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Inclusive capitalism
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On a drizzly Friday morning, on June 20, 2008, in Chanderi town of Madhya Pradesh's Ashok Nagar district, scores of people from the local weavers' community are gathering at Sri Kunj guest house for an important business meeting. Their number will swell to about 250 by the time the meeting starts at 11.30 a.m. In the next hour or so, these men and women, who represent the nth generation of an age-old tradition of handloom work, especially known for the famous, silk-and-cotton Chanderi sarees, will have their first experience of the ways of a modern business organisation.

As shareholders of DAH Chanderi Ltd, attending the first Annual General Meeting of the company, they will listen to the directors talking about not only things like quality control and timely production, but also less familiar matters such as balance sheet, profit and loss account, dividend, and change of auditors. The directors of DAH Chanderi will also call for the approval of all resolutions, giving the weavers (including those who are barely literate) a first-time feel of the statutory privileges of the shareholder of a company.

The weavers' acculturation to the formalities of a corporate organisation is, after all, one of the important objectives in establishing DAH Chanderi, one of the 17 "supplier-region companies" (SRCs) set up across India by Fabindia, the Delhi-headquartered Rs 260 crore retailer of handloom garments and handicrafts.

These SRCs, also described as "community-owned companies", are part of Fabindia's ambitious plan to organise its expanding supplier base into corporate entities and enable thousands of homebased artisans in rural areas, who are mired in economic backwardness, to become shareholders.

Up to June-end 2008, DAH Chanderi and other SRCs had sold shares at par value of Rs 100 per share to about 9,000 artisans, who also get assured Fabindia orders through these companies. The 86-store strong retailer plans to set up dozens of more SRCs and sign up a total of at least one lakh artisan-shareholders by 2010 in step with its own expansion and in line with Managing Director William Bissell's vision.

Change in Chanderi

At the AGM of DAH Chanderi, the general mood is that of a happy social gathering. Manu Hasija, the CEO and a Director of DAH Chanderi, has even arranged samosas and tea. At the entrance, two men busily check the identities of a crowd of shareholders—some of them have come with their children—before allowing admission.

Lending more importance to the occasion is the presence of the media (the local press and this Business Today writer and his photographer colleague) and even two representatives of the International Finance Corporation (IFC), the private sector arm of the World Bank, who are here as interested observers.

“Since you have been facing the problem of not getting the right quality of cotton yarn at the right price, we have arranged to get all our supplies from Coimbatore. All the weavers we have spoken to are very happy with quality and price of the Coimbatore yarn,” Prakash Tripathi, Director of Artisans Microfinance (AMFL), Fabindia’s investment arm and main promoter of the SRCs, tells the weavers, who respond by clapping.

More clapping follows as Tripathi reads out in Hindi the numbers— turnover: Rs 1.08 crore, PAT: Rs 2,20,000, and (most importantly) a dividend of 10 per cent—from the audited annual report. “On an average, DAH Chanderi has been getting orders worth Rs 37 lakh a month from Fabindia. This will expand as orders from Chanderi increase and other handicraft centres in Madhya Pradesh, such as Bagh and Maheshwar, chip in,” Tripathi, also a Director in the SRC, later tells this writer.

fabindia

By the numbers

Sales turnover in 2007-08
Rs 260 crore

Growth in sales
35-40 %

Gross margin
About 40 %

Retail presence
86 stores in 39 cities

Currently sources from 22,000 artisans
(in ‘almost all states’)

Plans to source from 100,000 artisans by 2010

Plans to make 100,000 artisan shareholders by 2010

Top 4 sourcing states

The company has been coordinating with the weavers to get Fabindia’s orders fulfilled, control quality, arrange for some common production resources (such as dyeing and plying of yarn, sewing for home linen fabric, even packaging) and logistics.

Currently operating from rented premises, DAH Chanderi has also purchased land where it plans to build a “resource centre” (a kind of R&D centre) and other facilities. Shoib Ansari, one of the two representatives of the weavers on the board of directors of the SRC, says Fabindia’s entry into Chanderi has meant diversification of products away from sarees (and so more demand), fair and transparent pricing of fabric, assured orders, and the promise that DAH Chanderi will address the production-related problems faced by all weavers, such as sourcing of yarn. Mano Bai, a middle-aged, illiterate woman, proudly shows this writer her share certificate and a dividend cheque of Rs 100, received for the 10 shares that she holds in DAH Chanderi. (Many of the weaver-shareholders don’t have bank accounts to deposit their cheques. After the AGM, Tripathi is besieged by people wanting him to get their bank accounts opened).

‘Community-owned’ companies

“Most of the artisans we work with have never known any income source in their lives other than a daily or per-piece wage. It’s a huge leap for them to own shares in a company,” says Smita Mankad, the MD of AMFL, who is busy stabilising

Andhra Pradesh, Uttar Pradesh, Rajasthan and Gujarat

the operations of 17 SRCs that have been set up in India's craft-rich regions since October 2006.

The articles and memorandum of association of an SRC allow up to 49 per cent of the equity to be held by AMFL, 26 per cent by artisans, 10 per cent by employees, and 15 per cent by external investors, which tend to be social venture capital funds. The authorised capital of an SRC, whose board has one or two artisan-directors, ranges from Rs 40 lakh to Rs 1 crore. "The idea is to offer shareholding at par value to as many individual artisans as possible, rather than shareholding by artisans' groups, trusts, or NGOs, who will generally have to buy at premium," says Tripathi. External commercial investors are also showing interest. Aavishkaar Micro Venture Capital Fund, for example, has so far bought into four SRCs at a premium of 3-4 times the par value of a share. "We plan to make equity investment in three more SRCs," says Vineet Rai, the CEO of the Mumbai-based VC fund.

Mankad says the companies have been set a collective turnover target—Rs 175 crore for 2008-09—that's linked to Fabindia's turnover and planned to become operationally profitable by the end of the current fiscal.

While for now the SRCs, whose number will increase "according to needs", only supply to Fabindia, they will also be allowed to deal with other buyers in the domestic and export markets in future, she adds. The retail company also envisions diluting its shareholding in SRCs as they mature and allowing the artisan-shareholders to increasingly take care of their businesses.

What is an SRC?

Fabindia has set up 17 supplier-region companies (SRCs) for the purpose of aggregating its artisan-suppliers and making them shareholders. Also described as community-owned company, these companies get assured orders from Fabindia. The retail company has introduced a share valuation and trading mechanism to allow shareholders to realise the value of their stock. The number of SRCs is currently 17 and is set to go up. The collective turnover target set for the SRCs for 2008-09 is Rs 175 crore.

Five of the large SRCs in terms of Fabindia sourcing are listed alongside.

Name of the company
Geographical area covered

Desert Artisans Handicrafts

Creating value

"SRCs create value for memberartisans in three ways: they give the crafts people sustainable jobs, an investment opportunity, and appreciation in the value of their shares," says Bissell, a champion of market-based models for helping small producers, and who's also the son of Fabindia's American founder John Bissell.

Aavishkar's Rai says SRCs represent a "fairly bright innovation" of aggregating rural producers, giving them ownership in the business, and also providing technical and managerial inputs to sustain these businesses. "What Fabindia's brand, buying power, managerial inputs and finance that comes with them can do are something that just a group of producers cannot do. These SRCs already have assured orders from Fabindia. They simply have to get their production right, which I hope will also create great shareholder value in 5-6 years' time," says Rai.

Meanwhile, Fabindia has worked out a share-trading mechanism as a means of providing liquidity and realising value for SRCs' fast growing base of artisan-

Jodhpur
11 districts in Rajasthan

Desert Artisans Handicrafts Bhuj
7 districts in Gujarat

Bijnor Artisans
5 districts of Uttar Pradesh

Deccan Crafts & Weavers
Karnataka

Krishna Weavers & Artisans
Andhra Pradesh

shareholders. “We have a formula for valuing the shares, certified by the auditors and based on the turnover and profitability of the company. We open the share-trading window at certain intervals and every shareholder gets the option of buying, selling or holding shares,” says Mankad.

After shareholders are informed of the prevailing share price, their responses are obtained in writing. “We then match the buyers and the sellers. In case bids are more than the shares on offer, we’ll do pro rata allocation of shares to the bidders. The share certificates are endorsed in the purchaser’s name.

The entire cycle is completed in that share-trading window.”At the AGM of DAH Chanderi Hasija, the CEO, informs the shareholders that the price of their Rs 100 share has climbed to Rs 147!

The genesis of SRCs

For Fabindia, the SRCs are turning out to be a hugely exciting experiment in ‘inclusive capitalism’ involving the handloom and crafts sector, which has long been languishing despite large government intervention, grants and subsidies. An SRC is a for-profit corporate entity, not a cooperative (which has long been the model favoured by the government for the rural economy) or any ‘informal’ business organisation whose nature could be at odds with its commercial objectives.

The origins of SRCs go back to early 1990s, when Fabindia was primarily an exporter with only one store in Delhi. In 1991, the young Bissell, freshly back from the US, had incorporated Desert Artisans Handicrafts (DAH) in Rajasthan as an organisation that would organise rural artisans, improve their lot and develop for Fabindia a strong supplier base for handloom fabric and other craft products. In the subsequent years, the work of DAH, which supplemented Fabindia’s pre-existing supplier base, would spread from Rajasthan to Gujarat, Madhya Pradesh, and other states; the company would eventually splinter into the present-day SRCs.

The right model

Over the 1990s, Bissell got a better sense of the main problems faced by rural artisans—unorganised production, low productivity, inadequate finance, and very weak market linkages. Bissell gained another insight into the rural economy. “In rural India, age-old social relations are often a determinant of people’s economic performance.

For example, in Rajasthan and Gujarat only a person from Meghwal caste can sell land to another Meghwal.” He also became increasingly convinced that government interventions and promotion of cooperatives don’t help the artisans. “A lot of poverty in the rural areas is because of the fact that there are very few ways for people to own assets or property. It’s difficult to divide land or a tractor, for instance. There are not many divisible assets to own,” says Bissell.

The cooperative model of business organisation is based on the ideal of collective ownership and decision-making. In co-ops, each member has one vote regardless of his investment in the business, governing boards are elected by vote rather than share-holding, and so a business is always vulnerable to politics and intrigue. "Cooperatives do well in aggregating small producers… in making the whole more than the sum of all. But they do not allow individual ownership of property, discouraging entrepreneurship and more and better production. And so they also do little to alleviate poverty."

Bissell, however, was smart enough to learn his lesson from cooperatives and incorporate it into designing his own solution for the development of the handicrafts sector—a company in which artisans will be the shareholders. Like a cooperative, a company also aggregates small producers into organised bodies. But a company also allows them to hold shares ("divisible assets" whose value varies with the company's book value and which can be made saleable through a system of trading), thus making them part-owners.

Challenges

Aavishkar's Rai says he is not sure if artisan-shareholders in SRCs would be able to realise much value in their shares in the first 2-3 years, even though the premium that his fund has paid in buying into the four SRCs has already caused "distinct" appreciation in their share values. "But after 3-4 years, Fabindia's sharetrading window could be recognised as a novel mechanism for creating liquidity in quite illiquid assets of these unlisted companies."

Mankad says till such time when India acquires "many micro-stock exchanges" for small and rural companies, the share-trading mechanism of the SRCs will work to create value for the artisan-shareholders. The SRCs also face the difficult challenge of paying handsome dividends to demonstrate to the artisanshareholders that there is value appreciation in their investments and yet generate capital for fast growth. Their ability to meet this challenge will depend on how well they manage their debt, says Rai.

Looked at closely, Fabindia's SRC model also reveals some serious conflicts of interest; the retailer is a shareholder in an SRC as well as a buyer and an artisan is selling his product and labour to an SRC and is also a shareholder in that company. "In a classical sense, there is a conflict of interest in this model. But you can't conduct this experiment without this conflict of interest. How else can you open so many SRCs and create benefits on all sides?" says Rai. "I believe as long as you can create value for all sides, even if unequal, you are doing a great job."

It will be interesting to see how Bissell's bold experiment shapes up in the years ahead.

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