

## **Corporate Governance in Cooperative Societies & Banks.**

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### **Prologue :**

Corporate Governance is a simple practice of “just doing things fairly”. As a rational human being each one of us expects good quality product and service, as a fall out of proper governance, in every facet of our life- in politics, in economy in the social and small cultural life. The same practiced in the corporate entity level can be broadly understood as Corporate Governance. If ethical practices and building up long term relationships leading to more profitable outcomes are factored in the Corporate Governance policies of an organization, business growth would be an automatic follow through.

### **The Concept:**

The Corporate Governance as the expression is not capable of being precisely defined but can broadly be understood as denoting direction and control of the affairs of the company. As an inclusive definition it covers the policies and practices adopted by a corporate entity in achieving its objectives in relation to its shareholders. Corporate Governance is not a destination, but a journey to be covered by a commercial entity. *The concept has more significance at contextual and operational level rather than conceptual level.*

The fundamental objectives of Corporate Governance are the enhancement of the long term values of **shareholders** and at the same time protecting the interest of other **stakeholders**. It is process of constant endeavor to ensure equilibrium amongst all stakeholders, by harmonizing their rights and interest. In essence it stands for effective accountability to all **stakeholders**. In a normative sense Corporate Governance is prescribed as a code of corporate conduct in relation to all the stakeholders, external as well as internal.

The Corporate Governance presently in vogue was introduced as a remedial measure for fall out of corporates which was outcome of unethical behavior of management of the company. It is the Cadbury Committee in UK which recommended the Corporate Governance in form of code of conduct for management for directing and controlling the affairs of the company. It was the point of emergence of the concept of present Corporate Governance.

### **Corporate Governance – Responsibility of Top Management, Especially of Board of Directors.**

The responsibility towards Corporate Governance is exclusively of Board of Directors, and which has to be performed ethically and diligently. Mere drafting of code or framing the rules will not serve the purpose of Corporate Governance. What is needed is sincerely practicing it.

In India, Shri Kumarmangalam Birla Committee appointed by SEBI made very useful recommendations which have been accepted and implemented in form of Listing Agreement Clause – 49, in respect of listed companies. Subsequently other committees viz Nareshchandra Committee, Narayanmurti Committee, also made their vital contribution for the cause.

### **Cardinals or Hallmarks of Corporate Governance:**

The cardinal features or hallmarks of Corporate Governance are-

1. Well defined objectives / values of the organization in form of Vision Statement. The Board of Director should establish strategic objectives and corporate values for itself, senior management, and other employees of the organization and frame policies to achieve them, in clear and unambiguous terms.
2. Endeavour of management for protection of interest and enhancement in long term values of stakeholders and harmonizing their interests.
3. Competent Board of Directors with independent deposition: The board

of directors should have clear understanding of their role. They should be free from fear and favour. They should perform diligently with support of various committees, with delegated powers.

4. Accountability and transparency at Board and all operational levels.
5. Effective system of internal control and vigilance mechanism, with prime thrust on internal audit.
6. Remuneration policy consistent with organizational values and objectives.

These factors with high standards constitute pathological tests for good Corporate Governance. Higher the standard, higher is the quality of Corporate Governance.

**Present Scenario:**

Even in spite of introduction and implementation of Corporate Governance, both at national and international level, the hick-ups and scams are not uncommon. Satyam Computers, Global Trust Bank in India, while Enron, Sub-prime crisis in USA, reveal the limitations of the Corporate Governance merely introduced as a regulatory measure. Barring few honorable exceptions, the Corporates are gratified with its purely technical compliance. But one must be candid enough to admit that Corporate Governance, even though introduced as a regulatory measure has been successful in sensitizing the stakeholders. Various provisions in Company's Act, guidelines issued by SEBI, have made the stakeholders aware of their legitimate rights. Of course these are only few initial steps of course in the journey in the right direction.

**Corporate Governance: It's Relevance with Co-operatives.**

**The Co-operative Identity:**

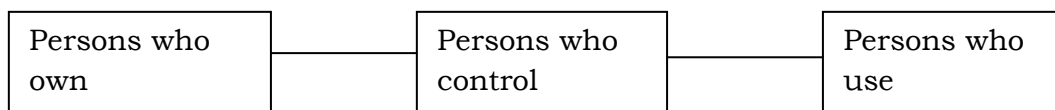
By definition itself, the Cooperatives are an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations though jointly owned and democratically controlled enterprise. The main object of the co-operative is the economic upliftment of common man. The distinct feature of co-operatives is the member of co-operative institution has only one vote, irrespective of his

shareholding. This regulatory provision differentiates the Cooperatives from Corporates.

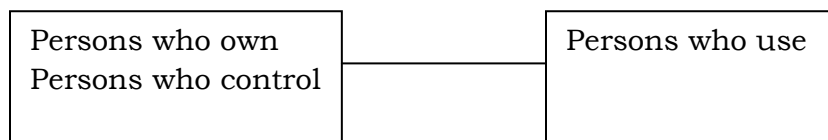
The Cooperatives have to operate very much like other businesses. They must serve a market efficiently and effectively. They have to be well managed and they must survive financially. However there are important distinctions that make Cooperatives unique in nature. For any organization there are three types of persons i.e.(i) the persons who own ( owners/investors /share holders), ii)the persons who control (the policy/decision makers/management) and iii) the persons who use them (the customers) In case of corporates especially large enterprise or multinational, these three are separate and distinct groups. In a small retail business, for example the first two components are often identical. But users/ customers are separate. However in Cooperatives all the three come together to form a unity, Those who own, those who control and those who use are One .

See the following diagram :

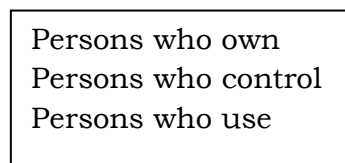
1) Large Business / Multinationals



2) Small Private Business



3) Cooperatives



In Corporate enterprises , the responsibility and accountability is indirect and difficult to trace. In case of Cooperatives responsibility accountability are direct

The Cooperatives aim at reducing disparities, improving social conditions and ensuring social justice, sustainable growth, and concern for the society.

### **The Cooperative Values and Principles**

The Values of co-operatives viz Self- help, Self Responsibility, Honesty, Equality Solidarity Openness, Social Responsibility and Caring for Others are the Vision Statements of Co-operatives. Co-operative Values and Principals enunciated in 1925, by the International Co-operative Alliance are Mission Statement for the Co-operatives. The Seven Principles, popularly called as Co-operative Rainbow are:

- i) Voluntary & Open Membership
- ii) Democratic Member Control
- iii) Members Economic Participation
- iv) Autonomy & Independence
- v) Education, Training & Information
- vi) Co-operation Among the Co-operatives
- vii) Concern for the Community

The values and a Principles of co-operatives symbolize the aims and ideas of co-operative movement. The seven colored flag embodies in it co-operative principles. The Co-operatives by their own effort inspired by a sense of fraternity, equity and love of the social justice, strive to remedy the past and create new economic system a system in which capital plays the role of servant instead of master. The object of production is organized self help instead of profit. The human dignity is given the pride place for achieving a more equitable and efficient economy, social reforms, and more equitable system of democracy.

The co-operatives have very strong foundation of its ethical values and principles which are hallmark of good governance. The principles of Corporate Governance are not alien to co-operatives but they are innate with it. The Corporate Governance in vogue is modern concept of management while Co-operative Governance, for doyens and seers of co-

operatives are their “Articles of Faith”. Unlike today’s Corporate Governance the cooperative governance is not a remedial measure to cure the disease.

### **Types of Cooperative Societies:**

Broadly there are following types of co-operative societies-

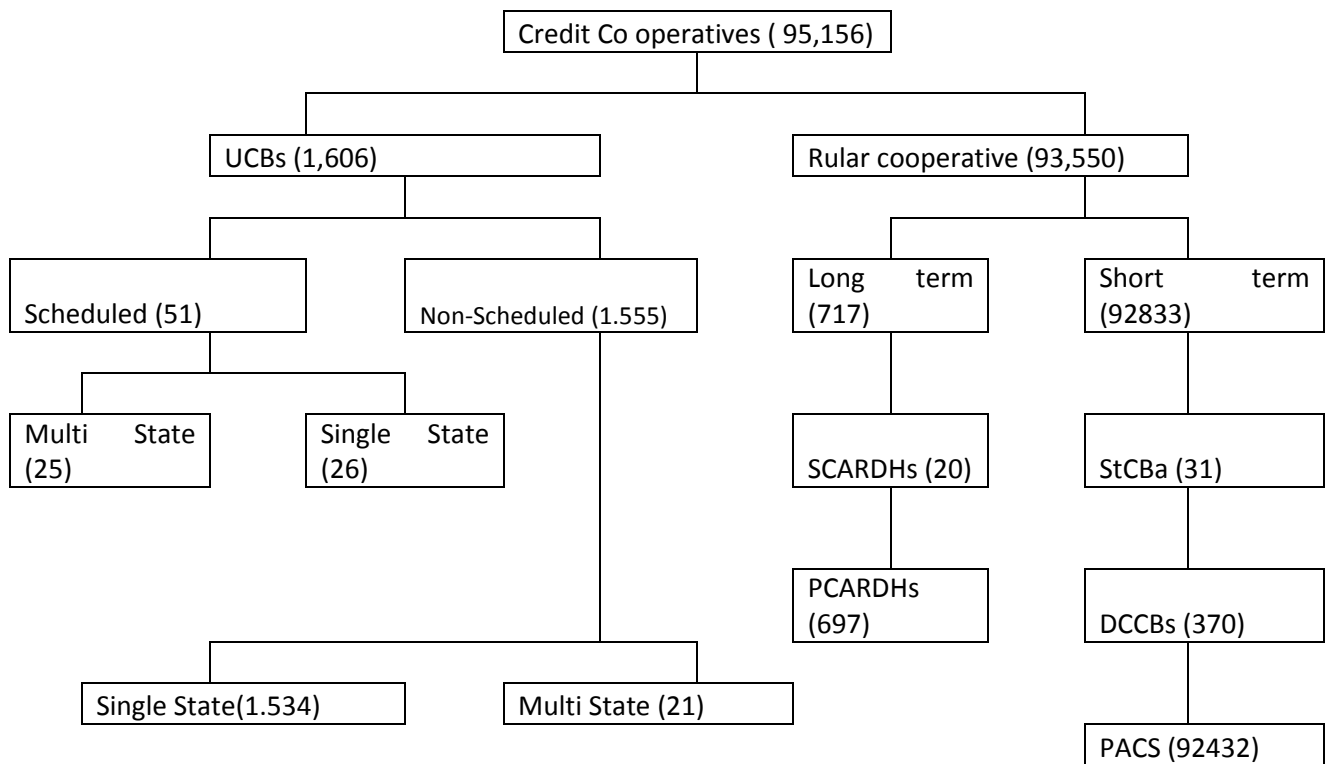
1. Housing Co-operatives
2. Utility Co-operatives or Consumer Co-operatives
3. Agricultural Co-operatives
4. Credit Unions (Co-op Credit Societies) and Co-operative banks
5. Federal or Secondary Co-operatives (Co-operative Federations of member of Co-operatives)
6. Co-operative Wholesale Society
7. Co-operative Union
8. Co-operative Party

### **Co-operatives an Indian Scenario:**

Co-operative occupies an important place in the Indian economy, perhaps no other country in the world has the co-operative movement as large and as diverse as it is in India. Co-operation in a vast country like India is great significance because :

- i. It is an organization for the poor , illiterate and unskilled people
- ii It is an institution of mutual help and sharing
- iii. It softens the class conflicts and reduces the social cleavages
- iv It reduces the bureaucratic evils and follies of political factions
- v It overcomes the constraints of agricultural development
- vi It creates conducive environment for small and cottage industries

**Structure of Cooperative Credit Institutions in India  
(As at end March 2013)**



STCB- State Co-operatives Banks

DCCB- District Central Co-operative Bank

SCARDB- State Co-operative Agricultural and Rural Development Bank

PVARDB- Primary Co-operative Agricultural & Rural Development Bank

The Co-operative movement is well developed in state of Maharashtra and Gujarat. Whereas- Andhra Pradesh, Rajasthan and Karnataka, have shown remarkable progress and there is a vast potential for the development of Co-operatives in remaining states. In India there are at present, 6.00 lacs co-operative societies of different types with membership over 250 million people. The co-operative has their presence in all villages of the country, covering 70 percent of householders.

The Cooperatives have been a key instrument of financial inclusion in reaching out to the last mile in rural areas. However, notwithstanding the important role played by Cooperatives in national economy, their financial viability and soundness remain some of key areas of concern.

Besides, the transition from controlled economy to open competitive economy in the name of globalization or liberalization has thrown a whole lot of challenges and threats to co-operative sector.

During the span of last two and half decades the co-operatives are passing through a phase of crisis of credibility. They are constantly under in media glare and crucified as if they are only seasoned culprits for financial scams. The crisis of credibility of co-operatives has posed numerable question marks on their existence and survival. Various factors could be attributed for weaknesses of co-operatives. some of them are-

- 1) Weak structure at primary level
- 2) Lack of responsiveness from federal organizations towards the needs of their members organizations.
- 3) Working of different co-operatives in isolation rather than unified system.
- 4) Lack of awareness and apathy of members
- 5) Restricted Coverage.
- 6) Functional Weaknesses.
- 7) Over dependence on government.
- 8) Cast ridden elections to the office of co-operative societies.

But the crux of the problem is total lacking of Corporate Governance in co-operatives. The root cause of downfall of number of sugar factories in Maharashtra and liquidation or merging of number of some Urban Co-operative banks are revealing cases of bad or lack of Corporate Governance. It is admitted that there is striking resemblance between concept Corporate Governance in corporate sector and Values and Principles of Co-operatives. But unfortunately this resemblance at conceptual level has been kept inadvertently or intentionally out of reach and context when it comes for its implementation in co-operative sector.

The major hurdles in implementing the Corporate Governance in Co-operative sector are-

#### 1. Legal Constraints:

Incase of Corporates, the amended Company Act, SEBI Act strongly advocate the implementation of Corporate Governance. There are no such provisions even in new amended Cooperative Acts.



2. Lack of professionalization and trained personnel.
3. Due to democratic set up the importance is given to electoral merit of Directors rather than their qualitative merit. As a result, many a times the board of directors of co-operatives may not be independent and competent, resulting in bad management .Favoritism and nepotism become prime considerations.
5. Politicization of Cooperatives
5. Inadequate or total lacking of Cooperative Principles at Board Level and senior management level.
6. Ignorance for self sustainable growth or long term interest of stakeholders but preference to short term and unwarranted benefits.
7. Remuneration policy not commensurating with market trends. Competent and efficient personnel not attracted.
8. No statutory restriction on tenure of directorship.
9. Weak internal control system Distaste of management for internal audit.
10. Inadequate Management Information System.
11. Lack of operational transparency.
12. Restrictions on raising the capital no access to capital market.

### **Corporate Governance and Urban Cooperative Banks**

Amongst the all stake holders , in case of banks, protection of interest of depositors is of paramount importance because of Contagion Hazards to which banks are exposed. The Cooperative banks are highly vulnerable because of their regulatory frame work, and lack of regulatory support

## **Endeavour to implement Corporate Governance by Reserve Bank of India**

It is a primary duty and legal obligation cast on Reserve Bank of India. to protect the interest of depositors. Besides, the banking related regulations are entrusted to RBI while administration of banks is the responsibility of State /Central Registrar of Cooperative Societies. The RBI aims to fulfill its legal obligation through regulatory frame work and introducing measures for Corporate Governance. The RBI has taken various direct and in direct measures to introduce Corporate Governance in Cooperative banks, which include

1. Recommendations of Madhavdas Committee made applicable to Urban Co-operative banks in 1978, which enunciate important principles of Corporate Governance.
2. Introduction of Prudential Norms for Asset Classification and Income Recognition Capital Adequacy etc to co-operative banks.
3. Implementing disclosure norms to Urban Co-operative Banks, having deposits of Rs. 100 crores and above.
4. Taking Initiatives towards a unified regulatory framework ( Vision Document 2005) Setting Committees in form Task Force for Cooperative Urban Banks (TAFUCB) for States to address various issues of Urban Cooperative Banks.
5. Prescribing” **Dos and Dont’s** “for Directors of Urban Co-op Banks.
6. Disclosure of actions taken by RBI and penalty imposed on Urban Co-operative Banks in Annual Report.
7. Ban on loan to directors of Urban Cooperative Banks on recommendations of Joint Parliamentary Committee.
8. Issuing guidelines to strengthen internal control and internal audit.
9. Introducing Rating models ( A/B/C/D) based on performance/ financial health and management of the bank.

10. Introduction of Off-site Surveillance (OSS) to all Urban Co-operative Banks having deposit size of Rs. 100 crores and above.
11. Putting restriction on dividend.
12. NABARD has also imposed certain regulatory conditions on Primary Agricultural Societies, District Central Co-operative Banks and State Co-operative Banks while granting financial aids.
13. High Powered Committee on Co-operatives (2009) appointed by Central Government has made significant recommendations, including review of Constitution Amendment Bill ( 106<sup>th</sup> Amendment Bill 2006), which are going to have a far reaching impact on Co-operatives, culminating in paradigm shift in co-operative movement of the country. Many of the recommendation of the committee are focused on strengthening Corporate Governance in Co-operative banks
14. Issuing Directives for Supervisory Action Frame Work for Urban Cooperative Banks in March 2012.

### **Implementing the Corporate Governance**

There should be a proactive approach for implementing Corporate Governance in Co-operative sector. Its implementation should not be postponed till it is made mandatory. It can be implemented by following measures.

- a) Measures at Organizational Level
- b) Measures at Statutory Level
- c) Measures at Sectorial Level

#### **a) Organizational Measures**

- i. Defining in unambiguous terms aims and objects in form of Vision Statement and deciding strategical planning to achieve them by stating Mission Statement and uploading the same on website of the Bank/ Society
- ii. Setting up organizational structure clearly defining the roles,

responsibilities and authorities at all levels of management.

iii. Composition of Board

As per Clause 49 of listing agreement of SEBI, the Board of Director of a company should consist at least 50% non executive director. There is no such no provision in State Cooperative Acts. This issue has been addressed in new Amended Cooperative Act 2013 by making provision for to expert directors.

iv. Code of conduct

There should be code of conduct for Directors and senior management. Its compliance should be reviewed on annual basis. The necessary undertaking should be obtained from the director regarding his commitment to strictly adhere to his role and responsibility specified in the code of conduct.

v . Role of Board of directors should be confined to policy making and directing the organization. They should not interfere in day to –day to working of the society.

vi. Formation of Committees

The Board should form its various sub-committees with delegated powers and specified role and responsibilities considering the nature of business of the society. The important committees include ,Audit Committee, Remuneration Committee, Grievance Committee, Fund Management Committee, Loan & Advance Committee.

vii. Harmony in relationship between Board of Directors and senior executives including MD/CEO.

viii. Effective internal control system Innovative Internal Audit with adequate remuneration, commensurating with the duties and responsibilities.

Due to inbuilt constraints and limitations cooperative lack in professionalism. The statutory audit confines its role to expressing opinion on true & fair state of affairs of the organization and if necessary giving qualificatory remarks. However it does not aptly address the lacunae in working system and procedures and suggest or participate in corrective measures. Hence the internal audit has very significant and vital role to play. It is necessary for the board of directors and senior management to recognize and appreciate the importance of the internal audit and take responsive role which ultimately would strengthen the Corporate Governance.

- ix. Transparency at all operational levels .
- x. Regular rapport with all stakeholders and providing them necessary information of their interest.
- xi. Uploading various policies of society/bank on the website

**b) Statutory Measures**

- i) Removing anomalies in the Acts that are applicable to Cooperatives societies
- ii) The stringent punitive provisions in the act for delinquent and fraudulent deeds of the management should actually be executed. They should not merely be words of threats.
- iii) More autonomy to co-operative to avoid undue and unwarranted interference and dominance of government.
- iv) Measure to strengthen and enhance the equity allowing free and mutual membership to co-operative institutions.
- v) Measures for consolidation by merger or acquisitions of non- viable entities.
- vi) Standardization of Statutory audit fees in line with Public Sector bank.

### **c) Sectorial Measures**

- i) Implementing constant measures for creating awareness about cooperative culture amongst the stakeholders.
- ii) Forming strategic alliance amongst Cooperatives in their respective fields to avoid competitions amongst them and tackle competition from outsiders.
- iii) Providing legislative representation both at state assemblies and parliament exclusively for Cooperatives.
- iv) Rating or accreditation of cooperative societies by evaluating its standard of Corporate Governance.
- v) In annual report of the society, there should be separate section on Corporate Governance and its compliance.

### **Role of Chartered Accountant & Corporate Governors:**

In cooperative sector, Chartered Accountants have very vital role to play. Traditionally Chartered Accountants are associated with Cooperatives as an internal auditor or a statutory auditor. But that is not end of it. They should contribute their expertise for better management of Cooperatives. They should take it as a social obligation. There are number of instances, where Chartered Accountants have given their contribution in successful turnaround of cooperative institution from a weak and ailing to a vibrant entity posing for growth. The cooperative sector is beckoning the fraternity of chartered accountants. Apart from traditional attestation function, there are other areas also, such as funds management, credit appraisal, monitoring of loan accounts, tax planning, arbitration vetting of One- Time Settlement proposals, treasury operations, staff training and implementing and evaluation of Corporate Governance, where Chartered Accountants can make their vital contribution which will strengthen the cooperative sector.

### **Conclusion:**

From the elaborate discussion on the subject, it can be epitomized that the principles of Corporate Governance are not alien to co-operatives but they are rather innate with co-operative culture. The founder fathers of Co-operative movement like Late Dr. Dhananjayrao Gadgil, Vilakuntbhai Mehta and other stalwarts had vision and perception for Corporate Governance, which is embodied with ethical and social values akin to Co-operative Governance. The principles of modern Corporate Governance are derivatives of co-operative governance. The co-operatives have significant share in Indian Economy. The Corporate Governance for co-

operatives is the synthesis of different statutory provisions, ideals and aspiration of members, encircled with social objectives. There is a need for co-operatives that they should endeavor to pursue the Corporate Governance in such a way that it becomes the way of their lives. The Co-operative Values should be held in high esteem and kept non-polluted from personal and political motives. The spectrum co-operatives is very wide. Unlike Corporates, co-operatives are not aimed at enriching and protecting interest and values merely of equity holders, instead they are expected to function for overall economic development of a common man. **The major challenge to co-operatives today is their capacity to integrate themselves with their national and global counterparts without sacrificing their own cultural ethos. Corporate Governance plays a crucial and vital role in this endeavor.**

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Ref. 1. RBI Publications

2. Information and data from Indian Co-operatives News Letter.

CA Sudhir Pandit