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The Emerging Urban Co-Operative Banks (UCBs) In India: Problems and Prospects

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Abstract

Urban Co-Operative Bank (UCBs) are one of the most important players in the financial system of India. Although a recent innovation, these banks have been able to expand rapidly across the country through several specialized approaches. These banks typically catalyze transforming their local economies and thus fare better against decentralized competitors such as remittance companies and private equity funds. This paper attempts to outline the development, structure, and impact of UCBs in India by conducting a systematic study on this emergent phenomenon that has been gathering momentum since its launch in 2007. Despite their rapid growth, there are still many challenges confronting UCBs that must be addressed for sustainable development to continue with continuing success.

Keywords: Urban Co-Operative Banks,Borrowers, Bankers,Credit Information, Savings Services, Loans.

Introduction

In India, the number of borrowers and bankers has been increasing over time. For this system to function efficiently, borrowers need a safe and convenient way to access loans, whereas banks need a fair value for their investment in them. The emerging cooperative banking structure provides both these needs. This structure is a type of financial cooperative that provides a secure banking environment for rural communities. In 2006, India had roughly 953 million people living in rural areas, 70 per cent of the total population (World Bank 2008). To attract the Indian government and multinational corporations to invest in rural areas, it is important to provide small loans with low-interest rates to these communities. This has been identified as a key solution to poverty elimination and stimulating growth in the Indian economy (Uttar Pradesh Rural Livelihoods Project 2007). Although many banks have contributed to this cause by establishing branch locations in rural areas, the traditional banking system still does not have adequate capital or incentives to lend out money at lower rates for these kinds of projects. This has been addressed by the formation of UCBs.

The Indian government, through the Ministry of Infrastructure and Rural Development in partnership with the Ministry of Rural Development in 2006, has initiated a process to provide opportunities in rural co-operative banking in conjunction with Universal Access to Credit (UAC) that is run by the World Bank. This process is ongoing and will see five UCBs established in five countries: India, Philippines, Mexico, Bangladesh and Ecuador (World Bank 2008). In India alone, there are at least 13 such cooperative banks established which include state-owned banks such as Punjab National Bank and Punjab State Cooperative Bank.

UCBs deliver cheap credit to rural communities and make loans accessible to those who would not otherwise receive them. UCBs avoid many of the problems associated with traditional banking systems such as long wait times to receive an application for a loan, low-interest rates and lack of quality credit information (World Bank 2008). UCBs can provide loans at a price that is much lower than commercial banks and offer micro-finance services such as savings accounts to their customers (World Bank 2008).

UCBs can be of many different types depending on the community's need—such as an insurance company, micro-credit provider, farmers' co-operative, etc. There is no single template for UCBs to follow and each community has its unique needs. For example, in India, the primary purpose of UCBs is to provide credit to farmers for agricultural purposes. Customers can apply for loans using an application form that is verified by the bank's employees who know the local customers well (Jain 2007). They use their knowledge of customers' financial history, production practices and collateral to determine how much credit they are willing to loan out (Kumar 2007). UCBs employ a system of profit-sharing that encourages the UCB to be financially successful and requires the UCB to share profits with its members (Jain 2007).

UCBs can also provide services such as insurance, savings services and loans. Insurance is an important service for UCBs because it provides them with a source of income and financial security for their members (Jain 2007). Savings accounts are an important source of income for rural India's households as they can be used as collateral. UCBs can provide Saver's Credit which allows low-income people to deposit money into these accounts which they can use as collateral when applying for a loan (Higgins 2007).

Objectives of the study

The main objective of this study is to provide a comprehensive overview and description of the emerging issues and challenges of urban cooperative banks (UCBs) in India.This study provides an empirical examination of the impact of UCBs on the growth of the Indian economy.

Research Methodology

To provide clear insight on emerging urban co-operative banks in India, the present study is based on a secondary source of information. It is worth mentioning that UCBs have been playing a pivotal role in India's banking sector over the years and this insightful piece explores the prime reasons for their increased significance. The study also throws light on some of the emerging challenges being faced by these institutions and discusses measures to overcome them without any further delay.

Literature Review

This segmentreviews the literature on UCBs in India, which are comparatively new in the country. The objective of this literature review is to understand the emergence of UCBs in India, their limitations, problems and prospects for these financial service providers.

An emerging trend across the globe is that people are becoming more aware of their environment and wanting sustainable practices, with an increasing number of people looking for organic produce over conventionally grown crops. Financial services will be changing too. It is predicted that over the next decade, social finance will be a major player in the financial sector. Social finance is concerned with investing people's money in ways that benefit the community. It is most commonly associated with microfinance and microcredit, which involves giving loans to very poor people, but it has also been used to describe initiatives such as ethical banking and cooperative banking system (HARIBA, 2013).

The definition of co-operatives can be broadly categorized as:

Cooperative Societies: A co-operation is a form of working together for the common economic or social wellbeing of people with a common interest. It is a social institution in which people organize to meet their common economic and social needs and aspirations through a jointly-owned and democratically-controlled enterprise(Karthikeyan &VadivelRaja, 2014).

Self-Help Groups: Self-help groups (SHGs) are women's groups which, in recent years, have been set up to promote women's economic empowerment by forming linkages with formal financial service providers. In India, these self-help groups operate locally within villages or urban slums to promote the small business of their members. The success of these groups has been demonstrated both from the perspective of the individual member as well as at a group level. These SHGs help members improve their livelihoods by reducing risks, building savings and setting up income-generating activities (Basak, 2012).

Co-operative banks play a vital role in financial inclusion, as it provides a wide range of banking services to their customers. As per statistics, cooperative banks have the highest rural bank presence(Basak, 2012).

More than 700 urban co-operative banks are functioning in India with the largest two being the Housing & Urban Development Corporation Ltd.(HUDCO) with 500 branches and Dena Bank with 347 branches, which are subsidiaries of the Government of India. These government-owned UCBs are estimated to have an 85 per cent market share of deposits and 70 per cent lending share. number of UCBs in Maharashtra, followed by Karnataka and Tamil Nadu. A new financial regulator namely, National Financial Reporting Authority (NFRA) has been set up in India which gives a statutory status to UCBs and mandates them to come under its purview. However, UCB is outside the ambit of Reserve Bank of India (RBI) regulations and it is not advised for any non-banking entity to foray into this new business. It would be interesting to understand what is driving this sector and what are its constraints(Khan, 2014).

The concept of cooperative banks can be traced back to 16thcentury Britain when an Act of Parliament in 1732 made it compulsory for all local civic governments or parishes to form cooperative societies for each area. These local co-operative societies were given the exclusive right to issue banknotes. The emergency during the world war led the British government to place these UK co-operatives under the direct control of the treasury, thus giving rise to conventional banks. After independence in 1947, India did not have any formal regulation on the cooperative sector. The country's first cooperative credit society was set up in Kolkata n 1874 by Radha Kant Thakur. India's first cooperative bank was set up in 1952 in Kerala, followed by Tamil Nadu and Karnataka in 1954. In 1991, the Government of India passed the NCRB Act which was later amended in 2001. In 2005, a new bill called the "Co-operative Societies Bill" was introduced by the ministry of agriculture (GoI). The main objective of this bill is to provide for the amendment of the Co-operative Societies Act 1960 (Cases). The Co-operatives Act provides for registration and supervision of co-operative societies(Rao & Rao, n.d.)

15 state-level apex banks act as the regulatory body for cooperative banks. These apex banks are under direct control and supervision of the State Govt. The Banking Regulation Act 1949 (BRA), which is the basis of the regulation of conventional banks, does not apply to cooperative banks. However, provisions of the Indian Penal Code 1860 (IPC), Reserve Bank of India Act 1934 (RBI Act) and Prevention of Money-laundering Act 2002 (PMLA) do apply to co-operatives. More than 35,000 registered societies are operating under the cooperative act with cumulative deposits exceeding Rs 8 lakh crore. More than 700 urban co-operative banks are operating across the country with some prominent ones being SHG Urban Coop Bank Ltd., Jana Urban Coop Bank Ltd., Delhi State Workers' Credit Society Ltd. and Cuddalore Rural Coop Bank Ltd(Apte&Nerlekar, n.d.).

In October 2013, the government of India introduced the "Cooperative Act, 2013" which came into force from 1st January 2014 onwards. The cooperative legislation provides a framework to set up and function as a regular "life insurance company" by the cooperative societies registered under the Co-operative Societies Act, 1860 (The Cooperatives Societies Act). It also allows them to raise funds by selling equity shares and also allows banks and financial institutions to extend loans and advances to cooperatives. The Cooperative Act 2013 has replaced the older Cooperative Societies Act, 1912 and 1908 in its entirety. The Cooperative Societies Bill, 2010 which was introduced in the Rajya Sabha by the Nationalist Congress Party leader Ajit Pawar in April 2010 was finally approved by Parliament in December 2012 after a long regimen of over 4 years(KOLI, 2001).

There has been considerable debate regarding access to formal banking credit for women's self-help groups (SHG) in India because of their lack of collateral and lack of due diligence on loans extended to women borrowers. Although, there are multiple reasons for this often-cited paradox; however the main reason is based on the statement that banks perceive poor repayment records among poor women(Haqqi, 2014).

Co-operative banks in India have been emerging over the years, and it has been observed that most of the existing institutions are privately owned and operated. The evolving Indian economy is one of the main reasons for this trend. There is a need to change the current scenario, which would result in sustainable livelihoods.

The challenge facing India's Cooperative movement can be summed up with two words—the marginalization of poor people. A cooperative bank can help transform economic activities by providing an alternative avenue to reduce poverty through community-based banking services while reducing inequality(Ramkishan, n.d.).

The Emerging Urban Co-Operative Banks (UCBs) In India

As per the definition, a cooperative bank is an institution owned by its members and non-members who form part of a larger community or group. The vision of emerging cooperative banks in India is to create a bank that can serve the community by providing various financial products to the members, the local business community, SMEs, and retail customers. The bank will also provide credit facilities for agricultural produce in its region. The size of operations needed in small towns is in the range of Rs. 5 crores to Rs. 50 crore depending on region sensitivity. This will be enough to give a sound platform for growth within a small geographical area reachable in an hour's drive from its branch headquarters. Any cooperative bank must have a board made up of representatives from diverse areas which would be able to reflect the needs and aspirations of the people it serves.

The amalgamation of local co-operative societies must also be carried out. People's participation and their empowerment is the key to reviving the banks and other rural institutions. Any such effort should be based on a careful study of all such rural institutions and the causes for their decline and should aim at strengthening them with effective measures.

The current banking system in India is dominated by a few large banks, and these banks have a stranglehold on the market. The Urban Co-operative Banks (UCBs) sector has been unable to thrive due to this unfair competition. In this review, we explore how UCBs are functioning as an emerging sector with the perspective of policymakers and regulators, examining their strengths and weaknesses as well as exploring avenues for improvement.

The Urban Co-operative Banks (UCBs) sector in India has been facing pressure and challenges for a long time now. The dominant focus of the existing regulatory framework is to ensure that competition among all financial intermediaries is high and that there is no undue favouritism provided by the government to any particular enterprise. Unfortunately, this has resulted in divergent expectations amongst consumers and non-professionals, which makes the sector vulnerable to dominance by larger banks(Ramu, 2007).

The challenges faced by the UCBs sector include:

a) Scalability and expansion: UCBs face difficulty in expanding and increasing their reach across urban India. This is because the banks are not allowed to take deposits from customers less than 18 years of age, and those above 70 years. Additionally, they cannot charge interest rates on deposits, which means that all deposits made into these banks must be invested as loans. This prevents the growth of these banks as deposit sums held by them form a majority of their total capital (Ramu, 2013).

b) Decentralization / Integration with the Government: UCBs are not governed by the Reserve Bank of India, which makes them feel financially insecure due to a lack of accountability. The

Government itself is unable to help UCBs obtain capital significantly since it cannot provide the basic infrastructure required for regular deposits. Consequently, UCBs are unable to obtain finance from the Government for expansion and development. This inability is possible because UCBs have been granted a few more rights than other financial intermediaries in India(Ramesha, 2007).

c) Security of assets: UCBs have been compelled to buy assets from large banks at extremely low prices, which further exposes them to monetary losses. In this regard, they get trapped in a conflict with the dominant banking system and are subjected to unfair practices of the big banks.

The main issues faced by UCBs also include:

a) Absence of a unified identity: Due to a lack of a unified identity, the sector is unable to achieve great levels of customer trust and loyalty. UCBs cannot disassociate themselves from the onerous image projected on them by the big banks. This lack of a united identity is also apparent in their performance, which is quite uneven(Navi, 2013).

b) Lack of talent: The talent necessary to develop UCBs is not currently available. There are not enough people with the required experience; the apathy of the Government exacerbates this problem. This also results in uneven performance across UCBs.

c) Monetary management: The ability to manage monetary resources effectively is very low, exposing them to greater supervision by the RBI and financial regulators. The systems that exist are not well-defined or consistent across states or even cities. This problem is further compounded by the fact that UCBs are not allowed to charge depositors any interest, which forces these banks to invest in less-than-ideal ventures.

d) Lack of awareness: There is very poor awareness amongst the general public about the better functioning of these banks. The majority of people still prefer to keep their monies with larger banks, which results in poor deposits.

e) Non-permissible loans: The sector has no statutory authority to provide loans. This makes it difficult for the sector to compete with large banks and other financial intermediaries that can provide loans to individuals and small firms.

f) Non-availability of finance: Financial institutions are not involved in the development of UCBs, and this has resulted in the sector suffering from a lack of capital. The absence of financial support is one of the major reasons why UCBs are unable to scale up their operations (Jawahar Babu &Selkhar, 2012).

g) Poor public perception: UCBs have gained a negative image due to their association with policies followed by larger banks. Big banks have deliberately tried to malign the UCBs sector, which has also resulted in poor public perception (Gupta 2014).

h) Poor infrastructure: The infrastructure required to build a successful UCB is not present in most states. This limits the expansion of the sector and has resulted in a fragmented financial structure.

In today's world, there is a great demand for banks that are accessible to people from all walks of life. In this review, we will identify how UCBs can be a solution to this problem.UCBs have been able to carve their place in the Indian economy because they provide bank-like services while retaining certain characteristics of cooperative banks at the same time. The uniqueness of these banks lies in the fact that they are well-regulated by the RBI, but not provided with all the benefits enjoyed by other commercial banks (Sawant, 2012).

The positive aspects of UCBs include:

a) Universal banking: UCBs provide universal banking in their local area. They cater to individuals, small companies and large corporate houses alike.

b) Operational flexibility: Operational flexibility is comparatively high when compared with other financial intermediaries in India.

c) Accessible services: Most UCBs are located within or close to local communities so that their services can be easily accessed by locals.

d) High levels of customer trust: The UCBs have remained unaffected by the malpractices of larger financial institutions. Consequently, they have remained at the forefront when it comes to customer trust.

e) Decentralization: The sector does not have a centralized database that tracks all the operations of an individual bank. This has enabled UCBs to have high levels of decentralization within their operations.

f) Low costs: The low-cost structure provided by UCBs is one of its main strengths because it is supported by significant economies of scale. Consequently, it is easier for them to earn money through their operations.

g) Efficient fund management: UCBs can maintain lower levels of operational losses when compared to large banks, which results in fewer capital requirements. This is largely because they are not allowed to charge interest on deposits, unlike other financial institutions in India.

h) Non-profit making status: UCBs are not required to turn a profit to keep their operations alive. Consequently, their funds are used for social purposes only (Nair 2014).

i) Mutuality: Most of the people who belong to the community where a UCB is located have the same interests, which increases public trust. participate in its operations, such as depositing money or becoming a member. Consequently, UCBs have a strong mutuality of interest with the communities they serve.

j) Cooperative infrastructure: UCBs have a centralized infrastructure for monitoring and maintaining records on their customers and their transactions. This is used to create an efficient and cooperative environment.

k) Low-interest rates: The lending rates charged by UCBs are comparatively lower when compared to other financial institutions in India.

l) Environmental sustainability: The sector has been able to achieve this due to the collaborative efforts of various stakeholders in the sector.

m) Small size: The fact that most of the UCBs in India are small in size has enabled them to preserve their unique structures.

n) Customer orientation: Most of the UCBs in India are customer-focused, which is evident in their attitude towards running transparent and ethical organizations (Gupta 2014).

o) No visible evidence of malpractices: UCBs follow high standards in all aspects of their operations.

p) Government support: The Government of India has supported the UCB sector with various schemes aimed at increasing its profitability.

q) Achieving scale: In India, as the UCBs sector grows, it will be able to achieve higher levels of scale.

r) Cooperative values: UCBs retain their co-operative values by making a conscious effort not to make a profit from their operations.

s) National level network: The Bankers' Bank of India allows the UCBs to operate under one umbrella. Consequently, this has enabled them to operate at the national level (Gupta 2014).

t) Cost-effective banking: UCBs can provide low-cost banking services that are comparable with those offered by large banks.

Conclusion

Lack of bank account/ bad credit history can be one of the biggest hurdles for people getting started with banking. However, there are urban co-operative banks that provide accounts to financially excluded segments like women or disadvantaged groups without any hassles or fees. These co-operative banks offer low-interest deposit rates but aim to provide convenient access to cash through their traditional infrastructure like an ATM. They also offer limited services like savings accounts and credit cards. UCBs may represent a cheaper and more inclusive alternative to the large and powerful banks that dominate the Indian banking system. The main reason: they do not follow the traditional banking model of making high-return loans to profitable companies and standing ready to bail them out with government money. As such, these cooperative banks do not wish to depend on the banks' money and hence keep their deposits at a relatively high rate to attract depositors.

The basic objective of cooperative banking is to provide financial services for specific groups without having to rely on conventional methods. A new set of rules was made to facilitate an urban cooperative bank's startup and growth, which allowed more banks to operate in urban areas. The major benefits of this model are that banks are managed by the common people of the community, thereby giving them greater motivation to serve their community. They are thus able to make more localized decisions suited for their customers.

There are many strengths of these cooperative banks in India, one of which is that they are run by the customer itself with no hassles of any kind. For example, in Tamil Nadu, there are nearly 200 cooperative banks that support small entrepreneurship and help individuals become financially independent with no hassles. They assist in state-wide projects like Edayar Anna (Mother Earth) housing, an effort to provide shelter for the poor, the elderly and the disabled. UCBs also offer interest-free loans to socially excluded groups like women, unemployed youth, disabled persons and other disadvantaged communities.

There are many limitations in terms of the financial growth of UCBs in India. For example, the registration process for a cooperative bank can be very time-consuming. A new co-operative bank has to get registered under the Societies Registration Act of 1860 or/and under any one of the State Co-operative Societies Acts for that particular state. The country has no specific framework to help build up and support new UCBs especially in terms of investment, credit and financial advisory. Thus, the government must provide the right kind of environment for such banks to grow. Their growth potential is limited if they cannot find appropriate partners for them to work with. Moreover, the UCBs in India cannot provide other financial services like other banks such as investment and credit opportunities. This is why they require cooperation from other banks.

Despite many limitations that these cooperative banks face, their number is increasing every year. This proves that there exists a need for such entities to fill the gap of financial services and growth in the market. However, if they want to compete with conventional banks, they need to work together and offer bigger and diverse products and services. Their growth will only accelerate if the government provides them with more support in terms of loans, seminars and training sessions etc.

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