

THE CO-OPERATIVE FEDERAL BANK OF CEYLON GIVES WAY
TO THE PEOPLE'S BANK *People's Bank, Research Department*

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The People's Bank was established by Act of Parliament No.29 of 1961, and when in July of the same year it commenced business it replaced the Co-operative Federal Bank. Although the registration of the Cooperative Federal Bank of Ceylon had taken place in December 1947 it was formally inaugurated for business only in 1949. This Bank was intended to be the apex bank of the Cooperative Movement and to particularly be a balancing medium for surplus funds of the cooperative movement, but it failed to realise these objectives for various reasons. In its thirteenth year of operations it finally gave way to the People's Bank, and under the provisions of the People's Bank Act, it was deemed to be dissolved and its assets and liabilities were transferred to the People's Bank from July 1, 1961. To this extent the establishment of the People's Bank could be regarded another milestone in the system of cooperative banking.

The beginnings of the system of cooperative banking can be traced back beyond the formation of the Cooperative Federal Bank in 1947, or the three cooperative banks organised at secondary level by primary cooperatives in 1929 and 1930 to the Cooperative Credit Societies begun in the early 1900s.

In 1906 there had been two known Cooperative Credit Societies one in Teldeniya in the Kandy District and the other in Weligama Korale in the Matara District. However, it was only after the passing of the Cooperative Credit Societies Ordinance No 7 of 1911 that the Cooperative Credit Societies were stabilised legally. The first Credit Societies after 1911 were of the unlimited liability type, where the members were individually and jointly liable for the debts of the society. In this early period two other types of Cooperative Societies - Cooperative Credit Societies of limited liability and Cooperative Thrift and Savings Societies - were also registered. The first Cooperative Credit Societies of unlimited liability and of limited liability were formed in 1912 and 1921 respec-

tively. By 1921 there were 154 Cooperative Credit Societies. By 1931 there were 600 registered Cooperative Societies with a membership of 24,068 and by 1942 the number of these societies had further increased to 2,036 and their membership to 91,988.

Although savings promotion was the main objective of the Co-operative Thrift and Savings Societies, loans were also granted upto 75 percent of their savings. But these Societies were mainly formed by public servants and they received the benefits of the societies. The Co-operative Credit Societies of limited liability were also mostly located in urban centres and served the small traders and industrialists. Only the Co-operative Credit Societies of unlimited liability provided credit facilities to the rural farmer.

In the early period of the Co-operative Credit Societies government granted loans to these societies. The State was the first financier of the co-operative movement in the country and in the early years of the movement when the Local Loans and Development Fund was established by the government in 1916 the granting of loans to the Co-operatives became more systematic.

In the late 1920's the primary co-operative societies had realized the need for their own banking system. The first co-operative bank was set up in Jaffna as a secondary co-operative bank - the Central Bank of Jaffna - in 1929. Within the next two years another two co-operative banks were set up in Kandy and Colombo and thereafter similar banks were formed in other provinces and districts. These banks were formed affiliating the primary societies in their respective provinces or districts and these were registered under the Co-operative Societies Ordinance of 1911, with the primary co-operative societies as members. These banks accepted deposits from Co-operative Societies as well as the public, and they were expected to provide the credit needs of Co-operative Societies in their respective areas. With the setting up of Co-operative Provincial and District Banks, the

Local Loans and Development Fund stopped its lending to the Credit Societies which were affiliated to the Provincial and District Banks. In the late 1930's with the increasing number of Co-operative Credit Societies and volume of their transactions it was felt that an apex bank to serve the entire Co-operative Sector island-wide was necessary.

The Banking Commission appointed by the Government in 1934 examined the co-operative credit system in the country as well, and was of the view that the Co-operative Movement had developed satisfactorily and also stated that although more Co-operative Central Banks may be set up an all island apex bank for the Co-operative Sector was not necessary. The Commission suggested that instead of a new Co-operative Apex Bank, that the co-operative banks could deal directly with the state aided commercial bank which they proposed should be set up. The first state aided indigenous Commercial Bank, the Bank of Ceylon - was set up in 1939, but it failed to associate directly with the Co-operative Sector as was originally expected of it.

During the World War II (1939-46) when the country was faced with severe food shortages, the government decided to open up a network of Co-operative Stores Societies all over the country for distribution of limited supplies of essential commodities. During the same period the Government took steps to form the Co-operative Agricultural Production and Sales Societies (CAPS) for stimulating local food production and facilitating distribution. These measures brought about a rapid expansion of the co-operative sector and the number of Co-operative Stores Societies increased from 38 in 1942 to 4,004 in 1945 with a membership of 1,033,228. In 1947 there were 26 CAPS Societies with a membership of 43,525; but with the development of the Co-operative Movement the number increased to 995 CAPS Societies with a membership of 247,000 by 1957.

Meanwhile the number of Primary Coop Societies increased from 1,970 in 1942 to 10,539 in 1957. Also, the Co-operative Provincial and District Banks increased to 7 by 1942

and to 12 by 1947; while loans from these banks to the Co-operatives kept increasing from Rs 1.2 million in 1941 to Rs 15 million in 1942.

The failure of the Bank of Ceylon to deal directly with the co-operative sector and further development in the Co-operative Societies and the increase in the number of the Provincial and District Co-operative Banks in the late 1940's led to the feeling that an all island apex bank for the Co-operative Sector was a necessity. The Co-operative Commissioner in his Administration Reports 1945-48 emphasised that the need for a Co-operative Apex Bank had been actually felt for some time".

The Co-operative Federal Bank of Ceylon Ltd. an Apex Co-operative Bank was registered on December 6, 1947 under the Co-operative Societies Ordinance of 1936 and it was governed by its own by-laws. This Bank formally commenced business on 7th July, 1949 with the primary objective "of providing a central source of credit for the Co-operative Movement of Ceylon, of facilitating the investment of funds to be employed by the Bank in the furtherance of that Movement, and of acting as a balancing medium for the surplus funds of a member societies". Its objects more particularly were:

- (i) to carry on banking and credit business,
- (ii) to act as a balancing medium for the surplus funds of societies,
- (iii) to supervise inter-lending among societies,
- (iv) to provide educational assistance to the staff of societies.

The Co-operative Provincial and District Banks as well as other Co-operative Societies were eligible to become share holder members of the Federal Bank. Individuals could also be share holding members of the Bank but their number (excluding Chairman and the members of the Board of Directors) could not exceed fifty (i) each Provincial and District Bank and each member society holding 100 shares or more; (ii) every 50 societies affiliated to a provincial or District Bank, and (iii) Jointly all individual share holding members could elect one representative to the General Body of the Bank. The Board of

Directors of the Bank consisted of:

- (i) The Chairman nominated by the Minister under the Co-operative Federal Bank of Ceylon (Financial Aid) Ordinance.
- (ii) Six persons elected at a general meeting.
- (iii) The representative of the individual members of the Bank on the General Body,
- (iv) Representatives of Provincial and District Banks and member Societies (which hold more than 100 shares each).
- (v) Not more than 2 nominees of the Registrar where the Board has requested the Registrar to nominate additional members for service on the Board,

(Only share-holders of the Bank or members of share-holding societies were eligible to be appointed members of the Board)

The capital of the bank was composed of (i) an undetermined number of shares of the value of Rs 100 each; (ii) deposits, (iii) loans and (iv) accumulated profits. The Board could raise loans by floating of debentures, with the prior approval of the Registrar of Co-operatives.

Financial assistance to the Bank by the Government was provided under the Co-operative Federal Bank of Ceylon (Financial Aid) Ordinance No. 39 of 1947. Under this Ordinance the Bank received from the Government an initial loan of Rs 2 million, to be paid back at the end of 10 years, with no interest payable for the first 5 years and after this interest at a rate of 1½% per annum which could be reduced or stopped while the interest free period could be extended by Parliament. During the period where the interest was not payable on Government loans the Bank was obliged to carry 1½% of such loans to its reserve fund. In addition, as long as no interest was payable by the Bank 25 percent of the net profit was required to be carried to the reserve under Section 34 of the Co-operative Societies Ordinance. The loans granted by the Government to the Bank gave it a first charge on the assets of the Bank. In addition to the initial loan of Rs 2 million another loan of Rs 4 million was granted by the

Government in 1953 at a 3 percent interest.

The Bank could grant loans primarily (i) to Provincial and District Banks (ii) to Co-operative Societies which served more than the area of operation of one Provincial or District Bank and (iii) to Co-operative Societies in areas not served by Provincial or District Banks.

With the establishment of the Co-operative Federal Bank there were hopes that the financial structure of the Co-operative Movement would be complete. Soon after its establishment the Commissioner of Cooperative Development reported "the financial structure of the local Movement can now be said to be complete the inauguration of this central agency for co-ordinating and controlling the entire finances of the Movement is particularly welcome at this juncture, when the Movement needs all the funds it can secure to carry out its very heavy programme of expansion and development".

There were many obstacles to its carrying out an efficient banking and credit business. In respect of credit facilities, the advances made by the Coop Federal Bank to the Co-operative Banks and Societies were wholly inadequate. Some Co-operative Provincial and District Banks had to also obtain advances from commercial banks to fulfil their financial requirements. This was mainly due to insufficiency of resources the Coop Federal Bank faced. There was no legal provision for attracting all the deposits of Co-operative Societies to the Bank, and the Societies deposited most of their surplus money with provincial or District Banks and only a comparatively small part of their money was deposited with the Federal Bank. (See table).

Since the loans granted by the Government to the Bank gave the Government first charge on its assets the Bank could not obtain loans from other Commercial banks. Also, the Bank could not raise funds on debentures since there was no guarantee by government. Most of the subscribers to the shares of the Bank were Co-operative Bank and Societies. Since they purchased shares not as an investment but for the purpose of becoming

Levels of Deposits made in the Co-operative Federal Banks and Co-operative Provincial & District Banks

| Source of Deposits | 1956 | | 1958 | | 1960 | |
|---------------------|------------------|-------------------------|------------------|-------------------------|------------------|-------------------------|
| | Coop. Fed. Banks | Coop. Pro. & Dis. Banks | Coop. Fed. Banks | Coop. Pro. & Dis. Banks | Coop. Fed. Banks | Coop. Pro. & Dis. Banks |
| 1. Co-op. Societies | 3.9 | 11.0 | 5.0 | 24.7 | 4.4 | 26.8 |
| 2. Government | --- | 1.5 | 10.7 | 0.8 | 8.2 | 0.2 |
| 3. Individuals | 1.3 | 0.7 | 1.3 | 0.9 | 1.1 | --- |
| 4. Others | 3.0 | 1.6 | 1.7 | 2.3 | 3.1 | 3.4 |
| Total | 8.2 | 14.8 | 18.6 | 28.6 | 16.8 | 30.4 |

eligible for loans, the Bank could not raise its share capital to a considerable level.

Furthermore, though the Bank could open current accounts for members of the public it could not grant loans to them but only to the Co-operative institutions. It confined its activities to Co-operative banking particularly to the grant of small-scale loans to the Co-operative institutions which normally did not give an attractive profit. As a result the Bank could not benefit from the more lucrative fields of commercial banking. The Co-operative Bank's demand for funds on their overdraft limits in the Federal Bank had fluctuated widely. The Federal Bank had to keep a large part of its funds, which were borrowed on interest, idle without investing in order to meet the occasional demand of Co-operative Banks. The earnings of the Federal Bank were also poor due to the insufficient gap of interest rates between its borrowing and lending. While it borrowed funds at the rate of upto 3 percent interest, it lent at the rate of 3½ percent to 4 percent. The Federal Bank was also compelled by the Government to make advances on high risk agricultural activities, in pursuance of a certain agricultural policies, without any government guarantees on these advances. The recovery position of the loans, particularly of the marketing loans, was not satisfactory; and of the marketing loans granted by the Federal Bank to the Co-operative Societies about 14 percent were overdue.

Another drawback was that the Federal Bank had no branch network of its own in the country. The Provincial and District Banks were not its own branches but entirely separate

entities. The Federal Bank had to use the services of these Provincial and District Banks in providing credit facilities to the Co-operative Societies, particularly in the areas where these Provincial and District Banks had been set up. The Coop Federal Bank lent funds to the Provincial and District Banks for re-lending to Co-operative Societies. This intervention of the Provincial and District Bank as 'middlemen' merely increased the cost of borrowings (the interest on the loans) of Co-operative Societies and members of these societies. The Federal Bank could not maintain a unified system in assisting Co-operative Societies since it assisted Co-operative Societies directly in certain areas and through the Provincial and District Banks in others.

After the first 6 years of the Bank's operation, the Central Bank of Ceylon drew attention of the Ministries of Finance and of Agriculture to the fact that no dividend had yet been paid to shareholders and that the entire capital funds of the Bank amounted to only Rs.605,000. Apart from the low level of liquidity, low income was also a problem. After years of operation its reserves stood at only Rs 261,000.

A cause for concern was the fact that the Coop Federal Bank's business with the Cooperative Societies was on the decline and the Commissioner of the Cooperative Development stated in his annual report for 1960 "an unsatisfactory development is the decrease in the Finance and Savings Deposits made by Co-operative Institutions in the Federal Banks". Fixed Deposits had declined from Rs 539,000 in 1959 to Rs 272,000 in 1960; while savings deposits had come down from Rs 988,000 in 1959 to Rs 750,000 in 1960.

There was also a decline in the amount of loans (excluding drafts granted to Cooperative Banks and other Societies) with only Rs 7,096,000 granted in 1960 as against Rs 13,450,000 granted in 1959.

The Co-operative Federal Bank was not able to win the confidence of the Provincial and District Banks and Co-operative Societies or obtain their co-operation and partly for this reason some of the Co-operative Banks tended to do their banking business with other Commercial Banks also. In view of these limitations on its resources and influence the Co-operative Federal Bank did not enjoy the confidence of the Provincial Banks and the Co-operative Movement generally, in order to either act as the balancing medium for surplus funds of societies, or to supervise lending among societies, which were the Bank's second and third objectives.

One of the main reasons attributed to the failure of the Co-op Federal Bank was the composition of its Board of Directors.

The large majority of the Directors were the elected representatives of the Provincial and District Banks and Co-operative Societies. But by a system of election it was not possible to have many efficient and experienced personnel on the Board. As the Minister in charge of Co-operatives stated "it is not possible by this elective method to obtain a sufficient number of directors with the requisite variety of experience and the degree of ability for conducting efficiently the complicated affairs of a large Bank".

Furthermore, the Directors on the Board were elected representative of the Co-operative institutions and they had to sanction large loans which these same cooperative interests had applied for. Members of the Board therefore generally acted in the interests of their respective Co-operative institutions rather than in the interest of the Co-operative Federal Bank. Also, the Board of the Federal Bank often consisted of a large number of members varying from seventeen to twenty and it found difficult to come to quick decisions in its business affairs. Its fourth objective was to undertake training of staff for the cooperative banking system but this

which hampered the Co-operative Federal Bank during its existence. The Government held 50 percent of the shares of the new Bank which strengthened the capital structure of the Bank. The balance 50 percent of the shares were allocated to the Co-operative Societies. According to the provisions of the People's Bank Act all co-operative societies were required to deposit their funds only with the People's Bank. This requirement enabled the Bank to raise the resources it needed for lending. And also the Bank was empowered to raise resources for its short term and medium term loans from government funds or by debentures with a government guarantee. The Bank was given the powers to adopt commercial banking standards and practices. This enabled the Bank to engage in the lucrative field of commercial banking activity including foreign exchange business, which was to ensure that the Bank would not run at a loss.

The new Bank, however, was expected to provide banking services not only to the Co-operative sector but also outside the sector, extending to individuals among peasant farmers and the rural sector. The People's Bank Act No. 29 of 1961 stated explicitly that the objectives of the new bank were "to develop the Co-operative Movement of Ceylon, Rural Banking and Agricultural Credit". The Bank was also expected to set up a network of its branches throughout the country particularly in the rural areas with a view to assisting the vast majority of the people in the country in 'promoting the economic growth' and 'transforming the rural economy'.

One feature that emerges clearly from this overview is that the Co-operative Development Bank Bill, ultimately re-titled the People's Bank Bill, was formulated to remedy the shortcomings of the Co-operative Federal Bank which had failed to live upto expectations as an effective apex bank for the Co-operative Movement. The People's Bank came in instead to serve the Movement and the agricultural and rural sectors more effectively. To this extent the origins of the People's Bank could be traced back to 1947 to the setting up of the Co-operative Federal Bank and herein lies the significance of this Bank.