FOSTERING FARMER'S ORGANISATIONS WITH BUSINESS RIGOUR

Advancing local development through meso-credit, Farmer Private Ltds and economic chain development

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Why a new approach for the development of India's farmers is needed

Although India is rapidly transforming itself into an open, more efficient and rapidly developing market-driven economy, in rural areas such transition has been lacking or progressing painfully slow for most farmers. Marginalized and small farmers in particular are unable to escape the powerful grip and dependence on middlemen, informal lenders and other intermediaries. Although there have been several attempts to assist farmers in escaping from their poverty trap, the results have been disappointing.

Loan and grant schemes, if at all they reach the individual farmers, do not have the desired effect as these schemes do not tackle the core problems of dependence of the farmers, which brought them in poverty in the first place. As a result, most loan and grant schemes are in effect only patching solutions rather than a structural solution.

Other attempts have been focused on strengthening the farmer's position by organizing them in self-help groups, in cooperatives or other forms. These interventions have been more successful in breaking the farmer's dependency on intermediaries, but their success and failure are mainly determined by their leadership and/or continued government intervention. Only exceptional examples exist where these farmer groups have been able to move up the value addition chain, become fully self-sustainable without (too much) political interference. At present in India, about 4% of its total employees are working in cooperatives, but comes at a annual cost of 780.000.000.000 RS to match the losses and investments of the cooperatives. Every single Indian is paying RS 780 per year to sustain the cooperative system, without realistic prospects to turn them into healthy businesses. Apart from the disappointing, and costly results, the heavy government support to such groups creates an additional problem of local market distortion: investments are not made on the basis of healthy business opportunities and creates once again dependency on external support. It also results in unfair competition towards new private investments / companies that wish to set-up viable businesses in similar sectors, but which have no access to similar (seemingly) unlimited, free financial support from government.

As a result the rural population at large and the small and marginal farmers in particular, hardly benefit from the development of India's modern, urban-based economy.

A new tripartite partnership to move farmers up the economic chain

With support from private investors, originating from successful business families, a new approach for advancement of small and marginal farmers is now being tested in India and other countries. This approach is an attempt to find a critical entry point for rural development by concentrating on setting-up healthy agro-businesses in which farmers themselves gradually gain economic ownership, supported by both NGOs and experienced private entrepreneurs.

Similar to the self-help groups and cooperatives, the aim is to set-up healthy business in handling, processing and trading farmer's commodities on a commercial basis. The main difference of the new approach is that the farmers, along with a social-conscious corporate partners, become equal business partners of the investor. The farmers will only gain full economic ownership, once the investment is repaid fully. No paternalistic form of aid, but a sound economic partnership between an investor and a (farmer-owned) company, supported by experience entrepreneurs.

Along with a corporate business partner, the farmers are to set up a commercially-run business (a joint venture in the form of a private limited), based on a solid feasibility and business plan. This farmer-run joint venture enters into a loan agreement with (social) investors and becomes responsible for setting-up and running the business in a commercially responsible manner. The joint venture is to generate sufficient profit to: i) meet its loan obligations, ii) capitalize the company, iii) pay premium prices to the farmers who supplied produce and/or iv) invest in new profitable business ventures (allowing the farmer to move further up the value-addition chain). As a result, the farmers benefit in the form of good and assured prices for their commodities and possibly additional premium or dividend payments if sufficient profit is realized.
In such partnership, the (social) investor, the social conscious entrepreneurs and the farmers become mutual depend business partners. Whereas the financial risk is to remain largely by the (social) investor, the farmers have most interest in making the business a success for their own future and village/region.

Aim of the new approach

The aim of the new approach is to create a profitable partnership between investors and farmer groups, by setting up joint agro-processing enterprises, based on solid feasibility studies and business plans. The new agro-businesses are to become sufficiently profitable and economically independent from further external support. The value-addition created is used, among others, to repay the investment to the investor and, at the same time, transfer the economic ownership to the farmer groups. To avoid that the management of the agro-business is driven by the short-term benefits for the farmers (main draw-back of the cooperative model), the majority of the board members (who appoint and oversee the daily management) is to remain with professionals, rather than farmer representatives only. The economic ownership of the companies however, can be fully transferred to the farmer groups. By doing so, the long-term success and profitability of the company prevails in running the business.
As most of the investment is to be repaid and will be re-invested in new farmer businesses, the model becomes self-perpetuating. In addition, the model creates no market distortion or unfair competition. Instead, farmers become equal an fair business partners, boosting their pride & confidence as well as commitment to fulfill their financial obligation to its supporting business partner/investor.

Some of the guiding principles behind the projects where the new model is being tested, are:

⇒ **Invest in profitable agro-business ventures** – set up farmer-owned businesses, based on professional feasibility analysis and business plans.
⇒ **Farmers: equal business partners** – farmers are not merely ‘beneficiaries’ or ‘the target group’, instead they are an equal business partner of their private business partner(s) and investor
⇒ **Loan, no free money** – the investment required is brought in by a private business partner, driven by its social corporate responsibility, rather than by its profit seeking objectives, but is to be repaid to sustain the model.
⇒ **Farmer ownership** – as repayments are made on the investments, the economic ownership of the company is automatically transferred to the farmer groups.
⇒ **Continued strategic guidance by professional/business partners** – whereas farmers are to gain 100% economic ownership over the business, and they are to be represented in the governing body (Board of Directors), the majority of the BoD will remain professional or business partners, to ensure that the long-term interest of the company and continued strategic guidance is secured.
⇒ **Invest, but also plough back profits** – While investing in higher value-addition processing, the model is intended to plough back part of the profits to the farmers and into new economic activities in the region.
⇒ **Collective action to save time, energy & money**
⇒ **Improve bargaining position**

⇒ **Take out intermediaries –** e.g. the middlemen or informal lenders.

⇒ **Overcome difficulties of farmers in handling & logistics –** e.g. inaccessibility and transportation, especially in undulating terrains, leads to excessive wastage. Collectively, the farmers can more easily organize solutions or obtain external support (e.g. from (local) government or private sector).

Limitations of the present legal forms of farmer collectives

In India, the most popular form of legal structures for farmer groups are cooperatives, producer companies and self-help groups. Contrary to Private Limiteds, where wealth creation for a selected few prevails, these forms of collectives are designed to make farmers stronger and protect them from exploitation by middle men or other buyers. Most cooperatives, farmer companies and self-help groups are considered successful if this objective is met. There are only rare cases however, where these collectives are self-sustainable, let alone grow and flourish, similar to healthy private limited firm. The two most important reasons for this limited success are i) political/government interference and ii) the fact that the daily management is directly appointed by the farmers. As a result, the managers are often forced to have the short-term interest of (selected) farmers prevail, instead of the long-term economic health of the business. The absence of such business rigour and professional management often hampers the businesses to flourish over a sustained period. It is in this context that this new model of farmer ownership through a partnership of (social) investor and farmers is now being tested. The business rigor of a private firm is combined with the distribution of benefits and rural economic development objectives.

Background of promotor

The new business approach to help small and marginal farmers, originates from a Dutch private foundation. This foundation was created by a successful business family, who started as small vendors on local markets in Holland. The self-made business flourished and the family expanded their business to various sectors. Over time, the business expanded to various successful chains of stores all over the country, and new business opportunities were taken on board, from drug stores to real estate.

*Part of the family capital has been allocated to a development fund, which aims to help poor families in rural areas of developing countries. It does so, by providing them with **opportunities** to collectively build up successful business ventures through honest, hard work and wise **investments**, which would allow them to flourish and become **economically independent**.*

Micro vs meso credit… loan vs grant

This new business approach towards development, whereby the farmers and investors become equal business partners, has a lot in common with the well-known micro-credit schemes. The main difference is the scale of the credit and the debtors:

Micro – credit	*New approach*
o Debtor is individual (family)	o Debtor is collective group of farmers
o Credit is limited amount	o Credit can be significant volumes (typically between €20.000 to €1.5 million)
o Individual contract	o Elaborate institutional ownership and loan arrangements, to protect both investor and individual farmers

At present, the approach is tested as a combination between a grant and loan component of the project. The loan component is meant for all hardware investments and initial running cost of the commercial business. The grant component is utilized for the assessment of the business opportunity, to write a good business plan and for external organizations (NGOs) to inform & organize farmers and guide them through the process

How to ensure the farmers are the real beneficiaries?

In order to translate the above ideas and principles into reality and have the farmers benefit from the new approach, it essential to properly organize the farmers. Some critical aspects to consider in this respect are:

- ✓ Membership open for small and marginal farmers
- ✓ Farmer participation in a democratic control body
- ✓ The Farmer organizations are to be autonomous and independent bodies
- ✓ Trading in high & reliable quality goods
- ✓ Proper, transparent price settings, based on actual, prevailing market prices and cost incurred
- ✓ Political and religious neutrality
- ✓ Education, training and information to improve (quality of) yield & profitability
- ✓ Trading by immediate payment to the farmers
- ✓ Concern for the community

In addition, the legal arrangements of the farmer organization, the new companies and the transfer of ownership and oversight are to be properly worked out, taking into account prevailing local legislation and available legal entities. Separate papers are (to become) available on legal arrangements per project per country. Critical aspects to consider are:

- ✓ Legal form of the farmer organization (e.g. association, trust or other form)
- ✓ Legal form of the joint venture (e.g. private limited)
- ✓ Initial share value and distribution among farmer organization, investor and/or other (private) caretakers
- ✓ Principles behind possible transfer of shares
- ✓ Type of shares are rights
- ✓ Initial and eventual composition of supervisory body, e.g. Board of Directors
- ✓ Profit distribution based on supply
- ✓ Common understanding of the corporate principles.

Conclusion

The new approach, now being tested, is a collective action between financing institutions, farmers, NGOs, private entrepreneurs and government in order to compete & flourish in an open market, with the benefits flowing back to the farmers.