

AN ANALYSIS ON EFFECTS OF DEMONETIZATION ON COOPERATIVE BANKS

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ABSTRACT

This research paper focuses on the effect of demonetization on Banking Industry. We have taken the consideration of Cooperative Banks across the country after demonetization. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Banks work as a lifeline for any economy; any positive or negative effect over them also affects economy of the country to a great extent. Hence, it becomes important to know how recent demonetization will affect the banking industry. This study focuses that demonetization is good but it has to be taken into consideration that most of the black money is kept in the form of land, buildings or gold or kept abroad. Only 4% of the total amount of black money is in cash, on which taxes are not being paid. Out of this, a lot of money is in circulation in everyday transaction. With move to demonetize Rs.500 and Rs.1000 notes by the central government had a strange fall out when Cooperative Banks, which are the backbone of the rural economy, have been paralyzed with the ban of accepting the old currency that are no long legal tender now. Cooperative banks have been the trusted centres to bank for millions of farmers and middle, low-income people for long. These institutions are known to offer them easier loan and deposit products and hence are the favourite institution for the poor. The restriction on the conduct of business after demonetization will have major impacts on these banks.

KEYWORDS: Demonetization, Taxes, Money Circulation, Legal Tender, Financial Health

Demonetization is the act of stripping a currency unit of its status as legal tender. It is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit. In 2016, the Indian government decided to demonetize the 500 and 1000 rupee notes, the two biggest denomination notes. These notes accounted for 86% of the country's cash supply. The government's goal was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy. By making the larger denomination notes worthless, individuals and entities with huge sums of black money gotten from parallel cash systems were forced to convert the money at a bank which is by law required to acquire tax information from the entity.

The demonetization initiative caused a sudden breakdown in India's commercial ecosystem. Trade across all facets of the economy was disrupted, and cash-centric sectors like agriculture, fishing, and the voluminous informal market were virtually shutdown, with many businesses and livelihoods going under completely - not to mention the economic impact of millions of people standing in line for hours to exchange or deposit canceled banknotes rather than working or doing business.

"The unbanked and informal economy is hard hit," explained Monishankar Prasad, the New Delhi-based author and editor for *Alochona*, an Australian current events publication. "The poor do not have the access to structural and cultural resources to adapt to shock doctrine economics. The poor were taken totally off guard and the banking infrastructure in the surroundings is rather limited. The tech class has poor exposure to critical social theory in order to understand the impact on the ground. There is an empathy deficit."

If there is any immediate casualty to Prime Minister Narendra Modi's demonetization exercise, announced on 8 November, that could possibly be for the country's cooperative banks, which are struggling to stay afloat. Though inefficient, cooperative banks are still critical for the last mile in rural India. This will continue for at least the next 5 - 10 years till larger banks/payment banks/small finance banks take firm hold in rural India.

Post demonetization, the cooperative banking sector is gasping for breath on account of a severe liquidity crisis. Soon after the demonetization announcement, cooperative banks were asked not to accept the old Rs. 500, Rs 1,000 currency note deposits or exchange those notes with the new currency notes. This meant that these lenders could only deal with permissible denominations of Rs 100 and below or takes deposits in new currencies that are hardly available in the system.

This has effectively left many smaller cooperative banks with a few thousand rupees of funds. "There is practically no business in the bank for last two months or so. It is going to be tough," said an official with one of the primary cooperative banks in Kerala, a state where cooperative banks play a crucial role in taking the banking services to the last mile.

Cooperative banks are particularly important for farmers and lower income groups who want small ticket loans in less time in relation to larger banks. The banking correspondents (BCs) system hasn't worked well so far though. Banking correspondents are agents of banks who operate in areas where there are no bank branches. The BCs collect deposits and offer loan products on behalf of the banks.

According to data from NABARD, there are 32 state cooperative banks, 370 district central cooperative banks (DCCBS) as on 31 March 2015. The number of primary agricultural credit societies (PACS), the smaller ones, as on 31 March 2014, stood at 93042, as per the latest data available.

Why cooperative banks should matter to us?

There are a couple of reasons why the government and the Reserve Bank of India (RBI) did not allow cooperative banks to accept or exchange old notes for the new currency.

First, the checks and balances at these banks aren't perceived to be strong enough to counter efforts to push black money into the banking system. Cooperative Bankers too aren't trained well. These banks aren't as tightly regulated as scheduled commercial banks. Most of these banks are indirectly controlled by politicians or local businessmen. Hence, there is, of course, reason to worry to let these banks participate in such a massive exercise. But, by choking funds to cooperative banks and prolonging the crisis can inflict significant damage to the health of several cooperative banks, which are already on the verge of closure. The small ones are more vulnerable.

The cooperative sector has largely been a failure on account of the accumulated losses, etc, but that situation is beginning to change after an overhaul initiated by the RBI and NABARD in 2010. Many inefficient corrupt banks have been shut and the remaining is good enough to continue.

State cooperative banks across the country have deposits to the tune of Rs. 1,02,859 crore as on 31 March 2015 as against Rs 1,04,369 crore as on 31 March 2014. They have a total loan outstanding of Rs. 1, 14,545 crore as on 31 March 2015 with an impressive loan recovery percentage almost 95 percent.

On the profitability front too, the sector has done relatively well, of late. Of the total, 29 state cooperative banks posted total profit of Rs. 1,105 crore during 2014-15 as against Rs 926 crore by 27 state cooperative banks during 2013-14. Their NPAs stood at 5.02 percent of their total loans and advances outstanding as on 31 March 2015 as compared to 5.53 percent as on 31 March 2014.

In absolute terms, their NPAs stood at Rs. 5,746 crore during 2014-15 as against Rs. 5,699 crore during 2013-14. Also, these banks' accumulated losses decreased to Rs 617 crore as on 31 March 2015 from Rs. 696 crore as on 31 March 2014.

Similarly, primary agriculture credit societies (PACS) too have an impressive record of deposit-lending operations, at least in recent years. Total members of PACS as on 31 March 2014 aggregated Rs. 13.01 crore of which, borrowing members at Rs. 4.81 crore constituted around 39 percent. On the deposit side, these banks mobilized Rs. 81,895 crore as on 31 March 2014, indicating a growth rate of 34 percent over the previous year. Currently, all these banks are under stress on account of severe cash crunch and most of them are not functioning.

As mentioned earlier, following restrictions, there has been hardly any business in cooperative banks across the country. Also, since there are no new funds, their lending operations and even ATM services have been hit hard. Even large multi-state cooperative banks, like Mumbai-based Saraswat cooperative bank are struggling to get funds for routine transactions of normal customers.

Second, the whole chaos will take away the trust of common man from cooperative banks. Customers will think twice again before depositing their hard-earned money or taking a loan against their property from a local cooperative bank.

In states like Kerala, there have been massive protests already. Besides giving a major jolt to the cooperative banking sector, the PM will also risk the

wrath of millions of common people - customers, who have deposited money in these banks.

As far as the crisis is concerned, the situation is precarious since most of these banks (especially PACS) are left with very few funds in acceptable denominations. Their credibility has also taken a hit since people will now be scared to park their money in future in these banks due to uncertainty. The current crisis could take the shape of a permanent impairment if cash crunch continues for a few months. It will take a long time for them to recover.

Impact of Demonetization on Cooperative Banking System

The volume of rural credit in India is mainly for short term credit (one year) for production of Kharif and Rabi crops and vegetables and medium term credit (three to five years) for allied sectors such as wells, pump sets, dairy, poultry, horticulture, plantation, etc. A small portion goes to non-agricultural sector such as artisans and tiny business/services.

Total rural credit disbursed by Commercial Banks (CBs), Regional Rural Banks (RRBs) and State/District Central Co-op Banks (SCBs/DCCBs) together in 2014-15 is about Rs. 845329 crore in 854 lakh accounts of which Rs. 346666 crore goes to small and marginal (poor) farmers in 486 lakh accounts. The number of total accounts at 854 lakh is a low number against rural population in crores. Money lenders and traders still play a big role in providing informal production credit plus consumption credit to rural people at high interest rates. 518 lakh Kishan Credit Cards have been issued by all these credit agencies to farmers with average limit of one lakh rupees which can be used for both agricultural and consumption needs. Outstanding loans against such credit cards are reported to be Rs. 196781 crore as of March 2015. The major chunk of credit goes to Kharif and Rabi operations every year.

The share of co-op banks:

The share in rural credit of SCBs and DCCBs which have not been allowed to accept and exchange old 500 & 1000 notes by RBI unlike Urban Co-op Banks (UCBs) which are mainly located in urban and semi-urban areas and has a very limited role in rural credit.

All SCBs and DCCBs are subject to statutory annual and bi-annual inspections under Banking Regulation Act, 1949. They are also subject to banking

license, liquidity (cash reserve and statutory deposit) ratios maintenance with RBI and deposit insurance norms. It is therefore; wrong to say that they avoid KYC norms in maintaining deposit and loan accounts. However, they are exempt from income-tax on their profits which are very low in view of loans being given to farmers at lower rate (8 % for crop loans). On the other hand, to attract deposits, they pay higher rate of interest (by 0.5 - 1 %) on deposits compared to other banks, making their profit margin from thin to thinner.

Almost all SCBs have Scheduled Banks' status under the RBI Act, 1935. The SCBs are responsible for the DCCBs' operations. In 19 states, 371 member DCCBs with 14060 branches are extending rural credit to the farmers on behalf of the SCBs (3-Tier system) and in 12 states and UT, the SCBs does it directly through its 1131 branches (2-Tier system). The borrowing members are 92789 primary agricultural and non-agricultural credit societies of the farmers/artisans and also 31 lakh individual farmers/artisans whose societies are ineligible to borrow from the DCCBs or the SCBs due to high overdue percentage. The societies are members of either the DCCB branches in three-tier system or the SCB branches in two-tier system.

During 2014-15, rural credit of Rs. 340392 crore was disbursed by the SCBs/the DCCBs to the farmers and artisans through such co-op societies and also to individuals. Their total deposits are Rs. 436523 crore. The overdue as on March 2015 was 22% in DCCBs and 5 % at the SCB level. Thus, rural people are more honest in repaying their dues. In the event of famine, drought or scarcity, such short term loans are rescheduled payable over 3-5 years so that they do not turn ineligible for next year's crop seasons. There are total 2.60 lakh employees in this 3-tier/ 2-tier system with 1.64 lakh at village level, 0.83 lakh at DCCB level and 0.13 lakh at the SCB level. (Source: National Federation of Co-op. Banks)

RBI data says 370 DCCBs held deposits of Rs. 236,890 crore as of 2014 while PACS had Rs. 81,900 crore deposits. Operations at 370 district central cooperative banks (DCCBs) and over 93,000 Primary Agricultural Credit Societies (PACS) have been severely hit with the Reserve Bank of India (RBI) slapping restrictions following the demonetization of Rs 500 and Rs. 1,000 notes. Urban cooperative banks (UCBs) too have complained to the RBI that commercial banks are refusing to provide them currency support, affecting their

operations. The RBI has not given any reason for the curbs on DCCBs and PACS - these are considered the lifeline of the rural economy, especially for farmers in states like Maharashtra, Kerala, Uttar Pradesh, Gujarat, Tamil Nadu and Karnataka — but banking sources said it could be related to lax KYC (know your customer) norms and money laundering in some cooperative banks. RBI data says 370 DCCBs held deposits of Rs. 236,890 crore as of 2014 while PACS had Rs. 81,900 crore deposits.

The RBI has stipulated that DCCBs and PACS can allow existing customers to withdraw money from their accounts up to Rs. 24,000 per week until November 24. It has said no exchange facility against the specified bank notes (Rs 500 and Rs 1000) or deposit of such notes should be entertained by DCCBs. It has advised all banks to permit withdrawal of cash by DCCBs from their accounts based on need. According to Pramod Karnad, Managing Director, Maharashtra State Cooperative Bank (MSCB), only UCBs and SCBs are allowed to exchange and deposit notes. The Mumbai District Cooperative Bank, chaired by BJP member Pravin Darekar, has filed a petition in the Bombay High Court against the RBI circular preventing cooperative banks from accepting deposits in demonetized currency notes. The petition states that the circular is discriminatory and arbitrary besides violating fundamental rights. “No reason has been given for singling out cooperative banks like this. We act as bankers to other cooperative societies within Mumbai district. If the circular is followed, cooperative societies will not be able to deposit the discontinued currency notes with their banker. This would cause loss to members of such societies,”. The petition points out that several hospitals, petrol pumps, medical stores have their accounts with the bank and they too will be affected. It states that there are 103,873 saving accounts being operated by individuals and 12,285 saving accounts of housing societies.

Although over 1,500 UCBs in the country are allowed to exchange and deposit demonetized notes, they said they have been at the receiving end of the demonetization scheme following inadequate remittances from the central bank. “While the apex bank has been making all efforts to provide liquidity for the nationalized and private sector banks, the common man’s cooperative banking sector has been ignored with close to 52 cooperative banks being left out with empty hands over the past days,” the UCBs said in a letter.

The Maharashtra State Cooperative Banks Federation Ltd, in a letter to RBI Deputy Governor R Gandhi, said, “after the announcement of the scheme of withdrawal of legal tender character of existing Rs. 500 and Rs. 1000 bank notes, commercial banks refused to provide currency support to our UCBs on November 10, 2016, treating us as ‘general customers’. Later, in spite of issuance of circular by the RBI that the limit of Rs 10,000 is applicable to general customers and not applicable to cash withdrawal from a bank account by one bank from another bank, these public sector banks, especially SBI and Bank of India refused to adhere to the request of UCBs.” “While the RBI did offer some remittances in the first few days, the approach in the past days are far from encouraging for the fraternity, which has been fighting shoulder to shoulder with other bankers to make the national cause of demonetization a great success,” the letter said. As many as 1,579 cooperative banks have over 10,000 branches and close to 3,000 operational ATMs across the country and constitute nearly four per cent market share in the banking business mix of the country. UCBs have to depend on local currency chests of public/private sector banks to withdraw or deposit the currency, while many others have partnership of payment systems with the National Payments Corporation of India (NPCI).

Most of these UCBs, the letter stated, are direct members of the RBI for CTS (cheque truncation system) and, therefore, expect good cooperation from the SBI as well as from the other public/private sector banks. “While there are huge queues lined up with public and private sector banks, the cooperative banks have been left out for want of legal tender adding to the chaos,” the letter stated.

Cash deposits in 285 district cooperative banks (DCBs) across India surged six fold in the first four working days after the recall of high-value currency on November 8, as compared to reserves a day before the announcement. An analysis of classified bank transaction data revealed DCBs deposited Rs. 3,051.2 crore with public sector banks between November 8 - when Rs 500 and Rs 1,000 were withdrawn - and November 14, when the Reserve Bank of India (RBI) banned the institutions from accepting cash. This is six times the Rs. 496.88 crore reserves in the DCBs on November 7. All cooperative banks maintain a current account with a public sector bank, where they have to hold their cash deposits.

There are three types of cooperative banks in India, state cooperative bank, urban cooperative banks and district cooperative banks. Only DCBs were banned by RBI after allegations of money laundering. But around 100 urban cooperatives banks are also being probed by the ED. In the first three weeks after demonetization, nearly Rs. 12,000 crore worth high-value cash deposits worth Rs. 80 lakh each were made by 325 urban cooperative banks from remote districts, This is nearly a 25-fold increase in cash balance of these urban cooperative banks compared to their last balance on November 7.

The government and Reserve Bank of India (RBI) are set to bring out tougher norms for cooperative banks, which have come under scanner for alleged discrepancies and irregularities in the wake of the demonetization drive. According to a recent report by the income tax department, most banks have indulged in money laundering after the central government announced ban on high-value bank notes of Rs. 500 and Rs. 1,000 from November 8 midnight.

Many banks accepted and exchanged the old currency notes at a premium and parked large deposits in multiple accounts, the report added. Moreover, several accounts have been opened without following Know-Your-Customer norm, the report pointed out. A senior government official said these banks could become conduits for black money in the future. At present, the scrutiny and vigilance on these banks is not as stringent as that on scheduled commercial banks. "These banks need to be monitored as carefully as any other scheduled commercial banks have been used for a large number of inappropriate activities in the past and these can be used for the same purpose in the future," the official, who did not wish to be identified.

Demonetization: Retaining Credibility of Co-operative Banks:

With move to demonetize Rs. 500 and Rs.1000 notes by the central government had a strange fall out when Cooperative Banks which are the backbone of the rural economy, have been paralyzed with the ban of accepting the old currency that are no long legal tender now.

Operations at 370 district central cooperative banks (DCCBs) and over 93,000 primary agricultural credit societies (PACS) have been severely hit with the

Reserve Bank of India (RBI) slapping restrictions following the demonetization of Rs. 500 and Rs. 1,000 notes.

In a direction to the banks, RBI says that they have advised the Urban Cooperative Banks through its Regional Offices and the State Cooperative Banks through National Bank for Agricultural and Rural Development (NABARD) of the need to ensure strict compliance with the instructions issued with regard to exchange of specified bank notes as also deposit of such notes into the accounts of their customers. But there were reports that some cooperative banks were not strictly adhering to the instructions issued in connection with the withdrawal of legal tender status of the existing Rs. 500 and Rs. 1000 bank notes (specified bank notes).

The Reserve Bank of India's restrictions drive during the demonetization for the Cooperative Banks who have provided credit to farmers and three-tier banking system is one of the largest in the country. Like the Railways, the Cooperative Banks have also been described as the lifeline of the state's economy and there had been protests following the RBI decision and the cooperative sector went on strike last week.

The government must allow Cooperative Banks to function or farmers which have been their source of funds for decades and have suddenly become invalid. Dr. Anand Rai Vyapamm scam whistleblower has rightly pointed out that this step was taken because some cooperative banks are dominated by politicians and were reportedly being used to launder Rs. 500 and Rs. 1000 notes.

The discrimination towards the Cooperative Banks will put the credibility of the banks at stake. The RBI and the Central Government should have taken this into consideration before meting out discriminatory treatment. The whole chaos will takes away the trust of common man from cooperative banks. Customers will think twice again before depositing their hard-earned money or taking a loan against their property from a local cooperative bank. Due to uncertainty, the people will now be scared to park their money in future in these banks due to uncertainty as their credibility has also taken a hit. The current crisis could take the shape of a permanent mutilation if cash crunch continues for a few months and it will take a long time for them to recover. Instead, the government should have tried to strengthen the

infrastructure and capabilities of these banks instead of bringing them on the verge of collapse.

CONCLUSION

Cash crunch is the new norm for most people after demonetization, and some of the worst impacted are customers of co-operative financial institutes - banks and societies. One problem with the structure of the cooperatives is that there are multiple regulators. The control of the Reserve Bank of India (RBI) on state, district and urban cooperative banks get diluted because of this. Also, cooperative banks and societies chose their management through an election process. Given that cooperative banks are largely controlled by politicians, investors also need to be very careful about their banking practices. If the loans are granted very easily, the deposits will be at risk. Customers should not get lured to banking with a cooperative financial institution just because it does not insist on you giving PAN number, or does not deduct TDS on interest, etc. If you are not comfortable doing the due diligence, then it is best to avoid co-operative banks. Even as things are on the mend, the problems - situational and institutional - are still there. There is surely cause for concern, but experts advise against any panic decisions. They insist that investors need to evaluate whether or not they are banking with strong institutions. "Instead of avoiding cooperative banks altogether, customers need to do stress on due diligence.

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