Performance of Primary Cooperatives in India: An Empirical Analysis

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2006

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Abstract

Cooperatives as an institution in India are more than a century old. With more than a lakh grass root level cooperatives, their presence is formidable. Notwithstanding, impressive gains made by cooperatives in terms of their rural outreach and coverage of small and marginal farmers, their financial health has been a matter of concern. The study is an attempt to enquire into the factors which impact financial health of cooperatives reflected through their recovery performance. The empirical findings suggest that government should allow the cooperatives to evolve in a natural manner rather than through initial official encouragement and subsequent intervention. Government's contribution to share capital of cooperatives should be stopped. There is also a need to revisit the issue of appropriate member size for a base level cooperative so that cooperative principles are internalized amongst members. Very large cooperatives should be avoided both in principle and practice.

Key Words: Cooperatives, Government and Recovery
JEL Classification: G21, H19

Cooperatives were institutionalized in India in the beginning of the twentieth century to help the rural peasantry meet its genuine credit requirements by promoting member driven and self governed institutions. The legal basis for Cooperatives was provided through the enactment of Cooperatives Credit Societies Act, 1904. Apart from meeting credit requirements, cooperatives were supposed to herald a new worldview of development through mutual support and encouraging thrift. Over time, they have evolved as an integral part of the multi agency framework for credit delivery in India. With more than 1.06 lakh outlets, averaging one ground level credit cooperative for every

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six villages, the cooperative system has a total membership of more than 120 million rural people making it one of the largest rural financial systems in the world[2]. Commercial banks and regional rural banks (RRBs), the two other purveyors of credit in the multi agency framework, have also increased their rural penetration with nearly 50,000 rural/semi-urban branches. However, the cooperatives dominate in their reach to the rural hinterland both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments of the population. In terms of number of agricultural credit accounts, the short term cooperative credit system (STCCS) has 50% more accounts than the commercial banks and RRBs put together.

Notwithstanding their formidable presence in terms of number and reach, their financial health has been a matter of perennial concern. While the commercial banks and RRBs had a gross NPA level of 3.3 percent and 7.26 percent respectively[3], the overdues for cooperatives were as high as 32.48 percent as on March 2006. The poor financial health of the cooperatives leads one to surmise whether the cooperatives can be seen as sustainable financial entities. Though their financial condition had been precarious, a lot of hope was pinned on the cooperatives' ability to bring about an all round development of the rural economy in India. This can be appreciated from the legendary statement, 'cooperatives have failed; cooperatives must succeed' made by the All India Rural Credit Survey Committee (AIRCS) way back in the year 1954. State partnership was introduced in the cooperatives around mid 1950s with a view to transform them as effective vehicles of development, after fifty years of their existence. It has been another fifty years since the initial days of state partnership with cooperatives. Notwithstanding the state

[2]Repot of the Committee on Financial Inclusion (Chairman - C. Rangarajan)

[3] Data Source: Report on Trend and Progress in Baking in India 2006-07 for NPA figures of SCBs and RRBs. NAFSCOB is the source for data on Primary Agricultural Credit Societies.

involvement and guidance in the activities of the cooperatives, their financial performance has been dis-satisfactory. This raises a fundamental concern as to what went wrong with government intervention in the working of the cooperatives and further whether such intervention in case of cooperatives is desirable.

Numerous Commissions and Committees have gone into the problems afflicting cooperatives and suggested measures to secure their financial viability. The latest among the Committees is the Vaidynathan Committee, which was mandated to chalk out an implementable action plan for reviving rural cooperative banking institutions. The Vaidynathan Committee has made wide-ranging recommendations including that for retiring government capital from the cooperatives to make them viable. Though the ills associated with government intervention in cooperatives are well documented there has been little empirical validation to the problems associated with government interventions.

Apart from government association, there are certain less highlighted but quite important issues relating to cooperatives, which might be responsible for their poor performance. One major weakness of the cooperatives in India has to do with design of their organisational form. The idea of successful cooperatives was borrowed from the Raiffeisen community in Germany. In the initial design, a typical feature that contributed to the success of cooperatives is the 'peer pressure' amongst members. The ideal size suggested for a cooperative that would ensure peer pressure was between 90 to 100 members[4]. With average member size of more than 1175[5], peer pressure, the quintessential for the success of cooperatives is missing in India. To what extent this deficiency in the organisational form of cooperatives has a bearing on the performance of

[4] This was suggested by the Maclagan Committee on Cooperation in the year 1915.
[5] As on 2005-06.

PACS also needs to be studied. In addition, the manner in which cooperatives in India conduct their business in terms of resource mobilisation and fund deployment could also have an impact on their performance. In this backdrop, the present study makes an attempt to enquire into such factors that influence the performance of the PACS and the role-played by the government in a broader context.

The rest of the study is organised in five segments. Section-I: provides a brief review of the evolution of the rural cooperatives in general and that of rural cooperative banking institution with more specifics in the post independence period. Some stylised facts relating to the functioning of PACS is discussed in Section-II. The methodology of the empirical analysis to decipher the influence of different factors on performance of cooperatives is discussed in Section: III. Section-IV discusses the empirical results. Concluding observations based on the empirical results are presented in section-V

Section-I
Evolution of the PACS

The India Cooperatives Act 1904 was formulated under the British political dispension. The socio economic scenario prevailing at those time and subsequent economic and political events had a bearing on their evolution. The growth of cooperatives was modest till independence, which got a Philip after independence. The very outlook towards cooperatives underwent a significant change after independence and especially, during the second five-year plan. The conditions created by the Second World War, the emphasis on intensive and rapid rural development in the post-war reconstruction programmes of State Governments and the channeling of state aid through co-operative institutions contributed to their steady quantitative expansion after Independence. At the time of the first plan, there were 1.81 lakh Societies with a membership of about 14 million and a working capital of Rs. 276 crores. Though cooperatives of various types[6] proliferated, agricultural societies accounted for more than 80 per cent of the total. The cooperative movement constituted an important economic and social force when the country embarked on the planning process in the year 1951. The first plan tried to leverage these institutions for all round development of the rural areas and especially the agriculture sector. This plan recognized that division of the needs, activities and assets of a villager into mutually exclusive parts such as credit, production, sale etc., is somewhat artificial. As such, the plan envisioned one multi purpose co-operative in each village that will cater to the multiple needs of its members. The first plan set an advance target of at least Rs. 100 crores per annum to the cultivators through the cooperatives. During the course of this plan the All India Rural Credit Survey committee (AIRCS) was appointed in the year 1951. The recommendations of AIRCS shaped the future of cooperatives in India.

The AIRCS committee viewed cooperatives as the panacea to the multi faceted problem of rural India. The implementation of recommendation of AIRCS Committee lead to emergence of State partnership at all levels of cooperatives in the form of share capital contribution, provision of technical, managerial and financial assistance of different kinds to cooperatives. With government involvement, cooperatives came to be perceived as agencies of the State rather than an autonomous member based economic enterprises. Subsequently, in an attempt to simplify, rationalise and modernise the existing laws relating to cooperatives a Model Bill was formulated based on the recommendations of the Committee on Cooperative Law, during the Second five year plan. This Model Bill was supposed to help the State governments to comprehensively

[6] Besides agricultural societies of all types credit, processing, marketing, farming, irrigation, consolidation, etc., there were industrial co-operatives, labour societies, and consumers' co-operatives in rural as well as in urban areas, housing societies; processing factories; and urban banks.

amendment their respective cooperative laws. The Model Bill also sought to facilitate the implementation of schemes of cooperative development under the Second Five Year Plan. An important feature of the Model Bill was to include a specific Chapter regarding 'State Aid' to cooperative societies. This Chapter included a number of provisions regarding the direct and indirect partnership of State in cooperative institutions and also for grant of loans, subsidies, and guarantees to cooperative institutions.

The emphasis on cooperatives continued in the subsequent five-year plans. The decade up to the 1990s marked active government intervention, which led to the degeneration of cooperatives from autonomous member driven bodies to appendages of the State. There was a paradigm shift in the State's approach to cooperatives with the implementation of the recommendations of the AIRCS in the year 1954 which envisaged State partnership. The Mirdha Committee while assessing the growth of cooperative movement in the year 1965 had observed that Government policy of deliberate expansion of cooperatives had led to politicisation of cooperatives and entrenchment of vested interests in their management. The Committee observed that cooperatives had drifted much away from their objectives and ideology. Based on the observations of the Mirdha Committee, the Conference of State Ministers of Cooperation recommended stringent provisions in cooperative legislation to curb vested interests in the year 1969. Accordingly, the cooperative legislation in most of the States incorporated provisions, which destroyed autonomous and democratic character of cooperatives. Some of these restrictive provisions included 'Registrar can amend bye-laws of the cooperatives', 'government can nominate Directors on the Committee of Management', 'government can annul the resolution of cooperative societies', 'Supersession/suspension of Committee of Management', 'amalgamation and division of cooperative by Registrar', etc. Government's interference in the activities of the cooperatives reached its nadir in 1977 when democratically elected Management Committees of Cooperatives were supersessed in nine states with a change in Government at the central level. The restrictive provisions in the cooperative laws had rendered the cooperatives to be viewed as government entities. The character of the cooperatives in the 1950 to 1990 period had changed from member centric to state-centric.

The decades of the 1990s witnessed attempts at unshackling the cooperative sector from the bondages of the government and restore the democratic character of the cooperatives. With the efforts and persuasions of the National Cooperative Union of India and Cooperative Development Foundation of Andhra Pradesh, the Planning Commission of India appointed an Expert Committee to prepare a Model Cooperative Bill to restore genuine Character of Cooperatives based on Cooperative Principles. The Expert Committee under the Chairmanship Chaudhary Brahm Prakash submitted its report and Model Cooperative Bill to Planning Commission in the year 1991. The Brahm Prakash Committee emphasised the need to make cooperatives self-reliant, autonomous and fully democratic institutions and proposed a Model Law. Progress in implementing the suggestions was tardy because of the states' unwillingness to dilute their powers over cooperatives.

The passage of the Mutually Aided Cooperative Societies Act by the Andhra Pradesh government in 1995, however, marked a significant step towards reforms. Following the example of Andhra Pradesh, eight other States *viz.*, Bihar, Chhattisgarh, Jammu and Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Orissa and Uttaranchal have passed similar legislation to govern and regulate mutually aided cooperatives. In all cases, these new laws provide for cooperatives to be democratic, self-reliant and member-centric, without any State involvement or financial support. They provide for cooperatives registered under the old law to migrate to the new Act. Subsequent Committees on cooperatives notably those headed by Jagdish Capoor, Vikhe Patil and V. S. Vyas have all endorsed this recommendation and strongly supported replacing existing laws with the proposed Model Law. These Committees have also recommended revamping and streamlining the regulation and supervision mechanism, introducing prudential norms and bringing cooperative banks fully under the ambit of the Banking Regulation Act, 1949. To facilitate the implementation of these reforms, they proposed that governments provide viable cooperative credit institutions with financial assistance for recapitalisation. Summary recommendation of different committees on cooperatives in the post independent period is given in Annex-1.

A system overhaul of the cooperatives has been suggested by the Vaidyanathan Committee, which had the mandate to recommend an implementable action plan for reviving rural cooperative banking Institutions, taking cure from the commendations of previous committees in this regard. The Vaidyanathan Committee was also mandated to suggest 'an appropriate regulatory framework and the amendments which may be necessary for the purpose in the relevant laws', 'to make an assessment of the financial assistance that the Cooperative Banking Institutions will require for revival', 'the mode of such assistance', 'sharing pattern and phasing of the financial assistance' and also 'to suggest any other measures required for improving the efficiency and viability of Rural Cooperative Credit Institutions'. The Task Force dwelled upon how the State Governments have become the dominant shareholders, managers, regulators, supervisors and auditors of the short-term credit cooperatives. The principle of mutuality[7] from which cooperatives all over the world derive their strength, has been missing in India. It noted that the "borrower-driven" cooperative credit system in India is characterized by conflict of interest and has led to regulatory arbitrage, recurrent losses, deposit erosion, poor portfolio quality and a loss of competitive edge for the cooperatives. The Task Force Report also recognised that there is an impasse in the laws governing Cooperative-banking institutions in the country as cooperation is a State subject while banking activities are regulated by a Central Act. Further, the Task Force took cognizance of the poor quality of internal control systems, human resources, house keeping and audit in the cooperatives. The Vaidyanathan Committee has suggested an implementable Action Plan with substantial financial assistance for recapitalisation subject to introduction of strict legal and institutional reforms together with technical assistance for human resource development, establishment of a common accounting system and computerisation. It is widely held that the implementation of the Revival Package would result in strong and robust cooperatives in a conducive legal and institutional environment. At the macro level, the Revival Package is expected to promote growth with social justice and greater financial inclusion.

An Important aspect related to cooperatives, which the Vaidyanathan Committee addressed is the equity contribution by the State governments. The Committee recommended that the cooperative credit institutions should return the equity contribution obtained from State Governments. The Task Force also recommended that soft loan support be provided to cooperatives, which lack the resources required to return

[7] The principle of mutuality requires that both savings and credit functions of cooperatives should go together and get equal emphasis

government equity. NABARD has been identified as the nodal agency to implement the recommendations. The States are in different stages of implementation of the recommendations of the Committee. Though it has been the contention of many of the committees and task forces that government's involvement in the affairs of the cooperatives is detrimental to them, there is no empirical basis backing such an assertion.

The Vaidaynathan Committee had cautioned against dilution or cherry picking of its recommendations for the effectiveness of the revival package. Inspite of its repeated cautions, one finds substantial dilution in the Committee's recommendation at the implementation stage[8]. For instance, the Committee had recommended for retirement of government equity over time but subsequently it has been decided to retain 25 per cent of government equity in cooperatives. Another recommendation that Registrar of Cooperatives should retreat from the governance and other aspects relating to cooperatives has been modified to entrust with them a consultative role. More importantly, the eligibility conditions for the cooperatives to avail the revival package have also been diluted. The recovery norm of more than or equal to 50 percent for the PACS as suggested by the Vaidyanatahn Committee has been lowered to 30 per cent. Also there has been a complete relaxation of the norm relating to gross interest margin as a proportion to operating expenses. Similarly the eligibility norms set for the District Central Cooperative Banks to avail for revival package have been completely withdrawn. With such gross dilution in the original recommendation, one doubts the efficacy of the revival package in reinventing the cooperatives.

[8] There has been certain amount of dilution in the stipulations laid down by the Vaidyanathan Committee in the Memorandum of Understandings (MOUs) that are signed by the cooperative institution with NABARD, the State Government and the Central Government. The States will be eligible for financial assistance only after they sign the MoUs. The details of the original and amended stipulations of the Vaidyanathan Committee's recommendation for rehabilitation package are given in Annex-2.

Another dimension on which the different Committees enquiring into the performance of the credit cooperatives have maintained a stoic silence is on the issue of appropriate membership size for a Cooperative. This is important because ‘peer pressure’, which the members exert on one another for repayment of loans, is crucial to the success of the cooperative model. And it is a matter of common observation that the element of peer pressure gradually weakens as the membership size grows in any voluntary association of people such as cooperatives. With substantive growth in membership size, one can conjecture that intensity of peer pressure has weakened in the base level cooperatives. This puts a question mark on sustainability of cooperatives. Whether growth in membership size has a bearing on the performance of the PACS is a matter of enquiry, which has received very little attention in the existing literature on cooperatives. Section-II reviews the literature on cooperatives to identify the various factors, which could possibly have a bearing on their performance.

Section-II
Literature Review

The literature on cooperatives is predominantly narrative. Empirical work using macro level data on cooperatives is conspicuous by their absence. Whatever little empirical work concerning cooperatives is available is based on case studies. While some case studies employ primary data obtained through surveys others make use of balance sheet information. Kulandaiswamy and Murugesan (2005) made an attempt to evaluate the performance of PACS in its various dimensions using a comprehensive yardstick of performance. They have studied 30 PACS for a ten-year period using thirteen performance parameters in the selected development blocks of western Tamil Nadu using field survey data. Kulandaiswamy and Murugesan employ scoring procedure validated by parametric (Analysis of Variance - one way) and Non-parametric (Kruskalwalli) tests to classify PACS into three performance categories viz, poor, moderate and good. Their study found working capital, total loans outstanding, total business turnover, overdues, net worth and loans to weaker sections as relevant and valid performance indicators for PACS. Based on their study, they have advocated measures such as re-capitalization, amalgamation, bringing down overdues and improving the overall efficiency of PACS. Based on the available literature, eight broad categories of indicators have been developed namely organizational (structural), functional, self-reliance, profitability, cost, democratic, participation and social efficiency to evaluate and quantify the performance of PACS. Instead of identifying drivers of performance, Harper and Roy (1997) employed a two-step procedure to identify the some critical factors, which seem to be generally associated with the success of cooperatives. In the first step, a questionnaire with eleven pairs of contrasting statements was sent to a number of individuals and institutions in Indian and United Kingdom to develop a set of hypothesis describing factors key to success of the cooperatives. The first stage analysis brought out a set of views such as 'groups should avoid being linked to any particular group', 'Group should focus on one activity only to ensure manageability', 'Group should have members with different skills and abilities' etc. on which there was more unanimity in their influencing the success of cooperatives. In the second stage, a sample of eighteen successful cooperatives and other group enterprises were selected to test the hypothesis obtained in the first stage and draw inferences. Though this study employed a novel approach, given its narrow scope in terms of coverage, the inferences has to be taken with due care.

A broad overview of performance indicators for cooperatives is provided in Murugesan (2007). Performance under each broad indicator category is evaluated using ratio analysis. Cahalam and Prasad (2007) have used a number of ratios under four broad groups viz, liquidity, operational, productivity and profitability ratios to study the financial performance of nine select PACS in West Godavari District of Andhra Pradesh. Some studies have used financial viability analysis comprising analysis of income and expenditure pattern, profit and loss pattern and break-even analysis of business (advances plus deposits) and also for its assets and liabilities to comment on the viability of cooperatives in the specific context of Maharastra (Shah, 2002). Case studies though have their own merits; the findings can't be genreralised across a broad spectrum. However, it is difficult to trace any attempt at the individual researcher level to examine the performance of PACS on a broad canvas *i.e.*, across the states. State level ratio analysis of the comparative performance of PACS has been attempted by a number of Committees and Commissions that were set to look into different dimensions of the problem concerning cooperatives. However, parametric estimate of the different factors governing the performance of PACS is one area, which has not been explored. This study attempts to build an empirical model to draw certain inferences about the performance of PACS over time. Before we develop the empirical model, what follows is a discussion on certain stylised facts on the performance of the PACS in Section-III.

Section-III
Sylised Facts

The cooperative system in India has got an involved structure. The co-operative banking structure in India comprises of two main components, *viz.*, urban co-operative banks and rural co-operative credit institutions. While urban co-operative banks have a single tier structure, rural cooperatives have a complex structure. It has different segments to cater to the short term and long-term credit needs. The short-term cooperative credit structure (STCCS) is organized in a three-tier structure. Within the STCCS, primary agricultural

Diagram-1

credit societies (PACS) at the village level form the base level, the district central co-operative banks (DCCBs) are placed at the intermediate level and the State co-operative banks (StCBs) function at the apex. The STCCS mostly provide crop and other working capital loans primarily for a short period to farmers and rural artisans. Further, the structure of rural co-operative banks is not uniform across the States and varies significantly from one State to another. Some States have a unitary structure with the State level banks operating through their own branches, while others have a mixed structure incorporating both unitary and federal systems. Diagram-1 spells out the broad structure of the short-term cooperative credit in India.

The primary societies have undergone restructuring from time to time. Changing viability norms suggested by different Committees at different points of time have led to frequent restructuring of PACS through liquidation and amalgamation. As such, the number of PACS in the country across the decades has shown wide fluctuations. With as high as more than two lakh primary societies in the year 1960-61, their number has halved in 2005-06 (Table-1). While it is perfectly normal to expect periodic shake-ups in a particular sector or industry where the inefficient units are forced to liquidate or wind up, the restructuring of the cooperatives in India have been engineered by the government. More importantly, the notion of viability has been changed quite frequently as such the performance of the PACS have been measured on a varying yardstick. Not withstanding the restructuring of PACS, the membership growth of PACS has been impressive. The total members of PACS which was 4.4 million in 1950-51 has grown 28 fold in the year 2005-06 with an annual growth of 6.3 per cent. PACS, which used to cover only 1.2 percent of the population of the country in the year 1950-51, embrace more than 11 percent of an increasing population. Though both number of PACS and their membership has grown, the average member per society which used to be 42 per society in 1951-51 has increased more than 28 times to 1176 in 2005-06. With such large number of member, it is difficult if not impossible to ensure peer pressure amongst members of the primary society, which was so vital in the initial design of cooperatives for their success. As the cooperatives now lend for a host of purposes, with growing membership size, it becomes all the more difficult to have a strong element of vigilance amongst the members. While average members per society have increased by 15 times, average borrowers per society have increased by only 10 times between 1960-61 and 2005-06. The proportion of borrowing members was highest at 53 per cent in 1960-61, which gradually declined to 33 per cent in 1990-91. Though there was some improvement in the

Table –1
Progress of PACS in the post Independence Era

(Crores)

Year	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01	2005-06
Number	1.05	2.12	1.61	0.94	0.83	0.99	1.06
Members	44.08	170.41	309.63	576.53	801.15	999.18	1251.97
Owned funds	17.26	75.57	265.31	757.95	1642.03	5593.75	9292.01
Deposits	4.48	14.50	69.40	291.34	1348.97	13481.07	12561.19
Borrowings	19.21	179.59	675.19	2957.42	7778.59	25889.66	41017.60
Working capital	40.96	309.92	1153.46	4036.03	11871.92	53867.47	73386.67
Loans Advanced	22.90	202.70	577.88	1769.41	4678.85	25698.31	42919.59
Loans Outstanding	29.13	218.00	784.48	2450.64	6877.23	34522.33	51778.99
Overdue	6.41	44.00	322.00	1086.20	3139.34	10037.88	15476.23
Average Member per society	41.98	80.38	192.31	613.32	966.40	1011.31	1176.84
Proportion of Borrowing Members	NA	53.00	37.00	32.40	32.87	46.57	36.80

Note: Numbers and Member are in Lakhs
Source NAFSCOB for data for the period 1990-91 and beyond, data for previous years are taken from INDIASTAT.

year 2000-01, the proportion of borrowing members is a paltry 37 per cent as on 2005-06. These numbers defy the general feeling that people become members of cooperatives to avail a loan. The data suggests two things. Either there are motives other than availing credit at work to become a member of a cooperative or else it could be that members who are interested to avail credit are denied the opportunity. Evidence from case studies reveals that both factors are at work[9]. Membership of a cooperative provides an identity to the member as well as a platform to meet their socio-political aspirations. Further, many members are averse to borrowing as a matte of philosophy of life. More importantly, members who might be interested in getting a loan find it difficult to avail the same in the present scheme and design of loan disbursement. At present, agricultural loans through the cooperatives are made available through Kisan Credit Card (KCC).

[9] Based on a survey by the Orissa State Cooperative Bank.

Land ownership is a pre requisite for obtaining KCC. In many parts of India where tenancy farming is prevalent, farmers who are the actual tillers of land but do not own land are deprived of KCC and agricultural loan. Even farmers having a KCC, the elaborate credit disbursal process may be acting as a deterrent. An overview of the process involved in disbursal of credit through the cooperatives is given in Annex-3. This is particularly the case for cooperatives, which do not disburse credit.

The PACS are spread all over the country with impressive business growth over the years. The various business indicators like deposit mobilization, borrowings and working capital have grown at roughly 15 per cent per annum in the fifty-five year period between 1950-51 and 2005-06. The loans advanced by the PACS have always exceeded their deposits as they borrow heavily from the higher tiers to cater to the credit needs of their members. The PACS, however, have fared poorly in their management of the deployed funds. While in the fifty-five period under scrutiny, loans per member grew at 7.8 per cent per annum; the overdues grew at a still higher 8.4 per cent per annum. Seen in terms of borrowing members, the situation looks much more critical. While loans advanced per borrowing member have increased 42 times between 1960-61 and 2005-06, the overdues increased by 69 times per borrowing member over the same time period. The high proportion of overdues of the PACS has adversely affected their financial performance. While 44321 PACS were making profits another 53026 were incurring losses as on 2005-06. Further, the aggregate losses of the PACS at Rs. 1920 crore, outweighed the profits of Rs. 7193 crore. Hence, it is a matter of enquiry if we an identify some broad determinants of the performance of the PACS at the macro level, which can serve as a guide while designing their restructuring so as to make them viable.

Section III
Data and Methodology

While modelling the performance of an entity, the first issue that confronts one is the choice of an appropriate indicator of 'performance'. For a financial institution, performance ultimately boils down to some indicator of profitability. However, for a cooperative institution, an appropriate indicator of performance goes beyond profitability. Performance of a cooperative should also be judged by its ability to inculcate the principles of cooperation amongst its members. At the same time, the long-term viability of a PACS is a must if it were to cater to the needs of its members. While profits are easily identifiable, determining viability is a tricky issue. As norms for viability has been changing, the ability of a PACS to recycle funds can be considered as a reasonably good indictor of the viability. Ability to recycle funds to a great extent depends on the recovery performance of the PACS. Recovery of loans to some extent would also reflect whether the members of the society appreciate the 'principle of cooperation', *ceteris paribus.* As such, we have preferred recovery performance as an indicator of the health of the PACS. As far as variables affecting the recovery performance of a PACS are concerned, both qualitative and quantitative factors play an important role.

The success of base level cooperatives such the PACS, which have individuals as member, to a great extent depends on the internalization of the principle of cooperation. Peer pressure ensures recovery in a cooperative. It has been already hypothesized that peer pressure weakens as member size of a cooperative grows. Thus growing member size of cooperatives is likely to have an adverse impact on recovery. To study the impact of growing member size of the cooperatives on their recovery performance, we have used Average member size of cooperatives as another explanatory variable in the empirical model.

It has been repeatedly pointed out by different Committees that government patronage has done more harm than good by inducing indulgence on part of the members. Instead of feeling responsible for the success of their cooperative and behaving diligently, members perceive government involvement as some sort of guarantee against bankruptcy. The most tangible form of government's involvement is contribution to the share capital of PACS. With government's involvement, cooperatives are perceived to be charitable institutions where members treat loans as grants. To ascertain whether government's involvement is really detrimental to recovery effort of the PACS, we consider government's contribution to the capital as one of the explanatory variable. As far as the business of the PACS is concerned, they lend funds to members obtained by way of deposits and borrowings from higher tiers of the cooperative credit system. Cooperatives garner deposits from their members and also form the general public. However, the PACS restrict membership with full voting rights only to borrowers. Non-borrowing depositors are treated as nominal members without voting rights. The Vaidyanathan Committee observed that such practice is not only inconsistent with cooperative principles and democratic functioning but also logically inconsistent, as fund providers have no say in the management of their own money.

To assess whether denial of voting rights to the non borrowing depositors have a bearing on the performance of the PACS, we have considered share of deposits in the working capital as another explanatory variable. As far as borrowed funds are concerned, they are obtained from the middle tier central cooperative banks and the PACS are accountable for its diligent application. It is expected that as share of borrowed funds rise as a proportion of working capital, there is a compulsion for the PACS to be more vigilant about the use of the funds and that should be positively influencing their recovery efforts. To ascertain what kind of effect the borrowed funds as a proportion of working capital exerts on the performance of PACS, we have considered share of borrowings in working capital as another explanatory variable.

One of the chief motivations for an individual to become a member of the cooperative, in most cases, is to avail funds. The safety of funds lent out often is crucially dependent on the purpose and duration for which the loan is sanctioned. Broadly PACS grant credit both for agricultural and non-agricultural purposes[10]. Agricultural credit accounts for the maximum proportion in their loan portfolio. Keeping in view the diverse needs of agricultural operations, loans of varying maturities are sanctioned. Loans up to eighteen months for carrying out seasonal agricultural operations are treated as short term and loans beyond eighteen months and up to sixty months are labeled as medium term. The recovery of the short-term agricultural loan may differ from that of agricultural loan with a medium term horizon, as different types of risks may be associated with them. While vagaries of nature may affect recovery of short-term loans, recovery of non-agricultural loan would depend on proper assessment of the credit need and effective credit monitoring, *ceteris paribus*. To consider the impact of the loan mix of PACS on their recovery performance, we have considered the proportion of medium term agricultural loan to short-term agricultural loan as another variable. Further, we use growth in the food credit (GFC) as a conditioning variable

Based on the above discussion, to ascertain the impact of the various factors on the performance of the PACS, time series regression models have been used. Equation (1) describes the specification of the model. Equation (1) can be estimated by least

[10] There is another category 'others' in the loan portfolio of the PACS.

squares. Growth in food credit is used as a conditioning variable that represent the state of activity in the agriculture sector.

$$RECOVERY_t = C+\eta_1 AVGMEM_t + \eta_2\ GOVCAP_t + \eta_3 DEPTOBOR_t + \eta_4 LOMEDTOSHORT_t + \eta_5 GFC_t + \varepsilon_{i,t} \qquad (1)$$

Where,

$\eta_1, \eta_2, \eta_3, \eta_4$ and η_5 are parameters to be estimated.

AVGMEM $\Rightarrow$ Average members per society

GOVCAP $\Rightarrow$ Share of Government Capital as a proportion of working capital.

DEPTOBOR $\Rightarrow$ Deposits of the PACS a proportion of its borrowings.

LOMEDTOSHORT $\Rightarrow$ Medium term loans as proportion of short-term loans

GFC $\Rightarrow$ Growth in food credit by the Banks

$\varepsilon_{i,t} \Rightarrow$ Error term

The subscripts t refers to the time dimension, which is yearly in our case.

Equation (1) can be estimated by ordinary least square method. However, time series models are susceptible to serial correlation in the residual. The simplest and most widely used model of serial correlation is the first-order autoregressive, or AR (1), model. The AR (1) model incorporates the residual from the past observation into the regression model for the current observation. To account for serial correlation an auto regressive specification of first order AR (1) is also estimated. Given the small sample size, the specification is confined to a first order auto regressive process.

$$RECOVERY_t = C+\eta_1 AVGMEM_t + \eta_2\ GOVCAP_t + \eta_3 DEPTOBOR_t + \eta_4 LOMEDTOSHORT_t + \eta_5 GFC_t + AR(1) + \varepsilon_{i,t} \qquad (2)$$

The study covers the period 1988-2005. NAFSCOB is the sole agency, which collects and compiles information on the PACS functioning across the country. NAFSCOB publishes information for PACS on some key parameters. Absence of balance sheet of individual PACS by some national level organisation puts practical constrains on the kind of analysis that can be done for the PACS. The study is based on PACS functioning across the country for which consistent information was available for the study period.

Section IV
Empirical Results

The fit of the AR (1) model is roughly comparable to that of the model without the AR (1) specification. In such a situation the information criteria becomes a guide for model selection. The Akiake and Schwarz information criteria measure the distance of the specified model from the "true" model. As such a smaller value of AIC and SBC criteria is preferred in choosing between alternative model specifications. As the model with AR (1) specification has got lower values, for both the Akaike and the Schwarz information, it is preferred[11]. All variables in the AR (1) specification is highly significant. We now discuss the broad picture, which emerges from the estimations.

First, as has been surmised by a number of studies, increasing contribution by Government to the share capital of PACS is found to be detrimental to the recovery performance of the PACS. The negative effects of government intervention seem to outweigh the positives flowing from government association. Second, as membership size grows in the PACS, it is detrimental for the recovery. This result is significant as most of the Committees and Commissions of late, who have enquired into the problem of cooperatives, have not addressed the issue of optimal member size. While the Maclagan Committee in the year 1914 had stressed for smaller size cooperatives, the preference in the planning period has been for bigger size cooperatives for viability. This is a classic case of missing the woods for the trees. In its zeal to promote cooperatives in a big way, the Government ignored some basic principles of cooperatives, which is key to their success. Cooperative since their inception were conceptualised as a small and neatly firm

[11] The AR(1) model is stationary as the AR root has a value of –0.36. A stationary AR model should have all roots with modulus less than one

group of people where more than material means, the moral pressure which the members exert on each other is key to their success. Peer pressure ensures recovery and recycling

Table-4: Least Square Estimation Results

Independent Variables	Simple OLS		OLS with AR	
	Coefficient	P-Value	Coefficient	P-Value
Constant	127.1231	9.178	144.4344	12.252
AVGMEM	-0.0132	-1.734	-0.0211	-2.537
GOVCAP	-22.8877	-4.845	-26.4546	-6.535
DEPTOBOR	-0.1692	-1.756	-0.2976	-3.496
LOMEDTOSHORT	-0.3328	-2.642	-0.2910	-2.389
GFC	-0.0316	-2.233	-0.0552	-4.307
AR term			-0.3630	-2.326
Adjusted R^2	0.70		0.77	
Akaike Information Criterion	5.16		4.91	
Schwarz Information Criterion	5.45		5.25	
DW STATSTICS	2.24		2.21	

of funds and contributes to the success of cooperatives. Peer pressure, however, is diluted as membership size grows. As such, the advocates of cooperatives in its early days had favoured small sized cooperatives. This basic principle of cooperation was turned upside down in the post independence era in India. Cooperatives were seen as a panacea to all the ills of the rural India given their wide presence across the length and breadth of the country. Government found in the cooperatives a mechanism to reach out to the rural poor without having any regard for the fundamental factors, which contributed to their success. There are States in India where the average membership size is even more than 5000. The much-hyped Vaidyanathan Committee also has not addressed the issue of ideal member size of cooperatives.

Third, as deposits as a proportion of borrowings rise, recovery is adversely affected. This is perhaps because of the fact that non-borrowing depositors do not have adequate representation in the functioning of a PACS. We have already seen that, the proportion of non-borrowing member is quite high for the PACS. To that extent, there is less accountability in the use of the funds mobilised through deposits. The Vaidyanathan Committee has also pointed out this anomaly that the members whose fund is being deployed, does not have a say in the working of the PACS. Unlike for deposits, PACS are accountable to the higher tiers for the funds borrowed from them. As such when deposits rise in proportion to borrowings, recovery is adversely affected.

Fourth, as far as loan composition is concerned, the short term loans seems to be more amenable to recovery than the medium term loans. As proportion of medium term loan vis-a-vis short term loans rise, recoveries are adversely affected. To get a better explanation of why this is so, perhaps one has to look into the composition of the loan portfolio of the PACS. Without detailed information, one plausible explanation could be that medium terms loans unlike the short-term loans are exposed to greater uncertainty because of the elongated repayment period.

Section –V
Concluding observations

This study was an attempt to decipher the factors, which contribute to the financial health of the PACS, which form the base of the short-term cooperative credit structure prevalent in India. The study considered recovery performance of the PACS as the most suitable indicator of their performance. Unlike the extant literature on cooperatives which is primarily narrative and in some instances based on case studies, the present study was an empirical model based attempt to examine certain hypotheses concerning the cooperatives. Some of the hypothesis tested in the study like ‘whether government’s involvement has done more harm than good for the cooperatives?’, ‘whether high proportion of non borrowing members loosens accountability in the cooperative structure and contributes to their deterioration of financial health?’ are well discussed in the literature. However certain other issues like the impact of member size and mix of the loan portfolio on the performance of the PACS were also studied.

The results indicate that as the PACS have drifted from some of the core principles of cooperation, their recovery performance has suffered. As membership size has grown over the years in case of the PACS, their recovery has taken a beating because peer pressure, which ensures recovery, has gradually weakened. Thus there is a need to relook into the issue of optimal member size of the cooperatives in the interest of their viability. This is a neglected aspect in the present-day literature on cooperatives but merits attention from all stakeholders. In conformity with popular perception, government’s contribution to the share capital is found to be detrimental for the recovery performance of the PACS. Government’s contribution in share capital not only gives it a hand to meddle with the affairs of the PACS; it might also be inducing indulgence amongst members because of the comfort of government bail out in case of difficulty. The latest amendment in the Vaidyanthan Committee’s recommendation that Government can retain 25 per cent of equity capital in case of PCAS needs to seriously given a second thought. The attempt should be either to completely dislodge government equity in the PACS or not to consider the PACS as cooperatives but to accept them as quasi government ventures for which the parameters of performance needs to be revisited. The study also found that as deposits grow in proportion to borrowings, the recovery performance is adversely affected. This is perhaps for the reason that non-borrowing members form the majority of the members who does not have a voting right in the PACS. This makes a case for allowing the depositors of the PACS to be given voting rights so that they can have a say in the management of their own funds. This will also make the base level cooperatives more democratic in nature.

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Annex-1
Chronology of events shaping the Functioning of cooperatives in India
(Post–Independent period)

All India Rural Credit Survey Committee (AIRCS) (1954)	➢ Not only recommended State partnership in terms of equity but also partnership in terms of governance and management. ➢ Recommended linking of credit with marketing ➢ Suggested to enlarging the area of operation of cooperatives. ➢ The recommendations of AIRCS Committee were primarily responsible for the conversion of Cooperative from peoples' institutions to Government cooperatives',
Committee on Cooperative Law (S.T.Raja)	➢ Formulated a model Bill for guidance of State governments to proceed for comprehensive amendment to their cooperative laws. ➢ Argued for State aid to cooperatives by incorporating a specific Chapter on 'State Aid to Cooperatives' in the Model Bill.
All India Rural Credit Review Committee, 1964(B.Venkatappaiah)	➢ Suggested viability norms, rehabilitation of societies, setting up of Small Farmers' Development Agency and disbursal of investment credit through cooperatives
Committee on Cooperation, 1965 (Mirdha Committee)	➢ Recommended that only needy people should be admitted as members. ➢ Audit of cooperatives should be independent of the Cooperative Department in the States. ➢ Contribution ought to be made to cooperative education fund
Santhanam Committee, 1969	➢ The scale of cultivation finance should include a reasonable amount towards the consumption expenses of the member's family. ➢ Village societies should be empowered to pursue action under the land revenue recovery provisions to drive up recovery. ➢ Margin between lending rate by PACS to members and its borrowing rate from the DCCBs should be three percent
National Commission on Agriculture, 1971	➢ To establish a new type of organization, 'farmer service societies (FSS)' at the base level to provide all types of credit, technical guidance and a full package of services especially to small farmers to develop their farms in an integrated manner. FSS could be financed either by commercial banks or cooperatives banks. ➢ The FSS scheme was put into operation in 1973-74 in almost al states ➢ To cover effectively large areas of operation say a block or population of 10,000 so that a cooperative could function as a viable unit. ➢ To provide for a two third representation to enable weaker sections to have a say in the society.
Special Study Group, 1971	➢ Recommended the organization of Large Sized Agricultural Multi Purpose Cooperative Societies (LAMPS) in tribal areas as the bottom structure to provide all types of credit under a single roof, technical guidance and arrangement for marketing of agricultural and tribal based products. ➢ LAMPS were later alternately known as Large Area Adivasi Multi Purpose Societies.

R.G.Sariya Committee, 1972	➢ Suggested coverage of 50 percent of total villages, 30 percent of total village population and 25 percent of total marketable surplus under cooperatives.
Hazari Committee, 1975	➢ Recommended integration of the short term and long term cooperative credit structure. ➢ The integration was supposed to avoid splitting up of security; ensure a single contact point for farmers and enhance the profitability of primary societies. ➢ No consensus could be reached on the Committee's recommendations.
National Commission on Agriculture (1976)	➢ Recommended for setting up of farmers' service cooperative societies with an active support from the Nationalised Banks.
Sivraman Committee, 1981(CRAFICARD)[12]	➢ NABARD was created as apex institutions in rural finance and the responsibility of monitoring and regulating the rural credit institutions were transferred to it.
Agricultural Credit Review Committee, 1989(A.M.Khusro)	➢ Recommended viability norms for PACS ➢ Suggested for preparation of block development plans and training to officials of PACS. ➢ It also recommended setting up of an apex bank 'National Cooperative Bank of India' to cover the entire cooperative credit. ➢ Suggested a conscessional rate of interest for small and marginal farmers at 1.5 percent above the highest interest rate of deposits. ➢ The interest rate for other agricultural borrowers should be free from any regulations but subject to an interest rate ceiling of 15.5 per cent.
Chaudhary Brahm Prakash Committee, 1991	➢ Committee suggested to restore the democratic character of cooperatives, to curtail the power of Registrar and to confer full autonomy to the cooperatives. ➢ Prepared a Model Bill to amend the flaws in present legislation on Cooperatives. The Bill sought to grant financial and administrative autonomy to the Cooperatives. Andhra Pradesh was the first state to take lead in this direction followed by others like Rajasthan, Kerala etc.
Task Forces to study the Cooperative Credit System and suggest measures for its strengthening, 2000 (Capoor Committee)	➢ Granting of autonomy and strengthening the member driven character of cooperative institutions. ➢ The duality of control should cease and the Banking Regulation Act 1949 be made fully applicable to cooperative credit Institutions. ➢ The cooperatives be allowed to deploy its funds outside the 'cooperative fold' by entering into housing loans, consumer loans, consortium financing, financing of services, distribution of insurance products, etc. ➢ Suggested for the voluntary amalgamation of cooperatives based on the economies of scale and revitalisation package for cooperatives to be based on financial, operational, organisational and systematic considerations.

[12] Committee to Review Arrangement for Institution Credit for Agriculture and Rural Development.

Expert Committee on Rural Credit (Vyas Committee), 2000	➢ It recommended for speedy implementation of the recommendation of Capoor Committee; ➢ To adopt the Model Bill drafted by the Brahm Prakash Committee by all the States; ➢ To restore financial health of the PACs, DCCBs and StCBs. ➢ To scrap the cadre system IN cooperatives ➢ To Integrate the short term and long term credit structures: ➢ Effective steps and support from the State for the prompt recovery of NPAs.
Balasaheb Vikhe Patil Committee, 2002	➢ This Committee was mandated to suggest a revitalisation package for the Cooperatives. ➢ The Committee concluded that the NPAs settlement is crucial for the improvement of the health of the cooperatives and hence efforts should be made to work out the modalities for the one time settlement of NPAs. ➢ The financial burden associated with revitalisation of cooperatives may be shared by the Union and State governments in the ratio of 60:40 and in a proportion of 90:10 for the state of-Jammu & Kashmir and the North Eastern states.
Advisory Committee on Flow of Credit to Agriculture and other Related Activities from the Banking System (Vyas Committee, 2004)	➢ Pointed out that credit disbursement would considerably increase if investment and production credit were integrated and scales of finance used at the district level were reviewed and readjusted in line with requirements of modern, market oriented capital-intensive agriculture using newer technologies and superior inputs. ➢ Linkages between production and marketing should be strengthened by increasing pledge finance, credit for marketing and introduction of advances against warehouse receipts. ➢ Outsourcing certain development agents like SHGs, NGOs, members of panchayati raj institutions, village functionaries, farmer's clubs etc. would help banks expand their outreach without adding proportionately to their costs. ➢ If the multi tier cooperative structure adds to the transaction costs, there would be a case for eliminating one of the tiers. ➢ Good PACS could seek synergies with commercial banks if their functioning is hampered by weaker DCCBs,
Task Force on the Revival of Cooperative Credit Institutions, 2004.	➢ Task Force (2004) stressed the need to revitalise the cooperative credit institutions by providing financial assistance to wipe off the accumulated losses and to strengthen the capital base. ➢ The need for a financial package was estimated to be Rs.14,839 crores to be shard by the Union and State Governments. ➢ The Task Force also emphasised on the need for improvement in the legal framework and institutional restructuring in order to make Cooperative institutions democratic, member driven, autonomous and self-reliant institutions.

Annex-2
Vaidyanathan Committee: Revised Eligibility Criteria for Revival Package

Institutions	Original Criteria	Revised Criteria
PACS	1) Gross Interest Margin should be more than or equal to 50 per cent of operating expenses and 2) Recovery should be more than or equal to 50 per cent 50% of demand	Loan recovery of at least 30 per cent of the demand as on 30th June 2004. State Government will be under obligation to determine the future set up of ineligible PACS with recovery level of less than 30 per cent. The quantum of financial assistance will be determined through Special Audit of Accounts of PACS, DCCB & OSCB as on 31st March 2004. Govt. of India may consider relaxing the eligibility norm for PACS / DCCBs for North Eastern States, Scheduled Areas & Tribal Districts. .
DCCBs	Positive net worth and those with negative net worth with deposit erosion of less than 25 per cent.	All DCCBs are eligible.
SCBs	Positive net worth and those with negative net worth with deposit erosion of less than 25 per cent.	All SCBs are eligible.

Annex-3

Here we discuss the credit sanctioning process in PACS, which do not disburse credit to the members directly. Sanctioning of credit to the members of a PACS is an involved process, which may take more than a month. Upon an application for loan, the PACS first scrutinize credit requirement of the members and recommend the same to the DCCBs. DCCBs are the disbursing agencies of credit. PACS, which does not undertake banking business, the credit to the farmers is, dispensed from the DCCB branches through the KCCs. As per the present arrangement[13], PACS fix the credit limit for the borrowers, which are scrutinized by the Cooperative Extension Officer (CEO) and are ratified[14] by the Block Level CEO. The approved credit limit list of the PACS members are submitted to that branch of DCCB under which the PACS falls. The branch manager of the DCCB, however, has no authority to sanction loans to the members of the PACS. The DCCB branch, instead, approves the credit limits for the farmers based on the recommendations of the Local Advisory Committee (LACs). The LAC is headed by a Chairman cum Director who is appointed by the Board of the concerned DCCB. The LAC has a loan sanctioning power up to Rs. 50,000 for agricultural purposes. The farmer, who is a member of the PACS travels to the concerned branch of DCCB to avail the sanctioned credit.

Many a times, the CEO who scrutinizes the loan is not available as he is a field officer without a specified office. Generally one CEO covers four to five villages. His unavailability at a defined location at a defined time makes loan application a cumbersome process. As the loan application needs to be recommended by the block level cooperation officer also, his availability also delays the loan sanctioning process. Even after meeting all these hassles when the credit limit is sanctioned, the farmer has to visit long distances to the branches of DCCB to avail the loan. On some occasions, the farmer has to visit more than once to get the sanctioned loan as defined by KCC credit limit. All this adds to the woes of the farmers in availing credit through the mechanism of cooperatives. Given these hassle, the village moneylender often appears to be a better alternative though the interest rate charged by him is much more. It must be recognized that timely availability of credit is if not more than at least of equal importance as the cost of credit.

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[13] The process outlined here is based on first hand information gathered from a few PACS operating in Bihar. The procedural aspects followed in other States might be different.

[14] Block level CEO acts on behalf of the block development officer (BDO) in matters relating to cooperation.