FUND MANAGEMENT IN COOPERATIVE BANKS

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PREFACE

A cooperative bank is a financially viable structural unit with functional specialization which belongs to its members, who are simultaneously the owners and the customers of their operating unit. With a wide range of banking and financial services the cooperative banking unit in India offers their members best possible result against their expectations and they are different from stockholder banks by their well-designed goals, values, and governance. Fund management is a rich, complex and vitally important facet of banking business. This book presents different dimensions of fund management approaches in the cooperative banking services in the country. It traces various styles, strategies, and practices introduced in the banking lending and investment services in the cooperative sector, where fund management has to play an active role. One of the leading reasons of slow progress of cooperative banking business in India is the poor financial management practices. To address what we perceive to be the diminution of fund management approaches in recent years, we offer in this volume the leading operational bottleneck along with the consequence-based practices in the financial management area of the state cooperative banks during the last decade.

The study divided into seven segments dealing with the study design, structural differences, trend and pattern analysis, resource utilization approaches, best-practice DEA score of the prevailing fund management scenario of the cooperative banking units in North-Eastern region of India, and findings, suggestions and future research outline. This book will support the reader's inquiry and help to foster in a modest way the last decade legacy and relevant aspects of fund management efficiency score of the state cooperative banks operating in the N-E Region based on their size, age, and periodic segments using static and dynamic panels and

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their ranking through the means for groups in homogeneous subsets by the R-E-G-W Range Test. In reading through the chronologically arranged chapters, a careful reader will recognize issues, connections, constraints and variables when they direct their attention to those facets of fund management approaches that are more recent. It is in this spirit that our readers are urged to continue their quest beyond the front and back covers of this volume.

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LIST OF ABBREVIATIONS

ASCB	Assam State Cooperative Bank.
APSCB	Arunachal Pradesh State Cooperative Bank.
CCB	Central Cooperative Bank.
DCCB	District Central Cooperative Bank.
FSS	Farmers Service Societies.
MESCB	Meghalaya State Cooperative Bank.
MISCB	Mizoram State Cooperative Bank.
MSCB	Manipur State Cooperative Bank.
NABARD	National Bank for Agriculture and Rural Development.
NER	North Eastern Region.
NSCB	Nagaland State Cooperative Bank.
NAFSCOB	National federation for State Cooperative Banks.
N.E	North Eastern.
PACS	Primary Agricultural Credit Cooperative Societies.
PCARDB	Primary Cooperative Agriculture and Rural Development

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PP	Profitability Performance
RBI	Reserve Bank of India.
RU	Resource Utilization
SSCB	Sikkim State Cooperative Bank.
SCB	State Cooperative Bank.
SCARDB	State Cooperative Agriculture and Rural Development Bank.
TSCB	Tripura State Cooperative Bank.
UCB	Urban Cooperative Bank.

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1

INTRODUCTION AND DESIGN OF THE STUDY

1.1 INTRODUCTION:

A cooperative bank is a financially viable structural unit with functional specialization which belongs to its members, who are simultaneously the owners and the customers of their operating unit. With a wide range of banking and financial services the cooperative banking unit in India offers their members best possible result against their expectations and they are different from stockholder banks by their well designed goals, values and governance. To deal with the practical problems democratically, elected Board of Directors from among the members accepts and complies with the ground rules. As a member of the cooperative unit every person has equal voting right, in adherence to the principle of "one person, one vote". Cooperative Banks go back to the year 1904 with a glorious history of over one hundred years of operational continuance in India. As a major advance in financial mediator in independent India, the cooperative banking units from their inception has been shouldering the responsibility to supply credit both for farming and rural growth (RBI., 1972).

To push the envelope of financial inclusion in rural India, the cooperative banking system has evolved over the decades by differentiating the credit composition into two parts, as usual in short term credit structure and in long term credit structure. As appears that the short term credit structure is not uniform throughout the country. In the bigger states, it is of 3-tier with State Cooperative banking units at state level, District Central Cooperative banking units at district level and Primary Agricultural Cooperative Societies (PACS) as a micro units at the

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base level. The network of cooperative banks, with thirty one State Cooperative banking units and twenty State Cooperative Agricultural and Rural Development banking units, one thousand six hundred six Urban Cooperative banking units, three hundred seventy District Central Cooperative banking units with around 5.04 lakhs primary level cooperative societies, covers almost all the rural community in India. The vast economic and human resources of the State Cooperative banks (SCBs) speak of the importance and contribution of Cooperative Societies as the premier and dependable rural financial institutions in India.

In the smaller states including entire NE Region, the short-range credit structure is of 2-tier: one with SCBs at the state level and the other is PACS at the base level. In few states, there are mixed short-range credit structures. In long-range credit structure comprises of federal structure and unitary structure. Under the federal structure the State Cooperative Agriculture and Rural Development banking units occupy the position at the state level and the primary agricultural and rural development banking units at the bottom level. In the case of unitary system, the branches of the SCARDBs serve the people at the base level. In the two states namely Assam and Tripura of the NE Region of India, the long - range credit structure is predominant as is evident in unitary system whereas in six other North Eastern states, the State Cooperative banking units have been serving as integrated credit structure for both short-range and long-range credit since their inception. The cluster of the cooperative credit and banking structure in the NE Region consists of eight State Cooperative banking units with two hundred nineteen branches, two Agriculture and Rural Development banking units with thirty nine branches. As per as the banking industry is concerned, the North Eastern state has one thousand two hundred seventy nine branches of commercial banking units, six hundred forty five branches of regional rural banking units and two hundred fifty eight branches of cooperative banking units.

At the forefront of the cooperative movement as an alternative and viable instrument for financial inclusion for development the rural economy passed through various experiences and spread out geographically throughout the world. The development of the world over the centuries has shown that for a concentrated development at all levels; it is ultimately the people who have to come together and organized themselves for individual

development on collective basis. In this direction, the philosophy and practice of cooperation has been an age old and time tested mechanism, which withstood the passing passages of time and waves of political, social and economic ideologies. Cooperation as a means of development has been the foundation of developments all over the world. The developed, developing as well as the underdeveloped countries have adopted cooperation as a means to their social and economic reconstruction. Cooperative means working together for the achievement of common objective. Financial enclosure, it means delivery of financial services, including banking services and credit at a reasonable cost to the vast sections of depressed and low-income groups. The various financial services would include access to savings, loans, insurance, payments and discharge facilities by the prescribed financial system to prevent financial exclusion. Democratic in features, the cooperative movement envisages as a functional mechanism for accumulating the resources of people with small means and providing them with access to different financial services. In the backdrop of the reform process underway for cooperative banks, they have a very significant role to play in facilitating greater inclusion. The vital role of the financial structure is to allocate the role of banking towards the most productive applications. The active growth and technological advance of the Indian economies suggest that our financial system has performed this task well over long periods.

As contemplated cooperative banking units are registered either under the state laws governing cooperatives or within the multi- state cooperative society's law. If a cooperative bank operates in only one state, the state law applies and in the case of cooperative banking units operating in more than one state, the law that take steps is central one. While the state law/ Central law governs the constitution and related matters, the business of banking is regulated by the banking regulation as appropriate to the cooperative banking units. The Banking Regulation Act is pertinent to the cooperative banking units subject to the modifications stipulated in Part- V (Section 56) of the Act. The Act was made applicable to cooperative banks by the banking Law (Applicable to Cooperative Societies) Act, 1965. As defined in section 5 of the Banking Regulation Act. (as applicable to cooperative societies), a cooperative banking unit means a state cooperative banking unit, a central cooperative banking unit and

a primary level cooperative banking unit.

The relative importance of funds management and study of profitability in, cooperative sector has been keenly felt only in recent years. There is a concept that the cooperative sector stands for mutual service alone and not for profit. But reasonable return on capital is essential for any concern for its growth and development. In view of growing complexity of banks' business and the vibrant working environment, fund management has become more significant, especially in the banking sector. The success of bank immensely depends upon its management of funds. In the context of globalization and application of prudential norms and deregulation of interest charge, the fund management in cooperative banks requires new orientation for attaining higher efficiency and profitability. The new approach prescribe for increasing the spread of interest, which requires the reduction in interest cost and increase of interest income in order to withstand the competition from other players (Mohan., 2008). In these circumstances, bank should focus additional attention on maintaining safety level along with optimum allocation of fund in profitable manner so as to minimize the risk level. The congregation and reallocation of resources at the lowest possible costs and deployment of resources ensuring higher yield are the essential factors that ensure the profitability, solvency and liquidity of the banking operations.

The voluminous literature in the area of operational performance of SCBs speaks little about the contribution by the SCBs particularly underlining the backward region like NE Region of India. To enhance value and to improve performance the present fund utilization practices followed by the SCBs obviously necessitate a paradigm shift in the financial, functional and operational areas. Blocking of idle cash, poor investment management strategy, irrational deposit mix with a large percentage of high cost deposit, inability to raise low cost borrowings etc. are the inhibiting factors reducing the earning capacity of SCBs and all these are the attributes of poor financial management practices and therefore it calls for further investigation particularly in NE Region of India. The selection of the topic has been made with a view to evaluating, analyzing and examining the prevailing fund management practices of the SCBs in NE Region of India.

1. 2 STATEMENT OF THE PROBLEM:

The banking landscape, particularly those relating to competition and profitability, has changed considerably over the last decade. Developments in information and financial technologies have transformed banking practices and products. Advances in information technologies contributed to the internationalization of the money and capital markets with a range of financial products. The internet connectivity has created a world of new challenges and pressure in banking services and transactions potential. While it is easier for banks to participate and compete across borders, significant changes are occurring on the demand side also. The international integration, together with national deregulation and entry of innovative types of competitors, have heightened competition between banks in the countries involved and will continue to do so in the years to come. Despite the facts that transaction costs are substantially lower for a multi-channel distribution strategy, but the competition from non-bank financial units continues to have an impact on demand, both observed and potential. As a result, response curves have shifted considerably, both on the market level and for individual banking unit, and the assumption that the price elasticity of demand faced by all banking units is the same and constant over time seems more and more questionable.

In a competitive setting a bank may not always be a price taker, especially when there is presence of increasing returns to scale, and (or) there is possibility of switching costs and product differentiation. Further, along with regulatory barriers, cross-subsidization may cause spill-over effects from one concentrated banking market to another. All these issues need an analytical framework by incorporating pragmatic suppositions about banks. For whatever reason, the existence of market power may create bank that maximizes profits without minimizing costs or vice versa. In banking operation performance measurement through intermediation approach assumes that a bank unit attracts deposits and other funds and transforms them into loans and investments using inputs such as employees, capital and materials (Altunbas, Gardener, Molyneux., & Moore., 2001). But the production approach assumes that a bank unit provides services related to loans and deposits and in this approach interest payments are not regarded as banking costs (Swank, 1995), (Berger & Humphrey, 1997). The contradiction is that as per production approach output

may be better specified as the yield to maturity plus notional income but the arguments that deposits may be included as outputs rather than inputs under the intermediation approach cannot be ruled out. Potential solutions of the issue may be a different formulation of the constraint under which each bank units can solve their minimization and maximization problems.

For survival and growth, a number of banking units within national borders may response differently from their smaller competitors. Most approaches measure the performance and competitive position of a bank as a whole, ignoring the fact that banks produce various products and operate on various markets. Competitive positions may differ per bank unit or market. Bank efficiency is highly important in explaining and interpreting bank performance. Approaches based on observation of individual bank unit can get out of this problem somewhat, as they distinguish various bank-size classes, operating on different markets e.g. small units on local market. A bank unit may produce costs and with a higher profit than other bank units if it makes better use of its resources and transforms them into outputs in the cheapest possible way. It is expected that any unit of the state cooperative bank though structurally different should operate in such a way that it pursues its own goals in what is the best conceivable optimal way. Because each bank units are agents, interacting with other agents (such as governments and consumers) in pursuing their goals, they must have to take exogenous factors into account. Further the issue relating to the efficiency measures may change over time. A special case is symmetrical shift of the productive frontier resulting from technological advances making their way into the production process. There is no sound theory providing the correct distribution of the efficiency term and there is little known about the economic validity of the efficiency scores, particularly with increasing completion, therefore, it is unsafe to transpose best practices in one unit or location to another without in-depth observations. With traditional intermediary area of expertise though the Cooperative banking units are relatively efficient, but with increasing disintermediation, the question arises as to how to measure and interpret the result. And whether the increased efficiency has not been forced by increased competition?

The rational of this work is rooted in factual information that the government revamping packages may fail to response adequately as the competition has intensified internationally.