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Financial inclusion and inclusive growth: Perspectives on urban co-operative banking in India

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Abstract
Banks play a major role in not just purveying credit to the productive sectors of the economy but also as facilitators of financial inclusion. Co-operative banks play an important role in meeting the credit requirements of both the urban and rural India. Though the cooperative banks account for a small share in the total credit they hold a significant position in credit delivery as they cater to different geographic locations and demographic categories. The wide network of co-operative banks, both rural and urban, supplements the commercial banking network for deepening financial intermediation by bringing a large number of depositors/borrowers under the formal banking network. Demographically, these institutions have enabled access to financial services to low and middle-income groups in both rural and urban areas. A nation can grow economically and inclusively only if it's excluded population can turn out to be financially independent. Cooperative banks emerged as the best way to reach those sections of disadvantaged and low income segments of society who are excluded from benefits of delivery of financial services at affordable costs. This paper mainly attempts to examine the role played by urban cooperative banks in India in priority sector lending in achieving financial inclusion and thereby to facilitate inclusive growth.

Keywords: Financial inclusion, Inclusive Growth, Priority Sector Lending, Urban Co-operative Banks.

1. Introduction
The concept of inclusive growth has gained increasing policy attention when it was introduced for the first time in the 11th Five year Plan. It is credit and financial services that contribute capital formation in the economy which is considered as an essential pre-requisite for inclusive and sustainable economic growth. Therefore, access to a well-functioning financial system, by creating identical opportunities, enables economically and socially excluded people to integrate better into the economy, so as to actively contribute to development and protect themselves against economic shocks (RBI, 2008) [8]. This makes growth broad based by meeting the small and frequent needs of the bottom of the pyramid. The role played by urban co-operative banks in this regard is unavoidable.

The Co-operative movement has a long history in India. Co-operative societies were set up in India towards the close of the nineteenth century drawing inspiration from the success of experiments related to the co-operative movement in Britain and the cooperative credit movement in Germany. The co-operative movement involves autonomous association of persons united voluntarily to meet their common economic, social and cultural needs through a jointly owned and democratically controlled enterprise. Mutual help, democratic decision making, voluntary and open membership, economic participation, autonomy etc are the basic principles on which the co-operative structure is designed. Thus the principle of mutual aid, which is the basis of cooperative organisation, and the practice of thrift and self-help which sustain it, generate a feeling of self-reliance and empowerment.

Among all cooperative movements, Cooperative banks are the oldest and the most numerous in India. Many of them are nearly a century old. The cooperative banks arrived in India in the beginning of 20th century as part of Government's effort to develop a new type of institution, based on the principles of cooperative organisation and management. Cooperative banks came into existence with the enactment of the Cooperative Credit Societies Act of 1904.

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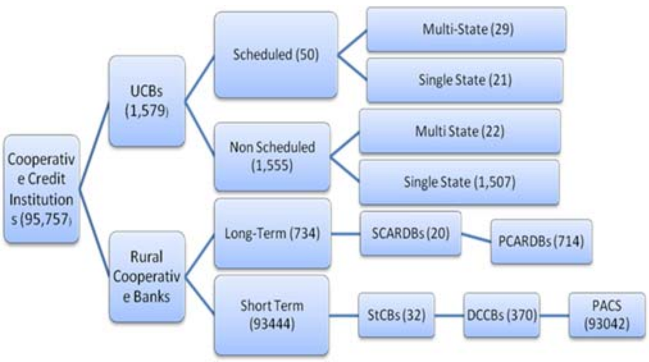
Cooperative banks are credit institutions formed primarily to provide banking services to their members. These banks were conceived as substitutes for moneylenders, to provide timely and adequate short term and long term institutional credit at reasonable rate of interest. With a wide network and extensive coverage, these institutions have played an important development role in enlarging the ambit of institutional credit by way of inculcating banking habits among the poor and those in remote areas. Most of these banks cater exclusively to a particular community or category of members, e.g. farmers, traders, the salary earners, women, villagers, workers etc.

The cooperative credit structure in India consists of two broad segments, viz., the Urban Cooperative Banks (UCBs) and the Rural Cooperative Credit institutions. UCBs concentrate on credit delivery in urban areas, while Rural Cooperatives concentrate on rural areas. While the urban cooperative banking system has a single tier comprising the Primary Cooperative Banks commonly known as urban cooperative banks-UCBs, the rural cooperative credit system is divided into long term and short term cooperative credit institutions, which have a multi-tier structure. The structure of the cooperative banking sector in India is provided in Chart (1). Generally, the short term and medium term agricultural credit needs are satisfied by the state co-operative banks, the central co-operative banks and the primary agricultural credit societies constituted at apex level, district level and village level, town or city level respectively. While long term agricultural credit needs are satisfied by State Co-operative Agriculture and Rural Development Banks and Primary Co-operative Agriculture and Rural Development Banks. The UCBs have been playing an important role in the socio-economic development of the country by making available institutional credit at affordable cost, particularly, in the urban and semi-urban areas. The cooperative credit endeavour was the first ever attempt at micro credit dispensation in India (The High Power Committee on Urban Cooperative Banks, 1999).



Source: Report on Trend and Progress of Banking in India 2014-15

Chart 1: Structure of Co-Operative Credit Institutions in India Position As On March 31. 2015

- **StCBs:** State Cooperative Banks;
- **DCCBs:** District Central Co-operative Banks;
- **PACS:** Primary Agricultural Credit Societies;
- **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 2015 for UCBs and at end- March 2014 for rural co-operatives.

2. Review of Literature

Asher (2007) [4] argued a case for a paradigm shift in the way urban cooperative banks (UCBs) are managed, governed, and regulated in India to enable them to enhance their contributions to achieving greater degree of financial inclusion, and more broad based growth. He argued that if the UCBs are to remain relevant and play a significant developmental role in India, they will require same quality of governance and regulation as well as professionalism and modernization as the mainstream commercial banks. The governance and regulatory structures need to be brought in conformity with India's current and prospective economic structure; and relevant laws modernized. This requires a paradigm shift in the role of UCBs. Beenu Singh (2011) suggested Relaxation of KYC norms, opening of branches in unbanked rural centres, and opening of more brick and mortar branches in order to improve banking access and thereby to achieve financial inclusion rapidly. Besides the use of Business Correspondents, extensive use of PACS (Primary Agricultural Cooperative Societies) would provide valuable services to their members with a sense of belongingness and there is a need to revitalize these cooperatives as per the Vaidyanathan Committee for financial inclusion in the rural areas. Ranjan Kumar Nayak (2012) [5] argued that though the number of poor is decreasing over the years but the trend is not substantial signifying that Indian growth is not inclusive. Since cooperative banks are local in nature and cater the needs of local people, they have a clear advantage over commercial banks for financial inclusion. Also, labour costs and operating costs of cooperative banks are considerably less than that of commercial banks. It is evident that cooperative banks have feasible options for inclusive growth through rural development, creating opportunities for employment and income generation. Anurag Singh and Priyanka Tandon (2012) [10] stressed that the banks need to redesign their business strategies to incorporate specific plans to incorporate financial inclusion of low income groups treating it both a business opportunity as well as a corporate social responsibility. All these studies emphasise the importance to be given to the cooperative banks in achieving inclusive growth. But none of the studies emphasis the role played by the urban cooperative banks with respect to priority sector lending as a means to achieve inclusive growth. Against this background the study aims to analyze the role played by the urban cooperative banks in the inclusive development of the country.

3. Statement of the Problem

In semi-urban and rural areas, there are a number of unbanked and under banked districts occupied by people like artisans, migrant labour, small businessmen, retailers, etc., who find it difficult to join the formal financial sector and they depend on rural or urban credit institutions for their small needs. These classes of people are expected to contribute economic development of the society. The cooperative banks, both rural and urban, can certainly take a lead in this. Cooperative banks, though account for a small proportion of the total business undertaken by the banking system in India, have a prominent place in the Indian financial landscape owing to their potential role in furthering financial inclusion as also because of financial inter linkages that these institutions have with the rest of the financial system. Moreover, their potential is tremendous in our country as they are providing such a type of customised services they can offer at the local level. This paper highlights the main role played by the urban cooperative banks in India to achieve inclusive growth and also attempts to evaluate the credit extended by these banks to priority and weaker sectors in promoting financial inclusion in India.

4. Objectives of the Study

The main objectives of the study are**:**

- To analyze the composition of advances of urban cooperative banks to priority and weaker sectors in India during the last seven years.
- To examine the performance of urban co-operative banks in priority sector lending in India in promoting financial inclusion.

5. Methodology

The study mainly relies on secondary sources of information for analysing the role of urban cooperative banks in promoting inclusive development of India. The report on Trends and progress of banking in India by RBI, various published articles and websites etc have been used for this. To analyze the composition of advances of UCBs to priority sector and weaker sectors and their performance in promoting financial inclusion, a seven year period from 2007-08 to 2013-14 have been employed. To analyze the above objectives, statistical tools such as tables, percentages, compound annual growth rate, t ratio and R square have been applied.

6. Results and Discussion

6.1 Financial Inclusion-The Role of Urban Co-Operative Banks

The Committee on Financial Inclusion in India headed by Dr. C. Rangarajan, has defined Financial Inclusion 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”. It implies incorporating the excluded population in the financial system of the country, and to ensure that their financial & social security needs are taken care of through suitable financial service providers. The essential elements of financial inclusion includes access to payments, remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded from the formal financial institutions.

The client profile of cooperative banks in general and urban cooperative banks in particular predominantly consists of priority sector segments viz. small business establishments, SSI, retail traders, self-employed, etc.,. Thus, UCBs, by their very structure and nature of clientele, are well designed to cater to financial inclusion. Considering the specific features of UCBs such as their organisational structure (member-driven), clientele, easy access and reputation as a friendly neighbourhood bank, these highly localised institutions have the potential for widening and deepening financial inclusion in their area of operation by pooling their individual resources. The priority sector loans of the UCBs are today at 46 per cent while the prescribed target was 40 per cent. To this extent, UCBs are already contributing to financial inclusion. However, there remains a huge hidden potential waiting to be tapped. Given with 271 districts not having any presence of UCBs, there exists a huge prospective for UCBs to increase their spread and business and also take part in the national mission of financial inclusion.

Table I: Details of Deposits and Loans Accounts Of Ucbs (As At End-March 2010)

Item	Scheduled	Non scheduled	All UCBs
1	2	3	4
Number of Deposit Accounts	2,19,15,317 (35.5)	3,98,45, 850 (64.5)	6,17, 61,167
Of which: No-frills Accounts	3,41,434 (27.5)	8,98,007 (72.5)	12,39,441
Number of Loan Accounts	12,51,546 (8.0)	1,43,03,228 (92.0)	1,55,54,774

***Source*:** Report on trend and Progress of banking in India, 2009-10
Note: Figures in parentheses are percentages to respective totals.

Introduction of ‘no-frills accounts’ is considered as one of the most important steps to expand the banking network among the number of initiatives. Notably, UCBs also opened a considerable number of ‘no-frills accounts’ so far. Since the non-scheduled UCB sector handles more banking business than the scheduled UCB sector, the number of deposits accounts, ‘nofrills’ accounts and also loan accounts were higher in the non-scheduled sector as compared to the scheduled sector. However, the share of loan accounts of the non-scheduled sector vis-à-vis scheduled sector was particularly striking as the scheduled sector was having only eight per cent of the total loan accounts of the entire UCB sector as compared with its non-scheduled counterparts.

6.2 advances to priority sectors and weaker sections

The concept of priority sector was evolved after Nationalization of banks in 1969 with a view to lending to priority sector areas as this will result in to employment generation and consequent income generation. The scope of these sectors was changed from time to time by the Reserve Bank of India. In order to include socially excluded population such as SC, ST and women “weaker sector” was defined. Thus priority Sector lending was made more and more focused on the excluded now a day. UCBs were started to priority sector lending targets in 1983 on account of the important role played by these institutions in providing banking facilities to low and middle income groups from urban and semi-urban areas. Presently, UCBs have to provide 40 per cent of their Adjusted Net Bank Credit (ANBC) or credit equivalent of Off-Balance Sheet Exposure (OBE), whichever is higher, as on March 31 of the previous year, to priority sectors. Of this target, at least 25 per cent needs to be given to ‘weaker sections’. However, unlike SCBs, UCBs are not bound by any separate target for agriculture due to the particular nature and area of operation of such banks. But, now a day, these banks are also extending loans to agricultural sector also.

Sector- wise advances of UCBs have been classified into two parts i.e. priority sector and weaker section. Under priority sector and for weaker sector, the advances are made under seven heads i.e. agriculture & allied activities, retail trade, small enterprises, education loans, housing loans, micro credit and state sponsored programmes for SC/ST. Out of these, Small enterprises, housing loans and micro credit, are the three major constituents in terms of priority in providing credit to weaker sections by UCBs. The composition of advances of Urban Cooperative Banks to priority sectors and weaker sectors during the last seven years is presented in table (1). As at end-March 2009, a large part (39 per cent) of the priority sector advances of UCBs was towards small enterprises closely followed by housing loans (with a share of 25 per cent). Further, UCB credit to small enterprises recorded a phenomenal growth of 41 per cent during 2009-10 contrary to the concerns about a slowdown in bank credit to these enterprises following the global crisis.

Table 2: Sector- Wise Classification of Advances to Priority Sectors and Weaker Sectors by Urban Cooperative Banks (Amount in Rs. Crore)

A	2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14	
	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Sector Section	Priority Sector	Weaker Section
1) Agriculture & Allied activities	5,363 (11)	1,464 (12)	4,731 (9)	1,732 (12)	6,383 (9)	2,225 (12)	3954 (6)	1507 (8)	5800 (7.5)	2100 (11)	6,800 (8)	2,300 (10)	5,800 (6)	2,400 (9)
Direct Finance	2,264	614	1,415	537	1,882	611	NA	555	1,900	800	2,500	700	2,300	900
Indirect Finance	3,099	850	3,316	1,195	4,501	1,614	NA	952	3,900	1,300	4,300	1,600	3,500	1,500
2) Retail Trade	10,271 (22)	2,828 (23)	10,235 (19)	2,958 (20)	10,429 (15)	3,005 (17)	-	-	-	-	-	-	-	-
3) Small Enterprises	15,011 (32)	3,418 (28)	21,283 (39)	3,748 (26)	29,279 (41)	4,400 (25)	36812 (59)	11928 (63)	36,600 (48)	7,400 (38)	42,500 (50)	7,700 (34)	46,100 (47)	7,810 (30)
Direct Finance	8,697	2,013	15,331	2,866	20,622	3,207	NA	9,991	30,600	5,800	36,800	6,200	39,800	6,200
Indirect Finance	6,314	1,405	5,952	882	8,657	1,193	NA	1,937	6,000	1,600	5,700	1,500	6200	1,700
4) Education Loans	610 (1)	186 (1.5)	1,461 (3)	557 (4)	1,838 (3)	591 (3)	1363 (2)	399 (2.1)	2000 (2.6)	700 (4)	1700 (2)	700 (3)	1,700 (2)	700 (3)
5) Housing Loans	11,916 (25)	3,155 (26)	13,882 (25)	4,271 (29)	17,923 (25)	5,213 (29)	16361 (26)	4,021 (21)	18,300 (24)	5,300 (27)	19,500 (23)	6,800 (30)	20,600 (21)	7000 (27)
6) Micro Credit	3,012 (6)	946 (8)	3,130 (6)	1,035 (7)	4,779 (7)	2,077 (12)	3954 (6)	1000 (5.3)	14,200 (18)	4,100 (21)	13800 (16.2)	4900 (22)	3,200 (3)	1,100 (4.3)
7) State ponsored Programs for SC/ST	675 (1)	152 (1)	526 (1)	273 (2)	754 (1)	387 (2)	273 (0.4)	96 (0.5)	200 (0.3)	100 (1)	100 (0.1)	50 (0.2)	200 (0.2)	100 (0.4)
8) Others	-	-	-	-	-	-	-	-	-	-	-	-	19965 (21)	6473 (25)
Total	46,859	12,149	55,248	14,573	71,385	17,898	62716	18951	77,000	19,500	85,300	22,500	97,600	25,700

***Source*:** Trend and Progress of Banking in India, various issues
Note: Figures in parentheses are percentages to respective totals.

As at end-March 2010, about 65 per cent of total advances of UCBs went to priority sectors of which more than 16 per cent of the total advances went to weaker sections. The composition of the priority sector lending of UCBs as at end-March 2010 showed that maximum loans under priority sectors went to small enterprises sector followed by housing and retail trade. Further, the composition of lending to weaker sections showed that almost one third of it went to the housing sector and another one fourth went to small enterprises implying that UCBs play an important role in providing adequate and timely credit to small and weaker sections of the society. As at end-March 2011 advances to priority sectors by the UCBs constituted almost 46 per cent of their total advances. A further breakup of total priority sector advances revealed that small enterprises and housing loans constituted almost 59 per cent and 26 per cent, respectively, of total priority sector advances. The share of agriculture under priority sector declined in consequent years. Given their urban focus, UCBs mainly cater to the credit needs of small enterprises and the housing sector. These two sectors accounted for nearly one-third of the total priority sector credit of UCBs in 2011-12. Micro credit, a component of the priority sector, has increased in terms of importance for UCBs. Within the total priority sector credit given to weaker sections, which can be taken as a reflection of the contribution of UCBs to financial inclusion, micro credit showed a significant increase in 2011-12.The aggregate credit to weaker sections has increased in 2012-13 reflecting improved financial inclusion efforts by UCBs Thus, these institutions primarily cater to the requirements of urban consumers which explains the predominance of these two sectors in the UCBs' credit portfolio. Small enterprises, housing loans and micro credit, are the three major constituents in terms of priority in providing credit to weaker sections by UCBs. The aggregate credit to weaker sections has increased in 2012-13 reflecting improved financial inclusion efforts by UCBs.

The percentage share of priority sector and weaker sector in total advances (Table 2) exhibited an increasing trend during the years 2007-08 to 2009-10, then it started to decline in the year 2010-11 and in the consequent years there is only a small increase. The same trend is noticed in the case of weaker sector also. The compound growth rate in the case of priority sector lending over the seven year period was 13.00 percent and in the case of weaker section the CAGR accounts 13.29 percent.

Table 3: Percentage Share of Priority Sector and Weaker Sector Lending In Total Advances of UCBS

Year	Total advances	Priority sector lending	% share in total advance	% change over the previous period	Weaker section lending	% share in total advance	% change over the previous period
2007-08	88981	46859	52.7	-	12149	13.7	
2008-09	97918	55248	56.4	17.9	14573	14.9	8.05
2009-10	110303	71385	64.7	29.2	17898	16.2	8.02
2010-11	136341	62716	46.0	-12.1	18951	13.9	-16.55
2011-12	158000	77000	48.7	22.8	19500	12.3	-13.01
2012-13	181000	85300	47.1	10.8	22500	12.4	0.81
2013-14	199651	97600	48.9	14.4	25689	12.9	3.88
CAGR		13.00			13.29		

Source: compiled from Report on Trends and Progress of banking in India, various issues.

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	R Square	F Ratio
		B	Std. Error	Beta				
1	(Constant)	17064.276	9264.892		1.842	.125		
	Total advances	.387	.064	.938	6.036	.002	0.879	36.434

a. Dependent Variable: Priority sector lending

The R^2 value, which measures the goodness of fit of the model was 0.87 indicating that nearly 87 percent of the variance in the priority sector lending (dependent variable) was explained by the independent variable (total advances). The F ratio was significant at one percent level of both priority sector and total advances.

7. Conclusion

Financial inclusion 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. This definition of financial inclusion is truly met by the urban co- operative banks. Thus, it can be concluded from the analysis that the urban cooperative bank is playing a catalytic role in reaching the bottom of the pyramid for achieving Inclusive growth in India. This will help to achieve the economic and social development of the economy but still there is a long road ahead to achieve the desired outcomes. The cooperative banks in general have the large potential which yet to be tapped. There exists a huge potential for UCBs to increase their spread and business and also participate in the national mission of financial inclusion. For this, UCBs should give wide publicity to their services to connect with large population segments. In the study, it was found that within the total priority sector credit given to weaker sections, which can be taken as a reflection of the contribution of UCBs to financial inclusion, micro credit showed a significant increase in 2011-12. The aggregate credit to weaker sections has increased in 2012-13 reflecting improved financial inclusion efforts by UCBs Thus, these institutions primarily cater to the requirements of urban consumers which explains the predominance of these two sectors in the UCBs' credit portfolio. Small enterprises, housing loans and micro credit, are the three major constituents in terms of priority in providing credit to weaker sections by UCBs. The aggregate credit to weaker sections has increased in 2012-13 reflecting improved financial inclusion efforts by UCBs. Thus urban cooperative banks, in general, are better equipped to address these issues, with their widespread reach, lower operating costs, flexibility, and deep-rooted connections with the local communities, which, in turn, inspire trust. With over 95000 rural and 1,579 urban cooperative banks registered in India, these organizations can play a pivotal role in the "real last mile financial inclusion" and thereby to achieve inclusive growth.

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