



## Mains Practice Question

**Q.** How are cooperative banks are different from scheduled commercial banks? Examine the advantages, challenges of cooperative banks, along with suggestions for their better performance. (250 words)

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### Approach:

- Introduce by mentioning why the issue is in the news.
- Tabulate the differences between Cooperative Banks and Scheduled Commercial Banks.
- Mention the advantages, challenges and suggestions.

### Introduction:

Recently, the **Reserve Bank of India (RBI)** imposed restrictions on withdrawals from Punjab and Maharashtra Cooperative (PMC) Bank, which triggered a panic among bank customers. It has brought to the fore the issue of riskiness of banks, especially co-operative banks and the need to restore confidence among customers.

### Body:

#### Difference between Cooperative Banks and Scheduled Commercial Banks:

Cooperative Banks	Scheduled Commercial Banks
1. Provide finance to agriculturists, rural industries and to trade and industry of urban areas.	Banking services to individuals and business
2. They are owned and operated by members, who are its customers.	They include public and private sector banks, with respective government and private ownership.
3. Dual-regulation of Urban Co-operatives: <ul style="list-style-type: none"><li>▪ <b>State Registrars of Co-operative Societies (RCS)</b> - for single state banks;</li></ul> <b>Central Registrar of Co-operative Societies (CRCS)</b> for multi state banks <ul style="list-style-type: none"><li>▪ <b>RBI under <i>Banking Regulations Act 1949</i> and <i>Banking Laws (Co-operative Societies) Act, 1955.</i></b></li></ul>	Regulated by RBI under <b><i>Banking Regulation Act, 1949.</i></b>
4. <ul style="list-style-type: none"><li>▪ Operates on the principles of cooperation, such as open membership, democratic decision making</li></ul>	Operates with profit motives.

and mutual help.

5. Slightly higher interest rates.

Interest rate on deposits is less.

### Advantages of Cooperative Banking:

- **Effective alternative to unregulated banking:** Cooperative Banking provides effective alternative to the traditional defective credit system of the village money lender.
- **Easy availability of credit:** It provides cheap credit to masses in rural areas. Cooperatives Banks offers higher interest rate on deposits.
- **Encouraged the culture of savings and investments:** Instead of hoarding money, rural people tend to deposit their savings in the cooperative or other banking institutions.
- **Improved agricultural practices:** Cooperative societies have also greatly helped in the introduction of better agricultural methods. Cooperative credit is available for purchasing improved seeds, chemical fertilizers, modern implements, etc

### Challenges of Cooperative Banks:

- **Organizational and financial limitations** of the primary credit societies considerably reduce their ability to provide adequate credit to the rural population.
- **Transparency issues:** Banks show inadequate governance and financial irregularities which have multidimensional impacts.
  - For ex: financial irregularities, failure of internal control and system, and underreporting of exposures in case of PMC Bank issue.
- **Resource constraints:** Raising working capital has been a major hurdle in their effective functioning. Also, **large amounts of overdues** restrict the recycling of the funds and adversely affect the lending and borrowing capacity of the cooperative.
- **Competition from other banks:** With faster adaptability of technology and customer friendly services, people prefer taking credit from Scheduled Commercial Banks, Payments Banks, and Small-Finance Banks.
- **Regional Disparities:** Cooperatives in other states are not as well developed as the ones in Maharashtra and Gujarat. There is a lot of friction due to competition between different states which affects the working of cooperatives.

### Suggestions for their better performance:

- **Countering dual-regulation problem:**
  - Setting up of an independent regulator for Urban Cooperative Banks.
  - Setting up a board of management of eligible and proper persons as opposed to elected Directors. **(H Malegam committee)**
  - Merging and converting some of the Co-operative Banks to Small Finance Banks **(R. Gandhi Committee)** as is being implemented under the voluntary transition scheme of RBI.
- **Resolving capital issues by forming a Joint Stock Company:** An umbrella organization should be promoted by the banks themselves to raise the capital from the market.
- **Empowering RBI:** RBI should be empowered to implement resolution techniques such as winding-up and liquidating banks, without involving other regulators under the cooperative societies' laws.
- **Regular scientific audit system:** State governments should regularly conduct a forensic audit of the loan portfolios & purchases of a representative sample of cooperative banks. Accountability for erroneous audit along with penal action should also be ensured through appropriate statue.

### Conclusion:

Hence, the RBI must ensure that Cooperative Banks adopt more professionalism in order to retain people's confidence in the banking sector.

