

Genesis and Architecture of Urban Cooperative Banks

Introduction

2.1 Cooperative endeavour is not an alien phenomenon to India. Kautilya, in his Arthashastra described, "Guilds of workmen as well as those who carry on any cooperative work shall divide their earnings either equally, or as agreed upon among themselves".¹ The Cooperative Credit Movement in modern India, curiously, is a state initiated movement. The then State regime, though it had an unbenign political dispensation towards native subjects, had taken a lead to create an institutional credit structure essentially to cater to the needs of farmers and lower income groups. It is further interesting to note that cooperative initiative so taken was perhaps the first ever attempt at micro credit dispensation in India. Briefly outlining the theory of Cooperation, the Report of Maclagan Committee on Cooperation, the seminal document on cooperative credit movement in India, graphically describes:

" that an isolated and powerless individual can, by association with others and by moral development and mutual support obtain in his own degree the material advantages available to wealthy or powerful persons, and thereby develop himself to the fullest extent of his natural abilities. By the union of forces material advancement is secured, and by united action self reliance is fostered, and it is from the interaction of these influences that it is hoped to attain the effective realisation of the higher and more prosperous standard of life which has been characterised as better business, better farming and better living".²

Genesis of urban cooperative credit movement can be traced from the same underlining strand of thinking as expressed by Maclagan Committee.

2.2 The Co-operative society Act of 1904 was passed as per the recommendations of Sir Edward Law Committee which was appointed on the basis of the report of Sir Fredrick Nicholson, who was commissioned to study the theory and practice of agricultural land banks in Europe by Government of India. Report of Sir Edward Law was instrumental in realising that cooperative movement would not really advance without a special legislation. However, the urban cooperative credit movement did not receive the impetus till the Maclagan Committee recognised its importance as seen from the fact that urban cooperative credit societies (602) constituted a meagre 4.4% of the 13745 agricultural credit societies. The following twin factors might have inhibited the growth of urban cooperative credit societies.

(a) There was a deliberate and selective emphasis on the spread of agricultural credit movement by Government of India. *"In introducing the cooperative credit movement into India, the Government of India ordered that establishment of societies among the agricultural classes should be the first care of local governments. The Agricultural problem is more difficult to deal with than industrial problem, and it is necessary that effort should be concentrated."*³

(b) The second reason, perhaps, was due to low level of urbanisation.

Despite the above, Maclagan Committee strongly felt that "urban credit societies might serve a useful purpose in training the upper and middle urban classes to understand ordinary banking principles."⁴

Genesis of Urban Cooperative Banking Movement

2.3 Evolution of urban cooperative banking movement in India can be traced through 3 distinct phases which are discussed in the succeeding paragraphs.

Phase I (1904-1966):

Inspired by the success of urban cooperative credit movement in Germany and Italy, the first mutual aid society 'ANYONYA SAHAKARI MANDALI' was organised in the then princely State of Baroda in 1889 under the guidance of Late Shri Vithal Laxman Kavthekar. The enactment of Cooperative Credit Societies Act, 1904, however, gave the real impetus to the movement as the first urban cooperative credit society was registered in Canjeevaram town in the then Madras province in October, 1904. Thereafter, few more societies were organised in Madras and Bombay provinces.

2.4 In 1912, some major amendments were brought in the Act with a view to broad basing it to enable organisation of non-credit societies. The Maclagan Committee's recommendations, as mentioned above, have much to contribute in evolving the urban cooperative credit movement. With the transfer of the subject of "Cooperation" from Central to Provincial Governments, as a sequel to the constitutional reforms popularly known as "Montague Chelmsford Reforms" and passing of the Act of 1919, the then provincial Govt. of Bombay passed the first State Cooperative Societies Act in 1925⁵ " which not only gave the movement its size and shape but was a pace setter of cooperative activities and stressed the basic concept of thrift, self help and mutual aid."⁶

2.5 In the formative phase, urban cooperative credit societies came to be organised on community basis and their lending operations were confined to meeting the consumption oriented credit needs of their members. The term 'bank' was very loosely used by many societies in the initial phase. Many urban banks which were organised in the early part of this century were essentially credit societies but later converted themselves into UCBs. Many urban credit societies which were not engaged in any banking functions, also used the word 'bank' or 'banker'. There was no well defined concept of urban cooperative bank. It was the Joint Reorganisation Committee popularly known as Mehta Bhansali Committee (1939) in the then Bombay province, which, for the first time, made an attempt to define an urban cooperative bank. It defined a credit society as an Urban Cooperative Bank (UCB) whose paid up share capital was Rs.20000 or more and was accepting deposits of money on current accounts or otherwise subject to withdrawals by cheque, draft or order. In Madras province, urban cooperative credit societies accepting current account deposits and maintaining certain amount of liquid resources, as prescribed by Registrar of Cooperative Societies, had come to be known as Urban Cooperative Banks (UCBs), irrespective of size of their share capital. Subsequently, in 1966, when banking laws were made applicable to cooperative banks, provisions of section 5(CCV) of Banking Regulation Act, 1949 [As Applicable to Cooperative Societies (AACS)] defined an Urban Cooperative Bank, as a primary cooperative bank other than a primary agricultural credit society:

- (i) the primary object of which is the transaction of banking business;
- (ii) The paid up share capital and reserves of which are not less than Rs.1 lakh and

(iii) the by-laws of which do not permit admission of any other cooperative society as a member.

2.6 With the economic boom created by IIInd World War, the urban banking sector received tremendous impetus and started diversifying its credit portfolio, branching out from meeting traditional consumption oriented credit needs into catering to the needs of artisans, small businessmen and small traders.

2.7 Various Committees and Study Groups, like the Central Banking Enquiry Committee (1931), the Cooperative Planning Committee (1946) popularly known as Saraiya Committee, Varde Committee (1963), the Study Group on Credit Cooperatives in Non-Agricultural sector (1963), and Working Group on Industrial Financing through Cooperative banks (1968) have commended the working of UCBs in extending support to the micro agencies, to whom the commercial banking sector was quite wary of lending. Interestingly, the survey made by RBI in 1958-59, for assessing the financial pattern of UCBs and their role in financing Small Scale Industries, revealed that notwithstanding absence of state support to urban banking sector (unlike its counterpart viz. in the Agricultural Cooperative Credit sector), the UCB sector, as a whole registered a fairly good rate of progress.

2.8 Data prior to 1948 about the urban cooperative banking sector is, unfortunately, not available. As at the end of financial year 1948-49, the number of UCBs stood at 815 and rose to become 1106 by the end of financial year 1966-67. During this period, the deposits held by UCB sector rose from Rs.17 crores to Rs.153 crores, registering a growth of 800% [Urban Cooperative banks were brought under the purview of B.R. Act, effective from 1 March, 1966]. An interesting feature of urban cooperative credit movement in the early part of this century was that the public confidence in urban cooperative credit sector, particularly the lower and middle income groups, was unshaken notwithstanding the collapse of joint stock banks. It is indeed interesting to note that during the years 1913 and 1914, in the then Bombay Presidency, United Provinces and Punjab, where banking crisis led to collapse of no fewer than 57 joint stock banks, there was a flight of deposits from the joint stock banks to cooperative urban banks. The Maclagan Committee graphically chronicled the phenomenon:

"As a matter of fact, the crisis had a contrary effect, and in most provinces, there was a movement to withdraw deposits from non-cooperatives and place them in cooperative institutions, the distinction between two classes of security being well appreciated and a preference being given to the latter owing partly to the local character and publicity of cooperative institutions but mainly, we think, to the connection of Govt. with Cooperative movement".⁷

2.9 Similarly, between 1939-1949, when 588 joint stock banks failed in various states eroding public deposits to the tune of Rs.26 crores, there was not even a miniscule impact on urban cooperative banks, presumably due to the fact that cooperative institutions were subjected to stringent regulation as compared to a lax supervision over commercial banks. It is indeed strange to note that commercial banks were governed by the Company Law applicable to ordinary non-banking companies. Very aptly, the Central Banking Enquiry Committee 1931, had come to the conclusion that the provisions of Indian Companies Act were inadequate to deal effectively with

banking malpractices and recommended comprehensive legislation. Although Companies Act was amended in 1936 and a separate Chapter relating to Banking Companies was added, the provisions therein were still found to be ineffective. This was a classic era of laissez faire banking and was a perfect Hobbesian state of nature. Shri B. Ram Rau, the then Governor, RBI, succinctly described the scenario "*Any financial adventurer who required money for a speculative venture or for financing a business, in which he was interested, started a bank with many branches and collected substantial deposits by the offer of high rates of interest and by lavish advertisement.*"⁸

2.10 Compared to the above scenario, the segment of urban cooperative banks was fairly better regulated and UCBs did not reflect any symptom of systemic failure. As a matter of fact, in Madras province, UCBs were required to maintain fluid resources, a concept akin to Statutory Liquidity Ratio prescription.

Phase II (1966-93)

2.11 During this period, the demand for extension of deposit insurance was gaining momentum on account of significant increase in the operations of Urban Cooperative Banks and their volume of deposits and more particularly in the context of sad experience of Palai Central Bank failure. As extension of deposit insurance to cooperative banking sector presupposes some semblance of Reserve Bank control over them, some provisions of B.R. Act, 1949 were made applicable to Urban Cooperative banks in 1966 after an intense debate among State Governments, Government of India and RBI. This was a landmark in the evolution of urban banking movement in India. Consequently, the cooperative banks came under duality of control.

The banking related functions such as licensing, branch licensing, area of operation, exposure norms, interest rates etc. are governed by RBI directives and regulations; incorporation and registration of cooperative banks, audit, management, liquidation, winding up, amalgamation etc., these functions are governed by the State Governments by virtue of powers conferred on them by the respective State Cooperative Societies Acts. Ironically, irritants thrown up by this dual control regime, have become one of the most vexatious issues before the UCBs and cooperators. The Committee deals with this very important aspect later in this Report in [Chapter VIII](#).

2.12 It is interesting to note that the Banking Regulation Act does not recognise the term 'urban cooperative bank' and defines it as a primary cooperative bank. The word "primary" is used to denote that the bank performs the role of a primary unit in a 3-tier cooperative credit structure. By this definition, the Urban Cooperative Banks were made an integral part of the well developed 3-tier cooperative credit structure which was developed to cater to the needs of rural India. The Urban Cooperative Banks, by implication, have to be affiliated to District Central Cooperative Bank (DCCB) at district level and to State Cooperative Bank (SCB) at apex level and these banks, in turn, were supposed to help, nurse and guide the UCBs. Historically, UCBs were organised in semi-urban, urban and metropolitan centres. This was the reason why they came to be popularly known as urban cooperative banks. However, the cooperators, UCBs and their federations have, strongly pleaded for deleting the word 'primary' from the statute in view of phenomenal increase in their size and operations surpassing even District Central Cooperative Banks (DCCBs). This issue is examined later in [Chapter VIII](#).

2.13 Between 1966-93, the resources mobilised by way of deposits by the UCBs have registered a phenomenal growth. From a meagre Rs.153 crores as at the end of June 1967, they rose to Rs.13531 crores by the end of March 1993. The credit base surged from Rs.167 crores to Rs.10132 crores during this period. Year wise key financial indicators of UCBs are given in [Annexure IV](#). The annualised average growth of deposits and advances was found to be quite impressive. The number of urban cooperative banks had grown from 1106 to 1399 during the corresponding period.

2.14 A class of urban cooperative banks, which are popularly called, Salary Earners Banks also emerged as a matter of course and had their own place in the urban cooperative banking system over the years. These banks are essentially thrift societies set up by employees of governmental departments/ PSUs/large establishments for mutual help on the principles of cooperation. These societies also started using the word 'bank' and were accepting deposits from members of public. Since Reserve Bank of India did not find any rationale for their continuing as banking entities, as they were essentially thrift societies, they were advised to go out of the purview of the B.R. Act, after returning the deposits to non-members. As a result, 599 salary earners banks went outside the purview of the B.R. Act, during the period 1 March, 1966 to 30 June, 1977 by converting themselves in to cooperative credit societies. Marathe Committee had also endorsed this view. As on 31 March,1999, there were 90 salary earners banks.

2.15 Yet another interesting feature of the history of urban cooperative banking movement is that despite the exit of so many salary earners banks from the ambit of B.R. Act, the number of UCBs increased from 403 (excluding salary earners banks) to 1023 during 1 March 1966 and 30 June 1977. This increase in number of UCBs was not on account of a liberal licensing policy stance of RBI but an offshoot of statute induced expansion i.e., automatic conversion of Primary Credit Societies in to UCBs..

2.16 The only difference between a primary credit society and an urban cooperative bank is the level of owned funds. If the owned funds of primary credit society reaches Rs.1 lakh, automatically, it has to apply to RBI for a licence to carry on banking business. If a primary credit society, after attaining Rs.1 lakh of owned funds, does not meet the criteria laid down by the RBI, it can carry on banking business till its licence application is rejected by RBI. Due to this peculiar statutory dispensation, a large number of primary credit societies had necessarily to be brought under the ambit of B.R. Act.

RBI has, therefore, decided in 1978 that Registrar of Cooperative Societies should not register any new primary credit society the object of which was to carry on banking business. Because of this automatic entry of PCBs into the banking sector, today, there are as many as 181 unlicensed banks under RBI jurisdiction. The Committee deals with this problem later in the Report in [Chapter V](#).

2.17 The period between 1966-1993 can be termed as an over regulated regime. The licensing policy of RBI was too restrictive as it was governed by the dictum "one district - one bank" notwithstanding the cooperative initiative demonstrated by the cooperators. Urban Cooperative Banks were also not allowed to expand beyond municipal limits. There was an embargo on their

entry into rural areas and financing agricultural operations. Branch licensing policy was linked to the "planned expansion of branches". There were also restrictions on deployment of UCBs' surplus resources outside the cooperative fold. Growth of urban banking sector was confined to the states of Maharashtra, Karnataka, Gujarat and Tamil Nadu where the cooperative movement had already taken strong roots. The regional disparities in the growth of urban cooperative movement was mostly due to strong cooperative initiative exhibited in these states and absence of similar cooperative leadership in other states. But with liberal licensing policy stance of RBI, from May 1993, some states such as Madhya Pradesh, Andhra Pradesh and a few other States have shown signs of urban banking growth as is evident from the table below :

Table 2.1

State	New Licences issued May 1993	No. of Banks <i>prior to</i> after May 1993 to August 1999
Andhra Pradesh	65	89
Madhya Pradesh	42	44
Rajasthan	26	15
Uttar Pradesh	47	32

Phase III: Post 1993 - Scenario:

2.18 The year 1993 was a watershed in the annals of urban cooperative banking movement. After Narasimham Committee (Report I) addressed the ills of banking system in 1991, and suggested a road map for liberalising the banking sector, a similar need was also felt to look de novo at the regulatory issues relating to UCBs. Accordingly, RBI appointed the Marathe Committee in 1991⁹ to address these issues. Recommendations of this Committee were quite far reaching, particularly, in the realm of new bank licensing, branch licensing and area of operation etc. Essentially, Marathe Committee, suggested to dispense with the "one district-one bank" licensing policy and recommended organisation of banks based on the need for an institution and potential for a bank to mobilise deposits and purveying of credit. It also felt that existence of commercial banking network should not prevent the cooperative initiative. RBI accepted these recommendations and had come out with its new policy approach in May 1993, Between May 1993, when the revised policy was put in place and 31 March 1999, RBI has issued as many as 537 licenses for setting up new banks. The liberalised branch licensing policy's stress was more on bank's inherent financial strength rather than assessing the need for a branch and its viability in a given centre. As a result, the branch network of UCBs has increased from 3691 as at the end of March 1993, to 6619 by 31 March, 1999. Urban cooperative banks were also allowed to extend their area of operation to the entire district without specific approval from RBI and banks, with deposits of Rs.50 crores and above, were permitted to cross the borders of the States of their registration. Banks complying with certain norms can now also open extension counters without RBI permission.

2.19 RBI had also appointed a Working Group¹⁰ under the Chairmanship of Shri Uday M. Chitale in December 1995 to review the existing audit systems of UCBs. With a view to instill professionalism in the audit of UCBs, the Working Group suggested that audit of UCBs, with

deposits of Rs.25 crores and above, be conducted by Chartered Accountants, thus, ending the monopoly of State Government's audit of UCBs. It has suggested a standard format of audit for all the states. The Working Group also suggested revised audit rating model for UCBs. Regrettably, none of the states, not even the cooperatively advanced states, has implemented the recommendations of Chitale Working Group.

2.20 Besides, easing regulatory restrictions, a number of policy pronouncements were made in the operational sphere too. UCBs can now invest 10% of their surplus funds outside cooperative fold. Ceiling on quantum of advances to nominal members has been increased substantially and scheduled UCBs have been allowed to do merchant banking/forex operations. Effective from November 1996, urban cooperative banks have been given freedom to finance direct agricultural operations. The interest rates on deposits of urban banks have been deregulated from 21 October, 1997. They can also install ATMs without prior approval of RBI.

2.21 Thus, in the post Marathe Committee dispensation, there was a paradigm shift in RBI's regulatory approach. An excessively controlled regime gave way to a thoroughly liberalised dispensation. The shift in RBI policy on UCBs was a natural corollary of its policy stance on financial sector. Strangely, State Governments who are co-regulators, have not brought out any significant parallel reforms in tune with liberalisation process set in by RBI. The notable exception is Andhra Pradesh which enacted the Mutually Aided Cooperative Societies Act, 1995 freeing the cooperative societies, registered under this Act, from Government control as long as they do not solicit share capital or seek guarantees from State Government.

Urban Banking Architecture

2.22 The UCB structure underwent phenomenal transformation ever since it was brought under the purview of B. R. Act, 1949. The UCB The Number of urban cooperative banks rose from 1106 as at 30 June 1967 to 1936 as at the end of March 1999. The deposit strength increased from a meagre Rs.153 crores to Rs.50544 crores during the corresponding period. The average deposits per bank which stood at a measly sum of Rs.13.83 lakh as at the end of March 1967, rose to Rs.26.11 crore during the aforesaid period.

2.23 The discernible characteristic feature of UCB structure is its heterogeneity . Of the 1936 UCBs at the end of March 1999, over 50% are unitary in nature (with single branch banking). The five states of Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu account for 78.97% of total UCBs in the country. Of these, Maharashtra alone has 616 banks and accounts for 31.8% of total number of UCBs in the country ([Annexures V](#) [A&B]). The heterogeneity in their size is another facet of the UCB structure, which is quite evident from the [tables 2.2](#) and [2.3](#) given below :

Table 2.2
As on 31 March 1999

Banks with deposits base	No. of Reporting Banks	Deposits (Rs. in crores)	% to total deposits

Scheduled UCBs	29	17464.46	34.55
Others above Rs.100 crore	60	10030.48	19.84
Above Rs.50 crore and upto Rs.100 crore	123	8538.27	16.89
Above Rs.25 crore and upto Rs.50 crore	186	6412.68	12.69
Above Rs.10 crore and upto Rs.25 crore	322	5138.50	10.17
Rs.10 crore and below	779	2960.02	5.86
TOTAL	1499	50544.41	100.00

From the above table, it is evident that scheduled urban banks alone account for 34.55 % deposits of UCB sector. Deposits of scheduled urban banks together with deposits of non-scheduled banks with over Rs.100 crores account for a major chunk of 54.39% of UCB's deposits. Reserve Bank is, therefore, required to focus its regulatory attention on these entities. UCBs with a deposit base below Rs.10 crores, numbering about a whopping 779 held only 5.86% of UCBs deposits. Similarly, the size of owned funds of UCBs also exhibit large variance among the banks which may be seen from the following table:

Table 2.3

(As on 31 March, 1999)

UCBs with owned funds	No. of Reporting UCBs	Owned funds (Rs. in crores)
Above Rs.100 crores	8	1504.85
Above Rs.50 crores and upto Rs.100 crores	8	580.76
Above Rs.25 crores and upto Rs.50 crores	26	886.64
Above Rs.10 crores and upto Rs.25 crores	88	1261.40
Rs.10 crores and below	1369	2688.87
TOTAL	1499	6922.52

2.24 The growth profile of UCBs, as a sector, in terms of deposits and advances far outstrips that of commercial banking sector. The growth of deposits of UCBs during the years 1997-98 and 1998-99 stood at 32.5% and 24.4% against 19.8% and 19.3% of commercial banks respectively. Apparent lower growth rate for 1998-99 is due to non-receipt of data of all the UCBs. Similarly, advances registered 29.1% and 17.4% growth respectively as against 16.4% and 13.8% growth posted by commercial banking sector during the same period. The gross NPAs of UCBs stood at 11.76% for the year ended 31 March 1998 ([Annexure VI](#)) as against 16.0% gross NPAs of public sector commercial banks.

2.25 Notwithstanding impressive growth profile of UCBs, the Committee feels that the urban banking sector is facing the following problems : i) Dual control; ii) increasing incidence of weakness; iii) low level of professionalism.

2.26 Though the Committee desists to use the word "mushroom" growth of UCBs, it has reservations about the substantial increase in the number of banks particularly in some pockets. One of the cities in South India, which is not known for its cooperative ethos, witnessed a

sudden boom of UCBs expansion. The phenomenon, does not seem to be so much on account of sudden emergence of cooperative spirit/ leadership and entrepreneurial capabilities, as due to stringent norms regulating NBFCs. Market reports also tend to corroborate this thinking. The Committee is of the view that the regulator should probe into this phenomenon so as to prevent the spread of weeds in cooperative sector.

2.27 Despite the above problems, a noticeable feature of urban banking sector is the nature of its clientele. UCB structure is exemplified by its pronounced focus on the needs of small men and micro credit sector. Of the 1499 reporting banks as at 31 March 1999, the credit base of as many as 933 banks was lower than Rs.10 crores each. Banks with credit base upto Rs.50 crores account for as many as 1371 banks constituting 40.5% of aggregate credit of reporting UCBs on 31 March, 1999. The clientele of UCBs are predominantly engaged in the activities classified under priority sector. Priority sector discipline for UCBs was introduced in 1983 and UCBs were required to deploy not less than 60% of their advances to priority sector against 40% stipulation for commercial banks. For the year ended 31 March, 1998, an overwhelming segment of UCBs have been able to comply with the targets set for priority sector credit deployment. Of the 1241 banks which have reported the data regarding priority sector advances deployment, 1044 banks (84.1%), have deployed 60% or more of their aggregate credit to priority sector. ([Annexure VII](#)) From the available statistical data for the year 1997-98, over 80% of UCBs are flush with surplus funds. Unlike their fellow segments such as Primary Agricultural Credit Societies (PACS), District Central Cooperative Banks (DCCBs), State Cooperative Banks (SCBs) in the cooperative fold, this sector is not surviving on external assistance such as refinance from NABARD etc. As on 31 March 1998, borrowings of State Cooperative Banks constituted Rs.8656.93 crores, whereas UCBs' borrowings constituted a miniscule Rs.886 crores. An interesting feature of UCB structure is that, over 25% deposits resources of DCCBs & SCBs in major states such as Gujarat and Maharashtra are coming from urban cooperative banking sector. It is, thus, a case of reverse flow in a 3-tier cooperative credit structure where primary units are supporting the federal units at district and state levels.

2.28 The urban cooperative banking sector has come to occupy a formidable place in cooperative structure. It is going to emerge as an important segment of banking sector in the next millennium. The sustainable growth of this buoyant sector, however, depends to a great extent on efficacy of regulation.

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1. Arthashastra - III,14.
 2. Report of the Committee on Cooperation in India - 1915.
 3. Report of the Committee on Cooperation in India - 1915.
 4. Report of the Committee on Cooperation in India - 1915.
 5. Report of the Agricultural Credit Review Committee (Khusro Committee), 1989.
 6. Report of the Committee on problems of Urban Cooperative Banks in Maharashtra,1977
 7. Report of the Committee on Cooperation in India, 1915.
 8. 50 years of Central Banking Governors Speech, RBI publication.
 9. Committee on Licensing of New Urban Cooperative Banks,1992.
 10. Report of the Working Group on Systems and Procedures of Audit in UCBs - 1996.