

# Cooperatives for Financial Inclusion in India: Concerns and Challenges

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**Abstract**—Many economic growth stories from different parts of the world help us draw one clear conclusion that growth can be sustainable only when it is inclusive. A growth process that amplifies inequality will lack durability and will pose an eventual threat to economic and social stability. A major section of the Indian population subsists on the periphery of the financial systems of India. In order to attain inclusive growth, financial inclusion is a critical link. Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan). To assess the reach of banking services in 100 countries, a first-ever Index of Financial Inclusion ranked India 50. A very low proportion of Indians, 34%, have access to banking services. There are several challenges in elevating the effective participation within cooperatives in India. The paper discusses the contribution of cooperatives for achieving financial inclusion in India and how the different factors play crucial role in building cooperatives for attaining financial inclusion.

## 1. INTRODUCTION

Developing countries need rapid economic growth, but when it comes to effective poverty reduction, it is the distribution of that growth that matters. Growth of any country can be sustainable only when it is inclusive. A growth process that amplifies inequality will lack durability and will pose an eventual threat to economic and social stability. Growth, which is exclusive, has a far-reaching affect on the society, the economy, and the polity. A country lacking inclusive growth will face real or apparent inequities, which will have its own social consequences. A major section of the Indian population subsists on the periphery of the financial systems of India.

In order to sustain economic growth, reduce poverty and economic disparities, inclusive growth needs to be achieved and linked critically.

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this in the backdrop, the Planning Commission charted the Eleventh Five Year Plan (2007-2012) with inclusive growth as its explicit goal. The Twelfth Five Year Plan (2012-2017) draft mentions twelve strategy challenges which continue to focus on inclusive growth. Enhancing the growth capacity, employment generation, infrastructural advancement, accessible quality education, rural transformation, sustained agricultural growth were some of the goals listed. It is essential to deliberate all efforts towards inclusive growth as it is interrelated with numerous key issues faced by the government, like agricultural development, minimizing regional disparities, reducing poverty, social sector development, better and more employment avenues.

A society can be called financially inclusive only when all the segments of the society have accessible, timely, and adequate sources of formal credit and financial services. Access to finance is especially important to the poor and marginalized sections of the society as it aids them to process a sustainable living and alleviates them from poverty. Today, the majority of the Indian population is without access to financial services and products, like loans, savings accounts, pension schemes, insurance, etc. Banking penetration is estimated to be only about 5% among the lower income classes, and even among the middle- and high-income classes the penetration is about 45%.

Lack of access to formal banking and credit mechanisms in the already vulnerable lower income group drives them to borrow from informal sources at usurious interest rates. Apart from obstructing their ability to pay back, they get drawn into further debt and lose a substantial portion of their already inadequate earnings, worsening poverty levels and in some cases driving the debtor to commit suicide.

Recognizing the importance of a financially inclusive society, the RBI has formulated policies such as the mandate for banks to offer no-frills account, simpler Know Your Customer norms, and easier credit facilities (such as the General Credit Cards scheme) which are tailored towards serving the unbanked population and increasing banking penetration. Both, public and private sector financial institutions need to

give a further impetus to drive financial inclusion over the coming years.

Essentially, there have been two major factors making the cooperatives a success around the world viz., the extent of government control, and the degree of member participation. The level of preparedness of the cooperatives to face competition also acts as a determinant in today's globalized environment. There have been concentrated efforts by the Government of India and the Reserve Bank of India to promote financial inclusion as an important national objective. Certain major efforts made in the last five decades include - nationalization of banks, building up of robust branch network of scheduled commercial banks, co-operatives and regional rural banks, introduction of mandated priority sector lending targets, lead bank scheme, formation of self-help groups, permitting BCs/BFs to be appointed by banks to provide door step delivery of banking services, zero balance BSBD accounts, etc. Essentially, these initiatives aimed at reaching the large segments of the Indian population, which up until now was financially excluded.

## 2. CREDIT COOPERATIVE MOVEMENT

The popularity of the cooperative model has increased considerably throughout the world in recent years. One important reason for this is that the cooperative model has shown relatively strong resilience during recent financial and economic crises (Birchall and Hammond Ketilson, 2009). The interest in cooperative organizational forms has been stimulated by the United Nations. The UN has declared 2012 the International Year of Cooperatives (IYOC) in recognition of the worldwide importance of cooperatives for economic and social development. It is considered that Cooperative model of business may help in poverty reduction significantly and contribute greatly for inclusive growth through improvement of economic structure.

Historically, the credit cooperative movement emerged in response to a famine, which hit parts of Germany and other European countries in 1846/47. It also surfaced in the face of widespread poverty, usury, and expropriation in the middle of the shift from an agricultural to an industrial society. Indebtedness spread, peasants lost their farms to moneylenders, and small businesses went bankrupt. The interventions by state government proved to be ineffective while the measures taken at the individual and local level provided some relief. Schulze and Raiffeisen were among those who took initiatives in this regard in their respective societies, building on informal traditions in the area. A system of functional charity was established with a goal of promotion of self-help. This model replicated in countries, on principle, developed around self-help, self-reliance based on savings mobilization; self-determination and self-governance, with independence from government local area outreach and local enterprise promotion, with lasting relationships between bank and member-customer; individual savings and credit accounts

(rather than group credit); limited liability (together with collateralized lending) replacing joint liability; a legal and regulatory framework integrating credit cooperatives into the formal financial sector; indirect (auxiliary/ delegated) prudential supervision through auditing federations with mandatory membership of cooperatives, enabling the central bank to effectively supervise large numbers of small institutions through their apex organizations. Unlike the somewhat older savings banking movement, where municipalities and other government bodies mostly played a strong role as initiators and owners, credit cooperatives kept government out.

The year 1894 marked the dawn of this new system of rural finance in India, immediately after its emergence in Europe. The Co-operative Credit Societies Act was passed in India in 1904, and similarly in Burma, standardizing experiments made by various officials and "replacing the money lender by... the Raiffeisen Bank." As it turns out, India witnessed the largest credit cooperative movement worldwide but coincidentally government intervention, with the best intentions, ultimately played a destructive role, which it is now struggling, at great cost and enormous difficulty, to revive and reverse.

Credit cooperatives in India were very responsive, taking off with a legal framework. Compared to any other country, their expansion in India was more rapid. By 1912 credit cooperatives numbered 8,000; by the mid-1920s, they had reached around 50,000. Low rates of interest in the range of 9%-12% p.a., a fraction of those charged by moneylenders, was one of the factors contributing to that growth.

## 3. PROBLEMS FACED BY THE CREDIT COOPERATIVE SYSTEM IN INDIA

In the mid-1950s, the State cooperative law was passed which provided for state partnership in terms of equity, governance and management worsened the disease.

Encumbered by an ideology of central planning, the state assumed full control over all institutions including cooperatives. Members and local communities got alienated from governance. Instead, state governments were given full authority in matters such as appointment of chief executives, suspension of elected boards of directors, fusion or fission of co-operative banks, amendment of bylaws, vetoing of bank decisions, issuing of directives, supervision and enforcement of regulation, or rather the politically expedient absence of enforcement. Charge of registration, licensing, statutory inspections and audit of the cooperative banks was given to state cooperative administration. The states participate also in the ownership of cooperative institutions, at all levels. The original system and spirit of self-management and self-reliance got replaced by bureaucracy, government intervention, and loan channeling. As stated by the Committee on Financial Inclusion, in the 1990s "an increasing realization of the disruptive effects of intrusive state patronage and politicization of the cooperatives, especially financial

cooperatives... resulted in poor governance and management and the consequent impairment of their financial health." The system became borrower-driven, and the concept of mutuality and self-reliance was lost.

Since its inception, the Credit Cooperative System (CCS) grew continually in quantity and complexity. By 2006, almost 15,000 banking outlets and 106,000 primary credit cooperatives, with a total number of 135m shareholders were under this CCS. However, while cooperative finance is part of the self-help movement, its establishment and expansion in India involved the government as an active participant and promoter from inception. This stood in sharp contrast to countries like Germany, the Netherlands and others where the state was kept at bay, entering only in due course upon the request of the movement to provide a legal framework.

The results of this change in principles have been disastrous: by 2006 large numbers of cooperative banks, and more than 50% of primary credit cooperatives (PACS), were loss making – probably many more if international accounting standards were applied. According to NABARD's Annual Report for 2006, cooperative credit institutions suffer from low resource base, high dependence on financing agencies, imbalances, poor business diversification and recoveries, huge accumulated losses, lack of professionalism and skilled staff, weak MIS, poor internal check and control systems, etc. As of 31 March 2006, large numbers of cooperative institutions incurred losses: 4 out of 31 reporting state cooperative banks (SCBs), 88 out of 366 district central cooperative banks (DCCBs), 53,626 out of 105,735 primary agricultural credit cooperative societies (PACS), 8 out of 19 reporting State Co-operative Agriculture and Rural Development Banks (SCARDBs) and 194 out of 696 reporting Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). The total accumulated losses of the cooperative banking sector, excluding the PACS, amounted to Rs. 91.4 billion (US\$2.05bn).

The collective revenue of the world's largest co-operative enterprises is about USD 1.6 trillion. According to the ILO, Financial cooperatives serve over 857 million people – 13 per cent of the world population while agricultural cooperatives produce 50 per cent of global agriculture output. The ILO estimates that almost a 100 million jobs are provided by cooperatives amounting to 20% more jobs than being created by the world multinational companies. In industrialized and developing nations cooperatives play an important role in the economic development. To take Switzerland as an example, cooperatives are the largest private employer including well known cooperatives like Coop, Migros, and Raiffeisen Bank. Cooperatives can include Agricultural or farmers' cooperatives; Consumer Cooperatives; Housing cooperatives; Public service provision cooperatives; Shared services cooperatives or support services cooperatives; Worker cooperatives; Producer cooperatives; Labour cooperatives.

Social cohesion is one of the three pillars (together with living standards and productivity) identified by the World Bank that foster development through jobs. Cooperatives provide jobs and at the same time they support social cohesion. Cooperatives have a dual purpose in fostering development and helping countries in times of crisis namely through 1) economic performance; and 2) by offering opportunities for social integration. They offer an alternative to the social vacuum caused by joblessness, poverty, social disturbances and underperforming or non-existing institutions which are badly needed in poverty stricken Low Income Developing Countries consisting mostly of an informal sector and wide spread unemployment negatively affecting particularly youth and vulnerable groups of the society. In view of the possibility that the current recession will deepen in European countries, youth unemployment will become persistent.

Cooperatives as an organizational form can very well serve as alternatives of economic development based on inclusive growth, but for that sustainability over time and growth potential to generate good jobs and reasonable profits for its members and community is necessary. Examples in Europe, Switzerland (Migros, Coop, Raiffaisen), Kenya (Cooperative Bank of Kenya Ltd., CIC insurance), Lesotho (Boliba Savings & Credit) demonstrate the economic viability and growth potential of cooperatives. Yet, insufficient knowledge is available to replicate these experiences, especially in the context of international cooperation and technical assistance. The South-South Cooperation (India – case for Amul Milk Cooperative and Brazil - Mondragon) offer an interesting vantage point to understand cross border cooperation when introducing managerial practices and performance measures from one cultural and business context to another.

Today, the outreach of cooperatives is across India; each and every village is covered. In India, the share of Cooperatives in Agriculture Credit disbursement is 46%. 32% of Wheat procurement and 65% of Storage facility, all is handled by cooperatives. In fertilizer production and distribution, the Indian Farmers Fertilizer Cooperative (IFFCO) commands over 35 percent of the market share with more than 50 million farmers associated with it. In the production of sugar the cooperative share of the market is over 58 percent and in the marketing and distribution of cotton they have a share of around 60 percent. The cooperative sector accounts for 55 percent of the looms in the hand-weaving sector. Cooperatives process, market and distribute 50 percent of edible oils. Dairy cooperatives operating under the leadership of the National Dairy Development Board and through 15 state cooperative milk-marketing federations has now become the largest producer of milk in the world.

Poor infrastructure, lack of awareness, inadequate management quality, over-dependence on government, abeyant membership, non-conduct of elections, lack of strong human resources policy, neglect of professionalism, restricted coverage are some of the low-spirited areas of Indian

Cooperatives. Cooperatives are also unable to evolve strong communication and public relations strategies, which can promote the concept of cooperation among the masses all, hinder the growth, expansion, and vitality of the cooperatives.

#### 4. CONCLUSION

Rapid and sustainable growth needs to be facilitated through holistic and integrated solutions in order to achieve the ultimate goal of inclusive growth. The task of building an Inclusive India for its 1.2 billion people is so large and complex that it cannot be accomplished either by the government or by the private sector working in isolation. This imperative undertaking calls for resolute actions towards bringing inclusion in each and every aspect of how individuals, public and private enterprises as well as the government operate and envisage growing. Financial inclusion is a great step to palliate poverty in India. However, to achieve this, the government should provide an environment in which cooperative banks are free to pursue the innovations necessary to reach low-income consumers and still make a profit. Rural Financial service providers should learn more about these consumers and new business models to reach them. Unnecessary institutional bottlenecks need to be done away to provide a smooth and simple functional environment.

Government should facilitate enabling environment for existing and budding cooperatives. Proper dissemination of objectives knowledge and information about the potential strength is paramount. The main guiding principal should be economic motives and implicit aim of subsidization and political inference are fundamentally not correct and should not focused. Cooperatives are required to expose to global

economic factors and need to develop quickly their organizational structure, scale to reach critical masses, use of latest technologies etc. to operate globally with maturity. It is essential to acknowledge that various strategies are there for success of cooperative development for inclusive growth. It is incorrect to rule out any particular approach and continue dogmatically with a chosen one if this does not seem too feasible after a while. Flexibility and innovation is required for success of plan.

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