Financing FPOs - a Big Business Opportunity for Banks

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Abstract:

Finance for farmers especially the majority of small and marginal farmers has been a challenge in India. Collectivisation of farmers in the form of Farmer Producer Organsiations (FPOs) is expected to solve this problem at least to some extent. Although now around 3000 FPOs have been promoted by Small Farmer Agri-Business Consortium (SFAC), the position of finance is far from satisfactory as flow of institutional credit is not much. To augment credit absorption capacity and to improve the credit worthiness, several measures have been taken by Reserve Bank of India (RBI), SFAC and NABARD in the form of classification of the bank lending to FPOs as Priority Sector advances, equity contribution, credit guarantee, signing of MoU with banks, etc. NABARD has a subsidiary – NABKISAN , which is primarilty focusing on lending to FPOs besides other forms of collectives. The paper shares some experiences of some banks about financing FPOs and concludes that the FPOs, well nurtured by the institutions, provide a sizeable opportunity to the financing banks and other lending institutions of provision of credit.

The context: FPO movement

Provision of finance for agriculture and farmers has always been a challenge in the country especially for the small and marginal farmers who constitute the majority (85% of total farmers). Collectivisation in the form of Farmer Producer Organsiations (FPOs) is expected to solve this problem at least to some extent by mitigating risks in agriculture the farmers aggregate production and marketing efforts. Now the movement of FPOs is almost 5 year old and we boast of at least 3000 FPOs – around 2081 promoted by National Bank for Agriculture and Rural Development (NABARD) and 844 promoted by Small Farmer Agri- Business Consortium (SFAC) (SFAC, 2018) and another 200-300 are expected to be promoted under other programmes like Corporate Social Responsibility (CSR) of corporates by their foundations, Maharashtra Agriculture Competitiveness Project (MACP), etc. While it is obvious that without access to funding and credit, the FPOs cannot realize their full potential, still many of the FPOs are not able to receive

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funds from institutional sources. This paper examines the present position, the challenges and the options in this regard.

Legal forms of FPOs:

In India 3 prominent legal forms of FPOs are existing :

- Companies registered under Companies' Act (called as Farmer Producer Companies or FPCs)
- Cooperatives under respective state government's Cooperative Societies Act and Mutually Aided Co-operative Societies (MACS) (or self- reliant co-ops)
- FPOs under Societies Act or Trust Act

In view of SFAC policy of supporting on the FPOs registered as Companies registered under Companies' Act, majority of the FPOs are now FPCs (although we do not have precise data on the number of different forms of FPOs).

The types of finance required

The financing requirements of the FPOs based on their stages in the lifecycle. Stages of the FPOs are broadly categorized into three phases (Access, 2:

- Incubation and Early Stage
- Emerging and Growing Stage
- Matured Stage (Business Expansion)

In each of the stage of the FPO, the financial needs were found to be different. In early stages, financial need of the FPOs revolves around the cost of mobilizing farmers, registration cost, cost of operations and management, training, exposure visits etc. Mostly the need is met thorough the grant support from promoting organisations like NABARD, SFAC , international agencies, etc. Later in the emerging and growing stage, FPOs need working capital to run their businesses. As the FPOs move towards expanding their businesses, POs need term loans are needed to set up processing units, processing/grading/sorting yards,storage godowns, cold storage, transport facilities, etc.

Based on repayment period, the need for finance can be classified in two broad categories:

A. **Short term / working capital**: This is mostly to be repaid within a year and many times only a crop season of 3-4 months is required. This is mainly for stocking agricultural inputs like seeds, fertilizers, pesticides, etc. or purchasing produce from farmer members, adding some value by primary processing and marketing, within a short period.
B. **Medium and long term:** Some of the FPOs have purchased farm machinery like tractor, trolley, land leveler, power tillers etc., for hiring to farmers for a charge. As these machinery are having high capital cost and their life is long, it needs medium term finance – upto 7 years.

As most of the FPOs are new and do not have much experience in operations, their credit needs are mostly for short term as farmers demand input supply of reliable quality and adequate quantity at reasonable price. For this purpose many FPOs hae started providing this service. In some states, the Govt has provided them fertilizer license also to become a dealer.

Sources of finance

Following are the main sources to finance the requirements of FPOs:

A. **Equity:** As FPO is a business organization comprising of the farmers- producers, contribution by the members is the first step in establishing the FPO and therefore each FPO fixes a membership fees for each member – varying from Rs 100 to Rs 1000. Such own capital is the base for raising further finance by leveraging.

   The issue faced by most of the FPOs is that most of the farmers have not received the contribution from all members. The FPOs have to prepare strategies for mobilizing equity contribution by giving incentives and disincentives e.g., some FPOs have restricted sale of agricultural inputs only to members or the sale price is differentiated – more by Rs 20-50 per bag of fertilizer for non members as in a village situation they can not bar the non members altogether.

   Using Equity for leveraging credit from wholesale suppliers: The equity and own funds can be used by the FPOs for getting inputs on credit – sometimes up to 4-5 times – from the wholesale suppliers.

   Matching grant from SFAC: The Government of India, in 2013, announced "Equity Grant and Credit Guarantee Fund Scheme for Farmer Producer Companies (FPC)" for the FPOs registered as Companies. The Equity Grant Fund enables FPCs to receive a grant (by cash infusion) equivalent to the equity contribution of their members up to Rs. 10 lakh per FPC, thus enhancing the overall capital base of the FPC. It was learnt that 47 FPOs have been sanctioned the equity grant by SFAC in June 2018 ranging from Rs 2 lakh to Rs 10 lakh per FPO. However feedback indicates that many FPCs are not able to receive the grant, due to various reasons.

B. **Loan:** The traditional source of loans are banks and it could be a 'win -win' situation for both – the banks as well as the FPOs due to following reasons:
   a. **Advantage to the banks:**
      i. The finance to FPOs is priority sector advance- thus helps in achieving those targets
      ii. Dealing with an an FPO far more easier than dealing with hundreds or even thousands of member farmers .
      iii. The transaction costs will be significantly less- imagine the cost of daling with 500 farmers versus dealing with one FPO!

iv. The risks are also lower as the FPOs being a legal entity, there is transparency in their work and financial transactions, accounts, compliance, etc.

b. Advantage to the farmers:

i. Getting loans individually is at times difficult for small and marginal farmers from banks and loans from NBFC/MFIs are very costly.

ii. Through FPO, they can get better quality inputs like seeds, pesticide, fertilizers etc. at reasonable price

Efforts for augmenting institutional finance:

In view of the need to incentivise bankers to finance FPOs, Reserve Bank of India (RBI) included financingto FPOs up to INR 2 crore under Direct Agriculture finance under the Priority Sector Lending (PSL) and loans up to 5 crore to FPCs were considered to be included under Indirect Agriculture Finance (RBI, 2018), thus their target of Priority sector could be achieved to this extent. Further, for motivating bankers and creating awareness among banks, NABARD and SFAC has conducted and conducting several awareness and sensitization programmes. SFAC has also entered in MoU with several banks (public sector banks, private sector banks and Regional Rural Banks) for prioritizing FPO finance. No cooperative bank has entered into MoU with SFAC.

Besides the banks, there are some Non Banking Finance Companies (NBFCs) like Friends of World Women Banking (FWWB), Ananya Financial Services, BASIX, etc., which are funding the FPOs on selective basis.

Credit Guarantee

Government of India launched "Equity Grant and Credit Guarantee Fund Scheme" for FPOs in January,2014, enabling the FPOs to access a grant up to INR 10.00 lakh to double members' equity and seek collateral-free loan up to INR 1.00 crore from banks, which in turn can seek 85 percent cover from the Credit Guarantee Fund.

NABARD has supported FPOs and facilitated formation and nurturing and then for bank finance by way of creating awareness about the FPOs and through capacity building either directly or through institutes like Bankers Institute of Rural Development (BIRD), Lucknow, Mangalore and Bolpur. For professionalization of management of FPOs, a programme for CEOs of FPOs has also been supported.

NABKISAN

For directly financing FPOs (and other collectives), NABARD set up a subsidiary named, 'NABKISAN Finance Limited (NKFL) (formerly "Agri Development Finance (Tamilnadu) Limited") and commonly known as "NABKISAN". It is registered as NBFC and has now focused its attention on FPOs. Interaction with MD of NABKISAN[2] indicated that due to its focus on FPOs, it has emerged as the biggest institutional source of finance for FPOs at a reasonable cost. As on Aug 2018, it has about Rs 100 crore outstanding to FPOs which is to 300

[2] Interaction duing Aug-Sept.2018

FPOs. This portfolio comprises of two routes to finance – one – direct to FPOs – which is to about 170 FPOs amounting to about Rs 70 crore and second – through other agencies i.e., on-lending route through NBFCs of which FWWB (Friends of Women's World Banking) and Ananya Financial Services are prominent. The outstanding under this route is about Rs. 30 crore as on 2018. The plans, however, are ambitious to reach disbursement of Rs 66 crore during 2018-19 and Rs 100 crore during 2019-20.

NABARD has also launched its own Credit Guarantee Fund for FPOs of Rs 10 crore which will provide cover of a modest 50% to begin with. NABARD Chairman has indicated that NABARD is trying to find ways to boost funding for FPOs by looking to help them take the subordinated debt route, and 'credit enhancement', besides guarantees so that banks are encouraged to lend to them. Given that banks' credit exposure to the sector is not much now, subordinated debt, which is a secondary form of equity, will help FPOs garner resources better (NABARD, 2018).

Although, precise data are not available on the amount of loans provided by banking system to the FPOs, so far the progress in flow of bank finance is far from satisfactory.

Why financing FPO is so difficult?

The key reason for less flow of credit to FPOs is that the FPOs being recently incorporated and also being farmers' bodies, they do not have collaterals or other securities to offer to the banks, who are traditionally looking for such cover for the loans. Further, there is lack of awareness among the bankers, especially at the branch level, about these organisations. Therefore, it is difficult for FPOs to get the funding from the banks. SFAC and NABARD are trying to address these issues through provision of equity funding (SFAC) and credit guarantees (SFAC and NABARD) as described elsewhere in this paper. It is felt that NABARD and SFAC may take lead in awareness creation and capacity building the banks for financing the FPOs. The awareness should start at state level and district level forums such as State Level Bankers Committee (SLBC) and District Consultative Committee (DCC) and Block Level Bankers Committee (BLBC) meetings held by banks. Applications from FPOs to the banks could be reviewed at these meetings to assess progress in implementation.

Experience of Cooperative banks in Andhra Pradesh

While cooperative banks are generally not involved in FPO movement so far, it is heartening to learn that in Andhra Pradesh (AP) state, 3 District Central Cooperative Banks (DCCBs) have started financing FPOs viz., Vishakhapatnam, Vizianagaram and Srikakulam. This is a welcome development. Interactions with the District Development Manager, Vishakhapatnam (Mr Srinivasa Rao) indicated that due to promotional and capacity building efforts of NABARD and the State Government of AP, the banks could develop confidence to finance some of the FPOs which is collateral free. As of September 2018, the amount disbursed is low (varying from Rs 5 lakh to Rs 10 lakh each for 2 FPOs), the sanctioned loans are around Rs 50 lakh for each of the two FPOs. The bank's experience so far is good as shared by Mr Varma, Chief Executive Officer (CEO) of the DCCB, Vishakhapatnam and he hopes to disburse full Rs 50 lakh within a year and also sanction loans to 2 more FPOs within a year.

Credit Potential and opportunity for the banks

As indicated earlier, there are at least 3000 FPOs in the country of which at least 1500 are expected to be adequately active and having some credit absorption capacity. Even if a modest amount of Rs 10 lakh is the initial credit support, the requirement works out to Rs 150 crore which is much higher than the existing loans advanced. Further, with a little handholding, the credit absorption capacity could easily go up to Rs 50 lakh as articulated by one of the DCCBs. Thus Rs 750 crore credit portfolio for the FPO segment is perhaps a 'Low Hanging Fruit' for the banks in the immediate future. As cooperative banks are more closer to the ethos of the FPOs, perhaps, these banks may find it easy to connect to the FPOs. Here, we are not including the new FPOs which have to begin operations but only those which are already established and at different levels of operations.

Suggestions on financing FPOs:

Tagat & Tagat (2015) suggested following measures to meet the challenge of financing FPOs:

(a) **Providing comprehensive Early Stage funding:** In addition to promotional costs (which are being supported as grants from NABARD, SFAC, state governments and CSR funds etc.), there needs to be substantial funding for early stages. Working capital requirements are most critical for FPOs once they begin early stage activities such as bulk purchase of inputs, since the share capital of FPOs is unlikely to be enough.
(b) **Designing appropriate loan products:** As agriculture is characterized by high seasonality, high price volatility, long lead times, and complex value chains, the loan products for this sector therefore need to be worked out appropriately. At the level of the FPO, there can be products that enable effective service provision to members: support for hiring of machinery/tools etc.
(c) **Encouraging Value Chain Financing under Priority Sector Lending:** In addition to working capital loans to finance aggregation of produce from members, loans can be given to FPOs for quality improvements along the value chains of the produce. For example, FPOs dealing with pulses would require loans for small dal mills, to cotton ginning units for FPOs in cotton growing areas, decorticators in ground nut and so on.
(d) Warehouse Receipts-based Lending and Price Risk Mitigation;
(e) **Setting up a Dedicated Agri-Business Bank:** Setting up a dedicated agri-business bank was one of the recommendations of the round table conference on FPOs held at IIM Bangalore in April 2014. During the initial policy-making stages, there were also suggestions that SFAC or NABARD could set up a dedicated NBFC for taking care of the financial needs of the agri-business sector. However, given the rural branch network of commercial banks, Regional Rural Banks, and cooperative banks, they have a potential business opportunity for financing FPOs here.

The above suggestions could be considered by the policy makers like Government of India, SFAC, NABARD, financing banks. etc.

Conclusion:

Finance for FPOs is far from satisfactory but there is an immense potential to be tapped for a sustainable and desirable purpose. Banks need to look into this as a socially desirable as well as a commercially viable business. In fact, in view of lot of efforts of SFAC, NABARD and many other agencies, the FPO financing appears to be a low hanging fruit for the banks and financial institutions. A systematic campaign may be needed to increase awareness among bankers to look at the FPOs as business opportunity right from the national level, State level (by involving SLBC), district level and block level. It can be a 'win-win' for all key stakeholders – the farmers, the bankers and the government and the development agencies like SFAC, NABARD and others.

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