

Producer Company Model - Current Status and Future Outlook : Opportunities for Bank Finance

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In recent times, almost every major business house of the country is venturing in a big way into the agri-business sector, especially with regulations allowing corporates to now directly have contractual arrangements with farmers. One of the triggers for this newfound interest in agribusiness by the corporates is the change occurring in the retail markets, where consumers are making dramatic shift from purchasing at neighbourhood kirana stores to shopping at supermarkets, malls and food plazas, enabling development of food supply chains from the farms to consumers.

Ironically, at this very time we get news that between 1995 and 2005, one and a half lakh farmers committed suicide across the country. A Situation of Farmers study undertaken by the National Sample Survey Organisation (NSSO) of the Government of India indicates that forty percent of farmers, given a choice wish to get out of agriculture. How is it that when the capitalists are rushing into agriculture in droves, the farmers are rushing to get out of it?

With a population of over one billion and rising disposable income, the demand for food is only growing. Why then are the farmers in distress? Is there an explanation to this dilemma? One explanation for this is that value addition in agricultural commodities happen only post production. And since in the Indian context the farmer disposes off his produce in unprocessed form, there is no plough back of surpluses from value addition to the farmer. Can something be done to address this dichotomy? Producer Companies look to be one plausible solution.

Expectation of Farmers from Agriculture

The expectation of farmers while carrying on agricultural activities is, beyond meeting his consumption needs, to be able to get a reasonable return on the time and money invested by him. Also his desire is to increase his share in the consumer rupee. The structure of agricultural markets as they exist today involves a number of intermediaries and therefore, the producers share in the consumer rupee is small as can be see from Table 1, which is illustrative for a few vegetables and fruit but the same pattern exists in all agricultural commodities. Further, it is only when the commodity is processed and branded that value addition occurs. As the farmer exits from the scene after transacting in the primary market, he has no part in the surpluses that emerge post production. Only when agriculture as an enterprise in the long term generates surpluses or the farmer perceives deriving benefit would he

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make efforts to put back some of the surplus generated into the agricultural enterprise, creating further capital formation in agriculture. If not, he would divert the cash flows to other activities which he perceives to be more remunerative than his present engagement. As the farming community sees the general progress and all-round prosperity of the country through sustained growth of the economy at 7-8%, they also aspire for themselves and their future generations, improvement in their standard of living.

	Tomato	Potato	Cabbage	Cauliflower	Banana
Price paid by end consumer (Rs. per kg)	8.20	12.00	9.00	9.50	12.00
Price received by farmer (Rs. per kg)	2.00	6.60	5.00	5.50	4.00
Price realization by farmer as % of end consumer price	24	55	56	58	33
Percentage mark up (price paid by end consumer to the price received by farmer)	310	82	80	73	200

Source: Field Study by Profs. S Ragunath & D Ashok, IIM Bangalore

Expectation of Agri-business Enterprises

Agri-business enterprises after making substantial investment in capital infrastructure for building the supply chain look for consistent continuous and adequate supplies of produce on an ongoing basis. In the existing market mechanisms of agricultural mandies, there is no premium for quality, nor are there long term relationships. Agribusiness enterprises are therefore increasingly looking for direct tie-up with farmers to source the agricultural produce required by them. As these enterprises do not have the capacity or intend to deal with individual farmers, they are looking for aggregators or intermediary institutions that can pool produce in adequate quantity and help them to deal with a large number of small landholding farmers.

The Cooperative Option

Cooperatives are one form of organization that enables farmers to organise themselves as collectives and move up the value chain by ownership and operation of their own processing units and sometimes extend the chain upto the retail level. India has a large number of cooperative institutions in a vast range of enterprise sectors, but there have been few successes that can be talked about. Infact, the only stars are in the cooperative dairy sector and that too limited to a few states. The cooperative experience in our country has not been a very pleasant one, as cooperatives have largely been state promoted, with a focus on welfare rather than to do business on commercial lines. The cooperative institutions are controlled by the State through the Registrar of Cooperative Societies whose overriding powers to direct and regulate cooperatives on his terms whenever the Government deems

necessary has throttled the growth of the very institutions they were mandated to nurture.

Thus, cooperatives have never emerged as successful business enterprises but only as extended arms of the State. The reasons for this are many and have been analysed at length by several expert committees from time to time.

The Mutually Aided Cooperative Societies (MACS) Act to a certain extent has been an attempt to remedy the malady, but it has been accepted in only a few states, and even there, not many commodity cooperatives have migrated to the MACS Act.

Producer Companies

The concept of producer companies was introduced in 2002 by incorporating a new Part IXA into the Companies Act based on the recommendations of an expert committee led by noted economist, Y. K. Alagh, that was given the mandate to frame a legislation that would enable incorporation of cooperatives as companies and conversion of existing cooperatives into companies, while ensuring the unique elements of cooperative business with a regulatory framework similar to that of companies.

Salient Provisions of Companies Act relating to Producer Companies

In a 'Producer Company', only persons engaged in an activity connected with, or related to, primary produce can participate in the ownership. The members have necessarily to be 'primary producers.'

Primary produce has been defined as a produce of farmers arising from agriculture including animal husbandry, horticulture, floriculture, pisciculture, viticulture, forestry, forest products, re-vegetation, bee raising and farming plantation products; produce of persons engaged in handloom, handicraft and other cottage industries; by-products of such products; and products arising out of ancillary industries.

Formation

Any ten or more individuals, each of them being a producer, that is, any person engaged in any activity connected with primary produce, any two or more producer institutions, that is, producer companies or any other institution having only producers or producer companies as its members or a combination of ten or more individuals and producer institutions, can get incorporated as a producer company.

The companies shall be termed as limited and the liability of the members will be limited to the amount, if any, unpaid on the shares. On registration, the producer company shall become as if it is a private limited company with the difference that a minimum of two persons cannot get them registered,

the provision relating to a minimum paid-up capital of Rs. 1 lakh will not apply and the maximum number of members can also exceed 50. Members' equity cannot be publicly traded but only transferred.

Objects

The objects of producer companies shall include one or more of the eleven items specified in the Act, the more important of these being:

- (i) Production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of members or import of goods or services for their benefit;
- (ii) Processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its members; and
- (iii) Manufacture, sale or supply of machinery, equipment or consumables mainly to its members.

The other objects include rendering technical or consultancy services, insurance, generation, transmission and distribution of power and revitalisation of land and water resources; promoting techniques of mutuality and mutual assistance; welfare measures and providing education on mutual assistance principles.

Management

Every producer company is to have at least five and not more than 15 directors. A full time chief executive is to be appointed by the board. He shall be an ex-officio director and will not be liable to retire by rotation and shall be entrusted with substantial powers of management as the board may determine.

Members' Benefit

Members will initially receive only such value for the produce or products pooled and supplied as the directors may determine. The withheld amount may be disbursed later either in cash or in kind or by allotment of equity shares. Members will be eligible to receive bonus shares.

There is a provision is for the distribution of patronage bonus (akin to dividend) after the annual accounts are approved — patronage bonus means payment out of surplus income to members in proportion to their respective patronage (not shareholding). Patronage, in turn, is defined as the use of services offered by producer companies to their members by participation in their business activities.

Reserves

Every producer company has to maintain a general reserve in every financial year and in case there are not sufficient funds in any year for such transfer, the shortfall has to be made up by members' contribution in proportion to their patronage in the business.

Dispute Resolution

Dispute relating to producers companies are to be settled by conciliation or arbitration under the Arbitration and Conciliation Act, 1996 as if the parties to the dispute have consented in writing to such procedure.

Inter-State Cooperative Societies

Inter-State Cooperative Societies not confined to one State can also make an application to the Registrar for recognition as producer companies. The statute also provides for re-conversion of such producer companies to their former status as inter-State cooperative societies subject to the approval of High Court.

Further, "all the limitations, restrictions and provision of the Act, (other than those specified in Part IXA), applicable to a private limited company, shall apply to a producer company, as if it is a private limited company.

In other words, a producer company is a hybrid between a private limited company and a cooperative society. It combines the goodness of a cooperative enterprise and the vibrancy and efficiency of a company. It accommodates the unique elements of cooperative business with a regulatory framework similar to that of a private limited company.

Table 2 below gives a comparative picture of the main features differentiating a producer company from a conventional producer's cooperative

Features	Producer Cooperative	Producer Company
Registration	Cooperative Societies Act	Companies Act
Membership	Open only to individuals and cooperatives	Only those who participate in the activity
Relationship with other corporates/ business houses /NGOs	Transaction based	Producers and corporate entity can together float a producer company
Shares	Not tradable	Not tradable but transferable
Voting Rights	One person, one vote, but Government and RCS holds veto powers	One person one vote. Those not having transactions with company can't vote
Reserves	Created if there are profits	Mandatory to create every year
Role of Registering authority	Significant	Minimal
Administrative control	Overbearing	None
Borrowing Power	Restricted	More freedom and alternatives
Dispute Settlement	Through Cooperative mechanism	By Arbitration

International Experience

The United States of America, New Zealand and Denmark have provisions for cooperatives and producer enterprises to register and operate under the same laws as govern companies. While at the back end, these are producer owned enterprises, at the front end, they look and function like any other corporate enterprise.

Indian Experience

Although no comprehensive data base on the number of Producer Companies established in the country and their performance exists, estimates are that there would be fewer than hundred such companies as on date. Following is a listing of some Indian Producer Companies and their activities and performance:

Kerala

Indian Organic Farmers Producer Company Ltd. - The first farmers' producer company

The Indian Organic Farmer Producer Company Ltd. is an Aluva (Kerala) company of farmers producing organic products. Only producers with organic certification are eligible for membership of the company, where patronage for one share is fixed at Rs.40,000. Thus, the holder of one share can market his/her own organic products worth a maximum of Rs.40,000 through the company. An individual can purchase more than one share, but will have only one vote, irrespective of the number of shares held.

The company provides advice to farmers on mapping and assessing resources (mainly soil and water), sustainable resource utilisation and scientific production methods. The company markets organic products after branding. 'Healthy People, Wealthy Farmer, Healthy and Wealthy Nation' is the motto of the company. One of the company's future plans is attracting environmental funds from farmer-friendly groups abroad who are interested in supporting fair trade. (The HINDU, Sep 23, 2004)

Vanilla India Producer Company Ltd (VANILCO) / Banana India Producer Company Ltd (BIPCL)

Vanilla India Producer Company Ltd (VANILCO) has been promoted by Kerala based Indian Farmers Movement (Infarm), a charitable society with over one lakh farmer members for catering to the long-term interests of the vanilla farmers. VANILCO works in tandem with vanilla growers to produce and market the best and choosy vanilla beans and extracts. The company procures processes and markets the members' produce in the most professional manner to ensure handsome dividends and bonuses for its shareholders as also intervening in the market through pool procurement.

Banana India Producer Company Ltd (BIPCL) has also been formed by Infarm with a broader objective of "building brand equity for the 25 varieties Indian bananas cultivated in different parts of India at the international level. The company plans to promote each variety of banana as exotic varieties of "India Banana". The sole owners of BIPCL are the primary producers (farmers) of the country.

Infarm has been working towards value addition of agricultural produce for the last six years and has launched branded rice, honey, coffee, tea, coconut oil etc in the market. The NGO has set up retail outlets in several parts of Kerala and in cities like Delhi. (FnBnews.com, November 12, 2005)

Evangelical Social Action Forum (ESAF)

ESAF Swasraya Producers Company Limited (ESPCL), Thrissur promoted in 2006 by ESAF (Evangelical Social Action Forum), a premier NGO and leading MFI having 13100 women SHGs & 2.2 lakh members. The Producer Company has three areas of activity (1) Handicrafts, (2) Herbal & Agriculture, (3) Food, and Dairy & Meat. The Handicrafts & Herbal divisions could benefit 1000 Handicraft artisan families for production worth Rs 22.6 lacs and market Rs 23.5 lacs worth products during 2007-2008. In the herbal area, Rs 20.7 Lacs worth raw herbal drugs were traded.

ESAF has also incorporated a Retail Company also called ESAF Retail (P) Limited to support the Producer Company through forward & backward linkages and also run the eight retail stores which had a total turnover of Rs 2.5 Crores in 2007-2008.

Madhya Pradesh

The Government of Madhya Pradesh under District Poverty Initiatives Programme (DPIP) has promoted a large number of Producer Companies in various parts of the state, the details of which are given in Table - 3

S. No.	Name of the Company	Location	Commodities Dealt
1	Hardol Agriculture Marketing & Producers Company Private Limited	Shivpuri	Seed, grain
2	Lavkush Crop Producer & Marketing Company Private Limited	Raisen	Seed, grain
3	Khujner Agriculture Producer Company Private Limited	Rajgarh	Seed, grain
4	Churhut Agriculture Producer Company Private Limited	Sidhi	Rice, tomato
5	Rewa Crop Producer & Marketing Company Private Limited	Rewa	Seed, grain, chili
6	Nowgong Crop Producer Company Private Ltd	Chhatarpur	Seed, grain, chili
7	Khajuraho Crop Producer Company Private Limited	Chhatarpur	Seed, grain, chili

8	Narsingh Farmers Producer Company Private Limited	Narsinghpur	Seed, grain, peas, sugarcane, turmeric
9	Ram Raja Crop Producer Company Private Limited	Tikamgarh	Seed, grain, ginger, chili
10	Mahila Murgi Utpadak Company Limited	Tikamgarh	Poultry
11	Govind Seeds and Crop Producer Company Private Limited	Damoh	Seed, grain, potato
12	Neshkala Crop Producer Company Private Limited	Guna	Seed, grain, coriander
13	Sironj Crop Producer Company Limited	Vidisha	Seed, grain
14	Sagar Samridhi Crop Producer Company Limited	Sagar	Seed, grain
15	Sagar Shri Mahila Dugdh Utpadak Company Limited	Sagar	Milk production and processing
16	Karnavati Producer Company Limited	Panna	Seed, grain
17	Samarth Kishan Producer Company Limited	Shajapur	Seed, grain, bio fertilizer
Source: Panchayat Raj & Rural Development Department, Government of Madhya Pradesh			

These companies have a total membership of 44,800 share holders and have generated a turn over of Rs.4.84 crore. The World Bank India office in the Newsletter of March 2008 has reported that the formation of producer companies has stimulated introduction of horticulture crops like tomato, spinach and chili and has helped farmers to raise their incomes substantially. Local level value addition has provided 30 to 40% higher realizations on agricultural produce to participating farmers. It is reported that agricultural income level of participating farmers increased by 66% and savings of households have gone up by 183%. It has also enabled farmers to talk with companies like Reliance Fresh and ITC to do dedicated farming.

The Government of Madhya Pradesh has been supporting the emergence of producer companies through policy measures and financial support, the details of which are summarized in Table 4:

Table 4: Government of Madhya Pradesh's Policy for Strengthening Producer Companies
Key Features
<ul style="list-style-type: none"> ➤ Focus on Poor ➤ Modular Structure ➤ Insulation from political/ administrative control
Support and Benefits
<ul style="list-style-type: none"> ➤ Cost of organizing producer organization and hand holding support for three years provided ➤ Debt linked Start-up support based on business plan ➤ Viability gap support for establishment costs ➤ Treating on par with Coops/industries ➤ Performance linked – Back ended interest-subsidy ➤ Support – price preference, infrastructure development
Source: Anish Kumar, PRADHAN presentation at Workshop on Producer Companies

Gujarat

At Dari in Amreli District, a producer company has been formed with ten watershed development groups from ten villages who are working in agricultural input supplies and provision of technology under the guidance of Development Support Centre, Ahmedabad. The objectives of the company are to carry on the business of production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce e.g. groundnuts, oilseeds, grains, and other agro products of the members or import goods or services for their benefit, to provide for mutual assistance and technical consultancy services, to provide for insurance cover and credit facilities to the farmers in a profitable manner and to provide for welfare measures or facilities for the benefit of members.

The Junagarh Dairy which was in losses has been reconstituted as a producer company and now operates in over 130 villages and covers 5000 producers. The Dairy is able to give a better price for the milk than alternate channels and thus farmers are experiencing prosperity and investing in more buffaloes.

Amul

The Gujarat Cooperative Milk Marketing Federation popularly known as AMUL, the largest and most successful producer owned cooperative enterprise in the country, was as reported in the press in May 2006, planning to convert into a producer company. That it has not converted so far indicates probably that it is doing re-think on the idea.

Assam

In Assam, the Spices Board under the Ministry of Commerce, Government of India has promoted two producer companies, the Coinonya Farm Producer Company Limited for turmeric and Karbi Farms Producer Company Limited for ginger and chilly in Karbi Anglong District of Assam under organic cultivation for processing and export. The spices board has put in Rs. 1 crore as equity in each of the companies, while the rest of the equity is held by tribal farmers, 600 in Coinonya and 400 in Karbi.

Producer Companies of Artisans and Craftsmen

Rangсутra

Rangсутra, a Producer Company registered in 2004, comprises 1000 odd weavers, artisans and craftsmen from Rajasthan, Assam and Uttaranchal. Promoted by Sumita Ghose, the company's main object is to systematically develop the market for the produce of artisans, weavers and craftsmen. Combining the power of organization with the dynamism of a commercially viable outfit, the company plans to, "substantially increase the income of their members so they can send their children to school, improve their health and food intake," things that most people take for granted.

Masuta Producer Company

The NGO Pradhan has promoted Masuta Producer Company Ltd. comprising a group of 2000 tasar yarn weavers and spinners in Jharkhand. The company could generate a turnover of Rs.7 crores and a profit of Rs.38 lakh during 2006-07, inspite of tough competition from Chinese tasar which is 40% cheaper.

Fab India

Fab India, a company which exclusively markets produce of rural artisans and craftsmen through a chain of retail outlets spread across the country has decided to promote 35 producer companies in different states covering about 20000 weavers almost entirely from muslim, dalit and other backward classes to enable them to aggregate their fragmented production and increase volumes and returns. One of the companies floated by Fab India with weavers in Rajasthan has declared a 50% dividend in the current year. Fab India with 80 retail stores and plans to increase this number to 250 by 2010 sees the potential for having similar producer companies in about 350 districts of the country. The credit requirements of these producer companies are to be met from commercial banks, through a model devised by Fab India in association with ICICI Bank. (See Figure 1)

Banks Financing Producer Companies

As can be seen from the aforementioned case studies, so far most of the producer companies are still in a nascent stage and most are operating as providers of technical know how or facilitating marketing. It is probably for this reason that there has not been any significant demand for bank finance by producer companies and consequently not many examples of bank finance to producer companies are available.

One interesting experience is that of Bank of Maharashtra who has financed Panchakroshi Pashusamvardhan Produce Company Limited in Satara District for stall-fed goat rearing by small farmers. In this project, bank finance of Rs. 50,000 per farmer is directly extended to 100 farmers who are members of the producer company. The producer company has been promoted by two reputed NGOs with long years of field experience in the sector, Maharashtra Goat and Sheep Research Development Institute (MGSRD) and the Animal Husbandry Division of Nimbalkar Agricultural Research Institute (NARI). The main role of the producer company is envisaged to be provision of backward and forward linkages such as technical assistance and market access to the producer members to profitably rear goats. The company plans in the long term are to have a slaughter facility when the total number of goats available to the company reaches around 20,000. The experience of the bank with this project is being studied by other banks who are venturing into financing producer companies.

Challenges in Financing Producer Companies

As Producer Companies take stronger roots, they will require capital in large quantities from the banking system which will be a major challenge for banks, as the companies may not have much else than the producer member equity to leverage borrowings. Banks will thus be faced with the dilemma of what are the assets to back their loans and in what manner the company will be able to raise the margin money required to mobilize the loan.

Unconventional approaches would be required where credibility and reputation and the principles on which the company operates may be the only tangible assets, not physical assets. Similarly, guarantees and undertakings from the promoter institutions and purchase orders / agreements may have to be relied upon to extend finance. As the model is in the stage of evolution, banks will also require to act as incubators, and in some cases even go beyond the conventional banking role and provide professional and commercial support to these companies.

Spanner in the Works

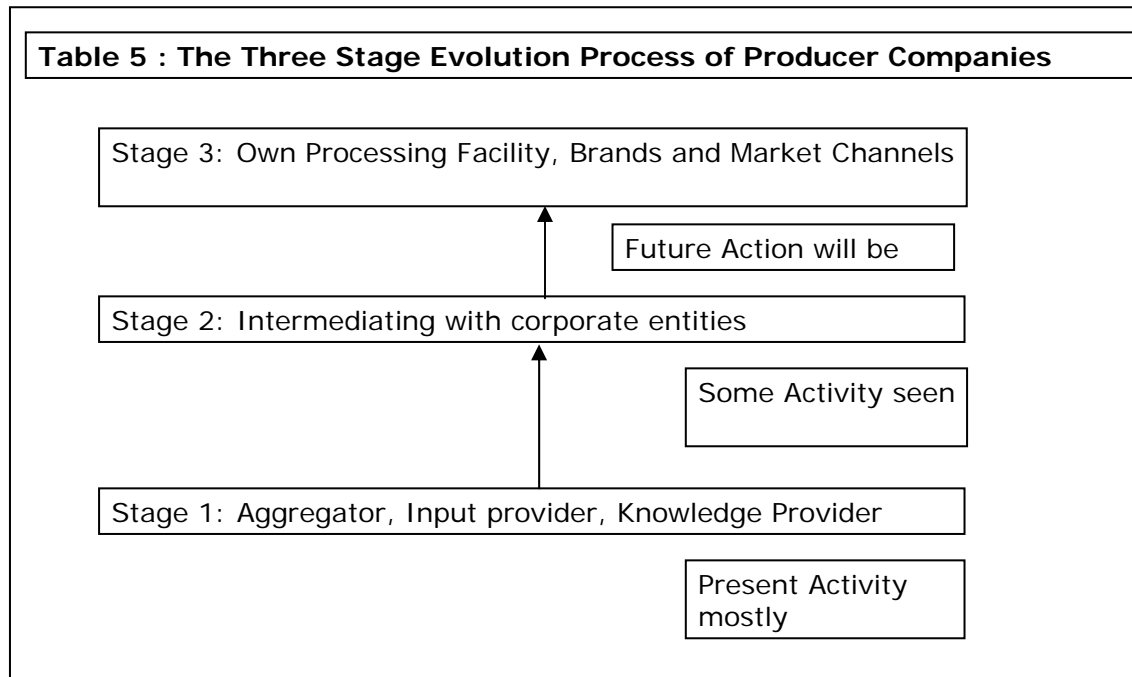
Just when the potential that Producer Company model can offer in empowering the primary producer and link with terminal markets is being recognized by the government and the corporate sector and its capabilities tested, the whole concept came under question and is being challenged. A committee under the chairmanship of Dr. JJ Irani to review the Companies Act which is in the process of being re-written has suggested that the "Special dispensations for Producer Companies need not be provided through the Companies Act, and if need be, a separate legislation may be considered for such entities." The committee probably was not aware of the long years of struggle and efforts made by cooperators like Dr. Kurien who often had to battle the cooperative bureaucracy in the government, seeing this as a model to insulate cooperatives from the stranglehold of the government and to professionalise them. There is now increasing appreciation among policy makers of the need to provide such an option to blend the best of the cooperative principles with commercial operations.

Future Outlook

As can be seen from the experience so far, most of the companies that are emerging in the producer companies' space are start-ups rather than existing cooperatives transforming into producer companies. Further, almost all of them have been promoted by a sponsor institution like a development agency or an NGO. Most of them are performing the function of providing technical services and inputs to farmers or pooling produce for collective marketing. This is the first stage of evolution.

In the second stage, more activity will be seen in the emergence of producer companies like that promoted by Fab India, where corporates come together with farmers to share prosperity with the farming community through commercial farmer corporate/ retailer partnerships.

Producer Companies having their own processing infrastructure, and developing their own identity, brands and supply chain will be the third stage. Only then will the producers be able to directly connect with and have command over the markets and thus a greater share in the retail pie.

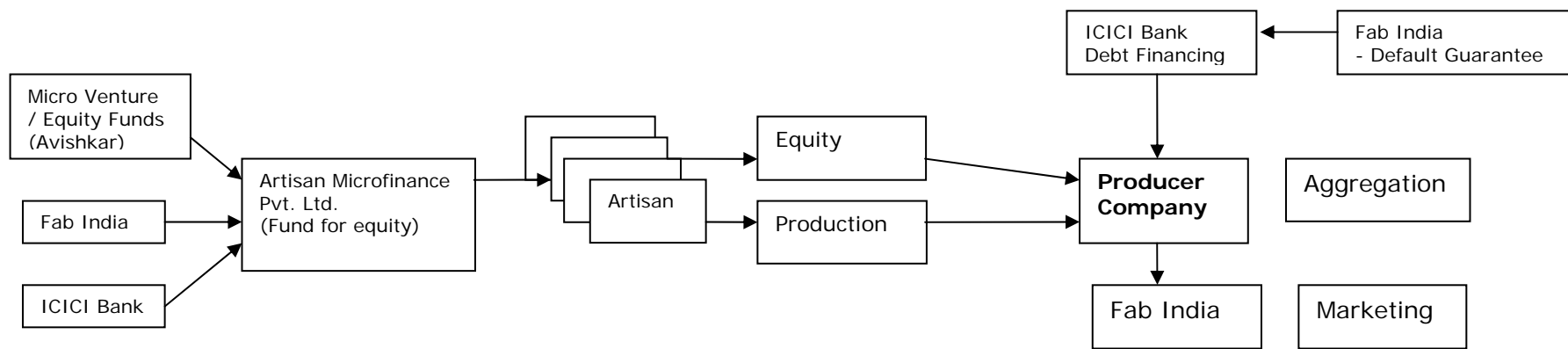


If through initiatives like producer companies, farming becomes more remunerative and the lot of farmers improves, the whole agricultural portfolio of banks would become robust. It is hoped that banks especially those that have their heart in rural India will support the emergence of a large number of producer companies in various commodity segments which will set off a wildfire that will bring back the glow of pride in the lives of the farming community.

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Figure 1: Structure and Operations of a Typical Artisans Producer Company promoted by FAB India



Based on information obtained from presentations made by Puneet Gupta of IFMR Trust at CAB