans, personal loans, call loans and collateral loans, etc. banks generally advance loans on the security of assets such as shares, life insurance policies, government securities, gold and other assets.

B) Cash Credit –

A cash credit is an arrangement by which a banker advances loans to the borrowers against certain securities. The entire loan amount is not given all at once. What the bank does is that is that it opens as account in the name of the borrower and allows him to withdraw the money as and when he needs up to certain limit determined by the value of the security pledged with the bank. The bank will charge interest only one the actual amount withdrawn by the borrower. However, in the borrower does not make use of the funds in his account the bank will charge some minimum interest.

C) Overdrafts –

This facility is generally given to those customers who already have a current account in the bank. An overdraft is a facility, which allows customer to overdraw their current accounts, generally against collateral securities to meet their temporary needs. The essential difference between a cash credit and an overdraft is that, the overdraft given occasionally for short period, whereas cash credit sanctioned regularly to commercial and industrial concerns for longer periods to meet their working capital requirements.

3) Discounting of Bills of Exchange

This is yet another type of lending which is very popular with the modern banks. Bills of exchange usually are of three months duration. The holder of the bill of exchange has a right to receive the amount stated therein on the maturity of the bill. If the holder of bill of exchange is in need of money before its maturity, he can get the bill discounted from the bank. The banker discounts the bill as its present value i.e. purchases it by paying cash and deducting interest as an agreed rate for the time, the bill has to run. This interest is known as a banker's discount. Discounting of bills considered the most suitable investment from the bank's point of view. This is because bills are certain to be paid on maturity, they have a stable value, they can be rediscounted with the central bank if necessary, the investment is for a definite period and finally, they yield higher returns. Bills of exchange thus, are ideal bank assets, which satisfy the principles of safety, liquidity and profitability.

4) Creation of Credit

Creation of credit is one of the important functions of modern banks. We have already seen that the money received by the banks by way of deposits advanced as loans to the borrowers. However, this is not a correct statement of facts, because banks lend money not only out of the deposits received by them, but they also create deposits themselves. This is why the banks are in a position to lend much more than what are actually received by them by way of deposits. This additional money, which the banks lend in excess of what they receive, referred to as 'created money'. The banks can raise a big superstructure of credit in the basis of relatively small reserves. This particular function of bank of creation of credit plays a very important role in the development of trade, commerce and industry.

II] Secondary Functions or Services of Banks

The modern banks perform a verity of functions, which are more in the nature of services. These services undertaken by the banks with a view to increase its utility to its customers and to the community in general. By providing a wide verity of such services, the banks attract more and more customers and get increasing business. These functions called as "secondary functions" or "subsidiary services" because they are supplementary in nature. These secondary functions can be broadly classified under two heads:

1) Agency Services
2) General Utility Services

1) *Agency Services:-*

The modern bank acts as a special agent of its customer and performs a number of functions for and on behalf of its customers. The bank renders the following services in the capacity of an agent of its customers:

I. Remittance of Funds –

The bank helps its customers in transferring funds from one from one place to another. Since the banks have their branches spread throughout the entire country, they serve as best mediums for transfer of funds from one place to another. The important modes of transferring funds from one place to another through banks are as under:

a. **Transfer of Money through Demand Draft (DD)** – A bank draft is drawn by one branch of a bank on another branch of the same or another bank and is payable on demand to the person whose name is mentioned therein or according to his order. Banks issue drafts for remitting funds from one place to another. If a person wishes to remit funds through a bank draft, he has to deposit the money to be remitted together with the commission. After collecting the amount and commission, bank issue the draft to the person, who need not necessarily be its customer. The buyer of draft sent it to the payee for encashment. The payee collects the amount from the branch on which the draft is drawn.

b. **Mail Transfer (MT)** – An account holder of one bank can remit funds to another account holder at another branch of the same bank through mail transfer. The account holder who wishes to transfer funds through mail transfer has to give written application with all the necessary details to the bank for this purpose. The bank after collecting the amount and the relevant information sends a message through ordinary post to the payee branch advising it to pay the amount to a specified payee or according to his order.

c. **Telegraphic Transfer (TT)** - In case of the telegraphic transfer the transfer of funds is quick because the massage for transfer communicated through telegram instead of ordinary post as in the case of mail transfer. This mode of transfer is similar to mail transfer in other respects, the only difference being that the bank charges more commission for such transfers. With rapid changes of means of communication, the modes of transfer for quick remittance of funds are also undergoing changes. Today, banks generally employ computer for quick transfer of funds.

II. Acting as trustee, Executor and Attorney –

Banks also act as trustees, executors and attorneys. Modern banks render these in return for a reasonable return. As a trustee, the banker takes care of the funds of the customers. Bank helps in proper management of trust. The bank preserves the 'wills' of the customers and executes them after their death. As an executor, the bank must carry out the directions contained in the will of the deceased. As an attorney, the banker authorized to receive interest and dividend on securities belonging to his customer. The power of attorney may also empower the banker to sign transfer forms and other documents in respects of sales and purchases of securities, on behalf of his customer.

III. Collection of Customer's Income –

The modern banker collects the income of his customers which may came form different sources such as salary, pensions, rent, moneys due on promissory notes, coupons, etc. The funds so collected on behalf of the customers, credited to their accounts. By providing these services, the bank earns some commission as well as the goodwill of their customers, which ultimately promotes the business of banks.

IV. Payments on behalf of Customers –

Besides collection of customer's income, the bank also makes payment on behalf of its customers. The bank pays premium to the insurance companies, loan installments, taxes, subscription or contributions, etc. which are of recurring nature. The banker acts as an agent of his customer and makes all such payments on his behalf. After making all such payments, the bank debits the accounts of its customers.

V. Collection of Interest and Dividends –

The bank collects interest on securities and debentures as well as dividend on shares, cheques, bills, etc. on behalf of its customers and creditors them to their accounts. The banks charges nominal amount for this service and debit the accounts of their customers for the service rendered.

VI. Purchase and Sales of Shares and Securities –

The bank buys and sells shares and securities of private as well as Governments securities on behalf of its customers. Since banks better informed about the market conditions that then the people, they buy and sell shares and securities on behalf of the customers' at the most favorable terms. Although banks charge a small amount by way of commission for this service, they render all possible assistance to their customers on their behalf.

VII. Other Agency Services –

The bank also acts as an income tax consultant and gives advice to its customers on income tax matters. The bank also acts as a correspondent, agent or representative of its customers and obtain passports, travellers tickets, secure air and sea passages, book accommodation in hotels and do such other jobs as desired by its customers.

2) *General Utility Services:-*

The modern bank renders a number of utility services to their customer. The bank does not perform these functions as agents but as part of their banking business. The service-oriented functions of the banks are as follows:

I. Safe Custody of Valuables –

An important function of a modern bank is that of keeping in safe custody, valuable of its customers such as gold and silver ornaments, shares and debenture, fixed deposit receipts, life insurance policies title deeds and other important documents. The modern banks provide locker facility to its customers at selected branches. The bank charges annual rent for the lockers.

II. Traveller's cheques –

The bank issues travellers cheque for the benefit of its customers. It is risky for a taveller to carry large amount of cash with him when he travels. To avoid such risk of loss or the inconvenience of carrying large amount of cash while travelling, the modern banks issue travellers' cheques. These cheques are issued in suitable denominations such as Rs. 25, Rs. 50, and Rs. 100 and can be encashed at the places mentioned therein or at the branches of the issuing bank.

III. Letter of Credit –

A modern bank plays an important role in promoting internal and external trade. Besides providing a convenient mechanism for making payments arising out of trade transactions, the modern banks facilitate trade and commerce, especially international trade (i. e. exporter and importer) and acquainted with each other, the exporters bear great risk if they draw bills on the importers after dispatching the goods, because if the defaults in accepting bill or making its payment, the exporter will suffer heavy losses. To avoid such risk, some short of arrangements is necessary to facilitate the smooth functioning of trade and commerce.

2.3.4 INVESTMENT POLICY OF A BANK

Co-operative banks like other concern have the objective of making profit to cover its operating expenses. In order to make profits, the bank has to judiciously invest its funds in various forms of income earning assets. The funds raised by bank cannot be kept idle in the banks but should be profitably invested with a view to earn profit. While investing its funds banks also have to consider security of its funds thus the bank has to make judicious distribution of funds among different assets, which determine the soundness of a bank. A good banker is one who formulates a wise investment policy, which safeguards the interest of both, the shareholders as well as the depositors. Following are the three principles, which the bank has to consider while formulating its investment policy.

1) Principle of Safety
2) Principle of Liquidity
3) Principle of Profitability

1) Principle of Safety:-

Bankers are dealers in money, they deal with money belong to others. Banks generally accept the deposits from the public. These deposits form the basis of their lending operations. While conducting their lending operations, the first and the most important principle that banks should bear in mind is the safety of the funds lent out. If the funds lent out are not secured and backed up by adequate securities, the bank would find it difficult to recover the loans advanced and land them in trouble. They will not be in a position to honor the claims from their depositors. The very existence of banks may be endangered under such circumnutates. Therefore, 'Safety First' should be the main banking principle. In their eagerness to make more profits, banks should never lose sight of the 'safety principle' while investing their surplus funds. The safety principle implies that a bank is in a position to get back the amount it lends out as and when it needs it without any loss. While making investment, the bank should bear in mind the following points to ensure safety of its funds.

a. **Credit-worthiness of the Borrower** – While lending out funds, a banker must see to that the funds lent out will definitely come back without any loss. Naturally, this demands a very careful selection of borrowers based on their credit-worthiness. While judging the credit worthiness the bank should take into account the three C's of the borrower – (i) Character of the borrower, (ii) capacity of the borrower to handle a business efficiently and to repay the loan and (iii) Capital depicting that the borrower is financially sound.

b. **The Purpose of Loan** – The safety of funds lent out, largely, depends on the purpose for which they lent out for productive purposes; obviously, the possibility of its timely recovery is more. On the other hand, if funds lent out for unproductive purposes, a banker should be very cautious because there is no guarantee of its repayment.

c. **Suitable Security** - In order to provide added safety and to minimize the risk of default, banks insist on security against funds lent out. The bank should carefully evaluate the security offered is higher than the amount of loan sanctioned and distributed to borrower.

d. **Diversification of Loans** – Diversification of loans is an important principle of sound investment policy. Every loan granted by a bank involves a risk. Therefore, a prudent banker should not lend out his funds to a few individuals or a few industries from the same field of area or sector.

e. **Loans for Short period** – After having taken all the previously mentioned precautions, to ensure the safety of the funds lent out, the bank, as far as possible, should grant loans only for short period's i.e. loans should given to the borrowers only to enable them to tide over their temporary credit needs.

2) Principle of Liquidity:-

Another important principle guiding the investment policy of a bank is principle of liquidity. The term 'Liquidity' means the ability of a bank to satisfy demands for cash by its depositors. To maintain liquidity bank should kept sufficient amount of cash with itself and invest sufficient amount in such type of securities and assets that should be converted easily in cash and available for payment. A bank should maintain a proper balance between liquidity and solvency. A solvent bank means a bank which value of total assets exceeds the value of its liability.

3) Principle of profitability:-

Third important principle guiding the investment policy of a bank is principle of profitability. Like other business banking business also, have to earn sufficient profit or income from its assets to meet all its expenses. Bank must have to pay interest to the depositors, salaries to the employees, etc. this demands that the banker should distribute his resource among different types of earning assets in such a manner as to derive maximum profit. Profitability, in the present competitive word, regarded to be a criterion for the efficiency of a bank. The bank therefore, invests its fund in such a manner that it gets surplus income. To generate surplus income, the bank must have to invest its funds in long-term securities. Although such securities earn maximum income, they are the least liquid assets and cannot be promptly converted into cash. In contrast, cash is the liquid asset but fetches no income, it is, in fact, a non-profit earning assets. Thus, liquidity and profitability are the two conflicting consideration and pull in opposite directions. Hence, a bank must maintain a sound balance between these two conflicting principles of liquidity and profitability.

2.4 CONCEPT OF CO-OPERATIVE BANKING

2.4.1 INTRODUCTION

The term 'co-operation' means working together. Co-operation is a form of business organization wherein a group of persons having one or more common economic goal voluntarily pools their resources and uses them for mutual benefit. Co-operation is one of an important sector where banking business has performed largely. A co-operative bank promotes economic activities and provides banking facilities and services to rural people.

2.4.2 DEFINITIONS OF CO-OPERATIVE BANKING.

1) Devine -

"A co-operative bank is 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."

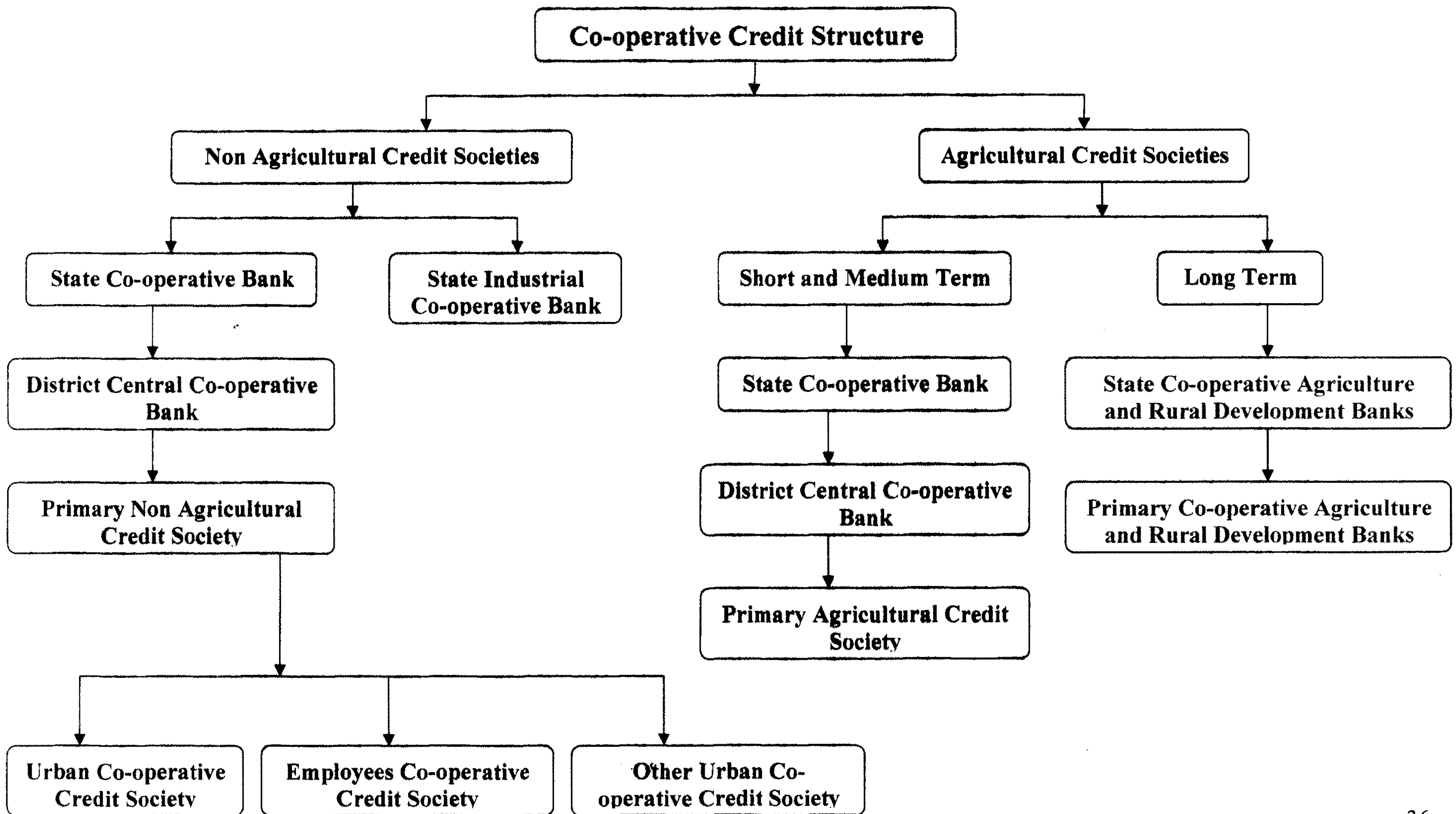
2) Dr. D. R. Gadgil –

"The co-operative Banking system is an integrated one and because of its three-tire structure, has been enabled to extend credit to agriculturists, artisans and small men in general. The three-tire system also allows a rationalized flow of resources from the metropolitan centers to the villages and combines this with fairly low costs of operations."

2.4.3 CO-OPERATIVE BANKING STRUCTURE IN INDIA.

2.4.3 CO-OPERATIVE BANKING STRUCTURE IN INDIA.

Chart 2.2
Co-operative Banking Structure in India



2.5 CONCEPT OF URBAN CO-OPERATIVE CREDIT SOCIETY

2.5.1 INTRODUCTION

Co-operative credit societies are those, which formed by the member by collecting capital based on co-operative principles in a specific area of operation for the economic upliftment of the members. These co-operative credit societies categorize into two segments viz, agricultural co-operative credit societies and non-agricultural co-operative credit societies.

Urban co-operative credit societies are the important segment of primary non-agricultural credit societies, along with the urban co-operative banks and employees co-operative credit societies. They are generally, organized by the people of particular community or profession and small income groups. The members of this society consist of traders, artisans, factory workers, professional men, salaried class, etc. They are operating in urban, semi-urban and rural areas by collecting deposits from members, and non-members and advancing loans mostly to small business man, handicraftsmen, salary earner's, etc., on personal security as well as against gold, silver and produce.

2.5.2 DEFINITION OF URBAN CO-OPERATIVE CREDIT SOCIETY

1) Section 56 of the Banking Regulation Act 1949 -

"Primary credit society" means a co-operative society, other than a primary agricultural credit society, –

1) The primary object or principal business of which is the transacting banking business.
2) The paid up share capital and reserves of which are less than one lakh of rupees; and,
3) The byelaws of which do not permit admission of any other co-operative society as a member.

2.5.3 OBJECTIVE OF URBAN CO-OPERATIVE CREDIT SOCIETIES

Urban co-operative credit societies are working with specific objectives these objectives are as follows

1) To inculcate the habit of thrift and saving amongst the members

2) To attract deposits from members and non-members
3) To lend money to the members and non-members at the reasonable interest rate
4) To employ the idle funds of society safely
5) To induce the people to join it as member and shareholders
6) To extend credit facilities to individual customers on the basis of physical securities
7) To develop banking facilities in rural and semi-urban sector

2.5.4 FUNCTIONS OF URBAN CO-OPERATIVE CREDIT SOCIETIES.

Urban co-operative credit societies perform various functions to achieve their objectives. The main functions of such societies are –

1) Accepting various kinds of deposits from members as well as non-members
2) Advancing loans to members for various useful purposes loans are also given to non-members on the security of their deposits
3) Borrowing adequate funds from the central financing agencies if necessary to lend money to members of society
4) Recover the loans from borrowers in time and repaying the loan taken from district central co-operative banks.
5) Encourage thrift, self-help and co-operation among the members.
6) Providing other banking essential services to the members within the provisions of byelaws of society
7) Encouraging social welfare and education activities by contributing money

2.5.5 MEMBERSHIP OF CO-OPERATIVE CREDIT SOCIETIES

The membership of urban co-operative credit societies compares of people of living in urban or semi-urban or rural areas, such as traders, merchants, salaried persons professional classes, etc. The conditions of eligibility for the membership of these societies prescribed in their buy-laws. The study group on co-operative credit in the non-agricultural sector (1963) was of the opinion that,

Generally membership of urban co-operative credit societies should be open to all persons competent to contrast and residing in the area of operations.

The liability of member in case of liquidation of the society is limited to the value of share held by them. A person enjoys many benefits by becoming a member of society such as right to get dividend, right to attend annual general meeting and voting, etc.

There is a scope for nominal associate membership by paying nominal fees to the society for keeping deposits and taking loans from the society. A nominal member cannot enjoy all the right that enjoyed by regular member. It means that such nominal members cannot exercise voting rights and cannot claim regular membership.

2.5.6 MANAGEMENT OF CO-OPERATIVE CREDIT SOCIETIES

The ultimate responsibilities of accomplishment of objective of society belong to management. The success and smooth working of the urban co-operative credit society is depending upon the efficient management. Management is a wider term. It denotes different meanings depending on the context in which it is used. It variously described as an 'activity' a 'process' and a 'group' of people vested with the authority to make decisions.

According to J. N. Schutae -

"Management is the force which leads guides and directs an organization in the accomplishment of a predetermined object".

Management in relation to the urban co-operative credit society may be referred to group of managerial personnel of the society. Management often used in referring to the group of managerial personnel on an organisation. The managerial group includes all those who have supervisory responsibility over others and the chief executive of the organisation. Thus, all people in the society from board of directors to secretary fall under the category of management. For achievement of the goals of the society management plans, organizes co-ordinates, directs and controls the group efforts. Management is always concerned with the group efforts and not individual's efforts.

Management of urban co-operative credit society refers to board of representative of members, which has to formulate plans and policies and execute the same for achievement of the objectives of the society. Like any other co-operative organization, the management of an urban co-operative credit society vests in a 'managing committee' or 'board of directors' who are elected by the general body consisting of all the members. The final voice in all matters rest with the general body but the actual conduct of the affairs of the society rests with the managing directors. Chairman is the head of the committee who is elected by the members of the managing committee. He has to look after the day-to-day affairs of society through an officer or a secretary.

The organizational pattern of society is as under

Shareholders

↓

Managing Committee

↓

Chairman

↓

Security

↓

Clerks

In large urban co-operative credit societies the management committee is also assisted by the various sub-committee e.g. loan appraisal committee, loan recovery committee, etc. The tenure of office the management committee varies form 3 to 5 years subject to the provisions of the state co-operative law. The strength of managing committee varies from 5 to 12 depending upon the size of membership subject to provisions of state co-operative law.

As the management of such societies is a typical work, it is necessary that the services of competent persons who have knowledge and experience of banking accounting and finance should be represented on the committee. The day-to-day management should be conducted by trained and efficient staff.