Financial Performance and Efficiency of Co-operative Banks

Special Reference to Meghalaya Co-operative Apex Bank Ltd.

Dr. Joyeeta Deb

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PREFACE

Co-operative banks have gained rehabilitated importance in view of the recent thrust on financial inclusion. This role of co-operative bank is crucial mainly in the north-eastern region of the country. The region is characterised by lower volume of advances, deposits and investments and consequently, a lower ratio of credit to deposit. Further, there exists a high rate of population per branch. Apart from this, the presence of private (Indian) banks is meagre and existence of foreign bank branches is only a recent incidence which is concentrated in one or two states of the region. Against this backdrop of poor pace of financial intermediation in the region, co-operative banks possess greater potentialities in view of its wider presence and accessibility in the rural and semi-urban vicinity of the region. Since the network of co-operative banks is widespread across different parts of the country, these institutions are considered as a potential instrument to bring people from far-flung areas under the formal banking network. However, the poor financial health of co-operative banks in general, and grass-root level co-operatives in particular remains as an impediment, which needs to be addressed in order to fully utilise the benefits of widespread network of these institutions. This book is devoted to study the financial performance of one of the State Co-operative Banks operational in one of the states of the north-eastern region (NER) of India, i.e., The Meghalaya Co-operative Apex Bank Limited having its presence in the state of Meghalaya. Besides, the book also covers the level of efficiency of the bank at its branch level. At the end, the major factors responsible for efficiency/inefficiency at the branch level is identified. This book is intended to help researchers, policymakers and other stakeholders to gain a deeper understanding about the state of affairs of the bank.

Author

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Author

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Introduction

Banking sector occupies a predominant position in any economy. It plays a vital role in economic development of a country. The systemic importance of the sector draws special attention of the policymakers, government and other stakeholders. As any adverse performance in the sector can shake the economy in a major way than any other sector or financial institutions, ensuring a sound and healthy state of affairs of the sector is of paramount importance. The banking sector all across the world has undergone major transformations over the years partially due to the changing economic needs/requirements of the nation and partially due to the irreversible process of liberalisation, globalisation, privatisation, technological upgradation, recurrent bank consolidation, etc. Like many countries of the world, Indian banking sector has also undergone several reform measures. All such measures are intended to make the sector more profitable, vibrant and dynamic. However, measuring the success or failure of these reform measures in terms of improved performance and efficiency of the sector pose an important challenge so far as the measurement technique is considered. It is viewed that the estimates of efficiency are sensitive to the choice of the technique. Hence, establishing an effective technique for measuring bank's performance is stressed upon by researchers and practitioners.

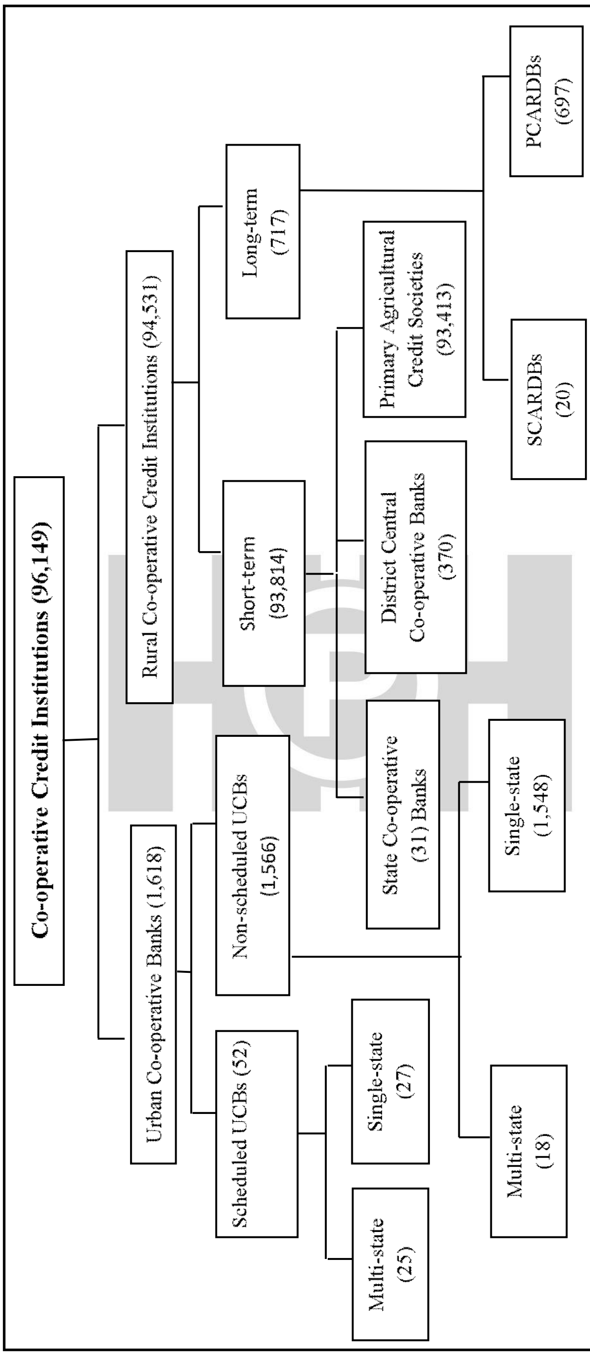
The banking sector in India can broadly be classified into commercial banks both under public and private ownership having presence throughout the country with wide network of bank branches. The Regional Rural Banks (RRBs), having businesses mainly in rural areas, are the important component of commercial banking in India. There are co-operative banks, though much smaller in size as compared to the commercial banks, but they play a greater role in rural financial intermediation. Apart from these, there are development banks which cater to the long run industrial requirements.

The rural financial system in India operates through two sets of institutions in the formal and informal sectors. Though the formal sector has adopted multi-agency approach, commercial banks and co-operative banks are the two prime channels to intervene in the rural financial intermediation. The co-operative banks, however, have gained renewed importance in view of recent thrust on financial inclusion. This role of co-operative banks is crucial mainly in the north-eastern region of the country. The region is characterised by lower volume of advances, deposits and investments and consequently a lower ratio of credit to deposit. Further, there exists a high rate of population per branch. Apart from this, the presence of private (Indian) banks is meagre and existence of foreign bank branches is only a recent incidence which is concentrated in one or two states of the region. Against this backdrop of poor pace of financial intermediation in the region, co-operative banks possess grater potentialities in view of its wider presence and accessibility in the rural and semi-urban vicinity. Since the network of co-operative banks is widespread across different parts of the country, these institutions are considered as a potential instruments to bring people from far-flung areas under the formal banking network. However, the poor financial health of co-operative banks in general, and grass-root level co-operatives in particular remains as an impediment, which needs to be addressed in order to fully utilise the benefits of widespread network of these institutions. It is indeed necessary for co-operative banks to devote adequate attention for maximising their returns on every unit of resources through effective services. Thus, ensuring healthy performance of such banks is crucial for the overall economic development of the region. Thus, the present study is intended to assess the financial performance of one of the State Co-operative Banks operational in one of the states of the region, i.e., The Meghalaya Co-operative Apex Bank Ltd. having its presence in the state of Meghalaya. Besides, the study also intends to evaluate the level of efficiency of the bank at its branch level. Lastly, the study tries to identify the major factors responsible for efficiency/inefficiency at the branch level.

1.1 History and Structure of Co-operative Banking in India

Co-operatives are voluntary democratically controlled organisations based on the principle of 'one man one vote'. They are organised on the principle of self-help and not-for-profit and intend to serve the interest of the members. Co-operative banks in India have made a remarkable progress in dissemination of banking services based on co-operative principles. Though much smaller as compared to scheduled commercial banks, co-operative banks constitute an important segment of the Indian banking system. They have been instrumental in creating banking habits among the lower and middle income groups. The history of the co-operative credit movement in India can be traced back to 1900-30 when the Co-operative Societies Act was passed (1904). In the year 1919, the subject of 'co-operation' was transferred from Government of India to the Provincial Government. The Government of Bombay passed the first State Co-operative Societies Act in 1925 which gave an impetus to the spread of co-operative movement in other states. Gradually, a need was felt to set up banks based on the principle of co-operation in urban centres. The Mehta Bhansali Committee (1939), Co-operative Planning Committee (1946), Rural Banking Enquiry Committee (1950) and All India Rural Credit Survey Committee (AIRCSC) also emphasised the role of urban co-operative banks. Consequently, the Reserve bank of India made a study on feasibility of such banks in 1958-59 and in its report submitted in 1961 acknowledged the indispensability of such institutions. In 1963, the Varde Committee recommended setting up of urban co-operative banks and defined the criterion of minimum capital requirement and population of urban centre where such banks should be located.

Chart 1: Structure of Co-operative Credit Institutions



SCARDBs: State Co-operative Agriculture and Rural Development Banks.
PCARDBs: Primary Co-operative Agriculture and Rural Development Banks.
Notes: 1. Figures in parentheses indicate the number of institutions at end March 2012 for UCBs and at end March 2011 for rural co-operatives.
2. For rural co-operatives, the number of co-operatives refers to reporting co-operatives.

Urban co-operative banks are the banks located in the urban and semi-urban areas. In the formative stage, co-operative banks were urban co-operative societies run on community basis and their lending activities were restricted to meeting the credit requirements of their members. With gradual growth; and also given the economic boom, urban banking sector received tremendous boost and started diversifying its credit portfolio. Besides giving traditional lending activity meeting the credit requirements of their customers they started catering to various sorts of customers', viz. self-employed, small businessmen/ industries, house finance, consumer finance, personal finance, etc. The UCBs even though treated as primary co-operative institutions, their area of operation in many cases extend to more than one state. Such institutions are registered under Multi State Co-operative Societies Act 2002. Traditionally, these banks were disallowed to provide loans to agricultural sector. But with time, their nature of operation has changed and they now cater to the financial requirements of small-scale industries, individuals and others. The Banking Regulation Act, 1949 was made applicable to co-operative banks in 1966 and Section 5 of this Act defined the 'urban co-operative bank' as a primary co-operative bank other than a primary agricultural credit society: (i) the primary objective of which is to transact in banking business; (ii) the paid-up share capital and reserve of which is not less than ₹ one lakh; (iii) the bye-laws of which do not permit admission of any other co-operative society as a member. Consequent upon the application of banking regulation, 1949 to co-operative banks, they were subjected to the dual control, one at the level of RBI and another at the level of Co-operative Registrar. The banking related functions of UCB such as licensing, area of operation, exposure norms and interest rates were subject to the control by RBI, whereas the other administrative aspects such as, incorporation, audit, management, settlement of disputes and liquidation became the subject matter for scrutiny by Registrar at the state central level. Besides, there are salary earners/wage earners/employees credit co-operative societies. While UCBs have a single tier structure, rural co-operatives have two distinct structures, i.e. short-term credit co-operatives and long-term credit co-operatives. The short-term credit co-operatives comprises of Primary Agricultural Credit Society (PACS) at the village level which forms the grass-root level, while District Central Co-operative Banks (DCCBs) are placed at the intermediate level, and the State Co-operative Banks (SCBs) operate at the apex level. The long-term structure of rural co-operatives comprises of State Co-operative Agriculture and Rural Development Banks (SCARDBs) at the state level and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) at the decentralised district or block level.

The Primary Agricultural Credit Societies (PACS) are the very foundation of co-operative societies. They operate at the grass-root level. These are the societies formed by farmers in the villages with a special objective to give a fight against the exploitations from the moneylenders and other such credit functionaries operational in the villages. PACs are multipurpose in nature. Their scheme of activities include accepting deposits, advancing credit, undertaking educative, advisory and welfare functions, promotion of the economic interests of the members, etc. The Reserve Bank of India controls the co-operative banks that falls under the banking Regulation Act of 1949.

The need for the institution of secondary tier co-operatives, with co-operatives as its members was felt. Accordingly, the enactment of the Co-operative Societies Act, 1912 was made which permitted the establishment of the higher federal or central co-operatives. Thereafter, the primary co-operative credit societies functioning in specified areas federated themselves into collective banking activities, giving birth to central co-operative banks with the prime objective to mobilise funds from urban outlets and divert the same to the village societies. Gradually, over a period of time every district in a state started having one or more co-operative bank. This reorganised them at district level to form District Central Co-operative Banks (DCCBs).

While PACs operate at the grass-root level the State Co-operative Banks (SCBs) operate at the apex level. They are formed in response to the request of Mehta Bhansali Committee in 1939. Setting up of such banks at the provincial level has added the federal character to the co-operative financial system. SCBs are formed mainly to act as a balancing centre by channelising funds from those DCCBs having surplus to those that have deficits. Further, SCBs are expected to intermediate between DCCBs, RBI and money market. The state government and DCCBs contribute to the share capital of co-operative banks. Based on the recommendations of the All India Rural Credit survey Committee Report 1954, the state government started contributing substantially to the share capital of SCBs. Initially, individuals were also permitted to subscribe to the shares of SCBs. which practice is currently eliminated. The SCBs offer financial assistance indirectly to farmers and other individuals by extending financial support to DCCBs which in turn provides support to primary co-operatives. The lending activities of SCBs include loans, cash credit, overdraft facilities, etc.

Apart from the short-term structure, there exists the long-term structure comprising of State Co-operative Agriculture and Rural Development Banks (SCARDBs) and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). The SCARDBs form the upper tier of long-term co-operative credit structure dispensing investment credit and are predominantly dependent on borrowings for their financial resources. The PCARDBs form the lower tier of the long-term credit co-operatives and are heavily dependent on borrowings.

1.2 Reforms and Reorganisations in the Co-operative Banking Sector

The co-operative credit institutions are considered to be a valuable link to the process of rural financial intermediation and are recognised as a principal institutional agent for providing agricultural credit in India. Notwithstanding to this fact, the co-operatives have failed to serve its role well in most of the cases. These institutions are encountered with multiple problems which have resulted in its fragility in terms of its performances. They encounter problems from different directions. There are internal problems with respect to its membership. Most of such co-operatives have failed to secure active member participation. Further, in many instances, non-users are often found to participate in the decision-making process and take role in Board of Directors. Further, there are operational constraints like lack of professionalisation, inadequacy of capital base, poor accessibility to financial services by its members and inability to reorganise the co-operative credit institutions as economic entities. The co-operatives are also subject to excessive politicisation and officialisation. Most of the co-operatives are operationally highly inefficient and rely heavily on refinancing facilities from government and other agencies. They also suffer from the growing competition from the commercial banks. The performance of the most vital link of the co-operative credit structure, i.e., the PACSs is also very weak. They are either dormant or are too small in size to be viable. Besides, there are governance issues.

Having recognised the co-operatives as an appropriate agency for purveyance of agricultural credit to the vast rural population including those in remote areas, studies that seek to strengthen the co-operative credit system have become a national priority. The co-operative credit structure in India is yet to adequately and appropriately transform itself into a viable and self-sustaining system. Such a scenario is highly inconsistent with the objective of enabling the co-operative banks to be effective partners in the emerging economic scenario and marching together with other financial institutions. In recognition of the continued relevance and catalytic role of co-operative banks in the development of agricultural and non-agricultural sectors of Indian rural economy in general and the need for their revitalisation, the Government of India from time to time have constituted several committees and task force to study the state of affairs and recommended suitable measures for its revitalisation. The reforms process initiated in India, aimed at attaining regulatory convergence amongst various financial intermediaries. These reforms also envisaged improving the efficiency and productivity of the rural credit delivery system which in turn would accelerate the requisite credit flow to the productive sectors of the economy.

The Government of India and the Reserve Bank of India have tailored measures for reforming the co-operative banking sector. The important measures initiated in this regard include creation of multipurpose co-operative societies by way of reorganisation of the selected PACSs. There were efforts towards rehabilitation of the identified weak banks. The 15-point programme for the development of PACSs was implemented in 16 Pilot Project Districts. Several committees were also set up from time to time to identify the problems and improve the functioning of the sector. Some of these committees are; 1. All India Rural Credit Review Committee (1969), 2. Marathe Committee (1978), 3. Khusro Committee (1989), 4. Capoor Committee (2000), 5. A. Vaidyanathan Committee (2004).

Financial reforms have not impacted the functioning of co-operative banks much. While there has been an improvement in the financial performance of the urban co-operative banking sector in recent times, the high levels of NPAs of UCBs continue to pose a threat to the financial soundness of these institutions. Rural credit co-operative institutions, both of the short and long-term nature too is beset with several structural weaknesses, such as poor resource base and high levels of accumulated losses. Besides, both rural and urban co-operatives have traditionally been subjected to a multiplicity of control from the Reserve Bank and state governments. However, as already discussed, several policy measures are initiated in the recent years to upgrade the performance of the sector. For example, the problem of dual regulatory control of the Reserve Bank and state governments over the UCB sector is addressed by way of the Vision Document – 2005, whereby the Government of India (for multistate UCBs) and various state governments (for single-state UCBs) entered into Memoranda of Understanding (MoU) with the Reserve Bank. Similarly, the Task Force on Revival of Co-operative Credit Institutions constituted by the Government of India in 2004 recommended the state governments to enter into MoU with the central government and National Bank for Agriculture and Rural Development (NABARD) for implementation of the revival package for rural co-operative institutions. However, some reform measures are strictly initiated for the UCBs. Some of these measures are:

- Subjecting the UCBs with the CRR and SLR conditionality.
- Extending the capital adequacy norms to UCBs.
- Granting flexibility and freedom in decisions concerning asset management and product planning.
- Extending asset classification and provisioning requirement.
- Tightening the norms guiding investment in portfolio.
- Initiating steps for professionalisation of management.
- Imposing grading system for monitoring.
- Implementation of CAMELS (Capital Adequacy, Assets Management, Earnings, Liquidity, Sensitivity to Risks).
- Extending the Banking Ombudsman Scheme 1995 to UCBs.
- Resolving the long pending issues of dual control.

1.3 Co-operative Credit Scenario in North-east India

The emergence of co-operative credit in the north-eastern region is only a new development in comparison to other parts and regions of the country. The co-operative movement took its start with the setting up of 'Gaonlia Banks' in 1912 in Assam. This gave an impetus in its later stage to the establishment of 'Assam Co-operative Apex Bank' in 1948. With the reorganisation of the erstwhile Assam State Co-operative bank over a period of time, the co-operative movement spread to other states in the region. The region's youngest state co-operative bank was established in Sikkim which became operational with effect from 1998.

In almost all the states of NER, there exists two-tier structure of co-operative credit, with the state co-operative bank at the apex level and the Primary Agriculture Credit Societies, Service Co-operative Societies, LAMPS (Large Sized Adivasi Multi Purpose Societies), Farmer Service Societies, etc., at the grass-root level. However, there exists separate long-term co-operative credit structure in the form of Agricultural and Rural Development Bank (ARDB) in the states of Assam, Tripura and Manipur, whereas in other states the short-term co-operative credit structure itself caters to the long-term credit portfolios.

As per the latest statistics in 2011, there are 248 branches of state co-operative banks in the region as against 1,014 branches at all India level. Table 1.3.1 presents the distribution of branches of the state co-operative banks in the different states of the region. It can also be seen from the table that in all the years Assam has the largest number of branches followed by Meghalaya. It is observed that a sizeable percentage of SCBs branches in the region are located in the semi-urban and urban areas. Only 42.42 per cent of the total branches of SCBs in the region are situated in the rural area while there is 45.67 per cent at all India level.

Table 1.3.1: Branches of State Co-operative Banks in NER *vis-a-vis* All India

State/ Year	Assam	Manipur	Meghalaya	Nagaland	Tripura	Arunachal Pradesh	Mizoram	Sikkim	Total	All India
2005	68	10	40	21	39	32	11	03	225	898
2006	68	10	40	21	39	32	11	04	225	910
2007	68	10	40	21	39	32	11	04	225	923
2008	68	10	41	21	39	32	11	06	228	920
2009	68	11	41	21	40	32	12	06	231	943
2010**	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
2011	69	11	44	22	50	33	12	07	248	1014

Source: *RBI Report on Trend and Progress of Banking in India. NA- Not Available ** Figures for 2010 is not available.*

1.4 The Meghalaya Co-operative Apex Bank Limited (MCABL)

The Meghalaya State Co-operative Apex Bank Ltd. was set up in 1971. Over its 41 years of existence, the bank has grown into a premier institution in the state. It is characterised by a two-tier credit structure with the bank at the apex level operating through 47 branches spread over the seven districts of the state. The MSCABL commenced banking operations with just two branches – one at Shillong and the other at Tura. Currently, the bank has a wide network of 47 branches, spread throughout the state providing effective banking products and other related services to the general public. Apart from mobilising deposit resources of more than 911.68 crores and accounting for advances of more than 263.23 crores as on 31 March 2010 for various developmental activities in the state, the bank has also engaged itself in various unique activities like, channelising concessional credit of NSTFDC (National Scheduled Tribes Finance and Development Corporation), NHFDC (National Handicapped Finance and Development Corporation) and NSCFDC (National Scheduled Tribes Finance and Development Corporation) to the tribals, handicapped and scheduled castes respectively of the state since 2007 with the support from the state government. Besides, MSCAB is the first bank to have two branches to be exclusively run and managed by women, and also have mobile banking service to cover seven rural centres in the East Khasi Hills District. Table 1.4.1 shows the branch expansion of the state co-operative bank(s) in the state *vis-a-vis* north-east and all India. Table 1.4.2 represents a comparative picture of CD ratio of the state as against the north-east and all India.

Table 1.4.1: Branches of State Co-operative Banks in Meghalaya *vis-a-vis* NER and All India

State/ Year	Meghalaya	Total (N.E)	All India
2005	40	225	898
2006	40	225	910
2007	40	225	923
2008	41	228	920
2009	41	231	943

Source: *RBI Report on Trend and Progress of Banking in India*

Table 1.4.2: Trend of CD Ratio of State Co-operative Banks in Meghalaya *vis-à-vis* North-east and All India

Year	Meghalaya	NE	All India
2004	24%	49%	83%
2005	22%	52%	86%
2006	21%	55%	87%
2007	25%	76%	98%
2008	27%	59%	91%

Source: *RBI Report on Trend and Progress of Banking in India 2008*

1.5 Conclusion

The importance of co-operative banks can hardly be overemphasised specially in the context of a country like India. Over the years it has shown remarkable progress on different counts especially in rural financial intermediation. It can be safely stated that there is a bright future ahead for these banks. Co-operative banks are yet to tackle the basic issues of profitability and viability. Vulnerabilities that have debilitated the system continue to abound. Instead of moving forward and stabilising, the financial strength of the co-operative banking system has displayed signs of deterioration. This has highlighted the need for a thorough and comprehensive examination of some of the vital causes for their continued weakness and need for suggesting appropriate measures required to revitalise them without much loss of time. The present study is an attempt in this direction to indentify the financial performance and branch level efficiency of the Meghalaya Co-operative Apex Bank Ltd., one of the premier financial institutions in the state and in the region.

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