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Farmer Producer Companies in India

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Abstract

This paper is a working paper that looks into the theoretical and practical issues in farmer producer companies in India. Farmer producer companies have been hailed as one of the growth engines that provides negotiating power to a group of farmers in a business transaction with strong stakeholders in the market. However, there are many problems that have surfaced in the last couple of decades that need the attention of policy-makers to make this mechanism a more effective one. This paper is an attempt to look at those problems for rectification.

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In a normal course, there are two or more parties involved in any transaction. Also, it is generally understood that the negotiating power of any party vis a vis the others depend upon many factors; one of these factors is the number of individuals in that party. The general idea in a transaction is that the greater the number of individuals that are there on one side, the better is their negotiating power in the transaction. This is the idea behind creating farmer producer companies – that there is power in unity.

A transaction has both relational and market components; it is in the relational transactions where such a negotiating power sometimes plays a crucial role between entities undertaking the said transaction. Historically, for transactions related to continuous production, many small producers have formed groups, similar to unions, to achieve the best negotiating power that they possibly could. The producers' efforts are focused on the continuous production. Individually each of these producers might be economically too small to diversify their efforts to take the products to the market and get a right price for them on their own. Since farming is considered a profession that leaves many people in the lower ends of the income spectrum, it is considered a good idea if multiple small farmers could join together to get a good economic bargain from more economically sound parties on the other side in the transaction.

The world of business organizations is however a different one. A business firm is an efficient model based on hierarchy such that some people at the top of the hierarchy are able to bring the organization under an umbrella. Hierarchy gives them the authority over others to steer the organization, where the organizations compete with each other in the world of markets. Hierarchy ensures efficient process of administration and sets clear goals for future; it sets clear performance parameters to incentivize people who work towards the said goals and reprimand others, who do not do so by even asking them to leave the organization. Profit or economic gain is the primary motive for the owners of the said business firm

Farmer producer company (FPC) as conceived in the Company Act 2013[1] , is an initiative to superimpose the principles of negotiating power by membership of a group as mentioned above, in the business firm. It allows the said group to form a registered business entity that is expected to have governing principles of negotiating power of many superimposing the operating principles of a business firm. Herein, lies both the strength and weakness of the FPC. The popular business phrase "where everyone owns, no one really owns" is a problem in the governing principles of FPC. Some of the main problems identified by extant literature on FPC suggests that FPC suffer from lack of management and governance mechanisms, lack of willingness from stakeholders for funding and so on. Moreover, sometimes there are government and agencies'-imposed requirements to continue to be an FPC. For example, to get the benefits of NABARD support in the FPC, the number of members of an FPC needs to increase from say 100 farmers from one village that would start an FPC to around 700 farmers in about 5 years to be capable to get the benefits attached to being an FPC. Such benefits include say around Rs 11 lakh of initial funding in the first 3 years and a loan of 1.5 Crores by NABARD for the first 5 years. Clearly, such a requirement on field entails that the new farmers, who are to be added to the business entity of an FPC, shall be not from same community or village but from others. The very unifying factor that underlies the "negotiating power" on the

[1] Part-IX-A Chapter-1 of The Companies Act (Singh, 2008)

principle of which the model was designed is defeated by keeping such a requirement. The government and its agencies like NABARD and SFAC have to realize that an FPC has been conceived of as a business entity. It can only work if such problems are not brought in on an essentially difficult and hybrid form of organization in itself. Increasingly, therefore, farmers are seen opting for other models like limited liability partnerships (LLPs), since the FPC model encompasses a built-in insecurity of the FPC model, on top of which many such requirements by the Indian government and its agencies make it even more difficult to run an FPC as a business entity.

Cooperative societies have been around in India, since before her independence, that brought small producers like farmers together by forming a group for increasing their negotiating power in the transactions within the markets. The most successful cooperative examples are from the Gujarat and Maharashtra region, particularly in the dairy sector. The other states also brought in laws that allowed for exemption from taxes and subsidies for such societies. However, in states other than Maharashtra and Gujarat, they were not successful in flourishing.[2] The main reasons given for their failure were those of inefficient management, government interference and bureaucracy. The governments used to give the permission to the formation of a cooperative society only if one or more of their bureaucrats or members in the government were included, who controlled the activities of the society.[3] To overcome this problem, The Companies Act of 1956 was amended in the early 2000s to add Farmer Producer Companies as a type of collective for farmers. Herein, the collective would be classified as a Producer Company and work to increase the profits and income of the individual members. The voting rights would not be based on shareholding but on democratic principles of one person one vote. Not only profit maximization, but the company was also supposed to assist farmers increase their yield by giving monetary, seed and technological assistance. Freed from government control, this was considered to be the best method for small farmers to become a collective and become more economically stable. They could negotiate better prices for their produce by increasing their collective negotiating power. It is important to look into whether the producer companies are fulfilling this purpose.

Producer companies are pan-India organizations. It means that they are governed under some central laws and not individual state laws. This allows for trading to be more flexible as there is more certainty in the laws. They can enter in joint ventures with other companies. While the main focus of cooperative societies was internal balancing of relations between members and assistance to weaker farmers, producer companies are more profit and trade oriented. They focus much more on marketing and sales. The Chief Executive Officer is appointed from outside of the members by the Board of Directors. The main job of the CEO is to gather information about the market, get in touch with potential buyers and negotiate with them and plan the production carried out by the company so as to give best results when it comes to profits.[4]

Most of the producer companies in India are established with the hep of NGOs looking to assist the farmers. The initial investment for the company comes from these organizations, as well as from government promoting events in order to increase the number of producer companies in

[2] Farmer producer companies: Fermenting new wine for new bottles
[3]Farmer Producer Companies in India: Demystifying the Numbers
[4]Supra.

their respective states. This while it has its benefits, there are certain downsides to it. Thanks to them relying on government grants and subsidies, many producer companies face difficulty in raising funds otherwise.[5] Another problem this causes is the number of unnecessary incorporations created. The successful dairy cooperative did not just come together randomly with no plan. They looked at the potential market, realized what they needed to do in the market in order to be successful, and then created the cooperative as a business venture. This was similar to how Amul was created looking at the Bombay market. Most of the producer companies get established under a government program or event in order raise capital early. But they have not analyzed the market before creating the company.[6] Thus, they find difficulty in raising funds from trade as they hadn't planned for it. Even though the main function of the CEO is to do just that, because it was unplanned, such appointments are made hastily without looking for the requisite knowledge and talent and this leads to lowering of profitability. They need to act more like a normal company in this manner, otherwise they will be completely dependent on the funds they can get from NGOs and Government programs.

One of the main reasons that the farmer producer company was given such a boost in the government programs was that it was supposed to provide a great revenue pool for small farmers. However, out of most of the producer companies currently active in India, very few of them have a good amount of paid-up capital. For example, Maharashtra only has 11 producer companies that have a paid-up capital of greater than Rs 50 lakh, which is less than half of those in Kerala, even though it has the highest number of producer companies in India. Uttar Pradesh has the second largest number of producer companies, but when it comes to producer companies with high enough paid-up capital, it doesn't even come in the top 10 states of in the list. This shows that just because a state may have a large number of producer companies, it is not a guarantee that they will have a large number of big producer companies.[7]

Another problem faced by the producer companies is the lack of knowledge. The way in which it functions is like that of a traditional company, the key difference being that they cannot sell their shares outside of their members, in order to prevent corporate takeover and keep farmers safe. However, this makes fundraising difficult. With the few avenues being that they get better at negotiating contacts and sales, the number of people who understand the working of a company are limited and that creates problems in the day-to-day activities of the company.[8]

Thus, though the idea of looking into increasing the number of producer companies for the betterment of farmers is good, how it is done needs a rethink. The fact that it is supposed to behave like a company as well needs to be kept in mind by the government. Instead of mere programs to increase the number of such companies, a better way would be to educate the farmers about how a producer company works, what they would need to do and how the potential markets will behave. When that is done, more successful producer companies will start coming up.

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[5] Farmer producer companies: Fermenting new wine for new bottles.

[6]Supra.

[7] Farmer Producer Companies in India: Demystifying the Numbers

[8] Farmer producer companies: Fermenting new wine for new bottles.

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