Resource Handbook

For establishing a Producer Company

Developed by

Action for Social Advancement (ASA), Bhopal

for

Food & Agriculture Organisation of United Nation

New Delhi

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Introduction

The project of “Organic Production of Underutilized Medicinal, Aromatic and Natural Dye Plants Programme for Sustainable Livelihoods in South Asia” (MADP) is being implemented in India and Bhutan by the Food and Agriculture Organisation of the United Nations. The project is funded by a Technical Assistance Grant from the IFAD for conversion to organic farming systems incorporating MADPs (Medicinal, Aromatic and Natural Dyes) of the area; adding value on farm; processing for further value addition; establishing quality and traceability aspects of certification; formation of business platform of producers; marketing of the produce of all sites with primacy to meeting the needs of the community for nutrition, health, increased purchasing power and sustained livelihoods.

The first phase of the project came to an end in April 2009. Following a request for no-cost extension, the project has been extended by the IFAD till December 2010. In Karnataka the MADP project is being implemented by the Biocenter, Department of Horticulture, Government of Karnataka in four districts namely Bengaluru (Rural), Mysore, Udupi and Gadag.

The FAO has sought the services of Action for Social Advancement (ASA), a non-governmental organisation, pioneer in setting up the Producer companies in India, to:

- prepare a resource book to guide the users on how to develop producer companies including financial and economic assessment before establishing a PC of small producers.

This resource book deals with the processes to be followed and preparations required to set up a producer company. The resource book is developed based on the experiences of ASA and from the findings and lessons that the ASA team had learnt during their feasibility assessment of setting up a PC in Gadag, Karnataka project site of MADP.

As per the Terms of reference (ToR) the following aspects have been covered in this Resource book. The resource book contains four chapters. Chapter-1 deals with the generic issues in regard to need of farmers collectives, genesis of Producer Companies Act., key differences in characteristics between producer companies and cooperatives, Chapter-2 describes the processes need to be followed and the preparations required at the field level for the incorporation of the company. The chapter also focuses on the legal requirement for establishing a company and process involved in it. Chapter-3 assesses the working capital requirement and running costs for a producer company. Chapter-4 explains the process of developing business plan of producer companies taking into consideration of market and various financial assessment, and Chapter-5 provides some practical guidelines for the assessment of institutional health of the producer companies.

The whole idea behind this resource book is not to provide prescription, as the producer companies require context specific strategic interventions (like any other community institutions), which is best manoeuvred by the practitioners working in a given situation, but to provide a methodical guidelines in establishing a PC. Thus, this resource book should not be considered as a sole source of information. It is suggested that the
interested users also seek details of legal compliances related with company affairs, available at the website of Ministry of Corporate Affairs (www.mca.gov.in).
CHAPTER 1
PRODUCER COMPANIES - CONCEPT AND PRACTICES
(This Chapter deals with the generic issues in regard to need of farmers collectives, genesis of Producer Companies Act., key differences in characteristics between producer companies and cooperatives, and experience of ASA¹ in establishing producer companies)

1.1 Background
The growth rate of agriculture in India over the last decade has been stagnating and has gone down to 1.8% in 2006. On the other hand industrial growth has been buoyant at more than 9%. Such skewed growth rates are a matter of serious concern for planners and policy makers of the country at the highest level.

While growth in green revolution areas are stagnating, hardly any progress has been made in about 60% of the cultivable land, which is still under rainfed farming. The country finds itself in a difficult situation in meeting the food and nutrient security of its one billion plus population. Clearly Indian Agriculture is at the crossroads and only radical and innovative policies will help to pull the country out of an impending crisis of enormous proportions.

A much discussed topic in Indian agriculture is how to integrate the farmers, especially the small farmers, with the value chain so that the net return at the farmers end is remunerative enough for the farmers to remain interested in agriculture.

India has over 92 million small holdings or nearly 21% of the world’s small holdings of 450 million, the second largest after China (Oksana Nagayets, IFPRI, 2005). The challenge is therefore enormous for India to ensure that small holdings are truly productive and are the main source of livelihoods for millions of her people dependent on it.

Several institutional models are being tried in India to integrate farmers with the value chain. The most common model is the producers cooperatives, which enable farmers to organise themselves as collectives. The cooperatives are registered with the Registrar of Cooperative Societies. India has a large number of cooperative institutions in a vast range of enterprise sectors. The cooperative experience in India has not been a very pleasant one, as cooperatives have largely been state promoted, with a focus on welfare rather than to do business on commercial lines (EV Murray, Producer Company model: Opportunities for bank finances, CAB Calling, April – June, 2008).

In 2002 through an amendment in the Indian Companies Act. 1956, the Government of India (GoI) enacted the Producer companies Act. by incorporating a new part IXA in the Indian Companies Act.1956 based on the recommendations of the Y.K. Alagh Committee set up for this purpose. The producer companies are incorporated with the Registrar of Company (RoC). The objective was to formulate a legislation that would enable incorporation of cooperatives as companies and conversion of existing

¹ Action for Social Advancement (ASA), an NGO based in Bhopal, M.P. is one of the pioneering organization in establishing PC with small farmers for agribusiness in Madhya Pradesh and Bihar.
cooperatives into companies, while ensuring that the unique elements of cooperative business with a regulatory framework similar to that of private companies.

The PC is formed with the equity contribution by the members and limited to them. The day to day operation is expected to be managed by the professionals, hired from outside, under the direction of the Board of Directors elected/selected by the General body of the PC for a specific tenure.

Since farmers or the producers are the equity holders of the company, a PC as an organisation provides an appropriate framework for owning the company by the producers themselves. The need to organise farmers, especially the small holders, is a well established fact. The basic purpose of the PC is to collectivise small farmers or producers for (a) backward linkage for inputs like seeds, fertilisers, credit, insurance, knowledge and extension services, and (b) forward linkages such as collective marketing, processing, market led agriculture production, etc. At the heart of this effort is to gain collective bargaining power for small farmers/producers.

The collectives of farmers in the form of producer companies is gaining popularity among the farmers/producers and among the promoting agencies primarily due to several advantages it carries in comparison to the conventional model of producers cooperatives. Producer Companies Act. enshrines the ethos and basic tenets of cooperatives and infuses a professional attitude into management. Table -1 provides a comparative analysis of producer companies and producers cooperatives to understand the differences in the basic premises of these two Acts which enable incorporation of producers collectives.

**Table-1 : Key differences between Producer Companies and Cooperatives**

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Cooperative</th>
<th>Producer Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectives</td>
<td>Single object</td>
<td>Multi-object</td>
</tr>
<tr>
<td>Area of Operation</td>
<td>Restricted, discretionary</td>
<td>Entire Union of India</td>
</tr>
<tr>
<td>Membership</td>
<td>Individuals and cooperatives</td>
<td>Any individual, group, association, producer of the goods or services</td>
</tr>
<tr>
<td>Share</td>
<td>Non tradable</td>
<td>Not tradable but transferable limited to members on par value</td>
</tr>
<tr>
<td>Profit sharing</td>
<td>Limited dividends on shares</td>
<td>Commensurate with volume of business</td>
</tr>
<tr>
<td>Voting rights</td>
<td>One member, one vote, but</td>
<td>One member, one vote. Members not having transactions with the company can not vote</td>
</tr>
<tr>
<td></td>
<td>Government and Registrar of</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cooperatives hold veto power</td>
<td></td>
</tr>
<tr>
<td>Government control</td>
<td>Highly patronized to the extent of</td>
<td>Minimal, limited to statutory requirements</td>
</tr>
<tr>
<td></td>
<td>interference</td>
<td></td>
</tr>
<tr>
<td>Extent of Autonomy</td>
<td>Limited in “real world scenario”</td>
<td>Fully autonomous, self ruled within the provisions of Act</td>
</tr>
<tr>
<td>Reserves</td>
<td>Created if here are profits</td>
<td>Mandatory to create every year</td>
</tr>
<tr>
<td>Parameters</td>
<td>Cooperative</td>
<td>Producer Company</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>----------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>Borrowing power</td>
<td>Restricted</td>
<td>More freedom and alternatives</td>
</tr>
<tr>
<td>Relationship with other</td>
<td>Transaction based</td>
<td>Producers and corporate entity can together float a producer company</td>
</tr>
<tr>
<td>corporate / business houses /</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NGOs</td>
<td></td>
<td></td>
</tr>
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Apparently the producer companies has inherent advantages over the cooperatives in many areas. Specifically of the PC there is less government control whereas the cooperative institutions are state controlled. The overriding powers of the Registrar of Cooperative Societies to direct and regulate cooperatives, whenever the government deems necessary, has throttled the growth of the cooperative institutions (EV Murray, Producer Company model: Opportunities for bank finances, CAB Calling, April – June, 2008). Majority of the cooperative institutions currently facing severe financial crisis and heavily dependent on the state’s subsidy for existence. The Mutually Aided Cooperative Societies Act (MACS) was introduced to overcome some of these limitation of the cooperatives, however, not many states have adopted the MACS and also not many commodity cooperatives have migrated to the MACS format.

1.2 Key Characteristics of Producer Companies

- It is a body corporate registered under the Indian Companies (Amendment) Act 2002. Ownership and membership of such companies is held only by ‘primary producers’ or ‘Producer Institution’, and member’s equity cannot be traded. However, it may be transferred, only with the approval of the board of directors of the producers companies.

- The clauses of Private Limited Company shall be applicable to the producer companies except the clauses specified in Producer Company Act. from 581-A to 581-ZT which make it different from a normal private or limited company *(refer the Producer Company Act for details)*.

- The PC is with limited liabilities and limited only by share capital. The liability of the members is limited to the unpaid amount of the shares held by them.

- The minimum paid-up authorized capital is Rs.5 lakh for a PC.

- Minimum number of producers required to form a PC is 10 while there is no limit for maximum number of members and it can be increased as per feasibility and need. However, based on the experience (not to be treated as prescribed) it is found that for agriculture based PC 800-1000 farmers is a good size for initial years to make it economically viable and increasing up to 2000 as the company grows.

- There cannot be any government or private equity stake in the producer companies, which implies that PC cannot become a public or deemed public limited company.

- The area of operation for a PC is the entire country.
1.3 Experience of ASA in establishing PCs

Since late 2004, ASA has been promoting the concept of Producer companies in M.P and Bihar. So far it has promoted 16 PCs with over 30000 small and marginal farmers in the resource poor regions of M.P and Bihar, with an average membership of about 2000 farmers per PC.

There is a professional management team in each of these PCs which carries out the operations under the directions of the Board of Directors (BoD) of the PC. The responsibility of the Management Team also includes building the capacity of the BoD by providing handholding support. These PCs are mainly into agribusiness and that too focused largely on the crop seed production, processing and marketing of agriculture produces, the activities which give higher return on investment and also ensure availability of quality seeds to its members. The average annual business turnover of each of these PCs is about Rs.10 million. However, there are exceptions with a few which have reached a business turnover of around Rs.25-35 million annually within 3-4 years of their operation after incorporation. The reasons for high growth can be attributed to:

- energetic management team and the BoD,
- cooperation from banking institutions which provided hassle free loans to the PC for working capital, and
- a clearly identified business opportunity that gives a high RoI.

A tentative assessment suggests that the benefits to a member are multifarious and in the form of:

- timely and easily availability of fertilizers, seeds and other agriculture inputs at a reasonable rate;
- bulk selling of agriculture produce for better price,
- extension services received by the farmers which the PC had arranged with the agriculture department or from other service providers,
- receiving of cash dividends from the PC.

No detailed study has been conducted yet, to ascertain the benefits in monetary terms. However, the members are happy with the services of the PC and there is a tendency of increased participation in the affairs of the PC by the members.

The efforts of ASA have brought in several policy changes in favour of producers organisations in Madhya Pradesh (MP). Besides several tax related relaxations the most significant one being the decision of providing management cost support to a PC for a period of three years and a one time working capital support of Rs.25 Lacs to the PC by the GoMP. Also the Government of Madhya Pradesh has agreed to provide them with land and machinery for business needs on merit basis. All these policy decisions are notified in the Government gazette.
The point worth mentioning that like any other institution the financial viability and the institutional sustainability are two core factors that determine the sustainability of the PC. Also the success of the producers collectives would largely depend on the skill and commitment of the promoting agency. The real challenge in building such institution is how to connect the individual producer to the governing system of the producers organisation. The agency promoting the producers organisation has to pursue both the social and economic objectives simultaneously. It is therefore a long drawn agenda irrespective of the legal format under which these institutions are formed. An enabling legal format can facilitate the process well but cannot ensure a vibrant institution without a proper process followed.
CHAPTER 2

INCORPORATION OF A PRODUCER COMPANY

(This chapter is divided in two parts. The first part deals with process to be followed at field level and the preparations required. The second part of the chapter focuses on the legal requirement for establishing a PC and processes involved in it)

2.1 The Producer Company Act. 2002 does not provide any guidelines or directions about the mobilization and social processes that need to be followed while forming PC. Also, there is not many literature available capturing the hands on experience in establishing producer companies mainly due to the fact that there are limited experiments currently going on in India on the PC. Hence, what is written in the following paragraphs about the social processes is largely drawn from ASA’s experiences of establishing PC in M.P. and Bihar and that too primarily for the agriculture produce. Also these experiences are context specific and may vary with the change in context as happens with any social processes. An attempt has been made here to write on those aspects related to social processes which normally come in the minds of practitioners before embarking on setting up producer company.

2.2 How different should be the social processes while setting up a PC vis a vis a community based organisation (CBO) ?

Practically nothing. The point to be kept in mind that PC is also a CBO with a shared objective, mutually agreed plan of actions, shared responsibilities and benefits and a mechanism of functioning where the decisions are taken by the opinions of majority. Generally the processes start with the conceptualization of the idea by the initiator about the objective and structure of the CBO that is intended to be formed in a given situation. It is the initiator, normally an external person or agency, takes the lead and in consultation with the potential members of the CBO forms the organization and continues to provide support till it is stable and growing. In this trajectory the role of initiator or promoting agency changes from Initiator to Facilitator. This is depicted in a diagram below.

The diagram shows that as the capacity within the people and the CBO increases, the role of the promoting agency changes from one of initiator to that of a facilitator. As this takes place, the methods of participation for dialogue also change.

Fig-1: Change in role of Initiator as the CBO matures
2.3 Whether primary CBOs (viz. SHGs, Forest collectors group, water users group, Common interest group, etc.) can be transformed into PC?

It is better to take such approach of organizing the primary groups on the basis of common interest, geographical locations and then federate them as PC to address the bigger issues of integration with the market, value chain development, etc. and that too when such need has been felt by the members of the primary groups. Such approach builds further on the organization building efforts already made with the primary groups. Since the primary groups are already strengthened therefore their participation in the process of PC formation will be effective resulting in better leadership and governance of the PC. This approach takes little longer time than direct formation of PC through membership campaign. In case of ASA, PCs were formed with the common interest groups, SHGs and Water Users’ Groups which were already existing and after formation of the PC the original identity of the CIGs / SHGs / WUGs was not diluted, they continued to function as the primary groups as earlier.

2.4 Whether the process of establishing PC is a self triggered by the members themselves or externally triggered?

It is externally triggered by the promoting agency because often poor do not realize the need to organize and use their organization as a means to fight poverty. Hence, the promoting agency leads the initiative in establishing the PC. This is true for majority of the community based organizations.

2.4.1 Who can be the Initiator for establishing PC?

- An NGO working with the primary producers group and willing to introduce the concept of ‘Producer Companies’ for the economic enhancement of the producers.

- Any person or group of persons not necessarily primary producer/s. This could be an interested group of people socially motivated and having no stake in the PC.

- Already strengthened CBOs like SHG federation, Cooperative societies can initiate the process of transforming them into PC. In this case it will be a self triggered initiative.

- Any Government organization or department willing to promote producer companies. Government can approach an NGO, administrative body (panchayat or any state department) or any community organization for the purpose. Government could give the financial and professional support to the implementing body.
2.5 Preparation for the formation of PC

This stage precedes the process of legally registering the company. As mentioned earlier that the processes related to the mobilization of producers is purely context specific and would vary with the change of context. The factors which contribute to the mobilization of producers are many and complex. However, it is experienced that existence of primary groups in the area, rapport of the external agency and their understanding about the local context and issues play a significant role in smoothening the mobilization process of the producers. However, an attempt has been made to describe the broad general steps that an initiator should follow while taking the producers on board to form the PC. The steps are neither in chronological order nor are in the water tight compartment. The steps would overlap depending upon the situation. The steps are:

- Before setting off to establish PC the Initiator must be clear with the objective and the potential of the business. S/he must have done the homework well for the area of operation, type and number of producers, assessment of requirement of land, infrastructures, volume of business, working capital requirement, financial viability, procedures of incorporation, etc. In short there should be a blue print or plan ready with the initiator before hand. Needless to mention that the initiator has to take a professional approach in completing these tasks and may need external professional support.

- Selection of area of operation on the basis of cluster approach means a cluster of 12-15 villages at least. Normally about 800-1000 producers are a good size to form an agriculture based PC, however this would change depending upon the products around which it is proposed to be developed. Normally selection of area and members is done on the basis of the commonalities like produce, farmers’ need and common problems they are facing in terms of production and marketing.

- The initiator starts the process, through series of meetings with the potential producers, develop rapport with them and introduce the concept. Possible risks of the proposed intervention and their implication on shareholding member has to be also shared with all potential members.

- Once the concept is understood by the potential members, normally an exposure visit to successful producer companies may be organized to further strengthen the understanding of the identified group of producers.

- Membership process has to be explained to the producers. Normally the share value is kept at Rs.10 per share. Per member share capital contribution depends
upon the economic condition of the producers. As in case of ASA, the number of shares per member ranges between 100 to 200. In some PC equal number of shares have been distributed to the members, whereas in some cases it is variable. There is no bar on the number of shares per member in the Act. However, it is suggested to have equal number of shares among the members to maintain a balance in the power structure of the PC. The norms for distribution of share per member should be mentioned in the Articles of Association of the PC.

- The member is required to apply for membership through a membership application form (specified in the Act.) to the BoD. The General body (GB) is the final authority to approve or reject the membership application.

- Once the concept is well accepted, based on the common understanding a business plan is developed in consultation with the members. The business proposal, its viability, market opportunity, size of business and possible benefits of the new enterprises must be shared properly with the potential members. In Chapter -4, the process of business plan development is discussed in detail.

- Simultaneously, the initiator in consultation and support from the members develops the draft ‘Memorandum and Articles of Association’ specifying the roles and responsibilities of each of the office bearers. The shareholders have also to finalize the authorized capital of the company and the cost of each share. While finalizing the cost of share and the number of shares per member, the paying capacity of the economically deprived shareholders should also be considered.

- Once these documents are in place, the first informal meeting of the shareholders should be organized. The basic agenda of this meeting is to get the approval on the Memorandum and Articles of Association as well as select/elect the Board of Directors of the company. However, it is advisable here for the initiator to avoid election at this stage as it can lead to drift amongst members.

- After having consent of the members about the directors of the company and the Memorandum and Articles of Association, the initiator can go ahead with the registration process. The amount collected through shareholders could be used for registration fees and other processing related expenditures like fees for Company secretary, stationary, travel etc.

- After having registration of the company, the first General meeting of the shareholders should be conducted within mandatory 90 days of the registration. Other than discussing the business plan, the General Body has to select/elect the Board of Directors for the next tenure. The proceedings of the meeting should be sent to the Registrar of Company (RoC) within sixty days of the meeting along with the list of finalized BoD.

The entire process might take two to six months (sometimes more), depending upon the response of the producers.
2.6 Registration of PC

A step-wise basic information for the formation of a ‘Producer Company’ is described as under:

Step 1: Digital Signature Certificate (DSC):

The Information Technology Act, 2000 provides for use of Digital Signatures on the documents in order to ensure the security and authenticity of the documents filed electronically. **It is now mandatory to have Digital Signature of minimum one Director or Chairman prior to enter the formal registration process.** This is the only secure and authentic way that a document can be submitted electronically. As such, all filings done by the companies are required to be filed with the use of Digital Signatures. Thus, it is necessary for a company to authorize a person’s signature who will sign the documents.

Form for DSC is available with the website of Ministry of Corporate Affairs (henceforth website of MCA). After filling the required information, the form has to be submitted online to the ‘Certification Agencies’. The DSCs are typically issued with one to two year validity. These are renewable on expiry of the period of initial issue. The issuance costs in respect of each Agency vary and are market driven.

Step 2: Director Identification Number (DIN)

The DIN number can be obtained online from a company affairs cell office without any fees by only providing identification proof number (only PAN Card, Voter Identity card, passport or driving license number is accepted). DIN form is available in the website of Ministry of Corporate Affairs and online application can be made for the same.

Step 3: Naming of a Producer Company

A producer company should be named using the following suffix “…..Producer Company Limited” appropriately indicating its status as a producer company. The word “private” is not used in the name and the absence of which does not indicate that the company is a “public”. The procedures include for the availability of name for a Producer Company are:

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2 From September 16, 2006, Ministry of MCA has initiated an electronic mode transaction for all the process of statutory filings under the Companies Act, 1956.
3 http://www.mca.gov.in
4 Certification Agencies are appointed by the office of the Controller of Certification Agencies (CCA) under the provisions of IT Act, 2000. There are a total of seven Certification Agencies authorised by the CCA to issue the Digital Signature Certificates (DSCs). The details of these Certification Agencies are available on the portal of the Ministry of Corporate Affairs www.mca.gov.in
5 As per the Companies [Amendment] Act, 2002, Section No. 581B
• Select, in order of preference, at least one suitable name upto a maximum of five names, indicative of the main objects of the company.
• Ensure that the name does not resemble the name of any other already registered company and also does not violate the provisions of emblems and names (Prevention of Improper Use Act, 1950) by availing the services of checking name availability on the portal.
• Apply to the concerned Registrar of Companies to ascertain the availability of name in e-Form 1(A)⁶ by logging in to the portal. A fee of Rs. 500/-⁷ has to be paid alongside and the digital signature of the applicant proposing the company has to be attached in the form. If all the proposed five names are not available, the applicant will be intimated by Registrar of Companies (RoC) and subsequently the applicant has to apply for a fresh name on the same application.

Moreover, there is further scope of changing the name if required however it is not easy to do it frequently. As per company Act 1956 section 21, an application to RoC with a supporting of a resolutions passed by 2/3 majority of BoD and 1/3 of General Body and fees of Rs.500 is required to be submitted along with new proposed name and 4 other alternative in order of preference.

Step 4: Memorandum & Articles of Association⁸

After ascertaining the name of the producer company, a memorandum and articles of association have to be prepared.
• Memorandum and Articles of Association should be printed (preferably a computer print out - printed on both side of the paper)
• Get the Memorandum and Articles of Association duly stamped⁹.
• Get the Memorandum and Articles of Association subscribed/signed by the requisite subscribers/promoters in his/her own hand, his/her father’s name, occupation, address and the number of shares subscribed for.
• Ensure that the Memorandum and Article is dated on a date after the date of stamping.

Step 5: Documents to be submitted to the ROC for the Incorporation of Producer Company¹⁰

File the following documents along with the fees payable¹¹ with the Registrar of Companies of the state, where the Registered Office of the company is to be situated:

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⁶ Pursuant to Section 20 & 21 of the Companies Act 1956
⁷ Fees should be deposited in the regional bank authorised by the MCA.
⁸ A small write-up on Memorandum of Association and Articles is given in Appendix 2
⁹ Stamping should be done in accordance with the requirement of the Indian Stamp Act, 1899 and the applicable rate depending on the State where the Registered Office of the company is to be situated.
¹⁰ The applicant can apply for registration of the new company within six months of name approval
• Copy of the letter of Registrar of Companies confirming the availability of name for formation of the company should be made;
• Memorandum and Articles of Association duly stamped and signed;
• Form 18 regarding situation (full address) of Registered Office\(^\text{12}\)
• Form 32 (in duplicate) regarding particulars of directors\(^\text{13}\)
• Form 1 (on a stamp paper) declaring compliance of all and incidental matters regarding formation of companies\(^\text{14}\)
• Form 29 – consent of the director
• An affidavit has to be submitted if the Memorandum of Association is submitted in Hindi by subscribers, claiming the understanding of same.
• Power of Attorney.

Please note that all the information and forms are available on the website of MCA (http://www.mca.gov.in), and can be accessed and filled up directly

**Step 6: Certificate of Incorporation**

• The Registrar of the Companies, on being satisfied that all the documents\(^\text{15}\) for the incorporation of a company is submitted, s/he is obliged to register the memorandum, the articles and other documents, if any, and issue a ‘certificate of incorporation’ within **thirty days**, which is a conclusive proof of its formation in terms of Part IX A. [Section 581C (2)].

• The incorporation of Company is effective from the date mentioned in the certificate of registration granted by the Registrar of Company.

• On incorporation, a company becomes a juristic person, i.e. a person in the eyes of law. It has perpetual succession i.e. its members may come and go but the company goes on till it is wound up by following the process of law.

• It has a common seal, which is affixed on all the documents executed on behalf of the company in the presence of a director and be signed by the authorized signatory or signatories.

• It is empowered to hold all properties in its own name and has its own right. It can sue others and can be sued by other and enter into contracts in its own name.

**Power of Attorney**

All the work required to incorporate the Company can be done either by the BoD. Alternatively, the General Body can authorize anyone of them or any other person to

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\(^{11}\) The amount of registration fees to be paid will depend upon the authorised share capital kept by the company in the Article of Association.

\(^{12}\) As per the Companies (Amendment) Act, 2002, Section No. 146.

\(^{13}\) As per the Companies (Amendment) Act, 2002, Section No. 303

\(^{14}\) As per the Companies (Amendment) Act, 2002, Section No. 33 (2)
follow the matter with the ROC (in most cases the service of a Chartered Accounting firm or Company Secretary is acquired for the purpose). In the latter case, they have to execute a power of attorney in favour of the person, who is authorised to act on their behalf.

A power of attorney form duly stamped and executed by all the subscribers of directors have to be submitted to the ROC.

A power of attorney holder is, specifically, authorised to make corrections, as may be necessary in the Memorandum and Articles of Association and all other documents filed with the ROC and to attest the same on their behalf and to receive the Certificate of Incorporation.

**Step 7: Tasks to be completed immediately after incorporation of the PC**

The following tasks have to be completed immediately after incorporation:

- Open a Bank Account with minimum two officially nominated signatories in the name of the Company.
- Procure PAN number from the Income Tax and TIN number from the Commercial Tax Department to carry out business. Also, the company have to register itself for Service Tax from Commercial Tax Department and VAT from Excise department.
- Apply for the commercial connection of Power supply to related agency/board for the office of the PC.
- Establishment of company office means arrangement of furniture and fixture along with a visible signage board.

**2.9 Estimated cost for incorporation of a Producer Company**

Table-2 below provides an estimated cost required for the incorporation of a producer company with minimum mandatory authorised capital of Rs. 5 lacs
Table-2 : Estimated cost for incorporation of a Producer Company

<table>
<thead>
<tr>
<th>Particular</th>
<th>Heads</th>
<th>Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Application for Name of PC</td>
<td>Fees</td>
<td>500.00</td>
</tr>
<tr>
<td>2. Digital Signature</td>
<td>Fees</td>
<td>2600.00</td>
</tr>
<tr>
<td>3. Stamp duty</td>
<td>Memorandum of Association (MoA)</td>
<td>500.00</td>
</tr>
<tr>
<td></td>
<td>Article of Association (AoA)</td>
<td>1000.00</td>
</tr>
<tr>
<td>4. Registration/ filing fees</td>
<td>MoA</td>
<td>16000.00</td>
</tr>
<tr>
<td></td>
<td>AoA</td>
<td>300.00</td>
</tr>
<tr>
<td></td>
<td>Form-1</td>
<td>300.00</td>
</tr>
<tr>
<td></td>
<td>Form-18</td>
<td>300.00</td>
</tr>
<tr>
<td></td>
<td>Form-32</td>
<td>300.00</td>
</tr>
<tr>
<td>5. Fees of CA / CS¹⁶ firm*</td>
<td>Consultancy fees</td>
<td>10000.00</td>
</tr>
<tr>
<td>6. Stamps cancellation</td>
<td>Charge</td>
<td>300.00</td>
</tr>
<tr>
<td>7. Affidavit expenses</td>
<td>Fees of Notary</td>
<td>450.00</td>
</tr>
<tr>
<td>8. Share transfer fees &amp; processing charge</td>
<td></td>
<td>5000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>37550.00</strong></td>
</tr>
</tbody>
</table>

Source: ASA

Note: Fees for CA and CS is driven by market rate

¹⁶ CA and CS denotes Chartered Accounting and Company Secretary firms respectively
CHAPTER 3

ASSESSING THE WORKING CAPITAL REQUIREMENT AND RUNNING COST OF A PRODUCER COMPANY

(This Chapter deals with the various factors to be considered and limitations faced while estimating the working capital and running cost of producers company. There is a detail discussion on the methods of financial assessment in the following chapter)

3.1 The working capital of any business unit is calculated on the basis of the following criteria:

- Requirement of Starting capital (based on the nature and size of business)
- Running cost (Salaries, admin & overheads) of the company
- Cost of furniture & fixtures
- Capital for basic infrastructures like Godown & Machineries etc. (if any)
- Cost of insurance (assets including man-power & machineries)
- Training and capacity building of farmers and PC functionaries

In the following paragraphs it has been attempted to describe the processes or steps to be followed and factors to be considered for estimating the working capital and running cost requirement. It is not possible to estimate the requirement of working capital since it depends on the nature of business and its volume which would vary case to case. However, the processes described here are based on the experiences of ASA while establishing several PCs.

3.2 Assessments of starting capital

It is a kind of capital required for starting of the basic activities of the PC such as initial investment which is mainly required for procurement of raw produce from the producers, storage, transpiration, etc. The quantum of capital would depend on the nature and volume of the business of PC.

For assessment of starting capital, the very first requirement is to identify the business activity and its volume. While calculating the starting capital the following points are to be kept in view:

- No. of producers
- Total expected volume of raw produce to be procured
- Time of the activity (no of days from procurement to sell)
- Purchase price
- Credit limit with the producers
- Cash-in and cash-out projection
- Period of storage and cost
- Transportation cost (producers to company go-down to buyers)
- Grading, if any,
- Any other costs which is specific to the area (statutory requirement. For example, in some states buyers for agriculture produce outside the APMC has to pay certain levy to the APMC for making purchase from the farmers directly)

The above will give an estimate for assessment of starting capital. However, from the experience of ASA it is observed that more than the estimating the starting capital the real challenge for the PC is to mobilize initial starting capital due to the following reasons:

- From the point of view of the financial institutions PC is a commercial entity and therefore all their proposal for financing need a margin money contribution by the PC which they cannot provide due to unavailability of reserves
- PCs are also required to provide collateral for the loan which is again a constraint for a new business entity like PC
- Initially PCs do not have any credentials for doing successful business which also makes the financial institutions uncomfortable for financing.

However, to overcome these initial problems the PCs in ASA have followed a different business model in the initial couple of years before they have generated reserves and credentials. They were:

- The PCs had taken up those business mix which required less or no working capital. Four such examples are given here.
  - supply of agriculture inputs like seeds and fertilizers to its members and also non-members. PCs in this case had taken dealership of seeds and fertilizers from the public and private companies and worked as commission agents on behalf of those companies in supplying materials to the members and also non-members on cash. Because of the significant quantity the PCs could make a good margin and not the least a business relationship with those companies which resulted in getting credit limit from those companies in the subsequent years.
  - The same experience was repeated in the case of procurement of agriculture produce also when the PCs identified the prospective buyers and arranged buy back guarantee from them. Sell was organized at the farm gate level and therefore no transportation and storage cost were involved at the PC level. PC ensured a transparent transaction between the buyers and sellers (members and non-members both) and by doing so they earned some margin from the buyers.
  - Many PCs took the advantage of GoI’s scheme which provide loan against the pledging of Warehouse Receipts (WHR). As per the scheme the bankers extend loan upto 80% of the value of the produce against the pledging of the WHR. This does not require any collateral. This was mainly used for the seed production activity when the PCs had to store the raw seeds for over six months before sell. The seed was produced through the members and procured against 80% of the payment of the value of the produce and rest after the receiving of sell proceeds. Since this activity gives about 25-30% profit margin the PCs could declare in
advance a good premium to the seed producers for which the producers agreed to receive late payment of balance 20%.

- PCs took the dealership from various companies for agriculture implements like water pump sets, mechanized plough, tractor, etc, which they sold to the members at a reasonable price and earned a good margin of profit/commission. There was no need to stock those materials. Implements were supplied on demand.

From the above examples the key learning that can be drawn are:

- Choose those activities in the initial years which require very less capital or no capital and which are risk free. Normally in trading kind of activities such opportunity exists. The point to be noted that majority of the middlemen in the agribusiness invest very little capital of their own.
- It is important for the PCs to learn the trick of the trade and they are also under the pressure of demonstrating success because the success would build their credentials among the members and to other stakeholders. In such condition the activity taken should be small and simple.
- Demonstration of fair trade practices is very important for the PC. These small activities give PCs the opportunity to demonstrate such practices. Both the members and the trade and industry with whom PC does the business appreciate such fair practices and it builds reputation for the PC.

3.3 Running Cost (including the cost of management team):

It is not compulsory for a PC to appoint a team of professional to look after its day to business. They can do it themselves. However, from the experience it is seen that for PC to emerge as a profit making entity the role of professional managers cannot be ignored. The most successful example is the dairy cooperatives in India where professional managers have contributed immensely to make it a success. There are many other examples (viz. ASA’s producer companies, PRADAN promoted poultry and Tasar cooperatives, etc.) which can be quoted in favour of this argument. Not only for business development but the value of professionals is immense in democratise the farmers organisation and strengthening its governing system.

However, how many professionals are required is completely a matter of context and discretionary. The number of professional staff would depend on the volume of business, diversity of activities and geographical spread of the business operation.

Every PC shall have a full time Chief Executive Officer (It is mandatory as per article 581W of Producer Companies Act) who is ex-officio director of board. The Act. has listed key functions of the CEO in the areas of administrative acts including bank account operation, programmatic functions and governance responsibilities. The CEO can be one among the directors or members of the PC.
or appointed by hiring from the market, in such case s/he will part of the management team.

In case of ASA in each PC there is a management team of 2-3 professionals from agribusiness background hired from the market. The senior most of the management team performs the duty of CEO while others look after the production, marketing and accounting job. The management team works under the direction of the BoD and report to them on a day to day basis. The Chairman of the BoD also works as a full time member in the management team and is a co-signatory of the bank account of the PC.

Since there are number of variables therefore it is difficult to estimate the running cost of a producer company. In the table below an illustration of running cost is given based on the experience of ASA. The point to be noted that it is only an illustration, however the reader can take a note of the cost items which are included in the illustration for their use, if at all.

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Expenditure Heads</th>
<th>No. of units</th>
<th>Unit Rate (in Rs)</th>
<th>Total Month</th>
<th>Total Cost (Rs.)</th>
<th>Increment@ 10% /Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Year -1</td>
</tr>
<tr>
<td>1</td>
<td>Salary</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I</td>
<td>Manager/CEO</td>
<td>1</td>
<td>20000</td>
<td>12</td>
<td>240000</td>
<td>240000</td>
</tr>
<tr>
<td>II</td>
<td>Production Officer</td>
<td>1</td>
<td>15000</td>
<td>12</td>
<td>180000</td>
<td>180000</td>
</tr>
<tr>
<td>III</td>
<td>Accountant</td>
<td>1</td>
<td>6000</td>
<td>12</td>
<td>72000</td>
<td>72000</td>
</tr>
<tr>
<td>IV</td>
<td>Marketing officer</td>
<td>1</td>
<td>15000</td>
<td>12</td>
<td>180000</td>
<td>180000</td>
</tr>
<tr>
<td>2</td>
<td>Travel</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>I</td>
<td>Salaried</td>
<td>3</td>
<td>1500</td>
<td>12</td>
<td>18000</td>
<td>18000</td>
</tr>
<tr>
<td>3</td>
<td>Office expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>I</td>
<td>Office Rent</td>
<td>1</td>
<td>3000</td>
<td>12</td>
<td>36000</td>
<td>36000</td>
</tr>
<tr>
<td>II</td>
<td>Electricity</td>
<td>1</td>
<td>1000</td>
<td>12</td>
<td>12000</td>
<td>12000</td>
</tr>
<tr>
<td>III</td>
<td>Water</td>
<td>1</td>
<td>200</td>
<td>12</td>
<td>2400</td>
<td>2400</td>
</tr>
<tr>
<td>IV</td>
<td>Telecommunication Phone /Fax</td>
<td>1</td>
<td>2000</td>
<td>12</td>
<td>24000</td>
<td>24000</td>
</tr>
<tr>
<td>V</td>
<td>Stationary</td>
<td>-</td>
<td>1000</td>
<td>12</td>
<td>12000</td>
<td>12000</td>
</tr>
<tr>
<td>VI</td>
<td>Cleaning</td>
<td>1</td>
<td>500</td>
<td>12</td>
<td>6000</td>
<td>6000</td>
</tr>
<tr>
<td>4</td>
<td>Meeting Exp.of BoD /GB</td>
<td>6</td>
<td>1000</td>
<td>6</td>
<td>6000</td>
<td>6000</td>
</tr>
<tr>
<td>5</td>
<td>License fees, Insurance &amp; Other statutory fees</td>
<td>Lump sum</td>
<td>10000</td>
<td>10000</td>
<td>11000</td>
<td>12100</td>
</tr>
<tr>
<td>6</td>
<td>Other Miscellaneous Expenses</td>
<td>1</td>
<td>500</td>
<td>12</td>
<td>6000</td>
<td>6000</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>804400</td>
</tr>
</tbody>
</table>

Grand Total for three years: 2662564
3.4 Cost of furniture & fixture

A PC will require a minimum office set up with furniture and fixtures like Computer, printer, Almiras, File Cabinet, internets and phone etc. Generally it requires minimum of Rs 1 Lacs for such arrangement and set up of a small office as is experienced in case of ASA. This is once again context specific and no standard cost norm can be prescribed.

However, what is important to note that PC needs a bare minimum office set up for its identity. An office set up and system contribute in creation of its identity which is often overlooked and instead an informality is brought in in the functioning of PC which should be avoided.

3.5 Cost of Infrastructure and Machinery

For commencing any business activities the producer company shall be in need of basic infrastructure including machinery. Needless to mention that nature of business would determine the type of infrastructure required. For a PC involved in agribusiness the basic infrastructure required are like go-down, weighing machine, graders, bag closure machines, etc. These infrastructure can be purchased or can be taken on rent depending upon the situations. In normal case, it is advisable to take them on rent. However, many a times such facilities are not available in the area or services are not upto the mark. Estimating cost for these infrastructures is difficult without a context. Therefore the estimation should be done in real time situation.

However, from the experience it is found that normally the PCs are engaged in the activities of procurement, aggregation and grading of raw produce before sell. Under such condition three basic infrastructures like go-down, grader and power are essential items.

3.6 Training and Capacity building of BoDs and FPC functionaries

This is an important aspect for the growth of the PC and cannot be ignored. The estimation of cost should be based on the annual plan for capacity building including training and exposure visit events.

The requirement of capacity building inputs is again contextual however, in the experience of ASA two formal training and two exposure visits are conducted for the BoD in the first year which costs about rupees one lac. The training are conducted on the provisions in the Act, rules and regulations, statutory compliances, roles and responsibilities of BoD and General body, banking operations, while the exposure visits are taken to the successful PCs where an interactive learning is facilitated.
**Note**: All the costs mentioned above are essential for the running of the PC. All these costs included in the PC will face huge financial burden from the beginning and the idea of setting up PC may not even take off. It is difficult to establish PC without any grant support for initial three years. Except for the starting capital for business the rests are expected to be covered under grant support by the promoting agency at least for three years before the PC can start generating enough surplus to meet those expenses. There is no experience in India where PCs have themselves borne their cost of establishment. The Government of M.P provides grant support to the PC for running cost for three years and one time working capital support of Rs.25 lacs. Support is also provided to the promoting agency for three years to meet their costs. All these support are subject to the performance assessment by an expert committee.
CHAPTER 4
ASSESSMENT OF THE FINANCIAL VIABILITY OF THE BUSINESS OF PRODUCER COMPANIES
(This chapter deals with various methods of assessing financial viability of the business of producer companies)

4.1 Introduction

In this chapter the approach of business plan development is taken. The methods of assessing financial viability is discussed as part of the business plan but in an integral manner with other components of the business plan like marketing plan, etc. In this chapter the fundamentals of business plan have been explained in simple terms. Each of these terms is also explained with the help of examples and calculations. Effort has been made to keep the language and applications simple.

"My business is very small. Do I really need to develop a plan like this?" This is the question that is often asked by owners of small businesses. The answer is, “You need a plan, if you don’t want to remain a small business forever.”

Every business, small or large needs a business plan, more so, in the case of PC and first-time businessmen. In these section you can look forward to writing the blueprint of the business of PC that you plan to support. The topics covered are:

4.2 The Business Planning Process

The business planning process starts with Business Ideas Generation, followed by Opportunities & Threats Analysis leading to Identification of Business Opportunities. Once the Business Opportunity is identified, the Marketing Plan is prepared. The final part of the process deals with the Financial Plan.
4.3 How to generate business ideas?

The first step in business planning is to identify the business opportunity. In our case, the area of business is already chosen, viz., agribusiness for the small producers. We now need to identify the specific business opportunity. This is largely a creative process.

Patterns of Creative Business Opportunity Identification

- **Development of problem-solving products/services**: You hit upon an idea that can be a solution to a problem experienced by farmers. For instance, collective sell of agriculture produce to the bigger market or collective purchase of agriculture inputs like seeds, fertilizers, pesticides, etc. and sell to the producers is a creative idea since it reduces the role of middlemen and ensures quality products and services to the farmers.

- **Exploitation of new technology or material to meet a widely felt need**: Millions of Indian farmers use hand made implements for agriculture like bullock driven wooden plough, bullock cart, thrashing by hands, etc. since they can not afford to own them. An idea of introducing the services of mechanized implements like tractor, thrasher, etc. on rental basis to the small farmers can change the way farming is done and it can be done in a cost-effective way.

- **Creating a demand for Agriculture extension services**: With the poor quality of state's agriculture extension services, the idea could be introduction of Agri-clinic where professional extension services can be provided to the farmers on a reasonable price. Similarly, introduction of products like crop insurance can serve the farmers in a big way.

- **Vision**: This is the ability to look into the future and relentlessly pursue the dream. Dr. Verghese Kurien of NDDB, saw the potential of linking millions of milk producing farmers with the market.

4.3.1 Brainstorming in small groups, is the technique that is generally used in generating ideas for new businesses. This process is done in two phases:

- In the first phase, the emphasis is on generating a large number of ideas, without commenting on the quality of the ideas. The group coordinator must ensure that ideas are not evaluated, but are only recorded in detail.

- In the next phase, ideas are evaluated and a short-list prepared. The criteria for evaluation may even be subjective.

4.3.2 Opportunity and Threat – Analysis & Business Opportunity Identification

Once a shortlist of ideas is generated, it must be critically evaluated with respect to the external business environment for identifying the business opportunity. This is also called Opportunities & Threats Analysis (O/T Analysis) and is used to evaluate whether a business idea is worth pursuing any further.

For every idea short-listed, write down the Opportunities & Threats in terms of:

- Size of the market.
- Its stability, i.e., is the demand for the product/service long term or purely temporary?
- The extent to which the market is unhappy with the existing service / solution.
- Level of competition, high, medium or low.
- Price and quality sensitivity of the market
- Degree of profitability and
- Barriers to entry/exit
- Changes in government’s policies such as subsidy, availability of low cost funds, etc.

At the end of the exercise, the O/T analysis would look like this:

**Table-4: O/T analysis of Marketing of collective produce of small farmers**

<table>
<thead>
<tr>
<th>Factors</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of the market.</td>
<td>Fairly large. The district APMC procures about 10% of the state’s requirement of food gains.</td>
<td></td>
</tr>
<tr>
<td>Its stability, i.e., is the demand for the product/service long term or purely temporary?</td>
<td>With increasing population and growing change in food habit this is unlikely to be affected in the next 20 years.</td>
<td></td>
</tr>
<tr>
<td>The extent to which the market is unhappy with the existing service / solution.</td>
<td>Due to unavailability of options farmers are dependent on the middlemen and unhappy about their unscrupulous practices. The market is sensitive in favour of procuring directly from the farmers.</td>
<td></td>
</tr>
<tr>
<td>Level of competition, high, medium or low.</td>
<td>Low, however, likely to be Medium with the competition from the middlemen as the business grows for the PC</td>
<td></td>
</tr>
<tr>
<td>Price and quality sensitivity of the market</td>
<td>Not very quality conscious, but price sensitive to a certain extent.</td>
<td></td>
</tr>
<tr>
<td>Degree of profitability and Barriers to entry/exit</td>
<td>Medium in the short-run. Barriers to entry and exit are very low.</td>
<td></td>
</tr>
<tr>
<td>Changes in government’s policies such as subsidy, availability of low cost funds, etc.</td>
<td>Favorable policy towards small farmers PC, likely to get subsidy and sympathy of the Government.</td>
<td>Banks do not provide any relaxation for loan to PC, it is hard to get loan from them. This can seriously affect the operations.</td>
</tr>
</tbody>
</table>
Based on the Opportunities & Threats analysis, you can identify a Business Opportunity.

4.4 Marketing Plan
Once the business opportunity has been selected, market analysis follows. The data for the analysis may be obtained from secondary sources such as procurement of the APMC, Policy Guidelines, specific studies conducted by others, etc. It may also be based on market research that has been carried out for this purpose.

The market analysis should cover details about:

- The overall market
- Changes in the market
- Market segments, their attractiveness, profitability
- Target market and customers
- Description of customers
- Competitors – Direct and indirect
- O/T analysis

Following the market analysis, an analysis of the Strengths and Weaknesses (S/W Analysis) of PC’s product and organization should be carried out. It would focus on the following:

- The uniqueness of PC’s product/service with respect to competitor’s
- Reliability and performance of PC’s product
- Customer friendliness
- Quality and promptness
- Payment terms
- Quality of manpower in PC and their experience
- Pricing
- PC’s standing in the market

The Strengths & Weaknesses analysis (S/W Analysis) together with the O/T analysis is called the SWOT Analysis. The O/T analysis helps you analyze the external business environment, while the S/W analysis focuses on the internal business environment, i.e., PC’s product, PC as organization, its competencies and policies.
At the end of the exercise this is how the **Strengths & Weaknesses analysis** would look like:

**Table-5: S/W Analysis of Marketing of collective produce of small farmers**

<table>
<thead>
<tr>
<th>Factors</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>The uniqueness of PC’s product/service</td>
<td>Small farmers’ produce to which the market has positive sensitivity.</td>
<td></td>
</tr>
<tr>
<td>with respect to competitor’s</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reliability and performance of PC’s product</td>
<td>High. It is driven by institutional policy and transparency policies</td>
<td></td>
</tr>
<tr>
<td>Customer friendliness</td>
<td>Ready stocks, no waiting time. Professional dealings</td>
<td></td>
</tr>
<tr>
<td>Quality and promptness</td>
<td>Quality products, no unscrupulous practices like adulteration, etc.</td>
<td></td>
</tr>
<tr>
<td>Payment terms</td>
<td></td>
<td>No credit terms</td>
</tr>
<tr>
<td>Quality of manpower and their experience</td>
<td>Technically qualified and experienced in agribusiness</td>
<td>Not experienced in marketing.</td>
</tr>
<tr>
<td>Pricing</td>
<td>Same as competitor or less</td>
<td></td>
</tr>
<tr>
<td>Your standing in the market</td>
<td>Being a small producers PC there is a sympathy in the market</td>
<td>Not very well known</td>
</tr>
</tbody>
</table>

**4.4.1 Choosing a Marketing Strategy**

After choosing the market segment that you wish to target and having carried out the SWOT analysis, you can make your choice of marketing strategy. The choice depends on a variety of factors including the image that the PC wants to project about the product and the organization, PC’s sales objectives like whether PC wants rapid penetration or is content with slow penetration of the market, etc.

The PC may choose one or more combinations of strategy, but has only the 4 Ps (Product, Price, Place & Promotion – called the Marketing Mix) as its tools to implement the strategy.

In the sections that follow, some of the choices of strategies are discussed for ready reference. The choice is not limited to these, but these are certainly, the more important ones.

**Positioning Strategy**

Once a market has been segmented and a particular segment chosen, the PC has to position the product in the market. This means the PC has to tell the customers about what it is offering and how it is different and better than the competitors.

Positioning is done in three steps:

- Identifying advantages of the product over the competitors,
Selecting the right advantage(s) to project, and finally
Signalling the position to the market.

Basis of Positioning
It is clear that the same product can then be positioned differently, depending on the specific needs of the customer. To understand the basis of positioning, let us look at positioning in terms of a PC’s product in this case Agri-clinic services which it intends to provide to the farmers of a given area:

- **Specific Product Features**: Problem diagnosis and solution, low cost solution, on-farm services, continuous follow up
- **Benefits, problem-solutions or needs**: Services provided within 24 hours after registration, expert suggestions, supply of agro-chemicals which are genuine and at reasonable price,
- **Specific Usage Occasions**: On-farm services. The customer can call the experts to his/her field to discuss the problem and solution
- **User Category**: The services are ideal for small farmers who have small holdings and can not invest much on the farming.
- **Against another services**: The agri-clinic services are more reliable than the Government extension services

Strategies based on Price and Promotion
Price and level of promotional spending are very important tools in achieving market penetration objectives. For instance, if the objective is to quickly gain a large market share, the strategy could be a combination of low price and high decibel promotion, leading to large volume of sales. The market strategies often have to decide on the level of quality and price that it can offer to a chosen market segment as compared to competitors.

Based on the strategies chosen, the Marketing Mix (4 P’s of Marketing) would be formulated and the marketing plan written. It should cover the following:

- Target markets
- Competition
- Environment
- Product /service
- Price
- Place
- Promotion
- Targeted sales in the coming year and projections for the next two years.

A suggested outline is provided here to write the market plan.

THE PC’s MARKETING PLAN

This is the marketing plan of ____________________________________________

I. MARKET ANALYSIS

A. Target Market

1. Who are the customers? Write a brief description of the target customers. (You may write about age, sex, education occupations, occasions of use, frequency of use, income levels, geographic location, etc.)

2. We will be targeting customers by:
   a. Products & Target Customers

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Product line</th>
<th>Target customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

   b. Geographic area? Which areas? ____________________________

3. Expected sales in the coming year

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Months</th>
<th>Product line 1</th>
<th>Product line 2</th>
<th>Product line 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>April</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>May</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>June</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>July</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Aug</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Sep</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
B. Competition

1. Who are our competitors?

   NAME  _____________________________________
   ADDRESS  _____________________________________

   Years in business  ___________________
   Market share  ___________________
   Price/Strategy  ___________________
   Product/Service  
   Features  ___________________

   (Note: write two more competitors using same template)

2. How competitive is the market?

   High  ___________________
   Medium  ___________________
   Low  ___________________

3. List below your strengths and weaknesses compared to your competitor's (consider such areas as location, size of resources, reputation, services, personnel, etc.):

   Strengths  Weaknesses
   1._________________________  1._______________________

<table>
<thead>
<tr>
<th>7</th>
<th>Oct</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Nov</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Dec</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Jan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Feb</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>March</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
C. Environment

1. The following are some important economic factors that will affect our product or service (such as natural calamity leading to failure of agriculture),

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

2. The following are some important legal factors that will affect our market (such as APMC imposes levies for purchase of agri commodities outside the market yard):

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

3. The following are some important government factors (such as, Govt. policies banning inter-state transfer of food commodities, Govt. provides subsidy to procure directly from the farmers etc.):

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

II. PRODUCT OR SERVICE ANALYSIS

A. Description

1. Describe here what the product/service is and what it does:

____________________________________________________________________________________

____________________________________________________________________________________

B. Comparison

1. What advantages does our product/service have over those of the competitor’s (consider such things as unique features, expertise, guaranteed services, on-farm services, etc.)?
2. What disadvantages does it have?

C. Some Considerations

1. Where will you get your materials and supplies?

2. List other considerations:

III. MARKETING STRATEGIES - MARKET MIX

A. Image

1. First, what kind of image do we want to have (such as small producers organization, quality service, professional management, low price, convenience, or ...)?

B. Features

1. List the features that we will emphasize:
   a. __________________________________________________________
   b. __________________________________________________________

C. Pricing

1. We will be using the following pricing strategy:
   a. Markup on cost\textsuperscript{17} _____ What % mark up? ______
   b. Competitive\textsuperscript{18} _____

\textsuperscript{17} \text{Mark up price} = \text{Cost price} + \text{profit desired}
\textsuperscript{18} \text{Competitive price} = \text{Follow the competitors in setting your price}
c. Below competition ____
e. Other ____

2. Are our prices in line with our image?
   YES___  NO___

3. Do our prices cover costs and leave a margin of profit?
   YES___  NO___

D. Customer Services

1. List the customer services we provide:
   a. ____________________________________________
   b. ____________________________________________

2. These are our sales/credit terms:
   a. ____________________________________________
   b. ____________________________________________

3. The competition offers the following services:
   a. ____________________________________________
   b. ____________________________________________

E. Advertising/Promotion

1. These are the things we wish to say about the business:
   ____________________________________________
   ____________________________________________

2. We will use the following advertising/promotion sources:
   1.
   2.
4.5 Financial Plan
The last part of the business planning process is the preparation of the financial plan. It is based on the marketing plan. The topics covered in this section are:

A. Concepts of finance
   - Budget and its importance
   - Fixed and variable costs
   - Working Capital

B. Financial Analysis
   - Break-even sales and BE Analysis
   - Interest rates calculations
   - Net present Value
   - Internal rate of return
   - Cash flow statement

C. Sensitivity analysis
   - Acid test ratio
   - Debt service coverage ratio

4.5.1 What is a ‘Budget’?
For any entrepreneur or business, ‘budget’ is the ultimate tool with which to monitor and keep a control over the business. A budget is a forecast of all cash sources and expenditures. Budgets help to determine how much money you have, where to use it, and whether you can achieve your financial targets. It shows the flow of money into, through and out of the business. The three basic elements of a budget are:

   - Sales revenue
   - Costs and
   - Profits

Sales revenue: Sales revenues are the key figures in any budget. One has to estimate the sales revenues that would accrue to the business as accurately as possible. These should be based upon the past sales records or the industry averages. Once the sales targets have been fixed (as accurately as possible), then the necessary costs can be estimated which would help in realizing the sales revenues.

Costs: Estimating costs in any business is a complicated procedure. Small changes in the assumptions on which the costs are estimated can render the whole budgeting exercise futile. Costs are of two types – ones that change with volumes of sales and ones that do not change. These are called variable costs and fixed costs, respectively.
- **Variable costs**: Variable costs are those that change directly with the sales volumes or with the size of the business. For example, the cost of inventory or raw material is a variable cost. The more you sell, the more raw material you have to purchase and vice-versa. Suppose you are in the business of aggregating the agriculture produces and sell it in the bigger market. The more number of farmers you add to aggregate produce, the more you have to spend on procurement, grading, transportation, etc.

- **Fixed costs**: Fixed costs are those which remain unaffected by the sales volumes. This means that you have to incur them, no matter how much is the sales volume. Rent or certain number of staff hired for the business are good example of fixed costs.

**Profits**: For any business to be viable in the long run, the sales revenues must always be greater than the costs. This difference in the sales and the costs is called profit. Simply put,

\[
\text{Sales} - \text{Costs} = \text{Profits}
\]

Or in other words:

\[
\text{Sales} = \text{Costs} + \text{Profits}
\]

This means that one should target the sales to be of such a volume that it covers all the costs and also have a reasonable amount of profits.

### 4.5.2 What is working capital?

Working capital is the difference between a business’ current assets and its current liabilities. In simple terms, working capital is the amount of money required by a business to cover its short term liabilities. Working capital includes:

- Cash
- Marketable securities
- Accounts receivables
- Inventories
- Accounts payable, and
- Wages/ salaries and taxes

Since any firm or business has about 40% of its capital tied up in current assets, decisions regarding working capital greatly impact business success.

### 4.5.3 How to prepare a Budget?

To prepare a good budget, the following three questions should be answered:
How much net profit (i.e. sales minus costs) do I want the PC’s business to make in the financial year?

How much it will cost (both fixed and variable costs) to generate that profit?

How much sales revenue is necessary to support both profit and costs?

Based upon the answers of the above three questions, the budget can be prepared.

4.5.4 Breakeven analysis

The most commonly used budgeting statement is the ‘breakeven analysis’. In simple terms, this means that one has to find out using the above three answers what should be the sales revenues so that all the costs incurred in the business are recovered. This volume of sales is called the breakeven sales or the breakeven point. The fixed costs that must be recovered from the sales revenues after the deduction of variable costs determines the sales volume required to breakeven. This also means that any amount of sales after this would result in profits for the business. At breakeven point, the total variable costs plus the fixed costs is equal to the total sales revenue. This can be expressed as:

\[ F + V(X) = P(X) \]

Where,
- \( F \) = fixed costs
- \( V \) = Variable costs per unit
- \( X \) = volume of output (in units)
- \( P \) = price per unit

Let us take a simple example to illustrate the above concepts.

Producers company-A (PC-A henceforth) wants to sell agriculture produce Gram to a bigger market. The following would be the costs:

- Cost price of Gram = Rs 3000 per quintal
- Fixed costs per year = Rs 1,00,000 (including rentals, salaries, communication, promotion, etc.)
- Additional variable cost per quintal of produce to be sold = Rs 250 per quintal (including transportation, waste, insurance, etc.)
- The sale price of Gram in open market = Rs 3,600 per quintal

What would be the breakeven sales for PC-A?

Assuming that the breakeven sales is \( V_b \)

The breakeven sales for PC-A would be:

\[ 3600x V_b - 100000 - (3000+250)x V_b = 0 \]
\[ 350 V_b = 100000 \]
\[ V_b = 285.714 \]

This means that PC-A will have to sell more than 285 quintals of Gram in one year to break even.
Now if PC-A also wants to recover the depreciation cost of its machinery (grading plant, generators, etc. of about Rs 10,000 per month) and also make a profit of Rs. 140,000 per year, then the quantity of Gram it will have to sell will be calculated by this formula:
Total sales – total costs = (10,000x12) + 140,000 = Rs 2,60,000

Applying the same formula:
\[3600 \times V_b – 100000 – (3000+250) \times V_b = 2,60,000\]
\[350 \times V_b = 3,60,000\]
\[V_b = 1028.57\]

This indicates that in order to earn a profit and depreciation cost, the PC-A has to sell more than 571 quintals of Gram per year.

A typical break-even chart would look like this:

**Fig-2: A typical Break-even Chart**

4.5.5 Sources of finance

In simple terms, ways and means to raise the capital or money required to be invested in a business is called ‘financing’. There are four basic but different ways to raise capital or funds for investing in any business. These are:

- **Personal financing**: This is the money that PC has ready access to and the PC does not have to pay any interest on. It may be sourced from the reserve and surpluses from the previous years. This is the easiest (but not the best) way to finance the business. However, in case of a new PC this opportunity will not be there.

- **Credit capital**: Credit capital can be obtained from credit companies or from potential buyers who give a grace period before the amount is due or interest
is charged. The producers who sell their products to the PC would not hesitate in giving credit period to the PC if convinced about the soundness of the business idea. On the other hand the PC can get part payment in advance from prospective buyers of certain agriculture produce that PC has made a deal to supply. It can get agriculture inputs from the Agro dealers on the conditions of payment after sales. But mostly this type of finance is not available for start-up businesses or a new venture.

- **Equity financing:** Equity financing does not require the business to directly repay the money lent or invested by the investors. In case of PC the equity comes from the members and no external financier can participate in the equity investment. Being a small producers company the equity contribution is less and it is not a very good source of financing.

- **Debt financing:** This is the most preferred way of financing a new business. Here it is a direct obligation to pay the interest on the money lent by the financier. The biggest advantage is that the financier does not have control over the business as opposed to equity financing. The important point to be noted in this is the rate of interest charged. However, it is not easy to raise debt financing for a producers company without collateral.

- **Grant support:** The PC being a small holders organization may seek working capital support from the Government under certain government schemes (viz. GoMP has a policy for working capital support, SJSY special scheme can provide infrastructure grant to the PC).

This brings us to the next concept, which is ‘interest’ on money borrowed or financed.

**4.5.6 What is interest? What are the various ways of calculating interest?**

Interest is the cost or value of money. In debt financing, there are two main parties – the borrower and the lender. A borrower is the one who receives money from the lender. An interest rate is the amount, usually stated as a percentage, demanded by a lender (or an investor) to make an amount of money available to a borrower to use or invest in his business. Following are the examples of some interest calculations:

If PC-A borrowed Rs 1,000 for 1 year at 12% interest then it has to repay Rs 1,120, at the end of the year. Of this, Rs 1,000 is the principal (abbreviated capital or lower case
P) and Rs 120 is interest (I or i). Together they are called Principal and Interest (abbreviated P & I or p + i).

Whereas, if PC-A were to borrow Rs 1,000 for 1 year at 1% interest per month compounded (meaning paying interest on interest as well as principal) monthly, then he will have to repay Rs 1,127 at the end of the year.

Similarly Rs 1,000 borrowed by PC-A for 2 years at 12% per year, compounded, requires a payment of Rs 1,254 at the end of 2 years.

An interest calculation based on borrowing Rs 1,000 for 5 years at 12% interest per year compounded is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Rs 1000.00</td>
</tr>
<tr>
<td>Add: 12% for Year 1</td>
<td>Rs 120.00</td>
</tr>
<tr>
<td>End of Year 1</td>
<td>Rs 1,120.00</td>
</tr>
<tr>
<td>Add 12% for Year 2</td>
<td>Rs 134.40</td>
</tr>
<tr>
<td>EOY 2</td>
<td>Rs 1,254.40</td>
</tr>
<tr>
<td>Add 12% for Year 3</td>
<td>Rs 150.53</td>
</tr>
<tr>
<td>EOY 3</td>
<td>Rs 1,404.93</td>
</tr>
<tr>
<td>Add 12% for Year 4</td>
<td>Rs 168.59</td>
</tr>
<tr>
<td>EOY 4</td>
<td>Rs 1,573.52</td>
</tr>
<tr>
<td>Add 12% for Year 5</td>
<td>Rs 188.82</td>
</tr>
<tr>
<td>EOY 5</td>
<td>Rs 1,762.34</td>
</tr>
</tbody>
</table>

EOY = End of Year

Hence if the loan is to be repaid after five years, the payment would be Rs 1762.34 of which the principal returned is Rs 1000, whereas the interest is Rs 762.34.

There are three most common methods of loan repayment calculations. These are:

- Interest only – meaning only interests during the loan duration and the last instalment is paid along with the principal amount.
- Equal payments – here the interest and the principal to be repaid are spread evenly for the entire loan term.
- Equal principal payment – in this case, the principal amount is paid in equal instalments, while the interest decreases (based upon the balance principal amount).

Let us assume that the PC-A has managed to borrow Rs.1,50000 from a commercial bank. The bank offers the PC-A about the three plans of repayment (interest only, equal payments and equal principal payments).

Given below is the repayment plan for each of the three options.

<table>
<thead>
<tr>
<th>Year</th>
<th>Yr 1</th>
<th>Yr 2</th>
<th>Yr 3</th>
<th>Yr 4</th>
<th>Yr 5</th>
<th>Yr 6</th>
<th>Yr 7</th>
<th>Yr 8</th>
<th>Yr 9</th>
<th>Yr 10</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Only</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>24000</td>
<td>17400</td>
<td>390000</td>
</tr>
<tr>
<td>Equal Payment</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>31035</td>
<td>310350</td>
</tr>
<tr>
<td>Equal Principal</td>
<td>39000</td>
<td>36600</td>
<td>34200</td>
<td>31800</td>
<td>29400</td>
<td>27000</td>
<td>24600</td>
<td>22200</td>
<td>19800</td>
<td>17400</td>
<td>282000</td>
</tr>
</tbody>
</table>

Given the three options, which option the PC-A should opt for?
To answer the above question, the PC-A could take recourse to calculating **Net present Value** of the future cash outflows in all the three options.

### 4.5.7 What is Net Present Value (or NPV)?

Present Value or PV is a method to calculate what would be the value of a future cash flow if it were to happen today. Here a discount rate (similar to interest rate) is used to calculate the PV. An interest rate looks forward in time. It represents what someone expects to earn in the future. A discount rate serves the same function, except that it works backwards in time, taking a future cash flow and giving it a value today. The Present value is calculated in the following manner:

\[
PV = \frac{A}{(1+D)^T}
\]

Where \( A \) = Amount expected,
\( D \) = Discount rate, and
\( T \) = Time (in years)

If PC-A were to earn Rs 10,000 in 1 year from today, its present value given a discount rate of 12% would be:

\[
PV = \frac{10,000}{(1+0.12)^1} = Rs 8928.57
\]

This means that if PC-A were to earn Rs 8928.57 today, it would be equivalent to getting (cash inflow) Rs 1000 in the next year. Please note that it would also mean that if PC-A were to give Rs 1000 next year (cash outflow), it would be equivalent to giving Rs 8928.57 today.

Similarly, if PC-A were to give Rs1000 in two years time from now, its present value would be Rs 7971.94.

The Net Present Value or NPV is the sum total of present values of such cash outflows or inflows over a period of time. This is used when calculating the present worth of future investments or cash inflows or installment payments.

The formula is as follows:

\[
NPV = A_1/(1+D/100)^1 + A_2/(1+D/100)^2 + A_3/(1+D/100)^3 + \ldots \ldots + A_n/(1+D/100)^n
\]

Where, \( A_1, A_2, A_3, \ldots, A_n \) are the cash flows expected in 1, 2, 3, and \( n \)th year respectively and \( D \) is the discount rate.

In our example earlier, given the three cash outflow scenarios for PC-A, the NPV for each one of them is given below:

<table>
<thead>
<tr>
<th>Table-8: Calculation of NPV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment plan</td>
</tr>
<tr>
<td>Interest Only</td>
</tr>
<tr>
<td>Equal Payment</td>
</tr>
<tr>
<td>Equal Principal</td>
</tr>
</tbody>
</table>

As we can observe, the NPV for all the three payment plans is almost same. This means that for PC-A or for the Bank, the three plans are the same. However, depending upon the paying capacity of PC-A or the money requirement of the Bank, one of the options can be chosen. For example, in plan 1 – Interest Only, the maximum amount is payable only in the 10th year. This may not suit the Bank as it will get far less money during the
initial years to service other loans. Also the risk is higher for the Bank. Most of the repayment plans prefer either plan 2 or 3.

Theoretically, the net present value of a future stream of cash flows (outgoing and incoming) must be positive to justify an investment. In other words, if a project is worth more than it costs (outflows are less than the inflows), its NPV will be positive.

In the example below the NPV has been calculated on three different marketing strategies generating three different cash flow although total cash flow is the same. In such case, a net present value analysis would help the PC-A to compare among the three choices.

<table>
<thead>
<tr>
<th>Table-9: Cash flow-1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yr 0</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>A</td>
</tr>
<tr>
<td>B</td>
</tr>
<tr>
<td>C</td>
</tr>
</tbody>
</table>

Please note that the outgoing cash (in Year zero) is always shown as a negative, as it is an investment.

Looking at these three choices, only two strategies (B & C) have a positive NPV at a 12% discount rate while the third (Strategy A) is negative. This means that even if the three strategies would cost the same (the sum total of all the three cash flows is Rs 1,65,000), the net present value of these is different and the Strategy with the best NPV (Strategy B in this case) should be normally selected over the other two.

Now if the discount rate changes, the NPV would also change. For example if the discount rate is lowered from 12% to 8%, the resulting NPV would be:

<table>
<thead>
<tr>
<th>Table-10: Cash flow-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yr 0</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>A</td>
</tr>
<tr>
<td>B</td>
</tr>
<tr>
<td>C</td>
</tr>
</tbody>
</table>

Now all the three strategies yield positive net present values.

Now if the discount rate changes to 16%, then NPV for the same streams of cash flow would yield the following result:

<table>
<thead>
<tr>
<th>Table-11: Cash flow-3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yr 0</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>A</td>
</tr>
<tr>
<td>B</td>
</tr>
<tr>
<td>C</td>
</tr>
</tbody>
</table>

In this case all of the three strategies yield negative NPV and hence do not appear attractive.

This exercise demonstrates that in financial analysis, and especially in net present value (NPV) analysis, the choice of discount rate is crucial. However for investments,
analysis only on the basis of NPV may lead to faulty outcome and decision as its result hinges crucially on the discount rate adopted. Calculation of discount rate is complicated and requires expert advice. Is there another, easier and a surer method to compare different cash flow streams? Yes, another technique called the Internal Rate of Return or IRR – is used for project analysis or the comparison of cash flow alternatives without having a specific discount rate.

4.5.8 What is an Internal Rate of Return?
An internal rate of return calculation allows you to determine the interest rate that a business will earn on the original amount of capital invested and the expected future cash inflows. In other words it provides the discount rate that a business produces rather than applying a discount rate determined from outside the business. It is calculated by equating the present value of expected cash outflows with the present value of expected inflows. Mathematically it may be represented as:

\[ A_0 = A_1/(1+R/100)^1 + A_2/(1+R/100)^2 + A_3/(1+R/100)^3 + \ldots + A_n/(1+R/100)^n \]

Where \( A_0 \) is the initial investment and \( A_1, A_2, A_3, \ldots, A_n \) are the cash flows expected in 1, 2, 3, and \( n^{th} \) year respectively and \( R \) is the rate or Internal Rate of Return. The internal rate of return – IRR – requires a computer for calculation.

On computer MS Excel programme:
- Enter cash flows in cells
- Open f*
- Choose Financial
- Choose IRR
- “OK”
- Highlight values from Year 0 to Year n
- “OK”
In our example of PC-A’s expected cash inflows from the three strategies, the IRR as calculated with the help of computer is as follows:

<table>
<thead>
<tr>
<th>Strategy</th>
<th>IRR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy A</td>
<td>7.74%</td>
</tr>
<tr>
<td>Strategy B</td>
<td>9.29%</td>
</tr>
<tr>
<td>Strategy C</td>
<td>8.73%</td>
</tr>
</tbody>
</table>

What do these values mean? Or what should be the acceptance criteria?
Here PC-A will have to compare the IRR from the three strategies with the required rate of return. If the IRR is more than the required rate of return, then the proposal would be accepted. For example, if the required rate of return is 12% then the IRR has to be equal to or more than 12% for consideration.

4.5.9 Cash Flow Statement
Cash flow statements show cash inflow and outflow over a period of time and are used for internal planning. If it is an established business, worksheets can be put together
from the actual figures of income and expenses of previous years combined with projected changes for the next period. If it is a new venture, one will have to project the financial requirements and disbursements. The profit at the end of the year will depend on the proper balance between cash inflow and outflow. The cash flow statement identifies

- When cash is expected to be received.
- How much cash will be received.
- When cash must be spent to pay bills and debts.
- How much cash will be needed to pay expenses.

It also allows the manager to identify the source of necessary cash, i.e., will it come from sales and services rendered or should it be borrowed? One has to make sure that the projections take into account receivables and how long it will take the customers to pay. The cash flow statement deals only with actual cash transactions and not with depreciation or other non-cash expense items.

A cash flow statement can be prepared for any period of time. It should be prepared on a monthly basis for the next year and revised not less than quarterly to reflect actual performance in the preceding three months of operations.

**Preparing Cash Flow Statement**

The vertical columns of a cash flow statement represent the twelve months, preceded by a total column. Horizontal rows on the statement contain figures for the sources of cash and cash to be paid out copied from the two previous worksheets and from individual budgets.

The figures are projected for each month, reflecting the flow of cash in and out of the business for a one-year period. Begin with the first month of the business cycle and proceed as follows:

- Project the beginning cash balance. Enter under the first month of the business cycle.
- Project the cash receipts for the first month.
- Add beginning cash balance and cash receipts to determine total cash available.
- Project the direct, indirect and interest expenses for the first month.
- Project monies due on taxes, long-term assets and loan repayments. Also project any amounts to be drawn by owners.
- Total all expenses and draws. This is total cash paid out.
- Subtract total cash paid out from total cash available. Enter the result under cash balance/deficiency. If the result is negative, be sure to bracket this figure.
- Project loans to be received and equity deposits to be made. Add to cash balance/deficiency to get ending cash balance.
- Carry forward the ending cash balance for January as February's beginning cash balance.
- Repeat the process through the last month of the business cycle.

To complete the total column, proceed as follows:
- Enter the beginning cash balance for the first month in the first space of the total column.
- Add the monthly figures for each category horizontally and enter the result in the corresponding total category.
- Compute the total column in the same manner as each of the individual months. If you have been accurate in your computations, the December ending cash balance will be exactly the same as the total ending cash balance.

An example of cash flow statement is given below:

<table>
<thead>
<tr>
<th>Cash Flow Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of business &amp; PC : _____________________ Projected / Actual Date:_______</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Cash sales</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>First of Month</td>
</tr>
<tr>
<td><strong>CASH IN</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Cash Sales</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>A/R Collections</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Interest income</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Sale of Fixed assets</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans received</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other cash sources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL CASH IN</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| **CASH OUT**          |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Inventory & Raw mat.  |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Salaries & Wages      |     |     |     |     |     |     |     |     |     |     |     |     |       |
| General supplies      |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Rep & Maintenance     |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Travel                |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Shipping & Delivery   |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Legal & Account. Fees |     |     |     |     |     |     |     |     |     |     |     |     |       |
| Telephone, rent       |     |     |     |     |     |     |     |     |     |     |     |     |       |
Utilities
Interest Charges
Taxes
Other operating expen.
Loan Repayments
Fixed Asset Payments
Capital Expenditures

**TOTAL CASH OUT**

End of Month

**CASH FLOW**

**CASH Balance**

**Operating Data**

Sales Volume
Accounts receivables
Bad Debts
Inventory on Hand
Accounts Payable
Depreciation

### 4.5.10 Sensitivity analysis

After having learnt all these concepts, how can we evaluate the performance of PC-A’s business? One of the measurements of the financial condition and performance of a business venture is a ratio or index, which relates two pieces of financial data from the business. There are several indices which can be used, here we would be discussing only two of the most commonly used ones, namely, acid test ratio and debt service ratio.

**Acid test ratio**

Acid test ratio or Quick ratio is the measure of the ability of the firm to be able to meet short-term obligations. This is a ratio of the current assets of the firm to its current liabilities. The current assets include cash and bank balance, short-term marketable securities and debtors/receivables. It may be noted that the inventories already lying with the firm are not included in the current assets. This ratio is the best available measures of the liquidity position of a firm. Usually an acid test ratio of 1:1 is considered satisfactory as a firm can quickly meet all its current or short-term liabilities.

**Debt Service Coverage**

While acid test ratio is a measure of the ability of a firm to pay off its current liabilities, the Debt Service coverage ratio is a measure of the firm’s ability to meet long-term obligations. This ratio is expressed as the amount a project pays (or proposes to pay)
each year for principal and interest on the debt/loan; that is, the amount of debt service to be paid when compared with the funds available to pay that debt service.

If PC-A’s income is Rs 100,000 and its operating expenses are Rs 50,000 it has Rs 50,000 available to pay principal and interest on loans (debt service). If the PC borrows Rs 1,50,000 for 10 years at 16% interest with equal payments every year, its obligation is Rs 31,035. When compared to the Rs 50,000 available for debt service the project has what is called a 1.6 times debt service coverage or debt service coverage ratio or DSCR (arrived at by dividing Rs 50,000 by Rs 31,035).

In real life however, the projects do not have such uniform debt service coverage calculations. For this reason we must look at what is called Average Debt Service Coverage (the sum of all the year’s available amounts divided by the sum of all the debt service payments) and examine the coverage ratios of each year. We should then focus on the years when the debt service coverage is the lowest as well as the average DSCR.

Why is the debt service coverage ratio important and how are they used?
DSCR is important because they tell a lender what excess funds exists in the event revenues or expenses are less or greater than estimated in a project. Most lenders have a specific cut-off ratio that must be met for both average and lowest year debt service coverage. If a business cannot meet these tests then the options with the borrower could be:

- Lowering the amount to be borrowed (and increasing the amount of equity that needs to be put in a project).
- Setting up reserves or credit agreements to pay the shortfall amount in the specific year.

Essentially Debt Service Coverage calculations determine how much debt a project can afford. Combined with IRR, these two tools assist the entrepreneur to determine the business viability.

4.6 Writing a Business Plan
Now that we have completed our marketing and financial plans, we are now ready to write out the business plan.

4.6.1 What is a business plan?
The business plan is a succinct document that specifies the components of a strategy with regard to the business mission, external and internal environments and problems identified in earlier analyses. A business plan is not written each time a modification to a strategy is made. It should be written when you develop a new venture or launch a major new initiative. The business plan serves several important purposes:

- It helps determine the viability of the venture in a designated market.
- It provides guidance to the entrepreneur in organizing his or her planning activities.
- It serves as an important tool in helping to obtain financing / funding.
A well-written business plan also will provide broad parameters upon which progress toward goals can be assessed and control decisions made at a later time.

4.6.2 What are the elements of a business plan?

- **Introduction & Executive Summary**: A typical business plan begins with a brief introduction followed by an executive summary. The *executive summary* is prepared after the total plan has been written. Its purpose is to communicate the plan in a convincing way to important audiences, such as potential investors, so they will read further.

- **Industry Analysis**: An *industry analysis* usually follows the executive summary. This section communicates key information -- the collection of which was discussed earlier -- that puts the venture or plan into the proper context.

- **Marketing Plan**: The *marketing plan* is the first step in developing any new strategy. It is developed within the context of the PC’s goals and should be based on a realistic assessment of the external environment, as discussed earlier. The marketing plan is written first because marketing decisions typically determine resource needs in other areas. Obviously, a decision to seek a large share of a market will require a significant commitment of resources of various kinds. How you choose to promote and distribute your product or service will have clear ramifications for your organizational, production, human resource and financial plans.

- **Financial Plan**: The *financial plan* underpins this entire system of plans. Three financial areas are generally discussed.
  - Financing pattern
  - Cash flow statement
  - Three year income statement

Usually an *appendix* is included in a business plan. This generally contains supporting information, documents and details that would interfere with clear communication in the body of the plan. Examples of this type of information include price lists, economic forecasts, demographic data and market analyses.

4.6.3 Tips on writing a business plan

The text of a business plan must be concise and yet must contain as much information as possible. This sounds like a contradiction, but you can solve this dilemma by using
the Key Word approach. Write the following key words on a card and keep it in front of you while writing:

**Who**  **What**  **Where**  **When**  **Why**  **How**  **How Much**

Answer all of the questions asked by the key words in one paragraph at the beginning of each section of the business plan. Then expand on that statement by telling more about each item in the text that follows.

There is no set length to a business plan. The average length seems to be 30 to 40 pages, including the supporting documents section. Break the plan down into sections. It takes discipline, time and privacy to write an effective business plan.

You will save time by compiling your list of supporting documents while writing the text. For example, while writing about the legal structure of your business, you will realize the need to include a copy of your partnership agreement. Write partnership agreement on your list of supporting documents. When compiling that section of your plan, you will already have a list of necessary documents. As you go along, request any information that you do not have, such as credit reports.

With the previous considerations in mind, you are ready to begin formulating your plan. Read through this entire publication to get an overall view of the business planning process.

### 4.6.4 Suggested Outline of a Business Plan

I. **Cover sheet**
   Serves as the title page of your business plan. It should contain the following:
   - Name of the Producer company
   - Company address
   - Company phone number (include area code)
   - Logo (if you have one)
   - Names titles addresses phone numbers (include area code) of CEO/Board of Director
   - Month and year your plan was issued
   - Name of preparer

II. **Brief description of the business**
   Gives a brief description of the business idea. What you propose to do? Why you think you would be successful?

III. **Table of contents**
   A page listing the major topics and references.
IV. Marketing Plan
Covers the details of your marketing plan. Include information about the total market with emphasis on your target market. Identify your customers and tell about the means to make your product or service available to them.

- **Target market**: Identify characteristics of your customers. Tell how you arrived at your results. Back up information with demographics questionnaires and surveys. Project size of your market.
- **Competition**: Evaluate indirect and direct competition. Show how you can compete. Evaluate competition in terms of location market and business history.
- **Place**: Tell about the manner in which products and services will be made available to the customer. Back up decisions with statistical reports rate sheets etc.
- **Promotion**: How will your advertising be tailored to your target market? Include rate sheets promotional material and time lines for your advertising campaign.
- **Pricing**: Pricing will be determined as a result of market research and costing your product or service. Tell how you arrived at your pricing structure and back it up with materials from your research.
- **Product**: Answer key questions regarding product design and packaging. Include graphics and proprietary rights information.
- **Timing of market entry**: Tell when you plan to enter the market and how you arrived at your decision.
- **Targeted sales**: State the sales targeted for the next 3 years. The first year’s sales may be presented month-wise.
- **Industry trends**: Give current trends project how the market may change and what you plan to do to keep up.

V. Financial documents
These are the records used to show past, current and projected finances. The following are the major documents you will want to include in your business plan. The work is easier if these are done in the order presented.

- **Cash flow statement (budget)**: This document projects what your business plan means in terms of rupees. It shows cash inflow and outflow over a period of time and is used for internal planning. Cash flow
statements show both how much and when cash must flow in and out of your business.

- **Three-year income projection**: A pro forma income statement showing your projections for your company for the next three years. Use the pro forma cash flow statement for the first year’s figures and project the next according to economic and industry trends.

- **Break-even analysis**: The break-even point is when a company’s expenses exactly match the sales or service volume. It can be expressed in total rupees or revenue exactly offset by total expenses or total units of production (cost of which exactly equals the income derived by their sales). This analysis can be done either mathematically or graphically.

- **Debt-service Ratio**: The Debt Service coverage ratio is a measure of the firm’s ability to meet long-term obligations. This ratio is expressed as the amount a project pays (or proposes to pay) each year for principal and interest on the debt/loan; that is, the amount of debt service to be paid when compared with the funds available to pay that debt service.

VI. SUPPORTING DOCUMENTS

- Brief profile of the PC and Resumes of the key Director/CEO
- Copies of Leases, if any
- Letters of Reference
- Contracts / work order / MoU for selling produces, etc.
- Legal Documents (registration, business license, etc.)
C H A P T E R  5

ASSESSING INSTITUTIONAL PERFORMANCE OF PRODUCER COMPANY
(This Chapter describes some practical tools that can be used to measure the health of the producer companies)

5.1 A method of institutional assessment of producer company, namely, Framework of Participatory Assessment of Institutional Performance of PC, has been discussed in the following section. This method is used frequently by ASA to assess the institutional performance of the PC time to time. Based on the findings of the assessment capacity building strategy for the PC is developed or modified.

5.2 Framework of Participatory Assessment of Institutional Performance of PC

The framework is comprised of a set of Criteria and Institutional Maturity Indicators, considered important for quality checks to ensure that the formation process and functioning of PC is such that it contributes towards strengthening of the governing system of the PC. A suggestive set of criteria and IMIs are given below.

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>INDICATORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Characteristics</td>
<td>• Size. Is the size good enough to be viable and socially cohesive</td>
</tr>
<tr>
<td></td>
<td>• Social homogeneity: kinship or other social ties, absence of dependency relations.</td>
</tr>
<tr>
<td></td>
<td>• Not dominated by politically / economically powerful members</td>
</tr>
<tr>
<td></td>
<td>• Poor and women are included (if mandated)</td>
</tr>
<tr>
<td>2. Identity &amp; structure</td>
<td>• Members know the purpose of forming PC</td>
</tr>
<tr>
<td></td>
<td>• Members represent their households.</td>
</tr>
<tr>
<td></td>
<td>• There is continuity in household representatives.</td>
</tr>
<tr>
<td></td>
<td>• All members can give an account of all the PC’s activities.</td>
</tr>
<tr>
<td></td>
<td>• All members can give an account (General) of the PC’s finances</td>
</tr>
<tr>
<td>3. Leadership</td>
<td>• Leadership roles change, fixed tenure</td>
</tr>
<tr>
<td></td>
<td>• Leaders have been elected/selected by the members.</td>
</tr>
<tr>
<td></td>
<td>• Selection/election of leader based on desired characteristics</td>
</tr>
<tr>
<td>4. Functioning</td>
<td>• PC has a set of rules (bye laws) which has been discussed and agreed and sanctions for rule breakers.</td>
</tr>
<tr>
<td></td>
<td>• Regular BOD meeting and AGM take place with significant attendance.</td>
</tr>
<tr>
<td></td>
<td>• The majority of members (X%) contribute to BOD / AGM discussion and decision making.</td>
</tr>
<tr>
<td></td>
<td>• Up to date maintenance of records and statutory compliances</td>
</tr>
<tr>
<td>5. Independence</td>
<td>• X% meetings of BOD / AGM regularly take place in the absence of promoting institution or with diminishing support</td>
</tr>
<tr>
<td>(in proportional to the age of the PC)</td>
<td>• Records are maintained without or with little support from the promoting agency (PA)</td>
</tr>
</tbody>
</table>

53
### Table 13: Criteria and indicators for assessing PC formation process and functioning

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>INDICATORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Resource mobilization</td>
<td>• PC raises fund to carry out business</td>
</tr>
<tr>
<td></td>
<td>• Overheads expenditure met with the own resources</td>
</tr>
<tr>
<td></td>
<td>• Reserve funds builds up to X %</td>
</tr>
<tr>
<td></td>
<td>• PC mobilises specialist skills or services from the government and private sources</td>
</tr>
<tr>
<td></td>
<td>• PC obtains govt. scheme to meet identified needs (convergence with other schemes)</td>
</tr>
<tr>
<td>7. Resource Management</td>
<td>• PC develops business plan and implementation is as per the plan</td>
</tr>
<tr>
<td></td>
<td>• PC has shown ability to negotiate with the various stakeholders</td>
</tr>
<tr>
<td></td>
<td>• PC effectively oversees/ manages the work of Executives working as salaried persons</td>
</tr>
<tr>
<td></td>
<td>• Budget control</td>
</tr>
<tr>
<td></td>
<td>• Transparency</td>
</tr>
<tr>
<td>8. Skill acquisition &amp; use</td>
<td>• X% of BOD members have attended training programmes (including specialised training)</td>
</tr>
<tr>
<td></td>
<td>• BOD has used planning skills to identify and solve operational problems.</td>
</tr>
<tr>
<td>9. Distribution of benefits</td>
<td>• Equitable distribution of benefits (dividends and services)</td>
</tr>
<tr>
<td></td>
<td>• Mechanism of benefits sharing developed and adhered to</td>
</tr>
</tbody>
</table>

Against each of this criteria and associated indicators the institutional performance of the PC can be assessed in different time frame. The timing of the assessment is context specific and therefore difficult to prescribe. However, it is suggestive that it can be used for some criteria in the beginning and repeat exercise can be conducted once in a year.

It is desirable that the assessment is done in a participatory manner, especially involving the members of the BoD, so that they get the maximum benefits by this assessment in the form of discussion, on the spot analysis, etc. This analysis would help the BoD to identify their strength and limitations for course correction. Hence, the process of facilitation is crucial.

Since the assessment is qualitative in nature therefore the facilitator for this assessment may choose to use different scales viz. 1 to 10 or attributes like very good, good, satisfactory, poor, etc. to bring in some amount of objectivity to the exercise.