

# National Study on Financial Cooperatives in the Context of Financial Inclusion in India

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## Study on Financial Cooperatives in the Context of Financial Inclusion in India

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# Abbreviations

|           |   |  |
|-----------|---|--|
| AC        | - | Air Conditioner  |
| ADWDRS    | - | Agricultural Debt Waiver and Debt Relief Scheme  |
| AGM       | - | Annual General-Body Meeting  |
| AIBEA     | - | All India Bank Employees Association   |
| AICTE     | - | All India Council for Technical Education  |
| AIDS      | - | Acquired Immune Deficiency Syndrome  |
| AIRCS     | - | The All India Rural Credit Survey  |
| AIU       | - | Association of Indian Universities   |
| AM        | - | Assistant Manager  |
| AMUL      | - | Anand Milk Federation Union Limited  |
| APCOB     | - | Andhra Pradesh State Cooperative Bank  |
| APMAS     | - | Andhra Pradesh Mahila Abhivruddhi Society  |
| APVS      | - | Annapurna Pariwar Vikas Samvardhan   |
| ASCOF     | - | Assam State Cooperative Federation   |
| ATM       | - | Automated Teller Machine   |
| BC        | - | Business Correspondents  |
| BDP       | - | Business Development Loans   |
| BIRD      | - | Bankers Institute of Rural Development   |
| BM        | - | Branch Manager   |
| BOD       | - | Board of Directors   |
| BR        | - | Banking Regulation   |
| CAB       | - | College of Agricultural Banking  |
| CAR       | - | Capital Adequacy Ratio   |
| CBMFIs    | - | Community Based Micro Finance Institutions   |
| CBS       | - | Core Banking Solutions   |
| CCM       | - | Centre for Cooperative Management  |
| CCS       | - | Credit Cooperative Structure/ System   |
| CCTV      | - | Closed Circuit Television  |
| CD        | - | Credit to Deposit  |
| CEO       | - | Chief Executive Officer  |
| CGS       | - | Centre for Gender Studies  |
| CICTAB    | - | Centre for International Cooperation and<br>Training in Agriculture Banking                        |
| CIT       | - | Centre for Information Technology  |
| CMD       | - | Chairman and Managing Director   |
| CME       | - | Centre for Management Education  |
| CR        | - | Community Representative   |
| CRAFICARD | - | Committee to Review Arrangements for Institutional Credit<br>for Agriculture and Rural Development |
| CRAR      | - | Capital to Risk (Weighted) Assets Ratio  |
| CRISIL    | - | Credit Rating Information Services of India Limited  |
| CRP       | - | Centre for Research and Publication  |
| CRR       | - | Cash Reserve Ratio   |

# Abbreviations

|       |   |   |
|-------|---|---|
| DBT   | - | Direct Benefit Transfers                                |
| DBTL  | - | Direct Benefit Transfer for LPG                         |
| DCCB  | - | District Cooperative Credit Bank                        |
| DCM   | - | Diploma in Cooperative Management                       |
| DDCCB | - | Dehradun District Central Cooperative Bank              |
| DFID  | - | Department for International Development                |
| DGM   | - | Deputy General Manager                                  |
| DICGC | - | Deposit Insurance and Credit Guarantee Corporation      |
| DIG   | - | Deputy Inspector General                                |
| ECB   | - | External Commercial Borrowings                          |
| ECS   | - | Electronic Clearing System                              |
| EMI   | - | Equated Monthly Installment                             |
| FAO   | - | Food and Agriculture Organisation                       |
| FD    | - | Fixed Deposit   |
| FIF   | - | Financial Inclusion Fund                                |
| FITF  | - | Financial Inclusion Technology Fund                     |
| FLCs  | - | Financial Literacy Centres                              |
| FLT   | - | Financial Literacy Training                             |
| FPOs  | - | Farmers Producer Organizations                          |
| FWWB  | - | Friends of Women's World Banking                        |
| FY    | - | Financial Year  |
| GB    | - | General Body  |
| GDP   | - | Gross Domestic Product                                  |
| GESI  | - | Gender Equality and Social Inclusion                    |
| GIZ   | - | Deutsche Gesellschaft für Internationale Zusammenarbeit |
| GM    | - | General Manager   |
| GoI   | - | Government of India                                     |
| HDCM  | - | Higher Diploma in Cooperative Management                |
| HDFC  | - | Housing Development Finance Corporation                 |
| HR    | - | Human Resource  |
| IAS   | - | Indian Administrative Service                           |
| ICA   | - | International Cooperative Alliance                      |
| ICICI | - | Industrial Credit and Investment Corporation of India   |
| ICM   | - | Institute Cooperative Management                        |
| ICT   | - | Information Communication Technology                    |
| IDBI  | - | Industrial Development Bank of India                    |
| IFAD  | - | International Fund for Agricultural Development         |
| IFFCO | - | International Farmers Fertilizer Cooperative Limited    |
| IGS   | - | Indian Grameen Services                                 |
| IIBM  | - | Indian Institute of Bank Management                     |
| IOB   | - | Indian Overseas Bank                                    |
| IRDA  | - | Insurance Regulatory and Development Authority of India |

# Abbreviations

|         |   |  |
|---------|---|--|
| IRMA    | - | Institute of Rural Management, Anand                             |
| IT      | - | Information Technology   |
| JCTC    | - | Junior Cooperative Training Centers                              |
| JLG     | - | Joint Liability Group  |
| JV      | - | Joint Venture  |
| KCC     | - | Kissan Credit Card   |
| KMUCB   | - | Konoklata Mahila Urban Cooperative Bank                          |
| KVP     | - | Kissan Vikas Patra   |
| KYC     | - | Know Your Customer   |
| LAMP    | - | Large Area Multi Purpose Societies                               |
| LIC     | - | Life Insurance Corporation                                       |
| LMC     | - | Local Management Committee                                       |
| LSO     | - | Loan and Savings Officer   |
| LT CCS  | - | Long-term Cooperative Credit Structure                           |
| MACIF   | - | Mutuelle Assurance des Commerçants et Industriels de France      |
| MACS    | - | Mutually Aided Cooperative Societies                             |
| MBA     | - | Master Business Administration                                   |
| MCA     | - | Master of Computer Application                                   |
| MCC     | - | Micro Credit Committee   |
| MD      | - | Managing Director  |
| MDP     | - | Management Development Centre                                    |
| MFI     | - | Micro Finance Institution  |
| MCID    | - | Micro Credit Innovations Department                              |
| MIS     | - | Management Information System                                    |
| MLA     | - | Member of Legislative Assembly                                   |
| MoU     | - | Memorandum of Understanding                                      |
| MP      | - | Member of Parliament   |
| MSCB    | - | Maharashtra State Cooperative Bank                               |
| MSCS    | - | Multi-State Cooperative Society                                  |
| MSCSA   | - | Multi-State Cooperative Societies Act                            |
| NA      | - | Not Applicable   |
| NABARD  | - | National Bank for Agriculture and Rural Development              |
| NABFINS | - | NABARD Financial Service Limited                                 |
| NAFSCOB | - | National Federation of State Cooperative Banks Limited           |
| NBCFDC  | - | National Backward Classes Finance<br>and Development Corporation |
| NBFC    | - | Non-Banking Financial Company                                    |
| NCCT    | - | National Council for Cooperative Training                        |
| NCDC    | - | National Cooperative Development Corporation                     |
| NCDEX   | - | National Commodity and Derivatives Exchange Limited              |
| NCUI    | - | National Cooperative Union of Indian                             |
| NEDFI   | - | North Eastern Development Finance Corporation Limited            |

# Abbreviations

|        |   |   |
|--------|---|---|
| NEFT   | - | National Electronic Funds Transfer                          |
| NGOs   | - | Non-Governmental Organizations                              |
| NHFDC  | - | National Housing Finance Development Corporation            |
| NIA    | - | New India Assurance   |
| NOC    | - | No Objection Certificate                                    |
| NPAs   | - | Non Performing Assets                                       |
| NPCI   | - | National Payment Corporation of India                       |
| NPS    | - | National Pension Scheme                                     |
| NREGA  | - | National Rural Employment Guarantee Act                     |
| NRLM   | - | National Rural Livelihood Mission                           |
| NSC    | - | National Savings Certificate                                |
| OBC    | - | Other Backward Class  |
| OCC    | - | Office of the Comptroller of the Currency                   |
| OD     | - | Over Due  |
| OPD    | - | Out Patient Department                                      |
| OSS    | - | Operating Self Sufficiency                                  |
| PO     | - | Post Office   |
| PA&RDB | - | Primary Agricultural and Rural Development Bank             |
| PACS   | - | Primary Agricultural Cooperative Societies                  |
| PaR    | - | Portfolio at Risk   |
| PCARDB | - | Primary Cooperative Agriculture and Rural Development Banks |
| PCBs   | - | Primary Cooperative Banks                                   |
| PCFs   | - | People's Credit Funds                                       |
| PDS    | - | Public Distribution System                                  |
| PGDM   | - | Post-Graduate Diploma in Management                         |
| PKPS   | - | Prathamika Krishi Pattina Sahakara Sangh                    |
| PLS    | - | Profit / Loss Sharing scheme                                |
| PMJDY  | - | Prime Minister's Jan Dhan Yojana                            |
| PoS    | - | Points of Service   |
| PRA    | - | Participatory Rural Appraisal                               |
| PRI    | - | Panchayat Raj Institution                                   |
| PSL    | - | Priority Sector Lending                                     |
| PSU    | - | Public Sector Units   |
| RBI    | - | Reserve Bank of India                                       |
| RCA    | - | Royal Commission Agriculture                                |
| RCS    | - | Registrar of Cooperative Societies                          |
| RD     | - | Recurring Deposits  |
| RICM   | - | Regional Institute of Cooperative Management                |
| RIDF   | - | Rural Infrastructure Development Fund                       |
| RMK    | - | Rashtriya Mahila Kosh                                       |
| RoC    | - | Registrar of Companies                                      |
| RRBs   | - | Regional Rural Banks  |
| RS     | - | Rupee   |

# Abbreviations

|          |   |  |
|----------|---|--|
| RSETI    | - | Rural Self-Employment Training Institute                                     |
| RTGS     | - | Real Time Gross Settlement   |
| SBI      | - | State Bank of India  |
| SC/ST    | - | Schedule Caste & Schedule Tribe  |
| SCARDB   | - | State Cooperative Agriculture and Rural Development Bank                     |
| SCB      | - | State Cooperative Bank(s)  |
| SCU      | - | State Cooperative Union  |
| SDC      | - | Swiss agency for Development Cooperation                                     |
| SEWA     | - | Self Employment Women's Association  |
| SFRC     | - | State Finance Regulatory Commission  |
| SHG      | - | Self-Help Groups   |
| SHPI     | - | Self-Help Promoting Institutions   |
| SIDBI    | - | Small Industries Development Bank of India                                   |
| SLR      | - | Statutory Liquidity Ratio  |
| SME      | - | Small and Medium Enterprise(s)   |
| SMS      | - | Short Message Service  |
| SOP      | - | Standard Operating Procedure   |
| SRC      | - | Self Reliant Cooperative   |
| STCCS    | - | Short-Term Cooperative Credit Structure                                      |
| STD/ PCO | - | Standard Trunk Dialing / Public Call Office                                  |
| TCS      | - | Tata Consultancy Services  |
| TOR      | - | Terms of Reference   |
| TSCAB    | - | Telangana State Cooperative Apex Bank  |
| USA      | - | United States of America   |
| UCB      | - | Urban Cooperative Banks  |
| UMLPCI   | - | Uttarakhand Microfinance<br>and Livelihood Promotion Cooperative Institution |
| UN       | - | United Nations   |
| UNDP     | - | United Nation Development Programme  |
| USD      | - | United State Dollar  |
| USRLM    | - | Uttarakhand State Rural Livelihood Mission                                   |
| UTI MF   | - | Unit Trust of India Mutual Fund  |
| VAMNICOM | - | Vaikunth Mehta National Institute of<br>Cooperative Management               |
| VC 1     | - | Vaidyanathan Committee package first round                                   |
| VO       | - | Village Organization   |
| WOCCU    | - | World Council of Credit Unions   |



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# Study on Financial Cooperatives in the Context of Financial Inclusion in India

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Aindrila Roy Chaudhury, Jaipal Singh, R. Jayachandran*

## Executive Summary

### 1 Introduction

Financial cooperatives are important players in the world banking system, which reach the poorest people and have a substantial economic impact. They serve over 857 million people worldwide, including 78 million living on less than \$ 2 a day, and represent 23 per cent of all bank branches. Financial cooperatives include cooperative banks (based mainly in Europe) and credit unions (set up originally in North America and developing countries), as well as banks owned by agricultural or consumer cooperatives. In Europe, there are 4,200 cooperative banks active in 20 countries, with 50 million members, 780,000 employees, \$ 6.3 trillion in assets and an average market share of 20 per cent. Worldwide, there are over 49,330 credit unions that operate in 97 countries, with 183 million members and \$1.4 trillion in assets (as of 2009).

In India, too, cooperatives have been prioritised as a sector that has outreach to rural people, especially farmers, which underscores their importance in meeting the goals of financial inclusion. Because Primary Agricultural Cooperative Societies (PACSS) constitute the first tier of the Short Term Credit Cooperative Structure (ST CCS), the penetration of PACSS is of particular relevance to the cooperatives' role in rural finance. Overall, in India, PACSS cover 96% of the total number of villages, indicating high rural penetration. However, cooperatives only provide 17% of agricultural credit, with commercial banks providing 72% and Regional Rural Banks (RRBs) providing 11%. Nevertheless, cooperatives serve a substantial proportion of agricultural accounts, providing smaller loans, compared to commercial banks. Cooperatives also serve a larger number of farmers; during 2011-12, cooperatives provided agricultural credit to 3.09 crore farmers, compared to only 2.55 crore farmers served by commercial banks and 82 lakh by the RRBs. Given the spread of cooperatives in rural areas and enrolment of a large number of farmers on the one hand, and a low share in the total agricultural credit provided, this research addresses the question of the current and potential role of cooperatives in the financial inclusion agenda of the government. The research asks what is the current prevailing enabling environment for cooperatives and whether it enhances their current and potential participation in financial inclusion. It also asks questions about the ground reality of cooperatives, and how cooperative sector can be strengthened and develop to its full potential in India.

The study on financial cooperatives has been commissioned by the United Nations Development Programme in India, as a result of the need expressed by the members of the

Microfinance Community of the United Nations Solution Exchange, a knowledge sharing community of the United Nations Country Team in India. The study provides an overview of the enabling environment for financial cooperatives in India and identifies regulatory gaps, particularly within the context of financial inclusion. The first part of the investigation involves a review of the enabling environment: the historical background, the contemporary institutional structure, and the cooperatives laws and their implementation. The second part involves field studies in the four states of Karnataka, Uttarakhand, Maharashtra, and Assam to uncover information regarding: products and services, coverage, external linkages, governance, performance, capacity building, and technology. The third part of the study involved an in-depth analysis of the information, and discussions with key informants to develop insights and recommendations to enable development and effective deployment of the sector in the financial inclusion agenda. The study team has identified issues, challenges and recommendations, which are briefly outlined in the following paragraphs.

## **2 Enabling Environment for Cooperatives in India**

The experiences of financial cooperatives in India sharply contrast those cooperatives in the broader international movement. Case studies of cooperatives in Germany, Vietnam, and the Philippines illustrate their role as member-based and member-promoted entities. Instead, Indian cooperatives have historically been promoted by the government, which has supported the movement through policies, refinance and capital, often becoming a shareholder in cooperatives. This involvement by the government has resulted in political interference (promoting other agendas at the cost of the cooperatives' sustainability) and in the lack of a sense of ownership by the cooperative members. Further, government-announced loan waivers have hampered credit discipline, and frequent mergers and reorganizations of cooperatives by government authorities have transformed cooperatives into involuntary creatures – instruments of government for the public good rather than self-help organizations for the benefit of their members.

While the Indian government's high-level involvement in cooperatives has disadvantaged them, a case study of the cooperative movement in Haiti shows that the opposite side of the spectrum—no government intervention—is also dangerous. In this case, the government ignored suspicious fraudulent practices, leading to the collapse of the movement in 2002, affecting the credibility of the sector and leading to the loss of low-income depositors' savings. It is clear that the government should take a regulatory and supervisory role while members should manage the cooperatives' operations.

Historically, financial cooperatives in India did not start out as business-oriented organisations that provide diverse financial services to their members, they were, instead, a state led initiative to offer subsidized credit for agricultural development. However, since the beginning, there was a need for improved governance of the cooperatives. As cooperatives were largely government promoted, and government had invested in their share capital, the government believed that not only supervision but also control was part of its legitimate role. Significant emphasis on savings and importance of member control came in only in the early 1980s.

The rationale for cooperative regulation is strong. As participants in other financial systems, borrowers and depositors of cooperatives need protection: the depositors need an assurance of the safety of their deposits, and borrowers need to have loan products and lending and recovery practices that are fair and non-exploitative. Further, cooperatives are of particular importance to financial inclusion because they reach low- to middle-income individuals and enterprises.

In India, significant changes have taken place over the past decade. The first breakthrough in the reform of cooperative legislation came from the Andhra Pradesh Legislature in 1995, with the passing of the AP Mutually Aided Cooperative Societies Act, 1995. The law allowed for greater autonomy of cooperatives and no financial support from the State for those cooperatives registered under this new act. Other states soon followed with similarly liberal laws. Further, the RBI and NABARD Expert Committees recognized and provided recommendations to simplify the complex and often conflicting regulations at the state and federal levels. In the later years, most of the committees appointed for the cooperative sector development have pointed out that progressively reducing state control on the functioning of the cooperatives is mandatory. They also emphasized the fact that there needs to be increased professional management and governance in the running of the cooperatives. Nevertheless, despite these improvements, cooperatives are still plagued with numerous challenges and issues: a lot of ground must still be covered to allow cooperatives to become fully autonomous and sustainable organizations.

An overview of the state of the cooperative sector reveals that the institutional arrangement of cooperatives in India is complex and creates several problems. The cooperative system is divided into rural and urban cooperatives. In most states, the former is further divided into the Short-Term Cooperative Credit Structure (ST CCS) and the Long-Term Cooperative Credit Structure (LT CCS). With some exceptions in a few states, the ST CCS is further divided into three tiers: primary agricultural credit cooperative societies (PACSS) with farmers as their members at the base; district central cooperative banks (DCCBs) as the intermediate federal structure with PACSS as principal affiliated members; and the State Cooperative Bank (SCB) at the apex in the state with DCCBs and other cooperatives as its principal members. In contrast to the rural federated structure, the urban cooperatives, popularly known as Urban Cooperative Banks (UCBs), operate independently. This system presents several problems to the sector. Firstly, the frequent competition between the tiers defeats the purpose of greater economies of scale with higher tiers providing wholesale services to lower tiers. The tiers are also redundant, increasing the transaction costs, and reducing efficiency and margins. Further, the distinction between urban and rural cooperatives is often blurred and the different regulatory treatment they receive only hinders fair competition.

The regulation of cooperatives in India is complex and sometimes conflicting. The cooperative banks come under the purview of both the Registrar of Cooperative Societies (RCS) of the state (in which they are located) and the Reserve Bank of India. Critics of the sector believe that this dual regulation creates inefficiencies, and at the same time prevents prompt regulatory action. The rationale of dual regulation is however, well understood,

with the RCS maintaining an oversight on cooperative regulations being followed, and RBI regulating the banking operations.

### **The laws that apply to cooperatives include**

**The relevant state's cooperative Acts.** In India, states have the jurisdiction to enact laws relating to cooperatives. As most state governments invested share capital in cooperatives, they also sought to take control of the management of cooperatives. The increased state control led to the passing to the self-reliant cooperatives acts in many states.

**The Self-Reliant Cooperative Society Acts/ Mutually Aided Cooperative Society Act (MACS).** In some states, this act replaces the traditional act while in others it runs concurrently, giving the option to eligible cooperatives to register under either act. The self-reliant cooperative act was been promulgated in nine states (Andhra Pradesh, Karnataka, Madhya Pradesh, Bihar, Jharkhand, Odisha, Chhattisgarh, Jammu and Kashmir and Uttarakhand), but has been repealed in Madhya Pradesh and Odisha.

**The Constitution (97th Amendment) Act, 2011** aims to standardize some systems and increase the democratic functioning of cooperatives. The Centre has asked state governments to amend their respective State Cooperative Society Act so that it is in tune with the Constitution (97th Amendment), 2011 before February 2013. Some states have not yet complied with this request and further, others face implementation issues.

**The Multi-State Cooperative Societies Act, 2002 (MSCSA)** regulates cooperatives that operate in 2 or more states. While the 2002 amendment largely improves upon the earlier MSCSA to provide greater freedom from state control to the members of cooperatives, it is still wanting.

**The Banking Regulation Act, 1949** was extended to cooperative banks from 1 March 1966, placing cooperatives' banking activities under the purview of the RBI.

**The Deposit Insurance and Credit Guarantee Corporation Act, 1961.** The deposits made in eligible cooperative banks are protected by The Deposit Insurance and Credit Guarantee Corporation (DICGC), an organization set up in 1961 by the RBI. This act does not extend to PACS, which are considered societies rather than banks.

The respective state laws and the Banking Regulations Act, 1949, together are applicable for the DCCBs, the SCBs and the UCBs.

Regulatory gaps include overlapping regulation, deficient supervision and excessive control from the government. Several writers on the cooperative sector have made recommendations for streamlining and strengthening regulations. The most recent development measure was proposed by the Vaidyanathan committee in 2004, as a revival package for the short-term cooperative structure. This was followed up by a revival package signed between the cooperatives, state governments, and NABARD. The package was not fully implemented in many states due to lack of compliance of conditions or lack of release of the requisite funds by one or the other partner. In states like Assam, the Apex Bank has been approved under the Vaidyanathan committee package first round (VC1) as the

institution responsible for strengthening of the PACSs. However, some funds are still to be released, mainly the central government's share. The revival packages have now been closed as the duration of the MOUs have ended.

The committee also recommended a legislative provision issued by the states that empowers the RBI to regulate the cooperatives under the Banking Regulation Act and through the Registrar of Cooperative Societies (RCS), and that NABARD extend a refinancing package to self-reliant cooperatives. These recommendations remain to be implemented, and continue to have relevance.

Despite the above mentioned recommendations made by the various committees on the functioning and management of the cooperatives to become strong financial institutions, there are multiple issues on the ground that needs to be addressed in relation to cooperatives.

### **3 The Ground Reality of Cooperatives in India**

There are several issues with regards to the membership patterns of the cooperatives. There were different kinds of memberships i.e. members, associate members and non-member clients. The products and services being offered to each of the category of members differed from state to state. Also, in Karnataka, the PACSs restrict the membership to those who are land owners. This results in keeping the entire chunk of landless labourers and most of the women out (as in most of the cases, any asset is generally in the name of the male members of the house). Also, in Assam, the membership is divided into class A and class B and each household is allowed only one class A membership. This makes the membership pattern unintentionally gender-biased as most of the class A members end up being males.

The following were noted while observing member-involvement and governance in the cooperatives sector. The study found that members' participation in cooperatives varies by state, tier, and cooperative. Cooperatives in states like Maharashtra do not involve members in major decision making, while those in Kerala, the members are highly involved. It is suggested that more and more members should be involved in decision making in cooperative so that it becomes more democratic in its functioning. Leadership was a critical element of success. It was noticed that in most of the cooperatives, there was a severe dearth of strong leadership resulting in poor governance as well. In exceptional cases like in Bidar, the success of the cooperatives in serving low-income individuals can be attributed to the leadership of the current Chairman of the DCCB Bidar, Karnataka, which is also known for an effective turnaround in profitability and outreach.

Lack of oversight resulted in multiple frauds which remained undetected. Also, there was a lack of trained professional staff which resulted in inadequate decisions and reporting. The lack of professionalism and professional staff is also attributed to the key posts in cooperatives being filled by the kith and kin and acquaintances of the leaders of cooperatives. We suggest that the recruitment to key positions in cooperatives needs to be objective and professional. Another reason of lack of professional staff is that there is serious mismatch in many of the training topics and programmes designed by cooperative trainings institutions, and those that the cooperative staff demand and are willing to spare time for.

A major cause of concern for cooperatives is that they are often subject to political interference as cooperatives have formed the foundation stone for many political leaders to establish their base and further their political careers. In Assam and Maharashtra, politicians have often used the government's share capital to exercise control and then use the cooperatives for their own agendas, influencing appointments and advances. While it is common to have some leaders controlling several organizations, it does make these organizations vulnerable to being used to serve individual interests, especially in the absence of institutionalized good governance practices. In Uttarakhand, government placed directors, having a dual role of state and cooperative employee, often serve their own interests. However, more research is needed to see whether the influence of a few politically linked leaders of cooperatives has an overall positive or negative impact on the performance of the cooperatives.

Apart from political influence, lack of autonomy due to government interference is a major cause of concern. The state government, in many states, uses various ways and means to influence and control the cooperatives in the states, particularly the ones registered under the traditional state cooperative act. In all four states, cooperatives typically only offer government-selected products and services and require the DCCB's or RCS's approval to provide additional ones. In Uttarakhand, the state is also allowed to establish, fund, and manage a cooperative registered under the self-reliant cooperative act (SRC Act) as in the case of the Uttarakhand Microfinance Livelihood Promotion Cooperative Institution. All such acts erode the cooperative's ability to address the members' needs and overall sense of ownership by the members.

Cooperatives provide both financial and non-financial products and services. The financial products include highly varied savings and loan products, and insurance and remittance services, the latter more common among UCBs. Mature UCBs and rural cooperatives have been able to start income generating activities which supplement the income from financial services, and have also been able to provide social support such as care for aged persons, and other disadvantaged persons.

While it comes to products and services, most cooperatives complain of having lesser autonomy in designing products and services which are more suitable for their client base. Apart from that, there seems to be an information gap between the cooperatives and NABARD. For example, the study team found that some cooperatives were following a guideline that prescribes upper limits to different types of loans. Some cooperatives interpreted the guideline strictly while other cooperatives and NABARD interpreted the guideline as flexible. It can be interpreted as what shows up as an information gap could also be different orientations to risk.

The report emphasizes that cooperatives are economic organisations that must first and foremost add economic value to the members. As against business organisations that maximise shareholder value, cooperatives focus on maximizing member benefits, by offering products that members need, at the most affordable price.

A study of the financial performance and viability of the different types of cooperatives in different states revealed that there were substantial differences among these. The reasons

can be the ability to mobilize funds by the cooperatives, weakness of PACSs due to their exposure to agricultural risks, particularly drought in regions like Maharashtra. PACSs also bear the risk of non-performing loans, as they cannot pass it onto the DCCBs due to a fixed interest rate margin on lending of 2%. Some PACSs can attain financial viability while others cannot. The reasons can be lack of funding, exposure to agricultural risks, seasonal revenues and costs, low scale, and remote locations. In case of SRCs, very little and inconclusive data was available. Nevertheless, it was observed that they do not enjoy the benefits accorded to PACSs, and so don't have the same level of financial viability.

It was observed with the help of an assessment of the Sahulat microfinance that cooperatives offer the best institutional form for implementing the interest-free microfinance, as is needed in the practice of Islamic Microfinance. The Muslim minority have examined all institutional forms, and as others mandate interest collection, the cooperative form was found the most appropriate since it is possible in cooperatives for the loans to be interest free. In the microfinance sector, there are different forms of financial institutions, namely, Self Help Groups, Non Banking Financial Companies (NBFCs), cooperatives and Not for Profit organizations. Interest Free Microfinance through cooperatives could be a promising institutional form. Sahulat believes that cooperatives offer the most suitable format for interest free microfinance because cooperatives are oriented not towards profits, but primarily towards member benefits, and can offer sustainability lessons to the whole sector of interest free microfinance through cooperatives.

The capacity building structures of the cooperatives are at the national state and regional levels. With one national (VAMNICOM), five regional (RICM), 14 sub-regional (ICM) and 109 state level institutions (JCTC) for cooperative management, infrastructure for dedicated training for the cooperative sector in the country can be termed as widespread and significant. Cooperatives at different levels in various states are covered by at least one of these institutions. These institutions offer a wide variety of programmes. However, analysis shows that there is a greater need of demand orientation of these institutes and also a greater willingness on the part of the cooperatives to use the capacity building opportunities offered by these institutes. Further, training and computerization of cooperative staff have emerged as important needs in all the states covered in the study. Mass education campaigns on the cooperatives; their principles and management do not currently appear to be the mandate of any of the cooperative training institutions who mostly cater to the operational requirements of running the cooperatives. Training organizations did not realise the mismatch, instead offered alternative explanations for the lack of participation in trainings. They alleged that trainings are a low priority for PACSs, especially as politically motivated and affiliated board members are uninterested in professional skills. As the employees of cooperatives are relatively older, being close to retirement age, they are unwilling to pick up new skills. Finally, the fees charged on some training are considered a deterrent. Computerization and adoption of Core Banking Solutions (CBS) have emerged as important capacity building requirements – particularly among PACSs. Efforts are underway to promote CBS and computerization among cooperatives.

## 4 Role of Cooperatives in financial Inclusion

Internationally, financial inclusion, in which cooperatives play an important role, has gained currency as an important element of social and economic inclusion. According to the World Bank's Global Financial Development Report 2014, "Research—both theoretical and empirical—suggests that financial inclusion is important for development and poverty reduction." In India, financial inclusion has been considered a critical policy goal. The current Director of the Reserve bank of India has said: "The imperative for financial inclusion is both a moral one as well as one based on economic efficiency. Should we not give everyone that is capable the tools and resources to better themselves, and in doing so, better the country?"(Rajan, 2013).

To improve financial inclusion, the RBI has undertaken various policy initiatives, including: relaxed and simplified KYC norms, simplified branch authorization policy, compulsory requirements for opening branches in un-banked villages, the setting up of intermediate brick and mortar structures, mandated financial inclusion plans for private sector banks, and revised guidelines for financial literacy centres. In August 2014, Prime Minister Narendra Modi announced the Pradhan Mantri Jan Dhan Yojana Scheme (GoI, 2014), aiming to enrol 7.5 crore households to open bank accounts. Under the scheme, account holders receive accidental insurance and can avail of Rs. 5,000 overdraft (after six months) from the bank. The programme has also introduced new technology that allows people to transfer funds and check balances through a normal phone (earlier, this function was limited to smart phones only).

Despite the efforts to promote financial inclusion in India, the size of the unbanked population is staggering. As the table below shows, only 35% of the population above 15 years of age has an account at a formal financial institution. By contrast, in China the number stands at 64% and in Germany, at 98%. The difference between female and overall accounts is also large in India, with only 26% of females having an account (as compared to 35% for the overall population). This difference is smaller in China, where 60% of females have bank accounts as compared to 63% for the overall population. In Germany, this difference is non-existent.

Cooperatives play a vital role in the delivery of credit to rural areas. Although cooperatives provide only 16% of agriculture credit, they have a much higher penetration, evidenced by the high share of cooperatives in total number of agricultural accounts held by the banking system. Cooperatives provided agricultural credit to 3.09 crore farmers during 2011-12 compared to only 2.55 crore farmers served by commercial banks and 82 lakh by the RRBs. Further, the outreach of cooperatives has increased, as they financed 67 lakh new farmers during 2011-12 compared to 21 lakh new farmers served by commercial banks and only 9 lakh new farmers by RRBs.

Cooperatives also have some key advantages over other institutions in promoting financial inclusion. Firstly, by being interwoven with communities, they have superior knowledge regarding borrower quality and business opportunities. This feature is particularly useful in an environment lacking sophisticated credit scoring. They also have a lower cost structure allowing them to reach segments of the population that are unprofitable for other

banks. Further, the cooperative can balance profitability with the development needs of the community, given that the owners are also members of the community in which the cooperative operates. Overall then, cooperatives can address market imperfections (such as informational asymmetries, transaction costs and contract enforcement costs), which are particularly binding on poor or small entrepreneurs who lack collateral, credit histories and connections.

However, the fact that they are not governed under the banking regulations act and do not follow basic banking norms and practices results in the fact that they do not enjoy the confidence that well governed financial institutions do. Consequently, they are not considered equal partners in the financial inclusion drive. Thus, despite the fact that the cooperatives are allowed to become legitimate BCs, they have not been preferred for that position yet. Those cooperatives that operate as banking institutions, namely the DCCBs, SCBs and UCBs who have adopted Core Banking Solutions (CBS) can participate in the financial inclusion drive and open accounts under the Prime Minister's Jan Dhan Yojana (PMJDY) of the government. It is therefore recommended that the cooperatives should become CBS compliant as soon as possible which will take care of this problem.

An overview of Indian financial cooperatives exposes the lack of consistent and reliable centralized data and the need to improve the regulatory environment in which cooperatives operate. Cooperatives can be strengthened by developing (even outsourcing the development of) sophisticated products and services. Finally, in order for there to be financial inclusion, there needs to be a focus on individuals rather than households, and gender-disaggregated information on bank accounts needs to be monitored. Civil society needs to take a greater interest in cooperatives in order for them to be able to continue to provide agricultural and rural finance to small holders and landless and excluded people, and for these people to be better integrated with the larger financial system. NABARD's grants for financial literacy and technology under the Financial Inclusion plan have reached mostly the RRBs. While the Apex Banks have also received some grants, they have not been able to meet the timelines as compared to the RRBs which have successfully reached their targets.

## **5 Need for a Paradigm Change**

The study shows that there is potential in the cooperative sector, which will be wasted if the financial inclusion movement bypasses the sector instead of using the immense potential it offers. The financial inclusion drive in India presents both an opportunity and a need to address the issues that would release the inclusive and development potential of this vast and important set of financial institutions in India.

Most importantly, all stakeholders need to put their scepticism aside and see the potential exhibited by some of the successful cooperatives in this study. The lessons arising from these are that given trust, freedom to operate, and technical support without control helps to create vibrant cooperatives that are inclusive, create economic benefits for members, and have a voice at the policy level. The scaling up of these lessons at the national level requires wide ranging changes, a move from scepticism to trust, strict implementation of regulations, freedom from political interference, and above all, professionalization and autonomy. The specific changes are elaborated in the recommendations for the sector.

## 6 Recommendations

The **recommendations** relate to creating a positive regulatory and policy environment for cooperatives, and enabling cooperatives to become professionally managed and governed organisations, which play an active role in financial inclusion.

### 6.1 | Changes in Norms and Institutions

The enabling environment for cooperatives should be made more positive and the ambiguities removed. Towards this, we recommend the following changes:

#### ***Incorporate a change in law to exclude politicians in key positions***

The law should be amended to ensure that active politicians are not allowed to contest for or occupy key positions such as chairpersons, executive directors, secretaries, treasurers and financial management positions in cooperatives registered under any act and at any level: primary, central or apex cooperatives. This one change will ensure that cooperative leadership and management is not politicised, and works in members' interest.

#### ***Streamlining implementation of Laws***

The current binary of cooperatives, whereby cooperatives under the state cooperatives Acts are supervised too closely, directed and controlled, and Self-Reliant Cooperatives are unsupervised and unaided, needs to be broken. The cooperatives registered under the state cooperatives Acts need to have greater autonomy, and the cooperatives registered under the SRC Acts need to have greater supervision and be better integrated with the capacity building and partnership structures of the government.

All states which have the traditional cooperative act should ensure strict compliance with the 97<sup>th</sup> amendment. This will help in professionalizing the cooperatives and make them more attractive financial institutions for both, clients as well as the regulators. Also, all states with the Self Reliant/ Mutually Aided Cooperatives Acts should ensure effective supervision, which is currently lacking with the Federation. The supervision of ALL cooperatives could be integrated with the cooperative department, and the department capacitated with the resources (human and financial) to effectively supervise cooperative functioning. This is essential for better oversight, and will also provide the SRCs with better access to cooperative training facilities, and partnerships with government departments under programmes such as the Rural Livelihoods Mission, which currently exclude the SRCs.

#### ***Strengthen the state cooperative departments***

The cooperative departments should be strengthened in terms of finances, human resources and the technical capacity for overseeing and guiding financial cooperatives. The departments could strengthen the state-level supervision structures by creating state-level regulatory forums, like the State Finance Regulatory Commission (SFRC) for instance, which supervise all the small financial institutions at the state level. The RBI, in turn, must train, license and provide accreditation to the SFRCs (Mor, Ibid.).

#### ***Direct Regulation of Cooperatives by the RBI***

Regarding the role of the state in cooperatives, the tension between development and regulation has never been resolved. We recommend a separation as follows:

The financial regulation, supervision and oversight of cooperatives could rest with the RBI, just as the RBI does for all other financial and banking organisations. As cooperatives move towards becoming more professional financial institutions, and adopt CBS, they can adopt banking principles and come under the supervision of RBI. We also suggest that same standards should be applied to PACSs as are applied to UCBs, i.e. they should be governed under the Cooperative Act by the Registrar of Cooperative and the Banking Act by the RBI. Regulatory supervision of the coops should be continued by the department of cooperatives.

## 6.2 | Building Strong Cooperatives

Building strong member based institutions requires that they be independent of subsidies and controls, and attain the capacities to operate as highly professional and accountable organisations. Towards achieving these objectives, the recommendations are as follows:

### ***Strengthen the Cooperatives Structure***

The discussion with different layers of cooperatives brings up a mixed picture, whereby in some cases the central and apex organisations support one another, while in other cases, they control and compete with one another. Each state needs to review the set of institutions it will have, and how they will be organically linked to one another. If competition is promoted, then a level playing field should be provided for each type of institution, and dependencies and controls need to be eliminated. If the partnerships among PACS, DCCBs and SCBs are by choice rather than mandated, they are likely to be more equal and mutually benefiting.

### **Building Capacities of Cooperatives**

As a first step towards this, the cooperatives should get support in getting **CBS enabled**. Once CBS enabled, it is much easier for the cooperatives to open accounts under the PMJDY, and will aid the government in achieving the financial inclusion agenda.

The task of **capacity building** should be assigned to cooperative federations and independent training institutions, which can be quasi and fully independent, offering courses on a fee basis to those who want to be trained in cooperative sector. This would then offer a pool of trained people that cooperatives can recruit from. The National Dairy Development Board has offered a replicable example through the creation of Institute of Rural Management, Anand (IRMA). Cooperative training institutions, like VAMNICOM and ICMs, could operate like IRMA, with fully or partly paid courses, and placements in the cooperative sector. Demand based training programmes will enable the institutions to become more market oriented and sustainable, and will also remove the problem of miss-match of demand and supply of training courses that currently ails the state funded cooperative training institutes.

### ***Making Cooperative Memberships Inclusive***

The fact that there are different categories of membership, i.e., regular members, nominal or associated members and non-members in some states indicates a step towards this direction. We, however, recommend that women and landless people are also provided primary/ regular membership.

In order to achieve optimal financial inclusion, the membership to PACSs should be open for all categories of people including non-farmers, landless labourers, women and men. As we have seen that in many states, land ownership as a clause for membership is a constraint for landless people to gain access to the services of the PACSs. Similarly, in many cases, the women do not have any assets to their name. This deprives them of becoming members. Also, there are many cooperatives which allow only one primary membership from each household. This generally results in a gender bias as mostly the men get that membership.

### ***Greater Autonomy for Cooperatives***

To enable cooperatives to function as fully member-driven institutions, the powers of the state governments to supersede Boards must be limited, and all users (depositors and borrowers) should be made full members with equal voting rights. Government should review whether it should have a margin caps and arrive at a solution in the interest of members and non-members. Cooperatives should be given more autonomy in raising and managing their resources, as well as designing their own products and services. More specifically, PACS should be allowed to use profits in their own business and not forced to hold deposits with DCCBs. (Capoor, 2000). These reforms entail removing state intervention in administration and financial matters.

## **6.3 | Professional Management of Cooperatives**

If financial cooperatives have to play a role in financial inclusion, they need to adhere to the four principles that have been held important for financial sector regulation: Stability, Transparency, Neutrality and Responsibility. (Rajan, 2009 and Mor, 2013)

SRCs should be allowed to offer more financial and non-financial services. Cooperatives should consider expanding their non-financial services, improving income and strengthening members' involvement. By providing these services, along with credit, cooperatives could play a crucial role in the region's economy – promoting economic, as well as financial, inclusion. For example, in Assam, cooperatives could operate as holding depots for handlooms and agricultural commodities for the northeastern region and provide marketing of organic agricultural and horticultural products to international markets. Tourism cooperatives could also be formed to provide end-to-end solutions to tourists to make their visits enjoyable and safe.

Since PACS and SRCs are not part of the banking system, and their deposits are not protected by the DICGC, they cannot issue Kissan Credit Cards (KCC) which can have transactions on ATMs and POS devices. It would be most appropriate for DCCBs and SCBs to provide services like ATM, cheque book and clearing house facilities directly while using PACSs/ SRCs as their business correspondents (BCs).

### ***Integrating cooperatives with markets for both equity and loans***

If cooperatives are allowed to ensure that the loans given out are secure or to raise equity from the markets, market discipline can be enforced through more transparent information. Rating by agencies such as CRISIL will enable depositors to respond by withdrawing and reallocating funds, thus creating pressure on management to effectively manage resources.

***Get a strong marketleader to raise its issues to the authorities***

The cooperatives sector needs a strong voice for representing its issues. Currently, the cooperative department is too weak, and cooperative apex institutions lacking the power and voice, sometimes even the motivation, to lobby for strong support to the sector. This role of lobbying should be played by the federation of cooperatives and unions. (The role of the champion could potentially be played by the NAFSCOB, which is currently the strongest vocal in representing issues of cooperatives, to influence cooperative policy in India.)

The report emphasises that there is a strong economic rationale for forming cooperatives. Cooperatives are first and foremost an economic partnership among members, to achieve what cannot be achieved alone. Cooperatives provide the collective strength, the countervailing power, to other forms of economic organisation.

***Sampark  
Bangalore, August 2015***



# National Study on Financial Cooperatives in the Context of Financial Inclusion in India

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## **1** Introduction

Financial cooperatives are important players in the world banking system, which reach the poorest people and have a substantial economic impact. They serve over 857 million people worldwide, including 78 million living on less than \$ 2 a day, and represent 23 per cent of all bank branches. Financial cooperatives include cooperative banks (based mainly in Europe) and credit unions (set up originally in North America and developing countries), as well as banks owned by agricultural or consumer cooperatives. In Europe, there are 4,200 (<http://www.un.org/esa/socdev/egms/docs/2009/cooperatives/eacb.pdf>) cooperative banks active in 20 countries, with 50 million members, 780,000 employees, \$6.3 trillion in assets ([http://www.eacb.coop/en/cooperative\\_banks/key\\_figures/last\\_key\\_figures.html](http://www.eacb.coop/en/cooperative_banks/key_figures/last_key_figures.html)) and an average market share of 20 per cent. There are over 49,330 credit unions that operate in 97 countries, with 183 million members and \$ 1.4 trillion in assets (<http://www.woccu.org/about/intlcusystem>) (as of 2009).

In India, too, cooperatives have been prioritised as a sector that has outreach to rural people, especially farmers, which underscores their importance in meeting the goals of financial inclusion. Because Primary Agricultural Cooperative Societies (PACS) constitute the first tier of the Short Term Cooperative Credit Structure (ST CCS), the penetration of PACSs is of particular relevance to the cooperatives' role in rural finance. Overall, in India, the percentage of villages covered by PACSs is 96% of the total number of villages, indicating high rural penetration. However, cooperatives only provide 17% of agricultural credit, with commercial banks providing 72% and Regional Rural Banks (RRBs) providing 11%. Nevertheless, cooperatives serve a substantial proportion of agricultural accounts, providing smaller loans, compared to commercial banks. Cooperatives also serve a larger number of farmers; during 2011-12, cooperatives provided agricultural credit to 3.09 crore farmers, compared to only 2.55 crore farmers served by commercial banks and 82 lakh by the RRBs (RBI, 2013). This report addresses the question of what is the current prevailing enabling environment for cooperatives and whether it enhances their current and potential participation in financial inclusion.

## 1.1 | Background and Rationale of the Study

Having started in the late 19<sup>th</sup> Century, financial cooperatives were the first Micro Finance Institutions (MFIs) in the world. Today's financial cooperatives that include credit unions, thrift and credit cooperatives, PACS, rural and urban cooperative banks, etc., are in one way or another based on the lessons drawn from well-known models promoted by, Shultze–Delitzsch, Dr. Wollemborg, and Desjardins and Rochdale, pioneers in the cooperative sector. In the context of inclusive development, cooperatives are critical institutions for both social and financial inclusion. Whereas social inclusion is addressed by sub-sectoral and service cooperatives, savings and credit cooperatives function as intermediaries of inclusive finance. Cooperatives play a significant role globally in the provision of microfinance services to the poor, an example being Rabo bank, which is also recognized as one of the world's safest banks. Further, cooperatives are known to be resilient financial service organizations in times of crisis, and they remain financially sound and trusted (ILO, 2013).

A recent report on financial inclusion in India says that the cooperative movement was the first effort towards financial inclusion. (CRISIL, 2014). The Indian financial cooperative system is also the largest in the world, in terms of the number of people served; it serves about 270 to 390 million people. (Grace, 2008). Although the cooperative sector has been plagued by problems leading to failure of some cooperatives, there have been sweeping changes in the regulations, which have provided for greater standardization of systems and improved oversight, while also safeguarding the democratic processes within cooperatives. There has also been experimentation with new types of financial cooperatives, including the Self Reliant Cooperatives (SRCs) and Farmers' Producer Organizations (FPOs). These organizations exist in a confusing regulatory environment, where the SRCs are marginalized by the traditional cooperatives now re-engineered under the 97<sup>th</sup> Constitutional Amendment, and the FPOs are collectives that operate under the Companies Act but with a cooperative philosophy.

The state of the current enabling environment for cooperatives has been discussed in recent forums, including the Microfinance India Submit 2013 and the United Nation Development Programme (UNDP's) knowledge sharing forum on microfinance, the Microfinance Community of United Nations Solutions Exchange (UNSE), where members highlighted the need to carry out an in-depth study of financial cooperatives in India. A subsequent e-discussion helped to develop the detailed Terms of Reference (ToR) for the study. The study intends to analyse the current regulations and identify the issues that plague the system from contributing significantly in the financial inclusion (FI) agenda. Further, it makes recommendations (regulatory and otherwise) to improve the situation and make them strong financial institutions. The UNDP has commissioned the study of financial cooperatives in the context of FI in India, and after a rigorous tendering process, assigned the investigation to Sampark.

The flow of the report is thus: the first section presents the background, rationale, objectives and methodology of the study. The second section presents the enabling environment for cooperatives, highlighting the history and background of cooperatives in India, cooperative regulation in India, the institutional structure of the cooperative structure and the capacity building institutions. Chapter 3, titled ground reality of cooperatives in India, briefly

describes the products and services offered by the cooperative sector, and the issues faced by them in functioning as strong financial institutions. Chapter 4 discusses the positioning and feasibility of the cooperatives for financial inclusion. The next chapter analyses the issues in a Gender and Social Inclusion framework as applied to cooperatives. Finally, the recommendations are presented, for creating a positive enabling environment for the financial cooperatives to contribute optimally to the financial inclusion agenda.

The **purpose** of the study is to **understand the state of financial cooperative sector in India and identify factors that enable these cooperatives to contribute to the effective financial inclusion drive.**

**The scope of the assignment is to:**

- **Review the Enabling Environment:** Review the existing Cooperative Acts in four different States (Assam, Karnataka, Maharashtra and Uttarakhand), and recommend changes that will enable cooperatives to take an active part in the financial inclusion drive in India, and to emerge as sustainable, transparent and accountable member based financial organizations
- **Gain stakeholders perspectives through interviewing relevant individuals and field visits to the above states;** and
- **Recommend strategies** to make the cooperatives strong financial institutions so that they can contribute to the financial inclusion agenda.

## **1.2 | Conceptual Framework of the Study**

The study of the enabling environment captured the historical perspectives on cooperatives, summarising and reflecting on the issues and recommendations of the several committees set up to direct the development of the cooperative sector from time to time. It analyses the regulatory framework, and the structure of the cooperative sector, including the institutions for capacity building of cooperatives at various levels. In doing so, the study presents a comprehensive framework for studying the enabling environment of cooperatives.

Another conceptual framework used to analyse the study findings is the Gender Equality and Social Inclusion (GESI) framework developed initially to strategise work with and for excluded groups in Asia (Bennett et al, 2006). The framework enables an understanding of a cooperative as a member based organisation that enable raising resources and creating assets for the members. In this framework, the theory of change envisaged is that greater access to resources and assets, combined with increased voice through collectives, provides the strength to influence policy change in favour of the excluded groups. The framework outlines three domain of change: 1) assets and services 2) voice, influence and agency, and 3) the rules of the game. The GESI framework is useful to understand the financial cooperative sector, analyse the strengths and constraints faced by the cooperatives and look at a way forward so that cooperatives can empower the poor and socially marginalised people by providing resources, enabling agency and creating a conducive environment. An application of the GESI framework to the study of financial cooperatives is attempted in Chapter 5.

## 1.3 | Methodology

The team followed a participatory approach for documenting and analysing the financial cooperatives by consulting all the relevant stakeholders.

The following sections outline the sample coverage and a detailed methodology that was followed to complete the assignment.

### 1.3.1 Sampling

The study required covering 15 different types of financial cooperatives. It used **mixed sampling** procedure to select the states and the cooperatives. For selecting states and unique cooperatives societies, **Purposive Sampling** was applied. However, for selecting other cooperatives like Urban Cooperative Bank (UCBs), PACS functioning as Self Help Promoting Institutions (SHPIs), Self Help Group (SHG) federations registered under thrift and Credit Cooperatives/Multipurpose Cooperatives, **Stratified Random Sampling** was attempted in a few states, to be able to cover less successful cooperatives along with successful ones.

**The states for sample study were identified using the following criteria:**

- Geographical location, to get representation of the northern, eastern, western and southern states in India;
- Different types of Cooperatives Acts in the States<sup>1</sup>; and
- States offering innovative and good practice examples of different financial cooperatives to analyse success/failure factors, and potential for replication.

Considering the time available for the study and cost efficiency, **four states** were selected for in depth micro level analysis of various financial cooperatives. The macro level environmental assessment was made at the all India level.

The states that were selected for the study are given in Table 1.

Following the regional criteria as main, Uttarakhand (Uttaranchal) was selected for the Northern region as the SRC Act has been enacted and the state also has cooperatives registered under the state cooperative society act. This would provide a perspective on how cooperatives can work for financial inclusion in a hilly/mountain region.

Table 1: Selection of States

| Region     | States                    |
|------------|---------------------------|
| North      | Uttarakhand (Uttaranchal) |
| South      | Karnataka                 |
| West       | Maharashtra               |
| North-East | Assam                     |

Karnataka was selected for the Southern region as it has both the SRC Act (Souharda Act) with SHG federations registered under that Act and also the traditional cooperatives act with urban and rural cooperative banks registered under it. It has both government and donor promoted cooperatives, to get comparative perspectives.

<sup>1</sup> Except the state that has 'only self-reliant cooperative act' as there seems to no state with only self-reliant cooperative act exists.

Maharashtra has re-engineered the traditional cooperative act and multi-state cooperative act. It also offered the opportunity to study both government and donor promoted cooperatives.

Assam was selected to cover the state that has the traditional cooperative act. Assam was also selected for getting the perspective of the North-Eastern region, and issues of financial cooperative sector in the mountain/ hilly region. The socio political situation of Assam provides a contrast to the mountain region, of Uttarakhand.

Having first done a geographical selection based also on the different types of cooperative acts in the States, other criteria were then superimposed, and they are as follows:

1. Location of the cooperatives: closeness and remoteness to town
2. Age of the Cooperatives; <5 years, more than 5 years
3. Size of the cooperatives; memberships, volume of financial operations
4. Composition of the cooperatives (mixed, women, men, socially excluded categories, etc.)
5. Activities of the cooperatives – engaged in financial and non-financial services
6. Donor/NGOs promoted and government programme promoted
7. Cooperatives linked with external agencies like banks and government programme and cooperatives not linked

Considering the criteria of selecting the states and cooperatives, the following states and number of cooperatives for in-depth case study analysis, are presented in Table 3.

The field study also covered 12 different stakeholders that are engaged in promoting and supporting the financial cooperatives in India. These include the Reserve Bank of India (RBI), National Bank for Agriculture and Rural Development (NABARD), donor agencies like International Fund for Agricultural Development (IFAD) and UNDP, promoting organisations like Rabo Bank, Friends of Women's World Baking (FWWB) and Ananya, training institutes like College of Agricultural Banking (CAB), Institute Cooperative Management (ICM), Rural Self Employment Training Intitute (RSETI) and Sahakara Rural Development Academy (SAHARDA), national and state level cooperative federations and unions like National Federation of State Cooperative Banks Limited (NAFSCOB), National Coopertative Union of India (NUCI) and International Cooperative Alliance (ICA), government department including cooperative, agriculture and National Rural Livelihood Mission (NRLM), and key individual experts who have worked in the cooperative sector. Some key informants and cooperative leaders were interviewed in the Madhya Pradesh and Rajasthan as well.

The details of the people covered in each state are given in Annexure 1.

### **1.3.2 Processes Involved**

The study was completed in different stages, with the first being the preparation of an inception report, followed by the secondary research and field investigations. These were captured in a preliminary report, which was shared with the members (over 3,000) of the

Microfinance Community of the UNSE, a knowledge sharing initiative of the UN Country Team in India. This was followed up by a draft report, which was then finalised after feedback from members of the community and other stakeholders. The study was completed in seven months, from January to August, 2015.

Even with utmost attention, some limitations can still be expected in a time bound study such as the present one. Some gaps in the study are inadequate coverage of Multi-State Cooperative Societies (MSCS), and of client perspectives. These arose due to the unavailability to the data sought, difficulties in reaching out to the selected cooperatives, reluctance of the cooperatives approached to speak with the study team, and lack of access to the required data and documents for understanding the financial position of the cooperatives. These were practical constraints faced by the field study team while implementing the field-work planned and covering the planned sample size. Despite this, the team managed to overcome these difficulties and collect some quality data to bring out a rich analysis of the situation.

**Table 2: List of the Cooperatives interviewed**

| <b>Assam</b>       |   |
|--------------------|---|
| 1                  | Duar Bagori Multipurpose Credit Society                                   |
| 2                  | Konoklata Mahila Urban Cooperative Bank                                   |
| 3                  | Cooperative City Bank   |
| 4                  | Assam Apex Bank   |
| <b>Karnataka</b>   |   |
| 5                  | Bidar Mahila Urban Cooperative bank                                       |
| 6                  | Prathamika Krishi Pattina Sahakara Sangha Niyamit - Nagora                |
| 7                  | Prathamika Krishi Pattina Sahakara Sangha Niyamit - Gadgi                 |
| 8                  | DCCB, Bidar   |
| 9                  | Eshwara Souharda Cooperative  |
| <b>Maharashtra</b> |   |
| 10                 | DCCB, Pune  |
| 11                 | Annapurna Multi State Cooperative Credit society                          |
| 12                 | Bhagini Nivedita Cooperative Bank   |
| 13                 | Mann Deshi Mahila Sahakari Bank   |
| <b>Uttarakhand</b> |   |
| 14                 | Ajabpur Primary agricultural society                                      |
| 15                 | DCCB, Dehradun  |
| 16                 | UCB, Dehradun   |
| 17                 | Uttarakhand Microfinance and livelihood Promotion Cooperative Institution |
| <b>India</b>       |   |
| 18                 | Sahulat Microfinance  |

**Table 3: Sample Size (number of states and Cooperative cases)**

| Sl. No. | Categories of Cooperatives and Relevant Organisations/People Covered | Study states     |           |             |           | National Level | Total | Planned Sample Size |
|---------|--|------------------|-----------|-------------|-----------|----------------|-------|---------------------|
|         |  | Maharashtra      | Karnataka | Uttarakhand | Assam     |                |       |                     |
| 1       | Cooperative Case studies   |                  |           |             |           |                |       |                     |
|         | Case 1: SRC  | N.A              | 1         | 1           | N.A       | 2              | 2     |                     |
|         | Case 2: PACS   |                  | 2         | 1           | N.A       | 4              | 2     |                     |
|         | Case 3: Special Coop or Thrift and Credit Society                    | 2                |           |             | N.A       | 3              | 3     |                     |
|         | Case 4: Cooperative banks (DCCB/ SCB)                                | 1                | 1         | 2           | N.A       | 5              | 3     |                     |
|         | Case 5: Urban Coop (state act/ SRC)                                  |                  | 1         | 1           | N.A       | 3              | 3     |                     |
|         | Case 6: MSCS   | 1                |           |             | N.A       | 1              | 2     |                     |
|         | Case Study sub Total   | 4                | 5         | 5           |           | 18             | 15    |                     |
| 2       | RBI  |                  |           |             |           | 0              |       |                     |
| 3       | Apex Level Financial Institutions (NABARD, SIDBI, NABFINS)           |                  | 1         | 1           | 1         | 4              |       |                     |
| 4       | Donors   |                  |           | 1           | 2         | 3              |       |                     |
| 5       | Promoting, CB (NGOs, international agencies)                         |                  | 1         |             | 2         | 4              |       |                     |
| 6       | Training/ Resource Agencies  | 3 <sup>www</sup> | 1         | 1           | 1         | 6              |       |                     |
| 7       | Cooperative Department   |                  |           | 1           | 2         | 5              |       |                     |
| 8       | NRLM/SRLM  | 1                |           | 1           | 1         | 3              |       |                     |
| 9       | National/State Cooperative Federations/ Cooperative Union            | 1                | 2         |             | 2         | 6              |       |                     |
| 10      | Individual consultants, experts/ others                              |                  | 1         | 1           | 2         | 4              |       |                     |
|         | <b>Interviews Sub Totals</b>   | <b>5</b>         | <b>6</b>  | <b>6</b>    | <b>12</b> | <b>35</b>      |       |                     |
|         | <b>Total</b>   | <b>9</b>         | <b>11</b> | <b>11</b>   | <b>12</b> | <b>53</b>      |       |                     |

# 2

## The Enabling Environment for Cooperatives in India

A study of the enabling environment involves an overview of the institutions that promote and support cooperatives, the legal framework in which the cooperatives operate, and the aura of historical trends, opinions, and expectations that constitutes the present support, and influences the future support, to cooperative institutions. As the study focuses on the current and potential role of cooperatives in financial inclusion, the policies and norms relating to financial inclusion attain high relevance.

This chapter covers the following aspects of the enabling environment for cooperatives in India:

- Historical evolution of cooperatives and issues arising there from
- The feelings and expectations from the cooperative sector are primarily those of lack of trust, and scepticism about cooperatives, which can only be overcome by more professional management and good governance of cooperatives
- The current state of the financial cooperative sector, including institutional arrangements (discussing the cooperative credit structure as well as the training institutes); and
- Cooperative regulation in India, and its implementation.

### 2.1 | History and Experiences of Cooperatives in India and Abroad

Financial cooperatives can be traced back to the agricultural credit cooperatives in Germany under Friedrich Wilhelm Raiffeisen (1818–1888). During the Industrial Revolution, many farmers and artisans faced the negative effects of the liberation of the serfs and the introduction of free trade. These farmers and artisans were burdened by having to pay off their former lords and were inexperienced in the independent management of a business. The failure of harvests in the years 1846–47 led Raiffeisen, the mayor of Weyerbusch, to create a self-help organization whose wealthier members provided money at the time of crisis and its poorer members repaid the amount borrowed on low interest rates (Sudradjat, n.d.). The five countries with the largest number of cooperatives are France, Japan, United States of America (USA), Germany and Netherlands. France and Netherlands have the highest proportion of turnover of cooperatives to the Gross Domestic Product (GDP) of the country. The Dutch Rabo Bank is the best known cooperative bank for agriculture and credit. (Bijman et al, 2012). Over the years the importance of cooperatives worldwide has increased so much that there are currently 57,000 credit unions in 103 countries that serve 208 million people (as of 2013) (WOCCU, 2014). The UN even named 2012 as the International Year of Cooperatives (WOCCU, 2011).

On a global scale, the penetration rate of credit unions is about 8%. The highest penetration rate is found in St. Vincent and the Grenadines (90%), followed by Barbados (78%) and Ireland (75%). The penetration rates are high in the USA and Canada (around 45%), yet they retain a small percentage of deposits. US credit unions have a deposit market share of almost 7% and around 100 million members. In Canada, credit unions have a deposit market share of 8% and more than 10 million members. The penetration rate in Latin America is more than

8%, but the deposit share levels trail behind significantly at around 3-4%. However, they are much more significant than these market shares suggest, because many credit unions reach down to some of the poorest people in each country and have a substantial economic impact (Groeneveld, *Ibid.*).

The discourse on international cooperatives holds that the government should play the role of a legislator, regulator and prudential supervisor, and not interfere in management. However, there is also evidence that leaders of cooperatives have jeopardized members' interests in many cases and so, regulation needs to be strong. Further, it is important that the government agency that regulates the credit unions be trained in their nature, risks and methodologies.

The history of cooperatives in India can be divided into “four phases representing significant developments or events in the history of the cooperative movement” (Sriram, 1999).

### **The First Phase: 1900-1930**

In 1904, the State of India passed the first legislation concerning cooperatives, namely, the Cooperative Societies Act. Cooperative credit societies were set up with the objective of providing credit to farmers at a reasonable rate (RBI, 2013). Until then, only a few cooperatives had taken form; the first was established in 1891 for farmers to have collective control over the common lands/pastures of the village (Hough, 1960). Cooperatives proliferated quickly after the 1904 act. By 1915, more than 800 primary cooperatives were established all over India.

The first three government committees to investigate the functioning of financial cooperatives: the Edward Law Committee, the Frederic Nicholson and the Maclagan Committee (1915) confirmed the need for the State to actively promote cooperatives. The latter advocated that there should be one cooperative for every village and every village should be covered by a cooperative. By this time, the State was already deeply involved in promoting financial cooperatives as instruments of credit delivery. In 1928, the Royal Commission on Agriculture in India suggested that the cooperative movement must continue to be directed toward the expansion of rural credit and that the State should patronize cooperatives and protect the sector (RCA, 1979). The interventionist role of the state shaped the cooperative structure we have today, including the system of refinance, and over time, the state became increasingly involved with cooperatives.

### **The Second Phase: 1930 – 1950**

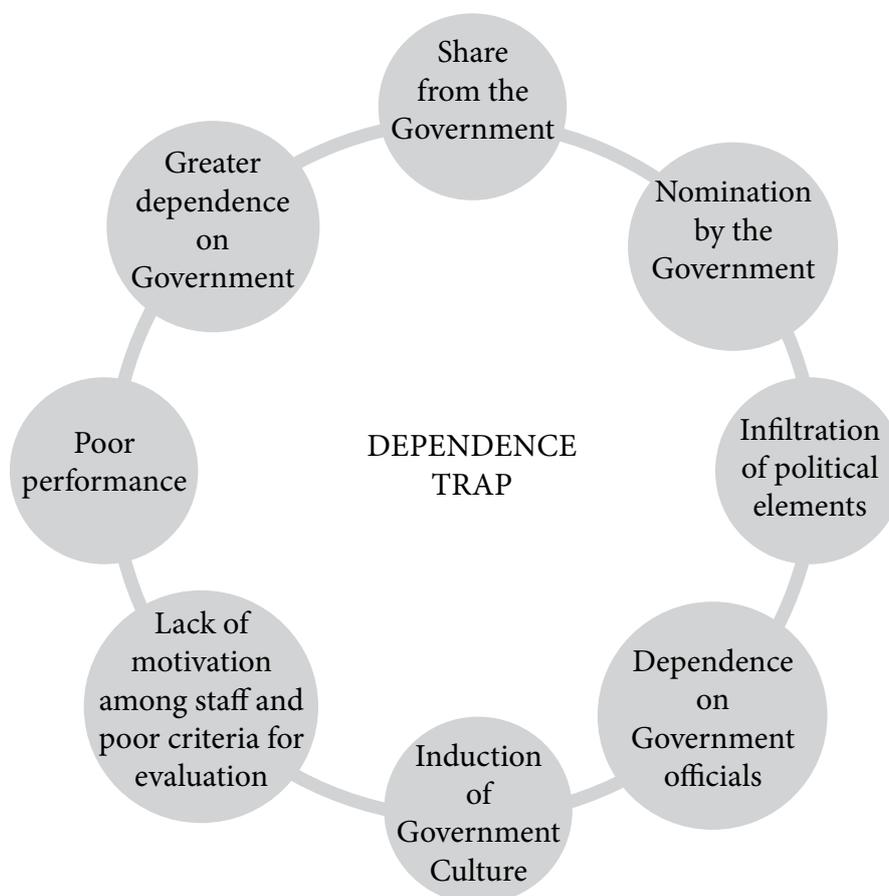
The early signs of sickness in the cooperative system also surfaced during this period. The 1945 Agricultural Finance Sub-committee observed that a large number of cooperatives were faced with the problem of frozen assets as a result of heavy over-dues. The committee recommended the liquidation of members' frozen assets by adjusting the claims of the society to the members' repaying capacity. This solution is an indicator of the State's interventionist role in the area of the credit discipline of members. Another committee set up in this phase, the Cooperative Planning Committee, examined the causes of cooperative failure, held small size of primary cooperatives as unviable, and suggested protection of cooperatives from competition.

### The Third Phase: 1950–1990

The third phase was action-packed. The All India Rural Credit Survey (AIRCS) submitted its report in 1954, recommending the participation of the State in the share capital of the cooperatives. It suggested that the State should hold at least 51% of the share capital of all cooperatives at all levels. It also recommended a common cadre of employees for all cooperatives, both credit and commodity functions for cooperatives, a larger area of operation and compulsory amalgamation of cooperatives (Sriram, 1994;4). In 1969, another committee was set up to review the progress made on the recommendation of the AIRCS. Ever since the AIRCS recommendations, the State has been involved in restructuring the cooperative sector, ignoring the basic issues of autonomy and self-help. As Mr. M. S. Sriram says in his study, “The view of the State has been that the rural areas need to be supported with cheap credit from the State and if the institutions that were meant to deliver this failed, there either had to be a re-organization or a new institution created. In brief, it initiated more studies and took more policy decisions.”

The subsequent committees illustrate the diversity of policy recommendations. The Narasimham Committee suggested floating Regional Rural Banks; the Hazari Committee recommended integration of the short-term structure with the long-term (though not implemented); the National Commission on Agriculture recommended setting up of Farmers’

**Figure 1  
Dependence Trap**



Source: Mr. Seetaraman and Mr. Mohanan (1985)

Service Cooperative Societies, this time with the active collaboration of the nationalized banks; the Bawa committee recommended the setting up of large cooperatives in tribal areas; and the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development, under the Chairmanship of Mr. Sivaraman, resulted in the formation of NABARD.

The financial involvement of the State caused interference at the operation level, leading to what is termed as dependence trap, as depicted in Figure 1. Further, populist measures such as the populist declaration of writing off farmer loans in 1989, undermined any intention to foster enterprising and independent cooperatives.

Toward the end of this phase, however, some alternative viewpoints were put forth. The Khusro Committee talked about 'savings as product necessary for cooperatives' and advised that 'business planning should take place at the local level and that strategies should be in place for cooperatives to sustain themselves' (Sriram Ibid).

### **The Fourth Phase: 1990 – Present**

This phase saw some developments in the area of the autonomy and self-reliance of cooperatives.

A parallel cooperative movement of SHGs picked up silently all over the country. Strikingly, while these groups "operated on the basic principles of cooperation and mutual aid as specified by International Co-op Alliance in its 1994 congress, very few registered themselves as cooperatives. (Several of these enterprises) operate as informal groups with just a bank account and some bookkeeping" (Sriram, Ibid.). The government monitored this movement and played a cautious but supportive role.

In the mainstream cooperative movement, an important development took place when the Brahm Prakash Committee on the Model Cooperative Act "suggested a radically different law which ensured autonomy to cooperatives in the country, thereby suggesting that the role of the State should be reduced in the co-op sector" (Sriram, Ibid.). However, given that cooperation is a State subject, it was only recommendatory in nature. Nevertheless, in 1995, the state of Andhra Pradesh passed a radically new law called the Andhra Pradesh (AP) Mutually Aided Co-operative Societies (MACS) Act to govern new-generation cooperatives. The new act runs concurrently with the old Act of 1956, allowing existing cooperatives a choice between the two. It allows cooperatives registered under it greater autonomy at the cost of no financial support coming from the States. Several informal mutual-aid groups have come forward to register under the new act. As of February 2005, there were a total of 13,891 cooperatives registered under this act, of which 3,428 were previously registered under the old act. Following the example of Andhra Pradesh, several states introduced self-reliant cooperative laws, including Jammu and Kashmir, Uttaranchal, Karnataka, Madhya Pradesh, Jharkhand, Bihar, Chhattisgarh and Orissa.

Subsequent committees, such as the Mr. Jagdish Kapoor, Mr. Madhav Rao, and Prof. A. Vaidyanathan committees echoed the new view that cooperatives should be member-driven enterprises, free of political interference. The Vaidyanathan Committee proposed significant

and wide-ranging reforms in the governance and management of cooperatives, including crucial amendments to the respective State Cooperative Societies Acts (RBI, 2013). As an incentive for reform, the Government of India (GoI) developed a comprehensive assistance package, the provision of which was contingent on major revision by the states of the legal and regulatory frameworks (World Bank, 2014). Based on the recommendations of the Vaidyanathan Task Force, the GoI announced a package for revival of the ST CCS in 2006. As of December 2012, twenty-five state governments signed the Memorandum of Understanding with the GoI and NABARD, agreeing to make amendments and receive the assistance package.

In early 2008, the GoI had announced the Agricultural Debt Waiver and Debt Relief Scheme, 2008, despite the warning of the World Bank regarding “the potentially adverse impact debt waivers could have on credit culture as well as the risk they posed to financial markets/institutions” (World Bank, *Ibid*). This scheme has been criticized for not mitigating the debt burden of all farmers but only of those borrowing from formal institutions and those being undertaking risky behavior (Srinivasan, 2008).

In essence, despite some setbacks, a new generation of autonomous financial cooperatives is slowly emerging in India.

## **2.2 | Cooperative Regulations in India**

Indian cooperatives face a complex regulatory environment, which is the result of the government’s historical orientation of development and protection.

Financial cooperatives in India did not start out as business-oriented organisations that provide diverse financial services to their members, they were, instead, a state led initiative to offer subsidized credit for agricultural development. Credit was offered first for crop production and land development. Savings services to members were offered much later.

All financial systems need regulation as their clients, both borrowers and depositors, need protection: depositors need an assurance of the safety of their deposits, and borrowers need to have access to lending and recovery practices that are fair and non-exploitative. As finance is a quasi-public good, it requires regulatory intervention to reach efficient outcomes. Further, market imperfections are binding on the poor and small entrepreneurs, making the regulation of this sector that much more important (Nayak, 2012).

The regulation of cooperatives in India assumes importance because cooperatives take deposits from low- and middle-income people, for whom deposit safety is a major concern. Regarding lending, two concerns arise. As cooperatives lend mostly to small and marginal farmers, and micro-entrepreneurs, whose requirements fall into Priority Sector Lending (PSL), the first concern is about extending production loans to them at fair prices. The second concern is that cooperatives engage in relationship lending, with credit decisions being based on soft information from members, undermining professional decision-making processes and causing higher credit risks. Further, cooperatives have been faced with several failures on account of mismanagement arising from the family control of cooperatives, the use of cooperatives for political purposes, and fraud by the leaders and staff. These factors

have undermined the view of cooperatives as professional financial service providers. Financial cooperatives need to follow banking principles and upgrade their systems before the government can recognise their members as financially included.

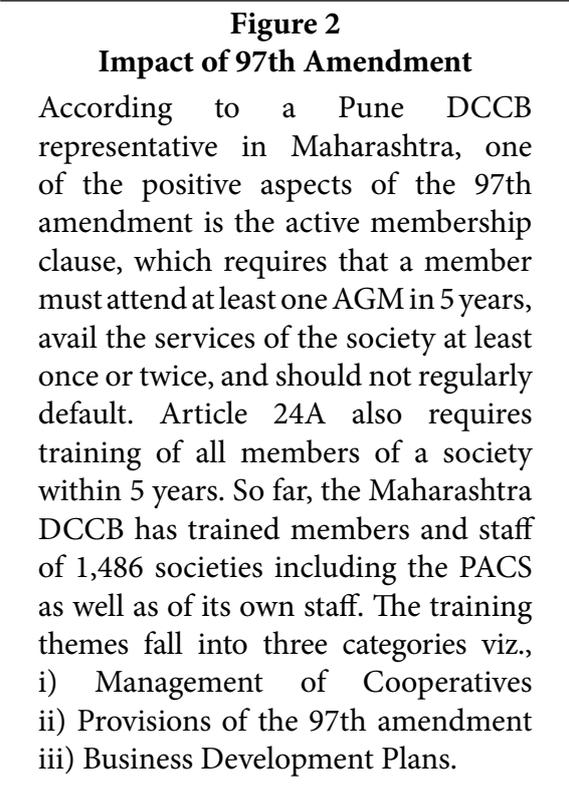
Cooperatives at different levels are governed by a set of laws, and as over 90,000 cooperatives are at the primary level, we discuss first the regulations for primary cooperatives.

**2.2.1 The State level Cooperative Acts for Primary Cooperatives**

**Centre or State Jurisdiction**

The first key issue about cooperatives regulations is about the domain of promulgation of cooperative laws. As cooperatives were promoted as a national priority, the first financial cooperative regulation was put in force at the Centre through the Cooperative Societies Act, 1912. By 1919, cooperation work was transferred to the states, and each state promulgated a cooperative law with the objective of expanding financial services systems to remote areas and low-income populations. Although all the state laws adopt the basic cooperative principles, some differences persisted based on local needs and requirements of state governments. In order to streamline and standardize some systems, and ‘to ensure that cooperative societies in India function in a democratic, professional, autonomous and economically sound manner’, the Centre pronounced The Constitution (97th Amendment) Act, 2011. The state governments were then asked to amend their respective State Cooperative Society Acts to bring them in compliance with the 97th Amendment, before February 2013. While the announcement of the 97<sup>th</sup> Amendment has been contested on the ground that the Centre cannot legislate on an issue which is under state jurisdiction (e.g. in Gujarat), many states have amended their Cooperative Acts subsequently, to bring them in conformity with the Amendment. There has also been acknowledgement from the states that the amendment has had positive impacts, as shown in Figure 2.

At the same time, flaws in the 97th Amendment were pointed out by some states. The 97th amendment provides for more independence and less interference from the government but some of the stakeholders in the state believe that there are provisions that could be potentially misused by the cooperatives in the region<sup>2</sup>. For example, the provision of non-active members in the new act could be misused. The management of the cooperative reportedly has been given the power to declare members as non-active (based on some criteria including attendance in Annual General -Body Meeting (AGM). Once declared as such, these members lose their voting rights. It is becoming evident that general members of cooperatives, whether in Maharashtra or



Assam, are mostly unaware of the provisions of the law and have little access to related education. In such a scenario, an aware and vested management could potentially misuse the clause to limit voting members.

Another lacuna in the act is that the amendment requires the state government to appoint professionals such as lawyers, finance experts, and chartered accountants. However, according to many stakeholders, the interpretation of 'finance expert' needs clarity. Specifically, the qualifications are unclear with regards to degrees and years of work experience required.

### **State Cooperative Acts and the Self-Reliant Cooperatives Act**

As most state governments had contributed share capital in order to promote cooperatives and were invested in the cooperatives, they viewed state control as a right. Consequently, the traditional cooperative acts of each state have provisions for state supervision and control of cooperatives in case of mismanagement noticed by officials or reported by members. With the governance and internal functioning of the cooperatives controlled by government officials, democratic and member-managed functioning of cooperatives was severely compromised and was the subject of many cooperative sector assessments.

An NGO led process led to the promulgation of the **MACS** in the state of Andhra Pradesh, and subsequently, such self-reliant cooperatives (SRCs) acts have been promulgated in nine states (Andhra Pradesh, Karnataka, Madhya Pradesh, Bihar, Jharkhand, Odisha, Chhattisgarh, Jammu and Kashmir, and Uttarakhand). These new laws provided a new space for cooperatives, whereby if the cooperative did not have state funding, and was capitalised through member contributions, the state would not interfere in its functioning.

With the state government's acts aligned with the 97<sup>th</sup> Amendment, the SRC Act was repealed in Madhya Pradesh. In Odisha, the SRC Act was repealed after some cases of misappropriation of funds by some SRCs came to light. The other 7 states still have SRCs, which offer parallel legislation to the state cooperative acts.

The benefits of the SRCs are, however, still debated. An interview with NRLM staff indicated that the SRC Act is not suitable for genuine SRCs. While the organization recognizes the importance of Village Organizations (VO) becoming legal entities, it is reluctant to help the VOs make this transition. This is because registration under the act creates some difficulties. One challenge is the payment of taxes (about 15 to 20%).

### **2.2.2 The Multi-state Cooperative Societies Act, 2002 (MSCSA)**

A multi state cooperative may be registered if a cooperative operates in at least two states, with a minimum of 55 members from each state. A total of 796 cooperatives societies are registered at Multi-State Cooperative Societies (MSCSs), most of which have several businesses, and are not limited to financial cooperatives (Agricoop, 2013). The Multi-State Cooperative Societies Act (MSCSA) of 1984 was amended in 2002 to provide greater freedom from state control to the members of the cooperatives, especially to those who have not

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2 The act is new and its impact is yet to be seen. There is currently no evidence of misuse but some stakeholders stated in our discussions that they believe some provisions could be potentially misused. These are the prevailing perception, currently not accompanied by hard evidence.

availed of any financial assistance from the government. However, while the cooperatives have some freedom, in cases of reports of mismanagement, the office of the Registrar of Cooperative can supersede the members and take control of the cooperative, irrespective of whether or not the cooperative has received financial assistance from the government. A new Bill has been proposed, but the amendments have not been passed by the Parliament yet.

### **2.2.3 The Regulations for Cooperative Banks**

Three types of institutions are registered as cooperative banks: the District Central Cooperative Banks (DCCBs), the State Co-operative Banks (SCBs) and the Urban Cooperative Banks (UCBs)<sup>3</sup>. Cooperative banks come under the purview of both the Registrar of Cooperative Societies of the state (in which they are located) and the Reserve Bank of India. Critics of the sector believe that this dual regulation creates inefficiencies and at the same time, prevents prompt regulatory action. The logic of the dual regulation, however, is that the Registrar of cooperatives keeps an oversight relating to the functioning of the cooperative according to cooperative principles, whereas the RBI requires adherence to prudential norms relating to income recognition, asset classification, provisioning for portfolios at risk and capital adequacy ratios. UCBs are eligible for refinance facilities on loans extended to enterprises in the priority sector, e.g. tiny and cottage units.

### **The Deposit Insurance and Credit Guarantee Corporation Act, 1961**

The deposits made in cooperative banks are protected by The Deposit Insurance and Credit Guarantee Corporation (DICGC), provided that the states' cooperative societies' acts have included provisions to empower RBI to keep an oversight on the cooperative banks. The deposit of the cooperative banks backed by the DICGC guarantee are entitled to a payment of up to Rs. 100,000 per depositor in the case of winding up or liquidation of the bank (DICGC, 2006).

### **2.2.4 The Regulatory Gaps**

The most recent development measure was proposed by the Vaidyanathan committee in 2004, as a revival package for the short-term cooperative structure. This was followed up by a revival package signed between the cooperatives, state governments, and NABARD. The package was not fully implemented in many states due to lack of compliance of conditions or lack of release of the requisite funds by one or the other partner. In states like Assam, the Apex Bank has been approved under the Vaidyanathan Committee package first round (VC1) as the institution responsible for strengthening of the PACSs. However, some funds are still to be released mainly the central government's share. The revival packages have now been closed as the duration of the Memorandum of Understandings (MoUs) have ended.

The committee also recommended a legislative provision issued by the states that empowers the RBI to regulate the cooperatives under the Banking Regulation Act and through the RCS, and that NABARD extend a refinancing package to self-reliant cooperatives. These recommendations remain to be implemented, and continue to have relevance.

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<sup>3</sup> Primary Agricultural Cooperative Societies are federated at the district level, and the federation is registered as the District Central Cooperative Bank; there are 372 DCCBs in India. In turn, the DCCBs are members of the State Cooperative Banks.

### 2.2.5 Promotional Measures

In addition to regulations, the government has extended support for the promotion and recovery of cooperatives. These include the following funds, which cooperatives are eligible to receive:

- **The Financial Inclusion Fund (FIF)**, set up in 2008 at NABARD with an overall corpus of Rs. 500 crore, on the recommendations of the Committee on Financial Inclusion set up by the Gol under Dr. C. Rangarajan. The objective of the FIF is to support “developmental and promotional activities” with a view to securing greater financial inclusion, particularly among weaker sections, low-income groups and in backward regions/hitherto unbanked areas.
- **Financial Inclusion Technology Fund (FITF)**: The Rangarajan Committee (2008) also recommended the setting up of the FITF at NABARD with an overall corpus of ₹ 500 crore. The FITF aims to enhance investment in Information Communication Technology (ICT) to promote financial inclusion; to stimulate the transfer of research and technology in financial inclusion; to increase the technological absorption capacity of financial service providers/users; and to encourage an environment of innovation and cooperation among stakeholders.
- **The Rural Infrastructure Development Fund (RIDF)** was instituted by NABARD with an announcement in the Union Budget 1995-96, with the sole objective of giving low-cost fund support to state governments and state-owned corporations for quick completion of ongoing projects relating to medium and minor irrigation, soil conservation, watershed management, rural drinking water schemes, rural market yards, rural health centres and primary schools, mini hydel plants, *shishu shiksha kendras*, *anganwadis* <sup>4</sup>, and system improvement in the power sector.
- **The Price Stabilization Fund** The Department of Commerce launched a contributory Price Stabilization Fund in April 2003 as a response to the distress caused to primary growers of tea, coffee, rubber and tobacco due to the decline in the international and domestic prices.
- **The Agricultural Debt Waiver and Debt Relief Scheme (ADWDRS)** was a one-time relief launched in May 2008 to address the problems and difficulties faced by the farming community in repayment of loans taken by them and to help them qualify for fresh loans.

In addition to promotional funds, there have been some regulatory changes that have provided impetus to cooperatives. The promulgation of the Warehousing (Development and Regulation) Act, 2007, whereby warehouse receipts have become negotiable instruments, has enabled greater liquidity in farmer’s income flows.

Another key developmental measure has been the direction by the RBI to all UCBs to complete Core Banking Solutions (CBS) implementation. To achieve this, NABARD has also initiated a project that enables cooperatives to take financial support for establishing CBS.

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<sup>4</sup> *Aanganwadis* are care centres for children in the age group of 2 to 5, and *shishushiksha kendras* are government primary schools for children in the age group of 5 to 9.

### 2.3 | Structure of the Cooperative System

The structure of the cooperative system is depicted in Figure 3 and explained from the grassroots to the federated structures.

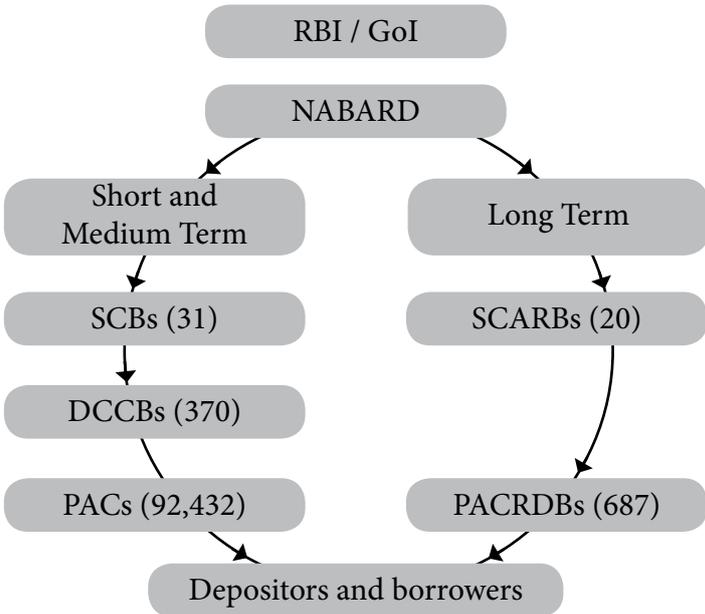
#### 2.3.1 Rural Cooperatives

The cooperative system in India consists of rural and urban cooperatives. The rural cooperative system, illustrated in Figure 3, consists of the ST CCS and the Long-Term Cooperative Credit Structure (LT CCS). Uttarakhand is an exception to this subdivision, as the Short Term Cooperative Credit Structure is merged with the LT CCS, with the State Cooperative Banks (SCB) providing the Long Term Loans.

The ST CSS is of most relevant to financial inclusion as it meets the crop loan requirements. The ST CCS functions as a three-tier structure in 16 states. It is composed of PACSs at the base; PACSs have farmers as their members. DCCBs act as the intermediate federal structure; PACSs are its principal affiliated members. SCBs, at the apex state level, have the DCCBs and other cooperatives as their principal members. In 13 smaller states and union territories, such as in Assam, PACSs are directly affiliated to SCBs and the ST CCS functions as a two-tier structure. In three states, a mixed structure operates, with a two-tier structure in some districts and a three-tier structure in the others (Bakshi, 2013).

The LT CSS, supporting farmer-level capital investments in agriculture, consists of two tiers, with Primary Cooperative Agriculture and Rural Development Banks (PCARDB) at the base, and State Cooperative Agriculture and Rural Development Banks (SCARDB) at the apex. NABARD provides direct finance and refinance to SCBs, SCARDBs and recently, also directly to DCCBs (NABARD, n.d.) NABARD then borrows from the RBI and the GoI, among other institutions (Maan and Singh, 2013).

**Figure 3  
Rural Cooperative Institutional Arrangement**



In Assam, there's no middle-tier between the Apex Bank and PACS. This two-tier structure resulted from a collapse of the earlier DCCBs, which then merged with the Apex Bank. This decision was taken in the late-seventies.

NABARD is a complex organisation with many functions: financier, promoter, regulator, supervisor, and development bank that needs to have a return on its assets. It has very highly motivated staff and could perform its functions well, but the orientation of different tasks that it has are completely different, the promotion and development tasks demanding a different

outlook from the regulating and supervision roles. In fact, NABARD is the fourth layer of the cooperative structure, as an Apex bank, and plays a strong promotional and supervisory role for cooperatives.

### **Self-Reliant Cooperatives**

SRCs generally operate on a standalone basis. In Karnataka, however, SRCs are federated into the Karnataka Souharda Federal Cooperative Ltd., described in the Figure 4. All SRCs in the state are required to be members of this federal cooperative. Some SRCs are unhappy with this relationship as they complain about the high cost of 5% of profits to receive little benefit in return. According to the Karnataka Souharda Federal Cooperative Ltd., its effectiveness is limited by its lack of power to enforce its regulation.

#### **2.3.2 PACSs-The Weak Foundation**

The PACSs are considered the underpinnings of the STCCs in India and the other tiers exist, mainly to support the PACSs in delivering adequate, timely and cheap credit to the farmer members.

The SRCs are governed by the Federation of SRCs at the state level. However, while membership in the federation is mandatory and expensive (5% of profits are paid in fees), the Societies report not receiving value for money. So far, the SRCs in Karnataka have reported limited use: guidelines issued by the federation and invitation letters to annual trainings. The Federations have not taken up significant capacity building, or liaising for revolving loan funds from the formal financial institutions.

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**Figure 4**

#### **The Karnataka Souharda Federal Cooperative Limited, Karnataka**

The Karnataka Souharda Federal Cooperative Limited is a statutory body formed by the Karnataka Souharda Act of 1997. It is the first federation of SRCs formed by an Act of the government. All the self-reliant cooperatives registered under the Act are required to be members of the federal cooperative.

The federation provides guidance on forming self-reliant cooperatives, model byelaws, information and circulars relating to the changes to Acts and rules. It also provides legal assistance, training, monitoring and supervision, and political representation.

Currently, 3,300 Self Reliant cooperatives are the members of the federation. The majority of these (2,300) are from urban areas and the rest (1,000) are from rural and semi-urban areas. More than 90% of SRCs provide financial services. About 250 SRCs are defunct, due to lack of guidance and misappropriation of funds.

The federation is funded by contributions from member SRCs, equivalent to 5% of the net profit of the SRCs in the form of direct fees and other mandatory education fees).

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There are more than 93,000 PACSs in the country with over 120 million members. More than 30% of the PACSs are in the western zone (Maharashtra, Gujarat and Goa). However they have less than 15% of the total membership. In sharp contrast, southern zone (Andaman & Nicobar, Andhra Pradesh (unified), Karnataka, Kerala and Tamil Nadu) have about 16% of the total primary societies but more than 41% of total members.

Over the years the PACSs have come to depend heavily on the DCCBs or SCBs (two-tier) to meet the loan requirements of their members. This is mainly due to low business volumes, poor deposit mobilization and poor recoveries. These shortcomings are however not new and have been pointed out in the past by several studies and committees. Two findings of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) constituted by RBI under the chairmanship of Mr. B. Sivaraman in 1979 needs reference here. One pertained to the deposit mobilization which was found “not encouraging” except in states of Kerala and Punjab while the second observation related to “deteriorating recovery performance” of the PACS.

Deposit mobilization is a key parameter and requirement for the financial health of a banking institution. In case of PACS, it has been found that in 2012-13 the total lending was 2.5 times (NAFSCOB) that of the total deposit mobilized. However, if Kerala, Karnataka and Tamil Nadu that together accounted for 80% of the deposits, are excluded then the total lending by PACS comes to over six times the total deposits (Bakshi, 2013). This study has also confirmed the trend with PACS reported to be mobilising deposits in Karnataka and Uttarakhand and while very few doing the same in Maharashtra and Assam. In fact, in the latter two study states most PACS were reported to be at best acting as credit retailing institutions (Maharashtra) or at worst, only as an agent of the Public Distribution System (PDS) (Assam). In Maharashtra, the competition with DCCBs was reported to be one of the reasons for poor deposit mobilization by PACS.

Going by anecdotal evidence, another critical parameter influencing performance of the PACS, is reported to be very poor recovery performance, particularly in Maharashtra and Assam. This affects not just the profitability of the PACS but also erodes the capital base as the PACS have to repay the loans to DCCBs irrespective of whether the members repay the PACS or not. Some of the reasons perceived to be the cause of poor recovery are:

1. Recurrent natural shocks leading to crop damage and failure
2. Past loan waivers creating hope for future waivers-these hopes are fuelled by bids by local political leaders in an attempt to score political points
3. Perception of cooperatives as government institutions and consequent lack of ownership and accountability

In addition, loss making non-financial activities like Public Distribution System thrust upon the PACSs further erodes their profitability and efficiency.

Only 44% and 42% of the PACSs in Maharashtra and Assam respectively are in profit (NAFSCOB, 2012-13). Interestingly, in the two states the number of tiers didn't seem to matter to the performance of the PACSs.

With a weak base tier it is a matter of time before the higher tiers get affected. In several states the middle and apex tier cooperative banks are weak and cannot support the lower tiers. In Maharashtra 14 of the 31 DCCBs are loss making. In some instances, the higher tiers try to insulate themselves from the problems of the PACSs by looking at alternate avenues. For example, the Apex Bank in Assam (Figure 7) lends mostly to non-agricultural sector and invests its funds mostly in safe securities rather than in loans to PACSs. It was forced to adopt this strategy after coming back from the brink of liquidation.

While the strategy ensures that the higher tiers survive and grow as banking institutions, it surely takes these institutions away from their core mandate which is to support agricultural credit and renders them indistinguishable from urban cooperative banks or for that matter any commercial bank.

It is not to say that the poor performance of the PACSs alone is responsible for the weakness of the higher tiers; mismanagement, poor business decisions, misappropriation etc are some of the other contributing factors.

Due attention needs to be paid to improving the performance of the PACSs, particularly with respect to recovery of loans and deposit mobilization (Bakshi, Ibid).

### ***2.3.3 District Central Cooperative Banks- Flab or Fab***

There are 370 DCCBs in the STCC structure. Occupying the middle tier of the three-tier STCC structure, the DCCBs are considered a link with the mostly rural PACSs and the largely urban SCBs.

The DCCBs were put in place to service the lending requirements of the primary cooperatives, in particular of the PACSs, which could not be completely met with the PACSs' own funds. The DCCBs are required to play both promotional and supervisory role vis-à-vis the PACSs. As banks, regulated under the Banking regulation Act, 1949, the DCCBs can mobilize deposits from general public as well as undertake banking functions such as borrowing from the SCBs for on lending to PACSs as well as to individual members.

Of the four study states, only Assam had no DCCBs owing to two-tier structure. According to NAFSCOB data (2012-13) there are total of 13655 branches of DCCBs in 19 states. There were a total of 3915657 members of which 3345428 i.e. 86% were individual members while the remaining were primary societies. However, there are significant variations in this trend across the 19 states. The Pune DCCB covered in this study had discouraged individual membership since 1972 and as a result its share of individual members is less than 22%. This holds true for the entire state of Maharashtra where the primary cooperative societies (84%) outnumber individuals in the DCCB membership. Uttarakhand had less than 5% individual members in DCCB. Karnataka, however has almost 78% of individual members in DCCBs.

On this issue of allowing individuals to be members of DCCBs, there is no consensus among experts. Interestingly, committees like the Maclagan Committee (1915), formed in the early years of cooperative movement, were not in favour of individual membership in DCCBs.

Later committees like The Rural Credit Survey Committee supported individual membership as a stop-gap arrangement till primary cooperatives were established in the area.

The DCCBs lend in short-term and medium-term to both agriculture and non-agriculture sectors. In FY 2012-13, the ratio of agricultural lending to total lending by all the DCCBs in the country was only 50.19%. This is significantly lower than the ideal share of 70% recommended by the expert committee on ST CCS. The committee had even recommended that any cooperative bank that lends less than 15% to the agriculture sector should be treated as urban cooperative bank.

As mentioned earlier in the section, the relevance of the middle tier has been questioned as it is seen as adding to the cost of business and competing with the primary societies that it is expected to support. In Maharashtra, the technologically and professionally superior DCCBs with their large branches are reportedly operating in the 'backyard' of PACSs. It is not clear if the DCCBs are filling a vacuum or if they are the reason behind lack of deposit mobilization by PACSs. While in Assam, the present two-tier structure has been the result of gross inefficiencies and mismanagement at the DCCB level. Either ways, it seems the DCCBs role in supporting the primary cooperatives have mostly been sub-optimal so far.

However, post Vaidyanathan committee recommendations and the revival package, DCCBs have been assigned the responsibility of strengthening the PACSs and funds for the same are being routed through the former and through the SCBs in the two tier system. The Pune DCCB has since set up a 'Vaidyanathan cell' which has identified 223 PACS for capacity building mainly in the area of business development planning that will enable the latter to diversify their activities including into non-financial sectors. In addition the DCCB also has a PACS development cell that is currently supporting 30 PACS in the above areas. The cost of capacity building is reimbursed by NABARD. In Assam, the SCB has with support of NABARD, identified 50 PACS to be provided with ATMs. One ATM will be provided in a cluster of ten PACS.

Notwithstanding the recent efforts supported by special funding, the 'developmental' role of the higher tiers in supporting PACS does not seem to be significant. On the contrary there appears to be a lack of trust in the ability of the PACS to undertake financial and non-financial activities, which has influenced decisions at DCCB and SCB levels, particularly in Maharashtra and Assam.

The Pune DCCB as well as the Assam SCB form and lend to SHGs directly. The reasons reported were 'lack of capacity' and 'lack of interest' at PACS level. However, in Karnataka, the PACS and DCCBs appear to have a better and more mutually beneficial relationship.

It would appear that the pressure of remaining viable banking institutions and following prudential norms coupled with poor recoveries at PACS level on the one hand and improving demand in non-agricultural sectors on the other, have nudged the DCCBs to focus less on PACS.

### ***2.3.4 The State Cooperative Banks- The Apex of the multi-tier system***

The SCBs, popularly known as APEX banks occupy the top of the federated cooperative structure. There are 31 SCBs in the three-tier system and 13 in the two-tier system. In Assam, the three-

tier structure was converted to two-tier in 1979 due to the poor performance of DCCBs. All the states in the North-east as well as smaller states like Delhi and Goa along with Union territories like Chandigarh and Andaman & Nicobar have two-tier structures. There were 1081 branches of state cooperative banks at the end of FY 2012-13. The membership of the SCBs doubled in the period from 2008 to 2010 and declined by almost 30% the following year (2010-11) and a steady increase bringing the total membership in 2012-13 to the level it was in 2009-10.

The total deposits in the state cooperative banks stood at Rs 89,905 crores at the end of FY 2012-13. The deposits have more than slightly doubled since 2003-04. The fixed deposits account for about 80% of the deposits by type while by source deposits by cooperatives account for almost 70% of the deposits.

The total loan issued in FY 2012-13 stood at 89961 crores, which is slightly higher than the total deposits with the SCBs. The loans have increased by more than 2.5 times in the period since 2003-04. The overdues to demand have steadily decreased from 2003-04 till 2006-07 and spiked to its highest levels in 2007-08. There was a sharp reduction in the following year and steady decline till 2011-12, the year it registered its lowest level. However, the percentage of overdues to demand has shot up again in FY 2012-13.

The state cooperative banks have been set up primarily to meet the credit needs of DCCBs and PACS. The banks supervise the functioning of DCCBs (Three-tier) and PACS (Two-tier). However, in some states like Assam, the share of credit to PACS in the total lending of the apex bank is less than 10%. The scenario is similar for most of the North-eastern states.

All except three state cooperative banks reported profits in the year 2012-13. Interestingly the state cooperative bank in Kerala was one of the loss making ones. This is in sharp contrast to good performance of the PACS in the state. It is also in contrast to situation prevailing in states like Maharashtra and Assam where the PACS are loss-making but higher tiers like DCCBs and SCBs are in profit.

### ***2.3.5 Urban Primary Cooperative Banks***

Urban Primary Cooperative Banks, popularly known as UCBs, are primary cooperative banks located in urban and semi-urban areas. In contrast to the rural three-tier structure, these operate independently although they are loosely integrated into the higher financing agencies, such as DCCBs and SCBs. The status of UCBs, registered under the Multi State Cooperative Societies Act, in the cooperative structure is not well defined. They are neither linked to any DCCB nor SCB on account of their presence in more than one state.

A few variations of this structure emerged in the field study. In Uttarakhand, UCBs have formed the Federation of UCBs for lobbying and also for cooperation among other UCBs. In other states, UCBs are represented on the board of directors of many DCCB, like the DCCB Bidar discussed in Figure 6 and DCCB Pune. The Board of Directors (BoDs) of the DCCB Bidar as well as Pune include representatives of non-financial cooperatives.

### ***2.3.6 Issues with the Indian Three-tier System***

A few issues with the Indian three-tier system stand out. Firstly, the competition existing

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### Figure 5

#### **Pratamika Krishi Pattina Sahakara Sanghas Niyamit, Nagora and Gadgi**

The PACS in Nagora, established in 1975, and the PACS in Gadgi, established in 1976, are both members of the DCCB Bidar, with which they have a synergetic relationship. Currently, the former serves 667 regular members in 4 villages and the latter 908 regular members in 13 villages. Both PACSs offer the same the financial products – which are selected by the Bidar DCCB – and similar non-financial services. The types of loans offered are: short term crop loans (at 10.75% interest rates – paid by the state government when payment is made on time), medium term loans (at 14.75% - of which 11.75% is a subsidy from the state government) for agricultural infrastructure, and business development loans (16%). The societies also offer savings, recurring deposits, and term deposits. They both also operate a PDS dealership and provide marketing services. The Gadgi PACS also operates a godown.

The societies support the Bidar DCCB's financial inclusion agenda. For example, they facilitate bank loans to SHGs by reviewing applications for loans, recommending SHGs for lending to the DCCB, and collecting payments. The societies also support their own members and individuals from the affiliated SHGs in opening bank accounts with the DCCB.

Further, the societies have also implemented a performance measurement system, designed by the DCCB to review the performance of staff members. The Deputy General Manager (DGM) of the DCCB reviews the performance of each PACS and its Secretary. The Secretary reviews the performance of the team and reports the results to the BoD. The staff salaries and incentives are linked to their performance.

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between the tiers defeats the purpose of a multi-tier system. The advantage of such a system would be economies of scale, with higher tiers providing wholesale services to lower tiers. However, in India, SCBs often serve the same individuals and cooperatives as the DCCBs and to some extent, those that PACSs seek to serve as well. As Dave Grace, the former vice-president of the World Council of Credit Unions (WOCCU), pointed out in an article on the cooperative system in India, “a well-developed system of trust and support has not been and cannot be established within such a competitive environment” (2008). In the Report of the Expert Committee to examine the Three Tier ST CCS (2013), the RBI also confirmed the existence of competition in deposit mobilization between the tiers.

The field study further confirms the existence of competition. Many experts in Maharashtra noted that branches of DCCBs are often located next to PACSs' and directly mobilize deposits in the same areas. The Pune DCCB alone has more than 260 branches. As a result of this competition, most DCCBs in the state are profitable while PACSs are weak and do not engage in deposit mobilization. The study also revealed that the relationship between the tiers varies; in some cases, even synergetic, as for the DCCB Bidar and its PACS in Nagora and Gadgi (Figure 5).

Additionally, the distinction between urban and rural banks has been blurred. Due to urbanization, many PACS are currently located in urban or semi-urban areas and cater to rural clientele. This is the case for Ajabpur Primary Agricultural Society, Uttarakhand (Figure 11). The earlier-mentioned Report of the Expert Committee has also found that some DCCBs

and the SCB consistently provide less than a 15% share of the agricultural credit in the operational area. Further, SCBs in the North-Eastern Region as well as in smaller states and union territories like Delhi, Goa, Chandigarh, etc. provide insignificant credit to agriculture and only cater to the requirements of the urban population. Policymakers, then, should determine whether existing barriers need to be removed in order to allow fair competition or whether truly re-enforcing tiers should be reinstated (Grace, 2008).

Another significant issue is the redundancy in the three-tier system. In the words of the above-mentioned Report, "The prevalence of the three-tiered structure leads to an increase in transaction costs that diminish profit margins." The existence of a third tier at the state level is unusual outside of India; in most countries, the third tier typically only exists at the national level. In India, the considerations of logistics and supervision have outweighed those of increased cost of transaction keeping the three tier structure of cooperatives in place, particularly in larger states.

Only 44% and 42% of the PACS in Maharashtra and Assam respectively are in profit (NAFSCOB, 2012-13). Interestingly, in the two states the number of tiers didn't seem to matter to the performance of the PACS.

With a weak base tier it is a matter of time before the higher tiers get affected. In several states the middle and apex tier cooperative banks are weak and cannot support the lower tiers. In Maharashtra 14 of the 31 DCCBs are loss making.

In some instances, the higher tiers try to insulate themselves from the problems of the PACS by looking at alternate avenues. For example, the Apex Bank in Assam (Figure 7) lends mostly to non-agricultural sector and invests its funds mostly in safe securities rather than in loans to PACS. It was forced to adopt this strategy after coming back from the brink of liquidation.

While the strategy ensures that the higher tiers survive and grow as banking institutions, it surely takes these institutions away from their core mandate which is to support agricultural credit and renders them indistinguishable from urban cooperative banks or for that matter any commercial bank.

It is not to say that the poor performance of the PACS alone is responsible for the weakness of the higher tiers; mismanagement, poor business decisions, misappropriation etc are some of the other contributing factors.

However, due attention needs to be paid to improving the performance of the PACS, particularly with respect to recovery of loans and deposit mobilization (Bakshi Ibid).

The fact that most of the large states have three-tier structure (Except Assam) and smaller ones, two-tier indicates that logistics and geographic spread were a main consideration given that most of the structure was put in place at a time of poor communication infrastructure.

However, there are weaknesses at all levels in the structure which varies from state to state. Except for the southern region, most of the PACS elsewhere are weak. The DCCBs and SCBs show profit in most of the states but in an exception the apex bank reports losses in a state where the PACS are profitable. These two situations taken together appear to suggest

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**Figure 6**  
**DCCB Bidar**

The DCCB Bidar, formed in 1922, currently covers 622 villages in Bidar through its network of PACS. It is also linked to 22,419 SHGs in the district with a total membership of over 3 lakhs. Its membership has recently reached 385 societies (of which 171 are PACS). Other member cooperatives include fishing and marketing societies. Of the 223,530 farmers members of PACS associated with the DCCB, 13% are from SC/ST. In addition to offering a wide range of credit and savings products, the DCCB also offers non-financial services, such as free-of-cost skill training for rural youth (under this program 9,540 youth were trained in one of the 36 trades offered). There is also a PACS development cell in the DCCB that focuses on the “Business Promotion” within PACS. The cell conducts market studies to identify emerging needs, explore new possible roles for member PACS and identify earned income avenues for PACS. As a result of the above initiative, the DCCB has identified and supported PACS to launch projects for leasing of tractors, constructing/renting out commercial buildings and bottling of drinking water. While achieving significant outreach to the poor in a remote and underdeveloped district, the DCCB Bidar is also able to be profitable. The past year’s net profits amounted to 5.55 crores, after increasing from year to year, and its reserve at year-end were 112.25 crores, including a reserve for bad debt of 48.5 crores.

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**The three-tier structure and the rural-urban distinction creates several problems:**

- Competition among cooperatives at different levels as they serve the same clients.
- Blurred distinction between rural and urban cooperatives.
- Increased transaction costs and reduced profit margins.
- Low overall efficiency of the cooperative credit system.
- Weak middle and high tier institutions (in some cases).

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**Figure 7**  
**Assam Apex Bank**

The Assam Apex Bank, established in 1948, is the only high-tier cooperative bank in the state, where there is a two-tier system. The cooperative faced many financial difficulties in the past, almost losing its banking license in 2006 and being prohibited from accepting deposits for 2 months in 2010. These symptoms of financial difficulty emerged from earlier problems, including over-lending to selected organizations and lacking due diligence.

Currently, the Apex Bank is on the path of improving its financial health and management. However, it continues to be weak in terms of anchoring and guiding the cooperative movement in the state. Now, exceedingly risk averse, the Apex Bank invests its funds in low-risk financial instruments (about Rs. 1,700 crores), rather than lending to the base tier (less than Rs. 286 crores). It also fails to support cooperatives through non-financial means, such as through capacity building support or ensuring regulatory compliance of PACSs.

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that the one to one correspondence between relative performances of different layers is not as strong as it may seem within a certain period of time.

This could be due to lending avenues other than agriculture sector available for the higher tier cooperatives (Assam, Maharashtra), strong recovery by DCCBs but poor recovery by PACS (Maharashtra) on the one hand that yields scenarios like weak PACS-profitable higher cooperatives. On the other hand self-sufficiency at primary levels/lower tiers due to deposit mobilization and diversified businesses could weaken the dependence on the higher tiers leading to Strong PACS/DCCBs-weak apex (Kerala).

The short-term federal cooperative structure was established primarily to provide agricultural credit, particularly to small and marginal farmers. However the share of the cooperatives in agricultural credit at present is less than 17%. The decline has been rather sharp in the two decades since 1992-93 when it had a share of 64%. This decline seems to coincide with the decline in the share of agriculture in the GDP, liberalizing of the economy, and spread of commercial banks in rural areas.

## **2.4 | Cooperative Training Institutions**

The cooperative sector in India has several institutions for capacity building of cooperatives at each level. At the apex level the National Council for Cooperative Training (NCCT) has the overall responsibility for guiding and managing the training in the cooperative sector. The objective of the council is to facilitate the process of human resource development for cooperatives in the country.

The training institutions in the cooperative sector exist and function at different levels. At the national level, the Vaikunth Mehta National Institute of cooperative Management (VAMNICOM) is responsible for training senior office bearers and top functionaries in the cooperative sector including those in the cooperation departments at state and national level. There are five Regional Institutes of Cooperative Management (RICM) located strategically in northern (Chandigarh), southern (Bangalore), western (Gandhinagar) and eastern (Patna and Kalyani, West Bengal) regions of the country. These institutions have the mandate to cater to the needs of the middle to top level cooperative functionaries from the states in the region.

Further, there are 14 ICMs. Almost all the institutions cater to more than one state, for instance ICM Pune also caters to the training needs of the cooperatives in Goa while the ICM in Guwahati caters to four states in North East. There are two ICMs each in Maharashtra and Kerala.

The NCCT has full and direct administrative control over these three categories of cooperative training institutions. These institutions are guided by management committees appointed by the NCCT. These committees consist of eminent corporates, administrators, academicians, bankers and management experts.

In addition to the above three categories of training institutions in the cooperative sector, there are 109 Junior Cooperative Training Centres (JCTCs) in 29 states (see table below). The number of centres varies from state to state. Tamil Nadu has the highest number

**Table 4: State-wise Training Centres**

| STATE             | No. of Training Centres | STATE         | No. of Training Centres |
|-------------------|-------------------------|---------------|-------------------------|
| Andhra Pradesh    | 6                       | Manipur       | 1                       |
| Arunachal Pradesh | 1                       | Meghalaya     | 1                       |
| Assam             | 1                       | Mizoram       | 1                       |
| Bihar             | 1                       | Nagaland      | 1                       |
| Delhi             | 1                       | Orissa        | 5                       |
| Goa               | 1                       | Pondicherry   | 1                       |
| Gujarat           | 6                       | Punjab        | 1                       |
| Haryana           | 1                       | Rajasthan     | 1                       |
| Himachal Pradesh  | 2                       | Sikkim        | 1                       |
| J & K             | 3                       | Tamilnadu     | 20                      |
| Jharkhand         | 2                       | Tripura       | 1                       |
| Karnataka         | 8                       | Uttaranchal   | 1                       |
| Kerala            | 10                      | Uttar Pradesh | 7                       |
| Madhya Pradesh    | 5                       | West Bengal   | 6                       |
| Maharashtra       | 13                      | Total         | 109                     |

of JCTCs (20) followed by Maharashtra (13) and Kerala (10). These centres expected to provide training to staff of the various cooperatives in the state/districts/blocks. The JCTCs are funded by both the central and state governments in the ratio of 50:50. The NCCT provides support to the JCTCs in the area of course design, library and classroom facilities, faculty development, pedagogical aids etc. The NCCT is also responsible for monitoring and evaluation of the training programs of the JCTCs through the Directors of the RICMs and ICMs who have been designated as the nodal officers. However, the administrative control of the JCTCs reportedly rests with the state government.

#### **2.4.1 VAMNICOM's Mandate and Role in the Cooperative Sector**

VAMNICOM was set up in 1967 to train professionals in the cooperative sector and as part of its mandate, operates a 36 week Diploma in Cooperative Management (DCM) for the officers and board members of the cooperatives, cooperative departments and allied sectors. The participants are not only limited to India but also come from countries in South Asia and Africa. The participants are sponsored by their respective institutions.

Since 1993, VAMNICOM also runs a two-year Post Graduate Diploma in Management (PGDM) (Agri Business Management). This program is aimed at graduate students and seeks to meet the increasing requirement of professional managers in the Agri business sector. The PGDM programme is recognized by the All India Council for Technical Education (AICTE), Government of India and is recognized by the Association of Indian Universities (AIU). Presently, the PGDM program appears to have become a mainstay of VAMNICOM.

The curriculum of the programme is a mix of few subjects related to agriculture marketing and cooperative management together with subjects related to mainstream management. The graduates of the institute find placement in institutions ranging from corporate, quasi-government, Banks, NGOs that have a strong rural or agriculture and allied focus. AMUL, Mahyco seeds, NABFINS, Chambal Fertilizers, SUGUNA foods, Friend of Women's World Banking, Ratnakar Bank, Spencers, National Commodity and Derivatives Exchange Ltd. (NCDEX), Mahindra Rise are reported to be some of the recruiters of the institution's students. The two-year programme currently charges a fee of Rs 6.5 lakhs per student. The course contributes a big share to the institution's finance and the institution accords a high priority to keeping the course attractive for potential students to apply <sup>5</sup>.

On the other hand, VAMNICOM also seems to be playing a major role in the cooperative sector in the South Asian region through the Centre for International Cooperation in Agriculture Banking (CICTAB). The CICTAB was set up on the suggestion of the Food and Agriculture Organisation (FAO) by the Ministry of Agriculture, Government of India. Originally conceived as a sub-regional centre for Nepal, Bangladesh, Sri Lanka and India, CICTAB's scope was expanded to include Bhutan and Maldives. The centre's role is also envisaged as providing a platform for experience sharing for developing countries in Asia and Africa. This area is also getting a lot of attention within the institution's decision making as it brings regional visibility and raises the profile of the institution.

However, given the attention of the institute on the above two focus areas, the question arises whether it leaves sufficient resources for the institution to focus on its national mandate for the cooperative sector? There may also be a danger of the original focus of the institute getting diluted.

VAMNICOM has six centres within the institution. These are Centre for Cooperative Management (CCM), Centre for Management Education (CME), Centre for Information technology (CIT), Centre for Gender studies (CGS), Centre for Research and Publication (CRP), Management development Centre (MDP). The CME manages the academic PGDM programme while the CCM manages the cooperative training programme including those for international participants.

The CRP is a recognized consultant of Government of India for evaluating women's dairy projects in the country. Besides, the centre is also recognized as a centre for conducting doctoral research by Pune University.

The responsibility centre approach of VAMNICOM where the different internal centres are entrusted clear responsibilities appears to be a good mechanism that helps the institution in managing different functional areas and priorities.

The cooperative training infrastructure in Maharashtra includes two ICMs, one located in Pune and another in Nagpur and 13 JCTCs.

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<sup>5</sup> This kind of professional programme is proposed in the recommendations for other institutions in cooperatives sector, and is included in the recommendations.

### **2.4.2 Institutes of Cooperative Management**

The two ICMs in the state are located in Pune and Nagpur respectively. The ICM in Pune currently operates out of rented premises that appear to be inadequate for their purpose. This setting stands in sharp contrast to the modern infrastructure and well-staffed campus at VAMNICOM, the central institution for cooperative training, also located in Pune. However, the institute claims to have a good library and computer lab.

The ICM's training targets are received from the NCCT in New Delhi. The ICM caters to the training needs of all employees and board members of the cooperatives in the states of Maharashtra and Goa. It also trains the newly appointed registrars and assistant registrars, who must undergo training for audit of 6 months and 3 months, respectively.

Following the Vadiyanathan committee package, the ICM has partnered with the DCCB for trainings at the taluka level. The ICM also conducts need-based training programme for 3 months (diploma) and 6 months (higher diploma) duration.

The ICM has a Local Management Committee (LMC) for supervising the academic and administrative activities of the institution. The LMC is constituted by the Chairperson NCCT in consultation with the State Government and the State Cooperative Union (SCU) or the Maharashtra Rajya Sahakari Sangh. The Chairperson of the SCU is generally nominated as the Chairperson of the LMC. The LMC also has representation from the Maharashtra State Cooperative Bank (MSCB) as well representatives from cooperative sector in Goa. The present chairperson of the LMC is from Goa SCU who is also a member of the governing council of the National Cooperative Union of India (NCUI). Since the SCU is under the regulatory control of the Registrar of Cooperatives of the state government, the state exercises some sort of control through the SCU on the ICM and the JCTCs.

The ICM Pune like all other ICMs runs a Higher Diploma in Cooperative Management (HDCM). For the cooperatives and departments that cannot afford to send their participants for the higher diploma course, the institute runs a correspondence HDCM. The ICM also runs sectoral diploma programmes (12 weeks) in different areas of cooperative management like Diplomas in; Cooperative audit, Marketing Management, Legal aspects of Cooperative Banks etc as well as short-term training programmes (1 to 5 days duration) for different functionaries in the cooperative system.

However, it was reported that the participation from the PACS in the ICM training programmes is much less than desired. It is possible that the financial weakness of the PACS in the state could be a probable reason.

### **2.4.3 PACS Development Cells**

The Pune DCCB has two cells working on the development of PACSs: the Vaidyanathan Cell and the PACSs Development Cell.

The Vaidyanathan Cell identified 223 PACSs out of 1,281 in Pune district for development under the revival package. After the cooperative elections, scheduled for May 5, these PACSs will be supported in non-financial businesses like drip irrigation, photocopying facilities,

fertilizer dealerships, gas agencies, and warehousing. To support the PACSs, the DCCB will offer training to 400 pre-selected participants on conducting surveys in villages to identify business opportunities, need assessments, and developing business development plans.

The PACS Development Cell, with the support of NABARD, has identified and is supporting 30 PACSs, 6 of which have started new businesses.

#### **2.4.4 Assessment of the Cooperative Training Institutions**

An overview of the cooperative training institutions reveals that while an integrated structure exists, and some institutions have professional training programmes highly acknowledged by the sector, others have inadequate infrastructure to fulfil their large mandate. A greater market orientation is needed, along with significant investments to upgrade the infrastructure of the institutions as well as their management and the type and quality of programmes offered.

## **2.5 | Providing a Positive Enabling Environment to Indian Cooperatives**

The major criticism of the cooperative regulations in India has been that they overlap, requiring compliance from cooperative banks of both state laws and national laws. However, even with overlapping regulation, the supervision is wanting, with both state infrastructure and RBI supervision being weak at best. As members are currently unaware and unable to exercise control over cooperatives, the government has been given a supervisory role. However, there is another view emerging, that government refinance and supervision should give way to market finance and control (Mor, Ibid, p 169). The cooperative sector regulations need to be streamlined, and implemented well, and the cooperative department needs to build the capacity for oversight and regulation.

Financial cooperatives have been promoted in India largely by the state, with an intention to offer cheap agricultural credit to farmers. This attitude has stayed over the years, and cooperatives have never been viewed as viable sustainable business organisations, and democratically managed community based microfinance institutions. This lack of business approach has prevented the cooperatives from becoming viable and self-reliant, vibrant business organisation. At the same time, cooperatives have very large outreach to members, and the potential for high outreach as well. They need a positive enabling environment, wherein the legal framework, supervising and regulating agencies trust them as organisations, and provide supervision and regulation, but do not supersede and control. The cooperative department needs an upgradation if it is to perform its role of promoting the sector. Cooperatives also continue to need significant capacity building inputs. The detailed recommendations towards strengthening the institutional structure and creating a positive enabling environment are given in Chapter 6 of this report.

# 3

## The Ground Reality of Cooperatives in India

The expectation of cooperatives as democratic and equitable organizations leads us to demand support for their proliferation and autonomy. We now turn to examine the ground reality of cooperatives in India, and whether this policy model has been realized in practice, or whether there are issues and concerns that need to be addressed by policy makers and stakeholders of the cooperative sector. In order to do so, we examine the evidence emerging from an assessment of the cooperatives in the four states, and discussions with a wide range of institutions.

### 3.1 | Membership of Cooperatives

An investigation of membership rules revealed some surprising insights in regards to the benefits available to members and client and to the requirements for membership.

#### 3.1.1 Benefits Available to Members and Clients

Members of cooperatives have voting rights, have access to the full suite of the cooperative's services, and have a rightful share of the profits of the cooperative as dividends.

Non-member clients only have access to a subset of the cooperatives' services and do not have voting rights or a share of dividends. The services made available to non-member clients vary by cooperative and state, and often depend on the state's regulation. For example, while borrowing is typically reserved for members, in Karnataka non-member clients can avail of certain loan products. Surprisingly, cooperatives in Uttarakhand are allowed to mobilize deposits from non-member clients – unlike in most other states.

In some states, cooperatives offer different levels of memberships. In Assam, for example, some cooperatives offered A-class and B-class memberships. In Karnataka, only regular members have access to all the benefits of the cooperative. Instead, associated members (also known as nominal members) have access to all services but do not have voting rights or a share of the dividends. The difference between non-member clients and associated members is that clients have access to fewer services.

While providing services to non-members conflicts with the character of cooperatives<sup>6</sup>, it also allows cooperatives to be more inclusive by providing financial services to more individuals. It also makes them financial viable.

#### 3.1.2 Requirements for Membership: Exclusive Inclusion

The study team found that in Karnataka, a requirement for regular membership in a PACS is land ownership, excluding from the cooperatives' membership those who are joint landholders, farmers not having a formal title to their land, and non-farmers living in rural areas (including agricultural laborers)<sup>7</sup>.

<sup>6</sup> By restricting memberships to a selected few individuals while providing services to non-members, cooperatives can become corporations in character and cooperatives by name.

<sup>7</sup> Legally, the title of the land would be in the name of the father, but after his death, it may be inherited by all the sons and each one of them appropriate a portion of the land for cultivation without going through the legal process of land ownership transfer. The bank recognizes only the title and the title holders and hence others are not able to become members of the PACS.

In Assam, one cooperative allowed only one member per households to receive an A-class membership, while additional household members could only receive B-class memberships. This practice introduced an unintentional gender bias in the allocation of membership, resulting in mostly only men receiving A-class membership.

For cooperatives to have a meaningful role in financial inclusion, membership requirements must be less biased and restrictive. This is further elaborated in the recommendation section.

## **3.2 | Member Involvement and Governance**

This section examines how cooperatives function as community based microfinance organisations, by assessing member participation in decision making, leadership issues, political and government's interference in cooperatives and instances of fraud in cooperatives.

### **3.2.1 Members' Involvement in Decision Making**

Involvement of members in decision-making in cooperatives is an important principle of cooperative management, signifying its member orientation and member-ownership.

The study found that members' participation in cooperatives varies by state, tier, and cooperative. According to stakeholders, in Maharashtra, members tend to be detached from the cooperatives' decision-making process. Instead, in states like Kerala, cooperatives are largely member-driven. This study's case studies in Assam showed a mixed picture: while some cooperatives appeared detached from their constituency, the case of the Duar Bagori Multipurpose Credit Society (Figure 8) illustrates initiative by the members.

### **3.2.2 Leadership as a Critical Determinant of Success**

The stakeholders reported that except in a few cooperatives, leadership in the financial cooperative sector is lacking. For instance, in Maharashtra, it was alleged that leaders of cooperatives are often primarily concerned with propagating their control over cooperatives and protecting family interests. While this is the prevailing view, the study did find several cases of good practice among cooperatives at each level, as reported in this study.

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**Figure 8**

#### **Duar Bagori Multipurpose Credit Society**

The Duar Bagori Multipurpose Credit Society Ltd was established in 1973 with 150 members in Kathuri village, in Assam. It was initially mostly involved in providing credit and acting as an agent for the PDS, but later expanded to more activities: petrol pump business, fertilizers distribution, seed production, and warehousing. These activities allowed the cooperative to be financially successful and continue to provide credit to its members. This success in meeting its customers' needs for credit and maintaining financial viability received the attention of the cooperative department.

In 2012, when the department was forming a federation of cooperatives – the Assam State Cooperative Federation (ASCOF), it requested the above society and another cooperative society to assist by taking the concept to other PACSs and convincing them to become members of the federation. The Society's involvement in ASCOF illustrates that success gives voice to cooperatives and their members.

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**Figure 9**  
**Composition of the Board of DCCB, Pune**

The Pune DCCB was established in 1917, after the Cooperatives Act of 1904 was amended in 1912 to permit formation of central societies (Gaikwad 2011). Currently, the bank operates 260 branches in the district and serves 8,944 societies and 2,513 individual members.

The Bank is governed by a Board of Directors with 21 members, including two professional directors. One director is chosen from each of the 13 blocks in the district to represent PACS. In addition to these seats, one seat is reserved for a director belonging to Scheduled Castes, Scheduled Tribes, and Special Backward Classes. Two seats are reserved for women on the board. Further one director is selected to represent each of the following categories: agriculture processing and marketing societies; UCBs; and other cooperative societies like housing, labour, irrigation, consumer societies.

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The board membership is an important indicator of leaders of the organisation, and the election process of many cooperative banks calls for diversity. Figure 9 illustrates the election process for directors of the Pune DCCB.

Some of the well-managed DCCBs have a pattern of board membership that includes representation from different geographical regions covered by the DCCB, from caste groups, women, and professional directors. Board positions are also voted by members of agriculture processing and marketing societies; UCBs; and other cooperative societies like housing, labour, irrigation, consumer societies<sup>8</sup>.

The success of Bidar's cooperatives in serving low-income individuals can be attributed to the leadership of the current Chairman of the DCCB Bidar, Karnataka, which is known for an effective turnaround in profitability and outreach. The Chairman has a strong political background (4 times MLA and 2 times MP) and is also accepted by the PACS' members as a dynamic leader with vision. The DCCB was therefore able to encourage PACS to increase deposit mobilization and thereby reduce the dependence on the government's share capital. The chairman used its political background to avoid interference from the government and focus on the development of the cooperative.

Many of the successful cooperatives studied featured strong leaders – such as Ms. Ratna Kushumur of the Bidar Mahila Urban Co-operative Bank, Ms. Chetna Vijay Sinha of the Mann Deshi Mahila Sahakari Bank, Ms. Medha Sawant of Annapurna MSCS and Ms. Lakhimi Baruah of the Konoklata Mahila Urban Cooperative Bank.

These cases show that good leadership can be impactful.

### **3.2.3 Common Instances of Fraud**

The states' cooperative departments reported multiple instances of fraud; especially by MSCSs. Further, the lack of oversight of self-reliant cooperative allows frauds to remain undetected.

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<sup>8</sup> An example is from Pune DCCB which has a diversified board. It is uncertain if all DCCBs have a similar pattern of constitution of their boards.

In response to this issue, the state cooperative department and DCCBs in Uttarakhand have set up a risk fund so that depositors can receive compensation of up to Rs. 8,000 in case of fraud by PACS. While this enables cooperatives and their depositors to benefit from deposit insurance, the amount insured is significantly less than in the case of banks, which is Rs. 100,000 per customer.

### **3.2.4 Inadequate Professional Staff**

Various stakeholders have pointed out that a lack of professionalism is a major issue in the cooperative sector. As a result, staff makes inadequate decisions and reporting. Further the heavy workload on the secretaries of cooperatives, as in Maharashtra, who often manage multiple cooperatives, impacts their ability to perform their work adequately. This shortcoming is the result of the poor financial capacity of PACS, which cannot hire a dedicated secretary. The cooperatives, fail to attract young professionals.

The lack of professionalism and professional staff is also attributed to the key posts in cooperatives being filled by the kith and kin and acquaintances of the leaders of cooperatives. This practice allows the management to stay concentrated in a few hands, instead of being broad based. This along with lack of Human Resource (HR) policy and poor pay package is also attributed as reasons for the failure of the cooperatives, particularly those that are part of the 3-tier or 2-tier structure, in attracting fresh talent. These are staffed mostly by people who have retired from active employment elsewhere. The recruitment to key positions in cooperatives needs to be objective and professional.

Further, the key cooperative staff, such as secretaries, needs rigorous training, While such trainings are offered by the cooperative training institutions, their design does not suit the needs of the secretaries of cooperatives. There is serious mismatch in many of the training topics and programmes designed by cooperative trainings institutions, and those that the cooperative staff can use.

### **3.2.5 Political Interference**

Another reality of cooperatives is that they are often prey to political ambitions of their leaders, as cooperatives have formed the foundation stone for many political leaders to establish their base and further their political careers. While this was not directly evident in all the cases studied for this report, many key informants referred to this trend.

On the one hand there is significant government control, on the other hand, there is the feature of significant influence of a few individuals over the cooperatives and related networks of support institutions.

In Assam and Maharashtra, a few powerful political leaders control the cooperative network. Politicians have often used the government's share capital to exercise control and then use the cooperatives for their own agendas, influencing appointments and advances. Frequently, cooperatives are forced to loan to particular constituencies without performing due diligence, resulting in bad loans that are later written off. In Assam, political control resulted in the closure of a successful cooperative sugar mill in Golaghat. In the case of Konoklata UCB

(see Figure 18), attempts of political interference slowed down the cooperative's registration process. The bank did however, successfully withstand pressure from some politicians to appoint staff.

Also in Uttarakhand some individuals wield significant power. For example, the long time chairman of the Uttarakhand Cooperative Federation is also the chairman of the ICM, and a member of International Farmers Fertilizer Cooperative Limited (IFFCO) and other national cooperative bodies, wielding significant influence across these institutions. While it is common to have some leaders controlling several organizations, it does make these organizations vulnerable to being used to serve individual interests, especially in the absence of institutionalized good governance practices. In Uttarakhand, government placed directors, having a dual role of state and cooperative employee, often serve their own interests. Further, in Uttarakhand, other special interests, such as those of fertilizer agencies, also influence cooperatives' decisions.

The evidence from the cooperatives in the study showed that the mere fact of political linkages of leaders cannot *per se* be considered negative, as many such leaders have used their influence to advance the interests of the cooperative. More research is needed to see whether the influence of a few politically linked leaders of cooperatives has an overall positive or negative impact on the performance of the cooperatives.

### **3.2.6 Government Influence and Control (Lack of Autonomy)**

While the rhetoric has been one of extending more autonomy to cooperatives as member managed organizations, the ground reality has been different.

The state government, in many states, uses various ways and means to influence and control the cooperatives in the states, particularly the ones registered under the traditional state cooperative act. In Assam and Uttarakhand, for example, the government often places its own officials to manage cooperatives. In the case of the Dehradun DCCB in Uttarakhand, a high-level employee sees herself as a government officer (even though she is employed by the DCCB) because she ultimately responds to the state's cooperative department. In all four states, cooperatives typically only offer government-selected products and services and require the DCCB's or RCS's approval to provide additional ones. In Maharashtra, cooperatives often seek approval from the RCS for an even wide range of business decisions<sup>9</sup>, including participation in government schemes such as the Jan Dhan Yojana (in the case of cooperative banks). In Uttarakhand, the state is also allowed to establish, fund, and manage a cooperative registered under the self-reliant cooperative act (SRC Act) as in the case of the UMLPCI (Figure 10).

The ground reality is that the government's influence over cooperatives negates the cooperative's autonomy, eroding the cooperative's ability to address the members' needs and overall sense of ownership by the members.

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<sup>9</sup> As explained in the enabling environment, cooperatives often seek formal approval from the RCS even when it is not required by law, as in the case of cooperatives obtaining RTGS/CBS.

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**Figure 10**  
**Uttarakhand Microfinance and**  
**Livelihood Promotion Cooperative Institution**

The Uttarakhand Microfinance and Livelihood Promotion Cooperative Institution (UMLPCI), established in 2008, is a state-government promoted organization registered under the SRC Act of 2003. The board members are Secretaries of various state departments like Rural Development, Forest, Department of Women and Child Development, among others. The government has extended share capital of Rs. 5 crores to the cooperative. Initially, the organization extended loans of Rs. 4 crores to Joint Liability Groups through a partner NGO and Microfinance Institutions. After a few years, per request of the state government, UMLPCI shifted its focus to implement a new scheme promoting self-employment and rural youth.

This use of the SRC Act is surprising: the institution is not a genuine cooperative, even less a cooperative free of government interference. The cooperative has been promoted under a government project and is heavily government controlled. The original intention of the government was to set up a bank like the Grameen Bank of Bangladesh, but as the capital requirements were high, a cooperative was promoted instead.

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This is so even under the SRC Acts in the States, wherein either the cooperatives are state-promoted<sup>10</sup> or they are not permitted to be partners of state-funded programmes<sup>11</sup>.

### **3.3 | Products and Services of Cooperatives**

Cooperative societies offer primarily savings and loan products, which are as follows:

#### **3.3.1 Savings Products**

Deposit services are offered only to members and shareholders, as the Banking Regulations Act allows only member-based organisations to mobilise deposits.

#### **Compulsory Savings**

Financial cooperatives require members to save compulsorily, and this can be enforced in two ways. Members who are sanctioned loans from the cooperatives have to save compulsorily. Cooperatives like the Annapurna Multi State Cooperative Credit Society require borrowers to save 10% of the loan amount upfront and 7-8% of the outstanding principal thereafter, and pay 6% interest on the deposit. Borrowers retain the choice to withdraw their savings on repayment of the loan. The interest rate paid on such deposits can go upto 18% in other states<sup>12</sup>. Nowadays, to increase capital, the borrowing members are required to buy shares of the cooperative instead.

The second way of enforcing compulsory savings is practiced by Eshwara Self Reliant Cooperative in Karnataka, where individual members are required to deposit Rs. 50 every month, and SHGs who are members are required to save Rs. 300. The interest paid is 6%.

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10 Uttarakhand had only one SRC, and it was state promoted

11 In Karnataka, the SRCs are denied partnerships with the Karnataka State Rural Livelihoods Programme as the state has no oversight or control over these cooperatives.

12 The Eshwara Self Reliant Cooperative in Karnataka requires the borrowers to save 10% of their loan amount as a fixed deposit. The annual interest rate is 18% on such deposits.

## **Voluntary Savings**

Besides compulsory savings, the cooperatives also offer voluntary group and individual savings account in which the depositors have the flexibility to deposit whenever they want but have to maintain a minimum balance of Rs. 500. Both types of accounts pay an interest of 4% to the depositors. The cooperatives also offer voluntary fixed and recurring deposits. The interest rate on the FDs is approximately 12% per annum. Senior citizens are typically paid 0.5% higher interest on the fixed deposits.

**Primary Agricultural Societies (PACs)** offer savings, recurring and term deposits for its members. The interest on savings deposits varies from 4-4.5% per annum, whereas the interest on recurring and fixed deposits varies depending on the term of deposits (from 1 to 5 years). Generally the interest on fixed deposits does not exceed 9%.

The **DCCBs** also offer savings schemes for individuals and SHGs (through PACs), recurring and fixed deposits. The PACs can also maintain a current account with the DCCBs. The DCCBs pay 9% on the deposits of the PACs. The FD interest rates vary from 4.5% for 7-14 days to 9.5% for 12 months to less than 2 years. In some cases the DCCBs pay 0.5% higher interest (e.g. DCCB, Uttarakhand) so that depositors prefer them to commercial banks. The DCCBs can invest the amount deposited with them in fixed deposits in other banks and government securities.

The **UCBs** offer savings services at a uniform 4% interest on saving deposits. These saving deposits can usually be opened with a mere Rs. 100 and require a minimum balance of Rs. 300-500. Rs. 500-1000 is required for accounts with cheque book facilities. There are also basic saving account facilities which can be opened with no deposit and have no minimum balance requirement. Recurring deposits for amounts as low as Rs. 50 are also offered by the UCBs with the interest paid ranging from 5.5 to 8.75%. Fixed deposits are offered for periods ranging from 7 days to 10 years. The interest paid differs accordingly and ranges from 3.5 to 9.25%. Senior citizens often get 0.25-0.75% additional interest. Perhaps the most distinguishing feature about the UCBs is that they facilitate daily collections from the doorstep of the individual. The main target group is petty traders and other daily earners. These daily deposits are collected by agents who earn a commission ranging from 2-3.5%. The daily collection is quite large – UCBs can collect Rs. 25000 per day from as many as 500 members. The daily collections vary immensely across states and range from Rs. 5 – 1000. The UCBs are free to design their own unique savings products. For example, the Cooperative City Bank in Assam has a scheme named lakhpati (Recurring Deposit) RD, where Rs.1000 deposited per month for a period of 75 months earns Rs. 1,00,000 at maturity. Premature withdrawal and loan against deposit are permitted under certain terms.

### **3.3.2 Loans**

Loans are offered only to members of cooperatives, or, conversely, all borrowers are required to become members.

**Rural cooperatives** such as Eshwara offer two kinds of loans – General and Specific. General loans carry an interest of up to 18% for SHGs, which further lend to their members at 24%. These loans can be repaid in 15 monthly instalments and the loan size ranges from Rs. 10,000 to 50,000. Specific loans have the similar particulars, except that the loan size

can be up to Rs. 2,00,000. Cooperatives also help their members secure external credit. In the Annapurna Multi State Cooperative Credit Society, borrowers have to form a Joint Liability Group (JLG) of 4-5 people to avail loans. The JLG acts as a group guarantee for the unsecured loans. The level of indebtedness of the borrowers is also assessed before the loan issuance. These loans are given mainly for the small enterprises and businesses.

The credit structure for **PACs** is detailed as follows. Short term agriculture loans for 6-12 months carrying interest ranging from 5 to 10.75%. The interest rate allocation of Ajabpur PACS is described in the table below.

Given the low margins on loans and the considerable risks, the Society limits its loan lending activities and focuses on deposit mobilization. Their deposits are Rs. 58 crores whereas they have given loan of only Rs. 37.13 lakhs (Rs. 3.13 as Short Term Loan and Rs. 34 Lakhs as Medium Term Loan).

In Uttarakhand generally the deposits are more than the loan because of three factors: A large inflow of remittances from those who work out of state (in services, local government services or as migrants to plains); these remittance permit the families to save. Secondly, the bank branches are so few and so far, people save money in PACS. Further, agriculture is of a subsistence nature, and there are no local avenues of credit absorption, limiting the demand for credit for income generating activities.

The **DCCBs** also provide credit facilities. Short term crop loans are provided at interest rates in the range of 4%. The loan products the Dehradun District Central Cooperative Bank in Uttarakhand are as follows:

In Karnataka, the interest cost is borne by the government if the loan is repaid on time. The DCCB, Bidar, charges no interest if the farmers repay the loan amount on time. Otherwise they are charged 10.7% interest.

**Table 5: Interest Rate allocation of Ajabpur PACS**

| Type of Loan            | Interest Rate     |             |                  |                                   |
|-------------------------|-------------------|-------------|------------------|-----------------------------------|
|                         | Charged to Client | PACS Margin | Received by DCCB | Government contribution (balance) |
| Short Term Agricultural | 5%                | 0%          | 9%               | 4%                                |
| Medium Term Allied      | 10%               | 2%          | 8%               | 0%                                |

### Medium Term Loans

Medium term loans are provided for agriculture allied activities such as bore-wells, pipeline, lift irrigation, tractor, drip irrigation, vermi-compost, solar pump sets, sericulture, horticulture, dairy, plantation, etc. Interest rates vary from 3-12.75% per annum depending on purpose and availability of government schemes. Long term loans are aimed at asset creation in agricultural as well as non-farm sectors like handloom, artisanal works, and establishment of plantations etc. Interest rates range from 10.25% to 12.75%. SHG-Bank linkage loans to SHGs at 4% per annum, for a period of 2 years and JLG-bank linkage loans at 4% per annum, for a period of 2 years are offered. Pledge loans for warehouse and godowns are

**Table 6: Dehradun District Central Cooperative Bank's loan products**

| <b>Loan</b>                         | <b>Purpose</b>   | <b>Max Loan</b>  | <b>Interest</b>   | <b>Term and Repayment</b>                                     |
|-------------------------------------|--|--|---|---|
| <b>Crop Loan</b>                    | To farmers for wheat, rice, sugarcane, pulses, ginger, vegetables, herbs etc.,               | As decided by district committee, through PACS in cash and inputs  | 5% up to Rs. 50,000/;<br>5.5% up to 3 lakh loan, and<br>7% on more than 3 lakh loan | Depending on crops in 6 months                                |
| <b>Medium Term Agriculture Loan</b> | Animal Rearing, Poultry, Fisheries, Horticulture etc.,                                       | As per project   | 5% up to Rs. 50,000/-,<br>5.5% for more than 50 K but less than 3 lakh              | Repayment in 5-7 years in six monthly or monthly installments |
| <b>Tractor Loan</b>                 | To farmers for Tractor, Trolley and implements   | 85% of the cost or Rs. 5 lakh whichever is less  | 5.5% annual   | Repayment in 7-10 years in monthly EMIs                       |
| <b>Farmers Home Loan</b>            | To farmers for house construction  | 80% of cost or Rs. 1 lakh whichever is low   | 7% annual   | Repayment in 5-7 years in monthly EMIs                        |
| <b>Durable Consumer Item Loan</b>   | To salaried middle class for TV, Fridge, AC, Furniture, computer, motor cycle, scooter etc., | As per the income up to Rs. 3 lakh annually  | 13% pa  | Repayment in 3-5 years in monthly EMIs                        |
| <b>House Construction Loan</b>      | To construct new house, buy house, repair existing house or to extend it                     | Urban area up to Rs. 20 lakh,<br>Rural area 12 lakh<br>For repairs in urban – Rs. 5 lak, Rural 3 lakh and depending on the cost and income of the borrower | 10% up to Rs. 5 lakh and<br>10.5 % on more than 5 lakhs                             | Max 15 years, in monthly EMIs                                 |
| <b>Vehicle Loan (commercial)</b>    | Small enterprises like autorikshaw, Taxi, Mini Bus, Jeep for taxi use                        | Three times of annual income or 85% of cost or Rs. 6 lakh whichever is less  | 10% up to Rs. 5 lakh<br>10.5 % on more than 5 lakh                                  | Max 15 years, in monthly EMIs                                 |

|  |  |  |   |  |
|--|--|--|---|--|
| <b>Vehicle Loan (personal)</b>                   | Vehicle for personal use   | Equal to 20 months salary or 85% of the cost or Rs. 6 lakh whichever is less                                       | 11% pa up to Rs. 3 lakh, 12% on more than 3 lakh              | Max 5 years, in monthly EMIs after one month                                 |
| <b>Self Employment credit Card</b>               | Handicraft, weaver, artisan, tailor, photography, STD, PCO booth etc.,   | Max Rs. 50,000/-   | 11.5% pa  | Max 5 years  |
| <b>Commercial Loan</b>                           | For Working Capital to businessman   | First year up to Rs. 10 lakhs, depending on the business, profit and repayment etc, Rs. 20 lakh max after that     | 13% up to Rs. 5 lakh, 13.75% on more than Rs. 5 lakh          | One year term  |
| <b>Higher Education Loan</b>                     | For Technical and Professional courses like engineering, medical, MBA, MCA in government approved institutions | 2.5 times of the guardian's annual income or 80% of cost of study or 7 lakh whichever is less                      | 10.2 % up to Rs. 3 lakh, 11% up to 5 lakh, and 11.5% for more | In 60 EMIs after 6 months of the course or one month of placement of student |
| <b>For Tourism</b>                               | For Self Employment of local people in tourism – for vehicles, hotels, guest houses etc.                       | Max Rs. 20 lakhs   | 11% up to Rs. 3 lakh and 11.5% for more than 3 lakhs          | Max 5-10 years in EMIs   |
| <b>Horticulture, vegetables and floriculture</b> | Commercial fruits, vegetables and floriculture   | Depending on project cost up to Rs. 20 lakhs   | 11% up to 3 lakhs and 11.5% for more than 3 lakhs             | Max 5 years in monthly or six monthly EMIs                                   |
| <b>NABARD sponsored schemes</b>                  | Dairy, heifer rearing, milk testing machines and equipments, private veterinary clinics                        | Rs. 5 lakh grants for 10 animals, Rs. 4.8 lakh grant for heifers, for clinics up to Rs. 18 lakh grant<br>And loans | 11% up to 3 lakhs and 11.5% for more than 3 lakhs             | In 3 to 7 years  |

provided to PACs. Personal, vehicle, home, gold, consumer and business loans are also offered.

Medium term loans range for up to 3 years and are offered at an interest rate of 10-14.75% percent. In Karnataka 11.75% of the interest is subsidized by the government for agricultural infrastructure. The PACs in Uttarakhand receive a 2% margin from the DCCBs for medium term loans. Business development loans often carry interest rates varying up to 16%. Tractor loans are also provided for a 5 year duration at an interest rate of 12%. Some PACs restrict the loan amount offered as they want to focus their resources on other income generating activities. It was also found that the DCCBs often dictated the terms of the credit products.

**UCBs** provide a very wide range of credit products. Loans are offered for business development, vehicles, housing, small industries, festivals, agriculture, micro enterprise and retail trade (for traders dealing in essential commodities like PDS shops), education – particularly for the girl child, consumption, renovation, consumer goods (for employed persons), marriage, land, etc. Cash credit for small business and petty traders and salary advances are also provided. Loans are secured against collateral or guarantee. Loans are secured against gold, property, deposits, salary account, shares, furniture, and consumer durables. This can be quite restricting for the poor. Loan products are particularly designed for women, SHGs and JLGs, and the backward and other backward castes (BCs/ OBCs) by the government. The Mann Deshi Mahila Sahakari Bank in Maharashtra offers business loans ranging from Rs. 5,000 – 200,000 tailored to the needs of rural women from poor households. They also offer loans to meet the requirements of women led small businesses.

### **Long Term Loans**

The cooperative institutions that offer long term loans include the State Cooperative Agricultural and Rural Development Banks (SCARDBs), and Primary Agricultural and Rural Development Banks (PA&RDBs). Long term loans, or term loans are extended for repayment periods ranging from 1.5 to a maximum of 15 years, and the rate of interest is fixed by banks as per RBI's guidelines from time to time. The limit of collateral free term loan is Rs. 100,000, above which banks obtain securities as per RBI instructions. They are given for enterprises and income generating activities as well as investments in land development, minor irrigation, godowns, cattle sheds, construction and deepening of wells, plantations, etc. They also include loans to working women, women entrepreneurs for small industries, and loans to professionals

### **3.3.3 Remittances and Pensions**

UCBs tie up with associate banks to provide inter-city cash transfers, CBS, and National Electronic Funds Transfer - Real Time Gross Settlement (NEFT-RTGS) facilities. They also issue demand draft for banks with which they have an association with. UCBs also offer bank guarantees, Short Message Service (SMS) alerts, Automated Teller Machine (ATM), (Electronic Clearing System) ECS enabled loan repayment, outstation banker cheque facilities in association with partner banks. Some DCCBs and UCBs offer remittance facilities through PACs. Some cooperatives offer insurances in partnership with (Unit Trust of India) UTI.

### **3.3.4 Enterprise and Social and Other Services**

Other than savings and credit facilities, cooperatives offer a host of other services. PACs are the points of PDS dealership in their areas. They provide godown and marketing services, improved seeds and fertilizers to the members. PACs facilitate bank loans to SHGs, review applications, recommend them to DCCBs, and collect payments from them. They also facilitate members and individuals from SHGs to open banks accounts with DCCBs.

Cooperative offer education, health facilities, skill training in tailoring and computer use, marketing advice, health awareness and vaccination camps, scholarship for students, crèche services, hostels for working women. In some instances they even arrange for streetlights, public toilets, regular water supply, and help the members procure ration cards.

## **3.4 | Information Gaps**

On some issues, there seems to be an information gap between the cooperatives and NABARD. For example, according to cooperatives in Uttarakhand, they are only allowed to finance certain activity and projects, while NABARD was unaware of any such restrictions. For instance, the study team found that some cooperatives were following a guideline that prescribes upper limits to different types of loans. Some cooperatives interpreted the guideline strictly while other cooperatives and NABARD interpreted the guideline as flexible. Possibly there is a gap in information/understanding. Alternatively, the limits are applied strictly by those cooperatives that want to be risk averse and restrict their lending operations. Therefore, what shows up as an information gap could also be different orientations to risk.

## **3.5 | Financial Ability and Sustainability**

The financial health of cooperatives varies by state. The study team gained additional insight on the performance of self-reliant cooperatives (on which the data is lacking) and on the factors that affect the variability of performance across the states. We also discuss the purported dilemma between financial viability and mandated operations.

### **3.5.1 Reasons for Variability Across States and Types of Cooperatives**

The performance of cooperatives varies widely across states and the types of cooperatives.

Relative to other states, Uttarakhand has a high portion of cooperatives in profit: of the 753 PACS in the state, 586 are in profit – including Ajabpur Primary Agricultural Society discussed in Figure 11.

According to experts interviewed in the state, the success of PACSs in the state may be attributed to their ability to mobilize large amounts of deposits from non-members, and the government-fixed high margins on deposits collected from the clients<sup>13</sup>. Some also stated that clients prefer to deposit funds with PACSs rather than commercial banks to evade income tax.

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<sup>13</sup> PACSs are required to deposit the entire collections from clients with the DCCB at a fixed interest rate.

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**Figure 11**  
**Ajabpur Primary Agricultural Society, Uttarakhand**

The Ajabpur Primary Agricultural Society is a PACS located in a semi-urban area in Uttarakhand. Initially, the Society was located in a village, Ajabpur, and catered to farmers. The earlier members fondly recollect the cooperative's critical role in providing high quality seeds, fertilizers, and credit to its members. Overtime, however, the village grew to form a part of Dehradun (the capital city of Uttarakhand) and the Society's members sold their agricultural land to builders. The Society then evolved to meet its members' and clients' needs, now catering to a mostly urban clientele. Despite this transition from rural to urban, the cooperative retained its name and regulatory classification as rural.

Interestingly, despite the small office, lack of computerization, and small number of staff, the cooperative society is highly profitable – with annual profits of about Rs. 16,000 per member. Its total profits - Rs. 3.41 crores - are higher than the profits of Rs. 1.35 crores of the Dehradun DCCB to which it is affiliated. The cooperative primary source of income is deposit mobilization – on which it receives a 3.75% margin by re-depositing the funds with the DCCB at a government-fixed rate. Also surprisingly, the cooperative's clients are mostly non-members: the number of deposits is 7,500 while the number of members is 2,174.

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While profitable, PACS in Uttarakhand heavily depend on subsidies and government-fixed interest rate margins on deposits. Therefore, if regulation were to change, their profitability would be affected. Further, while the fixed margins are satisfactory to the PACS, the Dehradun DCCB is negatively affected by the high interest rates in must provide.

Self-reliant cooperatives in Uttarakhand do not enjoy the same benefits of PACS and therefore face different financial outcomes.

In Maharashtra, PACSs face poor financial performance (only 44% of them are in profit) and high Non-Performing Assets (NPAs). The weakness of PACS in the state is partially due to their exposure to agricultural risks, particularly drought, which is a recurrent event in the region. PACSs also bear the risk of non-performing loans, as they cannot pass it onto the DCCBs due to a fixed interest rate margin on lending of 2%. The capital base of PACSs is then eroding overtime. Unlike PACS in Uttarakhand, cooperative societies in this state cannot mobilize deposits from non-members<sup>14</sup>.

### **3.5.2 Performance of SRCs**

In most states, no organization is involved in the collection of data on SRCs. Therefore, there's no conclusive figure on their financial performance. Nevertheless multiple stakeholders in Uttarakhand have indicated that SRCs<sup>15</sup> have difficulty in prospering due to: lack of funding, exposure to agricultural risks, seasonal revenues and costs, low scale, and remote locations. They do not enjoy the benefits accorded to PACSs, and so don't have the same level of financial viability.

14 Mobilizing deposits from non-member clients is against RBI's regulation. The state government in Uttarakhand is allowing this practice through a scheme informally called "mini-bank", which is being contested by NABARD/RBI.

15 This statement refers to non-financial SRCs because financial SRCs are currently lacking in the state.

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**Figure 12**

**Bhagini Nivedita Cooperative Bank Limited, Maharashtra**

This bank was founded by Mr. and Mrs. Dadhe in 1974. Mr. Dadhe was a Chartered Accountant and wanted to make financial services accessible to those who were excluded from formal banking at that time. The target groups were women and small businesses in urban and semi-urban areas. The bank is unique as its staff is composed of only women. Nevertheless, its services are available to both men and women, giving it access to a larger market.

Because the bank also serves men, it does not receive the tax exemptions available for Mahila banks (women's banks) – which serve only women. Its net worth is Rs. 134.4 crores and has shown sustainable profits over a period of time. It reported profit of Rs. 13.23 crores in 2014-15. Its deposits are relatively less at Rs. 660.62 crores and it maintains a credit to deposit ratio of 62%. All its branches are in urban Pune with only one rural branch. 70% of its customers are reported to be small borrowers and depositors (with average deposit size of about Rs. 25,000). Women form 80% of the total membership of 4,500. Dual control of the state registrar and RBI is an issue. However, management indicated that less government control– through oversight - could also lead to mismanagement and misuse problems.

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**3.5.3 Financial Viability and Mandated Operations**

Financial viability and mandated operations are often posed as exclusive alternatives. As the study team found in Assam well-functioning PACS are not demanding funds while the ill-functioning PACS create a risk. Therefore, the Apex Bank reportedly faces a dilemma: it can either engage in its mandated role to provide credit to its member cooperative at a loss or partake in more profitable alternative investments.

In other cases, however, financial viability is a condition – not an alternative – for mandated operations. Bhagini Nivedita Cooperative Bank Limited (Figure 12) is one of the many examples of cooperatives that derive their success in contributing to financial inclusion from their profitability.

However, not all cooperatives can attain viability. PACS often operate in remote villages (or mountainous territory as in Uttarakhand), where achieving economies of scale is often difficult. PACSs and SRCs located in these areas face low quantities, high risks, and high cost due to long travel distances. These factors pose difficulties in achieving financial inclusion and are a hindrance to achieving financial inclusion as well.

**3.6 | Interest Free Microfinance**

Cooperatives offer the best institutional form for implementing the interest-free microfinance, as is needed in the practice of Islamic Microfinance. The muslim minority have examined all institutional forms, and as others mandate interest collection, the cooperative form was found the most appropriate. The case of Sahulat microfinance, in the illustrates this.

**3.6.1 The Philosophy of Interest-free Microfinance**

The Sahulat model of interest-free microfinance traces its philosophical background to Islamic principles of money lending. The Islamic philosophy behind this is that moneylenders

should not make a profit from lending, which amounts to usury. Those possessing capital must lend it to those without capital, without exploiting the latter's' lack of capital.

### **3.6.2 Cost Coverage is Permitted**

The concept of interest free does not mean cost-free as there are administrative costs to the process. These costs are recovered by a service charge on the loan. The service charge must certain conditions, including no gains above the initial capital for the owner of and that the administrative costs should be born by the borrowers.

These service charges are calculated beforehand for the year and usually range from 1% to 1.5%. In case of extra collection for an year, the money can be returned back to the borrowers.

Another way of covering costs is an equity stake with the borrowing person or business. This could be a 40-60% profit split like a business partnership or venture capital.

#### **The eligible costs include:**

- **The administrative costs** for such an institution can be split into two components: cost of mobilization and cost of loan servicing. These two cost centres in themselves cover overheads, salaries, cost of maintaining deposits, administrative cost of advancing loans, follow-ups for recovery, and maintaining ledgers until they are fully repaid.
- **The cost of mobilization** component varies as a percent per annum.
- **The cost of loan servicing** component varies on the basis of the number of loan instalments and, secondarily, on the security pledged on the loan. Thus, the cost of loan servicing can be furthered divided into a fixed and a variable component. The fixed part is the cost of initial processing and final closing of the loan account while the variable component depends on the period for which the loan is carried on the books of the institution and the secondary aspects of the loan.

#### **Advantages of the Cost-Based Pricing Model**

Crucially, this loan-pricing model based on administrative expenses is simpler, and therefore more efficient, compared to customary loan pricing. Further advantages offered by this simplicity are that all parties, borrower and lender, agree to the price setting, and it creates a democratic and member friendly environment. Also, when the scale of funds increases, the price of the loan automatically falls.

#### **Why Interest Free Microfinance has not Proliferated**

Several important reasons for the limited reach of Interest free microfinance have been noted Khaled (2011). The first reason is the limited experience of such MFIs with Profit/Loss Sharing (PLS) schemes and their focus on Exchange/Debt financing instruments. Since the PLS schemes require vigilant reporting and a high level of transparency, they result in substantial operating costs for micro and small enterprises that are not accustomed to formal accounting. However, new models for microfinance should build in systems to guarantee transparency for PLS schemes while keeping the management cost low. This would lead to greater outreach and serve the needy with financial services on a sustainable basis.

## **Sahulat as a Model/Demonstration of interest-free Microfinance through Cooperatives**

Interest-free finance and cooperatives have an alignment of principles and offer the best form of institution to build upon. Sahulat Microfinance, promoter of interest-free cooperative microfinance, aims to address poor above subsistence level through its affiliated cooperative societies. Sahulat believes that MFI can serve people below subsistence level through grants and charity. Access to microfinance alone is not sufficient; finance has to converge with several other components of development of subsistence level. For the livelihood of below subsistence level other cooperatives (like agriculture cooperatives) may work in tandem in order to fulfil several related objectives of poverty alleviation. Thus in broader sense, Microfinance has larger role and several other components to work with simultaneously. To work for below subsistence level through livelihoods, the BASIX experiment is to be noted most importantly.

Sahulat has opted cooperative format not just as a technical help but cooperative in real terms. It believes that hurdles faced by interest free microfinance can be overcome through sustainability. A policy formulation with regard to registration of interest-free credit cooperative societies is required to emerge to solve the registration hurdle.

Certain restrictions with regards to deposits from shareholders for an MFI are a hindrance for the Islamic microfinance institutions. An Islamic concept called Zakat, i.e., 2.5% religious donations by Muslim people and the concept of collecting donation or fund-raising through shareholders has Sahulat looking to move towards the cooperative structure.

### **Cooperatives as an Institutional Form for Interest-free Microfinance**

In summary, since it is an inherent feature of cooperatives for the loans to be interest free, cooperatives may offer the best form of institution for Interest Free microfinance institutions. In the cooperatives sector, there are three predominant sectors, namely, the SHG, Non-Banking Financial Company (NBFC) MFIs and Not for Profit Organizations. Interest Free Microfinance through cooperatives could be a promising new sector in the domain. Sahulat believes that cooperatives format is most suitable format for interest free MFIs because cooperatives are not for profits but for benefits, and can offer sustainability lessons to the whole sector of interest free microfinance through cooperatives.

#### ***3.6.3 Challenges of Cooperatives and Ways Forward***

The challenge ahead for organisations promoting cooperatives are their growth is slow, governance issues arise, and that the cooperatives promoted do not cooperate with attempts to instil good governance and transparency practices.

The solutions to these problems is education of members of the cooperative Society. As the cost of education could not be borne by these societies with their regular business income until they reach the scale of viability; here, Sahulat sees its role in Research and Development in the field of education and helping the cooperatives.

### **3.7 | Knowledge and Capacity Building**

With one national (VAMNICOM), five regional (RICM), 14 sub regional (ICM) and 109 state level institutions (JCTC) for cooperative management, infrastructure for dedicated training for the cooperative sector in the country can be termed as widespread and significant. Cooperatives at different level in various states are covered by at least one of these institutions. Except the JCTCs, all other cooperative training institutions are centrally administered through the NCCT which receives grant-in-aid from the Government of India. The JCTCs receive only 50% financial support from the NCCT with the rest coming from the respective state governments, who also have the administrative control of these institutions. However they receive NCCT support in course design, faculty development, classroom facilities and pedagogical support.

As these training institutions are largely administered centrally by a single agency there is likely to be a high degree of consistency in policy, management approach and inputs and curriculum design. The faculties in these institutions appear to be well qualified and trained in premier institutions like Indian Institute of Management, Banker Institute of Rural Development etc. All the training institutions have pre-planned training calendar for short-duration programmes and run diploma and higher diploma courses that are of 3 to 9 months durations for stakeholders in the cooperative sector. Some of the higher level training institutions like VAMNICOM and RICM Bangalore and Chandigarh offer Post graduate management programmes in agri business management for fresh graduates. These programmes not only help these institutions generate resources but send out skilled management graduates to work in the rural sector, though not directly into the cooperatives, save for the established cooperative brands like AMUL. In fact, VAMNICOM has been rated among the top 100 business schools in the country by Outlook magazine in 2013 and 2014 which attests to a high degree of competence at the institutional level.

Training and computerization of cooperative staff have emerged as important needs in all the states. It is also clear that the trainings provided must be analyzed and contrasted to trainings demanded.

#### **3.7.1 Demand- Supply Mismatch**

On one hand, both demand and supply of training are high: training institutes and cooperatives recognize the need for training, exposure, and awareness on cooperatives among members, staff, and leaders. On the other, in all four states participation in trainings is low. In Uttarakhand, utilization in training projects sanctioned through the DCCBs and the ICM is less than 50%. This lack of participation in trainings is present even when training are provided free of costs. For this reason, the study team inferred that there's a demand-supply mismatch in trainings. As a result, multiple training institutes claim, mobilizing trainees is a challenge.

Table 7 describes some of the study team's learning in regards to training – either demanded or supplied.

**Table 7: Mismatch between demand and supply of trainings**

|   | <b>Trainings Demanded</b>   | <b>Trainings</b>   |
|---|---|--|
| Uttarakhand trainings organised by NABARD in BIRD Lucknow and ICM, Dehradun | Computerization and banking technology<br>Basic banking knowledge<br>Banking terminology and guidelines (e.g. SLR and CRR (Statutory Liquidity Ratio and Cash Reserve Ratio)<br>Leadership skills | Cooperative management<br>Functioning of boards<br>Account keeping<br>Compliance |
| Assam and Maharashtra   | Member education<br>Awareness of cooperative principles<br>Online accounting systems in PACS  | At present no institution is engaged in providing these trainings                |

Mass education campaigns on the cooperatives; their principles and management do not currently appear to be the mandate of any of the cooperative training institutions who mostly are designed to cater to the operational requirements of running the cooperatives.

JCTC appear to be the most suited to handle mass education campaigns given their proximity to the primary cooperatives and reach in some of the states. However, both in Assam and Maharashtra these were reported to be either poorly functioning or non-functional. In Maharashtra a stalemate was reported between the state government and the JCTC management that had rendered the centres non-functional.

Many cooperatives' staffs are not aware of the laws and provisions governing cooperatives. At the same time they have not accessed training from any of the cooperative training institutions. Even better performing cooperatives, particularly at the primary level, the management themselves have not accessed trainings in a long time.

Various PACSs have noted the need for training on handling online and common account systems. The lack of computerization and related training is a setback for primary cooperatives, which must accomplish many simple tasks manually.

Training organizations did not realise the mismatch, instead offered alternative explanations for the lack of participation in trainings. They alleged that trainings are a low priority for PACS, especially as politically motivated and affiliated board members are uninterested in professional skills. As the staff of cooperatives is relatively older, being close to retirement age, they are unwilling to pick up new skills. Finally, the fee charged on some training are considered a deterrent.

### **3.7.2 Capacity Building Requirements**

Computerization and adoption of CBS have emerged as important capacity building requirements – particularly among PACSs. Efforts are underway to promote CBS and computerization. For example, in Karnataka, NABARD has supported the DCCBs adoption of CBS in 10 districts in collaboration with Tata Consultancy Services (TCS), the technical partner. The DCCB Bidar has transitioned to using CBS on its own (without the support of NABARD).

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### Figure 13

#### Technical Support to APCOB and TSCAB

Andhra Pradesh has a three tier structure, with PACS as primary societies, DCCBs and the State Cooperative Banks. All DCCBs have transferred onto a core banking solution (CBS). In Andhra Pradesh, the LT and ST credit structures are combined. The State was the first to sign for the Vaidyanathan revival package, and has been a frontrunner in the cooperative movement in India.

The Rabo Bank International Advisory Services (RIAS) started providing technical support to Andhra Pradesh State Cooperative Bank (APCOB) two years ago through a project agreed between APCOB and RIAS. The agenda was to help APCOB modernise, and become sustainable and client oriented. A strategic workshop was held with the board and the General Body (GB) of the bank, and its affiliates, and a 5 year plan was made. The RIAS support was provided through two technical experts from RABO bank headquarters, who relocated to Hyderabad; one has recently completed his assignment and returned. Over the two years, the bank became more integrated, established a new IT system, adopted CS, engaged in new product development and brought in many changes in its human resources, with more professionally skilled personnel. The bank adopted phone banking, too. It seemed as if the ambitious change project in APCOB was mostly delivered.

Just at this time the state of Andhra Pradesh was divided into two: Seemandhra and Telangana, and during the elections, all the competing political parties promised debt waiver to the people. The threat loomed large, all the benefits of the professionalization over two years could be lost.

Consequent to the reorganisation of the state of AP, APCOB was reconstituted into two SCBs the Telangana State Cooperative Apex Bank (TSCAB), catering to the needs of Telangana State, and the residual APCOB, catering to Seemandhra. Both the SCBs function independently from 2<sup>nd</sup> April 2015.

With this, the management focussed turned to the bifurcation needs, such as obtaining the necessary banking licenses from RBI, and obtaining government guarantees that are necessary to obtain refinancing from NABARD. The banks are still engaged with these, although these processes will soon be completed.

At this time, RIAS technical support people have to wait, and later pick up the process again. Some of the work will have to be repeated, with leadership changes, and so re-commitment to the professionalization will be needed, and some of the HR and systems work may also have to be redone after the bifurcation. The senior management was keen on the change two years ago, and many changes could be brought about, the new situation will have to be re-assessed.

There is still a lot more to do: work on payment systems, inspection and auditing has slowed down, and will not be able to move forward in the absence of the RIAS team. The confidence in the commitment of the organisation derives from the fact that when the handholding project was started, the revival package by the government had already been released and funds had been used up, so the SCBs have been paying 60 to 70% of the costs of the project from their own funds.

A risk which exists is that after bifurcation, the influence of the government on the banks may increase. This is not an area in which RIAS has influence, so will just have to wait and hope for the best while they continue to provide technical support. The handholding projects had established milestones, change of board members, quality marks for human resources, reduction of NPAs, increased efficiency of operations, improved credit/ deposit ratios, and a target set for increasing the number of clients. All this work has come to a standstill after the bifurcation, and will need to start again, after the current phase of getting permissions and re-establishing these cooperative banks is completed.

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A case study of transformation of a State Cooperative Bank, with technical assistance from RIAS, is given in Figure 13.

#### **3.7.3 Need for Further Research**

The stakeholders interviewed in this study reported a demand and supply mismatch for training. This finding should be explored through further research; a formal survey of cooperative's demand for training should be conducted and contrasted to the trainings

offered. This will help the cooperative training institutions to bridge the gap and use the existing infrastructure to offer need based capacity building programmes which the cooperatives will also be willing to pay for.

### **3.8 | Assessing Ground Reality**

Thus ground reality of cooperatives shows that many cooperatives yield success stories, which can show the way forward for a vibrant cooperative sector. However, The cooperatives have not earned for themselves a position whereby members are involved in decision making; good governance may be expected without oversight; and cooperatives are free of political and vested interests of their leaders and senior management. Instead, primary cooperatives are either government led and controlled, or dependent on their leaders, with members being either unaware, or kept away from active engagement in the decision-making. The strict control by the government and the lack of professionalism and good governance in cooperatives seem to form a vicious cycle that perpetuates the prevailing skepticism about cooperatives as reliable community based microfinance organisations.

Banks are reluctant to lend to cooperatives because they have a low equity base, have low collaterals, limiting the confidence banks can place in their professional abilities. While the outreach of cooperatives is impressive, their financial health is worrisome. The proportion of PACSs in profit is only 53%. The amount of overdues to demand is also high. PACSs have about 25%, DCCBs 20%, and SCBs 5%. These numbers vary widely across states. Given particularly that the DICGC does not cover PACSs' deposits, high overdues and low profitability present a significant risk to depositors.

The cycle will not be broken by more control, but rather by regulations that provide more flexibility for cooperatives to operate, improving oversight, and the government investing in more and more member awareness, education and participation in cooperative affairs. The lessons from international cooperatives are towards according cooperatives more autonomy so that they may strengthen themselves over time. The approach should be liberalise the sector so that it can grow and become an active participant in financial inclusion, than to control it and constrain it to stay at the same level as it is today.

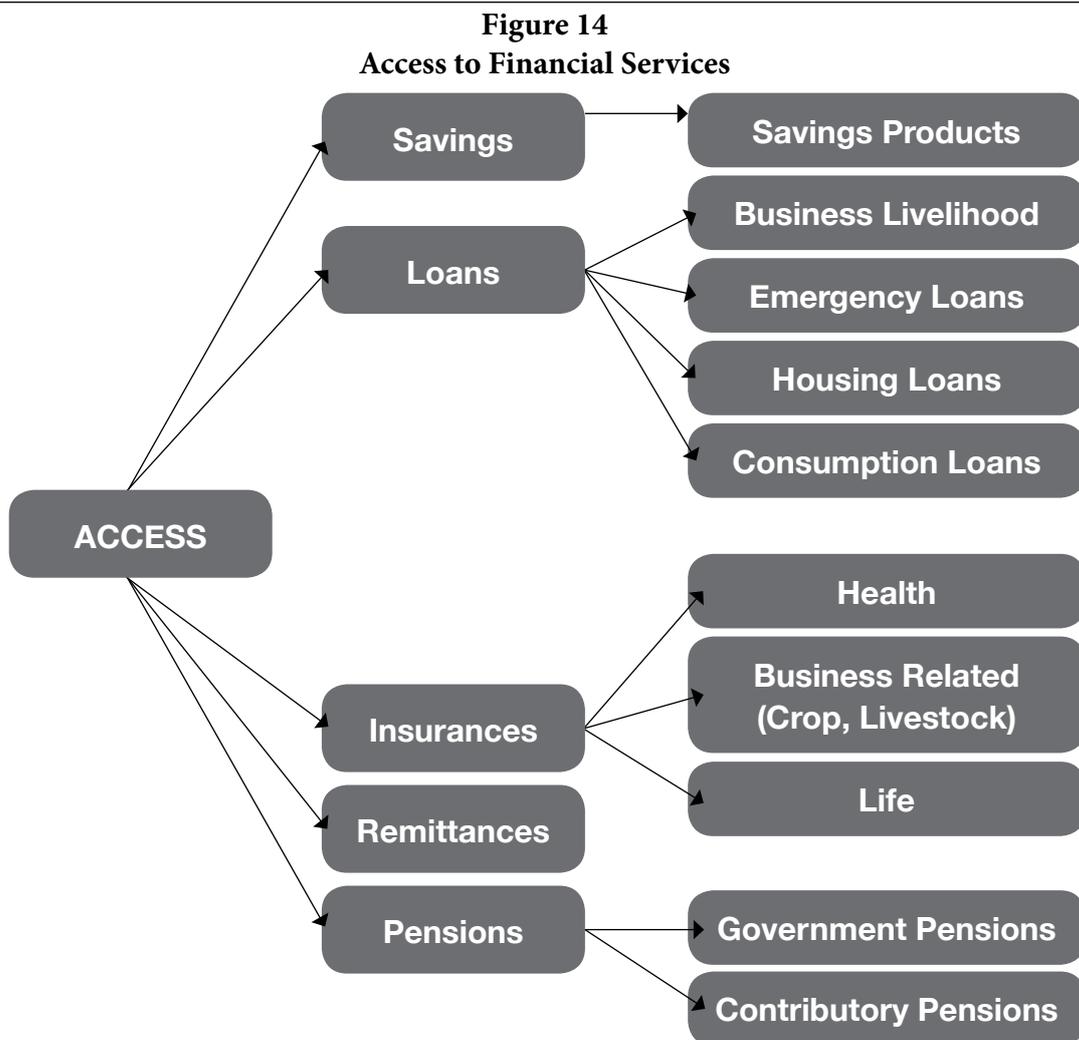
# 4

## Role of Cooperatives in Financial Inclusion

Financial inclusion has gained currency as an important element of economic and social inclusion and a critical component of inclusive growth, both in India and internationally. Financial inclusion has been an important component of the post-colonial development paradigm, as well as the current neo-liberal paradigm, as a public policy that relieves financial constraints and promotes poverty reduction and economic development. Although subsidised credit has been plagued with inefficiencies and political considerations for funds allocation, access to reasonably priced savings, credit and other financial services continues to be prioritised as an entitlement of a citizen in low-income countries.

### 4.1 | The Definition of Financial Inclusion

Financial inclusion is defined as the universal access to a wide range of financial services available at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products (Rajan, Ibid.). Financial inclusion



Source: Adapted from, A Hundred Small Steps - Report of the Committee on Financial Sector Reforms (Chairman: Dr. Raghuram Rajan)

encompasses the broadening of financial services (including savings, loans, insurance, pensions and remittances), as well as deepening financial services (creating outreach to those people who do not have access to the financial services sector). The access to financial services can then be depicted as in Figure 14.

## 4.2 | The Extent of Financial Inclusion in India

**Financial inclusion is measured on several dimensions, these include:**

- Physical access
- Affordability
- Eligibility
- Outreach
- Usage
- Quality of service.

The World Bank's Global Financial Development Report 2014 expresses financial inclusion as the proportion of firms and individuals that use financial services. In India, the outreach of financial services has traditionally been measured by the population that each bank branch serves or the number of kilometres that it covers. More recently, financial inclusion is measured by the number and percentage of households that have a bank account.

The concept of financial inclusion helps to focus on increasing the outreach of the formal financial system to those who are currently denied such access. However, the way the concept is now defined and measured, it is gender blind. Currently, "household access" is prioritised instead of "individual access", which privileges men as they are considered heads of households. The statistics are not gender-disaggregated, not revealing the extent to which women and men are financially included. Secondly, the current measurements in India assume that each household has only one account, and in the absence of information on multiple accounts per household, over-estimates the extent of inclusion.

The current state of financial exclusion is measured in India by the following indicators:

- The percentage of population that has a deposit account (currently 50 to 55%); there are about 684 million bank accounts for a population of about 1.2 billion (CRISIL, Inclusive Index, 2013)
- Only one out of seven persons has access to formal credit
- The percentage of the population with a life insurance policy (20%).
- The number and percentage of villages with bank coverage. (Of the total of 6,00,000 villages in India, currently only 2,11,234 are banked.)
- Access to financial services is geographically uneven, with the southern states having 62% inclusion. The number of people per branch (currently about 16,000 people per bank branch), and about 50% of Indian bottom line districts have just 3 banks per 1,00,000 of population. These districts had just 2% of the total bank branches, with 4,068 loan accounts per 100,000 population, compared to an all-India average of 11,680 accounts (CRISIL, *ibid.*)
- The total number of bank branches (122,294) of which rural branches (47,278) (Gol, 2015)

- The total number of (banking) business correspondents (1,23,805).
- The total number of ATMs (12,710)

Given the low financial inclusion, the government has taken several initiatives to achieve financial inclusion in India.

### 4.3 | The Initiatives and Challenges of Financial Inclusion in India

Prof. Amartya Sen (1985) argued that poverty is not merely insufficient income, but rather the absence of a wide range of capabilities, including security and the ability to participate in economic and political systems. Financial inclusion has been acknowledged as key to development and poverty reduction (World Bank's Global Financial Development Report 2014). There has been a global drive to consciously promote financial inclusion. A number of central banks and other institutions such as the International Monetary Fund, G20, International Finance Corporation, the Alliance for Financial Inclusion, and the Consultative Group to Assist the Poor have started initiatives to promote and measure financial inclusion (Amidzic et al. (2014).

In India, the government's promotion of financial cooperatives aimed to bring financial services to rural areas and thereby improve development. In the words of the 1928 Royal Commission on Agriculture in India's report, "If cooperation fails, there will fail the best hope of Rural India" (RCA, 1979). Other important financial inclusion efforts include the nationalization of banks, the incorporation of Regional Rural Banks, Service Area Approach, and the formation of Self-Help Groups (Rao, 2013). For example, after 14 major banks were nationalized in 1969, banks were required to select unbanked locations circulated by the RBI for bank expansion. To further encourage rural branch expansion, the RBI announced a new branch licensing policy in 1977, mandating that, to obtain a license for a branch opening in a banked location, a bank must also open branches in four eligible unbanked locations. This policy remained in place until 1990. Later, the RBI set up the Khan Commission in 2004 to look into financial inclusion and make policy recommendations, which it then implemented.

The RBI has undertaken various policy initiatives to improve financial inclusion. These involve:

"Financial inclusion broadens the resource base of the financial system by developing a culture of savings among large segment of rural population and plays its own role in the process of economic development. Further, by bringing low-income groups within the perimeter of formal banking sector; financial inclusion protects their financial wealth and other resources in exigent circumstances. Financial inclusion also mitigates the exploitation of vulnerable sections by the usurious moneylenders by facilitating easy access to formal credit".

*Mr. P. Vijaya Bhaskar,*  
Executive Director,  
Reserve Bank of India

"The imperative for financial inclusion is both a moral one as well as one based on economic efficiency. Should we not give everyone that is capable the tools and resources to better themselves, and in doing so, better the country?"

*Mr. Raghuram Rajan, Governor, RBI*

relaxed and simplified (Know Your Customer) KYC norms, a simplified branch authorization policy, compulsory requirements to open branches in un-banked villages, the opening of intermediate brick and mortar structures, a mandated financial inclusion plan for private sector banks, and revised guidelines for financial literacy centres.

In August 2014, Prime Minister Narendra Modi announced the Pradhan Mantri Jan Dhan Yojana scheme (PMJDY), (GoI, 2014) aiming to get 7.5 crore households to open bank accounts. Under the scheme, account holders receive accidental insurance and can avail of a Rs. 5,000 overdraft (after six months) from the bank. The program also introduced new technology to allow people to transfer funds and check balances through a normal phone (earlier, this function was limited to smart phones).

### **The financial inclusion initiatives face many challenges:**

- **Delivery Mechanism:** The last mile connectivity to the people in remote regions and to low income households continues to be a problem, and needs to be addressed.
- **Scalability:** The solution to low branch penetration has been sought in the initiative of employing banking Business Correspondents (BCs). However, BCs also have low transaction volumes, low earnings and lack of training and some may also prove unreliable, with the risk of misappropriation of funds.
- **Products:** Standardised products are unsuitable, requiring product differentiation, which cooperatives are better able to do as compared to banks.
- **Technology:** Although the Indian ATM network and technology have not yet achieved the necessary scale, the use of mobile technology is expected to contribute significantly to financial inclusion.
- **Financial Literacy:** The need for financial literacy is established, as without it, the mere opening of accounts has resulted in many accounts lying unused and others being used only to receive Direct Benefit Transfers (DBTs), such as social protection stipends, National Rural Employment Guarantee Act (NREGA) payments and gas subsidies. While there is recognition of the need to build the capacities of clients and empower the demand side, there is a lack of financial literacy initiatives and the resources needed to undertake the job at the scale needed.
- **Viability:** Financial inclusion involves outreach to areas which are remote and unreached, with inadequate infrastructure for expansion of bank branches, due to which its commercial feasibility is an issue.

Despite these challenges, the GoI and the RBI have made a strong commitment to financial inclusion, with a plan to have at least one account per household within a defined time frame. All types of financial institutions, i.e. commercial banks, NBFCs, Self Help Groups and cooperatives, are expected to play a role in this ambitious initiative. Recently, the UNDP has set up collaboration with NABARD to increase financial inclusion of the poor by developing appropriate financial products and services, with an emphasis on women's financial literacy (UNDP, 2011).

#### **4.4 Participation of Cooperatives in Financial Inclusion**

Cooperatives play a vital role in the delivery of credit to rural areas. Cooperatives make up 16% of formal rural credit, compared to 74% by commercial banks and 10% by RRBs. Although cooperatives provide only 16% of agriculture credit, they have a much higher penetration, evidenced by the high share of cooperatives in the total number of agricultural accounts held by the banking system (Rajan Kumar Nayak (2012). Cooperatives provided agricultural credit to 3.09 crore farmers during 2011-12, as compared to commercial banks and RRBs, who provide credit to 2.55 crore farmers and 82 lakhs farmers respectively. Further, the outreach of cooperatives has increased more, as they financed 67 lakh new farmers during 2011-12, as compared to 21 lakh new farmers who were financed by commercial banks and only 9 lakh new farmers by RRBs (RBI, 2013: 10-11).

Cooperatives have key advantages over other institutions in promoting financial inclusion. Firstly, by being interwoven in communities, they have superior knowledge regarding borrower quality and business opportunities. This feature is particularly useful in an environment lacking sophisticated credit scoring models (Sriram, Ibid.). They also have a lower cost structure, particularly due to low labour costs and minimal operating costs, allowing them to reach segments of the population that are unprofitable for other banks. Cooperatives can also be more flexible to their clientele because they are not required to hold to nationwide and global policies to alter their practices. Additionally, since their members are both - producers and beneficiaries, cooperative banks “balance the need for profitability with the broader economic and social development needs of their members and the larger community” (Nayak, 2012). Therefore, cooperatives can address market imperfections (such as informational asymmetries, transactions costs and contract enforcement costs), which are particularly binding on poor or small entrepreneurs who lack collateral, credit histories, and connections.

Well before the financial inclusion programme came into force, cooperatives have played a bigger role in providing credit to the vulnerable section, mainly small and marginal farmers, compared to the outreach by the commercial and regional rural banks. They argued that PACSs have played a key in role in promoting and nurturing SHGs, enabling these groups to access credit through the SHG-bank linkage programmes. PACSs have also established JLGs and enabled them to access credit. Moinak (2014) emphasized, from a small study conducted with few PACS in West Bengal, that cooperatives provide financial services to the weaker segment of the society, such as landless labourers, agriculture labourers, potters, fishermen, cobblers, etc. The financial services offered to these categories of people by PACS include no-frill accounts, agriculture loans, emergency loans against National Savings Certificates (NSCs) and Kissan Vikas Patras (KVPs), Kissan Credit Cards (KCCs) and agricultural education in collaboration with universities and national educational institutions. Mohite (2008) emphasizes how cooperatives have played a key in role in substituting moneylenders and serving the disadvantaged and the unserved people by providing cheap credit, through their access to soft loans and refinance by NABARD. In his analysis, he highlights that cooperatives work on the principles of relationship, which has enabled them to penetrate into rural areas to meet not only agricultural credit needs but also non-agricultural credit requirements (Elangovan and Paranjothi (n.d.).

#### **4.4.1 PACS as Business Correspondents for banks**

The suggestion that PACSs may operate as BCs for DCCBs and other banks was made in the Bakshi report, and was accepted by RBI and NABARD, who issued circulars to permit PACSs to play this role.

However, many authors have sounded notes of caution. While some agree that PACSs operating as BCs would help to reach out to vulnerable households, other point to various contradictions in the recommendation of the Bakshi committee. The counter-arguments are as follows:

- The success of BCs is highly dependent on the extent of their computerisation, which has been lacking, with PACS lacking a common accounting system and DCCBs slow in establishing CBS (Elangovan and Paranjothi (Ibid.)).
- The argument of the committee was that PACS only act as an agent to provide credit on behalf of the DCCB and they had to pass on the deposits collected from its members to DCCB due to lack of DICGC security. The high dependence of PACS on DCCBs is stated to be due to their lack of capital resources and lack of access to refinancing facility from NABARD, which would give them a cheaper source of finance than DCCBs. PACSs do not even have the possibility of financing from government and equity markets, like commercial bank do. This dependence would be further reinforced by the BC role that would lock PACSs into an agent's role for DCCBs, and harm their financial health. While this conflict of interest exists, currently there is no solution to the issue, until PACS grow to a level where they have CBS and/or can become payment banks.
- Critics highlight that taking on an agent's role forces primary cooperatives to transfer all their assets and liabilities to DCCBs, compromising their position as member based organisations, and weakening the power and voice of primary cooperatives (Shylendra, (2013)).
- PACS lack a clear focus and direction, and have an inability to lobby with the government for a positive enabling environment.

#### **4.4.2 Successes of Cooperatives in Creating Financial Inclusion**

The study found several cases of cooperatives creating financial inclusion. For instance, The Pune DCCB has so far opened 67,692 no frills accounts amounting to Rs. 46 crores. It is also linked to 30,126 SHGs, out of 52,382 SHGs in the district. Of these, 28,224 are women SHGs. The loans outstanding with SHGs amount to Rs. 599.66 lakhs. The bank considers these loans to be secure as the recovery rate is 86%. The bank also has a women development cell that looks after the activities related to formation and linking of SHGs. The Pune DCCB is required to prepare a 3-year Financial Inclusion Plan and submit it to NABARD.

In Assam, the picture is mixed at the state level. On the negative side, the Apex Bank missed the timeline to participate in the opening of accounts for Jan Dhan Yojana. On the positive side, however, the bank has a pilot project with NABARD, to provide ATMs through

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**Figure 15**  
**Cooperative City Bank**

The bank was registered as UCB under the state act in 1981. The present building housing the H.O and main branch inaugurated in 1989. An IAS officer was the first chairperson.

The present MD has taken charge only since two months and is still in a learning mode. He is new to banking but not new to financial sector as he has served 26 years in Assam Finance Corporation.

The Coop credit bank has 6 branches in all and all in Guwahati. It is in overall profit though two branches are in loss. This is attributed to some old OD accounts surfacing during the software switch.

The bank lends mostly in the form of cash credit loans to small businesses and shops in Guwahati. Its other products are medium term loans for vehicles and housing. Doesn't have any agri lending but said it could explore as the conversation has thrown up the idea!

The NPA is 7-8%, slightly gone up last FY.

The bank runs no special schemes to attract special sections of the population. It usually designs products and services by doing a survey of the various products and services on offer in the market, identifying gaps and also keeping in mind what the bye-laws allow.

The MD is personally interested in Micro finance and insurance the bank has entered into MoU with Oriental Insurance for the Bima Suraksha. (CBS is less than a year old in the bank. It has no ATMs. It is currently tying up with SBI for ATMs and Rupay cards.

The bank has just finalized agreement for Direct Benefit Transfer for LPG (DBTL). The bank is not part of the Jan Dhan Yojana. Tea garden finance is less than 10 per cent of its portfolio, mostly cash credit for warehousing.

The bank maintains salary accounts for DIG police office, State transport department, State electricity board, Loans to their employees which are then deducted from the salary account directly. This is an achievement given that there are several branches of various nationalized and private commercial banks in the city.

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PACSSs, open financial literacy centres for its clients, and also promote SHGs. It has also become an agent of the Life Insurance Corporation (LIC) and the New India Assurance (NIA) for the Bima Suraksha Yojana – a recently launched central government scheme to extend insurance coverage.

Under the Financial Inclusion plan, the Apex bank will be setting up three Financial Literacy Centres (FLCs). These centres will be funded by NABARD for first five years and will serve to spread financial literacy among general public. The Apex Bank is also promoting SHGs. However it is doing so directly and without the support of the PACSSs.

Cooperatives have played an active role in financial inclusion by extending credit and savings services. The DCCBs have organized public awareness camps and opened numerous banking accounts under the PMJDY scheme, established financial Literacy Centres (supported by NABARD).

Karnataka also offered success stories. The PACS in Nagora, established in 1975, and the PACS in Gadgi, established in 1976, are both members of the DCCB Bidar, with which they have a synergetic relationship. The societies support the Bidar DCCB's financial inclusion agenda. For example, they facilitate bank loans to SHGs by reviewing applications for loans, recommending SHGs for lending to the DCCB, and collecting payments. The societies also support their own members and individuals from the affiliated SHGs in opening bank accounts with the DCCB.

#### **4.4.3 Challenges Cooperatives Face in Enabling Financial Inclusion**

NABARD's grants for financial literacy and technology under the Financial Inclusion plan have reached mostly the RRBs. While the Apex Bank has also received some grants, it was not able to meet the timelines as compared to the RRB that has successfully reached its targets.

While cooperatives are supporting financial inclusion (as articulated by the SCB's officials) by providing savings and credit to members and non-members, financial inclusion is not yet a stated objective of PACS and DCCB.

In Assam, primary cooperatives are mostly absent from the financial inclusion drive promoted by NABARD and the RBI. NABARD directly promotes financial inclusion through Farmers' Clubs and SHGs, without the support of cooperatives.

One reason for primary cooperatives not being considered for financial inclusion is that they do not follow basic banking norms and practices. For instance, the membership of PACSs is open to all, and following the Know Your Customer (KYC) norms is not mandatory. RBI and the government are seen to have a negative attitude towards promoting cooperatives, because of the suspicion that the cooperatives could be potential money laundering channels because PACS funds are deposited into the formal banking system through DCCBs. As more and more PACSs begin to adopt KYC and CBS, this loophole will be covered.

Most SRCs are not permitted to do full scale financial services like issuing cheque books, ATM and clearing house facilities. These are essential in order to play a pro-active role in financial inclusion.

Cooperatives have been marginalized from the government's financial inclusion drive – partly due the corruption scandals, the lack of CBS, and not following RBI guidelines. Reportedly, the inefficiency of the cooperatives in Assam is limiting their access to NABARD's support under its FIF and FITF funds, which are earmarked for improving the delivery system in the cooperatives and rural banks to help them play a role in enabling financial inclusion. The support, at present is mainly going to the RRB as it is meeting the milestones set under financial inclusion plan. The Pune DCCB promotes SHGs through its branches directly and through NGOs, without involving PACS, which it views as incapable of SHG formation.

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16 NABARD requires Financial Inclusion plans from the banks/cooperatives that it funds under the FITF and FIF programs. The plans have certain milestones to be achieved. While cooperatives feel that they are not given special treatment, NABARD believes that cooperatives and state governments must fulfill their part of the commitments to the plans at each stage of the partnership, to get subsequent grants and inputs.

If they become CBS compliant, PACS can play a key role in financial inclusion as payment banks whereby they channel the subsidies or government programmes to earn commissions.

#### **4.5 | Official Use of Cooperatives as Agents of Financial Inclusion**

Indian financial cooperatives certainly have a widespread network, which have close contacts with millions of members and depositors. They already offer savings, loans and other financial services to their members. They could be good vehicles for financial inclusion; however, this potential advantage of outreach has not led to an important role for cooperatives in the financial inclusion initiatives of the Indian government.

This is due to the widely held perception that cooperatives are led by people with vested interests, and are not well managed according to banking principles. Currently, Indian cooperatives enjoy the benefits of mutual benefit organisations, but have not earned the confidence of the RBI or the government as banking organisations.

Those cooperatives that operate as banking institutions, the DCCBs, SCBs and UCBs who have adopted Core Banking Solutions (CBS) can participate in the financial inclusion drive and open accounts under the PMJDY of the government. Many leading cooperative banks, for instance, the Self Employment Women's Association (SEWA) Bank have done so, and have opened accounts under the PMJDY. Most primary cooperatives, however, have not adopted the CBS, and remain outside the purview of PMJDY. They can, however, be appointed as BCs by the DCCBs, SCBs and UCBs, or any other private or public sector commercial banks.

While commercial banks and rural regional banks struggle to reach to the rural areas, cooperative banks, with their wider network and rural orientation, have a greater potential to facilitate financial inclusion. However, they lack professionalism in managing and delivering the required financial services to the rural households (Ambarkhane and Sahasrabudhe (n.d.)).

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#### **Figure 16**

##### **Financial Inclusion through Community Based Microfinance Institutions**

The first one is with Andhra Pradesh Mahila Abhivruddhi Society (APMAS) and Sadhikarta foundation and Involves 10 VOs in 2 blocks in Bihar. The experience shows that banks are not yet willing to open accounts. The VOs have played the role of a bank enabling 200 women to save about Rs. 1.4 lakhs. The VO has actively encouraged savings. The VOs have opened accounts of SHGs, and give loans against savings. The VOs are registered as NGOs, under the Societies Registration Act, and not as cooperatives, and function as Community Based Micro Finance Institutions (CBMFIs).

In a study conducted by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) on the savings behaviour of members, it was found that the demand for savings was high, although the purpose and amount of savings differed across members. SHGs have proved a good channel for increasing savings.

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# 5

## Need for a Paradigm Change

The study shows that there is potential in the cooperative sector, which will be wasted if the financial inclusion movement bypasses the sector, instead of using the immense potential it offers. The financial inclusion drive in India presents both an opportunity and a need to address the issues that would release the inclusive and development potential of this vast and important set of financial institutions in India. This section analyses some of the key issues uncovered in this study, as a prelude to presenting the key recommendations.

### 5.1 | The Gender and Social Inclusion Framework

The Gender Equality and Social Inclusion (GESI) framework by Lynn Bennett (2006) enables as understanding of a cooperative as a member based organisation, that enable aising resources and creating assets for the members<sup>85</sup>. In this framework, the theory of change envisaged is that greater access to resources and assets, combined with increased voice through collectives, provides the strength to influence policy change in favour of the excluded groups. The framework outlines three domain of change: 1) Assets and services 2) Voice, influence and agency, and 3. The rules of the game (as defined by prevailing norms and institutions). An application of the GESI framework to the study of financial cooperatives is envisaged as follows:

- **Assets and Services** in the hands of those excluded improves their condition and also their ability to enhance influence and hold accountable state and other social actors. This study reviews the capacity building and other support provided to cooperatives.
- **Voice, Influence and Agency** provide access to decision making, and is largely determined by representation and organisation building. The framework allows the analysis of the cooperative institutional form as one where the members have space to raise voice and influence for better financial products and services according to their needs.
- **Norms and Institutions:** These refer to policies and institutions, including social norms. We may refer to them also as the broad enabling environment. The environment may be disabling with the informal systems of caste, gender, political patronage and business networks still support exclusion. Enabling factors include laws and regulations that demand equality between women and men, and among dominant and ethnic/ religious minorities. In this study, attention has been paid to this aspect through developing an understanding of the macro level perspective of institutional policies and legal constraints and opportunities for financial cooperatives to offer effective financial services. The existing laws, institutions and norms shape and circumscribe the enabling environment in which cooperatives work. The study analyses if the cooperatives

17 The GESI framework has been developed by DFID and the World Bank, and us has been integrated in the gender, women's empowerment and inclusion approaches followed by DFID and the Swiss Agency for Development Cooperation (SDC) Nepal, since 2012.

are constrained by laws and their implementation, or are able to function as independent entities.

- Hickey and du Toit caution that simplistic assumptions about reversing exclusion have to be tempered by the realisation that even when there is apparent 'inclusion', it is often in ways that keep the disadvantaged position of those excluded, and does not eliminate real inequalities. Another useful distinction may be made between "formal" inclusion and "substantive" inclusion. For instance, much of the "inclusion" of Dalits and women in governance structures and decision making mechanisms may be only at the "formal" level and does not really translate into greater power or influence for these groups as their power relations may not be substantially higher by such participation.
- The theory of change in this framework highlights that while work may be effectively done in one or two domains, truly transformative impact can be achieved only when all three domains are addressed. While each project may not address all three domains, a donor organisation can assess the overall impact of its interventions by analysing the extent to which these three domains of change are addressed.

The GESI framework is useful to understand the financial cooperative sector, analyse the strengths and constraints faced by the cooperatives and look at a way forward enabling agency of cooperatives creating a conducive environment for them to grow and play an active role in financial inclusion.

## 5.2 | Assets and Services

The issues raised in the ground realities chapter reveal the complexity of the issues surrounding access of cooperatives to assets and services from their members, government and the market.

Unfortunately, in India, cooperatives have always been seen as organisations for delivering official credit, and have worked as a credit rationing, or credit distribution system rather than vibrant financial organisations. The extent of refinancing available determines the amount of credit a cooperative distributes, making it a rationing system.

In the cases covered in this study, some primary cooperatives opted to keep member deposits safe and lend out only funds received from the state. Other cooperatives lend out the savings, but the credit portfolios were not necessarily safe, as defaults arose for many reasons.

This not only prevents external investments in the sector, but even the apex institutions express that they face a dilemma between their mandate to provide credit to primary cooperatives, and financial viability of their own cooperative bank. They state that while well-functioning PACS are risk averse and do not request funds, the ill-functioning PACS create a risk of non-repayment. These complexities create a situation where it is difficult to determine an overall strategy for provision of external funds to cooperatives. Any solution that emerges in the sector has to be state specific and left to the cooperative institutions in that state.

## 5.3 | Norms and Institutions

The analysis in the previous sections shows that the enabling environment for the cooperative sector has several facilitating factors, and at the same time is constraining in many ways.

### **Gender and Social Inclusion in Membership of Cooperatives**

To begin with the first issue we need to discuss is whether cooperatives are really inclusive organisations. From their inception, being conceptualised as organisations that reached out to farmers, cooperatives have had rules by which landowners were included, thereby containing an inherent bias against landless persons, tenants, and women, who do not own lands in their names.

About 80% of the households in the 37 villages covered by the Society are members of the Society. However, as it achieved large household coverage, it indirectly discouraged female participation through the following rule. The Society allowed only one member per household to receive A class membership and as result mostly men became part of this category of membership. Now if the society plans to expand the membership by including the women of these households as members then these women will most likely get Class B membership, which does not entitle the holder to voting rights (only dividends).

### **Reviews of the structure at state level**

The experience in Assam, where the cooperative structure has only two levels, raises the question whether a three layer structure would be worth investing in, in all States. Assam had a 3-tier structure, but due to inefficiencies, the middle level was removed. The question arises whether there is compelling evidence from other states in favour of the 3 tier structure? The argument, unfortunately, is not convincing. The case of Maharashtra seems to indicate that the middle tier is no guarantee that primary will work. The study has also shown that the middle tier can compete with, and profit at the expense of the PACSs.

This calls for a review of the cooperative institutions at the state level, each state needs to review the layers in the structure, how they interact, and how these interactions can be by choice, rather than mandated, and how they can be mutually supportive rather than controlling or competitive.

### **The Role of Government's Credit Programmes**

In India, the state has been a key player in the provision of microfinance to sectors prioritised by policy, which include agriculture and credit through women's self help groups and farmers' groups. Many of the earlier interventions have proved damaging, and the recent programme, the NRLM, was intended to address all the difficulties arising from its precedents. However, the recent interventions too have proved to be temporary and target oriented, and have destroyed the environment, many years of work done on the self-reliant cooperative, and brought in once again an expectation of cheap government money. Cheap money also comes with a low respect for repayment and credit discipline is harmed<sup>18</sup>. The number of MFIs has grown as well, offering credit with little or no scrutiny of the clients' creditworthiness. This has put pressure on the cooperatives, which offer interest rates between government and MFIs, and examine ability to pay. The competition from the

government programme and commercial banks was mentioned especially in Karnataka, for loans as well as for opening accounts under PMJDY<sup>19</sup>.

### **People's Ownership of Cooperatives**

The identification and involvement of members and shareholders with the cooperative ensures how they engage with it, and whether they demand accountability and transparency. The situation is complex. To begin with, cooperatives are seen more as government organisations, especially where the government has played a role in promoting them. Secondly, loan funds have been contributed at a cheap and pre-set rate, taking away both flexibility and ownership. Thirdly, loan waivers have contributed to irresponsible credit behaviour, with the expectation that the government will condone such behaviour, releasing the moral pressure for loan repayments. This is in contrast to the behaviour people have in traditional and more socially embedded credit institutions, where the ownership is higher and social norms demand high credit discipline. Thus ownership has to be restored to people, for cooperatives to become real community based and managed financial institutions.

## **5.4 | Enhancing Voice, Influence and Agency of Cooperatives**

The hypothesis in the GESI framework is that collectives provide those excluded with the opportunity, strength and confidence to raise their issues, thus creating the forces that would align them better with the mainstream. The representation of the issues by collectives is expected to improve access to assets, or changes in laws and policies, and therefore lead to better integration with mainstream organisations, and improvement in the condition and position of the marginalized group into the existing social structures.

By definition, by virtue of being member based organisations, cooperatives may be expected to have a strong voice, and influence on policies and programmes of the government and other institutions.

This influence was witnessed in Uttarakhand, where the Uttarakhand Cooperative Federation has significant presence as a business organization, as it has member cooperatives with large businesses such as fertilizer distribution, marketing, allocating warehouse space etc. There was some competition of these business cooperatives with the financial cooperatives, though, as PACSs too engaged in fertilizer distribution.

By contrast, in Assam, the cooperatives receive little representation or assistance from the Apex Bank, leading to a situation whereby the member cooperatives are not in a position to influence policy changes in their favour, or garner support from the state and other stakeholders to improve their financial situation and address their operational problems. The Assam case also shows that the secretaries of PACSs view themselves as government employees<sup>20</sup>, and as a result are responsive to neither the PACS's management nor the financing banks – i.e., the Apex bank.

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18 An example in this study is from the Assam state government, which actively promoted women-only cooperatives, registering 1,100 cooperatives, of which only a fifth are currently operational. The Apex Bank followed the government's request to extend credit to them, but misuse of these funds has led to defaults and losses for the Apex Bank.

19 In earlier studies conducted by Sampark on SHGs and women's federations, such competition and disruptive influence has been reported in Gujarat and Maharashtra as well. (Sampark, 2010; 2014)

20 It is not clear exactly why this is so. It seems that in the beginning, the state government had raised a cadre to manage the PACSs. However, the secretaries are paid by the cooperatives themselves.

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**Figure 17**  
**Mann Deshi Mahila Sahakari Bank, Satara**

The Mann Deshi Mahila Sahakari Bank, Satara, founded by Ms. Chetna Vijay Sinha in 1997, is an Urban Cooperative Bank with ISO 9001-2000 certification. The bank is owned, governed and run by women and provides most of its services to economically and socially backward rural women, almost all of whom are also shareholders of the bank and some of whom are on the BoD. The Bank has provided services to more than 200,000 women in the state and the majority of its clients are reportedly earning less than 2 dollars a day. The bank is innovative in its use of institutional linkages and technology to deliver products and services to the underserved. For example, the Bank has partnered with Industrial Development Bank of India (IDBI) Bank for sponsorship of its ATMs, Rupay cards, and Immediate Payment Service (IMPS). The bank has also partnered with HSBC Bank to issue 'E-cards' to its clients that enable them to undertake doorstep banking. Further, the bank is among the first in the state to offer a micro pension scheme, which it implemented in partnership with Unit Trust of India Mutual Fund (UTI MF).

The bank also works with its sister organization, Mann Deshi Udyogini to promote and support women entrepreneurs. Mann Deshi Udyogini supported by HSBC Bank, works with rural women to provide them business school courses, mentoring, and market linkages. The bank then supports these women with credit, including working capital loans. In the case of these types of loans, the bank ensures repayment by checking that the planned use of funds is aligned with the business goals of the entrepreneur.

While achieving a high degree of financial inclusion through its products and services, the bank is also able to be self-sufficient and is growing steadily. It has reportedly also achieved NPAs of 0% of loans outstanding over the past four years.

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A particularly illustrative case (Figure 16) is that of a women's cooperative bank in Maharashtra, which had significant influence on women's access to property rights. In 2004, the Mann Deshi Mahila Sahakari Bank, Satara, Maharashtra, successfully lobbied with the State's revenue department to add women's names to the property titles.

Another good practice example from a SRC in Koppal (Figure 17), who have several financial and social impacts emanating from the mutual support arising from SHGs their federation into cooperatives.

The cases of Duar Bagori Cooperative (Figure 8) and Mann Deshi Mahila Sahakari Bank (Figure 16) illustrate how financial success can create voice, influence, and agencies for cooperatives and their members.

ASCOF is a federation of all PACS, consumer cooperatives, Large Area Multi Purpose Societies (LAMPS), and women's cooperatives. This was formed in 2012 and Mr. Rahman is the chairperson of this federation. This has replaced an earlier state federation that was liquidated. Although the federation was initiated by the cooperative department, the PACSs were entrusted to enroll more members, and now has 100 members, and have mobilized share capital as well as funds for large business ventures. The collective has been highly successful, and provides good practice lessons for collectivizing and federating cooperatives for running and managing highly successful businesses.

In Assam as well as in Karnataka, there was evidence that by joining cooperatives, women increased their asset holding, and their influence in their households.

The study found that the federations of cooperatives at the district and state levels being banks, the pre-occupation is with financial operations rather than with using the power of collectives to influence policy. However, at the national level, the federation of State Cooperative Banks, NAFSCOB has been lobbying for policy change in favour of cooperatives.

The cooperative unions at both state and national level are more preoccupied with training and capacity building for cooperatives, and in rewarding cooperatives with good performance on different dimensions. They do not have a strong voice at the policy level.

### 5.5 | A Change of Paradigm

This study shows clearly that at time more than any other, a change of paradigm is needed in the approach to cooperatives. The official approach has been one of development and

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**Figure 18**  
**Financial and Social Impacts of Collectivisation**

The Eshwara Souharda Cooperative is a federation of SHGs promoted by Sampark, and registered as a self-reliant cooperative in 2008, in Koppal, a low-income district of Karnataka. The cooperative's experience highlights the role of cooperatives in promoting economic and social empowerment. Formed by illiterate women with the technical assistance of Sampark, the authors of this study, the cooperative now manages Rs. 2.78 crores in March 2015. More remarkably, the women members and leaders speak about increased mobility, ability to influence their community, a social support network, and pride in their informal education. They have been able to negotiate and bring down rates of interest charged by the NABARD Financial Services Company (NABFINS) on the loans extended to them.

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**Figure 19**  
**Konoklata Mahila Urban Cooperative Bank**

The Konoklata Mahila Urban Cooperative Bank, established in 1998, is a cooperative bank owned entirely by women – currently 8,128 in total. The Cooperative faced many years of resistance from the cooperative department in obtaining registration: the process involved attempts by government officials to interfere with the appointment of board members, mishandling of the application, long delay, and unreasonable denials. In the end, the cooperative was able to stay clear of political interference, accomplish its objective to provide credit to underprivileged women, and book profits in every year. Also importantly, through its resources, the cooperative was also able to engender social change in the household of the women member, in favor of more gender equality and security.

The change was generated by the cooperative bank's policies to require women ownership of assets (such as homes in the case of housing loans) to obtain the requested credit.

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promotion, but has been imbued with direction and control, which has only recently been eased, through the 97<sup>th</sup> amendment. Yet, the intention of the amendment has yet to take effect, as the attitude of the government has not yet changed.

The attitudes of the members themselves need to change, and they need to participate more in the affairs of the cooperatives, demanding greater transparency and accountability than hitherto. This is also linked to their ownership of the cooperatives, which is critical to the cooperatives becoming really social institutions, compared to their current positioning as quasi government institutions.

Most importantly, all stakeholders need to put their scepticism aside and see the potential exhibited by some of the successful cooperatives in this study. The lessons arising from these are that given trust, freedom to operate, and technical support without control helps to create vibrant cooperatives that are inclusive, create economic benefits for members, and have a voice at the policy level. The scaling up of these lessons at the national level requires wide ranging changes, a move from scepticism to trust, strict implementation of regulations, freedom from political interference, and above all, professionalization and autonomy. The specific changes are elaborated in the recommendations that follow.

# 6

## Recommendations

The following facts about cooperatives make them institutions that are best suited for carrying out the financial inclusion agenda of the state: 1. tremendous outreach, 2. the fact that they are member based organisations and 3. They are more equitable in approach than any other financial organisation in the system. However, they are still not made a part of the financial inclusion drive at large due to the various reasons cited in the previous sections. Despite the several changes in laws, the influence of the government on operations of cooperatives is still very large in India. In order to revive the cooperative system, the foremost requirement is to reduce the influence of the Registrar of cooperatives in each State. Cooperatives should be allowed to function without government interference.

The recommendations relate to creating a positive regulatory and policy environment for cooperatives, and enabling cooperatives to become professionally managed and governed organisations, which play an active role in financial inclusion.

### 6.1 | Changes in Norms and Institutions

The enabling environment for cooperatives should be made more positive and the ambiguities removed. Towards this, we recommend the following changes:

#### **6.1.1 Streamlining implementation of Laws**

The current binary of cooperatives, whereby cooperatives under the state cooperatives Acts are supervised too closely, directed and controlled, and SRCs are unsupervised and unaided, needs to be broken. The cooperatives registered under the state cooperatives Acts need to have greater autonomy, and the cooperatives registered under the SRC Acts need to have greater supervision and be better integrated with the capacity building and partnership structures of the government.

All states which have the traditional cooperative act should ensure strict compliance with the 97<sup>th</sup> amendment. This will help in professionalizing the cooperatives and make them more attractive financial institutions for both, clients as well as the regulators. Also, all states with the Self Reliant/ Mutually Aided Cooperatives Acts should ensure effective supervision, which is currently lacking with the Federation. The supervision of **all** cooperatives could be integrated with the cooperative department, and the department capacitated with the resources (human and financial) to effectively supervise cooperative functioning. This is essential for better oversight, and will also provide the SRCs with better access to cooperative training facilities, and partnerships with government departments under programmes such as the Rural Livelihoods Mission, which currently exclude the SRCs (Mor, Ibid.).

#### **6.1.2 Strengthen the state cooperative departments**

The cooperative departments should be strengthened in terms of finances, human resources and the technical capacity for overseeing and guiding financial cooperatives. The departments could strengthen the state-level supervision structures by creating state-

level regulatory forums, like the State Finance Regulatory Commission (SFRC) for instance, which supervise all the small financial institutions at the state level. The RBI, in turn, must train, license and provide accreditation to the SFRCs.

### **6.1.3 Direct Regulation of Cooperatives by the RBI**

Regarding the role of the state in cooperatives, the tension between development and regulation has never been resolved. We recommend a separation as follows:

- The financial regulation, supervision and oversight of cooperatives could rest with the RBI, just as the RBI does for all other financial and banking organisations. As cooperatives move towards becoming more professional financial institutions, and adopt CBS, they can adopt banking principles and come under the supervision of RBI.

We also suggest that same standards should be applied to PACSs as are applied to UCBs, i.e. they should be governed under the Cooperative Act by the Registrar of Cooperative and the Banking Act by the RBI. Regulatory supervision of the coops should be continued by the department of cooperatives.

## **6.2 | Building Strong Cooperatives**

Building strong member based institutions requires that they be independent of subsidies and controls, and attain the capacities to operate as highly professional and accountable organisations. Towards achieving these objectives, the recommendations are as follows:

### **6.2.1 Strengthen the Cooperatives Structure**

The discussion with different layers of cooperatives brings up a mixed picture, whereby in some cases the central and apex organisations support one another, while in other cases, they control and compete with one another. Each state needs to review the set of institutions it will have, and how they will be organically linked to one another. If competition is promoted, then a level playing field should be provided for each type of institution, and dependencies and controls need to be eliminated. If the partnerships among PACS, DCCBs and SCBs are by choice rather than mandated, they are likely to be more equal and mutually benefiting.

### **6.2.3 Building Capacities of Cooperative**

As a first step towards this, the cooperatives should get support in getting **CBS enabled**. Once CBS enabled, it is much easier for the cooperatives to open accounts under the PMJDY, and will aid the government in achieving the financial inclusion agenda.

The task of **capacity building** should be assigned to cooperative federations and independent training institutions, which can be quasi and fully independent, offering courses on a fee basis to those who want to be trained in cooperative sector. This would then offer a pool of trained people that cooperatives can recruit from. The National Dairy Development Board (NDDB) has offered a replicable example through the creation of Institute of Rural Management, Anand (IRMA). Cooperative training institutions, like VAMNICOM and ICMs, could operate like IRMA, with fully or partly paid courses, and placements in the cooperative

sector. Demand based training programmes will enable the institutions to become more market oriented and sustainable, and will also remove the problem of miss-match of demand and supply of training courses that currently ails the state funded cooperative training institutes.

### **6.2.3 Making cooperative Memberships Inclusive**

Another lesson to learn from other countries, including Netherlands, is about broad-basing the membership of cooperatives. In many states in India, land ownership as a clause for membership is a constraint for landless people to gain access to the services of the PACSs. Similarly, in many cases, the women do not have any assets to their name. This deprives them of becoming members. Also, there are many cooperatives which allow only one primary membership from each household. This generally results in a gender bias as mostly the men get that membership.

Further, membership could be focussed on specific membership groups, such as farmers, or women. While there is a rationale to it, and certainly women only cooperatives have more credibility than mixed cooperatives, this also restricts membership to a relatively smaller number of people in an area.

The fact that there are different categories of membership, i.e., regular members, nominal or associated members and non-members in some states indicates a step towards this direction. We, however, recommend that women and landless people are also provided primary/ regular membership. In order to achieve optimal financial inclusion, the membership to PACSs should be open for all categories of people including non-farmers, landless labourers, women and men.

Establishing organisations for a specific group of people becomes inefficient, while broadbasing helps to develop a diversified portfolio, catering to a large range of clients. Open membership will also aid deposit mobilisation, increase efficiency, and allow for some diversification in the portfolio, as diverse types of products will be designed. This will enable the company to offer the more costly financial services as well, such as insurances, especially those that cover risks of weather.

### **6.2.4 Greater Autonomy for Cooperatives**

A key lesson to learn from international experience is the role of the government. In these countries, the government concentrates on good legislation and supervision, which is what the Indian government needs to do. The Indian government should not engage with credit delivery, but on supervision of cooperatives.

To enable cooperatives to function as fully member-driven institutions, the powers of the state governments to supersede Boards must be limited, and all users (depositors and borrowers) should be made full members with equal voting rights. Government should review whether it should have a margin caps and arrive at a solution in the interest of members and non-members. Cooperatives should be given more autonomy in raising and managing their resources, as well as designing their own products and services. More specifically, PACS should be allowed to use profits in their own business and not forced to hold deposits with

DCCBs (Capoor, Ibid.). These reforms entail removing state intervention in administration and financial matters.

Several cooperative promoting organisations place undue emphasis on democratic processes, such as one person one vote, insisted upon by organisations such as the ICA. However, some flexibility on these could be introduced without harming the cooperative principles. For instance, proportional voting rights, capped at a certain level, could fulfil the democratic principles as well as allow those who have higher investments to have a higher say.

Similarly, product design should lie in the domain of the cooperatives. In India, the social agenda of cooperatives is emphasised more than its economic agenda. This leads to lack of professionalism and transparency. It also detracts from becoming a long term, self sustainable organisation which would be viable for several years. Professionally managed cooperatives must focus on giving their members the products they need, have good repayments, and make good profits.

### **6.2.5 Higher Scale of Operations**

Cooperatives will need to transform within a state through mergers, or even have multi state cooperative societies which can scale up. Larger scale is critical for viability but there is a hitch in that NABARD does not provide refinance to MSCSs. If NABARD revises this condition, it will enable cooperatives to merge across states, providing the scale needed for viability and enabling cooperatives to sustain. This enabling step will be needed till the cooperatives attain the strength that they have done in Kerala, where cooperatives do not need refinance to survive.

### **6.2.6 Governance of Cooperatives**

In Indian cooperatives, corporate governance is linked one to one with the operations management. This needs to be set in order, by de-linking the two. The Board members should discuss and evolve the broad operational policies, which then the management can implement. The corporate governance and operational management should be quite separate. The management should be thoroughly professional.

## **6.3 | Professional Management of Cooperatives**

If financial cooperatives have to play a role in financial inclusion, they need to adhere to the four principles that have been held important for financial sector regulation: Stability, Transparency, Neutrality and Responsibility (Rajan, 2009 and Mor, 2013).

India can learn from the good practices in other countries, such as Western Europe and North America, which have several large and well run cooperatives which could compete with stock listed private companies.

For cooperatives to operate professionally, their boards have to be constituted in a different way, and their mandate should be different than it is now. Currently, boards of cooperatives are representatives of the governing bodies of their member cooperatives. This representative

system, if continued, must be on the condition that the member being nominated has some experience in banking, Information Technology (IT), or have other professional qualities that are needed for the supervision of a state cooperative. Secondly, they should **not** be active politicians. This should be legislated, so that political influence on cooperatives is reduced significantly. This is a practice in Netherlands, which ensures that board members have the qualifications to be on the governing board of a higher level cooperative, in fact they are often elevated from managerial to supervisory positions to ensure experienced people on the boards. Further, active politicians cannot be governing board members of cooperatives.

The second critical need is to ensure that the mandate of the governing board is only supervision, not operational management. The governing boards should be supervisory bodies, and should not interfere in the day to day management of cooperatives, which should be done by professionals.

The success of cooperatives should come from skilled staff, hired as professionals, uniform and standardised processes being followed, which are mostly IT driven. The cooperative should be able to attract good highly skilled staff. Even if the cooperative structure is 3 tiered, as it is in any Indian State, the operations can be centralised, so that cooperatives can become more efficient, client oriented.

An advantage of centralised operations will be the availability of skilled staff, who can be found or retained more easily in urban areas. Also, when operations are centralised, they are at higher scale and the business entity can afford skilled staff. Another message therefore is: centralise operations, to become more meaningful for the cooperative members, and to optimise their value.

Cooperatives need to recruit professionals to handle finance, risk management, IT and operations. They can have well integrated cooperative strategies. The apex institutions can then be real apex institutions, which modernised IT solutions to design better products, monitor operations at each level of the cooperative structure, and to give early warning signs in case of problems arising at any level. This intense monitoring is extremely important, because if early measures are not taken to stem recovery or sanction problems, then it may be too late to make corrections, the problems will magnify and the situation will go out of hand, then the only recourse left may be new injection of funds.

Processes can be put in place whereby clients can influence the cooperatives bank,, but this should not be through the governing board members controlling the operations. A system of keeping clients close to the organisation to them, client focussed product design (both on assets and liability side) will help cooperatives to compete with the best companies both Indian and foreign ones. Further, highly competitive cooperatives can also lower market rate for all clients, which is the key objective of a financial cooperative, to influence the microfinance market to have cheaper and more client focussed loan and savings products.

SRCs should be allowed to offer more financial and non financial services. Cooperatives should consider expanding their non-financial services, improving income and strengthening members' involvement. By providing these services, along with credit, cooperatives could play a crucial role in the region's economy – promoting economic, as well as financial, inclusion.

For example, in Assam, cooperatives could operate as holding depots for handlooms and agricultural commodities for the north-eastern region and provide marketing of organic agricultural and horticultural products to international markets. Tourism cooperatives could also be formed to provide end-to-end solutions to tourists to make their visits enjoyable and safe.

Since PACS and SRCs are not part of the banking system, and their deposits are not protected by the DICGC, they cannot issue KCC which can have transactions on ATMs and Point of Service (PoS) devices. It would be most appropriate for DCCBs and SCBs to provide services like ATM, cheque book and clearing house facilities directly while using PACSs/ SRCs as their BCs.

### ***6.3.1 Continuing and Monitoring Revival Support***

The revival package after the Vaidyanathan Committee has come to an end, as it has been 10 years since the introduction of the package. New revival packages need to be real handholding projects; they need to help build vision in cooperatives, and support them to work towards a vision, by making a strategy and assigning time frames. The release of the capital support from the revival package should be related to the progress achieved, so that it is possible to push for the change. Handholding projects need to have clearly agreed milestones for change of management, operations and systems. These could be:

- Change of board members, based on clearly set criteria for membership of the board
- Separation between board and operations management
- Standards set for human resources at each level
- Recruitment processes that adhere to the standards
- Operational milestones such as targets for increasing the number of clients, improved credit/ deposit ratios, reduction of Non performing assets (NPAs), increased efficiency of operations, etc.

Unless these measures are put into place, the funds from revival packages, which cost the state exchequer a lot, will not yield the desired results, and will be wasted away.

### ***6.3.2 Integrating cooperatives with markets for both equity and loans***

If cooperatives are allowed to ensure that the loans given out are secure or to raise equity from the markets, market discipline can be enforced through more transparent information. Rating by agencies such as CRISIL will enable depositors to respond by withdrawing and reallocating funds, thus creating pressure on management to effectively manage resources.

### ***6.3.3 Get a strong market leader to raise its issues to the authorities***

The cooperatives sector needs a strong voice for representing its issues. Currently, the cooperative department is too weak, and cooperative apex institutions lacking the power and voice, sometimes even the motivation, to lobby for strong support to the sector. This role of lobbying should be played by the federation of cooperatives and unions. (The role of

the champion could potentially be played by the NAFSCOB, which is currently the strongest vocal in representing issues of cooperatives, to influence cooperative policy in India.)

#### **6.3.4 Concluding Statements**

The report emphasises that there is a strong economic rationale for forming cooperatives. Cooperatives are first and foremost an economic partnership among members, to achieve what cannot be achieved alone. Cooperatives provide the collective strength, the countervailing power, to other forms of economic organisation.

As against other organisations that promote share holder value, cooperatives promote and optimise member value, or client value. They are focussed on members, or clients, and seek to offer products that their members need, at the most affordable price. They are not focussed on getting the highest profits.

*Sampark, Bangalore  
August 10, 2015*





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