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# The Dilemma in Controlled Environment

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The case is about the problems faced by the top management of a co-operative dairy in the state of Gujarat. Being a co-operative dairy and governed under archaic, colonial cooperative legislation, the dairy does not have authority to make decisions regarding what to produce, how much to produce, where to market the products, at what price, and the like. All these major decisions are taken either by the state federation or by the Registrar of co-operatives. On the hand, the industry is also opened for the private players, which further increases the competition and problems faced by the co-operative dairies. The case covers few aspects like product profile, key landmarks, marketing and finance challenges, future plans and competitive scenario in the Indian dairy industry. It may be helpful to understand the Indian dairy industry, environment in which the co-operative dairies operate and various challenges faced by the co-operatives.

**Keywords:** Marketing and finance challenges, Competition, Strategy.

**Background:**

Classic Co-operative Dairy Limited (Classic Dairy) was established on August 15, 1954 with the main objective of up-liftment of farmers under leadership of Mr. Krishnakant Amin, the founder chairman.

The move received huge response from the farmers and small-scale cooperative societies but, faced some financial crisis right after its inception. It received a loan of Rs. 3 crore under 'Operation Flood – I' programme for capacity expansion and infrastructure development.

Loyal and efficient leaders made the dairy a recognized one within very short span of time. During the flush season of 1985-86 daily collection of milk was 4.47 LLPD<sup>1</sup> (against the installed capacity of 4 LLPD) from 1131 primary milk co-operative societies and chilling centers.

Acquiring land of 65 acres on National Highway near Karjan Village of Bharuch, Narmada District, Gujarat state, India costed them a lot. So, to increase installed capacity of chilling center to 30,000 liters of milk per day near by Panoli area they, took finance from Small Farmers Development Agency (SFDA) of Rs. 50 lakhs.

**Key Landmarks (Achievements):**

The dairy got quality certification ISO 9001-2000 and an Environmental Management System ISO 14001 certification. In addition, it had also received 'National Productivity Award' for 6 times for achieving outstanding performance in effective utilization of manpower, machinery, material and money as well as maintaining the highest standard of quality, preserving environment, food safety & productivity in quantities and qualitative parameters.

Other awards and achievements like 'State Safety Award' and 'Certificate of Merit' by National Productivity Council made the dairy to recognize nationally.

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<sup>1</sup> LLPD- Lakhs Liters Per Day

The dairy had adopted Japanese Total Quality Management. This adoption brought 12052 Kaizens as well as 14 Small Group Activities (SGA). Moreover, Kaizen helped to reduce the production cost and increased efficiency level.

### **Product Profile:**

The Classic Dairy was one of the milestones in the state of Gujarat as milk processing co-operative society. The dairy procured raw milk from village co-operative societies, which operated their business at respective village levels. The milk procured from village co-operative societies underwent processing through automated plants and finally it produced basket of products, like pasteurized milk, lassi, buttermilk, flavoured icecream, dahi, shrikhand, mava, ghee, paneer, baby powder, dry milk powder etc.

The dairy manufactured various products mentioned above by following quality standards prescribed by NDDB<sup>2</sup> and SMMF<sup>3</sup>.

Classic dairy engaged in production as per schedule given by SMMF, but dairy had right to produce as per its convenience in case of excess procurement. In case of milk procurement in excess of dairy's installed capacity, the excess milk had been transferred to Best dairy, a unit of SMMF.

Procurement of milk was based on provisional prices decided by dairy. Procurement of milk by village level societies after some minor test of quality transferred to the dairy via chilling centers if required. After collecting milk from all village level societies, transport contractors brought the milk to the dairy within specified time. Dairy had the policy to make payments

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<sup>2</sup> National Dairy Development Board

<sup>3</sup> State Milk Marketing Federation

Adoptions of TQM  
fetched the certificate for  
high standards of  
Hygiene by Defence  
Services in India as well  
as Promotion Council of  
India.

on the basis of quality and quantity of milk received, irrespective of parties involved, i.e. milk collection centre or the transporter. The village cooperative societies were paid Re. 0.25 per litre commission for their services.

Classic dairy engaged its whole staff in procurement and processing of milk and providing finished goods as per SMMF's predefined schedule. SMMF gave detailed production schedule mentioning products and quantities to be manufactured.

### **Marketing and Finance**

The dairy produced variety of products, which were marketed under different brand name likewise the pasteurized milk having the brand name of Classic Super and Classic Supreme. Whatever quantity of production made at the dairy was marketed by a central state level marketing co-operative society named as SMMF and some quantity of products sold by the dairy itself to the retailers of their regional area. All the district level co-operative societies working in the state of Gujarat were considered as members of SMMF. The SMMF was a great success story, as indeed was the co-operative movement in the milk sector initiated and carried to great heights by the "Milkman of India", Dr. Verghese Kurien. Unlike other organization, the main objective of SMMF was not to maximize their profit but to generate reasonable value for member dairies and sub –member i.e. farmers.

The dairy products produced by different district level co-operative societies in Gujarat state (including Classic dairy) was marketed by SMMF not only in Gujarat but other state too. Even the targets of production were also decided and informed to their member co-operative milk producing societies from time to time by SMMF. The main focus areas of SMMF were as under:

- Common branding
- Centralized marketing
- Centralized quality control
- Centralized purchases and
- Pooling of milk efficiently

Classic dairy had cold chain supply system means deep freezers and refrigeration transport equipments. The dairy also had regional level marketing department to promote rural awareness for organized and co-operative milk producing business among the stakeholders.

The milk producers were paid on 20<sup>th</sup> and 30<sup>th</sup> of every month for the milk collected during first 10 days and during 11<sup>th</sup> to 20<sup>th</sup> days respectively. For the milk collected during last 10 days, the dairy paid to them on 10<sup>th</sup> of the next month. The milk producers were paid on the basis of fat and SNF content of the milk.

The dairy sold majority of the products through SMMF (as per the instructions of SMMF) and received prompt payments for the same. Classic also sold few of the excess products within the Narmada district through distribution network of retailers against cash. The retailers included Classic retail franchise outlets as well as other individual retailers. SMMF decided the selling price of all the products manufactured by Classic, like in the case of other cooperative dairies.

The dairy was 100% equity financed cooperative dairy. It did not use debt fund, as the finance manager was concerned about his return on assets and rate of interest on debt fund.

Milk being an essential commodity was outside the purview of tax structure. But GST<sup>4</sup> was levied at 8% on the milk products, like butter, ghee, shrikhand, raita, khoa (mavo), milk powder, etc. The Government of Gujarat had implemented the VAT<sup>5</sup> with effect from April 2006 and the milk products were taxed at 4% under VAT. The rate of CST<sup>6</sup> on inter-state sale was also 4%. With effect from April 1, 2007, it was reduced to 3%. So the VAT had positive effects on the dairy industry.

Normally the dairy paid dividend at 15% to the milk producers. During the years 1988, 89 and 90 there was drought in Narmada district, and in the conditions of scarcity of water and

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<sup>4</sup> Gujarat Sales Tax

<sup>5</sup> Value Added Tax

<sup>6</sup> Central Sales Tax

fodder the milk procurement was reduced to 1 LLPD against the installed capacity of 4 LLPD. Even the dairy incurred losses during those years; it paid 8.33% of dividend.

The noteworthy point here was that for the co-operative organizations the motive must be social welfare and providing basic necessity products to the people of the country. But some of the district level co-operative societies had created benefits to their shareholders by identifying the changing customer taste and preferences and market trend as well as buying behavior. On the similar lines, Classic dairy also developed products like, Khoa, Raita and Lassi.

The dairy maintained its financial records as per requirement for cooperative societies registered in India. But, revenue-generating areas (Profit Centers) were unidentified, as the dairy did not have any kind of cost accounting system. It did not know the consumption of raw milk per kilogram of butter and ghee and ultimately product wise cost and profitability. Many of the products were high revenue earner but sold in less quantity whereas low profit margin products were sold in high quantity. The dairy had processing capacity of 12 LLPD and it had to run its operations even below break-even. However, marketing, product-mix, product expansion/elimination decision were taken at SMMF level.

Classic daily monitored the procurement and processing of milk. It also had a monitoring system for wastage and production of various milk products. The concerned employee/officer was also answerable for wastage of milk. The dairy was also successful in taking various cost cutting measures, like reduced energy use, reduced water and fuel consumption.

The finance manager was concerned about the net profit for last five years and income from other sources.

### **Future plans**

The dairy industry was open for private players by removing entry barriers 15 year back. But till, not single big competitor entered in the market. But last year there were some powerful rumors that a renowned group entering in this industry with their non-perishable packaging with half the prices nationwide.

The MD had planned “Perspective 2020”, a project costing 11.7 million INR. Under this, the dairy planned to expand the milk processing capacity to 15 LLPD from existing 12 LLPD. For this perspective dairy started to construct a cold storage, and expected to complete within a year. Perspective 2020 included a detailed survey of development of animals and increase in procurement of milk 6 % by each year. Perspective 2020 was planned to produce excess ghee, paneer, shrikand, masti-dahi, milk powder and rasogulla.

### **Competitive Scenario:**

The opportunities in dairy industry were quite exciting. But the magnitude of the competition was also not to be underestimated. The competitors such as Britannia, Hindustan Lever Ltd., Nestle, Vadilal, Cadbury, Heinz, etc., were formidable.

The nature of competition varied among the different products. In the case of liquid milk, competition was from private dairies and contractors. There was also competition from newly emerging private dairies that had started supplying milk to consumers as well as sweet makers. There was intense competition for supply of milk, especially in the festival seasons, by the sweet makers who derived large profits from the sale of their sweets.

For butter and cheese, new entrants were making their mark. Britannia group had entered into food business, and more specifically in milk and milk related products such as butter. Britannia had introduced new forms of cheese such as cheddar cheese slices, and supported its products with extensive advertising campaigns. It was believed that advertisements played a powerful role in the demand for particular brands of butter and cheese.

The sweet market was highly fragmented, with numerous small time local operators producing their own branded and unbranded forms of sweets. The sales of sweets soared in the festival seasons, drawing milk supply by offering higher prices. Other food companies such as Hindustan Lever Ltd. and Nestle had also entered into the business of ready made or near ready sweets.

The ice cream market was an emerging market in India, witnessing the entry of numerous players. The national scene was dominated by Hindustan Lever, while at regional level Vadilal commanded substantial market share. There were also numbers of players in unorganized sector.

Interestingly, the state level federations could market their own products under their own brands anywhere in India, thus competing against their sister federations. Thus federation of Andhra Pradesh could market its Vijaya brand butter in Gujarat competing with Classic butter.

Further, cooperatives did not enjoy a level playing field in dairying- despite what the MNCs and business houses might say. Unlike private firms, cooperatives invested heavily in helping the farmers to increase their productivity. The dairy provided breeding services, veterinary services, extension advice and inputs- often at cost or less. It was committed to quality and would not compromise for the sake of easy money. It paid the full cost of its utilities. Most important, it operated under Cooperative Acts, which, in most states, invested the Registrar of Cooperatives with the power to intervene and overturn business decisions. No one could imagine the Registrar of Companies acting in the same fashion. The finance manager felt that the problem was even more serious than what appeared. Many of the private sector companies did not pay taxes, at least not fully, bribed factory and other inspectors to by pass legislations and many did not even pay for electricity. At the same time, in many states, private firms were eligible for tax holidays, exemption from sales tax, subsidized utilities and the like.

Unfortunately, not all the competition played a fair game. As Dr. Kurien lamented in one of his addresses to the shareholders: “Most of our competitors are registered under the Companies Act, a law that in spirit and practice respects the rights of owners and observed due process. By contrast, our cooperatives operate under archaic, colonial cooperative legislation, in which the rights of owners are observed in the breach and in which due process finds scant place. For example, while your federation and all the member unions are a part of the same three tier cooperative structure, yet you have to pay four percent Central Sales Tax



when your products are transferred from your member unions to any of the branches of your Federation that lie outside Gujarat. You then again pay local sales tax, when the product is sold within that state. On the other hand if a private company transfers its products from its plant to any of the its branches outside the state, it does not pay Central Sales Tax. As long as cooperatives remain in their present legal and regulatory shackles, competition can neither be free nor fair...”

**Questions:**

- 1) Analyze the case-using SWOT.
- 2) As a CFO (Chief Finance Officer) of the CLASSIC Dairy, what type of capital structure would you select?
- 3) Which is the appropriate costing method for the dairy and what additional information do you require to implement the same?
- 4) How do you see future of the dairy? Support your answer with key figures and logical reasons.

**Appendix 1****Three-tier System for Cooperative Dairies****State Marketing Federation**

All dairies in a State (SMMF in Gujarat)  
22 State Federations in India

**District Milk Processing Unions**

Every district in the state  
12 district unions in Gujarat  
170 unions all over India

**Village Co-operative Societies**

All villages in a district  
72,774 villages in India

**Milk Producers**

All milk producers in a village  
2.1 million in Gujarat  
9.31 million in India

**Appendix 2**  
**Classic Co-operative Dairy Limited**  
Profit and Loss A/c for the year

	2001-02	2002-03	2003-04	2004-05	2005-06
<b>Revenues:</b>					
Sales	3,46,92,95,566	4,33,09,41,031	4,92,86,93,821	4,99,47,54,053	5,98,72,07,211
Other Income	4,95,44,824	4,65,82,300	4,54,15,619	4,15,48,387	2,43,07,655
Closing Stock	34,67,60,118	23,03,24,846	11,60,27,831	73,45,50,227	49,38,62,422
	3,86,56,00,508	4,60,78,48,177	5,09,01,37,271	5,76,73,80,067	6,50,53,77,288
<b>Expenses:</b>					
Opening Stock	10,82,61,202	34,67,60,118	23,03,24,846	11,60,27,831	73,45,50,227
Purchases	3,00,93,33,723	3,44,42,20,053	3,99,67,53,371	4,67,90,11,780	4,70,65,54,206
Cooperative Development and Extension Expenses	3,24,60,605	3,61,23,679	1,11,51,597	1,24,34,913	1,19,95,631
Processing Expenses	5,87,61,689	6,30,76,240	7,54,84,952	8,69,77,153	8,94,69,922
Packaging Expenses	24,96,83,157	25,83,30,336	26,67,39,116	33,56,32,897	31,95,51,989
Power and Fuel Expenses	15,58,86,842	17,01,86,409	17,78,50,618	20,59,53,750	26,56,66,684
Salary Expenses	9,08,62,752	12,33,08,684	15,05,31,692	15,43,77,922	17,32,03,580
Staff PF, Gratuity and other Amenities	3,04,23,327	3,50,24,545	3,84,31,184	3,94,20,569	4,47,70,581

Repairs and Maintenance	2,53,23,564	2,28,09,749	2,96,81,291	2,47,27,268	3,01,46,570
Freight and Forwarding Expenses	69,15,116	1,14,92,952	1,01,66,783	1,30,09,584	1,52,82,343
Marketing Expenses	9,93,240	16,95,803	10,75,632	17,21,762	20,74,702
Post, Telephone, Printing and Stationery Expenses	22,08,146	22,52,647	21,37,104	26,90,430	23,25,136
Insurance Premium	24,58,970	34,60,886	30,71,063	33,44,401	41,95,887
Registration and License Fees	5,42,570	12,87,145	15,14,123	11,81,308	10,26,335
Rent, Rates and Taxes	7,74,121	7,27,127	6,75,132	12,14,038	47,65,036
Audit Expenses	53,93,834	56,29,448	59,55,945	66,65,051	75,63,129
Miscellaneous Expenses	11,26,677	8,61,022	10,96,481	9,14,900	18,89,745
Interest and Bank Commission	2,88,32,892	2,66,21,077	1,16,62,718	1,16,95,504	1,84,01,347
Depreciation	3,30,61,864	3,55,31,205	4,67,42,479	4,29,67,840	4,31,98,190
Income Tax Provision	-	-	-	-	20,00,000
Net Profit	2,22,96,217	1,84,49,052	2,90,91,144	3,08,83,766	2,67,46,048
	3,86,56,00,508	4,60,78,48,177	5,09,01,37,271	5,76,73,80,067	6,50,53,77,288

**Appendix 3**  
**Classic Co-operative Dairy Limited**  
 Assets as at

	2001-02	2002-03	2003-04	2004-05	2005-06
<b>Fixed Assets</b>	<b>56,10,67,055</b>	<b>59,09,79,934</b>	<b>65,83,10,407</b>	<b>68,57,19,543</b>	<b>75,86,97,300</b>
Investments:					
Share & Govt. Securities	3,18,29,790	4,58,39,790	4,58,39,790	4,60,49,690	4,60,49,690
National Savings Certificate	10,000	10,000	-	-	-
	<b>3,18,39,790</b>	<b>4,58,49,790</b>	<b>4,58,39,790</b>	<b>4,60,49,690</b>	<b>4,60,49,690</b>
Stock:					
Trading Stock	34,67,60,118	23,03,24,846	11,60,27,831	73,45,50,227	49,38,62,422
Stores	5,81,16,948	8,04,23,900	8,17,81,402	9,65,69,873	9,98,80,949
	<b>40,48,77,066</b>	<b>31,07,48,746</b>	<b>19,78,09,233</b>	<b>83,11,20,100</b>	<b>59,37,43,371</b>
Advances and Receivables:					
Deposits	48,44,192	48,44,192	59,75,517	58,88,019	56,32,817
Advances	1,36,70,433	1,81,51,560	2,10,62,141	1,23,50,401	1,41,65,262
Sundry Debtors	35,12,994	39,49,178	30,26,114	28,29,416	31,42,078
Due from societies	1,93,724	3,82,662	12,49,721	1,91,073	6,07,313
Trade Debtors	19,68,00,827	3,93,81,908	14,77,93,455	1,20,34,394	30,20,32,775
	<b>21,90,22,170</b>	<b>6,67,09,500</b>	<b>17,91,06,948</b>	<b>3,32,93,303</b>	<b>32,55,80,245</b>
Cash & Bank Balance:					
Fixed and Call Deposits	31,40,96,217	46,39,12,784	44,93,09,989	27,60,18,673	9,64,30,162
Current Bank Accounts	7,74,556	53,19,382	3,67,97,068	63,43,352	90,70,020
Cash on Hand	1,75,831	1,13,410	2,64,815	2,85,700	3,54,613
	<b>31,50,46,604</b>	<b>46,93,45,576</b>	<b>48,63,71,872</b>	<b>28,26,47,725</b>	<b>10,58,54,795</b>
<b>Total</b>	<b>1,53,18,52,685</b>	<b>1,48,36,33,546</b>	<b>1,56,74,38,250</b>	<b>1,87,88,30,361</b>	<b>1,82,99,25,401</b>

**Appendix 4**  
**Classic Co-operative Dairy Limited**

Liabilities as at

<b>Liabilities</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
Authorized share capital	25,00,00,000	25,00,00,000	25,00,00,000	25,00,00,000	25,00,00,000
Paid up share capital	10,18,48,800	10,19,66,600	10,19,66,600	10,19,66,600	10,19,29,300
Reserve funds and other funds					
Reserve funds	5,99,78,452	6,60,00,520	7,07,41,678	7,80,88,444	8,62,87,456
Other funds and reserves	22,31,22,150	22,54,29,849	22,64,90,751	23,81,86,148	25,13,69,371
	<b>28,31,00,602</b>	<b>29,14,30,369</b>	<b>29,72,32,429</b>	<b>31,62,74,592</b>	<b>33,76,56,827</b>

<b>Depreciation fund</b>	41,25,24,883	44,77,84,503	48,84,51,188	53,06,16,078	57,31,33,996
<b>Loan</b>	3,65,85,161	2,69,43,964	----	----	----
IDC operation flood II loan	12,23,22,778	10,92,91,493	----	---	----
NDDDB operation flood III loan	2,70,55,101	---	----	---	----
NDDDB loan cattle feed plant	<b>18,59,63,040</b>	<b>13,62,35,457</b>	<b>48,84,51,188</b>	<b>53,06,16,078</b>	<b>57,31,33,996</b>
Current liabilities and provisions					
Deposits	4,00,57,883	4,10,67,927	4,07,65,057	4,31,55,096	4,21,23,845
Sundry creditors	24,37,56,485	20,03,84,853	22,48,88,762	35,40,66,702	29,95,35,324
Creditors societies	16,64,90,681	15,27,91,670	28,75,38,672	37,66,14,438	27,08,13,804
Creditors for goods	6,30,89,608	8,81,94,309	9,75,04,398	12,52,53,089	7,79,86,257
Provision	1,27,24,486	53,28,806	----	----	---
Short term loan	----	----	----	----	10,00,00,000
	52,61,19,143	48,77,67,565	65,06,96,889	89,90,89,325	79,04,59,230
Net profit for the year	2,22,96,217	1,84,49,052	2,90,91,144	3,08,83,766	2,67,46,048
<b>Total</b>	<b>1,53,18,52,685</b>	<b>1,48,36,33,546</b>	<b>1,56,74,38,250</b>	<b>1,87,88,30,361</b>	<b>1,82,99,25,401</b>