Financing a Producers Organisation: Dilemma of an NGO Head

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Abstract

The case revolves around a decision dilemma faced by an NGO, Progress Foundation, that is involved in a implementing a cluster development project in Odisha. The project is expected to improve the income of women of the area through food processing activity. For procuring the funds under the appropriate scheme from the Government, the NGO must contribute 10% of the funds in the project. Ideally these funds should have been contributed by the producer organization, but their poor financial condition makes this an impossibility. However, the intricacies and nuances of the CDP scheme and the legal status of the organization also make the recovering of the seed investment by the NGO difficult. The case is focused on the predicament faced by the Secretary of the NGO to invest or not to invest.

Key words: *Cluster development programme, producers organization, special purpose vehicle, NGO*

Decision Situation

Mr. Rajesh Lochan, Secretary of Progress Foundation, was in a pensive mood. He had a decision to make. Progress Foundation was implementing a cluster development programme (CDP) with a total investment of INR 25 million of this a 10 per cent would have to be contributed by the implementing organization. The funds would be used to set up a food processing plant to help local farmer, mainly women farmers to make processed products such as pickles. Upon completion of the project, the machineries and infrastructure developed as part of CDP would be transferred to a producer organisation, the special purpose vehicle (SPV) formed for implementation of the cluster. The board had agreed to make this investment but was not sure how the INR 2.5 million contributed by Progress Foundation could be recovered. Being a non-profit society, Progress Foundation could invest in for-profit activities. Once the machines were transferred to the SPV, the latter would be an independent body and Progress foundation would have no control over it. The members of SPV

would reap the benefits, but they would question the appropriation of the contributed fund. Mr Lochan was now in a dilemma on whether to invest in the food processing project or not.

Progress Foundation and the Project Location

Progress Foundation, a non-governmental organisation (NGO), was headquartered in Bhubaneswar, the capital city of Odisha. The NGO operated in nine districts of Odisha, including three coastal districts. Its major activities were related to watershed development, restoration of natural resources, and livelihood promotion. The organisation was registered under Societies Registration Act, 1860, and had been operating in the area for the last 15 years.

One of its project areas, comprising of 50-60 villages was located at the juncture of Khordha, Ganjam and Nayagarh districts. The region had an unique agro-climatic condition **(see exhibit 1).** In the east, the region was bordered by the Chilika Lake (an estuarine water body) attached to the coastline. Towards the west it was fenced in by a large tract of mountains. The average annual rainfall in the region was more than 1500 mm. Given this unique environment, the area was suitable for fruit and vegetable cultivation. The region had a very high production of mango, jack fruit, and green vegetables. Consequently, there was a glut after the harvesting seasons and the market prices of the fruits and vegetable prices went down significantly. Due to this the people of the area, particularly women, were engaged in processing fruits such as mangoes to make pickles and sold it in the local market. The region had the national highway running through it linking two large regional markets, Bhubaneswar and Visakhapatnam. Hence, there was a lot of potential for developing market for such products.

The production and selling of such processed food happened on a very large scale. More than a thousand people, almost all of them women, were involved in food processing activities in their households. However, the home-based processing took place in a dispersed manner, and the whole business was unorganised. One kilogram of pickle that would easily fetch INR 200-250/- in market was generally sold at INR 60-80/Kg by these producers. With appropriate packaging and processing, it could command a wholesale price of INR 150/Kg. Further, other kinds of processed products such as fruit juice, jam, jelly, papad were yet to be tapped. Turmeric and ginger, which were grown in

abundance in the neighbouring districts, such as Kandhamal, could also be processed and sold. With growth in demand for organic and healthy food, the demand for such quality products was likely to increase.

.The home-based processing, that the women producers engaged it had limited outputs. Further, there was little control over the desired level of sanitation and hygiene. The modern retail chains demand that food processing be done in a centralised plant that can be inspected at their convenience. Use of advanced machineries and experts could help maintain quality standards. Centralised and mechanical production could help in getting quality certifications of regulatory bodies (such as FSSAI, BSI, Agmark etc). However, setting up such a food processing facility was expensive and beyond the investment capacity of an individual. Even for an organisation such as Progress foundation, with an annual financial outlay of about INR 10 million, and a reserve of about INR 2.5 million, it was a significant amount investment cost.

Provisions of the Cluster Development Programme

It was in this backdrop that Mr. Lochan attended a consultation workshop in Bhubaneswar, where a government official from the Industry Department presented the details of a cluster development scheme (**see exhibit 2** provides more details about different government funded CDPs). The scheme, namely CDP, is a scheme sponsored by the government, where the funds are channeled through a government agency called Small and Medium Industries Development Corporation (SMIDC). The CDP programme could provide an amount of about INR 25 million as grants for construction of a processing unit including construction cost and cost of machineries. The programme also provides grants for capacity building, community organisation and administrative costs to the tune of INR 2.00 million. However, the applicant organisation (here Progress Foundation) had to contribute 10 per cent of the project cost. Considering that the project would be appropriate for the locality, Mr Lochan, on behalf of Progress Foundation, had applied for the project.

The SMIDC appointed a technical support agency (TSA) to undertake the project formulation. The agency undertook a detailed survey in the village and prepared the estimates for the project. The budget was INR 25 million, out of which the government grant would be INR 22.5 million and Progress Foundation would need to contribute INR 2.5 million. The contribution had to be made before the project started. After preliminary scrutiny by the local office of SMIDC, the

project report was sent to the approval committee of SMIDC. After minor modifications, the project was approved in March 2021.

What is Cluster Development?

Cluster development is a recently emerging approach of development of micro and small industries in a locality. According to UNIDO, a cluster is defined as "geographical concentrations of inter-connected enterprises and associated institutions that face common challenges and opportunities". These enterprises also have a common source of supply of raw materials, same destination for marketing the products, and share common infrastructure and common culture (UNIDO, 2013). In a situation where smallholders have difficulty in accessing advanced machineries, cluster development helps. With necessary common infrastructure, such as machines and buildings, the artisans can easily access technology and market. Cluster development projects not only provide support for establishing infrastructure, but they also provide support for training, marketing, and branding. At global level, Sillicon Valley is the most popular cluster. In India there are hundreds of natural clusters, examples are: Applique cluster in Pipili; Sambalpuri cloth cluster in Bargarh-Sonepur area, Marble cluster in Rajasthan, and Cracker cluster in Sivakasi. Besides, there are many small-scale clusters, which are not well-known but are engaged in art and craft activities. Such small clusters lack adequate infrastructure and marketing. The objective of the cluster development programme is to support the artisans of this type of clusters to upscale their activities.

Agencies involved in the Cluster Development Programmes

The government supported CDPs are implemented through a specific structure. The programme is coordinated at the central level through SMIDC which undertakes the project appraisal, releases funds upon approval by government, and monitors progress of the project. The implementing agency, which is ordinarily an NGO, is responsible for community organisation, training, construction of the common facility centre, procurement and installation of machineries, helping the Special Purpose Vehicle (SPV) in marketing, and all other activities at the field level. The TSA helps the implementing agency in preparing the detailed project report and provides technical support in running the cluster. During the implementation, the implementing agency is

expected to handhold the artisans to organise and run the SPV so that the community can manage the cluster smoothly after the completion of funding period.

The implementing agency, thus, plays a pivotal role in the CDP programme. Not only it moots the idea of the project but is also expected to organise the community and expected to raise funds for the project. The difficulty with implementing the government schemes is further complicated. In such programmes, it has to go beyond its own organisational norms to accommodate the project's provisions. Moreover, it must maintain the coordination among communities, government, and the technical support agencies.

The Special Purpose Vehicle

Although the majority of the project cost was attributed to construction and machineries, the core idea was that producers engaged in traditional activities (if such a cluster naturally existed) would be organised into producer organisations. The producer organisations would be the SPV for the programme. The project duration was for three years. It was contemplated that by the end of the project, when the facilitating organisation (in this case Progress Foundation) withdrew, the SPV would have become capable to manage its affairs. The SPV was under the programme was either a not-for-profit society or a producer company or cooperative. However, the SMIDC functionary who appraised this project told that as the SPV would undertake the business of processing and marketing, hence a not-for-profit would not be suitable. Registering a cooperative was a tedious process. Mr. Lochan had therefore zeroed in on forming a producer company.

Without registration of the SPV the project would not have been approved. Hence Mr Lochan quickly identified a few producers and got a producer company (XYZ Food Processing Producer Company Ltd) registered. The SMIDC was happy to find that the SPV was registered and thus the project swiftly got approved.

Producer companies are registered under the Company Act. Such a company is a special form of entity that acts in the principles of a cooperative (e.g., it follows one-member-one-vote principle). Considering the problems in forming and managing cooperatives, and because of the government's interferences, the provision of Producer Company was made in 2002. The producer would have the flexibility of a private company while following the principles of a cooperative. Being democratic in nature, those who have higher equity capital also would get equal vote (one-

member-one-vote) and would not be able to control the business. In producer companies, only producers can become members. **Exhibit 2** provides further details of a producer company.

After the approval of the project, Mr Lochan attended a seminar, organised by the SMIDC, in which a consultant discussing SPVs said that to run a producer company was not easy. He suggested that private limited companies would be better suited for the purpose. He added that the one-member-one-vote principle was an impediment in attracting investors. This was followed by a debate that private companies can easily be taken over by traders too. Although the conclusion of the discussion was that producer companies were more appropriate for SPV in the CDP, Mr. Lochan wanted to get some clarification. He consulted a Charted Accountant who told that in the Producer Company, he (i.e., the representative of Progress Foundation) would have no role. It would be entirely controlled by the producers.

Issue with Regard to Recovering the Contribution Amount

Mr Lochan took the observation made by the CA to the SMIDC functionaries who had apprised the project. He enquired that if everything would be controlled by the producers and they would be fully independent, how could the contributed funds (INR 2.5 million) be recovered. Earlier he had thought that as the products would fetch a better price, the organisation would retain a proportion of the profit to recover the contributed funds. Mr Lochan had calculated that in running the plant, about 40 per cent would go for raw materials, and 20 per cent on operating cost. Keeping a reserve of 20 per cent for other costs he could easily retain 20 per cent of the sales as profit. If Progress Foundation has no role in managing the SPV, the producers might not agree in paying this amount back. He looked into various legal provisions and found the same thing; one such document mentioned the following:

> *"The NGO can promote producer organisation (PO) which will provide better income to the members. Sharing of profit among members is an important objective of the PO.' (NANARD, 2015: 2).*

The SMIDC functionary clarified that 10 per cent contribution was a mandatory part of the CDP guidelines. The project had been approved on that condition. Recovering the contribution was never a question. '*You had known it very well when you applied for the project. Your organisation is supposed to facilitate the whole process. You are not the owner of the SPV'*, he told.

Mr Lochan consulted a few colleagues and peers from other NGOs. They all pointed out that it was not a specific problem for this organisation, rather the whole development sector faced the obstacle. The NGOs are supposed be not-for-profit, they could not share the profit among their members. Hence, organisations like cooperatives and producer companies were formed to manage for-profit operations. The NGOs, at best, could act as a facilitator. But here comes the need of investment. The producer company, which is nothing but an association of low-income households, could not arrange large amount of investment. The NGOs must arrange the fund, but the question remains how would it recover the contributory funding?

Present Situation

When Mr Lochan received the sanction letter of the government about the project's approval, he was not sure whether to rejoice. The SMIDC would soon release funds for establishment of plants and machineries, hence Progress Foundation would have to contribute the funds, i.e., INR 2.5 million. Since he had learnt abount the concept of Producer Company in the seminar, he was in a dilemma whether to continue with the implementation. He had already spent a substantial amount of time, and money in getting the project materialised, the preliminary expenditure so far was about INR 150,000/-. However, if he took up the project, the company would have to shell out INR 2.5 million. He approached the board of governors who cautioned that INR 2.5 million is all that the organisation had in its reserve. They suggested Mr Lochan to quickly present what other alternatives.

One of them said, '*We have limited resources, if you want to use that is fine, but you have to justify how you are going to replenish the amount in five years. The reserve is expected to help for organisational growth and draining out it may not be good sign for the organisation'*.

'*Does the project have any provision for implementation?*' asked another board member.

'*Yes, there is about INR 2.0 million, but that would be just adequate to meet the administrative costs for the cluster development, like salary, and other costs*.' Mr Lochan replied.

The Alternatives

He consulted an official of TSA, who was an expert on cooperatives. He suggested that Mr Lochan should look forward to alternative matching grants from corporate social responsibility (CSR) funds or some government grants. However, it was easier said than done. Government/CSR grants had heir own objectives, why would they fund such matching grants?

The expert from TSA told Mr Lochan that the matching contribution of 10 per cent should ideally come from the producers. Hence, Progress Foundation can look forward to contribution from individual producers. As of now there were 250 producers involved in the project. It would mean that each producer should contribute INR 10,000/- for raising the required funds. Given the stark poverty in which the farmers lived, it was hard to expect such contributions from them. Their annual income from such processing activity was about INR 8000 to 9000 on an average (Approximate sales of Rs. 25,000 per household of which one third is considered as profit).

The expert said, "*You have projected that the producers would get significant benefits from the cluster development interventions (**see exhibit 4**). What is wrong with recovering it from them? If they cannot pay now, recover the same when they get the additional benefit. Show this contribution as a loan to the producer company*." Mr. Lochan said that this might attract objections from SMIDC. "*Then why do not you become a service provider to the Producer Company, help them in community organisation, capacity building, and marketing the outputs. And charge a fee—may be a cut from the profit*", the expert replied.

Mr Lochan tried to sum up these alternatives and rushed to the board meeting. He had to now present to the Board on how Progress Foundation could recover the money.

Exhibits

Exhibit 1: ***Indicative project area on the map of Odisha map***

Source: https://www.landrecords.co.in/bhulekh-orissa-land-records/

Exhibit 2: ***Government funded Cluster Development Programmes: An Overview***

	MSE -CDP	**SFURTI**
Objective	The objective is that all the enterprises operating within or near those clusters can become competitive vertically and horizontally and improve the competitiveness of clusters across sectors and regions of the country.	To organise the traditional industries and artisans into clusters to make them competitive and provide support for their long-term sustainability and economy of scale;

Project components	Common Facility Centre Infrastructure Development	Common Facility Centre Soft interventions like training, exposure, and marketing Thematic interventions like e-commerce promotion, brand building
Project Cost	INR 50 million to INR 100 million with 80 to 90 per cent government contribution and 10 to 20 percent SPV contribution. In North-Eastern states SPV contribution can be 5 to 15 percent	INR 25 million to INR 50 million with 90 per cent government contribution and 10 per cent of hard intervention. Implementing agency /SPV contribution. In North-Eastern States such contribution can be 5 per cent. If the imp. agency is a private company contribution could be 50% of hard intervention.

Source: GOI, 2020; GOI, 2022 objectives drawn verbatim

Exhibit 3: ***Salient Features of a Producer Company as Compared to a Cooperative***

Attribute	Description
Area of operation	Entire union of India (in cooperative it is restricted)
Membership	Any individual, group, association, producer of goods or services.
Shares	Not tradable but transferable; limited to members at par value
Profit sharing	Commensurate with volume of business
Voting Rights	One member one vote, irrespective of extent of shareholding (This is different from cooperatives where the Registrar holds veto power).
Government control	Minimal, limited to statutory requirements (this is in contrast to cooperatives where government has a significant control)
Extent of autonomy	Fully autonomous, self-ruled within the provisions of Act
Reserve	Mandatory to create every year (even if there is no profit – this is in contrast to cooperatives where reserve is created only if there is a profit)
Borrowing power	Borrowing limit fixed by Special Resolution in general meeting. Companies have more freedom to raise borrowing power
Relationship with other organisations	Producers and corporate entity can together float a producer company.

Source: (NABARD, 2015,pp 2-3) majorly drawn verbatim from this source.

Exhibit 4: ***Projected Cash flow of the Food Processing Plant (INR in millions)***

Year	Outflow	Inflow	Particulars
0	-25	0	Construction completes in first year

1	4.5	7.5	Plant runs on 50% capacity
2	9.0	15.0	Plant runs on 100% capacity
3	9.0	15.0	
4	9.0	15.0	
5	9.0	15.0	

Note: It is assumed that from second year onwards the plant runs on full capacity. 60% of sales revenue is spent operating cost, and 40% is operating profit.

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