POLICY BRIEF 66

# Enhancing Financial Viability of Farmer Producer Organizations

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In smallholder-dominated agrarian economies, institutions, such as cooperatives and Farmer Producer Organizations (FPOs), which are founded on the principles of collective action, have considerable potential for improving the efficiency, sustainability, and inclusiveness of agri-food systems by addressing the challenges related to farmers' access to technology, information, finance, and markets.[1] However, their long-term sustainability is often questioned because of the various factors related to governance, scale of operation, finance, and market dynamics. India has more than 33,000 registered FPOs, averaging nearly four FPOs in each block.[2] However, only one-third of these are claimed to be financially viable.[3] This necessitates a deeper understanding of the factors that influence FPOs' financial performance and long-term viability.

This brief note presents comprehensive empirical evidence concerning the financial performance of FPOs and the factors that influence it. The insights derived from this analysis can assist policymakers and institutional promoters in making informed decisions to implement mid-course corrections, developing appropriate interventions to enhance financial health, and leveraging the potential of FPOs to transform agri-food systems. Notably, the Government of India has been actively promoting FPOs and cooperatives in rural areas.

## Financial performance of FPOs

The Small Farmers Agribusiness Consortium (SFAC), operating under the Ministry of Agriculture and Farmers Welfare, Government of India, and the National Bank for Agricultural and Rural Development (NABARD), are the principal promoters of FPOs. In this brief note, we assess the financial performance of 1,069 FPOs that received technical and financial support from NABARD. The FPOs selected for this evaluation are those that had completed three years of operation. The selection criterion is based on the provision of financial support from the government to FPOs for a duration of three years to help them navigate initial setup difficulties, develop strong operational processes, and achieve financial stability and impact.

To assess financial viability and its determining factors, the FPOs are categorized into three groups: low (<10.5 Rs lakh/year), moderate (10.6 to 35.7 Rs lakh/year), and high-performing (>35.8 Rs lakh/year).[4] On average, high-performing experience significantly higher turnover, at least 15 times greater than that of low-performing FPOs and three times higher than that of moderately-performing (Table 1).

Figure 1 shows the relationship between turnover and the key determinants. Despite the notable differences in turnover, the distribution of FPOs across these categories remains nearly identical. Additionally, there are minimal differences in their maturity level (age). This indicates that an entity's maturity is not the sole factor influencing its financial viability; rather, it is affected by several other factors such as the scale of operation, access to capital, and governance.

The scale of operation is a crucial determinant of the financial performance of FPOs. High-performing FPOs

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1 Nikam, V., Veesam, H., Kumara, K.,and Chand, P. (2024). How farmer producer organizations are functioning in India?: An empirical evidence from a mixed method research synthesis. *Economic & Political Weekly*, 59 (22): 62-68.

2 Tata Cornell Institute. (2024). FPO dashboard, Center of Excellence FPO platform for India.

3 Mukherjee, S. (2020). Centre plans to promote 250 new farmer-producer bodies in FY 2020-21. Business Standard, Feb 29 2020. https://www.business-standard.com/article/economy-policy/centre-plans-to-promote-250-new-farmer-producer-bodies-in-fy-2020-21-120022801196_1.html

4 The FPOs were classified into three groups based on their annual turnover using the quantile approach, which divided the sample into three equal groups based on the distribution. The bottom, middle, and upper thirds represent low-performing, moderately-performing, and high-performing FPOs, respectively.

have a significantly broader reach, operating across an average of 22 villages and nearly double the coverage by their lower-performing counterparts. This expanded geographical presence allows high-performing FPOs to engage in a broader range of activities and access an extensive farmer base. Notably, high-performing FPOs have approximately 1.5 times more members than their lower-performing counterparts. In addition, they maintain a relatively diverse portfolio of commodities and activities.

A larger operational scale offers numerous advantages, including economies of scale in output aggregation and procurement of inputs and services, which contribute to the reduction of fixed and transaction costs and enhance price realization. Additionally, an expanded reach facilitates the dissemination of knowledge and adoption of best practices across a broader farming community.

Larger FPOs have greater equity capital and access to credit from financial institutions. Notably, the data indicate that high-performing FPOs mobilized twice the equity capital of their low-performing counterparts and secured nearly three times more credit from financial institutions. This financial advantage enhances their capability to invest in infrastructure for processing and value addition, which contributes to improvements in operational efficiency and market competitiveness. Moreover, the improved financial stability creates a beneficial cycle. When an FPO has the ability to handle larger funds, it earns the confidence of investors and financial institutions, further strengthening its financial standing. This, in turn, enables it to secure more favorable terms with suppliers, pursue new market prospects, and diversify its product offerings.

Interestingly, contrary to popular belief, there is a positive link between the financial success of FPOs and their distance from the market. This finding challenges the traditional notion of the benefits of being close to a market. This unexpected result implies that successful FPOs may have devised innovative strategies to turn this apparent drawback into a strategic advantage by reaching a wider consumer base and potentially accessing more profitable opportunities.

The participation of socially and economically disadvantaged communities, including smallholder farmers, female farmers, and marginalized groups such as scheduled castes and scheduled tribes in FPOs, is crucial for social development. However, there are concerns about their potential adverse effects on financial performance. The data indicate that FPOs, regardless of their financial performance, effectively integrated disadvantaged communities. However, given their limited resource base, the high participation of disadvantaged farmers, especially in the early stages of FPOs, may affect their financial performance. Nonetheless, successful FPOs have gradually addressed the challenges of balancing social inclusion with financial viability.

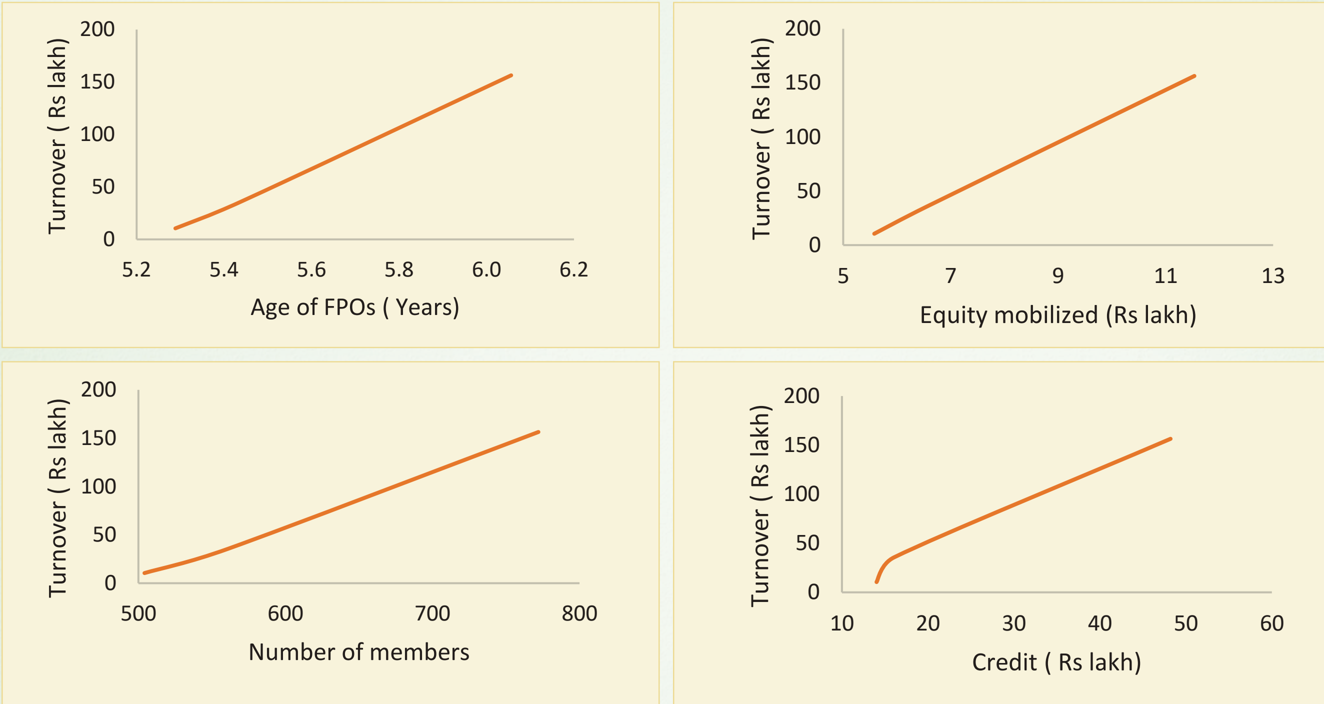
Finally, the financial performance of FPOs is significantly influenced by their governance structure. A key aspect

**Table 1. Key indicators of financial performance of FPOs**

| Variables | Low performing | Moderately performing | High performing | Total |
|---|---|---|---|---|
| Number of FPOs | 357 | 357 | 355 | 1069 |
| Turnover/FPO (Rs lakh/year) | 10.5 (0.5–22.5) | 35.7 (22.5–50) | 156.4 (50.1–2642) | 67.4 (0.5–2642) |
| Age of FPOs (years) | 5.3 (4–20) | 5.4 (4–10) | 6.1 (4–11) | 5.6 (4–20) |
| Number of members/FPO | 504 (101–1580) | 561 (101–2001) | 772 (124–3715) | 612 (101–3715) |
| Female members in FPOs (%) | 30.4 (0–100) | 34.5 (0–100) | 31.2 (0–100) | 32.0 (0–100) |
| Small and marginal farmer members in FPOs(%) | 82.1 (0.4–100) | 85.5 (2.5–100) | 79.6 (0–100) | 82.4 (0–100) |
| Members of SC/ST group* (%) | 36.8 (0.2–100) | 31.8 (0.3–100) | 24.4 (0.2–100) | 31.1 (0.2–100) |
| Number of villages covered / FPO | 12.6 (1–110) | 16.3 (2–86) | 21.7 (1–131) | 16.9 (1–131) |
| Number of activities/ FPO | 1.7 (1–9) | 2.0 (1–9) | 2.2 (1–8) | 1.9 (1–9) |
| Equity mobilized (Rs lakh/FPO) | 5.6 (1–64) | 6.6 (1–55.8) | 11.5 (1–135.9) | 7.9 (1–135.9) |
| Credit accessed (Rs lakh/FPO) | 14.0 (0.5–158) | 16.1 (1–190) | 48.2 (1–1500) | 28.4 (0.5–1500) |
| Average market distance from location of FPO (km) | 21.2 (0–400) | 22.6 (0–571) | 28.7 (0–600) | 24.2 (0–600) |
| Number of board directors/FPO | 7.9 (5–15) | 7.5 (5–15) | 7.4 (5–15) | 7.6 (5–15) |
| Female directors on FPO board (%) | 26.0 (0–100) | 27.2 (0–100) | 26.3 (0–100) | 26.5 (0–100) |

*Note*: Values in brackets represent the range. *SC-Scheduled Caste, ST-Scheduled Tribes.
For women and SC/ST members, a value of 100% indicates that the FPO is exclusively formed for these sections.

Figure 1. Relationship between turnover and its key determinants




is the number of directors on the board, which is legally limited to between 5 and 15. According to the data, FPOs with lower performance tend to have more directors, which does not correspond to their geographical scope, membership count, or equity capital, resulting in higher administrative expenses. This indicates that the board size should match the operational scale and membership size of the FPO.

## Optimizing the performance of FPOs

Several factors contribute to differentiation in the financial performance of FPOs. These factors include organizational structure, management practices, market access, product diversification, and operational efficiency. Each FPO's unique combination of these elements influences its financial outcome (Figure 2). Understanding the optimal levels of these differentiating factors is crucial for various stakeholders.[5] By identifying the ideal balance of these factors, stakeholders can implement more effective support mechanisms, allocate resources efficiently, and design tailored interventions to address specific challenges.

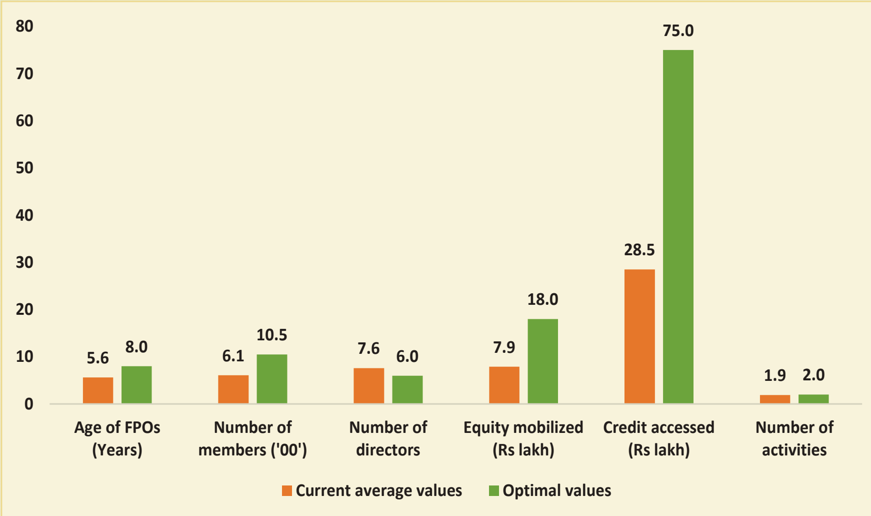
Our analysis indicates that an FPO typically attains financial stability in eight years of its establishment. This period is marked by a series of challenges that necessitate careful navigation and strategic planning. The primary challenges include acquiring the technical expertise required for efficient operation, understanding and complying with complex procedural requirements, and effectively exploring financial opportunities and market dynamics. Essentially, this suggests that FPOs require financial assistance and guidance for a duration that extends beyond the standard three-year period.

A membership size of approximately 1,000 is deemed optimal for an FPO to effectively harness its collective power to reduce transaction costs associated with the sale of farm produce, acquisition of inputs and services, spread risks, and enhance operational efficiency. This also helps raise equity and finances for investors to expand infrastructure including processing, storage, and distribution. Furthermore, our findings indicate that thinning the management board from eight to six directors can enhance the efficiency of the decision-making processes and decrease administrative costs.

Financial resources are essential to promote sustainable growth and enhance competitiveness. Currently, the average equity capital for an FPO is Rs 8 lakh, which is significantly below the optimal requirement of Rs 18 lakh. In addition to equity, access to credit from financial institutions is crucial for FPOs to expand their operations and capitalize on new opportunities. The current average credit access of Rs 28.5 lakh by an FPO is considerably less than the optimal value of Rs 75 lakh. This higher credit limit would enable FPOs to make substantial investments in processing units and

5 The combination of optimal values for better performance of FPO is arrived at by integrating machine learning techniques, specifically the Random Forest algorithm, with optimization methods, such as the Genetic algorithm.

Figure 2. Current average values vis-à-vis optimum values of key parameters of FPOs




cold storage facilities, which are vital for adding value, reducing postharvest losses, exploring new markets, or diversifying their product lines.

## Strategies for enhancing financial viability

The findings of this study have several policy implications for enhancing the performance of FPOs and their impact at the farm level.

***Extended period of government support:*** FPOs encounter numerous challenges in their initial phases, particularly in acquiring capital and technical expertise essential for growth. Current government support, which is limited to a three-year period, often proves insufficient for many FPOs, resulting in premature dissolution. To ensure the sustainability and effectiveness of FPOs, it is vital to extend the support period; beyond mere financial aid to encompass technical guidance (e.g., production techniques, post-harvest handling, and storage methods), procedural assistance (e.g., auditing processes, tax compliance, and access to government scheme benefits), and marketing support (e.g., establishing linkages and market intelligence).

***FPOs to improve the scale of operation:*** To achieve optimal economies of scale, an FPO must expand both its geographical reach and membership base. A membership base exceeding 1,000 members is crucial for achieving financial stability. Notably, to benefit from the government scheme, a minimum of 300 members is required. Additionally, to secure the prescribed matching equity grant of Rs 15 lakh, an FPO must mobilize 750 members.

***Strengthening the flow of finance:*** Equity capital and credit are essential to securing financial viability. Equity capital can be increased by expanding the membership base, thereby enhancing an FPO's capacity to obtain government grants. Equity capital, along with retained margins, constitutes the working capital necessary for the FPO's daily operations. Further, a robust equity base enhances creditworthiness.

Concurrently, there is a need to enhance FPOs' access to institutional financing. There is a substantial difference between the current and optimal credit levels. Notably, only 61% of the FPOs have successfully secured credit from financial institutions, with an average of Rs 28 lakh, which is much less than the optimal requirement of Rs 75 lakh. To address this issue, it is imperative to increase awareness among FPOs regarding government schemes and credit guarantee programs, educate bank officials about the specific credit provisions for FPOs, and develop comprehensive business plans.

***Optimizing the governance structure of FPOs:*** To enhance the financial viability of FPOs, it is essential to align the size of the board of management with the scale of the FPO. A streamlined board comprising six members, as opposed to the current average of eight, selected for their diverse expertise in agriculture, marketing, and finance represents an optimal leadership structure. This not only ensures efficient decision-making and reduces administrative costs but also leverages specialized knowledge to drive success and sustainability.

***Overcoming the inclusiveness and efficiency trade-off:*** While efficiency is crucial for ensuring long-term sustainability, inclusiveness is at the core of social development. However, there may be a potential trade-off between these two objectives. This perceived trade-off between inclusiveness and efficiency can be addressed by leveraging the unique strengths and knowledge of diverse communities. For instance, FPOs with a significant number of scheduled tribe members can capitalize on their expertise in local and indigenous products by enhancing their capacity in manufacturing, value addition, and marketing.



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