Sattva Knowledge Institute SKI perspective

HARNESSING SOCIAL STOCK EXCHANGE FOR FARMER PRODUCER ORGANISATIONS

July 2023

Acknowledgements

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Glossary

FPO	:	Farmer Producer Organisation
NBFC	:	Non-Banking Financial Companies
SSE	:	Social Stock Exchange
FPE	:	For-Profit Enterprise
CBF	:	Capacity Building Fund
FPC	:	Farmer Producer Company
PC	:	Producer Company
NABARD	:	National Bank for Agriculture and Rural Development
PUC	:	Paid-Up Capital
PODF	:	Producer Organisation Development Fund
CBBO	:	Cluster-Based Business Organisation
SEBI	:	Securities and Exchange Board of India
NPMA	:	National Project Management Agency
SBI	:	State Bank of India
SFAC	:	Small Farmers' Agri-Business Consortium
PSL	:	Priority Sector Lending
NABFINS	:	Nabard Financial Services
ZCZP	:	Zero Coupon Zero Principal
SVF	:	Social Venture Fund

Executive Summary

Farmer Producer Organisations (FPOs) are collective entities formed by farmers to pool resources, share knowledge, and engage in collective action. They play a crucial role in empowering farmers, promoting sustainable practices, and addressing the challenges of fragmented landholdings. However, the growth of the FPO ecosystem has stagnated due to challenges related to capacity, leadership, governance, business skills, the enabling ecosystem, and undercapitalisation. **Further, the current financing options available to FPOs in India are limited and insufficient, leading to a funding gap that hinders their growth and impact**. Challenges such as low paid-up capital from farmers, high interest rates from Non-Banking Financial Companies (NBFC), difficulties in obtaining bank loans due to collateral and credit history requirements, and legal barriers restricting external equity funding, contribute to these limitations.

In addition to the challenges related to accessing formal financial institutions, FPOs have not been able to access investments directly from impact investors, the philanthropic ecosystem or private capital sources. While impact investors are increasingly interested in supporting sustainable agricultural practices and rural development, they do not have any direct channel to finance FPOs.

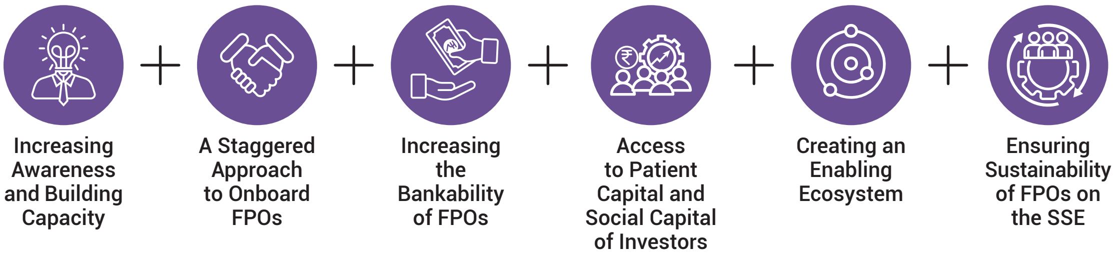
The establishment of a Social Stock Exchange (SSE) in India holds the potential to revolutionise the funding landscape for FPOs. FPOs in India, driven by both social and commercial imperatives, have strong potential to register and get listed on the SSE. These FPOs inherently fulfil the eligibility requirements outlined in the Securities and Exchange Board of India (SEBI) Technical Group Report, as they promote livelihoods for the rural and urban poor and have a significant portion of their revenues, expenditures, and beneficiaries within the target sectors. **Listing on the SSE would provide FPOs with an opportunity to access additional sources of funds, addressing the severe capital and credit shortages they often face**. Facilitating the listing of FPOs on the SSE can give these organisations access to previously inaccessible capital to scale their business activities, levelling the playing field and allowing them to compete more effectively in the market. Additionally, SSE can enhance transparency, align incentives, institutionalise reporting mechanisms and improve the reputation and bankability of FPOs.

While FPOs have a clear social intent and target underserved populations, making them eligible for listing on the SSE, they may face five key hurdles that could impede their participation. These include:

1. Ambiguity in SSE rules regarding FPOs' eligibility due to lack of explicit mention of FPOs as For-Profit Enterprises (FPEs), despite them fundamentally being FPEs.
2. Unsuitability of existing financial instruments on the SSE for FPOs, as existing instruments are primarily designed for non-profits (NPOs) and for-profit social enterprises.

3. Ineligibility for the Capacity Building Fund (CBF), hindering FPOs' readiness for SSE listing.
4. Challenges in demonstrating financial viability and sustainability due to narrow profit margins, high operational costs, and social trade-offs.
5. Limited resources for impact reporting, impeding FPOs' ability to meet SSE's reporting standards.

Opening up the SSE for FPOs will require orchestrating efforts among multiple stakeholders and enabling them to come together to form an ecosystem for FPO financing. Going forward, there are six key factors that need to be considered to enable FPOs on the SSE.



To foster the growth of FPOs while ensuring the protection of farmer ownership, it is worth considering the exploration of equity financing options through platforms like the SSE. By allowing private equity investments, subject to appropriate safeguards such as non-voting shares and limitations on external control, and by implementing necessary legal amendments in the FPO policy, we can significantly bolster the financial position of FPOs enabling them to venture beyond farm income and explore off-farm income as well in the long term.

Enabling FPOs as Catalysts for Change by Unlocking Capital

FPOs play a pivotal role in the agricultural landscape, empowering farmers, enhancing their bargaining power, and promoting sustainable agricultural practices.

The average size of landholdings in India has experienced a significant decline over the years, dropping from 2.28 hectares in 1970-71 to 1.08 hectares in 2015-16.[1]

This trend of land fragmentation is expected to persist in the future, driven by factors such as population growth, inheritance patterns, and changes in land ownership. Fragmented landholdings present several challenges, including lower productivity and limited access to credit for farmers.

FPOs have emerged as crucial players in addressing the issues associated with fragmented landholdings.

FPOs are collective entities formed by farmers to pool their resources, share knowledge and expertise, and engage in collective action. By bringing together small landholders, FPOs leverage economies of scale, enabling them to access markets, negotiate better prices for their produce, and reduce input costs through bulk procurement.

Furthermore, FPOs play a critical role in facilitating access to credit and financial services for their members. By aggregating the landholdings and financial needs of individual farmers, FPOs can negotiate favourable loan terms with financial institutions and secure credit on behalf of their members. This not only improves farmers' access to credit but also enhances their creditworthiness as a collective entity. FPOs also provide financial literacy and training to their members, empowering them to make informed financial decisions and manage their resources effectively.

FPOs, however, often face significant challenges in accessing the necessary financial resources to expand their operations, invest in infrastructure, and overcome market barriers.

Around 2019, the government announced a scheme for promoting[2] over 10,000 FPOs, and ₹6,866 crore was allocated to support and enable FPOs to thrive.[3] Recent data shows that there are a total of 16,811 FPOs currently in the ecosystem.[4] However, a deeper look reveals the signs of a bubble, with "rapid growth in quantity, with low quality" of FPOs.[5] Key data points indicate how after the initial momentum, the growth in the Farmer Producer Company (FPC) ecosystem may have stagnated.

The stagnation of the growth of the FPO ecosystem can be attributed to several factors. These factors encompass issues related to capacity, leadership, governance, sense of ownership, business skills, an enabling ecosystem, and most importantly undercapitalisation. These challenges can hinder their growth and limit their ability to fully capitalise on the opportunities presented by collective action and economies of scale.

Figure 1: Financial challenges faced by FPOs[6]

1. Only 18% of the PCs registered in FY'20 and FY'21 in last two years were able to reach paid-up capital of ₹5 lakh in FY 2021. [7]
2. Less than 25% of Farmer Producer Companies were able to grow paid-up capital beyond ₹1 lakh.
3. 45% of the FPCs that are older than seven years have been struck-off.

One of the primary challenges for FPOs is their limited access to formal financial institutions and credit facilities. FPOs, particularly those composed of smallholder farmers, often face difficulties in meeting the stringent collateral requirements set by banks and financial institutions. The lack of land titles or other tangible assets that can be pledged as collateral makes it challenging for FPOs to secure loans and access working capital. This limitation hampers their ability to make necessary investments in machinery, technology, storage facilities, and other infrastructure that can enhance their productivity and market competitiveness.

Furthermore, FPOs may struggle to demonstrate their creditworthiness and financial viability, due to limited financial management skills and inadequate documentation of their operations. Financial institutions require comprehensive financial records, business plans, and cash flow projections to assess the creditworthiness of borrowers. However, many FPOs, especially those in their early stages, may lack the necessary financial literacy and accounting systems to prepare such documents, making it difficult to obtain financing.

In addition to the challenges related to accessing formal financial institutions, FPOs have not been able to access investments directly from impact investors, the philanthropic ecosystem or private capital sources. While impact investors are increasingly interested in supporting sustainable agricultural practices and rural development, they do not have any direct channel to directly finance FPOs.

The notion of unlocking capital for FPOs through a dedicated SSE in India represents a paradigm shift, with the potential to bridge the gap between impact investors and FPOs seeking funding.

Enabling capital for FPOs has the potential to bring about transformative changes in the agricultural sector, creating a positive ripple effect on the livelihoods of smallholder farmers and rural communities. By facilitating access to financial resources, government schemes, financial institutions, impact investors, and development organisations can play a crucial role in driving sustainable rural development.

SSE in India could provide an alternative platform for FPOs to register as social enterprises and leverage debt funding at low or zero interest from impact investors and philanthropists, given they meet certain criteria and conditions.

In recent years, the concept of SSEs has emerged as a transformative force in the world of development finance, with the potential to channel diverse funding for various social impact organisations. SSEs provide a unique platform that aligns capital with social and environmental goals, enabling investors to allocate resources to organisations that generate positive societal change. One particular area where the recent SSE in India holds significant promise is in unlocking capital for FPOs. However, it will require orchestrated efforts among multiple stakeholders, and they will need to find a way to come together and form an enabling ecosystem for FPO financing.

From Seed to Scale: Understanding FPO Financing and Barriers

Behind the growth and success of FPOs lies a crucial element: their financing. Financing requirements for FPOs vary by the activities across the life cycle from pre-incubation to incubation, and consolidation stages.

As FPOs progress through various stages of their life cycle, from pre-incubation to incubation and consolidation, their financing requirements evolve to support different activities and objectives. Understanding the diverse financial needs and challenges faced by FPOs at each stage is essential for designing effective financing strategies and enabling their full potential.

Figure 2: FPO Life cycle Stages and Capital Needs based on operations[8]

FPO LIFE CYCLE STAGES

Early Growth and Incubation

OPERATIONS
- Infrastructure Development
- Farmer Mobilisation
- Registration
- Preparation of Business Plan
- Training & Capacity

CAPITAL NEEDS
- Registration & Outreach
- Training & Capacity

FUNDING AVAILABLE
- Grant Support for Training, Exposure & System Development.

Emerging and Growing

OPERATIONS
- Processing/Grading/Sorting
- Logistics
- Provision & Upgradation of Machinery
- Private and Government Partnerships
- Training & Capacity

CAPITAL NEEDS
- Cost of Logistics
- Technology & Innovation Costs
- Market Linkage Costs

FUNDING AVAILABLE
- Equity Financing
- Working Capital

Business Expansion

OPERATIONS
- Market Engagement
- Value Addition to Produce
- Retail Unit Setups
- Skill Enhancement & Training
- Stock Management

CAPITAL NEEDS
- Consultation to Agri-experts
- Market Linkage Cost
- Stock & Data Management

FUNDING AVAILABLE
- Debt Capital
- Term Loans

Grant support is crucial during the pre-incubation stage to establish operations and mobilise farmers.[9] During this stage, FPOs primarily require funds for registration costs, operational expenses, management, and farmer mobilisation to encourage their participation as shareholders in the organisation. Government agencies and promoting organisations, such as the National Bank for Agriculture and Rural Development (NABARD) through its Producer Organisation Development Fund (PODF), have been instrumental in providing grant and incubation support to FPOs in their early years. Furthermore, several donors including the World Bank, Ford Foundation, Rabo Foundation, and others have played a vital role in supporting capacity development and strengthening the governance of FPOs.

As FPOs enter the emerging and growing stage, they require equity financing and working capital loans. Equity financing in FPOs is typically raised through contributions from shareholder farmers, and it differs from other social enterprises as equity cannot be traded and private equity investments are limited to farmers only. Additionally, FPOs need working capital loans to support their bulk input purchases and crop procurement from farmers once the grant support concludes. Working capital loans can be obtained from NBFCs or formal banks. During this stage, however, FPOs are required to have well-developed business plans, maintain accurate data and bookkeeping, and establish balance sheets to qualify for loans.

In the mature stage, FPOs require term loans along with working capital to scale up their operations and expand their businesses. As FPOs focus on quality improvement and value addition, they may need term loans to establish small processing units and infrastructure units that enable innovation in the value chain. Access to credit from formal banks becomes crucial at this stage, as they offer reasonably competitive interest rates and can provide large ticket-size loans. FPOs can also utilise funds from NABARD earmarked for food parks to set up agro-processing units in designated areas. Additionally, mature FPOs can benefit from loans under the Priority Sector Lending and warehouse receipt financing, which allows them to use produce as collateral.

Estimates indicate that the current credit requirement for FPOs in India is approximately ₹600 crores. However, for more than 2,500 transacting FPOs, there is ₹350 crores of credit available from multiple stakeholders in the ecosystem, indicating a credit gap of ₹250 crores.[10]

Table 1: Credit absorption capacity of FPOs[11]

Description of FPO	Estimated number of FPOs	Average credit requirement (₹ lacs)	Total credit requirement (₹ crore)
FPOs into basic services like input supply	3,500	10	350
Mid-range FPOs doing input and market linkage	300	50	150
Larger FPOs with a turnover > ₹1 crore	50	200	100
Total	**3,850**	**350**	**600**

The funding ecosystem for FPOs primarily consists of four stakeholders who play a crucial role in enabling funding availability for FPOs. These include central and state government institutions, NBFCs, formal banking institutions, and impact investors.

1. Government Programmes and Schemes

The government plays a vital role in supporting FPOs through various schemes and programmes. The Scheme for Promotion of 10,000 FPOs aims to offer financial assistance, capacity building, and infrastructure development. While ₹6,866 crores have been allocated to support these FPOs thus far, only 3.5% of the allocated funds have been directly channelled to fund the FPOs so far.[12]

A significant percentage of the budget at 41%, that has been allocated for the scheme, is reserved for Cluster-based Business Organisations (CBBOs) and the National Project Management Agencies (NPMAs). These agencies are responsible for the formation, registration and enabling support for FPOs in their initial years.[13] Additionally, 33% of the budget is allocated for the Equity Grant and Credit Guarantee scheme under Small Farmers' Agri-Business Consortium (SFAC).

SFAC, along with NABARD, is responsible for grant disbursal to FPOs. While the Equity Grant scheme is a flagship product of SFAC, other key financial products available for FPOs include SFAC's venture capital assistance, and NABARD's PRODUCE and PODF schemes.[14]

Government policies have faced challenges in transitioning from a promotion approach to incubation of FPOs. While typically, FPOs require three to five years to grow and transition from low-cost, low-risk operations to selling their outputs, only 33% of them have been able to cross the ₹5 lakhs Paid-up Capital (PUC) threshold needed to start operations.[15] The SFAC scheme offers matching equity of up to ₹15 lakhs that an FPO can avail after two years of registration. However, data indicates that less than 4% are able to reach the ₹15 lakhs threshold, leaving a large proportion of FPOs ineligible to access the full benefits of the scheme.

Apart from the schemes mentioned above, the Agriculture Infrastructure Fund which has a budget allocation of ₹1 lakh crore, is focused towards building infrastructure and farmgate facilities. One of the objectives of this fund is to mobilise funding from banks and financial institutions, towards FPOs. Similarly, Priority Sector Lending (PSL) encompasses loans for various purposes, including loans up to ₹2 crores for FPOs' pre- and post-harvest activities, and purchases of agricultural implements, and machinery. Further, individuals engaged in farming with assured marketing of their produce at a predetermined price can access loans of up to ₹5 crores.[16]

2. Non-Banking Financial Companies (NBFCs)

The FPO ecosystem is primarily funded by three NBFCs including Samunnati, Ananya and NABKISAN Finance Limited. Additionally, there are other players such as Nabard Financial Services (NABFINS), Caspian and Maanaaveeya who are also active in the market.[17]

These NBFCs lend to FPOs across the value chain - while all of them provide working capital loans, NABKISAN Finance Limited and Samunnati also provide term loans to FPOs. NABKISAN Finance Limited has the highest outreach currently, with direct loans to over 250 FPOs and indirect loans to more than 150 FPOs. The total outstanding loans for all three NBFCs to around 800 FPOs amount to over ₹155 crore. NABKISAN Finance Limited, as a subsidiary of NABARD with equity participation from the government, has the lowest interest rate out of the three at an average of 11.5%, while Samunnati's average interest rate is around 14%.[18]

Table 2: Current credit flow from NBFCs[19]

Name	Nabkisan Finance Limited (Nabard Subsidiary)	Ananya	Samunnati
Legal Form	NBFC	NBFC	NBFC
Lends to	• FPOs • Agri value chain players • FPO lending intermediaries	• FPOs • Agri value chain players	• FPOs • Agri value chain players • Individual Farmers
Typical Product	• Working Capital Loans • Term Loans • Working Capital Term Loans	• Working Capital Loans	• Working Capital Loans (PO financing and invoice discounting) • Term Loans
Areas of Value Chain	• Pre-production (Input) • Post Production (output activities: harvest, marketing) • FPOs involved in On-lending tomembers • Pre-production (Input) Production • Post production (output activities: harvest, marketing)	• Pre-production (Input) • Post Production (output activities: harvest, marketing) • FPOs involved in On-lending to members	• Pre-production (Input) • Post production (output activities: harvest, marketing) • FPOs involved in On-lending to members
Operational data	• Total loans: 250+ (directly), 150+ indirectly • Total disbursed: ₹200 crore • Total outstanding: ~ ₹75 crores	• Total loans: 150 to 45 FPOs • Disbursed to: 80 FPOs • Total disbursed: ₹100 crore • Total outstanding: ₹30 crore	• Total loans: 250+ FPOs • Total disbursed: Over ₹250 crore • Total outstanding: ~ ₹50 crore
Ticket Size	₹3 lakhs to ₹5 crore (Mostly limited to ₹1 crore)	₹20 lakhs to ₹1 crore	₹3 lakhs to ₹2 crore
Interest Rate	10.5%- 12.5%	13.5%-16.5%	14%-21%
Tenor	4-18 months	3-36 months	4-18 months
Additional Services	NABKISAN facilitates linkage to the FPOs funded by it access support from the promotional programmes of NABARD.	Provides incubation support to FPOs in partnership with leading agencies. Ananya has the ability to lend even in the formative years of an FPO, provided the management team is strong.	Provides market linkages through in-house team. This results in better profits to the FPO resulting in better serviceability of the loan and reduced risk. Overdraft given on input loans to optimise interest cost on credit utilisation.

3. Formal Banking Institutions

The introduction of Priority Sector Lending policies by the Reserve Bank of India in 2015 was aimed at facilitating credit flow to sectors such as agriculture and allied activities, which includes FPOs. However, FPOs continue to face obstacles in obtaining loans from formal banking institutions, primarily due to perceived risks associated with their unique characteristics and operational setup.

These risks include lack of collateral, absence of strong balance sheets, and insufficiently developed business plans. Certain banks, however, do provide funding to FPOs, particularly during their intermediate and mature stages, if they meet working capital requirements. The State Bank of India (SBI), ICICI Bank, UCO Bank, Canara Bank, Vijaya Bank, among others, are examples of banks offering working capital loans to FPOs. Furthermore, in 2022, SBI entered into a co-lending model with Samunnati to enhance the financial inclusion of FPOs.[20] However, the funding received by FPOs from these institutions is often indirect.

Mr. Venkatesh Tagat from NABARD shared why banks are reluctant to lend to FPOs, *"Most of the public sector banks are hesitant to lend to FPOs directly because they find it difficult to understand their business model and cohesiveness. They prefer to work with intermediaries or use standard loan products under the SHG-Bank linkage program. Some private banks like Axis Bank and Yes Bank have shown some interest in lending to FPOs but their exposure is not very large as they face some challenges in terms of market volatility and repayment risks."*

4. Impact Investors

The funding ecosystem for FPOs also includes impact investors who aim to generate social and environmental impact alongside financial returns, by providing debt and grant support to FPOs at different stages of their growth.

Impact investing for FPOs has gained momentum in India. A report by McKinsey & Company states that impact investments in India delivered a gross internal rate of return of approximately 10% to investors between 2010 and 2016. A comparable rate to mainstream private equity and venture capital returns during the same period. The report also estimates that impact investments have the potential to grow from ₹33,000 crore in 2015, to between ₹50,000 crore and ₹66,000 crore by 2025.[21]

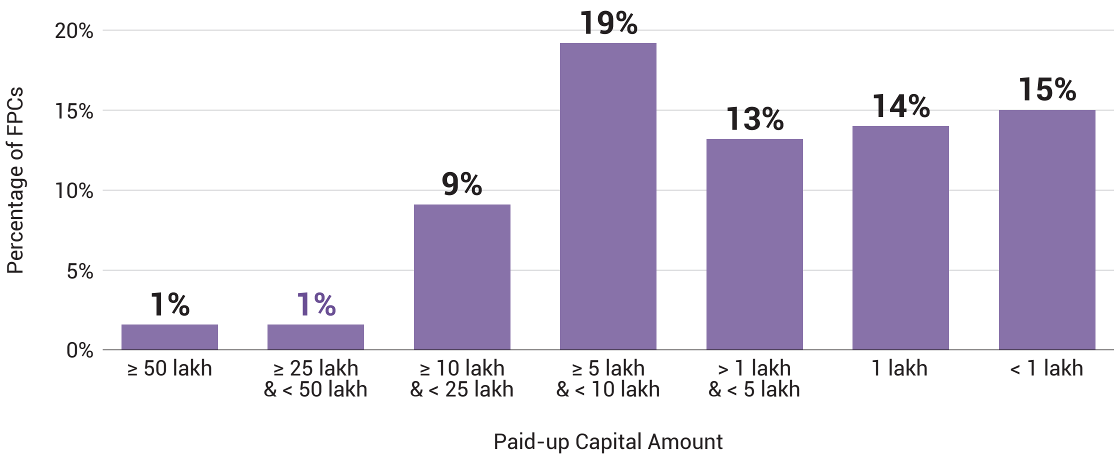
Impact investors typically fund intermediaries such as Samunnati, Villgro, and others, who then provide capital and support to FPOs. These intermediaries act as aggregators, and enablers for FPOs, helping them overcome challenges related to scale, governance, and market access.

Interviews with FPOs, industry experts, financial institutions and private philanthropic players have revealed five major challenges faced by FPOs in accessing finance, despite policies and incentives aimed at boosting lending to FPOs.

1. A major challenge faced by FPOs across the life-cycle stages is the mobilisation of farmers and reaching or increasing paid-up capital.

According to research, 52% of the Farmer Producer Companies have a PUC of less than ₹1 lakh. It is estimated that around ₹30 lakhs is spent on each FPO, but more than 80% of FPOs are unable to reach the threshold of ₹5 lakhs required to commence full-fledged operations.[22]

Figure 3: Paid-up Capital of FPOs at the end of FY21[23]



Source: xxxxxxxx

2. The undercapitalisation of FPOs is highlighted by the fact that shareholders of the company, in this case farmers themselves, are not completely aware of their multifaceted role.

Apart from being shareholders in the company, they also serve as the producers who supply the commodities traded to generate revenue. Conversations with Haritha Mitra FPO, which trades in coffee in Andhra Pradesh, revealed that mobilising farmers can be a major issue for an early stage FPO. Although Haritha Mithra has been active since 2019, farmers from whom produce was not procured from during the season did not explicitly see the value of being part of the FPO and were unwilling to contribute to the share capitalisation.

Without clear awareness of the benefits of being part of an FPO, or the potential profits in the initial stages, farmers are not able to or do not want to invest in shares given their limited capacity. Additionally, this equity funding through farmers is often insufficient to support the day-to-day working capital requirements, leading to high reliance on loans from NBFCs. During the interviews, experts highlighted that FPOs face limitations in accessing investment from external sources and primarily rely on grants and NBFC loans, as many farmers view FPOs as government projects and are not fully aware of the financial offerings they provide.

Further, increasing paid-up capital has been a difficult proposition for both mature and early-stage FPOs. Without clear awareness of the benefits of being part of an FPO, or the potential profits in the initial stages, farmers are not able to or do not want to invest in shares given their limited capacity. Additionally, this equity funding through farmers is often insufficient to support the day-to-day working capital requirements, leading to high reliance on loans from NBFCs.

3. High interest working capital loans from NBFCs are inhibiting access to large ticket loans required to scale up operations.

NBFCs such as Samunnati, Ananya, and NABKISAN Finance Limited have played a crucial role in supporting FPOs and facilitating their access to working capital loans. In the interviews conducted, all the FPOs mentioned receiving assistance from either Samunnati or NABKISAN Finance Limited. However, they also expressed concerns about the high-interest rates associated with these loans. *Table 2* on *page 14* highlights the interest rates ranging between 10% to 21% for the selected NBFCs.

Working capital loans are essential for FPOs at all stages of their development. Mid-stage FPOs, in particular, heavily rely on NBFCs to fulfil their financial needs. This is because grant support is typically limited and time-bound at this stage, and FPOs still lack the strong balance sheets required to secure loans from formal financial institutions. Consequently, NBFCs become the primary option, providing funding through renewable credit systems that offer more favourable terms and do not necessitate collateral.

For instance, Malihabad Mango FPO, based in Uttar Pradesh and engaged in mango trading for several years, primarily depends on a leading NBFC player for credit. However, they also aspire to secure term loans and develop infrastructure for processing. Expanding into value-added products like pickles necessitates a significant capital investment.

Similarly, Haritha Mithra FPO has future plans to establish a fermenting unit. They require a total credit of approximately ₹1 crore, which they have been unable to obtain. Since they do not own land, they do not qualify for funds under the Agriculture Infrastructure Fund, and banks have also denied them loans. While they can access funds from a leading NBFC player, obtaining ₹1 crore at an average interest rate of more than 10% is not financially feasible for them.

4. FPOs face difficulties in accessing funds from formal financial institutions because of a lack of collateral and in the absence of strong balance sheets.

In India, unlike other countries, there are no dedicated agribusiness banks that prioritise lending to FPOs. Commercial banks tend to prefer low-risk loans, which makes it challenging for them to meet the specific requirements of FPOs. The lack of visibility on FPOs' operations and business potential due to information asymmetry and vulnerability of agriculture to vagaries of climate change further hinders banks' involvement in financing FPOs.[24]

Mr. Srinivas Chekuri, the Managing Director of Haritha Mithra FPO, that had attempted to borrow from a bank noted,

"We were in talks with a leading bank and were almost ready to secure the loan. However, they were not convinced without a business plan. Early-stage FPOs find it difficult to make a case for profitability, and without access to collateral, accessing funds from banks remains a pipe dream."

Additionally, the requirement of collateral poses a significant obstacle for FPOs when seeking loans. Banks are often unable to consider inventory as collateral, and the absence of a credit history makes due diligence difficult, further diminishing the chances of securing a loan for an FPO.

An example is Kurinji Sustainable Agriculture FPO, which has been active since 2015 and has over 1,000 shareholders. With a working capital requirement of ₹25 lakhs, which was previously fulfilled by Samunnati, Kurinji FPO had applied for a loan from a nationalised bank but was denied due to the lack of collateral. Despite achieving an annual turnover of around ₹2 crores last year, the FPO has faced persistent difficulties in securing funding.

5. FPOs lack access to patient capital due to the current legal issues preventing external capital investment or equity financing for FPOs.

Currently, there are no avenues through which FPOs can obtain external funding through equity financing. Under the Companies Act 2013, trading of equity shares is prohibited, limiting equity ownership solely to shareholder farmers. While this legal provision has its own advantages, it also significantly hampers the potential for equity investment from social impact investors.

Social enterprises, particularly startups, often rely on patient capital from sources such as friends, family, and impact investors to initiate and expand their operations. Equity and debt funding are crucial means by which they secure this capital. However, external equity funding is not possible for FPOs due to the aforementioned restriction. While impact investors are increasingly interested in supporting sustainable agricultural practices and rural development, they do not have any direct channel through which they can directly finance FPOs.

Enabling access to capital for FPOs has the potential to bring about transformative changes in the agricultural sector, leading to positive impacts on the livelihoods of smallholder farmers and rural communities. Governments, financial institutions, impact investors, and development organisations can play a crucial role in driving sustainable rural development by facilitating the availability of financial resources.

The SSE, is an innovative avenue that aims to bridge the gap between impact investors and organisations seeking funding, and could potentially help FPOs access more capital. While SSE has the potential to be a promising channel to finance FPOs, there are potential barriers that FPOs may encounter during the process.

Social Stock Exchange as a Key to Unlocking Diverse Capital for FPOs

The SSE is a regulated platform that is designed to facilitate investments to non-profits (NPOs), and for-profit social purpose organisations. It aims to bridge the gap between investors seeking to make a positive social and environmental impact and organisations dedicated to addressing pressing issues.

The SSE is a novel concept in India that was first proposed by the Finance Minister in the budget speech for the year 2019-20. It is an electronic fund-raising platform that allows social enterprises and voluntary organisations working for the realisation of a social welfare objective to raise capital as equity, debt or as units like a mutual fund.[25] The exchange provides a transparent and accountable framework, ensuring that listed entities meet predefined social and environmental impact.

Moreover, the SSE offers investors the opportunity to identify investment opportunities that align with their social and environmental values. The exchange provides standardised reporting mechanisms, enabling investors to assess the impact created by listed organisations and make well-informed investment decisions.

Figure 4: Key objectives of SSE[26]

While the primary objective of SSE is to allow enterprises with a social purpose to unlock greater capital for social impact funding, it has the potential to serve THREE key purposes

1. Bring interested NPOs and FPEs onto a common platform of legal requirements for the purposes of accessing the SSE
2. Inculcate a cultural shift in NPOs and FPEs, and enable transition towards a disclosure-driven fundraising system
3. Provide means for NPOs and FPEs (especially smaller organisations) to signal the primacy of social impact and the quality of their governance and transparency

The Technical Group at SEBI drew inspiration from sectors listed in Schedule VII of the Companies Act 2013 and SDGs to identify 17 eligible sectors. These include promoting healthcare, education, employability, and livelihoods; eradicating hunger, poverty, malnutrition, and inequality, supporting incubators of social enterprises, and gender equality empowerment of women and LGBTQIA+ communities, among others. Additionally, the SSE also qualifies organisations based on criteria such as the target population or region served and the proportion of reach, which helps demonstrate the primacy of their social impact.

Figure 5: SSE Eligibility Criteria for Organisations

Organisations need to establish their primacy of social impact through the following criteria

ELIGIBLE SOCIAL SECTORS

Activities undertaken by the SE must **fall under one of the 17 broad areas of eligible social objectives** as defined by the Technical Group at SEBI.

TARGET BENEFICIARIES/ REGION

Target underserved or underprivileged population segments, or regions recording low performance in the development priorities of national and state governments.

ELIGIBLE SOCIAL ACTIVITIES

Organisations must have at least **67% of their eligible activities** towards the target population. This can be determined on the basis of revenue earned, expenses incurred or type of existing customer base.

Organisations and activities which are not eligible to raise funds using SSE

- Corporate foundations: Primarily funded by parent corporate entity
- Political or religious organisations or activities
- Professional or trade associations
- Infrastructure and housing companies (except affordable housing)

SSE offers various fundraising instruments, depending on the nature of the social enterprise seeking funding. These include Zero Coupon Zero Principal Bonds (ZCZP), mutual funds, and Pay for Success bonds for NPOs, and Social Venture Funds (SVFs), and equity for FPEs. The SSE offers a range of financial instruments that empower investors to support social enterprises while achieving positive social and financial outcomes. These instruments include SVFs, Pay for Success bonds, and mutual funds, among others. For instance, SVFs play a crucial role in providing both capital and non-financial assistance to social enterprises that possess scalable and sustainable business models. By investing in SVFs, investors contribute to the growth and development of these enterprises while also benefiting from potential financial returns.

Pay for Success bonds are another noteworthy instruments available on the SSE. These bonds establish a connection between the repayments made by social enterprises and their social performance. By linking financial obligations to social outcomes, pay for success bonds incentivise organisations to achieve their intended impact while offering them flexibility in terms and conditions. Mutual funds represent another option for investors on the SSE. These funds pool money from multiple investors and invest in a diversified portfolio of securities. By participating in mutual funds, investors gain exposure to a variety of social enterprises, spreading their risk and potentially maximising their financial returns.

FPOs in India, which are registered under the Producer Companies Act (within The Companies Act 2013), are inherently categorised as FPEs driven by both social and commercial imperatives. Since they meet the eligibility

requirements of the SSE, these FPOs have strong potential to register and get listed on the exchange.

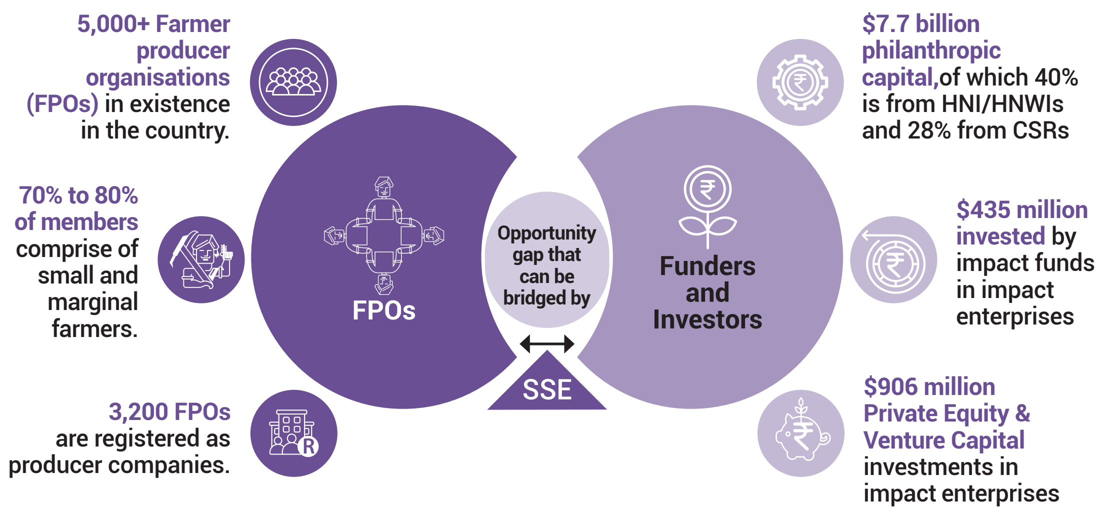
FPOs, under the Producer Companies Act, are defined as enterprises formed by producers involved in agricultural and allied activities, whose primary objectives include supporting production, facilitating processing and marketing of their members' produce. Further, they are expected to improve the livelihoods of small producers by providing a platform for collectivising them, aggregating their farm produce, enabling pooling of funds, and improving their bargaining power within markets.

FPOs inherently fulfil the sectoral eligibility requirements stated in Section 2 of the SEBI Technical Group Report, including "promoting livelihoods for the rural and urban poor, including enhancing the income of small and marginal farmers and workers in the non-farm sector". They also fulfil the criteria of having more than 67% of their revenue, expenditure and beneficiaries from within the sector.

Richa Govil, a Professor at Azim Premji University explained how
"Producer companies are for-profit enterprises with a social purpose, driven by both social and commercial imperatives. Listing on the Social Stock Exchange will enable them to raise capital and debt from investors seeking a mix of social and commercial returns. The Social Stock Exchange would also benefit from listing producer companies as they directly contribute to social impact among marginalised groups."

Since most FPOs face severe capital and credit shortages, which prevent them from starting or growing their business operations, listing on SSE would create an opportunity for these organisations to access additional sources of funds.

Figure 6: Bridging the Opportunity Gap through SSE[27]



The SSE can play a pivotal role in addressing these challenges by offering FPOs access to a diverse range of innovative financial instruments that are tailored to their specific needs and objectives. By facilitating the listing of FPOs on the SSE, these organisations could gain access to capital that was previously inaccessible, helping them overcome the financial hurdles that hampered their growth. Further, this newfound access to capital has the potential to level the playing field for FPOs, enabling them to compete more effectively in markets dominated by larger, well-financed organisations.

In addition to accessing diverse capital, SSE can ensure transparency, align incentives, and enhance the reputation of FPOs.

Figure 7: Potential Benefits for FPOs through SSE

1. The diverse financial instrument offered on the SSE can aid FPOs in overcoming the obstacles related to collateral, credit history, or profitability, which frequently hinder their access to bank loans or other formal financing sources.

FPOs have the option to access debt funding through **social development bonds**, which establish a connection between their repayments and social outcomes, while also providing them with flexible terms and conditions. For instance, in 2013, the Ford Foundation placed a grant of ₹5.6 crore with the Client Fund of Rabobank Foundation to offer guarantees to financial institutions in India that would lend to FPOs.[28]

Alternatively, FPOs can secure funding through **SVFs**, which not only provide capital but also extend technical assistance, mentoring, and capacity-building support to help them expand their operations and increase their impact. For example, Samunnati currently offers agricultural finance and market linkage services to FPOs and other participants in the agricultural value chain in India. While Samunnati is not a social venture fund itself, it has received funding from social venture funds such as Elevar Equity, Accel Partners, ResponsAbility, and Nuveen.[29]

To further underscore the value of FPOs as investment opportunities, interviews conducted with FPOs and agricultural experts have shed light on the demand for alternative financing channels, the potential role of the SSE in releasing capital beyond traditional grants and loans. Further, the interviewees also emphasised the importance of financial innovation and the necessity to adapt existing financial instruments to suit the unique needs and structures of FPOs.

2. SSE can enable an alignment of interests and incentives towards common social objectives for FPOs and their investors or donors.

On the SSE, FPOs would be relying on instruments that would reward them for achieving pre-defined social outcomes such as increasing farmers' income, reducing poverty and enhancing food security. These instruments could help FPOs avoid mission drift or compromise on their social values while pursuing financial sustainability or growth.

3. The SSE can help FPOs enhance their reputation and recognition among various stakeholders such as investors, banks, government agencies, NGOs, and others.

Listing on the SSE allows FPOs to showcase their commitment and establish their credibility in creating social impact while adhering to high standards of governance and transparency. This demonstration of dedication can attract a wider audience, including members, promoters, customers, partners, and supporters who align with their cause. Furthermore, FPOs can leverage the SSE platform to highlight their impact, success stories, best practices, and innovations, to inspire other FPOs and social enterprises.

While FPOs have a clear social intent and target underserved populations, making them eligible for listing on the SSE, they may face five key hurdles that could impede their participation.

1. **Ambiguity in the current SSE rules regarding FPOs:** Producer companies, including FPOs, currently meet the eligibility requirements for the SSE. However, they may face exclusion due to a lack of explicit mention or examples of FPEs. It is necessary for SEBI to explicitly include producer companies in the definition of FPEs allowed to list on the SSE.

2. **Unsuitable financial instruments on the SSE:** The existing financial instruments on the SSE are primarily designed for NPOs and for-profit social enterprises. FPOs with their unique structure, need, and challenges, require differentiated financial instruments or structures that can be listed on the SSE. Specialised financial instruments such as subordinate debt or second-tier capital, which meet specific criteria of membership, transactions, and profitability, could benefit FPOs in raising capital without diluting equity or violating regulatory restrictions.

3. **Ineligibility for the Capacity Building Fund:** FPEs, including FPOs, are currently excluded from the Capacity Building Fund, which provides financial and technical support to NPOs for SSE readiness. This limitation poses a significant challenge for FPOs, as they also require capacity building support to strengthen their organisational and technical capabilities. Access to dedicated funds for capacity building is crucial for FPOs to meet the listing criteria and reporting standards of the SSE, overcome challenges in productivity, market linkages, governance, and management, and attract social investors.

4. **Demonstrating financial viability and sustainability:** FPOs may encounter difficulties in demonstrating their financial viability and sustainability due to narrow profit margins, high operational costs, and social trade-offs. With thin margins and factors like low volumes, high transportation costs, poor infrastructure, and market volatility, FPOs operate under challenging financial circumstances. Moreover, balancing social objectives with financial goals can present conflicts, such as paying higher prices to farmer members than prevailing market rates, impacting profitability and competitiveness.
5. **Limited resources for impact reporting:** According to interviewees, FPOs lack the resources and capacities to meet the impact reporting standards required for SSE participation. Meeting the minimum reporting standards for demonstrating impact is a prerequisite for joining the SSE. However, FPOs often operate with limited staff and financial resources, making it challenging to gather comprehensive data and evidence of their impact. FPOs such as Kurinji Sustainable Agri expressed the need for support in acquiring skilled staff to handle impact reporting, as their current capacity may not be sufficient to fulfil the requirements.

Creating an Enabling Ecosystem to Onboard FPOs on the SSE Platform

The Social Stock Exchange offers a significant opportunity for FPOs to access external funding through diverse financing options. On the other hand, investors have the chance to invest in enterprises led by farmers themselves and contribute to their growth. Investing in FPOs provides greater visibility of impact since the funds directly benefit the last-mile farmers. However, to address the potential hurdles that FPOs may face on SSE as mentioned in the previous section, multiple stakeholders must come together and act collaboratively to create an enabling ecosystem.

Figure 8: Framework for orchestration needed between stakeholders to enable FPO onboarding on SSE to unlock capital[30]

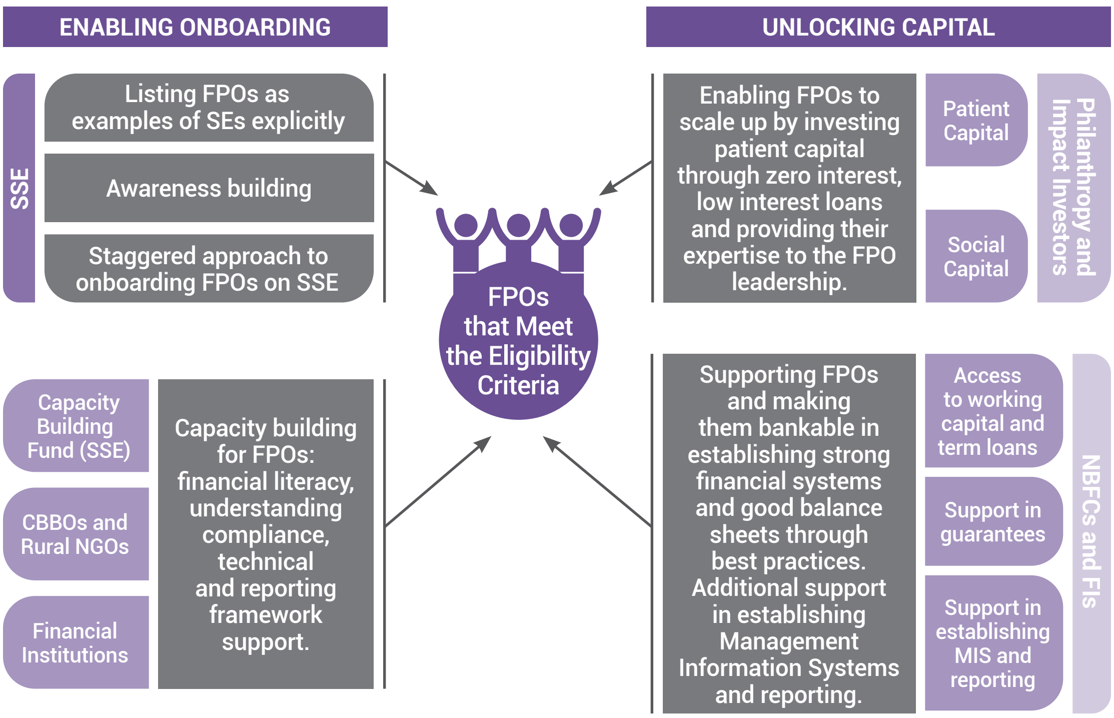
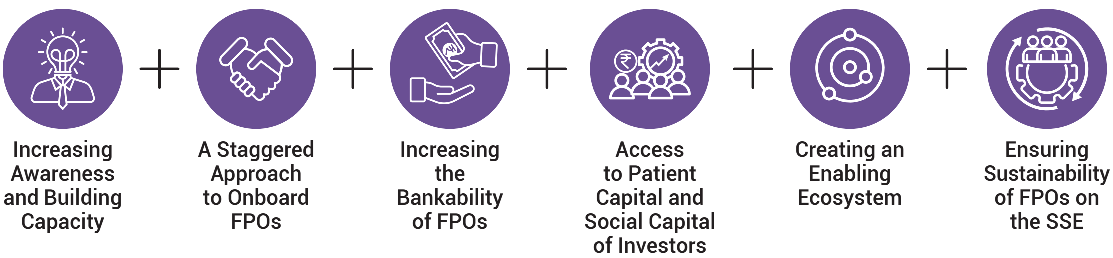


Figure 9: Key Factors to enable FPOs on the SSE



1. Increasing awareness and building capacity

The first step towards onboarding FPOs on SSE has to be to **explicitly highlight FPOs as social enterprises that can be eligible to access funding on the SSE**. The second step is then to generate awareness regarding the platform and communicate in clear terms the eligibility requirements, compliance, as well as the reporting frameworks that need to be met in order to access funding on SSE.

The FPOs consulted were largely unaware of what it would entail to be onboarded on the SSE platform. While FPOs are largely open to receiving external capital through debt financing, the intricacies of the platform, especially impact reporting, seemed daunting for them. At their core, FPOs are farmer groups struggling to make their agribusinesses profitable. Expectations of them yielding annual impact scorecards may be unrealistic, especially without additional support.

As mentioned earlier, enabling access to the Capacity Building Fund on SSE earmarked for NPOs, can be a solution to the issues of awareness and capacity. CBBOs and rural NGOs involved in incubating, promoting and supporting FPOs can be actively involved in understanding the SSE ecosystem and enable FPOs to meet all compliances. Further, the resource institutions can also assist in establishing monitoring mechanisms that can be key in impact reporting.

Mr. Venkatesh also shared some ideas to build capacity for the FPOs,
"The SSE itself should support this capacity building by setting aside some funds or leveraging existing funds like Financial Inclusion Technology Fund or Financial Inclusion Fund managed by NABARD. The SSE can also partner with entities like BIRD, SFAC, NABARD or other experts to deliver the financial literacy programmes to FPOs. They can also use the existing promotional grants under the 10,000 FPO programme to support this initiative."

2. Taking a staggered approach to onboarding FPOs on the SSE Platform

A staggered approach to onboarding FPOs, beginning with the matured ones, would allow the SSE to grow gradually and sustainably. This would help to avoid any problems that could arise from a sudden influx of new FPOs. As more and more FPOs are listed on the SSE, the market will become more liquid. The staggered approach can also help in building trust and confidence among the FPOs and the investors, as well as creating a learning curve for both parties. The FPOs can start with smaller amounts of funding and simpler reporting frameworks, and gradually move towards larger amounts and more rigorous impact assessments. The investors can also gain more familiarity and exposure to the FPO sector, and understand its unique challenges and opportunities. This way, the SSE can create a conducive environment for FPOs to access capital and scale their impact.

3. Increasing the bankability of FPOs, improving their access to finance, enabling financial literacy, and building business acumen

Financial institutions have the capacity to fulfil requirements if they see a business requirement and incentive.

FPOs can increase their bankability by developing sound accounting and record-keeping systems, and managing their finances prudently. This can help them to showcase their creditworthiness and impact potential to the investors on the SSE platform.

This was echoed by **Aneesha Bali**, NAFPO project lead,
"A good practice of business has to be there and FPOs need to have a very defined guideline on how they would be spending the money that they receive. This will build confidence with investors from the private sector in the absence of a robust monitoring system. Also, there has to be digitised information available of farmer members and the FPOs."

Furthermore, FPOs can also improve their access to finance by enhancing their financial literacy and business acumen. This can enable them to understand the various financial products and services available in the market, and choose the ones that suit their needs and goals.

4. Enabling access to patient capital and leveraging social capital of investors

Patient capital entails an investor's willingness to wait for a longer time for returns on their investment. The role of patient capital in nurturing the startup ecosystem is indispensable. As elaborated earlier, FPOs do not have access to external capital through equity financing. Additionally, after the initial years have crossed, mid-stage and matured FPOs do not have grant support either. Onboarding on SSE will allow FPOs to tap into the pool of impact investors that prioritise social returns. FPOs can gain access to debt financing with low or zero interest from investors who are willing to invest in the growth of FPOs in the long-term.

Long-term debt financing of significant amounts, without high interest rates, will allow FPOs to scale up and sustain operations, especially when it comes to building infrastructure. For FPCs like Haritha Mithra who have a fermenting unit, and Kurinji Sustainable Agriculture who have a processing unit, funds accessed on the SSE platform will be integral.

Moreover, SSE presents an opportunity to leverage the social capital of investors. A study of 1500 funding rounds for startups examined how the social networks and social capital of venture capitalists contribute to the complexity of their role in startups beyond mere financial investment.[31] Similarly, like other social enterprises have access to the social capital of investors, FPOs also need the exposure in order to become full-fledged business.

Business acumen of FPOs or CBBOs are not essential requirements for starting operations - this may be the reason why a majority of FPOs are not able to take off. On the SSE platform, investors, apart from investing financially, should be encouraged to invest their time in the sustainable growth of FPOs.

5. Creating an enabling ecosystem and supporting FPOs in establishing reporting frameworks

The social impact reporting requirement is an important aspect of the SSE that can prove to be very useful for FPOs. However, external stakeholders will need to aid FPOs to establish strong reporting frameworks and monitoring mechanisms. Currently, while FPOs are able to manage bookkeeping with support and training from promoting agencies and CBBOs, understanding of impact reporting is nascent, if any.

Mr. Venkatesh highlighted the fact that

"Monitoring and evaluating the performance and progress of FPOs is a challenging task as it requires collecting and analysing data and information from farmers and FPOs, which are often difficult to obtain and verify. There are some agritech startups providing data analysis and technology support to track activities and outcomes of FPOs. The performance and progress of FPOs may also depend on the type of crop they deal with, as different crops have different value chains and market players. FPOs dealing with commercial crops may have more potential and interest to be onboarded on the SSE than those dealing with local or staple crops."

Financial institutions can be a key resource here and provide support through capacity building and raising awareness about impact reporting. FPOs have massive social and environmental impact that goes undocumented. With support of rural NGOs and financial institutions FPOs will be able to establish strong systems that can sustain their scale and operations. This kind of reporting framework is envisaged to further build their credibility in the ecosystem and improve their access to finance. Alternatively, the SSE platform can also have an inbuilt impact reporting tool for social enterprises with a good user interface, keeping in mind accessibility and ease of use for farmers.

6. Mitigating risks: Ensuring sustainability of FPOs on the SSE platform

The SSE can also help in mitigating the risks associated with FPOs and enhancing their sustainability. Moreover, it can provide a transparent and accountable mechanism for FPOs to report their financial and social impact, and to communicate their challenges and achievements to the investors and other stakeholders. SSE could also facilitate the provision of technical assistance and mentoring support to FPOs, through its network of partners and experts which can help FPOs to overcome their operational and strategic difficulties, and to improve their efficiency and effectiveness. Moreover, the SSE can also create a platform for peer learning and collaboration among FPOs, as well as other social enterprises. This can help FPOs to share their best practices and learnings, and to leverage the synergies and opportunities in the sector.

Mr. Venkatesh suggested,
"FPOs may face the challenge of unrealistic expectations or disappointment once they are a part of the SSE, as they may think that they will get some immediate or tangible benefits like loans or grants. If they do not see any value addition from being registered on the SSE, they may lose interest or trust in the platform. The SSE governing council should ensure that some minimum support or assistance is provided to the FPOs within a reasonable time frame after their registration, such as capacity building, financial literacy, market linkages, etc. This would help to keep their hopes and aspirations alive and also enable them to leverage the opportunities and advantages of being on the SSE."

Charting a Progressive Future: Expanding Financial Horizons for FPOs on the SSE

The Companies Act 2013 appropriately safeguards FPO ownership by reserving all shares exclusively for farmers, protecting them from external capital influence. However, when considering FPOs as genuine social enterprises, the value of equity financing should not be underestimated. In various startup scenarios, particularly in the agritech sector, investments from venture capitalists have significantly contributed to their growth. Based on the collective research and expert inputs, there are two critical types of financing that will expand the horizons for FPOs on the SSE.

- **Equity financing for FPOs can be extended through joint ventures on platforms like SSE:** NABARD, in a 2019 report, highlighted that amending the Companies Act 2013 to allow private equity investment would strengthen the financial position of FPOs and enable the development of more commercially sustainable businesses.[32] While this would require systemic changes, it would be worth exploring the possibility of private equity investments for FPOs.

  This could involve allowing the trading of non-voting shares and implementing bylaws that limit the control of external equity shareholders. Alternatively, a two-tier model of joint ventures among FPOs could be explored, where they register as private companies and access equity funding on platforms like SSE, similar to other social enterprises. These funds could then be directed towards the member FPOs. These are preliminary ideas intended to initiate discussions to enable external equity investments in FPOs for their sustainable growth.

- **Access to finance can be facilitated from formal banking institutions by addressing information asymmetry through the SSE:** The SSE has the potential to increase access to finance from formal banking institutions such as banks and NBFCs by providing reliable and verified information about each other. It can also help address the information asymmetry and transaction costs that often hinder FPOs' access to finance.

  The platform can offer FPOs credit ratings and impact scores based on their financial and social performance, enabling them to demonstrate their creditworthiness and impact potential to formal banking institutions. According to a study by NABARD, around 90% of FPOs are funded by NBFCs[33]. Accessing credit from banking institutions is challenging because FPOs struggle to meet collateral and documentation requirements.

  The SSE can also provide formal banking institutions with due diligence and risk assessment reports based on the financial and social data of FPOs, assisting them in evaluating the viability and suitability of FPOs for their financial products and services. Finally, the exchange can facilitate the disbursement and repayment of loans and grants by offering a secure and transparent platform for fund transfer and monitoring.

Collectivisation of smallholder farmers is the swiftest way through which farm productivity, farmer incomes and access to resources can be improved. The food processing industry, in particular, is projected to reach ₹43,901,00 crore by 2025 with a CAGR of 15%, holding the potential to increase farmers' income.[34] Additional funds accessed through SSE can allow FPOs' to scale-up and tap into value-addition and processing, enabling them to venture beyond farm income and explore off-farm income as well in the long-term.

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