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Policy Research in Farmer Producer Organization Models

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AGRICULTURE SECTOR MODERNIZATION PROJECT

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Agriculture Sector Modernization Project (ASMP)

Final Report

A Policy Research in Farmer Producer Organization Models

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List of Abbreviations

AD	–	Advisory Director
AGM	–	Annual General Meeting
ASMP	–	Agriculture Sector Modernization Project
ATDP	–	Agriculture Technology Demonstration Park
BOD	–	Board of Directors
CC	-	Coordinating Committee
Coop	–	Cooperative Society Ltd
DOAD	–	Department of Agrarian Development
DS	–	District Secretariat
FC	–	Farmer Company
FCoop	–	Farmer Cooperative Societies Ltd
FO	–	A Farmer Organization registered with the DOAD
FPO	–	Farmer Producer Organization any entity of Organized Farmers
GM	–	General Manager
GN	–	*Grama Niladhari*
LKR	-	Sri Lankan Rupee
MASL	-	Mahaweli Authority of Sri Lanka
MOA	–	Ministry of Agriculture
NGO	–	Non-governmental Organization
PC	–	Producer Company
TSHDA	–	Tea Smallholders Development Authority
TSHDS	-	Tea Smallholders Development Society
US	–	United States
ZDC	–	Zonal Development Committee

Final Report

A policy research in farmer producer organization models for Agriculture Sector Modernization Project

Executive Summary

The History of Farmer Producer Organizations (FPO) in Sri Lanka goes back to ancient times. There have been several formats of the FPOs established and tried in Sri Lanka to accomplish goals ranging from managing irrigation systems up to rural development initiatives. Many of the FPOs have not been able to raise rural smallholder farmers' agribusiness and household incomes. However, the FPOs have been identified as a vehicle to mobilize resources for sustainable rural development. A FPO can be defined as a formal institution which is farmer-based and farmer-controlled, set-up with the objective of serving both individual farmer and farming community's needs.

The Agriculture Sector Modernization Project has been planned and implemented by the Ministry of Agriculture with generous funding from the International Development Association of The World Bank. The key development objectives of this project were to support increasing agricultural productivity; improving market access for the small-holders; and enhancing value-addition activities of smallholder farmers and agribusiness in the project areas. The project has chosen FPOs as an instrument for agricultural modernization. Under this project, FPOs have been proposed in seven districts within five provinces.

The general objective of this study was to carry out an in-depth policy research to identify and recommend the most appropriate model of farmer organization network for the Agriculture Sector Modernization Project. It also attempted to identify the legal, regulatory, structural and management requirements needed for sustainable FPOs. This short-term study endeavored a qualitative inquiry. Qualitative data were gathered through a stratified purposive sample selected from the project areas as well as outside. Data were collected from the FPOs and a range of their stakeholders. The data were gathered through farmer interviews, discussions, observations, and interviews with key informants. Data were collected from key categories of FPOs viz FCoops, FCs, FPOs established by the Tea Smallholder Development Authority, ASMP, Mahaweli Authority and Department of Agrarian Development. Results were analyzed along vital themes namely institutional factors, governance factors, management factors, product and market factors, and structural factors.

There are numerous models of FPOs created in the world. These have been established to provide services such as marketing, production, managing common property and resources, financial services, technical services, training, social and welfare, and policy advocacy. Many of these models served social objectives rather than business objectives of farmers. Their success or failure was mostly attributed to internal factors such as institutional arrangements, governance and the management.

On average, FPOs showed positive positions in some aspects. The Advisory Directors appointed by the facilitating organizations provided guidance to these FPOs. They managed to reduce business risk through selling multiple products. Institutions were positive in their governance. Regular AGMs were held while maintaining financial transparency. The FPOs evidenced unsuccessful in business due to corporate illnesses prevalent. They practiced democratic voting and the benefits were distributed proportional to the patronage by members. Further, there was no market for shares of the FPOs. These resulted five principle institutional problems namely, free-rider, horizon, portfolio, control and influence, that destined them to ill-perform. These institutional problems severely restricted the capital of the FPOs. The investments could be transferred or sold. Farmers and their FPOs showed poor creditworthiness. Members did not elect all the directors to the Boards. The Management of these were not separated from the ownership and control resulting loss of accountability. Managers did not have clear job descriptions or incentive schemes. No FPO had active long-term strategic plans, vision, or mission developed using a participatory approach.

The FPOs did not serve their year-round sales contracts although they had potential to do so. Members sold their produce individually despite benefits being proportional to the level of patronage. To worsen the situation further, many of the FPOs were subjected to political influence. Therefore, in Sri Lanka, the FPOs were not structurally equipped to provide the benefits expected by the smallholder farmer members.

It is recommended to practice voting and the distribution of benefits proportional to the level of investment; create conditions where shares can be traded among the eligible farmers; and to separate the management from the ownership and control. The MOA should play an empowering role rather than one that is controlling. Shareholder-base should be broadened at least to the district level.

The process of appointment of AD should be more FPO-friendly. The AD and GM should have clear job descriptions and their skills and qualifications should match their portfolios in the FPO. Further, patron members should not hold salaried positions in their respective FPOs.

Having carefully discerned the factors that promote and stimulate farmer organizational success, it was necessary to ascertain the most appropriate legal structure for the Agricultural Technological Development Park (ATDP), the business unit of the project. In this respect the researchers considered the statutory provisions currently available in Sri Lanka, as the relatively short term of the project and its limited scope did not permit the drafting of a special statute that would cater to farmer business organizations specifically. The researchers identified the following business structures in the initial survey of legislation.

1. The Public (unlisted) limited Company and the Private Company under the Companies Act No 7 of 2007
2. The Agrarian Development Council and the Farmer Organization under the Agrarian Development Act No 46 of 2000
3. The Cooperative Society under the Cooperative Societies Law No 5 of 1972 as amended.
4. The registered society under the Societies Ordinance No 16 of 1891 as amended
5. The Corporation incorporated by the Minister under the Mahaweli Authority Act No 23 of 1979

The company form, along with its characteristic of separate legal personality and proven record of success in the business world was an obvious initial choice. However, it was equally clear that the concept of a company was foreign to the ordinary farmer and therefore they may not embrace the concept immediately. The rules and procedures of the company law and requirement of the engagement of professionals were also identified as challenges.

The registered society was a much simpler form with less stringent statutory requirements. However, it was never drafted for the society registered to engage in business and therefore lacks some structures that facilitate investment and business activities. The absence of the concept of shares was most conspicuous.

The parliament in the year 2000 had introduced a new Agrarian Development Act, which identified several organizations for farmers to be assembled. The lowest rung in the hierarchy was the Farmer Organization, with their delegates forming Agrarian Development Councils. A similar aggregation is implemented at District, Provincial and National level organizations. These bodies have been created with the coordination and advisory aspects in mind and not with a view to organize the farmers to engage in business.

The cooperative society is by far the most familiar business organization to the farmers having witnessed them in operation in this country for a period close to century. Apart from the research data gathered that demonstrated the failure of the cooperative model as a business organization both overseas and locally, it was noted that the Cooperative law (last amended in 1992) was very out dated with provisions that applied to the socialist era. It also paved the way for substantial intrusion in to the activities of a cooperative and was detrimental to the independence and self-sustainability sought by this project.

The researchers also considered the corporations that can be incorporated under the Mahaweli Authority Act. The choice was unconventional, but required exploration and analysis as the model appeared to have some potential as a business entity. The corporation had many of the advantages of a company but was not governed by the Companies Act per se. However, it could only operate within the Mahaweli special area. It is also bound by governmental financial regulations and treasury oversight. Hence its independence and adaptability to environmental challenges was found wanting.
The research data had indicated the advantages of having a network structure with several levels of the value chain having a separate dedicated structure. Thus the legal research considered the merits of having such a structure by using a combination of the business models referred to above

It was immediately apparent that whilst each of the above structures had their own unique advantages, they also presented challenges that needed to be overcome if they were to be used as the legal form of the ATDP.

After analysis the research indicated that a structure with two tiers and an informal illusory third tier would be most appropriate for the purposes of the ATDP. Thus the clusters of farmers consisting of 200-300 farmers would be organized in to informal farmer associations which would only undertake coordinating activities between the farmers and the farmer society (and later the Farmer Public Limited Company).

Since the ASMP had commenced prior to the commencement of the research, and had already formed clusters of farmers in several project areas, an additional requirement of formalizing these transactions between the ASMP and individual farmers and/or transactions between the ASMP and the informal clusters arose. The researchers thus recommended that, in such area (only) the clusters be registered as societies. Thus all transactions referred to above that had occurred between individual farmers, informal clusters and the ASMP must be assigned in favour of the registered farmer cluster Society. Thus the respective farmer cluster societies would own all assets granted by the ASMP. Thereafter, these societies would be amalgamated creating a single society. This society shall be the first tier of the two tier structure.

In the areas where the aforesaid concern does not arise, the first of the formal tiers would comprise of a single registered society, and enroll all farmers of the clusters as members. This step is an intermediary step to ensure that adequate number of farmers are enlisted with the program, and that their commitment to the programme is secured.

Upon the expiry of a period of about three years (a time span to be determined on observation of the progress of the society and making a judgment call on the same), and the management committee of the society and the Ministry of Agriculture observes noticeable commitment from the farmers with farmer numbers exceeding 1000, the society could then be converted in to a unlisted public limited company, by offering the shares of the company as a public offer to the members of the registered society. From then onwards the society shall be abolished and all members shall be shareholders of the company. This will enable the profits earned by the society previously, and all new profits earned as a company to be distributed (following a conservative dividend policy) to the farmers.

The second tier will be the joint venture of several such ATDP companies forming a Private Company, with each Public Company holding a share of the ownership agreed between them. This second tier is to engage in a business that's in a higher position in the value chain using the products of the ATDPs. If successful the profits of the second tier would also ultimately trickle down to the farmers, and assist in the achievement of poverty reduction, one of the stated goals of the ASMP.

Chapter 1 Background

1.1 Brief account of the study

Sri Lanka is regarded as a lower middle-income country with a population of over 21.4 million people. Its GDP per capita has been 4,065 in the year 2017. Sri Lanka's economy was growing considerably well at an average of around six per cent during the last decade. It reflected how the country addressed the economic reconstruction with policy thrust towards economic growth and stability. The country seemed to be trusting a shift of economic development from a rural-based one in to an urban-based one. However, the country has policies in place to prevent the rural economy from being neglected, where agriculture plays an important role.

Agriculture plays a vital role in Sri Lanka's economy in terms of providing employment. As much as 25.5 per cent of the labor force is involved in Agriculture. Sri Lanka is an agricultural country that traditionally favors the production of food to feed a rising population. The agricultural sector in Sri Lanka is characterized as dualistic, comprising of plantation and non-plantation sectors. The plantation sector is largely export-oriented and mainly involves in the production of tea, rubber, coconut and few other crops. In contrast, the non-plantation agriculture is concerned with the production of paddy, subsidiary food crops, fruits, and vegetables mainly for domestic consumption.

The smallholdings in both these sectors were gathering momentum during the past few decades. Given the crucial role played by the smallholder farmers in the rural agrarian economy, the policy emphasis was to increase their income by encouraging commercial production of non-traditional crops for export, domestic markets, and for processing. However, the commercialization process in the non-plantation agriculture sector has remained slow. The non-plantation agriculture is more prominent in the Dry Zone of Sri Lanka. Having realized the importance of the agricultural sector in the economy of Sri Lanka, successive governments have initiated policies and plans for its restructuring and development. The productivity and profitability within the non-plantation smallholder sector have been identified as inadequate. Therefore, there has been a need to shift the agricultural strategy to address these issues by (a) modernizing the resource use and (b) shifting the sector from a low-value system that produces primary products towards a system that will produce high-value, value-added and export-oriented products. A significant plan so adopted was the formation of FPOs to achieve higher productivity and profitability. Details of establishment of FPOs in Sri Lanka is given in Table 1.1.

Table 1.1: Details of FPOs established in Sri Lanka

Category of FPO	Number of FPOs	Number of members
TSHDS (TSHDA, 2015)	1394	271,272
Mahaweli FPOs (MASL, 2018)	1059	115,571
ASMP Project (ASMP, 2020)	20	1771
FCs (Esham & Usami,2007)	80	6364

A vast majority of the agricultural land occupied by the non-plantation food crop sector in Sri Lanka has been cultivated by the small-holders. They also account for a large proportion of the annual production of food material to feed the nation as well as for exports. The Agriculture Sector Modernization Project (ASMP) has been planned and implemented by the Ministry of Agriculture (MOA) with funding from the International Development Association of The World Bank. The key development objectives of this project were to support increasing agricultural productivity; improving market access for the small-holders; and enhancing value-addition activities of smallholder farmers and agribusiness in the project areas.

The project comprises of three components viz (i) agriculture value chain development; (ii) productivity enhancement and diversification demonstrations; and (iii) project management, monitoring and evaluation. The sub-component of Agriculture Technology Demonstration Parks (ATDP) is a prime sub-component of the component (ii). This sub-component would support the introduction, demonstration, and scale-up of innovative agriculture technology packages for smallholder farmers and the FPOs with the view to support productivity improvements, diversification, commercialization, and more sustainable and climate resilient production patterns.

The MOA has already taken initiative in setting-up of ATDPs. These have been proposed in seven districts viz Jaffna and Mullaitivu (Northern Province), Batticaloa (Eastern Province), Monaragala (Uva Province), Anuradhapura and Polonnaruwa (North-Central Province), and Matale (Central Province). These districts have been selected based on the high poverty headcounts and agriculture development potential.

Farmer Producer Organizations: A working definition

Smallholder farming sector holds a significant extent of land and known to contribute significantly towards the agricultural output of the country. One of the focus areas of the ASMP is to contribute to the structural shift in the economy of the country. Smallholder farmers are an important sector due to their capacity to produce a diverse range of crop produce in significant quantities. The FPOs have the ability to link smallholder farmers to high value institutional markets. Their coordinating efforts play a significant role as an institutional vehicle in promoting agricultural development. Therefore, identification of best FPOs models and establishing them would be an important modern-day need of the country.

For the purpose of this study, a Farmer Producer Organization is defined as a formal institution[1] which is farmer-based and farmer-controlled set-up with the objective of serving both individual farmer and farming community's needs. Services offered by the FPO are mainly to enhance agribusiness activities and livelihoods of its member farmers.

[1] An institution set-up with a social or an institutional influence for collective action.

1.2 Objectives of the study

The general objective and specific objectives of the study are presented as below.

General objective of the study

The general objective of the project was to carry out an in-depth policy research to identify the most appropriate model of farmer organization network for the Agriculture Sector Modernization Project.

Specific **objectives of the study**

The specific objectives of the study are as follows.

1. To identify appropriate legal and regulatory setup for establishment of the FPOs / Farmer Companies (FC) under the ASMP with necessary legal powers to operate as an independent organization, a group of organizations or a consortium.

2. To identify appropriate organizational structure to operate from cluster village level to national level.

3. To identify appropriate management system for the FPOs / FCs to facilitate membership for decision making in planning and implementation of commercial agriculture in efficient and sustainable manner to achieve the specific objective of the ASMP on value chain development.

1.3 Scope of the study

The scope of this policy study would be to cover the following extents of content.

1. Critically review the FPO models that have been operating in Sri Lanka in the agriculture and related sectors of the economy and to identify the reasons for success or failure of such models and discuss the relevant policy barriers.

2. Conduct a comparative study of models of the FPOs / FC models operate in India, Bangladesh, Vietnam and Thailand, and to draw lessons for Sri Lanka.

3. Identify most appropriate FPO / FC that could be empowered to undertake commercial agriculture including trading, enter into agreement with private partners, own assets etc. on behalf of the membership.

4. Make recommendations on policy reforms / legal reforms and organizational / institutional setup required to establish and operate, appropriate Farmer Organization model for Sri Lanka to be established initially under the ASMP operational areas.

This study was allocated a time duration of three months from 01st January 2020. Therefore, it was undertaken as a short-term study.

1.4 Outline of the report

This report is structured in seven chapters: Background; Approach and Methodology; Institutional and Legal Review; Key Findings and Descriptions; Performance Factors of the FPO; Best Performing e FPO for Sri Lanka; and Conclusions. A brief introduction to the study and the study objectives are included in this chapter (Chapter 1). The study method is presented in Chapter 2. In Chapter 3, a review of institutional and legal aspects is included. Useful descriptions and key findings of the study are presented in the Chapter 4. Performance factors of the FPOs as identified through key findings are presented in the Chapter 5. Chapter 6 presents recommendations for best models for the FPOs for Sri Lanka. Finally, conclusions are presented in Chapter 7.

Chapter 2 - Study approach and methodology

This chapter presents details pertaining to the study approach, sample, sampling method, and geographical location of study area, data collection tools and the method of analysis of data.

2.1 Objectives

This inquiry was carried-out as a short-term study within a duration of three months commencing from 01st January 2020. This in-depth policy study was conducted for the ASMP with the objective of identifying the most appropriate farmer organization model for the project areas. It also attempted to identify the legal, regulatory, structural and management requirements needed for the creation and continued sustainable existence of the FPOs.

2.2 Geographical coverage

The project has been proposed for seven districts in five provinces viz Jaffna and Mullaitivu (Northern Province), Batticaloa (Eastern Province), Monaragala (Uva Province), Anuradhapura and Polonnaruwa (North-Central Province), and Matale (Central Province). These districts have been chosen by the ASMP based on the prevalence of high poverty rates despite a great agriculture development potential. Thus, the geographical coverage of this study has been accordingly defined.

2.3 The study population

As stated previously, the study aims to identify the most appropriate model for the FPOs for the ASMP. There are a number of different categories of the FPOs established and operating at present in Sri Lanka. This inquiry was limited to formal FPOs only. Therefore, the target population for the sample was made up of the formal FPOs that were established under diverse statutory frameworks in Sri Lanka. As mentioned earlier, this study was set-up to investigate the institutional make-up of the FPOs established and to consequently establish an FPO on the recommendations of this policy study within the project area. This requirement led the researchers to select a few samples of the FPOs that were situated beyond the geographical area of the project.

2.4 Study approach

The FPOs had unique internal and external factors. In this study, emphasis was placed on statutes, opinions and drivers that resulted business and organizational behavior of smallholder farmers within their natural settings of producer organizations. Furthermore, the study attempted to capture beliefs, values and motivations that determined their behavior within the FPOs that were governed by legal frameworks and regulations. Therefore, a qualitative inquiry was required as the study approach. This study endeavored a qualitative approach using the case study strategy.

2.5 Sampling method

Stratified sampling

The overall population was divided in to subgroups of various categories of the FPOs. These categories were the Farmer Cooperatives, Tea Smallholder Development Societies, FPOs already established by the ASMP, FPOs established by the Mahaweli Authority of Sri Lanka[2], and FPOs established by the Department of Agrarian Development. These categories were considered as several strata due to their expected uniformity within the category. Farmer Companies established and facilitated by various state organizations were identified as a widely popular farmer-owned institutions established as Peoples' Companies for business purposes. They were also considered in this study but were not taken as a sample due to their non-existence as a legal framework. They were required to re-register according to the new Companies Act. Each FPO category was considered as a case in this inquiry.

The study, being a sort-term study, was faced with resource constraints, especially in respect of time. In light of the above, a deliberate decision was taken to consider a smaller sample with emphasis placed on greater precision in sample selection. Therefore, the sampling technique chosen was stratified sampling.

Purposive sampling

Purposive sampling was used to select the FPOs for investigation and participants in Focus Group Discussions. They were selected (on a judgmental basis) on the basis of entities that can provide quality (rich) data. This data collection strategy involved the choice of FPO leaders, who are most advantageously placed or in the best position to provide the data required, and the GMs of entities wherever applicable. This sampling strategy enabled detailed descriptions of each case in addition to identifying shared patterns that traverse through the cases in the strata of the population. Purposive sampling ensured that diversity within each stratum and within the sample was sufficiently captured. Every attempt was made to draw an adequately representative sample. Researchers were in contact with various contact personnel such as state officials, bankers, input sellers, personnel from processing companies to collect data from multiple sources and to avoid data distortion by personal prejudice. Some of the FPOs visited were located outside the project areas.

2.6 Data collection approach

It was observed through the preliminary desk study and the experience that there were different types and forms of the FPOs operating within the seven districts under study. The individual FPOs were the entities that had a legal personality. However, FPOs within each category were quite similar especially in their internal factors, processes and legal frameworks. Therefore, each FPO category was considered as the unit of analysis in this study. Key stakeholders of the FPOs were identified. These were mainly the internal stakeholders such as smallholder farmers; leaders of the FPOs, and contextual stakeholders. Desk study revealed that the contextual stakeholders mainly included government officials of various capacities and in various government institutions; finance providers; providers of technical knowhow; managers employed; input suppliers; providers of various services in agricultural supply chains; stakeholders in the local and export supply chains; exporters' associations; and graduates in agribusiness management as potential managerial employees.

The data collection strategy included holding face-to-face interviews and discussions with farmer members, leaders of the FPOs, and key informants, telephone interviews, field observations and the analysis of secondary data. Secondary data were collected from reports (both published and

[2] Even though the Mahaweli Authority Act permits the creation of corporations, it appears that the MASL has not utilized these provisions to create any such corporations.

unpublished) compiled by individuals, organizations and the state. Some of such documents were constitutions of the FPOs, bylaws, financial statements, and statutes. These tools were used to collect qualitative evidence. A semi-structured interview guide was used as the case study protocol to collect data (Annex I) encompassing the establishment of the FPOs and their institutional arrangements; key operations and business activities; reporting requirements; production processes and the involvement in supply chains; productivity and economic impacts; business environments; social set-ups; and governance models in various FPOs to facilitate the discussions and interviews. Semi-structured interview guides were also used (Annexes II to V) to collect data from other key stakeholders of FPOs. An emphasis was made to understand the internal factors affecting the progress of the FPOs. The research team made field observations on assets, operations, documentary evidence, livelihood aspects and various artefacts of the farmers and their FPO to make judgments and to support conclusions. Ethics issues were given attention in this study, particularly relating to the participants' privacy and confidentiality.

2.7 Data analysis

This study generated qualitative data that necessitated a careful analysis to meet the study objectives. For concurrent analysis, data triangulation was practiced by collecting data from multiple sources. The data gathered through interviews and discussions with farmers and FPO leaders, observations, and interviews with key informants were transcribed. Data triangulation and association were performed in order to consolidate data around relevant variables in order to carry out the data analysis task. Following steps were applied during the analysis of data.

- Transcription of qualitative data
- Reduction of dimension of data
- Data correlation and consolidation
- Data comparison and pattern matching

The Figure 2.1 below depicts the key steps in the data analysis process adopted in the study.

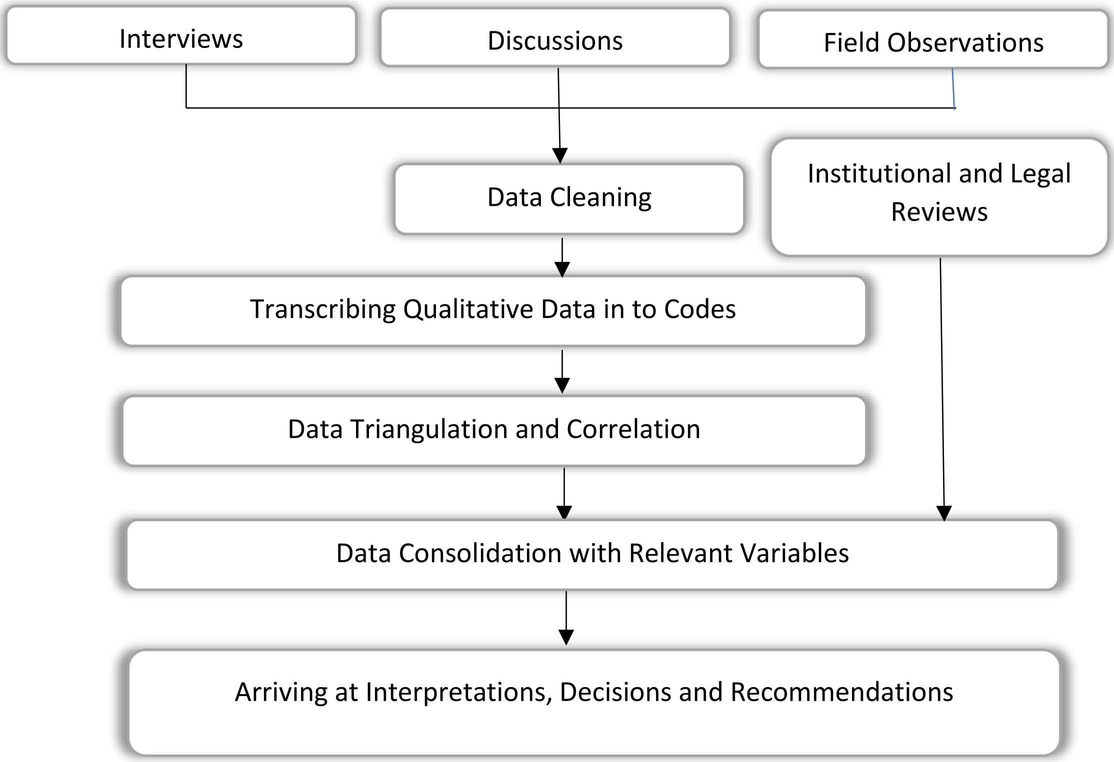

Figure 2.1: Data analysis flow chart

2.8 Implementation issues

The limited time allowed to carry-out the study is considered as a significant obstacle. Some of the samples (e.g.: FCs) from different FPO formats established within Sri Lanka were studied through desk work with the analysis of secondary data. However, every effort was taken to conduct interviews and to collect quality data that brought-about valid conclusions.

The scope of this study was limited to identify appropriate organizational structure to operate from cluster village level to national level. This limitation restricted the study to explore towards pre-identified boundaries.

Review of business models of the FPOs in neighboring and other countries (India, Bangladesh, Vietnam, Thailand and other developing and developed countries) was done through desk work. This is considered as an inherent weakness in such an approach which cannot be fully avoided but may make the scope limited. But Efforts were taken to study all the important facets of such foreign organizations such as nature of organization of farmers; establishment; operations; and success or failure of such organizations.

Chapter 3 - Institutional and legal review

3.1 Review of farmer producer organization models

3.1.1 The Farmer producer organizations

Literature on the FPOs have brought forward many definitions highlighting the key characteristics of such organizations. These definitions, thus distinguish the FPOs from other types of rural organizations. Stockbridge, Dorward and Kydd (2003) emphasized that the membership of the FPOs is regarded as a key feature of the FPOs while provision of services for the members as a core function of the FPOs, and access to these services as the main reason for farmers to join a FPO. Rondot and Collion (1999) have identified the FPOs as formal and traditional organizations. Formal organizations such as the FPOs consist of a formally defined membership while providing the opportunity for its members to maintain relations with the external business environment. Traditional organizations such as a village or a kinship group, on the other hand, tend to be more concerned with managing internal and social relations among its members (Rondot and Collion 1999). According to Kassam et al (2011), the FPOs are defined as formal voluntary membership organizations created for the economic benefit of farmers to provide them with services that support their farming activities such as: bargaining with customers; collecting market information; accessing inputs, services and credit; providing technical assistance; and processing and marketing of farm produce (Table 1). The criteria of formal membership usually include a payment of membership fee and/or a percentage of farmers' produce whereas informal membership is usually based on ethnicity, gender and other factors that are not necessarily related to farm business. Penrose-Buckley (2007) suggested that the FPOs have three main features namely; rural businesses; producer-owned and controlled; and engaged in collective marketing activities.

3.1.2 Classification of farmers' organizations

There were a few common terms used interchangeably to identify the entities set-up for the benefit of farmers viz Farmers' Organizations, Farmer Organizations and the FPO. The classification of the FPOs located in many different geographical locations is an interesting yet a diverse task. Farmers' Organizations could be categorized according to their membership size, services provided and their level of operation (Kassam, et al., 2011). Farmers' Organizations typically operate at the local level as farmers' clubs or self-help groups, at the meso level as local association or federation of farmers' clubs, or at the higher level as regional or national federations or associations (Kassam, et al., 2011). The Korean and Taiwanese FPOs had similar historical antecedents in the colonial period as formal organizations (Burmeister et al., 2001). Farmers ' organizations in Japan became official entities during the Japanese occupation, when rural self-help groups were made part of the colonial administrative apparatus that had been established among the land-owned elite (Kwoh, 1966). Farmers' organizations can also be classified as community-based and resource-orientated organizations or as commodity-based and market-orientated organizations (Chamala & Shingi,1997). Further, the FPOs can also be categorized as informal farmer groups and pre-cooperatives, farmers' associations, federations and unions, farmer cooperatives which are owned and controlled by their members, or chambers of agriculture with a general assembly elected by farmers (IFAP, 1992). Farmers' Organizations are also regarded in different terms in literature as agricultural self-help farmer groups, farmer associations, producer organizations, community-based organizations and rural producer organizations (Manzano,2016).

There may be more FPOs expected to be more oriented towards farm business and with the advantage of facing less institutional problems (explained elsewhere in the report). Farmer Companies (FC) in Sri Lanka and Producer Companies (PC) in India were examples for this category of the FPOs.

3.1.3 Services provided by farmers' organizations

The FPOs have played a vital role in many countries as institutional vehicles for encouraging agricultural development, while in some countries there is evidence of them being less effective (Illy, 1978). However, the FPOs operated in Agriculture have been extensively studied and literature based on the FPOs operated within consumer-oriented agricultural products such as cocoa, coffee, horticultural goods, milk, and tobacco are abundantly found in literature (Rondot and Collion, 1999). Ghana's the FPOs and associated institutional structures were helpful in enabling small farmers to interact with both input and output markets and thereby promoting market penetration. Farmer-based organizations in Ghana were actively engaged in agricultural development through institutional, organizational, and technological innovation (Asante, et al., 2011). Stockbridge et al., (2003) highlighted that the FPOs in Meso-America that includes southern Mexico and Central America provide many resources to farmers that are crucial to their success in entering the markets (Table 3.1).

Table 3.1: Services provided by the FPOs

Service	Details of provisions
❖ Marketing	Input supply, output marketing, bargaining, processing linkages, market information
❖ Production	Collective production activities, product consolidation
❖ Managing common property and resources	Irrigation water, pasture, fisheries
❖ Financial services	Savings, loans and other forms of credit
❖ Technical services	Extension, research, technical advice, education
❖ Training	Business and entrepreneurial skills, general training
❖ Social and welfare services	Health, safety networks, self-help
❖ Policy advocacy	Formalities, liaison with facilitating institutions

Source: Stockbridge et al., 2003 (amended)

The institutionalization of participatory methods, decentralization of services, establishment of multi-stakeholder platforms and multi-stakeholder funding mechanisms possibly improve demand-driven agricultural services (Asante et al., 2011). Farmers' Organizations at the grassroots level in Malawi have a greater chance to solve local issues than regional or national organizations such as access to common property resources, primary markets, and technical or economic services, which are better suited to lobbying for policy change (Rondot and Collion, 1999). In Meso-America, there are many success stories of the FPOs contributing to successful and efficient involvement of farmers in their value chains (Hellin and Higman 2003).

3.1.4 Establishment, governance and management of farmers' organizations

Farmers' Organizations may differ in terms of applied organizational structure, value and scope of activities, corporate governance and management (Kassam et al., 2011; Chlebicka, 2015).

Governance includes how decisions are made, the distance between members and the leadership of the FPO, how profit is managed (Kassam et al., 2011), electoral procedures, and financial reporting. During the early years of the FPOs' formation, participants have little knowledge of the FPO's business or still do not trust the leadership. As is usually the case, small-scale the FPOs find it difficult to raise money for the acquisition and working capital. According to observations by Kassam et al (2011) one of the most crucial factors for the functioning of the FPO is the leadership confidence of stakeholders, and a clear sense of ownership. Leaders of the FPOs need to be responsive to the needs of stakeholders (especially the owners). It has been identified as important for the FPOs to have right processes such as participatory decision-making; clear transparency from leaders to stakeholders by regular election of officials; and limiting the terms as stipulated.

For many FPOs in developing countries, determining the fate of earnings is a difficult task, mostly owing to a conflict of interest between stakeholders who want to get their dividends paid in the short term and the FPO leaders who might want to recycle profits back into the FPO to help ensure long-term sustainability (Kassam et al., 2011). Therefore, the ownership structure and the manner in which profits are allocated (depending on the proportion of shareholders held as in a true company or dependent on loyalty as in traditional cooperatives) need to be carefully considered, as it can affect the incentives of members to participate in the FPO or use its services, so that the form in which profits are distributed is relevant and ideally will fulfil members as well as strengthen the sustainability of the organization. In Indonesia, a FPO's management consisted of a general assembly, a board of directors, an audit committee and an electoral committee. The annual forum for policy making determined the strategies of the company and appointed the board of directors and committees. According to Ibnu et al., (2018), the FPOs have been practicing democratic decision-making through voting, and the income generated (e.g. money from trading activities) was shared equally among all participants.

Kassam et al (2011) has reported important findings about the management in the FPOs (especially in the fishery the FPOs) in Asia. Farmers' Organizations in developing countries in Asia including Thailand, India, Bangladesh and Indonesia tend to have hired skilled managers to manage their organizations. The reason has been that the FPO leaders may not have enough business knowledge, and management skills and experience to effectively manage their FPO and thus need to get the services of a hired manager to support them. Further, the management committees in the FPOs may not be the best way to manage because the business environments were changing rapidly and decision-making has to be as swift to be able to respond to changing circumstances and to respond to the new opportunities that might emerge. Hiring professional managers also has its drawbacks when leaders of the FPOs were unable to assess the performance of managers and when leaders have not had the industry knowledge to understand what the managers were doing. Therefore, in the long run the FPO members should set minimum levels of business comprehension to efficiently monitor and control the function of working managers (Kassam et al., 2011).

Farmers' Organizations have had to make profits or conduct other tasks that are adequately advantageous for members to continue paying membership fees and making large enough donations to the FO to support it in the long run in order to survive in today's competitive economies, offer long-term benefits to members and maintain financial viability (Kassam et al., 2011). In order to continue supplying participants with long-term economic and other incentives, the FPOs were needed to find ways to increase their revenue, reduce their expenses and, in short, run like a true company. Some of the common business tactics the FPOs have implemented to raise revenue included increasing volume of business to capture economies of scale; adding value by improving quality, processing or differentiation; diversifying into high-value products; accessing new markets; and negotiating higher prices through increased bargaining power. Details of some of the common types of the FPOs are briefly described as below.

3.1.5 Informal Farmers' Organizations

Informal FPOs are a common vehicle for farmers to coordinate. Informal FPOs that do not have legal rights, are non-registered FPOs and they are how most FPOs start off (Penrose-Buckley, 2007). Only once the advantages of doing so outweigh the additional costs that come with registration and other formalities should FPOs register. In some countries the laws that govern the FPOs are weakly specified or require small-scale producers to have an inappropriate structure providing farmers with less incentive to register their organizations. For example, in Vietnam, cooperatives are the only legal structure available for collective business, but cooperatives have a lot of rules and regulations that are not suitable for small enterprises (Penrose-Buckley, 2007). It was reported that the registration may be a disadvantage if the FPO competes in an unregulated informal market with informal traders (as example, if the FPOs in Thailand are expected to pay tax if their rivals do not). Without registration, however, the FPOs can have problems accessing financial resources (such as formal credit or technical assistance) and can be seen as less reliable by potential business partners than other registered FPOs (Penrose-Buckley, 2007). It has been shown that the FPOs are less likely to be sustainable in the long run if not formally registered.

3.1.6 Farmer Cooperatives

The most well-known type of the FPO is the Farmer Cooperatives (FCoop). Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination (Poole and Frece, 2010). The cooperative movement has a long history and has roots in the eighteenth century. During the nineteenth century, various community organizations from Asia, Europe and North America started to collect benefits from their collective purchases, selling's and savings activities (Manzano, 2016). However, the first modern day cooperative was founded in Rochdale, England. The Rochdale Pioneers initiated the fundamental principles which characterized the modern prototype of cooperatives as most of the people know them today (Manzano, 2016). These fundamental cooperative principles included the open and voluntary membership; democratic member control; members' economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and concern for community (Axworthy,1977).

Evidence show that modern cooperatives were originated in Europe and disseminated to other industrializing countries during the latter part of the 19th century as a self-help method to mitigate the vicious cycle of poverty (Hoyt, 1989). Traditional cooperatives were owned and governed by their members, having equal shares and each of whom has a say in running the cooperative through equal voting rights (Kassam et al., 2011). The primary aim of cooperatives was to provide its participants with competitively priced resources and profit from the selling of members ' goods, which are then typically sold to members based on how much they use the services of the cooperative (Kassam et al.,2011). The operations structure of a cooperative is composed of the management and employees, and is often represented by a traditional organizational chart (Butler, 1988).

The income of the current cooperatives is divided based on the proportion of members' interests rather than by patronage (how much they utilize cooperative services) (Kassam et al., 2011). Cooperatives typically have a complex framework that needs multiple rules and regulations, allows them less agile than associations and reduces their internal administrative costs (Kassam, et al., 2011). Development of Cooperatives has been strongly influenced by the political environment and the political approaches for cooperative promotion.

For example, FCoop in China developed faster in the 1950s when the government authority changed from Kuomingdang to China Communist Party and the implementation of the Agriculture Cooperative law in 1956 (Garnevska et al., 2011). In Indonesia cooperatives are typically more successful in terms of assets and resources (Ibnu et al., 2018). Farmer cooperatives in Africa have distributed smallholder farmers the opportunity to take advantage of the bargaining power of a cooperative (for purchasing inputs and selling outputs) (Kotecha et al., 2002), access market information and credit (Oxfam, 2001), and provide an organizational structure that can promote farmers' involvement in the liberalization reform process (Baffes et al., 2003).

Japanese agricultural cooperatives (JACs) are considered to be most effective agricultural organizations in the world. Japanese cooperatives root back in seventeenth century (Rajaratne, 2007. It was before the 13th Century, in France and Switzerland, that the milk producers of Gruyère and Emmenthal formed farmer cooperatives with specific economic objectives. In the UK the first attempts to set up cooperatives date from the late eighteenth century (Poole and de Frece, 2010). A review of existing organizational forms of smallholder farmers’ associations and their contractual relationships with other market participants in the East and Southern Africa revealed that the Kenya’s first Co-operative Society, Lumbwa Co-operative Society, was formed in 1908 by the European Farmers with the main motive of purchasing fertilizer, chemicals, seeds and other farm inputs and then market their produce to take advantage of economies of scale (Poole and de Frece, 2010).

3.1.7 Producer Organizations

Producer organizations, one type of the FPOs, exist in many different forms and provide a wide range of services. They range from formal institutions such as producer cooperatives, to informal producer groups and associations. Apart from the term producer organization, literature suggests different other terms for producer organizations such as farmer organizations, producer groups, marketing groups, producer and marketing groups, agricultural cooperatives, producer-own enterprises or member-owned firms (Falkowski & Ciaian, 2016). There are two types of POs including traditional or defensive form of cooperation established as a response to address market failures and the other is vertically integrated or offensive organizations such as marketing/processing cooperatives (Michalek et al., 2018). A PO may have the legal form of a cooperative, but there may be other different forms existing (Chlebicka, 2015). The shared feature of producer organizations is that they apply cooperative principles in their operations. However, in Poland, the majority of producer organizations have the legal form of a limited liability company and only 30% of the producer groups are registered as cooperatives (Chlebicka, 2015).

3.1.8 Farmer Companies

In the early 20th century the British brought agricultural marketing cooperatives into Sri Lanka (Rosairo, et al., 2012). The cooperative movement has historically been promoted and supported as a strategy for serving smallholders and elevating them from subsistence to commercial farmers (Winslow, 2002). The cooperative movement however struggled to organize farm services and products (Senanayake, 2004). In 1995, the National Development Council of Sri Lanka recommended that small holders coordinate their marketing through Farmer Companies (FC) owned and patronized by smallholders, rather than traditional marketing cooperatives (Esham and Usami, 2007).

Farmer Companies (FC) need a mentioning due to their popularity. They have been made popular by policy-makers who required them to achieve rural development goals. Sri Lanka introduced FCs in the mid-1990s to help its smallholder farmers to access high value markets. They were required to transform traditional smallholder farming in to dynamic commercialized business ventures (Senanayake, 2004). Further, the establishment of such organizations that could reward farmer-investors was motivated, in part, by the poor performance of producer and marketing cooperatives that rewarded farmer-patrons. In practice, these FCs adopted a mixture of institutional arrangements borrowed from traditional cooperatives and investor-owned companies, creating a range of hybrid firms (Rosairo, et. al., 2011).

Farmer Companies were originally registered under Part VII of Sri Lanka's Companies Act, No. 17 of 1982, which provided for 'Peoples Companies'. Act 17 was replaced by a new Companies Act in 2007 and all existing FCs were required to re-register under the new Companies Act No. 7 of 2007. Farmer companies were investor-owned firms established under the Companies Act as people's companies (amended later). Therefore, FCs can be defined as organizations registered under the Companies Act of Sri Lanka, owned and patronized by farmers for their economic benefit (Rosairo, 2010).

They were registered as Peoples' Companies to protect against possible private ownership by imposing limits on membership and share trading. Only farmers and other agricultural stakeholders living within a specific geographical region could become shareholders, and shares couldn't be traded except among farmers eligible for membership. However, according to the applicable clause of the act in Sri Lanka, the overall number of shares a shareholder can own is limited to 10 per cent of the shares issued at a given time (Esham & Usami, 2007; Rosairo et al., 2011 and 2012). Farmer Companies were set-up to maximize returns to their owners (shareholder farmers) while avoiding the institutional problems that severely disadvantage the traditional cooperatives. They were considered as hybrid organizations that were more similar to traditional cooperatives than they did to true companies. Few FCs were surviving reasonably well, but majority have not succeeded (Esham and Usami, 2007; Rosairo et al., 2012)). Therefore, it was suggested that there was a continued presence of the key institutional problems (Section 3.1.10) that constrained access to capital, business growth, and the sustainability of the FCs. Also, they lacked developed organizational structures that could support proper corporate growth.

3.1.9 New Generation Cooperatives

New farmer-owned associative models have arisen in the US since the mid-1990s. Cook (1995) hypothesized that the property rights issues would lead to a necessary restructuring of cooperatives. Fulton (1995) also speculated that the technological change and individualism among leaders would become obstacles to cooperative growth and success on the agricultural sector in the United States. It was subsequently suggested in this changing context that the cooperatives would either be unsuccessful altogether, or make moderate changes to the cooperative structure, or finally make a radical deviation from the existing cooperative norm (Cook & Chaddad, 2004). What has arisen in this last level of change is a kind of associative the FPO that has abandoned the traditional cooperative substantially, but is referred to as a New Generation Cooperative (NGC).

Ownership rights of new generation cooperatives in United State are limited to current member patrons (owners) and are in the form of tradable and appreciable delivery rights (Cook & Chaddad, 2004). Members buy the rights to perform on the basis of their desired (or expected) patronage (Cook & Chaddad, 2004). Capital investment in this manner is proportionate to use (or patronage).

Although traditional modes of cooperation have been defined as protective, aimed at protecting farmers and mitigating danger, new generation cooperatives can be seen as 'offensive'. Offensive cooperatives also found ways of coping with declining income and' adding interest' to their products, at least in part because of their equality of access and capital management. Consequently, the growth of new generation cooperatives has required a' realignment of their ownership structure' (Cook & Chaddad, 2004). Features of such new-generation cooperatives are a closed membership, a contract-based membership, and a homogeneous membership with common goals and policies (usually only a small percentage of producers who can access sufficient amount of assets, etc.).

The work on new generation cooperatives from both Canada and the US provides an interesting guide to ownership and management privileges. New-generation cooperatives in these countries are seen as providing a solution to some of the cooperative's systemic and structural problems including questions of insufficient property rights and equity concerns (Poole and De Frece, 2010).New Generation Cooperatives in Western Canada are the result of recent social action-oriented pioneers trying to address market failure problems, oversupply demand deflation, structural weaknesses of traditional cooperative property rights and free rider concerns.

Different strategies are defined in their by-laws and business processes in the form of asset appreciation frameworks, proportional patronage dispersed power, base equity capital plans and participation policies regulating entry (Nilsson & Van Dijk, 1997).

Caswell (1989) indicated that investor-owned corporate agribusiness companies in Europe retained significantly higher levels of directorship and company communication by board representation than U.S. agricultural cooperatives did. She argues that this omission of a selection of outside members on cooperative boards supports the concept of democratic control but may adversely affect the scope of board decision-making. Based on the case of wheat industry in Western Canada, Nilsson and Van Dijk (1997) stated that the assumptions for strategic information are a possible source of tension between management and executive boards by giving the uncertainty and superficial existence of global market decision-making. Cooperative boards and members as customer-owners of an organization's tied-equity category have high expectations about how much organizational and strategic knowledge should be made available for their perusal (Nilsson and Van Dijk, 1997).

3.1.10 Reasons for failure of Farmer Producer Organizations

Different FPO models have been introduced to assist and benefit farmers especially in the rural areas in the world, have had mixed results during the past. Numerous studies have been done and a large number of articles have been written to explain the reasons for good and bad results of these FPOs. Some of the FPOs have failed to show a good performance due to their internal reasons while some others have failed due to external environmental reasons. Farmer Producer Organizations were usually constrained through financial weakness which could be overcome only when they had access to significant amounts of donor money / assets or are mandated to collect levies on crop sales. Farmer Producer Organizations have also failed when members did not prioritize activities, political interference by farmers unions and when research and extension priorities are never made explicit (Carney,1996). A review of World Bank experience in the development of cooperatives and rural organizations (Hussi et al., 1993) highlighted lack of autonomy and excessive political interference as the main reason why these organizations have so often failed in many countries.

One of the commonly cited explanation for why the FPOs fail lies in their attempts to undertake activities that they do not have the experience of skills to undertake collectively (Stringfellow et al., 1997). Frequently, these attempts are encouraged and supported by development agencies wishing to expand farmers' incomes, but failing to fully recognize the constraints for achieving this through collective action. Literature warn that the FPOs are harmed by attempts to encourage them to scale up too rapidly or to undertake too many or complex activities (Chirwa et al., 2005). They can also be undermined by subsidies, by a failure to focus on core commercial activities offering clear benefits to members, and by donor and government support and interference that treat them more as development agents than as private businesses (Kindness & Gordon, 2001). Also, much of the coordination problems in the FPOs in developing countries was due to the failure of coordinating complementary investments (Hoff, 2001).

Berdegue (2002) reported on problems faced by some of the FPOs in Chile where close social relations prevented them from enforcing rules of sanctions, due to the fear of alienating friends, neighbors, or members of the same families. In Mexico, many collective and cooperative rural organizations have a history of being used for political ends and subject to manipulation by corrupt leaders, or have failed because of interpersonal jealousies and mistrust (Key and Runsten 1999). There was also the issue of mistrust between producers and buyers in FPO situations. Rehber (2004) reported that in Turkey, when the spot market prices were higher than the contract prices, small-scale vegetable producers were accused of selling their goods produced under contract on the open market. However, when the contract price is higher than on the open market, farmers tried to supply more products to the contracting processor, having obtained produce from other farmers who were not included in the contract.

In Portugal the 1974 revolution gave rise to a strong cooperative expansion but since the mid-1980s a period of significant cooperative failures occurred, as a result of intense market competition (Bijman, 2012).

Fulton & Hueth (2009) have stated that some of the FCoops in the US have shown sub-optimal results due to poor management rather than flaws in the cooperative business model. In developing countries attempts to coordinate farmers into cooperatives have often failed, although cooperatives have the potential to supply farm inputs and market farm products that are both important for agricultural development (Hoyt, 1989). The Department of Trade and Industry (2003) in South Africa provides a brief overview of cooperative development in African countries. Akwabi-Ameyaw (1997) suggests that in Africa FCoops have often failed because of problems in holding management accountable to the members (i.e., moral hazard), leading to inappropriate political activities or financial irregularities of management. Van Niekerk (1988) reports that cooperative failures in the former (less-developed) homelands of South Africa were due mainly to lack of management experience and knowledge, lack of capital resources, and disloyalty of members due to ignorance.

However, the Malawian experience with Ministry of Agriculture supported the FPOs in the 1970s and 1980s was much more positive, supporting very high rates of maize productivity growth and credit repayment, although with limited human capacity development. Although most of these clubs were growing maize and failed in the 1990s (as a result of simultaneous shocks from drought, from political and economic liberalization, and from macro-economic instability) a significant number survived growing cotton or have managed to resurrect themselves with new opportunity to grow burley tobacco (Chirwa et al., 2005).

In the Southwest of Cameroon, where Cocoa Farmers' Organizations were more prominent relative to the Central and South, farmers have not embraced the idea of forming or joining cooperatives. This is caused by the many failures in the past that soured farmers who lost revenue and received little benefit despite paying dues (Wilcox and Abbott, 2006).

In Sub-Saharan Africa, due to the withdrawal of the state from being a provider of many services through privatization, democratization and liberalization, most cooperatives failed to compete in the open-market economies, and eventually collapsed (Abaru et al., 2006). The decline of cooperatives and other the FPOs, lead to farmers' lack of a collective voice. Consequently, farmers cannot access inputs and technologies at affordable prices. Subsequently, a number of small-scale farmers remain poor and cannot influence policies that affect their well-being: hence, the need for formulation of different FPOs (Msuta and Urassa, 2015). Local farming groups established for access to inputs and/or market outputs in Zimbabwe had largely disintegrated in part because there was considerable mistrust among farmers in relaying useful market information (Masakure & Henson 2005).

There were some examples of FPO failure situations in China. The failure of Nanmazhuang Cooperative which was established in 2004 to help members coordinate the planting and management of organic rice. The rice cooperative still exists nominally, but it has failed as a cooperative because it did not arise as a spontaneous initiative of the farmers; the leaders of the cooperative lacked sufficient management skills to run a market-oriented facility; and the competition and conflict among different lineages and cliques in the village (Day and Schneider, 2018). The other example was the failure of Northpoint Farmer Cooperative which was also formed in 2004. An initiative by the cooperative to establish its own farm failed after only a couple of years. The cooperative had later almost totally withdrawn from supporting agricultural production, with bulk purchases making only a marginal difference, and participation in this was not exclusive to cooperative members (Hu et al.,2017).

The reasons for failure of cooperatives in general were mostly attributed to internal (institutional) problems of the organization. As such, the new institutional economics literature explains five fundamental institutional problems that can weaken traditional cooperatives (Sykuta & Cook, 2001). An internal free rider problem arises when a traditional cooperative distributes its profits among its members according to their patronage rather than their level of investment in the cooperative. An external free-rider problem arises when the non-members are offered same terms as members for their transactions with the cooperative. A horizon problem arises when the members cannot earn capital gains when they want to leave the organization as the shares of a traditional cooperative are not tradable and have only a nominal price. New members if any, can capture these gains by not paying a market price for shares. The absence of internal market for shares creates a portfolio problem where members cannot match their business risk preferences with that of the cooperative. A control problem arises in a traditional cooperative when members cannot sanction (or appreciate) the management in the absence of an active market for its shares. An influence problem arises when the voting rights are democratic rather than proportional to the level of investment.

The institutional problems discussed above severely restricted the borrowing by the traditional cooperative and the FC as financial institutions prefer their lending to be secured by equity against loan defaults. The influence problem further aggravates the situation through a hold-up problem especially when a traditional cooperative wants to attract debt capital to acquire relation-specific assets (Royer, 1999; Rosairo et. al., 2012). In addition, Esham & Usami (2007) have reported that the failure of FCs in Sri Lanka were due to shareholders perception of the company as a service provider but not a business organization; misconception of shares as a subscription to access the services rendered by the FC; and making the minimum investment purely to access the group loan scheme. Senanayake (2004) reported that many of the FCs failed due to political influence; lack of entrepreneurial skills; and absence of systematic approaches or processes. All these have far reaching implications on the sustainability and growth of FCs. As such, FCoops and Sri Lankan FCs do not seem to be growing institutions because they both experience all the problems explained above and consequences due to their quite similar institutional arrangements. Therefore, FCoops and FCs that practiced procedures and principles borrowed from FCoops could not be considered as strong candidates for agricultural modernization projects that have strong business focus.

3.1.11 Review on farmers' organizations found in the neighboring Asian countries; Vietnam, Thailand, India, and Bangladesh

Farmers' organizations in Vietnam

Moustier et al., (2010) had identified that the Agricultural cooperatives in Vietnam falls under four distinct phases; (1) the voluntary collectivization period of 1954-1975; (2) the compulsory collectivization period of 1975-1981; (3) the de-collectivization period of 1981 – 1997; and (4) the neo-collectivization period since 1997. During the mid-1980s, Vietnam led to economic reforms where the collective farms were transformed into service cooperatives based on the share capital and voluntary membership or either liquidated (Wolz and Duong, 2010). Voluntary FPOs in the form of commercial joint-stock cooperatives were legally established in 1996. The new cooperative law of 2003 (effective as of 2004) made the voluntary cooperative the foundation to obtain economic status, negotiate contracts, and pay taxes (Moustier et al., 2010). The revised Cooperative Law of 2003 also simplified the registration process (Wolz, and Duong 2010) and strengthened the independence of cooperatives from the local administration which seemed to have a strong control in day-to-day activities (Dang et al., 2008). The Cooperative Law was revised again in 2012 by significantly reducing the minimum number of persons to establish a new cooperative for business purpose into 10 where the Cooperative Law in 2003 covered a whole village (Anh et al.,2019).

Wolz, and Duong (2010) have identified two types of agricultural cooperatives including transformed cooperatives and the newly established cooperatives. Both these types were different models and the key differences in the characteristics of both these types are depicted in the Table 3.2 (Wolz, and Duong,2010). Further in Northern Vietnam there are Farmer Associations which were set up with the help of the Agricultural Science Institute in 2003 to respond to marketing problems encountered by farmers (Moustier et al., 2010). There are Cooperative Unions which are simple small intermediate organizations that gather only farmers who wish to join and specialize only in a partial function of management operation (Akiba , 2015).

The Managing Board is considered to conduct the implementation of decisions of members of FCoops. Members of the Managing Board are elected among the members of the Cooperative. Literature suggests that the Law of Cooperative of Vietnam has introduced another model of leadership for cooperatives where members shall elect a Board of Directors.The Board of Directors takes the responsibility to recruit managers and other employees (Nghiem,2006).

The Cooperative Law 2003 also permits the creation of a federation of cooperatives (also referred to as unions), at national, provincial and municipal levels. By mid-2007, 39 cooperative unions spread throughout the country had been registered (Beard & Agrawal, 2002).

However, literature suggests that there was a drop in number of agricultural cooperatives in Vietnam due to the exit of inefficient cooperatives during the period when the Vietnamese economy experienced a downturn with GDP growth dropping from 2006 to 2011 (Cox and Le, 2014). It was identified that the failure and increased risk of bankruptcy of the many types of Cooperatives in Vietnam was mainly due to the mismatch between supply and demand of their produce (Ho et al., 2018).

Table 3.2: Main characteristics of agricultural cooperatives as of 2000

Criterion	Transformed Cooperatives	Newly-established Cooperatives
Membership	Open to all agricultural households	Restricted to those who follow the highly focused objective
Number of members	300-500	10-20
Subscription of shares in cash	(in general) No	Yes
Value of total assets - Available as current assets - Available as cash-in-hand	300-800 million VND* - About 20 per cent - Less than 10 per cent	15-100 million VND* - Almost 100 per cent - Almost 100 per cent
Activities	5-10: Emphasis on: - Irrigation - Electricity supply - Plant protection - Input supply - Extension (new crops, varieties, production techniques etc.) Multi-purpose	1-3: Emphasis on: - Input supply - Extension (quality management) - Joint marketing
Number of decision makers	5 - 10	1 – 3
Stakeholders involved	Multiple stakeholders	Single stakeholder

Source: Wolz and Duong,2010

Farmers' organizations in Thailand

In the context of Thailand, a the FPO is defined as a body providing credit, savings, farm supplies, joint marketing, and agricultural extension services to members (Kramol et al., 2020). The most common types of the FPOs identified in Thailand are farmer groups and FCoops where the latter is mainly focused on commercial marketing (Kramol et al., 2020). The Cooperatives in Thailand are categorized into seven types namely, Agricultural Cooperatives, Land Settlement Cooperatives, Fisheries Cooperatives, Thrift and Credit Cooperatives, Consumer Cooperatives, Service Cooperatives, and Credit Union Cooperatives (Thuvachote, 2011). Sathapatyanon, et al., (2018) have stated that the Agricultural Cooperatives in Thailand are organized vertically based on a three-tier system; primary cooperatives at district level, provincial federations at provincial level and national federation at the national level. Farmer groups and cooperatives are established within villages and sub-districts (*tambon*) and are linked at district and provincial levels through farmer networks and higher-level organizations (Kramol et al., 2020).

The Cooperative League of Thailand (CLT) is the top national apex organization where all types of Cooperatives are affiliated and acts as a cooperative education promoter (Mukhjang,2012). Furthermore, the Agricultural Cooperative Federation of Thailand functions as the center of the Agricultural Cooperatives providing comprehensive services to its members including the promotion of production, supply of inputs, marketing knowledge and welfare to achieve economic and social objectives (Mukhjang,2012).

Cooperatives in Thailand engage in a wide range of business activities ranging from credit business, savings and deposit, marketing business, purchasing business and services business (Thuvachote, 2011). Statistics revealed that there are around total of 11,447,405 cooperative members in 8,263 cooperatives comprising 4,480 agricultural cooperatives and 3,783 non-agricultural cooperatives by 2016 in Thailand (Sathapatyanon, et al.2018).

Both farmer groups and FCoops have the same organizational principles, including voluntary and open membership, democracy, autonomy, independence, cooperation, human resource development, information dissemination, and community spirit (Kramol et al., 2020). The key challenge of the system is that the Cooperatives appear to benefit more than the member farmers in the sense that not all benefits accruing from the activities of the network are distributed among the member famers (Sathapatyanon, et al.2018). Majority of the Cooperatives Thailand are small sized and are fragmented in the supply chain making them difficult to thrive or sustain on the competitiveness (Krasachat & Chimkul 2009). Mukhjang (2015) underlined four major obstacles for Cooperatives in Thailand namely (1) limitation of knowledge and understanding about the cooperative; (2) lack of linkage for mutual cooperation; (3) absence of an institution directly responsible in harmonizing the information technology development system; and (4) inadequate role of the Cooperative League of Thailand.

Farmers' organizations in India

Cooperatives, democratic organizations controlled by their members, who actively participate in setting their policies and making decisions, are considered to be a prominent form of the FPOs in India (Datta,2014). Agricultural cooperatives were established under the Co-operative Credit Societies Act, 1904 (Bikkina et al.,2018). However, a more comprehensive Act, known as the Co-operative Societies Act of 1912 was introduced and this Act recognized non-credit societies apart from the credit societies (Kumar et al.,2015). By law, the Cooperatives are required to have a minimum of ten members, where laborers and dependents may be provided with nominal or 'dummy' membership in fictitious societies. Further, the profit distribution within these societies usually emphasized land contribution over labor contribution (Ebrahim,2000).In addition, the Department of Agriculture, Cooperation and Farmers

Welfare of India had compiled policy and process guidelines for the FPOs in 2013 to encourage the formation of the FPOs and laying out indicative guidelines for the formation and performance of these collectives (Turaga, 2018).

In recent years of India, two important institutions; Producer Companies and vertical integration of production units with larger firms of marketers and agro-processors through contract farming, have emerged to make an impact on the farmers (Chen et al.,2015). India also had other collective organizations such as self-help groups which are usually formed as non-farm organizations, although some of these served as nucleus for Producer Companies in the agricultural sector (Singh and Singh, 2014).

Producers Companies of India are a variant of traditional cooperatives. These Producer Companies are guided by a special provision of the Indian Company Law where the India's Companies Act, 1956 was amended in 2002 to allow for incorporation of producer organizations (Chen et al.,2015; Tagat and Tagat,2016). Producer Companies retain the basic characteristic of the cooperatives such as one member one vote, limited interest on shares, returns for members in proportion to their participation in the business, users alone are owners, no trading of shares, membership restricted to the producers, but they give greater emphasis to professional management. Most producer companies have a stunted growth mainly due to the minimal support of the organized banking sector and still most of the state governments are patronizing traditional cooperatives (Chen et al.,2015). However, literature suggests that the success of producer companies depends on more or less the same factors as for cooperatives, because it depends on farmers' commitment to the company (Trebbin and Hassler, 2012).

Cooperatives in India have also experienced problems in relation to their leadership, member commitment, as well as opportunism and free riding as well as problems with financial and managerial resources causing a lack of performance (Datta, 2004). Thus. there are several pitfalls including poor infrastructure, lack of quality and professional management, overdependence on government, dormant membership, non-holding of elections, lack of strong human resources policy, neglect of professionalism, erosion of values, decline in service-oriented leadership, too much dependence on government help and financial support, adverse impact of rigid bureaucratic processes, outdated legal framework, and the absence of knowledge-based market orientation, that have made Indian agribusiness cooperatives unsuccessful (Das et al., 2006; Shah, 2007).

Farmers' organizations in Bangladesh

Farmers' Organizations in the name of different cooperative societies are not new to Bangladesh and such types of organizations have been involved in a range of agricultural products (Islam et al.,2018). In Bangladesh, agricultural cooperatives were considered an effective instrument for increasing agricultural production and attaining distributive justice mainly to save farmers from exploitation by traders, middlemen, and money lenders (Muneer,1989; Milovanovic et al,2016).

The registration procedure of the FPOs in Bangladesh is considered to be a tedious task since it is a centralized process. There are three main institutions related to the registration of FOs including the Department of Social Services; the Office of the Registrar of Joint Stock Companies and Firms; and the Department of Cooperatives. Further, the agencies like the Department of Youth Development also provides registration to youth groups, including youth farmers' clubs (FAO, 2014).

Farmers' Organizations were formed in the agriculture sector with the direct support and facilitation of government extension agencies and non-governmental organizations. However, the continuation of those organizations was not satisfactory mainly due to rigorous control (rather than dissemination and motivation) that the government institutions exercise (Islam et al.,2018). Mondal (2010) highlighted that the top-down approach by the influential must be avoided in order to make cooperatives successful. Literature suggested that agricultural cooperatives still lacks professionalism in their operations and pointed out that the lack of trust among the members of the cooperatives had made them unsuccessful in Bangladesh (Nitu, 2019).

3.2 Review of legal provisions relative to farmer producer organization models in Sri Lanka

An initial status review of legal provisions of different entities of farmer organizations was completed. This review has considered the following Acts.

1. The Companies Act No 7 of 2007
2. The Agrarian Development Act No 46 of 2000
3. The Cooperative Societies Law No 5 of 1972 as amended.
4. The Societies Ordinance No 16 of 1891 as amended
5. The Mahaweli Authority Act No 23 of 1979

This review attempts to identify the laws under which farmers may organize themselves in to business entities.

This review analyses the aforementioned legislation for the purpose of making an initial theoretical assessment of their suitability to be used as the legal framework for the proposed Agriculture Technology Demonstration Parks.

It is to be noted that the Sole Proprietorship has not been considered in this review as it is not a creature of a statute and very few statutory provisions if at all attract it. It is also disregarded for its inherent unsuitability to operate as an ATDP.

The law relating to Partnership is found in the Partnership Ordinance of (containing seven sections) and in the English Law. An exposition of the English law of Partnership is beyond the scope of this review as the review pertains to statutory and regulatory provisions. However, it is to be noted, that the lack of legal personality, and the limit as to the number of members does not facilitate the achievement of the objectives of the ATDP.

3.2.1 The Companies Act

The Company is the most popular form of business organization used in Sri Lanka and therefore the most popular candidate as a legal structure that can be used for an ATDP.

Companies are established under the Companies Act No 7 of 2007. The main features of the Company form are discussed hereinafter along with their specific applicability to an ATDP.

The main feature of a company is its separate legal personality, which permits a Company to enter in to transactions on its own independent of its owners or its directors. All rights and obligations from contracts entered in to are that of the Company. This makes the Company form inherently suitable as an ATDP.

Types of Companies.

The Companies Act provides for two types of Companies that are suitable for commercial purposes. Whilst the Act permits the incorporation of Companies limited by guarantee they are not considered in this analysis, as they are inherently unsuitable for business purposes.

Limited liability

A company that issues shares, the holders of which have the liability to contribute to the assets of the company, if any, specified in the company's articles as attaching to those shares

Unlimited liability

A company that issues shares, the holders of which have an unlimited liability to contribute to the assets of the company under its articles.

It is to be noted that the concept of limited liability has shielded shareholders from being personally liable for the debts of a business and has contributed to the popularity of the company form as a business structure over the last century. Therefore, the authors are of the view that this advantage should be afforded to the proposed ATDP. Thus, the limited liability company form presents the model that suits the ATDP.

The Act refers private limited Companies directly and to the concept of an unlisted public limited company by implication. Each of which shall be considered now.

The Public Limited (unlisted) Company

The Public Limited Company, is permitted to offer its shares to the public. It must be noted that this does not mean that a public limited Company is compelled to issue shares to the public, but that it merely has the legal competence to do so. However, every offer of shares made to the public has to be made by complying with a number of stringent requirements set out in the Companies Act. The terms of the offer have to be made declared in a written document (referred to as the prospectus) which has to be registered with the Registrar of Companies. Thus this model is often used by companies who seek to obtain a listing in the Colombo Stock Exchange at a future point of time, once the Company has expanded and requires a substantial equity injection for its evolution.

Due to the "public" nature of this type of company, it is placed under numerous disclosure requirements under the company law. Whilst the same disclosures apply to the Private Company form, the Companies Act permits a private Company to obtain an exemption from some of the requirements by passing a unanimous resolution by its shareholders.[3]

[3] Schedule IV of the Companies Act

Since the requirements are common for both types of companies, they shall be referred together in the following paragraphs.

The Private Company

The Private Company is the form of Company that is widely regarded as suitable for business that is carried out with the combined equity capital of a numerically small number of investors.

A Private Company by very definition is,

(a) Prohibited from offering shares or other securities issued by the company to the public; and
(b) bound to limit the number of its shareholders to fifty[4],

This limitation on the number of shareholders presents a threshold issue for an ATDP that requires resolution. If the proposed ATDP model requires all farmers in the clusters to be shareholders of the ATDP, the private Company model would be unsuitable as the number of farmers offering patronage to an ATDP is expected be in excess of 300. It is also unlikely that the ATDP would be employing all of its farmers (which would then prevent the application of the maximum shareholder rule). In contrast, if the ATDP is to be owned by a few shareholders (who may or may not be farmers) the private company model appears viable. However, a creative business structure could be generated even where the former requirement is found to be an imperative requirement upon the analysis of the data of this study.

The Shares of a Company

A share of a company is the means by which investors become owners of the Company. The shareholders purchase shares of the Company and henceforth become shareholders.

Generally, a share in a company confers on the holder —
(a) the right to **one vote** on a poll at a meeting of the company on any resolution;
(b) the right to an **equal share in dividends** paid by the company;
(c) the right to an equal share in the distribution of the surplus assets of the company on liquidation.

However, a company may issue different classes of shares, and in particular may issue shares which
- (a) are redeemable;
- (b) confer preferential rights to distributions; or
- (c) confer special, limited or conditional voting rights or confer no voting rights.

A share in a company is transferable in the manner provided for by its articles and such articles may limit or restrict the extent to which a share is transferable.

This feature makes the company attractive as a viable model. The purchase of shares offers a channel for investment to be brought in to the ATDP. Whilst the initial capital would be provided by donors, this would need to be supplemented by the funds received from share issues. This also provides an

[4] This limit does not apply to shareholders who are employees or former employees of the entity section 27 of the Companies Act No 7 of 2007

opportunity for fresh capital to be injected at a future time, should the need arise. The claim to the ownership of the Company would also create a certain intangible (a sense of kinship) nexus between farmers and the ATDP that would be very beneficial to its success.

In terms of governance, the voting rights attached to a share provides a control over the direction of the ATDP and make it directors accountable to its shareholders. With shares being very widely dispersed, this accountability may be fairly high. Of course, this would only be fruitful if the shareholders remain alert and interested in the workings of the ATDP.

The right to dividends may prove to be a strong incentive for farmers to remain with the ATDP. However, expectations of the shareholders may have to be managed, with the initial years not having sufficient profits to be distributed. The Companies Act has an inbuilt mechanism to prevent dividends being declared that may place the company in peril. Directors are expected to satisfy themselves (via an auditor's certificate) that the company would satisfy the solvency[5] test immediately after declaring such dividend. The declaration needs to be approved by the shareholding[6]. Apart from the above, the Articles of the Company may have to include certain restrictive stipulations on retaining profits for future investment, to prevent overzealous directors from declaring dividends that are inimical to the long-term sustainability of the ATDP.

Whilst the Company form has certain obvious advantages as an ATDP it also has certain features which may offer a challenge as a suitable vehicle for an ATDP. The companies Act sets out a number of procedural requirements which the management of an ATDP may find onerous.

The requirement to file returns

Every company must at least once in every year deliver to the Registrar of Companies an annual return.

The requirement to hold an Annual General Meeting

The board of a company must call an annual general meeting of shareholders to be held once in each calendar year. The holding of these meetings requires giving adequate notice to shareholders, drafting suitably worded resolutions to be passed and a degree of formality in proceedings.

The duty to maintain records

The Companies Act requires every company to keep accounting records which correctly record and explain the company's transactions, and will—

(a) at any time enable the financial positions of the company to be determined with reasonable accuracy;

(b) enable the directors to prepare financial statements in accordance with this Act; and

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[5] Section 57 which states that a company shall be deemed to have satisfied the solvency test, if—
(a) it is able to pay its debts as they become due in the normal course of business; and
(b) the value of the company's assets is greater than —
(i) the value of its liabilities; and
(ii) the company's stated capital.

[6] Section 56

(c) enable the financial statements of the company to be readily and properly audited.

Annual reports

The board of every company is required to, within six months after the balance sheet date of the company, prepare an annual report on the affairs of the company during the accounting period ending on that date.

Whilst these requirements may be cumbersome, they have been put in place for good and valid reasons. They ensure a great degree of transparency in the workings of the Company and help prevent the occurrence of fraud and other irregularities by the Board, senior management and employee.

Auditors and Company Secretary

The Companies Act also requires a Company to have a duly qualified auditor who is responsible to conduct an audit of the financial statements of the Company every financial year. This requirement though undoubtedly necessary for the long-term sustainability of an ATDP, places a significant financial burden on the entity. Similar sentiments can be expressed of the requirement for a duly qualified Company secretary to be employed by the Company.

Conclusion

The Companies Act provides detailed provisions as to the creation of a Company. It may offer a possible legal structure that may be utilized for the ATDP. The Company form provides for a great degree independence to the owners. It also provides for a robust audit and control procedures. However, if the proposed ATDP is to be owned and managed by farmers, the Company form may present several challenges. They include the unique disability of the Private Company to accommodate more than 50 members. The parallel obstacle in a public company, of having to make a "public offer" to the farmers to accommodate all farmers in the ATDP to purchase share in the company. Apart from the above, the general difficulty in maintaining compliance with many of the rigorous procedural requirements the Company form also requires the engagement of numerous professionals such as auditors and private secretaries, which may prove economically burdensome. Despite the aforesaid challenges, the Company form may present a viable solution.

3.2.2 The Agrarian Development Act

The Agrarian Development Act No 46 of 2000 was introduced by the government of Sri Lanka with the repeal of the then existing Agrarian Services Act. One of the many changes the Act introduced was creation of Farmer Organizations.

The Act envisages the formation of Farmer Organizations for a designated area determined by the Commissioner General of Agrarian Development. Each such FO must be registered with the Commissioner General. These Farmer Organizations are then united within a structure known as an Agrarian Development Councils with each district having several such Councils. Those Councils are then federated at District, Provincial and national level creating a hierarchical structure.

The lower two tiers of this model is immediately seen as an attractive structure for the ATDP as the Farmer organizations, and the Agrarian Development Councils seem to be already established and stabilized over the last decade. However, whether those in existence match the requirements of the project needs to be ascertained. Irrespective of the aforesaid, the suitability of the structure is discussed below.

Juridical Nature

A registered Agrarian Development Council is deemed a body corporate having perpetual succession and a common seal and may sue and be sued in its corporate name. Thus, this body may be considered as the structure for the ATDP and the Farmers Organization, which has a similar juridical nature can be used to organize the clusters in to formal organizations.

Like Companies, the Agrarian Development Act has specifically vested them with the power to contract, obtain loans, mortgage property, own property etc. Thus, there has been a very obvious effort to imbue these organizations with many of the positive characteristics of a company.

Membership

The Full membership of a Farmer Organization is limited to those residents within the area of authority whose livelihood is farming[7]. This geographical area is determined by the commissioner general of agrarian development. A further qualification would have to be added in granting membership so that only those cultivating a designated crop may gain entry to the organization. Whilst the Act permits associate membership to be granted to an Owner or occupier of agricultural land and people engaged in the production of agricultural produce. Whether this expansion of membership is required or necessary for an ATDP needs careful consideration.

The Agrarian Development Council will consist of delegates of the Farmer Organizations and appointees of the Commissioner General. These appointees may have significant influence in to the workings of the organization though they have not been vested with the voting power where decisions are taken after a vote.

Management

The management of the FO is by a committee elected by the membership at a general meeting of farmers thus there is room for democracy within the organization with each farmer entitled to a single vote. The most important decision a Farmers Organization would be deciding on its representative to the ATDP (Agrarian Development Council).

The management of the ATDP will be done through the board of delegates of the FOs[8], the nominees of the Commissioner General and hired employees of the ATDP.

Audit

[7] Section 43.
[8] Section 51(3)

Limited powers of inspection and audit have been granted to the Commissioner General to look in to the affairs of the farmer organizations. The act fails to give details of these powers but permits the Commissioner General to supplement the Act by issuing more detailed regulations.

In contrast the audit of Agrarian Development Councils are set out in greater detail with them being expected to maintain formal accounts which are to be submitted for audit by the Auditor General. Apart from the auditor General the Commissioner General has also been given very wide powers of oversight.

Borrowing powers

Both the Farmer Organization and the Agrarian Development Council has borrowing powers as extensive as a company. However, whether the FO can borrow in practicality is another matter, as it may not have any assets to provide as collateral.

Powers of enterprise

The Act does not specifically empower the Agrarian Development Councils to engage in business. Its role appears to be an advisory one involving at the most an organizational role, inducing famers cooperate and work together. However it is interesting to note that the Act permits an Agrarian Development Council to form Peoples Companies and to own shares in a peoples Company[9]. Even though peoples companies are no longer permissible under the new Companies Act, this provision may be construed as permission being granted for the creation of limited liability Companies (it is to be noted that arguments to the contrary can also be made). Thus an agrarian Development Council may use such a company as an instrument through which it can to business.

On the other hand Farmer Organizations have been permitted to engage in “the supply of goods or services relating to agriculture”.[10] However no specific provisions facilitating business activities have been provided for. But these provisions may be utilized to create the ATDP- Cluster model.

Despite the above positives it must be noted that several challenges exist in utilizing the provisions of this Act. As stated at the outset the act envisages a hierarchy above the agrarian Development council at district, provincial and national levels. Such a vertical structure is contrary to the agreed model of this project and also leaves room for interference from the organizations higher up in the structure. The hierarchy has room for intervention by political authorities as senior positions in the hierarchy are political appointees.

Another setback is the absence of any share ownership or similar mechanism. This prevents the profits earned by the ATDP to be distributed among the farmer members.

3.2.3 The Societies Ordinance

The Societies Ordinance is a statute enacted in the late 19th century providing for the establishment and registration of certain types of Societies. The ordinance only provided for the registration of certain

[9] Section 52(2)
[10] Section 49(2)

types of societies under its provisions. The Act refers to two types of organizations that may be registered[11].

a) Mutual Provident societies.
   These are described as those having as its objective of
   - promoting thrift,
   - to give relief to the members in times of sickness or distress,
   - to aid them when in pecuniary difficulties,
   - of aiding them in times of pecuniary difficulty
   - for making provision for the widows and orphans of members

b) specially authorized societies
   These are societies **for any purpose** which the Minister may, by notification in the Gazette, authorize as a purpose to which the powers and facilities of this Ordinance ought to be extended.
   Thus at the outset it is to be noted that the ATDP would not fall in to category (a) above. However, it is possible to obtain the cooperation of the Minister in obtaining special authorization if the registered Society is the best suited vehicle for the ATDP.

Requirements for registration

Apart from satisfying the provisions of section 3 the following are mandatory requirements for a society to be registered.
- A minimum of seven members
- A minimum of capital of ten thousand
- The rules of the society must be furnished to the Registrar at the time of registration and they must not be contrary to the rules set out in schedule 1 of the Act and must contain provisions relating to all aspects set out in the said schedule.

Thus it is to be seen that the process of registering a society is a rather simple one. In fact the following analysis would demonstrate simplicity to be an ever present theme in the Societies Ordinance. This simplicity makes a registered society an attractive candidate for an ATDP, as the farmers who are expected to perform the functions of the ATDP would be less adept at dealing with complex procedures.

Juridical Nature

Once registered, the society is recognized as a body corporate, and is therefore capable of entering in to contracts, commence legal proceedings by its own name, and capable of owning property. Importantly, the legislature has also cloaked the society with the characteristic of limited liability, thereby protecting the members from being personally liable for the debts of the Society only to the value of any unpaid membership dues.

Thus a society is very similar to a limited liability Company. However one advantage a Society has over a Private Limited Company is that the numerical limitation of 50 shareholders a private Company

[11] Section 3 of the Societies Ordinance No 16 of 1891

has in terms of section 27(b) of the Companies Act does not apply to a Society and that it may have as many members as it wishes to enroll.

Audit

The society is mandatorily required to subject itself to audit annually by a public auditor. The Society is also required to file an annual return with the Company Registrar setting out the statement of receipts and expenditure, and a statement confirming audit by public auditor. However it must be said that this requirement is not onerous as those set out in the Companies Act. The Act also entitles any member and any other person sufficiently interested in the funds of the society to inspect the books of the society. Thus it could be said that the Act provides for a fairly robust oversight into the finances of a society.

Power to hold property

The ordinance specifically endows a registered society with a variety of property rights including the power to, purchase and own property, take property on lease, Mortgage any property it holds and provide loans to its members.

Powers of investment

A society is permitted to invest any portion of the funds of the society, not immediately required for its purposes,

- upon real or leasehold securities,
- in the shares, or on the security of any other society registered under this Ordinance,
- of any company registered under the Companies Ordinance, with limited liability, or
- the public funds, Government stock, or securities of * [Great Britain, India, Burma or] Sri Lanka;

The aforesaid property and investment powers are crucial if the ATDP is to take the form of a society.

Conversion to a Company

A society may, by special resolution, determine to convert itself into a company under the Companies Act, or to amalgamate with or transfer its engagement to any such company.

The aforesaid powers may be important in creating an ATDP in the first instance and thereafter expanding them.

Whilst the above characteristics are encouraging several disadvantages need to be highlighted. Firstly it is noticeable by the absence of any specific provisions to that effect, that the ordinance never envisaged a business undertaking being conducted through a registered society. But perhaps the more striking lacuna is in the absence of any mechanism to distribute the profit of the society among the members. In mutual provident benevolence funds, the society retains and invests its profits so that the same can be utilized to assist a member at a time of grievance. But a profitable ATDP would need the profits to be distributed among its members.

Finally, the ordinance presents another significant obstacle by preventing any single member from receiving in excess of Rs 25,000 as any form of benefit from the society.[12]

This is a provision that has been introduced to ensure that no person from a mutual provident fund would receive an inequitable benefit in a given year. Unless this provision is removed from application, the Societies Ordinance may not be suited to function as a business entity.

Conclusion

The authors are of the opinion that several legal impediments exist for the use of a registered society as a Farmer Organization. Firstly, only "mutual provident societies" within the meaning of the Ordinance can be registered thereunder. Thus the framework of the act suggests that legislature never intended for the society form to be utilized for the purpose of business undertakings being performed through it. The structure also does not provide for a mechanism to distribute profits by way of dividends. The ordinance also prohibits any member from receiving in excess of Twenty five thousand rupees as a benefit in a given year. However, if not for the aforesaid, the Ordinance provides a fairly good structure comparable to that of the other structures considered here.

3.2.4 The Cooperative Societies Act

Sri Lanka has a long history of association with the Cooperative Society model with them being established during British rule and enjoying success during the world war periods. The present Act was enacted in 1972 and has been subject to amendment on several occasions since then.
This long history with the model is an immediate advantage should the cooperative Society model be adopted as the vehicle for the ATDP. Therefore an analysis of the law is required.

Nature of a Society

The registration of a society converts the same in to a body corporate by the name under which it is registered, with perpetual succession and a common seal, and with power to hold property, to enter into contracts, to institute and defend suits and other legal proceedings, and to do all things necessary for the purpose of its constitution.[13]

Similar to Companies, Cooperatives can also be registered in the limited liability form as well as the unlimited liability form. However, where a society can only obtain the membership of another society, if the latter is a limited liability society. Due to the obvious advantages of limited liability, this analysis will limit this discourse to the limited liability Cooperative Society.

Thus, a cooperative, similar to Societies under the Societies Ordinance and Farmer Organizations under the Agrarian Development Act, has been vested with some of the positive qualities of a Company. Thus the members are distinct from the Cooperative society and are to a great extent protected from being held liable for the liabilities of the cooperative society.

Societies which may be registered are as follows.

[12] Section 17
[13] Section 20

1) a society which has as its object the provision of services contributing to the economic, social, educational and cultural welfare of its members in accordance with co-operative principles
2) a society consisting of registered societies as members established for the purpose of facilitating the activities of such co-operative societies in Sri Lanka

On a strict interpretation of the above it may be construed as limiting cooperatives to welfare organizations and not to business enterprise. But where. The term welfare is given an expansive meaning, it is possible that business organizations working according to co-operative principles may be included in the definition.

The registration and setting up of cooperative Societies are fairly uncomplicated. Cooperatives can be established with a minimum of ten members where the membership consists of natural persons, and a minimum of three where the membership contains other societies as members.

It is also to be noted that the Act permits societies to be members of a registered society. This enables a federated or hierarchical structure to be created. Thus the clusters envisaged in the project may themselves be registered as cooperatives, with those cooperative structures then forming a parent Cooperative society which can be adopted as the ATDP vehicle.

Certain sections of the Act appear to be geared towards an agricultural business entity. Section 21 for example, permits a co-operative to, purchase produce from its member farmers and to sell the same in the open market. This resonates with the model that the project is attempting to implement presently.

The Act provides two methods for this. The first is the contractual method, by which the rules of the society would preclude its members from selling through any external channel. Whilst the rule may be difficult to police within the society, this would facilitate the buyers of produce gaining some form of assurance, as to price, quantity and quality. It is also notable that this method does not preclude non-members from selling to competitors.

The somewhat draconian Section 22 permits the Minister to make an order requiring each producer of an item of produce in Sri Lanka or in such province, district or area in Sri Lanka, as the case may be, whether such producer is or is not a member of the society, to sell to or through the society. This provision is a relic from the period when socialist provisions had the ascendancy. It may also be viewed as anti-competitive. However the provision may be used to give the ATDP an impetus during its initial period of difficulty. However it must also be noted that the provision provides a doorway to the minister to interfere in to the activities of the ATDP. An order made in terms of this order may also be counterproductive, as the project is to be made on the basis of voluntary assumption of the ATDP concept.

Security for trade creditors.

Section 32 is a similarly drafted provision that facilitates the pledging of any securities held by the Cooperative as security for running a general balance and specifically permit such creditor to liquidate the security **without recourse to court**.

This may make the cooperative more acceptable to suppliers granting credit.

Security for banks

This section provides **banks** (the term has been given an expanded meaning) with an added protection for loans granted by them secured by a registered by a mortgage over immovable property, where such a mortgage gets priority over all other debts of the COOP at the point of liquidation.

Power to deal with property

A registered society may acquire by purchase, gift or otherwise and take on lease lands, buildings or other movable or immovable property, or sell, mortgage, lease, exchange or otherwise dispose of lands, buildings or other movable or immovable property for any purpose connected with its objects.

Compulsory acquisition of lands and buildings

A Coop is capable of moving the machinery of the state to acquire land and property in terms of the land acquisition Act subject to paying compensation as assessed by the government assessor. This again is a draconian provision that was used meaningfully during the socialist collectivization period. The utilization of these provisions can be used with equal effect to the benefit of the ATDP. But the concerns raised previously apply here with equal force.

Powers of Investment.

A registered society may deposit or invest its funds in securities, debentures, promissory notes, in banks or in the shares of another society.

Exemption from stamp duty

Cooperative societies have been made exempt from stamp duty in respect of transactions it engages in. This may be very advantageous in respect of immovable property acquisitions and disposals.

Prohibition of election of politicians to the committee of a Coop

One of the main criticisms of the Cooperative movement in Sri Lanka is that its politicization. This is despite The Act contain a provision preventing a person who is a Member of Parliament, Provincial Council, Municipal Council, Urban Council or *Pradeshiya Sabha* from being eligible to be elected to or continue in office as a member of the committee of a registered Co-operative Society. The prohibition is only applicable to sitting members. Thus politicians, who have lost elections, non-elected officers of political parties may be appointed to the committee. It may remain the status quo unless membership is limited to farmers as in the case of farmer organizations.

Disposal of the net profits

One of the disadvantages of the cooperative society model is the numerous constraints the state authorities have placed on its autonomy through statute, regulations and official interference.

An example of the former is the curtailment of freedom in respect of dealing with the profits of the society. A registered society is mandatorily required to transfer an amount not being less than 25% of the net profits to the reserve fund of the society. Significantly, the amendment introduced in 1992 has made an attempt to introduce the concept of a share to cooperatives[14]. The new section does not provide sufficient details as to the manner in which the concept is merged with cooperative principles. Despite this lacuna, certain cooperatives visited by the researchers have introduced shares in to their constitutions, with members thereafter purchasing shares. Where the cooperatives are profitable, after the mandatory statutory retentions, their constitutions provided for the members being granted dividends from a portion of the profits on the basis of their shareholding. However, in practice this was rarely done, if at all. Remainder of the profit is divided between patronage payments, social funds and similar purposes.

Audit and inspection

The Cooperative Societies Act contains a fairly detailed set of provisions governing account keeping and audit of a society. A Cooperative is expected to keep Accounts of the income and expenditure, assets and liabilities and all other transactions. The Annual Accounts of the society must also be presented to the Registrar.

Quite apart from the accounts, the annual budget of the cooperative is expected to be submitted to the general membership for approval as well as to the Registrar. It is observed that this level of scrutiny and approval is unnecessary. When compared with corporate practice, budgets are generally never presented for approval at an AGM and is often considered confidential information of a business privy to only the senior management.

The act also contains a very detailed account of the audit procedure and process. The accounts of the society are audited by auditors appointed by the registrar annually. The accounts are to be audited by a person duly appointed by the Registrar. The Register may of his own motion or at the request of a majority of the committee hold an inquiry or inspection to hold an inquiry on the registered society. Thus it can be safely said that he audit measures are very robust though perhaps can be considered intrusive.

Exemption from stamp duty

A Cooperative is exempt from stamp duty in respect of transactions it enters in to.

Special provisions relating to Coops receiving state funding

Where a registered society obtains a loan, advance or grant from the Government, the society is compelled to obtain the approval, in writing of the Registrar, prior to acquiring by way of purchase, lease, gift or otherwise any land, building or other movable or immovable property or alienating by way of sale, mortgage, lease, exchange or in any other manner, and land buildings, and other movable or immovable property. If the Cooperative Society is to be used as the ATDP, it would be inevitable that state funding would be received. As such the ATDP would be subject to the aforesaid severe scrutiny. It is felt that such scrutiny will constrain the mobility of the ATDP as a business unit and would affect its ability to adapt to environmental and market changes.

[14] Act No 11 of 1992 introduced a new section 11A.

Conclusion

The Act has bestowed the character of a body corporate on a cooperative. This permits the Cooperative to enjoy some of the benefits that Companies enjoy. The Cooperative is also permitted to issue shares as well as obtain credit for the purposes of capital. It has also been given certain special statutory powers which may be used creatively in the establishment of an ATDP. However, Cooperative is also subject to fairly intrusive government control via the Registrar of Cooperatives. This may be both beneficial as well as inimical to the success of the business.

3.2.5 The Mahaweli Authority Act No: 23 of 1979

The Mahaweli Authority Act was considered in this research because the authors decided to consider legal regimes that are not obvious candidates at first glance. However, the Act contains many salutary provisions which may be replicated, if the legislature considers a specialized regime for farmer organizations at a future date.

Even in the absence of such special legislation, it is worthwhile exploring the possibility of using this structure.

This Act empowers the minister to whom the subject of Mahaweli is assigned to create a corporation for the purpose "of performing any one or more or any part of any function of the Authority" by publishing in the gazette an "Incorporation Order" upon obtaining cabinet approval[15]. Thus, this structure can be proposed as a vehicle for the ATDP.

Juridical nature

The Corporation thus created will have perpetual succession and a common seal and may sue and be sued in its corporate name. So, this is essentially a company that is formed by an incorporation order. So, the structure would enjoy almost all the advantage of a Company.

Powers and functions

The functions of the Corporation will be those specified in the Incorporation Order and such other functions as may be specified by the Minister by Order published in the Gazette. It is important that the incorporation order should set out the powers and functions of the corporation in very broad terms so that the corporation would not find itself unduly restricted.

The Board

The Corporation will be managed by a board of seven directors which will consist of such number of Government Directors and such number of Shareholder Directors as may be determined by the Minister by Order published in the Gazette. The Government Directors are subject to the direction and control of the Minister. This will in all probability lead to a certain amount of political interference in to its functions. If this number of directors can be minimized in the incorporation order, so that the shareholder directors would remain a majority, tis political interference may also be kept at a minimum.

[15] Section 35 of the Act

Capital

The capital of the Corporation shall be that specified in the incorporation Order and shall be divided into ordinary shares of one hundred rupees each: The shareholders are capable of increasing the capital by passing a special resolution. This arrangement permits a private public partnership at the inception, with virtually limitless private shareholding. Thus, any number of farmers may be made shareholders of the Corporation. This is a specific advantage the Corporation would have over the private Company model.

Allotment of shares

The Board may allot, grant option over or otherwise disposes of the shares referred to in to such persons, on such terms and conditions and at such times as they think fit. The liability of any shareholder will be limited to the amount, if any, unpaid in respect of the shares of such Shareholder. As stated previously the fifty-shareholder limit of a private Company would not apply to this corporation.

Non-government owned Corporations

Where the Authority is **not the sole** shareholder of a Corporation, the provisions of the Companies Ordinance (Act) will apply to the Corporation in regard to any matter for which there is no provisions in the Act.

The ATDP would initial be partly owned by the government due to the capital infusion by the donors. Thus this provision would apply to the Corporation. Thus the corporation would not operate in a lacuna but within some framework.

Non-applicability of the Companies Act

Even though the framework of the Company's Act would apply, the powers enjoyed by the registrar and the numerous procedural aspects of the Company's Act would not bind the corporation giving the corporation much needed flexibility.

Audit

The accounts of the Corporation shall be audited by two qualified auditors annually appointed by the shareholders of the Corporation. Thus, the affairs of the Company would be monitored for any impropriety of irregularity.

Conclusion

Thus, the establishment of a Corporation may require a fair amount of consensus and cooperation between ministries. However, once established, these corporations have many of the features of a Company. The corporation is less constrained by compliance requirements, as the Companies Act does not apply to its function and should be considered as a candidate to carry out the functions of the ATDP.

Key Findings

Thus, it may be said that each of the five-legislation considered in this study, offer a framework that may be utilized for the creation of the ATDP. Whilst each of the legislation considered had their own distinct advantages, they also present unique challenges in adapting them to the needs of the ATDP. Even though the challenges are not insurmountable, perhaps Sri Lanka may be better served if she were to have a special law drafted to meet the specific needs of the farmer organizations and the ASMP. The best suited legal structure of these or a combination of them would be recommended for the ATDP. A comparison of Acts referred for this study is given in the Table 3.3 below.

Table 3.3: A comparison of relevant Acts used in the study

Attribute / Law	Companies Act	Societies Ordinance	Cooperative Societies Law	Mahaweli Authority Act	Agrarian Development Act
Creation	By registration at RoC	<u>Mutual society</u> By registration at RoC <u>Special Society</u> Purpose must be gazetted	By registration	Incorporation order	Registration by CG agrarian Development
Constitutional instrument	model articles or custom drafted articles	Must include minimum as set out in schedule	Regulations published by gazette By-laws passed by members	Terms of the incorporation order By the Act and regulations By-laws created by the Board Provisions of Companies Act	By-laws subject to the Act
Corporate personality	Yes	Yes	Yes	Yes	Yes

Liability	Limited (*Act permits unlimited liability Companies too)	Limited	Limited (*law permits unlimited societies too)	Limited	Limited
Ownership	Shareholders	Members	Hybrid of membership and share ownership	Shareholders	Membership
Business capacity	Permitted	No express prohibition	Possible	Possible	No express prohibition
Restriction on membership	Private Limited 50 Public limited – no limit	Anyone with contractual capacity	Anyone with contractual capacity	Anyone with contractual capacity Full members Associate members	To farmers living within a selected geographical area Associate membership to owners of agri land and those engaged in production and marketing of agri goods Non-member observers
Executive Body	The Board of Directors	Committee of managers consisting of members	Committee of management	Board of Directors	Executive office bearers
General Body	General meeting	General meeting	General meeting	General meeting	General Meeting

Distribution of profits	Mainly through dividends	Can't be distributed	As dividends and rebates <u>Restrictions</u> 25%- reserve fund Portion to cooperative fund	Through dividends	Can't be distributed
Audit Procedure	Annual Audit by registered auditor	Annual audit by public auditor appointed by minister	Registrar of Cooperative Societies	Annual audit by qualified auditor	FOs By CG Agrarian Development Councils by Auditor General
Reporting Authority	RoC	RoC	Registrar of Cooperative Societies (* where applicable, to Provincial Registrar's created by provincial statute)	The Minister The Mahaweli Authority	Commissioner General
Amalgamation	Mergers between several companies	Several societies may amalgamate	Several Cooperatives may amalgamate to form a new one	Not specified and probably not permitted	Can federate at District, Provincial and National level
Powers of conversion	A private company can be converted to a public. A public company can be converted to a private (subject to shareholder number requirement)	Can convert to a Company	Not specified and therefore not permitted	Not specified and therefore not permitted	Not specified and therefore not permitted

Special Comment			Cooperative Societies being a devolved subject has been the subject of special statutes by Provincial Councils. Those statutes have retained almost identical provisions to this law.	Limited to the special Mahaweli area	ADC can Create and buy shares in people's Companies (and therefore public companies under present Companies Act)

Chapter 4 Key findings and descriptions

A range of formal FPOs formats available and operating in Sri Lanka were studied. There were organizations at regional, district, provincial and national levels serving various needs of the smallholder farmers in the project areas as well as outside within Sri Lanka. Descriptions of key features of FCs were discussed in the comparative institutional review (Chapter 3). A summary of key findings along with a brief descriptive account of the FPO types are presented in this chapter. A common template was used to present the facts for easy readability.

4.1 Farmer Cooperatives

Seven FCoops were studied during the collection of data. Five of them were dealing with fruits and vegetables while the other two were livestock and fishery cooperatives[16]. Some of the key aspects of these FCoops are set out below.

4.1.1 Institutional factors

These societies were registered under the Department of Cooperative Development under the provisions of the Cooperative Societies Ordinance. Key functions of these societies were identified as facilitation of cultivation of crops and animal husbandry by farmer members; consolidation of output of members and arranging sales facilities; linking farmers with processing firms; and providing welfare facilities for members.

The respective membership ranged from 191 up to 1326 members (Table 4.1). An important feature of all these FCoops was that their BoDs were served by appointed (advisory) directors in addition to those elected by the membership at the AGM. This provides for an opportunity for knowledge and skill transfer to the member farmer directors. Payment of dividends was a very rare event in these cooperatives. Only one cooperative (FPO11) has been able to pay dividends in the past, and it had occurred only in a single instance in the Cooperative's history. However, FPO10 has been offering its membership a range of social benefits such as a pension scheme for some of its members. Dividends if declared, should be paid according to the patronage by each member according to their constitutions. In contrast, the voting rights of members were not proportional to the shareholding of each member. There is no active market internally or outside the institution for shares of these FCoops.

Each member of these cooperatives had invested in an equal number of shares in these cooperatives. However, the patronage was different from member to member. There were active members as well as dormant members displaying a range in member commitment. There has been new joining of farmers to these cooperatives. It was observed that certain Cooperatives had employed non-member managers. However, they have not been rewarded with share options or incentive schemes by these cooperatives. But in view of the absence of a ready market for the shares, such a share option scheme

[16] The FCoops studied were Badulla District Greenhouse Growers Cooperative Society Ltd in Uva Paranagama and Bandarawela Dairy Producers Cooperative Society Ltd in Bandarawela in Badulla District; Vinayakapuram Farmers' Cooperative Society Ltd in Mulankavil, Iranathivu Fishery Cooperative Society Ltd in Iranathivu, and Kilinochchci Palmyrah Resources Development Cooperative Society Ltd in Kilinochchi Town in Kilinochchi District; and Vavuniya North Fruit Producers Cooperative Society Ltd in Sannasi Paranthan and Nedunkerny Palmyrah Resources Development Cooperative Society Ltd in Nedunkerny in Vavuniya District.

may in any event be futile. There has been an opportunity created through appointing advisory directors or appointed directors to exercise influence over the decisions of these organizations.

Table 4.1: Key institutional details observed in Farmer Cooperatives

key institutional variable	FPO1	FPO3	FPO8	FPO9	FPO10	FPO11	FPO12
Membership as of March 2020	191	1326	587	304	1223	500	400
Board of Directors	11	6	7	11	8	7	11
Advisory directors	1	1	2	1	1	2	2
Dividends were declared	No	No	No	Yes	No	Yes	No
Dividends were paid in cash	No	No	No	Yes	No	Yes	No
Dividends were paid in kind	No	No	No	No	No	No	No
Dividends were paid in shares	No	No	No	No	No	No	No
Dividends were proportional to patronage	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Active market for shares	No	No	No	No	No	No	No
Active internal market for shares	No	No	No	No	No	No	No
New members joined the FPO later	Yes	Yes	Yes	Yes	Yes	Yes	Yes
All members have equal number of shares	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Non-patron managers were rewarded with shares	--	--	--	--	--	No	No
Advisory directors were able to make / influence policy decisions	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Voting rights were proportional to shareholding	No	No	No	No	No	No	No
Non-members had representation and influence on BoD	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Creditworthiness of FPO	No	No	No	Yes	Yes	Yes	Yes
Creditworthiness of individual farmers	Yes	No	No	No	--	No	No

Membership was open and voluntary as long as the members' activities matched with that of the FCoop. Only one of the FCoops studied (FPO1) opened its membership to farmers in the whole district. Other FCoops restricted their membership to farmers in few DS divisions or GN Divisions. Therefore, it has been observed that the membership is geographically restricted to a rather small area.

Only four of these FCoops were creditworthy as organizations according to informants. In addition, farmer members of only one FCoop (FPO1) were creditworthy as single farming entities due to their possession of farming assets such as greenhouses. They informed that however, small loans were provided based on personal collateral and each member's capacity of repayment. Financial institutions have observed that sometimes loans released for individual farmers have not been utilized for intended purposes in the past.

The capital requirements of the Cooperatives had been initially met through share issue. The amounts raised have not been sufficient for the purposes of long-term sustainability. Therefore, a majority of these FCoops were heavily dependent on capital and asset donations made available from time to time

by the government, NGOs and foreign donors at significant levels. Members' and FCoops were opportunistic in this aspect.
Some of them were small or medium scale comprehensive processing facilities that were able to produce a high-quality value-added product. It was observed that these assets were underutilized and not utilized for a continuous production. The working capital needs were met through a monthly service fee or commission charged from the members.

4.1.2 Governance factors

Annual General Meetings were held regularly (Table 4.2). As explained earlier, there were directors who were not elected or nominated by the members. It was not clear whether financial forecasts were tabled at the AGMs. However, annual financial statements were duly prepared and submitted to the AGM and periodic financial audits were undertaken by the DCD thanks to the stipulations by the relevant Ordinance. Also, it was noticed that the managers were answerable to officials from the Department of Cooperatives Development.

Table 4.2: Observations on key governance factors of Farmer Cooperatives

Governance variable	FPO1	FPO3	FPO8	FPO9	FPO10	FPO11	FPO12
AGMs held regularly	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Members elected / nominated all the directors	No	No	No	No	No	No	No
Financial forecasts approved by the BoD	--	--	--	--	--	--	--
Financial statements were prepared and submitted annually	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Financial status was audited regularly	Yes	Yes	Yes	Yes	Yes	Yes	Yes

4.1.3 Management factors

There were interesting findings in the area of management in these organizations. The General Manager (GM) or the Chief Administrative Officer (CAO) was a patron member of the organization in many cases (Table 4.3). Only three FCoops had hired managers who have understood their role as strategy implementers. However, a professionally qualified GM, knowledgeable and skilled in business management was found to be employed by only one of these organizations. Key informants reported that the BoD members do not have corporate knowledge. Further, there were no processes evidently in place in these institutions to develop viable business strategies. These organizations have not provided clear job descriptions to their managers as the management was not a very significant component in many of these organizations.

Table 4.3: Observations on important management factors in Farmer Cooperatives

Management factor	FPO1	FPO3	FPO8	FPO9	FPO10	FPO11	FPO12
General manager is a patron member	Yes	No	Yes	Yes	No	No	Yes
Hired General Manager has management knowledge and skills	--	No	--	--	No	Yes	--
Managers had clear job descriptions	No	No	No	No	No	No	No
Institutional vision and mission were developed with members	Yes	No	No	No	No	No	No
Institutional objectives were developed with members	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Management prepared the long-term business plan	No	No	--	--	No	No	--
BoD has management knowledge and skills	No	No	No	No	No	No	No
Processes to develop business strategies were well-established	No	No	No	No	No	No	No
Strategy implementation was a responsibility of hired managers	--	--	--	--	Yes	Yes	--
Formal collection of useful information was in place	No	No	Yes	Yes	Yes	Yes	Yes
GM has been paid with bonus	No	No	No	No	No	Yes	No

Except in FPO1, the institutional vision and mission were not developed with the involvement of their members. It was implicit that the individual farmers were not skilled to execute such an exercise. It was also evident that these organizations lacked any active and sustainable long-term business plans. However, the institutional objectives have been identified with the involvement of members. Five of seven FCoops have maintained records of important aspects of the organization in a manner that facilitates easy reference. It was quite important to note that only a single FCoop has paid bonus or any form of incentive to its GM.

4.1.4 Product and market factors

All FCoops except for FPO3 dealt with multiple products produced by the members. Discussion revealed that majority of the institutions under study had year-round supply contracts in place with corporate buyers (Table 4.4). Some of them had the potential to produce a high-quality value-added product. However, it was revealed that the processing machines (Figure 4.1) and other facilities were heavily underutilized and that there was year-round production in these organizations to match the supply contracts despite possessing their own brand names.

Figure 4.1: Medium-scale semi-sophisticated Palmyrah processing machine available at a Cooperative

Many of the members did their sales individually on their own in these FCoops. Only FPO3 mentioned that all of the produce by members were sold through the FCoop. It was mentioned that many of these institutions made profits through members' patronage. However, poor institutional growth does not substantiate this fact. A significant discovery was that the non-member patrons were offered same conditions as member patrons. Small landholdings, weak market infrastructure, inability to engage in a continuous supply of products and sale of primary products have been the key weaknesses of these FCoops.

Table 4.4: Product and market factors of Farmer Cooperatives

Product and market factor	FPO1	FPO3	FPO8	FPO9	FPO10	FPO11	FPO12
Institution has sales contracts with corporate buyers	No	Yes	Yes	Yes	Yes	Yes	Yes
Institution has year-round sales contracts with corporate buyers	No	Yes	Yes	Yes	Yes	Yes	Yes
Institution has year-round production of processed products	No	No	No	No	No	No	No
Institution has established product brands	No	No	Yes	No	Yes	Yes	Yes
Institution produces value-added products	No	No	Yes	Yes	Yes	Yes	Yes
Members do their sales individually	Yes	No	Yes	Yes	Yes	Yes	Yes

Organization makes a profit through members' patronage	No	Yes	Yes	Yes	Yes	Yes	Yes
institution purchased (or has future plans to purchase) multiple products from members	Yes	Yes	Yes	Yes	Yes	Yes	Yes

4.1.5 Structural factors

Other than in few cases, there were not many employees hired by these FCoops. Their organizational structures were consisted only of the office bearers, members and few employees. Therefore, it was evident that there were no organizational structures developed to facilitate business activities of the respective institutions.

4.2 Tea Smallholder Development Societies

The Tea Smallholder Development Societies (TSHDS) were established under the sponsorship of the Tea Smallholdings Development Authority (TSHDA). The extension service of the TSHDA was instrumental in guiding and facilitating the establishment of these societies. Interviews with key informants were carried-out in order to obtain a knowledge about how TSHDS were oriented to achieve their objectives. Some of the key details associated with these societies are explained below.

4.2.1 Institutional factors

These societies have been established and registered under the Tea Smallholdings Development Act No. 35 of 1975. These societies showed quite different institutional arrangements compared to various other FPOs in Sri Lanka. They were established on a four-tier system. Officials from the TSHDA were holding ex-officio positions in these societies. Officials of the TSHDA who were holding posts ranged from Tea Inspector up to the highest officer, the Chairman of TSHDA. These officials could exert extensive influence on policy and other important decisions of these societies. The TSHDSs were established at the village level as the first tier covering few GN divisions. The second tier was the Zonal Development Committee (ZDC) which was the collection of all Chairmen, Secretaries and Treasurers of TSHDSs in respective zones. The third tier was the District Society Organization (DSO) which was comprising of Chairmen, Secretaries and Treasurers of all the ZDCs in the respective district. The fourth tier was a national body called the All-Island Tea Smallholdings Development Federation (AIF) which was comprising of all the Chairmen of DSOs around the country (Figure 4.2).

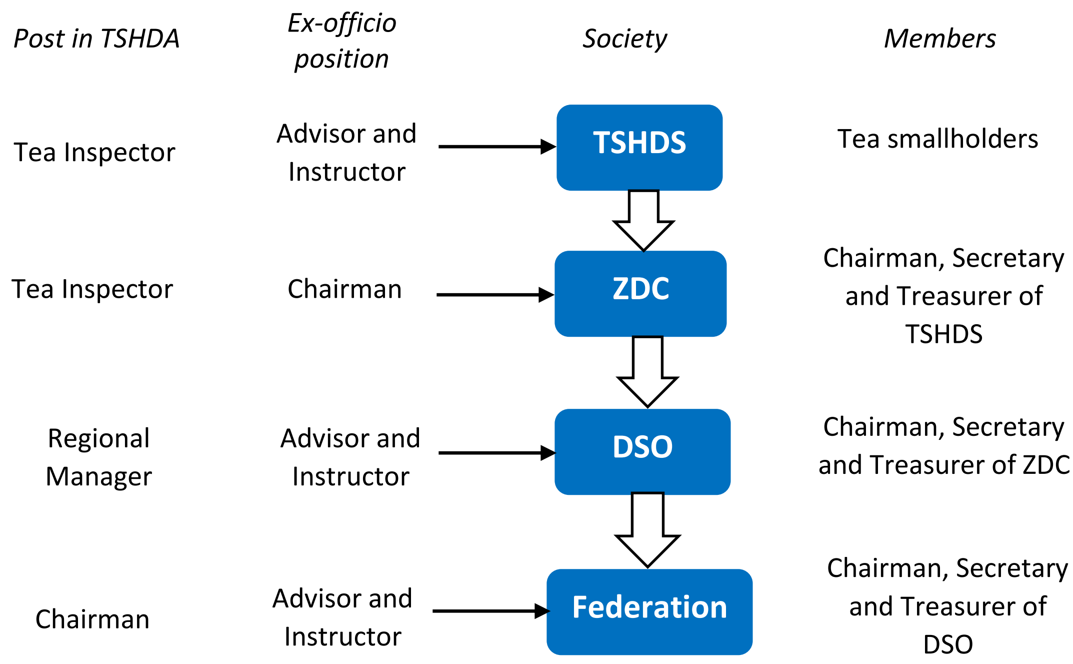

Figure 4.2: Four-tier system of tea smallholder societies

It was reported that there were around 1450 TSHDSs with a total membership of over 400,000 tea smallholder members from the tea growing areas of the country. It was revealed that the TSHDA enjoys the total legislative authority over all the above organizations. A common constitution for all the societies was used with minor amendments done to suit specific requirements of different societies.

Key functions of these societies were identified as facilitation for cultivation of tea by smallholder[17] farmer members; facilitation of selling the harvest or consolidation of harvest of members and arranging sales facilities; facilitating the tea smallholder subsidies; hiring simple farming equipment; and providing welfare facilities for members. Tea Smallholdings Development Authority was instrumental in providing these services through their extension interventions; land development interventions; and social development interventions. In addition, few very successful societies (described below) were engaged in the collection and supplying of green leaves to processing factories; engaging in plant and tea nurseries; provision of supplies to nurseries; and engaging in retail and agrochemical shop business.

The societies function under the leadership of a Managing Committee with the advice and instructions by an officer from to the TSHDA. About 90 per cent of these were functioning as active institutions. Only around one per cent were functioning as profit-making entities. Active and prominent leadership was an important feature in these institutions in the absence of salaried managers. Only these very successful institutions have declared dividends, which was a very rare occurrence, in the past based on the patronage. There were no shares as such in these institutions and members paid a regular membership fee. New members could join later under the same conditions as the longstanding members. The TSHDSs used democratic voting to elect members to their Managing Committees and to agree on important decisions.

[17] A tea grower whose tea land is less than 10 Acres in extent.

Individual members in vast majority of societies that were not in the leaf collection business did not engage in business directly with their societies. There were active members as well as latent members displaying a range in member commitment. There has been an opening created through appointing TSHDA officials as ex-officio members to the committees of TSHDSs to exercise influence over the decisions of these societies.

Membership was open and voluntary for tea smallholders in respective GS divisions. Therefore, the membership was geographically restricted to a rather small area. A part of the monthly membership fee was used as the working capital of the society.

Majority of TSHDSs lacked in assets hence not creditworthy as organizations according to key informants. Tea smallholders were creditworthy as single farming entities due to their possession of farming assets such as land. Therefore, small loans were provided by banks based on personal collateral and each member's repayment history. Majority of these societies were quite dependent on capital donations by way of planting equipment etc. made available from time to time by the TSHDA.

4.2.2 Governance factors

Annual General Meetings were held regularly. As mentioned above, not all the office bearers are members. Every TSHDS should appoint a suitable audit officer (usually a person with GCE Advanced Level education in the Commerce stream) at the AGM. Annual financial budgets were duly prepared and submitted to the AGM. This was mandatory of the society thanks to the stipulations by the relevant Act. The Federation which was the highest and the most influential tier in terms of policy is chaired by the Chairman of TSHDA. The Chairman of TSHDA was appointed by HE the President hence a political post. As a result, politicization of societies at all tiers has been evident in the past so many decades.

4.2.3 Management factors

There were no managers employed by these TSHDSs. The role of management in these organizations was performed by the office bearers who do not possess managerial knowledge and skills. The vision, mission and objectives were similar for all the societies as they were not developed with the involvement of their members. It was implicit that the individual farmers were not skilled in such an exercise. Further, there were no processes evidently in place in these societies to develop feasible business strategies or plans.

4.2.4 Product and market factors

The key product of members was the green tea leaves. In the very successful TSHDSs only these green leaves were collected by the society and channeled through to the processing factory. A nominal service fee was charged. These societies offered the same service to non-members also at same conditions as member farmers. Such TSHDSs were registered at the Sri Lanka Tea Board as leaf collectors according to the formality. Year-round production / sales contracts or own brand were not applicable for these institutions. In a vast majority of these societies, individual members sold their green leaves to processing factories of their individual choice. These societies were very poor in their business potential as they were operating more with social and welfare objectives.

4.2.5 Structural factors

Other than in rare cases, there were not many employees hired by these institutions. Therefore, their organizational structures consisted only of the office bearers, tea smallholder members and few employees. The Federation had a certain organizational structure (Figure 1). Therefore, it was evident that there were no organizational structures developed to facilitate business activities of the respective institutions.

4.3 Farmer Organizations established by the ASMP

Two FPOs established by the DOA in this category were studied. They were Pragathi Passion-fruit Growers' Society (FPO5) in Buttala in Monaragala District focusing on the production of Passion-fruit and Neithal Highland Farmers' Society (FPO6) in Kaluthavalai in the Batticaloa District focusing on the cultivation of green chilies.

4.3.1 Institutional factors

The membership has been geographically restricted to GN divisions within the DS division. The initial membership varied between 75 and 100. These societies were registered by the DOA. under temporary provisions. Key functions of these societies were identified as cultivation of mainly one crop by all the members; farmer coordination between the society and the DOA, Department of Agrarian Development (DOAD), District Secretariat and research institutes for farming activities; solving of problems in land and cultivation; facilitation of supply of various inputs needed for cultivation; and dealing with the marketing facilities for their produce. The above institutions have been instrumental as facilitating organizations in setting-up of the respective societies.

There has been an admission fee of LKR 300 to 500 and a monthly fee of LKR 50 – 300 per member charged as a service fee. There has been a proposal in FPO5 to charge LKR 2 per kilogram of produce sold through the society in future. The monthly fee has been used as the working capital of the society.

Some farmers have been members of different FPOs formed and operating previously. Those FPOs have not been dissolved and as a result, this may have created some kind of confusion among the farmers in a certain area. Some farmers in the area have memberships in multiple village level societies. Active farmers in the area have been identified and elected as the office bearers. FPO5 has elected 5 members to its Executive Committee while FPO6 has elected 13 members. In addition, the DOA has appointed an advisory committee member to each FPO. The office bearers elected have included President, Vice President, Secretary, Assistant Secretary, Treasurer or Finance Officer and committee members. These societies did not possess constitutions of their society. The constitutions will be drafted with the assistance of the committee member appointed by the DOA. Key informants in banks reported that these societies are not yet creditworthy as institutions. They informed that however, small loans could be released based on each member's capability of repayment. Their observation was that the loans for individuals have not been utilized for intended purposes in the past.

A key informant in FPO5 stated that the assets donated by the ASMP to the society[18] will be taken back by the society if any farmer is not operating properly. Further, it's reported that a farmer has already

[18] To be distinguished from the registered society created under the Societies Ordinance.

been identified as less functional and his assets will be taken back to the society to be given to a different new farmer. Thus it appears that an accountability for these assets will be at risk since these societies are not corporate bodies as yet and therefore requiring recovery measures to be taken against individual farmers who have passion of these assets. Therefore, membership stability is not clear even before the commencement in an environment where (1) standards with relation to poor functionality have not been established; (2) fate of the membership of the member who is less functional has not been established; and (3) compensation for his commitment so far has not been defined.

Common assets received by the Society or FPOs as capital donations included agro-wells, anicuts, pond and repairing some parts of the village road system.

4.3.2 Governance factors

Initial meeting was held with the facilitation provided by the DOA and the farmers seem to know the other fellow farmers in the society as they are in a very close society in which they know each other.

Farmers were selected mainly based on their past reputation as successful farmers; being active in their previous societies; and holding of clear land title. Both these FPOs have not undergone any financial audit.

4.3.3 Management factors

There was no hired management available in these institutions. The managerial role in these institutions have been performed by the farmers who held positions in the BoD.

4.3.4 Product and market factors

Small landholdings, weak market infrastructure, and sale of primary products have been the key weaknesses of these two FPOs. At present the FPO does not function fully. Farmer members are currently engaged with the routine production of crops that they have been doing with their previous the FPO engagements in addition to passion-fruit in FPO5 and green chili in FPO6. Three farmers premises have been used (free of charge) by FPO5 as product bulking (or consolidation of harvest) locations for a part of the harvest and Lanka Canneries Ltd picked-up the produce from these locations. Produce has been sold on individual farmer's basis. The remainder of the harvest was sold to the traders in the Manning Market in Colombo. Farmers in FPO6 have been selling their produce individually to the Dambulla Economic Center.

The farmer members in FPO5 received as donations a considerable volume of assets under the ASMP mandate to commence Passion-fruit, a promising crop in the area, cultivations. However, both these FPOs are yet to demonstrate that they will be a sustainable farmers' institution.

4.3.5 Structural factors

There are no employees hired by these FPOs. Therefore, their organizational structures consisted only the office bearers and the membership.

4.4 Farmer organizations established by the Mahaweli Authority of Sri Lanka

Mahaweli Project was commenced with the objective to increase the income levels of rural communities within the areas under its purview. Supporting agricultural development and strengthening FOs are important instruments used to achieve the above goal of the Mahaweli Project managed by the Mahaweli Authority of Sri Lanka (MASL). These FOs were created in accordance with the provisions in the Agrarian Development Act by the MASL. There have been 1059 such FOs established in ten Mahaweli Systems with a grand total of 115,571 farmers (MASL, 2018).

The key informants revealed that these FOs are much similar in their organizational make-up. Two FOs established under these provisions were studied in order to obtain an understanding of the institutionalization, governance, management, structure and market factors. The two FOs were 203D10 Farmer Organization in Thalagama, Galkiriyagama and 204D5 Farmer Organization in New Galkiriyagama. Data were also collected from key informants.

4.4.1 Institutional factors

The membership has been geographically restricted to farmers in particular distribution canals. The current membership in these two FPOs were 75 and 89 respectively. All members possess lands in the particular area. Half membership has been awarded by some FOs to individuals engaged in agriculture such as sellers of produce and livestock farmers. Key functions of these FPOs were the initiative in the management of irrigation water; distribution of fertilizers and other inputs; liaison with the agrarian services, organizing of workshops on income generating activities, resolution of disputes among farmers, and initiative in organic agriculture. Details on key institutional variables are given in Table 4.5 below.

Table 4.5: Key institutional details observed in Farmer Producer Organizations under the provisions of Mahaweli Authority of Sri Lanka (NA=Not applicable)

Key institutional variable	Mahaweli
Membership as of March 2020	75-89
Board of Officers	5-7
Advisory Officers	2
Dividends were declared	No
Dividends were paid in cash	No
Dividends were paid in kind	No
Dividends were paid in shares	No
Dividends were proportional to patronage	NA
Active market for shares	No
Active internal market for shares	No
New members joined the FPO later	No
All members have equal number of shares	NA
Non-patron managers were rewarded with shares	NA
Advisory Officers were able to make / influence policy decisions	Yes
Voting rights were democratic	Yes
Non-members had representation and influence on Board	Yes

Creditworthiness of FPO	NA
Creditworthiness of individual farmers in groups	Yes

The annual fee varied between LKR 300 and 620. These included the membership and maintenance fees. These were used as the annual working capital of the FPO.

There were Boards of Officers (officers) elected annually at the AGM from among the membership. The election of distribution canal representatives has taken place first. There were five or seven officers elected from within the above representatives including the President, Secretary, Treasurer and committee members for the whole FPO. The election of officers is by secret ballot on the basis of one-member-one-vote according to their constitutions. However, in practice these elections were mostly uncontested. There were no direct Advisors elected or appointed. However, the respective Unit Manager and the Institutional Development Officer were advisors of these FPOs by default. In addition, all these FPOs were operating under the guidance of the System Manager. Therefore, these non-members had control and influence the policy decisions of the FPO. Key informants in banks reported that the financial creditworthiness of these FPOs were not considered. Banks provided group loans to members of these FPOs signaling farmer members' difficulty be creditworthy. Therefore, it was the group loans that were released based on mutual surety.

These FPOs were not operating with a profit focus as these were set-up primarily to provide services to their membership. The concepts of shares and payment of dividends were not applicable to these FPOs.

4.4.2 Governance factors

Farmers were selected as office bearers based on their reputation as leading farmers. Discussions revealed that the AGM was held as an uninterrupted annual event. Members elected all the office bearers of the FPO. Income and expenditure statements were tabled at the AGM for approval. All their activities connected to state funds were subjected to Government Audit. Therefore, these FPOs had a good track record with regard to governance. These observations are summarized in Table 4.6.

Table 4.6: Governance practices at Farmer Producer Organizations under the provisions of Mahaweli Authority of Sri Lanka (NA=Not applicable)

Governance variable	Observation
AGMs held regularly	Yes
Members elected / nominated all the Officers	Yes
Income and expenditure statements approved by the Board	Yes
Income and expenditure statements were prepared and submitted annually	Yes
Financial status was audited regularly	Yes

4.4.3 Management factors

There was no hired management available in these FPOs. Making the annual activity plans and execution were carried-out by the Board of Officers and the farmer members themselves. Institutional vision and mission were framed with consultation of large number of external stakeholders such as state officers (Table 4.7).

Table 4.7: Observations on important management factors in Farmer Producer Organizations under the provisions of Mahaweli Authority of Sri Lanka (NA=Not applicable)

Management variable	Observation
Managers were employed	No
Institutional vision and mission were developed with members	No
Key institutional goals and objectives developed with members	No
A long-term business plan was prepared	No
Board had management knowledge and skills	No
Processes to develop business strategies were well-established	No

Key institutional goals and objectives were not specific to the particular FPOs but were a result of an interaction between the FPO and the respective Mahaweli System. The concepts of management and the business strategy were unfamiliar to these institutions.

4.4.4 Product and market factors

Small landholdings that were shrinking through the generations of the farmers; and the production and the sale of primary products; were key weaknesses of these farmer institutions. According to key informants, there were individual farmer members who supplied their produce such as soya beans and maize to large private sector companies on contracts. However, neither the members nor the FPOs have been able to secure year-round sales (Table 4.8). They normally didn't produce processed products. Therefore, value addition was at its minimum. These FPOs did not have product brands established. Further, these farmer institutions were not making profits through the patronage of member farmers.

Table 4.8: Product and market factors of Farmer Producer Organizations under the provisions of Mahaweli Authority of Sri Lanka (NA=Not applicable)

Product and market variable	Observation
Institution has sales contracts with corporate buyers	No
Institution has year-round sales contracts with corporate buyers	No
Institution has year-round production of processed products	No
Institution has established product brands	No
Institution produces value-added products	No
Members do their sales individually	Yes
Organization makes a profit through members' patronage	No
Institution purchased (or has future plans to purchase) multiple products from members	No

All the members sold their own produce individually. The FPOs did not perform business activities for the benefit of their farmer members. The paddy produced by the members were sold either to Paddy Marketing Board or to private traders on individual basis. Bulk of the vegetables produced by farmer members were sold at the Dambulla Dedicated Economic Center. The FPOs did not have any involvement in these activities. Members did not do their business activities through their FPOs i.e. were not patrons of their FPOs. Therefore, the FPOs did not earn profits through business activities with members.

4.4.6 Structural factors

There were no employees hired by the institutions. Therefore, their organizational structures consisted only with the office bearers and the membership.

4.5 Farmer organizations established under the Department of Agrarian Development

With the commissioning of major irrigation schemes to develop agriculture and livelihoods in rural Sri Lanka, a need has arisen to convert the concept of agrarian services in to agrarian development. A new Agrarian Development Act No. 46 of 2000 has been introduced to regulate and develop this sector. This Act has provided for the establishment of 'Farmers' Organizations', a category of FPOs. The DOAD has been facilitating these FPOs. Sustainable development of all agricultural lands and farming community in Sri Lanka has been the goals of the DOAD. Supporting agricultural development and strengthening FPOs were identified as important tasks in the present context.

Persons whose livelihood is agriculture and who has been engaged in agricultural activities for a period exceeding two years will be eligible for the membership in these FPOs. In addition, owners of agricultural lands in the area of authority of the FPO whose main livelihood is not agriculture or persons who engage in the production or sale of agricultural produce also become eligible to obtain membership. Agrarian Development Council of the district had some powers in monitoring these FPOs. The Act also has made provisions for the establishment of Farmers' Organization District Federation by the District Agrarian Development Councils to assist the carrying-out of agricultural policies; Farmers' Organization Provincial Federations; and the Sri Lanka National Farmers' Organization Federation.

Key informants reported that these FPOs are quite similar in their organizational framework. Two FPOs established under these provisions were studied in order to obtain a knowledge of the institutionalization, governance, management, structure and market factors. The two FOs were DAD 232315 Pambahinna Farmer Organization and 232301 Muththettuwegama Farmer Organization both of which were located in the Ratnapura District. Data were also collected from range of key informants.

4.5.2 Institutional factors

The membership of these FPOs has been geographically restricted to farmers in a particular agrarian administrative area which was identified as the area of authority of the FPO. The current membership in these two FPOs were 101 and 96 respectively (Table 4.9). Every person whose livelihood is agriculture and who has been engaged in agricultural activities such as production and sale of agro-produce were eligible for the membership. In addition, owners of agricultural lands in the area were also enrolled as members.

Table 4.9: Key institutional details observed in Farmer Producer Organizations under the provisions of Department of Agrarian Development (NA=Not applicable)

Key institutional variable	Observations
Membership as of March 2020	96-101
Board of Officers	11
Advisory Officers	1
Dividends were declared	No
Dividends were paid in cash	No
Dividends were paid in kind	No
Dividends were paid in shares	No
Dividends were proportional to patronage	NA
Active market for shares	No
Active internal market for shares	No
New members joined the FPO later	Yes
All members have equal number of shares	NA
Non-patron managers were rewarded with shares	NA
Advisory Officers were able to make / influence policy decisions	Yes
Voting rights were democratic	Yes
Non-members had representation and influence on Board	Yes
Creditworthiness of FPO	NA
Creditworthiness of individual farmers in small groups	Yes

These FPOs were primarily providing services chosen to benefit their members. Key functions of these FPOs were facilitation of agricultural activities of membership through annual cropping/activity plan; maintenance of irrigation canals and bunds; conducting *shramadana* campaigns; organizing workshops to support income generating activities and agricultural activities; liaison with the Department of Agrarian Development; resolution of disputes among farmers; promotion of organic farming; assistance in distributing fertilizers and inputs; small loan scheme for agriculture; and member welfare activities. They also facilitated loans for members through the Agrarian Banks. Further, the FPOs have established sub-committees to promote secondary income-generating activities.

The annual membership fee was LKR 60. Other income sources of the FPOs included undertaking the contracts offered by the government at five per cent commission to the FPO. It was reported that there were no agricultural insurance scheme or farmers' pension scheme actively operating at present.

There were Boards of Officers (officers) elected annually at the AGM from among the membership. There were 13 officers elected for the Board from within the membership including the President, Secretary, Treasurer and committee members for the whole FPO. The FPOs appointed an Audit Officer as well. In addition, the Department of Audit also had the power for auditing the accounts related to the consolidated funds of these FPOs.

The election of officers should be done by secret ballot on the basis of democratic voting. However, in practice these elections were mostly unanimous. There were no Advisors elected or appointed. However, the Divisional Agrarian Officer sat in the Board as an Advisor of these FPOs by practice. Therefore, there was non-member control and influence on the policy decisions of the FPOs. Key informants in banks reported that the financial creditworthiness of these FPOs were not considered. FPOs have not obtained credit facilities from the Agrarian Bank or other commercial banks. Commercial banks released small agricultural loans for the members on the basis of group surety. The Agrarian

Bank has released small agricultural credit facilities for individual members on the recommendation of the FPO and the Divisional Agrarian Officer.

These FPOs were not operating with a profit focus as these were established primarily to provide services to their membership. The concepts of shares and payment of dividends were not applicable to these FPOs.

4.5.3 Governance factors

Farmers were selected using democratic voting as office bearers based on their reputation as leading farmers in the area of authority and the leadership skills. Discussions revealed that the AGM was held as an uninterrupted annual event. Members elected all the office bearers of the FPO. Income and expenditure statements were tabled at the AGM for approval. All their activities connected to state funds were subjected to Government Audit. Therefore, these FPOs had a good track record with regard to the governance arrangements (Table 4.10).
Table 4.10: Governance practices at Farmer Producer Organizations under the provisions of Department of Agrarian Development (NA=Not applicable)

Governance variable	Observation
AGMs held regularly	Yes
Members elected / nominated all the Officers	Yes
Income and expenditure statements approved by the Board	Yes
Income and expenditure statements were prepared and submitted annually	Yes
Financial status was audited regularly	Yes

4.5.4 Management factors

There was no hired management available in the FPOs (Table 4.11). All the strategic and operational activities of the FPOs such as making the annual activity plans and executing them were carried-out by the Board of Officers and few of the active farmer members themselves. The concepts of management and the business strategy were unknown subjects for these farmer institutions.

Table 4.11: Observations on important management factors in Farmer Producer Organizations under the provisions of Department of Agrarian Development (NA=Not applicable)

Management variable	Observation
Managers were employed	No
Institutional vision and mission were developed with members	No
Key institutional goals and objectives developed with members	No
A long-term business plan was prepared	No
Board had management knowledge and skills	No
Processes to develop business strategies were well-established	No

4.5.5 Product and market factors

Small landholdings; and the production and sale of primary products in small quantities; were key weaknesses of these farmer institutions. According to key informants, there were individual farmer members and small groups who supplied their produce such as soya beans and maize to large private sector companies on contracts. However, neither the members nor the FPOs have been able to secure year-round sales (Table 4.12). There was no evidence of production of processed products. Therefore, value addition was at its minimum. These FPOs did not have product brands established. Further, these farmer institutions were not making profits through the patronage of member farmers.

All the members sold their produce by themselves. The FPOs did not perform business activities for the benefit of their farmer members. The paddy produced by the members were sold either to Paddy Marketing Board or to private traders on individual basis. Bulk of the vegetables produced by farmer members were sold at the Dambulla Dedicated Economic Center. The FPOs did not have any involvement in these activities. Therefore, the FPOs did not seem to generate any income through the business activities with their farmer members.

Table 4.12: Product and market factors of Farmer Producer Organizations under the provisions of Department of Agrarian Development (NA=Not applicable)

Product and market variable	Observation
Institution has sales contracts with corporate buyers	No
Institution has year-round sales contracts with corporate buyers	No
Institution has year-round production of processed products	No
Institution has established product brands	No
Institution produces value-added products	No
Members do their sales individually	Yes
Organization makes a profit through members' patronage	No
Institution purchased (or has future plans to purchase) multiple products from members	No

4.5.6 Structural factors

There were no employees hired by the institutions. Therefore, their organizational structures consisted of only the office bearers and the membership.

Chapter 5 - Performance factors of the FPO

Institutional arrangements, structural factors and process execution can be regarded as important in determining the performance of an FPO. These three areas are mostly internal factors. Therefore, it is important to gain an understanding of internal factors determining success or failure of FPOs in Sri Lanka. This chapter attempts to extract observations from the previous chapters to identify such performance determinants and to propose remedies for issues observed. While most of such determinants are internal factors, there are few that were originating in the external environment of a FPO. The determinants of factors of performance which are of external and internal of the FPO, were categorized into five constructs viz institutional arrangements; governance factors; management factors; product and market factors; and structural factors. Many of these factors explained below have been observed as dependent on the relevant legal structure of the FPO category. A summary to this effect is given in the Annex VIII.

5.1 Institutional arrangements

According to the UNDP, the institutional arrangements are the policies, systems and processes that organizations use to legislate, plan and manage institutional activities efficiently and to effectively coordinate with others in order to fulfill the institutional mandate. Such institutional arrangements which were important as performance determinants in the FPOs are discussed in this section.

Poor farmer member base

The largest FPO in terms of number of farmers visited, had 1326 farmers. The institutional review also highlighted that the number of members in many FCoops and FCs was limited although voluntary and open membership is a cooperative principle. This has resulted in these cooperatives being unable to raise sufficient equity capital. The situation with the other FPO categories was also similar. With the general characteristic of these members being poverty ridden, a substantially high equity investment from them cannot be expected. Thus, the size of the membership was identified as a critical success factor. The poor level of equity capital has also prevented the FCoops and FCs from obtaining debt capital as (formal) lenders required debt to be covered by equity, to meet the risk faced by lenders in a loan default situation. Therefore, widening the shareholder-base is considered as a solution to this issue to pool a greater equity capital.

Dependency on capital donations and grants

The FPOs were heavily dependent on capital donations from one project to another; from one government to another; and from one NGO to another. Therefore, the FPOs were not displaying sustainable capital growth when such capital donations were not continuing. This constraint also could be overcome and could make the FPO creditworthy through widening the shareholder-base as explained above.

Nature of appointment of Advisory Directors

It was a common practice that Advisory Directors (or Advisors) have been appointed by the facilitating organizations to serve in the Boards of Directors and Officers of the FPOs. This practice has provided opportunity for knowledge and skill transfer and guidance to shareholder directors and office bearers thereby enhancing the quality of decisions of Boards. This has been identified as a best practice. However, this has also created opportunity for the facilitating organization to exercise influence – known as the external influence problem, and control over board's decisions.

Dividends were not proportional to the level of investment

Farmer Producer Organizations showed a very poor history in declaration of dividends. Some FPO frameworks did not provide for the payment of dividends. According to their constitutions, member benefits were proportional to the level of patronage. Also, there weren't any member farmers with substantial shareholding in the organization. This resulted members with greater patronage free-riding on the members with greater investment – the internal free-rider problem as explained in Chapter 3. This has showed negative consequences including disincentive for investment and re-investment in the FPO (Figure 5.1). The remedy for this problem will be to distribute member benefits proportional to the level of investment in the FPO.

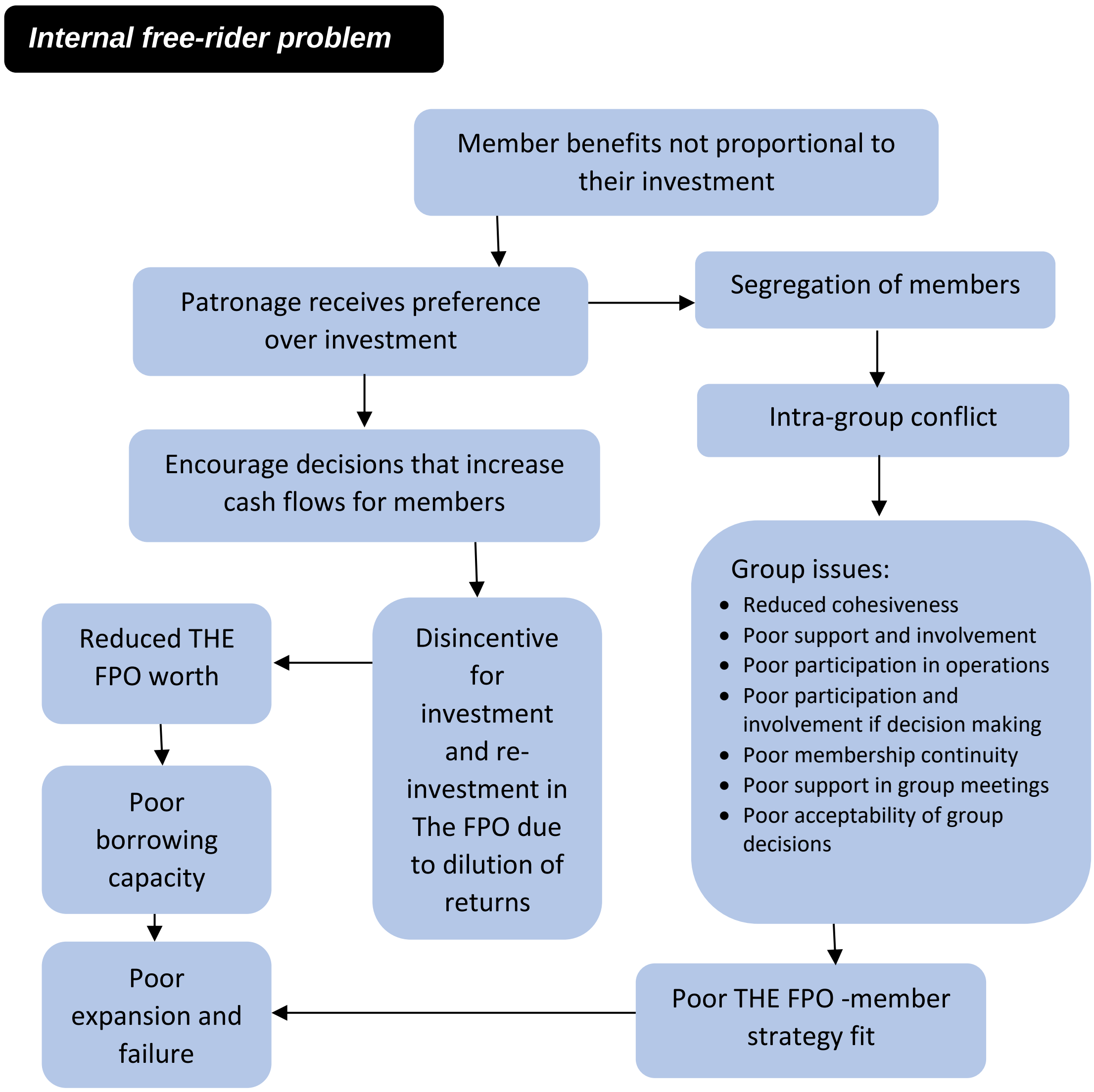

Figure 5.1: Consequences of internal free-rider problem

Absence of market for shares

There were no internal or external markets for shares in the FPOs where members had investments. Therefore, members were not able to capture capital gains when they wanted to exit the FPO as shares were not tradable – known as the horizon problem (Figure 5.2). Also, there was no internal demand for shares. Members did not buy shares from other members as risk preferences of the FPO and that of members did not match – known as the portfolio problem. Members also could not appreciate or sanction the management in the absence of a market for the shares of the FPOs - known as the control problem. Motivating existing shareholders for greater investment through creation of the FPO with high worth will be a long-term remedy for this issue. A rather quicker practical solution would be the widening of shareholder-base. Eligible new members will have to buy shares at a price higher than the nominal price, when there is demand for shares of these FPOs.

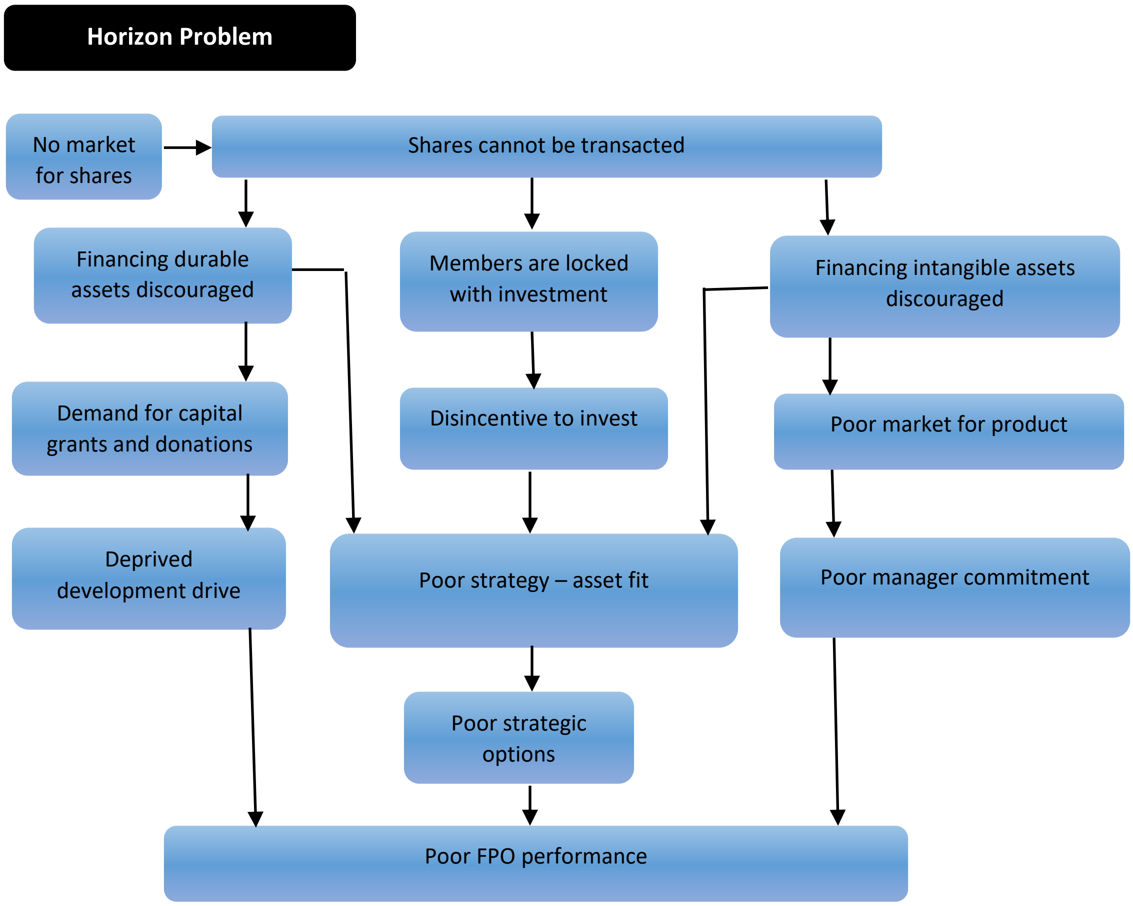

Figure 5.2: Effects of the horizon problem in FCoops, FCs and similar organizations

It was observed in the sample and in the review that majority of the members in the FPOs held equal shareholding. This has psychologically dampened the flair towards earning a higher profit than others.

A remedy for this situation is to take long-term action to create a value for shares through increasing the wealth of the FPO.

Voting rights were not proportional to shareholding

Members in FPOs such as FCoops were not able to practice this due to the democratic voting that was usually practiced creating an influence problem. This problem of not being able to appreciate the management will be eradicated if democratic voting is replaced with proportional voting. Further, in democratic voting, members with a higher risk appetite were not able to influence the BOD for innovative decisions and strategies because all the members had similar voting power. Whereas, in proportional voting members with greater number of shares would have a higher influence on the Board for innovative business decisions. This situation has been a disincentive for members to invest in higher number of shares in these organizations. In contrast, the principles of corporate governance regulate a healthy relationship among the shareholders, the BOD and the management. The management in a firm is typically accountable to the BOD and the board is accountable to the shareholders who have proportional voting rights and hence able to appreciate or sanction the management. However, t

Ownership and management were not separated

The GM in many of the FPOs was a board member. This practice exposed the organization to a serious internal influence problem. This practice has created the opportunity for many institutional and corporate illnesses such as role ambiguity; GM not been fully accountable to the board as he himself was a board member; for the GM to be influenced by risk aversive members towards risk aversive business decisions; and the management been headed by a person who was not skilled or knowledgeable in business management. These effects coupled with democratic voting would create the situation where executive managers will be able to influence policy decisions against majority investors. These serious issues could be avoided by employing a qualified non-shareholder GM.

Poor creditworthiness of member farmers

Individual farmer members of the FPOs were not creditworthy. This had serious ill-effects on supplying working capital in their agricultural ventures. They have used personal collateral risking such property in crop failures. Remedies to this restriction would be to establish active supply contracts between the member farmer and the FPO. Such contracts can be used as repayment guarantee via payments channeled through the banks. In addition, healthy buy-back agreements between the two parties will solve the working capital problem of the farmer. Buy-back arrangement can be facilitated by setting-up a revolving fund by the facilitating organization at the beginning. Both these solutions will also ensure complete patronage by the member farmer and the FPO receiving supplies to work on full capacity. Therefore, complete patronage was identified as a critical success factor and a win-win proposition. Proper supply contracts and monitoring of the member farmers' operations by the management will be a must in these arrangements.

Lack of empowerment of the FPOs

Autonomy and independence is an important cooperative principle accepted. However, it was evident that majority of the FPOs were heavily controlled by their facilitating state organizations for long periods of time. Many of them have undergone heavy institutional control. Some of the FPOs were operating with missions and objectives common to all such organizations in Sri Lanka. Shareholder Directors did not possess business skills. As a result, nurturing a business culture, strategic business processes and entrepreneurial activity were not taking place. Empowerment instead of control of these FPOs was the remedial measure for this issue. Therefore, it would be necessary that suitable business training programs are provided to improve business skills of the Board members.

5.2 Governance factors

Corporate governance is a process that aims to allocate organizational resources in such a way that it delivers highest value to all stakeholders; investors, employees, customers, suppliers and the whole community at large. Transparency, inclusivity, equity and responsibility should be delivered through decisions taken at the highest levels of the organization. Some key governance factors which could be considered as important performance determinants are discussed in this section.

Regular holding of Annual General Meetings

Annual General Meetings of these institutions were held regularly at least to be in line with the Statutes governing these FPOs. This has shown that the BODs were accountable to the shareholders. This has also provided for making important policy and long-term decisions and developed trust between the two parties. Statutes and facilitating organizations have played significant roles in this respect. Therefore, this has to be continued as a best practice.

Members didn’t elect or nominate all the directors

There were Advisory Directors (or Advisors) serving the Boards of these institutions. They were appointed by the facilitating organizations through mandate. This has brought benefits to the FPOs as explained above. However, this practice was observed negatively by the members as a control exercised by the facilitating organization. A remedy for this issue would be that the facilitating organization provides the opportunity for the Board to choose a preferred officer from a list of suitable officers at the AGM as the Advisory Director.

Approval of financial forecasts by the Board

Annual financial statements were approved at the AGM as a practice. Annual or seasonal activity plans have been prepared. However, it was not clear whether financial forecasts for the succeeding year was approved. A financial forecast signals an annual operational plan for the organization. Therefore, financial forecasts would be an important planning tool for a growing organization with a clear strategy.

Regular auditing of financial status

Financial status in FCoops was audited regularly and free of charge by the auditors of the Department of Cooperative Development. This was a statutory requirement but it has developed trust between investors and the Board. This was the practice in other categories as well. It would be a best practice if the FPOs carry-out regular audits on their own drive as independent organizations.

5.3 Management factors

Management factors include the conduct, manner or practice of managing a FPO. They also deal with how effective the organization's internal operations are in providing customer value to achieve advantage in the market, and understanding the external business environment and responding to it successfully. Important management factors that would be determinants of performance of the FPOs are discussed in this section.

General Manager was a patron member

As discussed above, the GM and some other officers such as Accounting Officers holding key positions of the FPOs were patron members. Such FPOs have not had attractive growth. Some of the key reasons were discussed earlier. The FPOs that had a salaried employee as the GM showed a better promise, where the said employee was appropriately experienced and technically qualified. Therefore, it would a best practice to separate the ownership of the FPOs from the management.

Unqualified and unskilled Management

Management was not led by a skilled and technically qualified GM in the majority of the FPOs. The FPO with qualified and skilled GMs showed great promise. Those GMs used various strategies to develop sales. There were healthy processes and practices incorporated in to the systems. They understood their strategic role in the organization and worked independently amidst poor incentives. Superior ability to execute will result higher performance even in unfriendly business environments and in unattractive industries. An organization's ability to execute along with its strengths and weaknesses are more important than its business environment in determining its performance. These results would be achieved only by skillful managers. Therefore, the FPOs could expect better results and growth when they employ qualified and skilled GM to lead their management of the organization.

Managers did not have job descriptions. Managers could have performed exceptionally well if they knew what was expected of them. Therefore, the FPOs could perform better if the managers had clear job descriptions.

Organizational vision and mission were not developed with members

Many of the FPOs had vision and mission entrusted to them by the facilitating organizations. As a result, members were not aware about the activities in the long-term future. Also, members did not show attachment to the activities of their FPOs. Vision and mission signal an organization's long-term future in business. They focus the attention of the organization and make all stakeholders of the organization directed towards goals and objectives. The FPOs can be improved strategically when the skilled management takes a participatory approach to draft organizational vision and mission.

Absence of long-term business plans

These organizations did not have long-term business plans. A business plan will assist the organization for a pre-decided growth; maintain a corporate growth; and also, will help to secure debt financing. A business plan will also help the organization to attract business partners such as corporate buyers and to develop voluntary links. Therefore, the FPOs could be improved by assisting them to develop long-term business plans.

Absence of well-established processes to develop business strategies

Organizations should make decisions and take action to formulate and implement strategies with the view to achieve their business objectives. Well-established processes to develop business strategies were often absent and consequently their implementation remained poor. Shareholder directors who were unskilled in business had been entrusted with the development of these strategies and processes in many the FPOs.

Majority of the FPOs, especially the FCoops, have incurred heavy expenditure on social and welfare activities. These were at the expense of the growth of the FPO. Business proposals were not originated by the management. Therefore, many proposals were social welfare-oriented and not business-oriented. The remedy for all these ailments would be to separate the ownership of the FPOs from the management as in true companies. Also, setting-up of healthy processes to develop business strategies would become a reality when a skilled management is hired through a proper and a formal hiring process.

Appreciation or sanctioning of the management

Payment of bonus for the management was a very rare occurrence in these the FPOs. Also, non-member managers were not rewarded with shares or share options. Therefore, along with the separation of management from the ownership, there should be performance-based incentive schemes in place for the hired managers.

5.4 Product and market factors

Absence of active links with corporate business partners

Commercialization of agriculture in Sri Lanka has been a key national priority as identified by the ASMP. Healthy links with business partners such as corporate buyers, to avoid primary markets, would be essential for the long-term growth of organizations. This seems especially important for organizations such as the FPOs which have contracts on economic participation with their shareholders. The FPOs were required to produce high value crops under the concept of commercial agriculture. Although the FPOs had links with corporate buyers, many of them were inactive. Main reason for this scenario was the inability of the FPOs to produce required quantities at the right time on a long-term basis. Nevertheless, many of the FPOs displayed their capacity to produce value-added goods. Therefore, many FPOs have not been able to capitalize on strengths and opportunities. The remedy for this weakness would be to ensure the availability of primary produce and value-added produce as outputs on sustained basis.

Weakness in utilizing product brands

Branded products have the ability to fetch a higher price in the marketplace while creating a pride in the minds of the producer. Brands and trademarks are durable and intangible assets. The shareholders' incentive to invest in such assets falls away when the shares do not have an active market. These FPOs were not making use of such trademarks that they own as they do not have a continuous year-round production of commodities with trademarks. Enhancing the worth of the FPO would be a remedial measure to resolve this long-term issue.

Direct sale of produce by members

It was observed in the majority of FPOs that the members practiced out-sales[19]. This was done with or without permission from the own FPO. This has seriously affected the performance of the FPOs as they were supposed to make profits through economic participation of members. Members were engaged in this practice despite benefits (if declared) being distributed proportional to the level of patronage. Absence of dividends and short-term view of farmers were reasons for this scenario. Therefore, strategies and healthy processes should be developed to capture total business of members. A FPO-wide buy-back arrangement would be a practical solution to resolve this issue.

5.5 Structural factors

Organizational structures susceptible to politics

Some FPOs such as tea smallholders' societies were following quite complicated federated organizational structures. Complicated organizational structures would impede expansion of organizations. The advisory role played at the helm of this organization was an officer appointed by the HE the President of the country. Usually, this appointment was done from outside the cadres of the relevant state institution i.e. a political appointment providing opportunity for politics within a federated structure. A national scale institution owned by smallholder farmer members would not be seen as an organization that can serve the business purposes of its members. A remedy for this issue would be to form a trade association to discuss policies at large leaving the provincial or district level organizations to operate as independent business entities which have simple organizational structures.

[19] Selling of produce by the members to buyers without channelling through the own FPO.

Chapter 6 Recommendations for most appropriate Farmer Producer Organization models for the ASMP

Farmer Producer Organizations play a significant role as an institutional vehicle for promoting agricultural development. They help farmers solve their common problems. Issues faced by various categories of the FPOs established in Sri Lanka were discussed in Chapter 5 as performance factors of the FPOs. These issues were largely internal factors. Therefore, a special emphasis was on the internal factors without losing focus on external and legislative factors. Some innovative suggestions were made in the previous chapter as remedial measures for these issues. Therefore, this chapter will present the recommendations of this policy research. These recommendations are not to be considered for implementation in isolation of each other. They should be considered for implementation collectively for the FPOs to achieve a truly significant growth and prosperity as independent business organizations.

6.1 Recommendations on the role of a facilitating organization

Commencement of the Farmer Producer Organization

This study recommends the MOA to be the facilitating organization in the establishment and empowerment of the proposed FPOs as the ASMP will cease to exist at project completion. It should ignite the initiation and facilitate the establishment of the FPO. It is best that the facilitating organization outlines a *pro tem* business plan, goals and objectives for the FPO to be established through a participatory approach because the shareholder directors lack management and entrepreneurial skills. These initial business plan, goals and objectives will become obsolete when the newly elected BOD approves the Vision, Mission, goals, long-term business objectives and the business plan that will be drafted collectively among the BOD and the management at a later stage.

Ownership over the FPO

The importance of corporate ownership over the FPOs cannot be over emphasized. The first alternative ownership format is that the MOA employs the entirety of the capital and owns the FPOs. This would entitle the MOA to decide on all aspects of the FPOs. The second alternative is that the MOA invests a part of the capital and has a proportional ownership similar to a government owned business undertaking. However, these ownership arrangements are not recommended for three reasons, (1) it may conflict with the portfolio of the MOA, (2) they would be subjected to restrictive financial and governance regulations imposed by the treasury, and (3) farmers wish to have their own organizations. The third alternative model is that the FPOs are wholly owned by farmer shareholders. This will encourage the MOA to empower the FPO and to observe them developing in to successful business entities that will greatly enhance the livelihoods of shareholder farmers. The FPOs will operate on the principles of independence. But they will suffer from the lack of expertise, and strategic and managerial skills. Therefore, a hybrid arrangement of the above is recommended as the solution. The FPOs shall be formally registered as an independent business entity, with the MOA having a formal right to appoint ADs to provide the FPOs with business and technical expertise until such time the FPOs are able to carry-out activities as independent business entities. The MOA would also provide facilitation of establishment of the FPOs and consider providing a start-up capital.

Creating an enabling link between institutions

The appointment Advisory Directors (who are non-elected directors), which would be the channel between the FPO and the MOA, would be a need. The MOA shall make few suitable nominations from within their officer cadres and the FPO may select the officer of their preference at the AGM (Section 5.2). This would make the AD a choice of the FPO and not an officer appointed by virtue of power of MOA. This shall be a non-voting position. The AD should be prohibited from engaging in business with the FPO. The facilitating organization may nominate an AD for a period of 3 years with the appointment being extended by the members annually at the AGM. One particular officer may be nominated for only two consecutive terms. This would be necessary to introduce different views and processes through different officers possibly coming from different sections of the facilitating organizations. The facilitating organization shall continue to provide all its services such as technical advice and information to the FPO on the same terms and conditions for a limited period of time to be set-out. It is recommended that the facilitating organization pays salaries of salaried employees for a stipulated period of time.

The roles, responsibilities and job tasks of ADs are extremely important in determining the success or failure of the FPO. The job tasks should be challenging. The facilitating organizations should ensure that the qualifications, knowledge and skills of ADs should match with their portfolios in the FPO. Key responsibilities of ADs would be as follows (also see Annex VI).

a. To collaborate with the elected directors and the management to empower the FPO to be able to carry-out business as an independent business entity.
b. To empower the BOD and the management, and guide the FPO to operate as a business organization and not as a welfare organization.
c. Provide autonomy and empowerment rather than state control.
d. Distance the organization from social and welfare objectives.
e. Embed within the organization the idea of shareholder benefits proportional to investment.
f. Help create a link between the FPO and the facilitating organization through enabling support policies.

An attractive performance-based allowance should be made available for the right contender for the time spent on the project; professionalism; contribution of knowledge and skills for the betterment of the FPO. The facilitating organization shall bear this cost until such time that the FPO attains a status of corporate strength to set-aside funds needed for payment of this allowance. The need should be ascertained in a future point of time to decide on the continuation of the position of AD.

Start-up capital and capital promotion policy

The FPOs should be empowered with knowledge and skills to operate on its own and to build-up capital. However, the facilitating organization may arrange initial capital donations to the FPOs and/or farmer members with a provision for initial working capital as a revolving fund. In the event that the farmers are provided with such direct grants, a need assessment and fair selection process would be recommended. Further capital donations through complementary development projects to the same business entity for a similar agricultural product or operation is not recommended as this may interfere with the effectiveness of the operations under the ASMP. This is because whilst the injection of capital is welcomed, the need to maintain the focus of the farmers in respect of the objectives of the ASMP is considered a higher priority. A multitude of funds from differing sources will distract the FPO and farmer's focus.

Majority of the FPOs have incurred heavy expenditure on member social and welfare activities. These were at the expense of the growth of the FPOs. Business objectives of the proposed FPOs should be highlighted, entertained, facilitated and legal provisions should deter decisions for spending on social welfare. Business orientation should be highlighted from the inception. Objectives related to social welfare should not be established. Capital, earnings and profits should not be diverted to other accounts to support social or shareholder welfare activities. It is recommended to introduce a capital promotion policy for retention of profits for capital growth (also mentioned below).

6.2 Recommendations on institutional factors of the FPO

Investment by shareholder farmers

Farmers would be investing in the Farmer Producer Organization by buying its shares. These shares should be similar to the ordinary shares as defined in the Companies Act. Each farmer may at his discretion purchase any number of shares he pleases. With the ATDP expected to have about 1200 farmers, a substantial equity capital could be raised at the inception. This could be further supplemented by several other share issues in the next succeeding years, if the Board deems it fit. Each share would entitle a shareholder to one vote at a general meeting of the FPO and a right to receive dividends, if declared by the FPO.

It would be advantageous if the constitutional document of the FPO permits the Board of Directors to issue other types of shares, such as preferential shares, non-voting shares, and redeemable shares. This would give the board a choice in the type of instrument the FPO would issue when it needs an injection of capital. It may also provide for the issue of bonus shares or share splits which would help the shareholders to monetize capital gains without an outflow of cash from the FPO. It is proposed that the Board of the FPO implement a conservative dividend policy, where most, if not all of the profits of the FPO are capitalized during the initial years of its operation.

Voting rights

Democratic voting has resulted key institutional problems in many forms of traditional the FPOs in Sri Lanka. Proportional voting rights and capitalization of profits (discussed above) should be introduced as in a company under the Companies Act. There may be a minimum amount of share capital stipulated for each shareholder to invest. Every effort should be taken to effect motivation in shareholder farmers to invest differential equity capital in the FPOs to instill an investment culture.

Discharge of shareholder benefits

It is recommended that the ordinary shareholder dividends be discharged proportionately to the level of investment in the FPO. This would free the organization from the internal free-rider problem and all the consequences outlined in the Figure 5.1. This will provide the shareholders an incentive to invest and re-invest in the FPO, which is a prime requirement in the quest to enhance the worth of the FPO. With the FPOs proposed endeavor on buy-back arrangements (explained later in the chapter) with farmer shareholders, the incentive for patronage will be accomplished.

Augmentation of shareholder base

Restriction on shareholders to very small geographical areas such as GN and DS divisions has brought about poor equity and debt capital situations in the FPOs. Therefore, it is recommended that the FPOs have a district basis to expand the shareholder base. All the farmers who are engaged in smallholding agriculture within the administrative district and who grow high value crop types approved by the BOD should be offered the opportunity to become shareholders.

The FPO should be made useful to all its shareholders by being effective in providing the expected business services. Winning their complete patronage to supply their total produce to the FPO becomes the responsibility of the management along with an active BOD.

Creation of a market for shares

Creation of demand for shares within internal and external markets in these organizations would be an extremely challenging long-term task. A healthy corporate worth has to be created for sale of shares among eligible farmers[20]. Removal of legislative restrictions is recommended. Shares should be made readily transferable among eligible smallholder farmers.

Creation of demand for shares in the internal market could be accomplished through motivation of existing shareholders for greater investment. This could be achieved through offering attractive dividends via better financial performance. This would also create an opportunity for the expansion of shareholder-base through a share issue to eligible farmers. The eligibility issue could be addressed by introducing suitable restrictions in the articles of the ATDP. The ATDP should operate strategically with a long-term plan in order to create a market for shares or make them readily saleable among eligible smallholder farmers. Management of the FPOs have a considerable role to play in this effort by managing the company to earn sustainable profits. Creation of a market for shares would help to eliminate the horizon, portfolio and control problems which were identified (Section 5.1) as key institutional problems that plagued the FPOs in Sri Lanka.

Separation of ownership from management

Regulatory as well as practical measures should be taken to separate the BOD and shareholders from the management. Roles of both parties should be clearly set-out and incorporated in to the Constitutional documents of the FPOs. This clear separation would make the management clearly accountable to the BOD and the BOD in-turn held clearly accountable to the shareholders. This would also eradicate the internal influence problem which was identified (Section 5.1) as a serious organizational illness in the FPOs.

As in a listed company, the Chairman should be the figurehead of the FPOs. The Chairman should be on parity with other board members in terms of authority. The organization is bound by the collective decision of the Board and not of its chairman or any other officer. The FPO would employ a hierarchy

[20] Farmer of an approved high value crop and be a smallholder in the respective administrative district.

of managers to manage the business of the FPO. No shareholder farmer should be offered salaried positions in the FPO.

Enhancement of creditworthiness of shareholder farmers

Direct and indirect solutions are recommended to enhance the creditworthiness of shareholder farmers. Assets offered to the farmers by the ASMP would be a reason for an enhanced creditworthiness. Farmers should be linked with corporate clients (buyers) via the FPO through formal supply contracts. Payments due to farmers would be paid directly to the FPO by the corporate buyers. Farmer Producer Organization would credit individual farmer's bank accounts after making appropriate deductions if any. This would enable the bank to deduct loan installments from the farmers thereby reducing the risk of loan default by farmers and enhancing their creditworthiness. This arrangement would assure the bank of deducting loan installments from the farmer before releasing the balance to his account. In the medium to long-run, farmer creditworthiness would improve when the business flourishes.

As explained in the Chapter 5, farmer shareholders faced difficulties in raising working capital for their cultivation practices. Converting the whole crop production business operation to a buy-back arrangement between the farmers and the FPO is recommended as an alternative to solve this issue. Farmer Producer Organization could bear farmers' working capital requirement by bargaining with suppliers for supply of starting materials and other inputs on credit. The FPO should ensure a lower than market price for inputs and better prices for their produce through a bargaining process. The FPO should make use of opportunities in attractive markets such as business with corporate clients with formal contracts for continuous supply. A revolving fund should be set-up to generate funding for this operation during the initial stages. However, the FPOs should operate with working capital planning rather than offering relief packages to their shareholder farmers and should exercise tight monitoring and control over farmer operations. The FPO should permit and actively encourage non-shareholder farmers patronizing its services. However, the FPOs should arrange this facility to such farmers only when the FPO achieves stability in the future and at a higher service charge than for shareholders.

Empowerment of the FPO

The establishment of new FPOs should be based on the needs and preferences of farmers, but not on the priorities of MOA and its officers. It is envisioned that the facilitating organizations would perform an empowering role over the FPOs during the next decade. It is recommended that the FPO should be empowered instead of being controlled by the state organization. This empowering role should include formal training programs on basics of agribusiness management. entrepreneurship and finance for BOD members; suitable training programs for key managers; assisting farming communities to develop their power by getting their involvement in processes using a more collaborative approach with farmers; and training programs on technical matters as an essential condition.

Suitable training programs on agribusiness and entrepreneurship for the members of the BOD and managers could be sponsored by MOA followed by a formal award/certificate. This is expected to boost the morale of personnel and empower them for their task of uplifting the business status of the FPO. It is also proposed that in selecting directors, attention be paid to their areas of expertise, exposure and knowledge. Thus, it is hoped that a few directors who are elected would be non-farmer directors who have excelled in their own respective fields such as Accounting, Finance, Agricultural Science and Law. Regular coordination meetings must be held between the Board and the MOA. While solving business problems, this would assist bridging the status gap between the farmer directors and non-farmer directors.

6.3 Recommendations on governance arrangements of the FPO

Establishment of good governance

It is recommended that the rules relevant to good governance should be in place in the constitutional documents and organizational by-laws to ensure trust between the FPO and shareholder farmers. Some of the most important practices are the preparation of audited financial statements; making the annual report with audited financial statements available for shareholders; approval of budgets; financial forecasts and operational forecasts at the BOD; managers directly accountable to the BOD; regular convening of the AGM; adoption of a zero tolerance policy on bribery and corruption; and nomination and election of directors by the shareholders.

6.4 Recommendations on management factors of the FPO

Employment of skilled General Manager

The management should play a very important role in the proposed business structure. The management apparatus should not lack capacity. Therefore, the GM should be a skilled, experienced, knowledgeable and qualified manager. The GM should be a graduate in Agribusiness Management; Agriculture; or Business Management. This should be a full-time post. The GM should provide leadership to all the other employees. A proper and a formal hiring procedure for the GM is recommended. Managers should be provided with an attractive and performance-based remuneration package with incentives and career path. Various managerial grades should be identified to ensure a career path.

The GM should report to the BOD directly. The GM should be free from state control and given autonomy to perform his tasks as in a private or public company and shall be provided with authority to enter in to formal contracts with corporate clients on behalf of the FPO. He should refrain from engaging in business activities with the FPO. He shall collaborate with the AD for technical advice. All the managers should be provided with letters of appointment along with clear job descriptions (Annex VII). Other employees also should be suitably qualified.

Development of a vision, mission and long-term business plans

The MOA should not continue to endeavor to make long-term strategic plans for the FPOs. A great sense of ownership and commitment is expected by developing them through a participatory approach. The management should develop them with the collaboration and approval of the BOD. Well-designed long-term business plans will assist the FPOs improve focus and achieve a forecasted growth. The facilitating organization has the special role of developing and establishing right processes within the FPOs. Farmer Producing Organizations should be empowered to become competitive organizations that have good business systems in place to deliver customer value. Further, they should be empowered to perform necessary value adding activities. The management of the FPOs and the AD should be held responsible for this task.

6.5 Recommendations on product and market factors

Establishment of sustainable links with corporate clients

The privileged circumstances of accessing high value markets through high value crop produce is highlighted here. Farmer Producers Organizations should enhance their market base through strategic business links with corporate clients. The establishment of steady and long-term business links, and forward contracts is recommended. These corporate links should serve the best interests of the business and the BOD. Managers should ensure healthy production processes, and continuous and complete patronage by farmer shareholders in order to serve such links. General Manager should be provided with authority to arrive at such links. Also, the management should not lose sight of the production of value-added goods.

Investment on intangible assets

Intangible assets are the assets without a physical presence. Most common examples of intangible assets with reach for the FPOs in Sri Lanka would be brand names and trademarks. These could improve the reputation and the long-term worth of the business. Managements and the boards of the FPOs should ensure investment on such assets. Acquiring trademarks and brand names will assist the FPOs in establishing links with corporate clients.

Establishment of multi-products for the FPO

It is recommended to establish multi-crop for the FPOs to reduce agricultural as well as business risk. The risk of crop (an income) loss from natural causes such as drought, pests and diseases could be reduced through multi-product operations. Also, the FPOs could serve the customers who demand for a range of products through multi-cropping. However, it is recommended that the FPOs carry-out a limited and a convenient range of complimentary business activities.

6.6 Recommendations on structural factors

Establishment of organizational structures

The MOA should facilitate the establishment of less complex organizational structures for the FPOs. A generic model for organizational structure suitable for the FPOs is given in Figure 6.1 below.

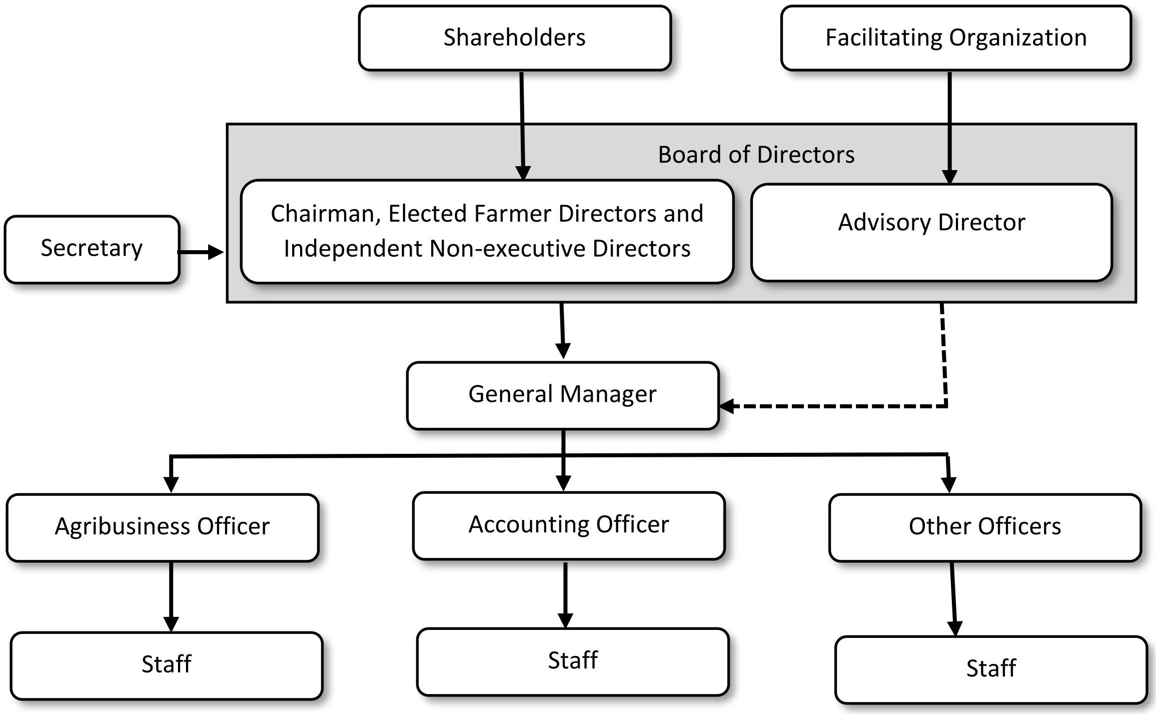

Figure 6.1: A generic structural model for the proposed FOs

Coordinating Committee

It is recommended to establish coordinating committees to make a link between the Clusters and the MOA. This should consist of office bearers of Clusters and the officials of MOA. Some conditions recommended for the Coordinating Committees are given below.

1. Coordinating committees should be informal groups of office bearers of all Clusters, and the Boards of the District Farmer Society/ATDP.
2. Coordinating Committees shall meet once a month to discuss relevant issues that the farmer members' experience.
3. Committees would assist to narrow the gap between the farmers and other officials who are stakeholders of the District Farmer Society/ATDP while helping the farmers with technical problems.
4. All eligible farmers may be recommended by the MOA during the early stages of the institution.
5. It is necessary to define specific administrative areas per specific Coordinating Committee before the establishment of the proposed institutional model.

District FPO

It is recommended to establish a District FPO. Some conditions necessary for District FPOs to operate sustainably, and to succeed and develop into a larger and a prosperous organization are proposed as below. District FPO is used as a generic title in this section. Many of the weaknesses present in the existing the FPO models in Sri Lanka should be eliminated. Other circumstances were presented and discussed briefly throughout this report.

1. This is the business operation level where eligible farmers will make investments and become shareholders and shall have limited liability. These should be formally registered as the business entity in the relevant district with the relevant authority.
2. One administrative district shall establish only one District FPO under the ASMP/MOA.
3. This level is equivalent to ATDP under the ASMP/MOA. It is recommended to indicate that the entity attends to business purposes leading to serve the development goals at the ASMP/MOA. Therefore, the title 'Agriculture Technology Demonstration Park' may not be suitable as the name for a business organization. It is recommended to choose an alternative title for this organization format.
4. Only the member farmers of Clusters within the respective district shall be enrolled at the District FPO.
5. Farmers should make formal contracts with their respective Clusters in the first instance. These include the assets that they have acquired from the ASMP/MOA.
6. These organizations must be managed by skilled managers.
7. Management of District FPO should be authorized to sign contracts with corporate clients and patrons.
8. They should be authorized to produce and sell primary agro-products and value-added agro-products.

Provincial FPO

Farmer Producer Organizations that follow federated formats at present have complicated structures and have failed to uphold the business expectations of their smallholder farmer members. They have provided opportunity for politics within a federated structure. Also, there is limited possibility of a single business organization with smallholder farmers on national scale. With their rather poor business skills, managing such a large business organization will prove unsuccessful. Therefore, a national federation is not recommended. Instead, a tiered structure covering a single province is recommended. Some conditions necessary for such Provincial FPOs to operate sustainably to succeed and develop into a larger and a prosperous organization are recommended as below.

1. These should be limited companies owned by District FPOs in the respective province.
2. These are proposed to be larger organizations that should be managed by skilled and knowledgeable managers.
3. It is of the researchers' opinion that these organizations doing the same business as the District FPOs is baseless. The Provincial FPOs should practice forward integration to move in to the next level of the value chain of the products that the District FPOs produce. Therefore, it is proposed that this entity should engage in producing and selling processed products only. This will also encourage the Provincial FPOs and District FPOs engage in complementary business.
4. Provincial FPO should have a legal personality to own assets and hire employees etc. It should own the processing plants and should undertake the product processing under its own brand name/s.
5. Shareholder farmers will have the opportunity to send responses or feed-back to higher policy levels through the Provincial Advisory Director. Provincial Advisory Director would be a higher officer than the AD in the District FPO.

6.7 The Selection of the Legal Structure of the ATDP.

In chapter three a brief survey of the variety of statutes available for the creation of an ATDP was conducted. The vehicles which appeared to be of potential were as follows.

1. The unlisted public Company under the Companies Act
2. The private Company
3. The agrarian development Council under the Agrarian Development Act.
4. A registered society under the Societies Ordinance.
5. The Cooperative Society under the Cooperative Societies Act
6. A Mahaweli Corporation under the Mahaweli Authority Act

Having arrived at a conclusion on the defining features of the most suitable business model and structure for the ATDP in the previous section of this chapter, it is now necessary to provide an appropriate legal framework within which the two alternative business models proposed can be placed. The following sections of this chapter will embark on a process of elimination to produce the best applicable legal framework(s) for the implementation of the ATDP and thereafter propose a methodology for the ATDP.

For ease of study all possible business structures have been categorized as either single tiered simple structure or as multi-tiered hierarchical structures.

6.7.1 The Single Tier Structure.

This model envisages a simple one tier organization with all farmers being made shareholders/ members of the ATDP. The expectation is that the ATDP with a membership of 1300 farmers, would be able to raise a substantial capital, paving the way for the organization to be sustainable over time. A further expectation is that the farmers would realize the incentive in such investment, as they begin to receive dividends in proportion to their shareholding.

The Unlisted Public Company

The unlisted public company at first glance appears to be the ideal candidate for this model. Its public nature, permits it to have a large number of shareholders. The shareholding of each farmer may vary, according to the particular farmer's appetite for investment and risk and would receive returns in proportion to his shareholding. It is this public character that, unfortunately presents a substantial hurdle. Whilst the incorporation of the Company would only require a few subscriber shareholders, and persons consenting to hold office as directors, the obstacle arises at the point of offering shares to the 1300 cluster farmers. The Companies Act mandatorily requires an offer of shares to the public be made through the issuance of a prospectus[21]. It is the opinion of the researchers that the offer of shares to 1300 farmers, even if carefully selected, would constitute an "offer to the public"[22]. The Companies Act sets out the requirement of a valid prospectus and the registration thereof. It must contain information and reports specified in schedule IV of the Act. Thus it is researchers' view, that the process of a public issue, would be too burdensome on a company that is bereft of any leadership of any substance, skill

[21] Section 37(3) (b) of the Companies Act
[22] Australian Softwood Forests Pty v Attorney General NSW [1981] 148 CLR 121

and exposure to this level of business complexity. In the absence of any material to demonstrate or suggest that a farmer organization could have the aforesaid capacity, we are of the opinion that the aforesaid impediment along with the additional cumbersome procedures and disclosures required of a public company, renders the public company form unsuitable as a structure to commence the project. We do not discount its utility as a suitable vehicle when the ATDP and its leadership attains a certain level of maturity.

The Private Company.

The private Company model is constrained by a statutory limitation on membership. This limitation is set out in section 27(b) of the Companies Act, and limits the number of shareholders to 50. Whilst this limit does not apply employees or former employees who had purchased shares whilst being employees, the requirement of having 1300 shareholders cannot be met in any simple way using this form. Thus the Private Company model stands eliminated.

The Agrarian Development Council

The Agrarian Development Council is a statutory body that is created by the federating of Farmer Organizations created under the Agrarian Development Act[23]. Thus this organization does not fit in with the simple one tier model discussed.

The Farmer Organizations on the other hand have several deficiencies making them unsuitable for an ATDP. Most notably, the concept of a share is foreign to both these structures. Thus, even where the Farmer Organization takes part in business (even though the statute does not specifically permit it), there is no mechanism to distribute the profits of the venture amongst the farmers in proportion to their investment. Farmer organizations are also meant to be limited to a small geographical area and is not expected to be wide spread enveloping an entire province.

The Registered Society

The registered society was initially considered a good candidate, due to its relative lack of regulatory constraints and having very many of the features of a company. Thus the Society having the capacity to enroll a virtually limitless number of members was especially advantageous. However, the Society is deemed unsuitable for two principle reasons. Firstly, the Society form does not have any mechanism for profits made by the ATDP to be disbursed among the membership. The society structure envisaged in the Act is for non-business bodies that conduct social welfare services. Thus even a society registered as a "specially authorized society" under the Act still is constrained by the limitations of the Act. However, the authors see a utility in this structure being used as a precursor, to a more evolved business structure, such as a public limited Company, upon the business progressing beyond a certain stage.

The Cooperative Society

The Cooperative Society was carefully considered by the authors, given the familiarity and popularity enjoyed by the model in the villages of Sri Lanka. Social capital is undoubtedly an aspect that requires consideration when establishing a novel business entity. But the limitations of the Cooperative model

[23] No 46 of 2000

have to be acknowledged. As stated previously, the cooperative model remains tightly regulated by the Commissioner of Cooperative Development and is subject to a myriad of procedural requirements. The intrusive nature of the public authorities including the ministry, does not permit an autonomous business entity. Its principal incongruity with the ATDP concept is its inability to share the profits among members in proportion to investment. Significantly, the amendment introduced in 1992 has made an attempt to introduce the concept of a share to cooperatives[24]. What can only be described as a very careless piece of drafting, it does not provide sufficient details as to the manner in which the concept is merged with cooperative principles. Despite this lacuna, certain cooperatives visited by the researchers have introduced shares in to their constitutions, with members thereafter purchasing shares. Where the cooperatives are profitable, after the mandatory statutory retentions, their constitutions provided for the members being granted dividends from a portion of the profits on the basis of their shareholding. However, in practice this was rarely done, if at all. Remainder of the profit is divided between patronage payments, social funds and similar purposes. Thus, the cooperatives, still do not give primacy to the concept of shares, as the concept runs contrary to the cooperative principles of democratic member control and member economic participation. For the aforesaid reasons, it is researchers' view that the Cooperative society be used in this project as a last resort.

The Mahaweli Corporation

The Corporation established by the Minister under the Mahaweli Authority Act is one of the candidates for the first model. This is because it replicates many of the characteristics of a company with the possibility of having a large private shareholding that is required by an ATDP. The hurdles that this model has is the possibility of being subject to ministerial interference. Whilst this could be minimized, if cooperation is achieved at ministerial level so that the incorporation order would be sufficiently drafted to limit undue intrusions. A very basic requirement would be to limit the number of minister appointed directors to one (who may act as an advisory director). The second obstacle is the application of financial regulations and the Public Corporations (Financial Control) Act[25] which may restrict the freedom of the corporation in becoming a dynamic business entity. Finally, the corporation has a geographical limitation in that it can only function in respect of the Mahaweli Special area. Thus ATDP's which fall outside the area will not be able to use this legal form to conduct business.

Thus it is researchers' conclusion is that the preferred legal structure for this model is the Society model. We recommend that the society be formed as a first step and the business activities be commenced. We further recommend that for the first three years or such other period that is deemed by the management of the business in consultation with the ASMP. The profits earned be retained/reinvested. Upon the completion of the 3rd year, the ATDP may consider whether it would be fruitful for the society to be converted in to a public limited company (unlisted) in terms of section 15(4) of the Act enabling its shareholders to receive dividends from that point onwards. It is recommended for MOA to state as a broad policy that, at the end of the three years a resolution would have to be passed by two-thirds majority for the society to be converted to a Company for members to obtain full range of benefits. Farmers will certainly do this as it brings benefits to them.

[24] Act No 11 of 1992 introduced a new section 11A.

[25] No 38 of 1971

6.7.2 The Multi-Tiered Structure

This business model considers a two tiered model, with the possible third tier formed at the provincial level as an aggregate of several ATDPS. Thus this model may comprise of a combination of the various legal framework that were discussed above and in chapter 3.

Public Company – Private Company model

The first model contemplates a two tier structure. The lower tier would comprise of private companies and the higher tier made up of a public limited (non-listed) company[26]. It is necessary to keep in mind that the lower tiers consist of clusters of farmer. It is projected that each such cluster would in turn comprise of about 300 farmers. Each "Private Cluster Company" would thereafter own the shares of the public limited company. As the public limited Company's shares would only be offered to three or four select cluster entities, it would not constitute a "public offer" and thus be devoid of the issues discussed in the previous section. Profits of the public company would trickle down to the clusters as dividends. The clusters in turn may be able to grant dividends to the individual farmers. The most glaring issue in this structure is the private Companies inability to accommodate 300 shareholders (owing to the limit set out in section 27(2) of the Companies Act). Thus either the clusters would have to be fragmented in to blocks of 50 shareholders. This in researchers' view is an unnecessarily complex structure involving high transaction costs. Thus we eliminate this option.

Private company- Private Company Model

This model is excluded for the very same reason as the first model as the lower tier private companies would be unable to accommodate all member of the cluster as shareholders.

Private Company public Company model

This is the inversion of the structure of the first model discussed under this category. This envisages each cluster to be formed in to a public Company. The public companies will then own the shares of the private Company in a proportion agreed between them. This structure is faulty as it is difficult to justify the effort involved in the creation of the Companies when compared with the benefit received through their incorporation. As discussed previously, the making of a public offer requires considerable administrative effort. If each ATDP were to have 3 clusters, the entire project would require 21 separate public offers. With the public offer being limited to 300 members, the capital that can be raised through such an offer would in all probability be insufficient to justify the entire exercise.

Private- Cooperative Model

This model is essentially a modification of the previous model with Cooperatives replacing the private Companies in the lower tier. Since the top tier would not be making a public offer, this model proposes that the company that is created for the ATDP be a private company, which would not be subject to too

[26] The readers are to note that the description of the structure is from structural perspective and not an ownership perspective. If the latter were to be chosen, the description would be that the private company would be the higher tier company with the public limited company at a lower level since the private company owns the public limited company. This structural description would be continued throughout this section for the purpose of maintain consistency.

many restrictions and disclosure requirements. This model certainly remedies the difficulty faced by the models so far discussed which have the private Company serving as the lower tier structure. If the cooperatives were armed with constitutions suitably drafted, with provisions for the issue of shares, one may take the view that the model is workable even though the concerns raised regarding cooperatives remain valid even in the limited role the cooperative is to be used in this model.

Private Company-Mahaweli Corporation Model

This model may also prove suitable in theory. But it involves the creation of several corporations to accommodate each cluster. Each Corporation would own the shares of a private Company (as with the previous model, a private Company is chosen). With each ATDP requiring 2-3 such corporations the entire project may require a large number of corporation incorporated by the Minister. This may be practically difficult to attain. Besides the aforesaid hurdle, this model is inherently unsuitable for ATDPs located outside the Mahaweli special area. As the project seeks a consistent modus operandi across the board, this model may not be suitable.

Private Company – Society Model

The society has the advantage of being able to enroll all the farmers of the cluster as its members. However, the difficulty in granting dividends to the farmer remains ever present. Whilst within this limited scope, the hurdle may be overcome by using creative methods, it is felt that resorting to such lengths, when other models provide alternatives, is unnecessary.

Private Company-Society (later public)-informal cluster

This structure can be considered a logical extension to the model discussed above. Thus the clusters would remain in formal or may even be organized in to an unincorporated association. These associations would not engage in any commercial activities, but perform merely coordination functions. All farmers will be enrolled as a registered society for a limited period until the ATDP matures to an acceptable standard. At this point it is hoped that the finances of the Society would also have improved with earning being retained over the period. Thereafter the Society would be converted in to a public limited Company (unlisted). A conglomerate of ATDPs could be created by forming a Private Company, which would be owned by the respective ATDPs in proportions agreed to between them. This last entity would only be justified if the pooled financial resources of the ATDPs are substantial and there's a space for strategic expansion through vertical integration in the supply chain.

The Cooperative in the Top Tier

A question may be posed as to why the above model cannot be replicated with a Cooperative placed at the helm. These authors feel that the reasons set out in the previous section on the discussion of Model one with regard to cooperatives, apply perhaps with greater force in this instance. Those hurdles may in fact be magnified if one were to consider a "Cooperative- Cooperative model". Thus this genus of models are discounted altogether.

The Mahaweli Corporation Cooperative Model

This is yet another theoretical possibility. This model will require the collaboration of the department of cooperative development, the ministry of agriculture and the Mahaweli Authority. Whilst within the present cabinet, the three subjects have been devolved on the same minister, this is by no means a certainty in the future and thus would present a complication. Apart from the above, the geographical restriction placed on the incorporation of Mahaweli corporations also present a difficulty.

The Model Available in the Agrarian Development Act

As stated previously, the Agrarian Development Act presents a readymade multi tired model that seems consonant with the needs of the ATDP. If the said model were to be used, the clusters can be formed in to farmer organizations. Representatives from the farmer organization would then form the Agrarian Development Council. As discussed previously the Agrarian Council is not empowered to conduct any sort of business. However, the Agrarian Council is permitted to form a Farmer's public limited Company[27]. Whilst the term "Farmer's Peoples Company" is not defined in the Act, it is assumed that the prefix farmer's was added to limit the membership to farmers. The Agrarian Development Council, and the farmer organizations may themselves own a shareholding. Thus the Agrarian Development Council may control the Company with the profits of the Company being divided among the farmer organizations. However, it is to be noted that this structure has no workable solution to ensure that the profits trickle down to individual farmers.

Alternatively, the Agrarian Development Council may merely facilitate the formation of the (public unlisted) Company, whilst only keeping a small or nominal shareholding. The farmers themselves will own almost the entirety of the issued shares. Thus this structure would then resemble a hybrid structure. The business of the ATDP would be carried on by the Farmer (public unlisted) Company whilst the coordination of the farmers will be through the conduit of farmer organizations and the Agrarian Development Councils.

Whilst this structure has the aforesaid advantages, the following concerns exist. The creation of a public Company, will involve the making of a "public offer", and the issues associated with task will apply here once more. The Agrarian Development Council being incapable of conducting business would not be able to perform the task of an interim body (as performed by the society prior to being converted to a company in a previous structure discussed). Even if the council performed business, the Act does not offer a readymade path for it to be converted to a company as in the Societies Ordinance. The logical question would then be, would it be possible to create a registered society as a precursor to the formation of a company. This is objectionable for two main reasons. Firstly, the Agrarian Development Act specifically permits the formation of a company, but does not make any reference to the formation of any other structure. Given that the Act was drafted to put in place a preferred structure for the farmer community, the authors of the statute may have been of the view that such provision is unnecessary. Thus the legality of the creation of both a public Company (as explained previously) and a society may be questioned. Secondly, the structure poses an administrative difficulty, as the entire network would be regulated by three different regulatory regimes. Namely, the Companies Act, the Societies

[27] It must be noted that the Agrarian Act which had been enacted prior to the New Companies Act, empowers the creation of Farmer's Peoples Companies. With the concept of a people's company abolished under the new aw, it is arguable that what is permitted now is the creation of limited liability companies (unlisted).

Ordinance and the Agrarian Development Act. This legal and administrative issues compel us to consider other structures, overlooking this structure.

6.7.3 Preliminary Findings

Upon a consideration of the analysis above that two models emerge as advantageous and suitable for the formation and operation of the ATDP.

Proposed Model One

The first structure for the ATDP is a flat one comprising of a registered society, with all farmers enrolled as its members. These members will be informally grouped in to clusters on the basis of the crop cultivated. The cluster's role would be strictly limited to coordination with the Society management Committee and its employees. Over time the society will be converted to a public Company (unlisted) so that the profits of the venture can be distributed amongst the farmers as dividends. As stated in the analysis, we encourage Several such ATDP's to aggregate and form a private Company for the purpose of conducting a business that is further advanced in the value chain i.e a forward integration. Thus the products of the ATDPs may be channeled directly to this private Company for processing and value addition and thereafter introduced to the market (Figure 6.2).

Whilst the application of the aforesaid model presents no difficulty in the case of clusters that are yet to be established, the application of the aforesaid model to the clusters already established and registered informally with the department of agriculture, appears to present a practical difficulty. This is with regard to the distribution of assets that had already taken place on a cluster basis. In such cases an informal or unincorporated cluster is found to be insufficient for the purposes of accountability and recoverability of assets.

As such the researchers propose an interim measure to meet the said challenge. It is proposed that the clusters be registered as separate societies. These societies should be granted a deadline to regularize all transactions that had taken place prior to their creation.at the end of the period, title to all assets distributed under the ASMP should be held by a Cluster Society. Thereafter the clusters falling within a district must be amalgamated in terms of section 15(3) of the Societies Ordinance, creating one amalgamated society. Thereafter, the aforesaid model proposed can be followed, and the Society can be converted to a Public Limited Company as advised above. A specific legal framework to facilitate the establishment of FPOs of this model should have to consider specific features or themes. A more detailed discussion on this topic is found in the Appendix IX.

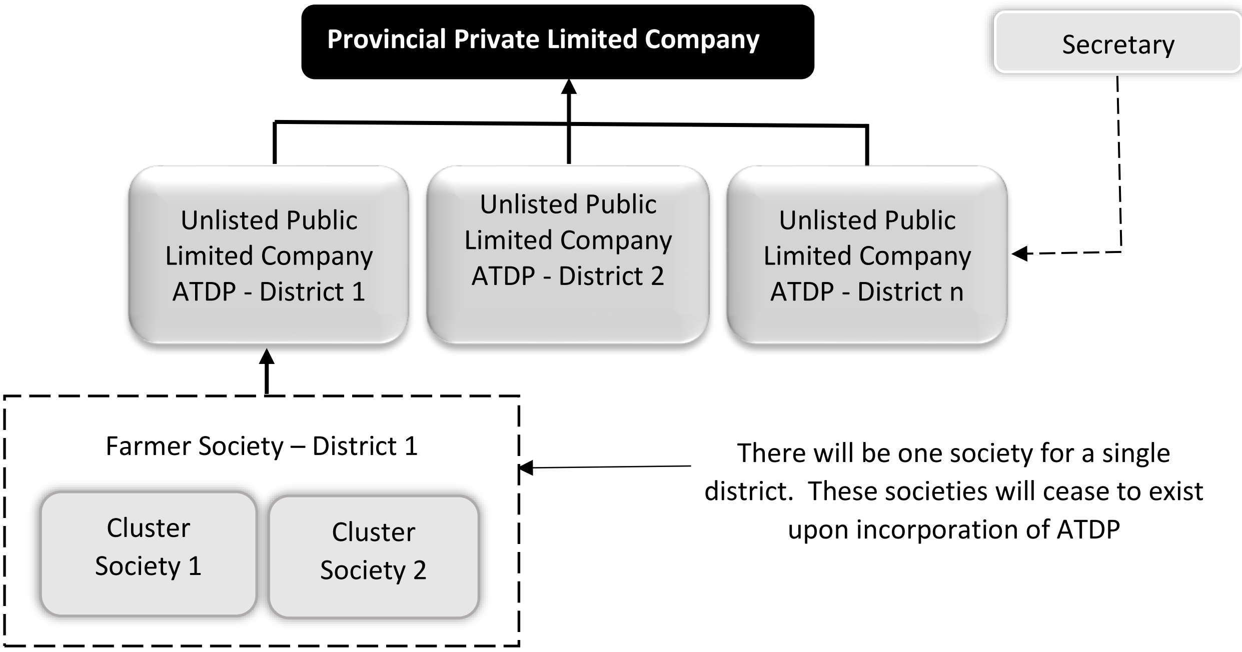

Figure 6.2: Sketch of the proposed model

Proposed Model Two

The second structure is a two tiered structure, with the bottom level comprising of Cooperative Societies and those societies investing in the shares of a private Company, which will operate the business of the ATDP. The ATDPs, profits would be distributed amongst the Cooperatives in proportion to the shareholding of each Cooperative. The farmers would then receive dividends from their shareholding in the cooperative, as well as any other monetary reward for their patronage.

6.7.4 Comparison of legal structures

Thus in both the models proposed the ATDP would eventually conduct its activities within the form of a limited Company. This is no surprise as the advantages of the company form has been highlighted through this research report.

When considering the two models, we find favor with the first model, as it leaves sufficient room for the entity to conduct its activities unimpeded by external parties. The first model also is able to eliminate the internal problems discussed throughout this report. The necessity for advice and guidance to the embryonic organization would be sufficiently satisfied by employment of skilled managers and advisory Committee members. The Coordination that is conducted by the cooperatives in the second model, would be sufficiently replaced by the informal cluster, with the added advantage of the absence of additional rules and bylaws that are mandatory in a cooperative. This model also has the advantage of being regulated by a single authority, the registrar of Companies, as opposed to multiple regulators in the cooperative model.

6.8 Final recommendation

Thus, it is researchers' considered opinion that the research data justifies selection of **Model One** as the most appropriate model for the ATDP under the Agricultural Sector Modernization Project. Further, all the recommendations presented in this chapter should be implemented for elimination of the internal problems to avoid all the corporate illnesses discussed, to obtain best benefits from the legal model recommended.

Chapter 7 - Conclusions

Agriculture plays a key role in Sri Lanka's economy in terms of providing employment. A quarter of the labour force in Sri Lanka is involved in Agriculture. Sri Lanka is an agricultural country that traditionally favours the production of food to feed a rising population which is over 21 million. The smallholdings in the agricultural sector were gathering momentum during the past few decades as they play a crucial role in the economy. Sri Lanka has policies in place to increase their income by encouraging commercial production of non-traditional crops for export, domestic markets, and for processing.

Having realized the importance of the agricultural sector in the economy of Sri Lanka, successive governments have initiated policies and plans for its restructuring and development. The productivity, profitability and the commercialization process within the non-plantation smallholder sector have been reported as being below expectations. Therefore, there has been a need to shift the agricultural strategy to address these issues by (a) modernizing the resource use and (b) shifting the sector from a low-value system that produces primary products towards a system that will produce high-value, value-added and export-oriented products. A significant strategy so adopted was the formation of the Farmer Producer Organizations (FPO) to achieve higher productivity and profitability.

A vast majority of the agricultural land occupied by the non-plantation food crop sector in Sri Lanka has been cultivated by the small-holders. However, in Sri Lanka, small-holders have their unique constraints. The Agriculture Sector Modernization Project (ASMP) has been planned and implemented by the Ministry of Agriculture (MOA) with a credit facility from the International Development Association of The World Bank. The key development objectives of this project were to support increasing agricultural productivity; improving market access for the small-holders; and enhancing value-addition activities of smallholder farmers and agribusiness in the project areas. The MOA has already taken initiative in setting-up of FPOs. These have been proposed in seven districts viz Jaffna and Mullaitivu (Northern Province), Batticaloa (Eastern Province), Monaragala (Uva Province), Anuradhapura and Polonnaruwa (North-Central Province), and Matale (Central Province). These districts have been selected based on the high poverty headcounts and agriculture development potential.

For the purpose of this study, a Farmer Producer Organization is defined as a formal institution which is farmer-based and farmer-controlled set-up with the objective of serving both individual farmer and farming community's needs. Services offered by an FPO are mainly to enhance agribusiness activities and livelihoods of its member farmers. This short-term study was undertaken as an in-depth policy research to identify the most appropriate model of farmer organization network for the Agriculture Sector Modernization Project. Their coordinating efforts play a significant role as an institutional vehicle in promoting agricultural development. Therefore, identification of best FPOs models and establishing them would be an important contemporary need of the country. The specific objectives of the study were to identify appropriate legal and regulatory setup for establishment of the FPOs; identify appropriate organizational structure to operate from cluster village level to national level; and to identify appropriate management system for the FPOs.

There are few main categories of formal FPOs established in Sri Lanka viz. Farmer Cooperatives and Farmer Companies, and FPOs established by the Tea Smallholder Development Authority, ASMP, Mahaweli and Department of Agrarian Development. The population for target sample consisted of all such categories of formal FPOs established under diverse statutory frameworks in. This study endeavored a qualitative inquiry through case studies. The uniform categories of FPO were considered as the unit of analysis. A stratified purposive sample was chosen from the project areas as well as outside for the collection of data. A uniformity within categories was expected and rich data were collected to arrive at conclusions and to propose recommendations.

Data were collected from the FPOs and a variety of their stakeholders. The data collection strategy included holding interviews and discussions with farmer members, leaders of the FPOs and key informants; field observations; and the analysis of secondary data. Data analysis was also completed utilizing a qualitative approach involving reduction of dimension of data; correlation and consolidation; data comparison; and pattern matching.

Farmer Producer Organizations evidenced unsuccessful as business organizations due to many corporate illnesses present in their internal environments. They practiced democratic voting and the benefits were to distribute proportional to patronage by members. Further, there was no market for shares of the FPOs. Neither shares nor the investment could be transferred or sold. Member bases of the FPOs were quite narrow and geographically oriented. These were the reasons for the key principle institutional problems namely, free-rider, horizon, portfolio, control and influence, that destined them to ill-perform in business. These institutional problems severely restricted the equity and as a result, debt capital of the FPOs. As a result, the FPOs were heavily dependent of capital donations from external donors, which was not sustainable.

Farmers and their FPOs showed poor creditworthiness and lack of working capital. Members did not elect all the directors to the Boards. The facilitating organizations rather controlled but not empowered the FPOs directly or indirectly through their agents who were Advisory Directors in the Boards of FPOs. The Management was not clearly separated from the ownership and control resulting loss of accountability to the Board. They have not employed skilled and professional managers. As a result, the FPOs lacked strategic plans that could support long-term business. Managers did not have clear job descriptions or incentive schemes. No FPO had active long-term strategic plans, vision, or mission developed using a participatory approach. However, many the FPOs displayed fair degree of financial transparency and the implementation of good governance practices.

The FPOs did not serve their year-round sales contracts although they had potential to do so displaying a missed opportunity. Members sold their produce individually despite benefits being proportional to the level of patronage. To worsen the situation further, many of the FPOs were subjected to political influence. Therefore, in Sri Lanka, the present FPOs were not structurally equipped to achieve benefits expected by the smallholder farmers.

It is recommended to practice voting and the distribution of benefits proportional to the level of investment; create conditions where shares can be traded among the eligible farmers; and the separation of management from the ownership and control. The facilitating organizations (MOA in this instance) should play an empowering role rather than controlling. Shareholder-base should be broadened at least to the district level. The process of appointment of AD should be more FPO-friendly. The AD and GM should have clear job descriptions and their skills and qualifications should match their portfolios in the FPO. Further, patron members should not hold salaried positions in their respective the FPOs.

Having determined the specific business model and the attributes of a successful FPO, the next task involved the identification of a suitable legal regime. It is unfortunate that the legislative and policy making authorities had not directed their attention towards a custom drafted statute. The Agrarian Development Act introduced in 2000, whilst making several advances as compared to is predecessor the Agrarian Services Act, failed to address this important aspect. Thus the research team had to consider the statutes presently in operation, to ascertain whether they could be put to use in a creative manner to attain the objectives of the ASMP.

Thus the following Acts of parliament and the legal structures created by them were considered.

1. The Public (unlisted) limited Company and the Private Company under the Companies Act No 7 of 2007
2. The Agrarian Development Council and the Farmer Organization under the Agrarian Development Act No 46 of 2000
3. The Cooperative Society under the Cooperative Societies Law No 5 of 1972 as amended.
4. The registered society under the Societies Ordinance No 16 of 1891 as amended
5. The Corporation incorporated by the Minister under the Mahaweli Authority Act No 23 of 1979.

Our analysis demonstrated that all of the aforesaid bodies had advantages that could be useful to an ATDP. All the aforesaid bodies had been bestowed with a separate corporate personality. This was considered the lowest threshold requirement an ATDP would require as it would facilitate a range of business activities such as entering in to contracts, holding property, obtaining debt finance, employing individuals etc.

The next requirement was that of raising capital. The objectives of the ASMP demanded an independent and self-sustaining ATDP. The research data also indicated that a reliance on regular donations was inimical to an organization's organic growth. Whilst the initial funding assistance of the World Bank through the ASMP would be substantial, sufficient capital for an ATDP could only be raised as equity, if and only if a sizeable majority if not all the farmers participating in the project contribute equity. Thus the structure would need to be capable of enrolling all farmers (a number well in excess of 1000) as members/shareholders. Certain structures as the Private Company failed in this respect whilst the other structures had the theoretical capability, but they in turn would face practical difficulties in dealing with such relatively large number. It also needs to be kept in mind that the ATDP may have to resort to further injections of equity from the members at a later time.

The next obvious requirement is for a mode of repayment on the investment made by the farmers. The Company form and those models which had embraced the concept of shares had the advantage of distributing the portion of the profits as dividends. The registered society model and the several models under the Agrarian Development Act did not provide for the issuing of shares.

One important finding on the analysis of the research data was the need to insulate the ATDP from all forms on interference and undue influence specifically including those of political and administrative nature. The independent raising of capital is an important safeguard in this regard. Despite this, certain statutes provide many avenues for such influence. This was most evident in the Cooperative Societies Act. The Agrarian Development Act and the Mahaweli Act also left space for undue influence from political and administrative sources. Companies and registered societies were less subject to such intrusions.

Thus in developing a model, the research team attempted to manage some of the inherent disadvantages the models had whilst using the beneficial features. One strategy adopted was to analyze the benefits of having a network of structure so that advantages of different models can be matched with the deficiencies in other models so that synergies can be gained. This method was also supported by the findings from the research data which indicated a business structure with several tiers with each tier engaging in a different step of the value chain.

The research team analyzed over twenty combinations of the above legal structures, with the structure with most potential discussed in some detail in chapter 6.

The structure recommended by the researchers for the ATDP is a structure comprising of a registered society, with all farmers enrolled as its members. These members would be informally grouped in to clusters on the basis of the crop cultivated. The cluster's role would be strictly limited to coordination with the Society Management Committee and its employees.

Since the ASMP had commenced prior to the commencement of the research, and had already formed clusters of farmers in several project areas, an additional requirement of formalizing these transactions between the ASMP and individual farmers and/or transactions between the ASMP and the informal clusters arose. The researchers thus recommended that, in such area (only) the clusters be registered as societies. Thus all transactions referred to above that had occurred between individual farmers, informal clusters and the ASMP must be assigned in favour of the registered farmer cluster Society. Thus the respective farmer cluster societies would own all assets granted by the ASMP. Thereafter, these societies would be amalgamated creating a single society. This society shall be the first tier of the two tier structure.

Over time the society will be converted to a Public Company (unlisted) so that the profits of the venture can be distributed amongst the farmers as dividends. The Researchers recommended that several such ATDP's to aggregate and form a Private Company for the purpose of forward integration.

On a final note the researchers wish to recommend that the policy makers consider drafting a special law for the creation of the FPOs if the present strategy is to be expanded to other provinces not covered by the ASMP as a long-term project. The Researchers trust that this research report would be a useful tool and a sensible point commencement for an endeavor such as that.

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Annex 1 - *Guide for interviews with board of directors (chairman)*

1 Respondent's Details

1. Capacity:…………………Contact details: Phone:………………Email:…………………
2. Gender: Male | Female
3. Educational qualifications:……………………………
4. Farming experience (yrs):………
5. Dates of election as a director and chairperson, Number of terms completed at office and designations:………………………………………

2 FPO Data

1. Name of FPO:………………………………………Website ……………………………
2. Date of registration and nature of incorporation: Public | Private.
3. Was FPO established by a facilitating organization? Details:………………
4. What were/is the selection criteria FPOr shareholders?..
5. No. of shareholders and gender make-up:……………………..……
6. Draw the organizational chart of the FPO.

3 FPO Assets and Recent Investments

1. Details of assets:……………………………………
2. Acquiring of long-term assets? …………………..
3. Does your FPO have own brands/product labels/patents? Details………………

4 Shareholding and Shareholder Benefits

1. What are the different kinds of shares that FPO has issued?........................ ....
2. History of shareholding/transaction by FPO:…………………………
3. What are the policies and practices related to the issue and sale of shares?.........................
4. Does the government hold shares? Details…………..…
5. Do you have non-patron shareholders other than the government? Details:…
6. Has the FPO declared dividends to the SHs? Details………..
7. Are the shares readily marketable?.......................................
8. Are shareholders allowed to sell produce outside FPO? Details:……………
9. Can non-members use FPO services? Details…
10. Has the FPO been able to attract external debt and/or equity capital in the past?.................

5 Electoral Procedures

1. Guidelines to select director candidates:……………..
2. The nature of voting rights of shareholders to elect directors: ………….
3. If there are any non-patron investors (such as the government), do they have voting rights?

6 Governance

1. Composition of Board of Directors: ……………………...
2. Does the FPO distribute the annual report every year to the shareholders? ……
3. Is this done before the next AGM? Yes | No. Comment:………………………………….
4. Are the accounts externally audited?...................................
5. Financial transparency and accountability……..……
6. How many board meetings each year?

7 External Influence

1. Has the government shareholding influenced your FPO business? Yes / No Details………

8 Other Matters

1. Were there any recent board decisions to impose limitations on expenditure by managers?
2. Are there any rules or flaws in the organizational structure that constrain the performance of the Board? ....
3. What are the perceived barriers and issues within Institutional Arrangements that can deter the performance of your FPO?
4. What are the positive features you have observed within the FPO in respect of Institutional Arrangements and Management Factors?...
5. What are the strengths and weaknesses of the FPO?..

9 Continuity

1. Do you want to increase SH base? Comments...........What are the positive and negative effects of new shareholders joining the FPO?...........................
2. What is your perception of out-growers supplying to your FPO?........Who will benefit?

10 Influence

1. Are there situations in which ordinary shareholders are able to influence activities?

11 Business Identity

1. Does the FPO have a mission and a long-term business plan? Details:…………..
2. Who were involved in making business plans, strategic choices etc?.........................
3. Your overall perception of this business plan: ………………………………
4. What are the expansion plans of the FPO in-brief.
5. What are the different core and non-core businesses that the FPO is engaged in? ………

12 Business Strategy

1. Are the board and hired management involved in strategic choices? Discuss details
2. What are the business environment factors and organizations that can affect your FPO?
3. Do you think that the operational processes in the FPO are geared to facilitate successful implementation of strategies formulated?
4. Has the FPO been able to secure/obtain financial resources to put strategies identified, into action?

13 Operational Management

1. What is the range of products produced/marketed by the FPO?....................................
2. Perception of the product portfolio's ability to generate profits for the FPO/ shareholders:
3. Have you identified and analysed the inefficient processes within the FPO? ………….
4. Have you identified and analysed the new technologies that are around in your industry?

14 Performance Indicators

1. In your view is the FPO achieving its key objectives?
2. In your view is the FPO implementing its key strategies successfully? Yes | No. Details

3. Some quantifiable parameters:

Year	Total revenue	Profit before tax	Markets (provinces , cities, etc.)	Number of buyers	Number of products	Number of shareholders	Price per share	Services offered
2007								
2006								
2005								
2004								
2003								

4. Are there any procedures to evaluate performance of BoD members? Details...................

Annex II - *Guide for interviews with General Manager*

1 Introduction

1. Gender : Male | Female
2. Qualifications:……………Experience in-brief:………………………………
3. Date of joining FPO:…………………Present designation/rank:…………………….…….
4. Details in-brief of other executives: Number of executives, designations, their positions in the organizational structure etc..:……………………………………………………….…

2 Institutional details

1. Your views about the FPO's business position: Comments/Reasons for your views ....
2. Which segment/s of the FPOare you managing?
3. Does the FPOhave an organizational structure? Features…………………..
4. If government owns shares of the FPO, is this an advantage?
5. Has the FPObeen able to attract external debt and equity capital?
6. Are there any restrictions/limitations for you in following aspects? Capital expenditure, Operational expenditure, Operational decisions such as credit period to customers, out-grower decisions and purchasing?
7. Are there any subsidiaries for your FPO? Does it have joint ventures with other companies or govt? What is your FPOs stake in them?...
8. Does your FPO have significant relation-specific assets? Details…………………
9. Has this affected attraction of equity and debt capital? Yes | No, Are or were there any other institutional/governance arrangements that advance/inhibit progress of your FPO?
10. What was/has been done to improve institutional and governance arrangements?..............

3 Governance

1. Were there any recommendations from the audit to resolve any financial issues prevailing? Details ....
2. Do you attend the board/shareholder meetings? Yes | No. Are minutes of those meetings circulated among shareholders and managers on time? Yes | No

4 External Factors

1. Possible external factors that can affect the performance of this FPO?..................

5 Business Identity

1. Does the FPO have a mission, long-term business plan?
2. Have you noticed any action by shareholders to include specific components of their interest, into the FPO business plan and other plans?
3. What are the key objectives of the FPO?
4. What are the different businesses that the FPO is engaged in?
5. What are the perceived barriers within Management Factors that can deter the performance of your FPO? ………..

6 Business Strategy

1. Are the hired management involved in strategic choices?
2. Is the FPO generally successful in implementing the strategies formulated?
3. Do the strategies of the FPO fit with the business environment of it?
4. Operational processes in the FPO are geared to facilitate successful implementation of strategies formulated? Comments:…………
5. What are the resources that can be binding for your FPO? Has the FPObeen able to secure/obtain financial resources to put strategies identified, into action?
6. What are the expansion plans of the FPO in-brief? What additional assets should be acquired to implement these plans? What can prevent/has prevented the expansion activities of FPO?......
7. What is the range of products produced/marketed by the FPO?...

7 Performance details

1. What services does the FPO offer to its shareholders?...
2. What advantages does the FPO offer to its shareholders?.........................
3. In your view, is the FPO achieving its key objectives?
4. What are the strengths and weaknesses of the FPO?..

Annex III - *Interview guide for bank managers*

1. Bank and branch :………………………………
2. Contact details: Phone:…………………….. email:…………………………
3. What are your interest rates for various types of fixed and other types of savings options at your bank?
4. Name of the FPO dealing with:……………………………………………………………
5. How long have your bank/branch been dealing with this FPO?...
6. Have you released credit to this FPO during the last 5 years? Details…

Year	Whether to FC or individual shareholders	Whether large, medium or small loan	Nature of collateral or guarantee	Remarks (Recovery rate etc.)

7. Do you have a group loan scheme for the shareholders of this FPO? Yes | No. Details…
8. How do you rank the current creditworthiness of these FPO/SHs?
9. Has the creditworthiness increased over time?

10. Are there differences in factors you consider when you provide credit to The FPOs and true companies? Yes | No. Details:…………………………….……………………………
11. What is the average recovery level of loans given to this FPO and shareholders?...............
12. Will you be willing to release more funds considering the overall recovery rates? Yes | No. Details………………………
13. What happens to bad loans if any taken by the FPOs?..
14. Does govt play a role in decisions with regard to releasing/writing-off of loans to/from FPO?
15. Have you provided overdrafts to this FPO/SHs? ....
16. If yes, have you changed the recovery period? Extended | normal | short
17. Will you offer increased ODs in future? Yes | No, If yes, reasons:………
18. Your overall perception of this FPO?
19. According to your experience as a banker, what are the positive or negative features and also strengths and weaknesses you see of this FPO?..

Annex IV - *Interview guide for potential buyers (Procurement Manager)*

1. Contact details (optional): Phone:…………………………Email:……………………….
2. Identification of FPO:……………………………………………………………………….
3. How long has your company been dealing with this FPO?.......................................
4. Product details:……………………………………………………………………………..
5. How would you rank the reliability of this producer?
6. Relationship with the FPO in terms of quantities, supply contracts etc:
7. Do you have a formal purchasing contract with this FPO? Yes | No.
8. What are the significant features of this contract? Products, duration, quantity, price determination, payment procedures, quality specifications, delivery arrangements etc.
9. What are the perceived positive and negative features of this FPO?...................................
10. Your overall perception of this FPO?
11. Would your company like to invest in this FPO in future? ....

Annex V - *Interview guide for input suppliers (Sales Manager)*

1. Company identification:……………………………………..……………………….
2. Contact details (optional): Phone:…………………………Email:……………………….
3. Name of key FPOs:……………………………………………………………………….
4. How long has your FPO been dealing with the FPOs?.......................................
5. Product details:……………………………………………………………………………
6. Do you like to have a formal selling contract with FPOs? ………………….
7. What are the significant features of these contracts? Duration, quantity or production quotas if any, price determination, payment procedures, quality specifications, delivery arrangements etc.
8. What are the perceived positive and negative features of these The FPOs?................................
9. Your overall perception of the FPOs?
10. Would your company like to invest in the FPOs? ....
11. Also discuss the strengths and weaknesses of the FPOs in Sri Lanka ………………………

Annex VI - *Draft Job Description – Advisory Director*

Job Title: Advisory Director (a fixed-term assignment)
Duration of Assignment: Three years
Organization: Farmer Producers Company Limited
Division: Board of Directors
Job Summary Ensures that the company growth towards a sustainable business entity; and oversees the total operation while introducing efficient processes
Specific Accountabilities 1. Establishes an enabling link between company and the Ministry of Agriculture. 2. Collaborates with the elected Directors and the Management of the company to empower the company. 3. Empowers the Board of Directors. 4. Empowers the management of the company. 5. Deeply embeds the concepts of proportional voting and benefits proportional to investment within the company. 6. Assists the company to establish right and efficient processes. 7. Assumes responsibility to develop the company in to a sustainable business operation. 8. Guides in business strategy process. 9. Guides to makes right policy decisions to distance the company from social and welfare objectives of members. 10. Guides to introduce right administrative procedures.
Skills, Knowledge, Abilities Should possess excellent business and administrative skills. Experience needed: Should be an experienced full-time Officer in the facilitating organization.
Relationship to Other Jobs Supervision received: To be decided Supervision given: Guidance to the Board of Directors of the company and its Management.

Annex VII - *Draft Job Description – General Manager*

Job Title: Agribusiness Manager
Organization: Farmer Producers Company Limited
Division: Overall company
Job Summary Oversees the farming and business operations of shareholder farmers and oversees the business operations of the society/company by providing leadership and organizing the activities during the production process of high-value crops.
Specific Accountabilities 1. Formulates and implements business strategies of the company. 2. suggest policy directions to the board of directors. 3. Plans the overall production effort of the company and its shareholder farmers. 4. Procures new farm equipment. 5. Procures fertilizers, agrochemicals, seed material and farm inputs at bulk prices and sells to shareholder farmers. 6. Maintains an active buy-back system with a large number of shareholder farmers. 7. Arranges selling of company's produce at competitive prices.

8.	Develops formal links with corporate clients.
9.	Prepares budgets and accurate financial records.
10.	Handles paper works and keeps administrative records.
11.	Employs, trains/instructs and supervises farm workers.
12.	Holds responsibility for all assets of the company.
13.	Initiates business activities for the company.
14.	Works full time on the company.

Skills, Knowledge, Abilities

Should possess excellent business skills and communication skills.
Should be willing to deal with a large group of farmers on full-time basis.
Should be a young person of below 30 years of age.
Education needed: BSc Degree in Agricultural Sciences with specialization in Agribusiness Management, BSc Degree in Agriculture or Business Management.
Experience: To be decided.
Induction Training: One month.

Relationship to Other Jobs

Promotion from: This is an entry level job
Promotion to: To be decided
Transfers: To be decided
Supervision received: Board of Directors
Supervision given: To be decided.

Annex VIII – *A summary on the organizational legal structures and their influence on success of FPOs*

Factor	Dependence on legal structure
Poor farmer member base	The unlisted company form permits a virtually unlimited number of shareholders. It is not impeded by geographical restrictions such as for Coops.
Dependency on capital donations and grants	This is unrelated to the legal structure.
Nature of appointment of Advisory Directors	This is a matter that can be clearly defined by the Articles of the Company. However even other organisations can make similar provisions in their constitutions. Any such clauses can also be changed by the members on passing a resolution. One advantage the company has is that it can appoint independent directors, who can exercise independent judgment and oppose arbitrary/undue influence from ministry appointed directors. A Coop cannot do this as all of its management committee must be members.
Influence from the registering authority	A Coops relations with the commissioner of Cooperatives is statutory. Thus the Commissioner has a right derived from the statute to interfere, influence the direction of a Coop. The Companies has no such influence from the RoC.
Dividends were not proportional to the level of investment	This only happens at a company and is a distinct advantage of the company form. (some coops technically can grant dividends on this basis for a portion of the profits)

Absence of market for shares	A true market for the shares will never arise unless the company is successful and is listed at a stock exchange. Otherwise all that is possible is for private sales to occur between individuals. These transaction will increase and the share will grow in demand, as the business starts becoming successful and the company declaring regular dividends.
Voting rights were not proportional to shareholding	This is another advantage that is unique to the company format.
Ownership and management were not separated	This has two aspects. The term management if understood in its wider meaning to include the board, the company form has an advantage in appointing/electing experienced, knowledgeable individuals to the apart from the farmers. The word in its limited sense refers to management staff who can also be employed. Most formats discussed in the research paper have the power to employ non-members in various capacities.
Poor creditworthiness of member farmers	This is an issue that cannot be resolved by the organisational structure.
Lack of empowerment of the FPOs	Whilst the Company form cannot compel the facilitating organisation to empower it, an independent board can most certainly reel unwarranted intrusion
Regular holding of Annual General Meetings	Most of the organisations have to have regular meetings, with breaches attracting various penalties by the Act
Members didn't elect or nominate all the directors	The company form requires all board members to be appointed by the members. This is so for almost all organisations (save the MASL which gave the minister the statutory right to appoint at least one member)
Approval of financial forecasts by the Board	Budgets and forecasts are good business practice.
Regular auditing of financial status	Every Company is required to conduct an audit by a chartered auditor in terms of the Company law.
General Manager was a patron member	The Company law prevent a supplier to the company from being employed in a senior management role. It is an obvious conflict of interest.

Organizational vision and mission were not developed with members	Even in companies, it is very rarely done with the members, although it may be put for approval at a general meeting
Absence of long-term business plans	This is a very common practice, with companies formulating five year or ten year plans. this is only possible
Appreciation or sanctioning of the management	This is a cultural issue common to organisations. Those with a strong goal orientation offer rewards and sanctions to employees. This may be less prevalent in community based organisations, where close relationships prevent such practices
Absence of active links with corporate business partners	Theoretically all organisations are capable of forming such links. These links are formed when synergies can be created out of such links. This is generally independent of the form of the organisation.
Weakness in utilizing product brands	The development of brands and other IP is once more a question of the strategy employed by the organisation and not dependent on its for.
Direct sale of produce by members	May occur within any organisational structure.
Organizational structures susceptible to politics	The Company form is perhaps the most insulated from politics out of the organisations considered. But it cannot be prevented entirely, in the context of appointments to high posts being made through the popular vote

Annex IX – *A brief guide for central themes in a custom-made legislation for FPOs in ASMP*

At the completion of the policy research to identify the most appropriate model of farmer organization in Sri Lanka (the Research), one of the findings reached by the researchers was the absence of a legal framework that caters specifically to the establishment of farmer producer organisations in Sri Lanka. This compelled the researchers to resort to the use of statutory provisions of various legislative instruments created to fulfil other objectives unrelated to the creation of farmer producer organisations. Thus the researchers proposed the creation of a custom designed statute that would meet the specific needs of farmer producer organisations.

Since the submission of the initial draft of the research report, the researchers have received feedback requesting for details as to the contents of such an Act. This annex will attempt to briefly identify the central themes of such a legislation. It is emphasised that this report should not be considered as a comprehensive work on the characteristics of the farmer producer Entity.

The Permitted Objectives

It is suggested that the provisions of this Act be only available to farmers intending to engage in the production of agricultural produce (a farmer producer organisation). This is proposed as such organisations encounter challenges that are unique to those faced by other businesses in the agricultural sector. Such other businesses may resort to the Companies Act[28] or any of the legal structures discussed in the policy research report.

The Nature of the Entity

The entity must be bestowed with a separate legal personality. The concept of a separate legal personality has benefited businesses for close to two centuries. Even business organisations that were not typically recognised as having a separate legal personality, have now moved in that direction. The most notable example being the introduction of the limited liability partnership in the United Kingdom. The statutory forms considered in the Research had all been bestowed with this characteristic by statute.

Limited Liability

The organisation would be a limited liability entity, with its shareholder's liability limited to any unpaid amounts on the shares purchased owed by them to the entity. The limited liability form has served company law well and there is no reason for any departure from that model.

The Capital

It is suggested that the entity be capable of raising capital by the issue of shares. It is to be noted that the success of the entity depends on the number of farmers who would subscribe to shares. With individual farmers being unable to invest in large amounts, the number of shareholders then become a critical success factor.

A significant risk in raising capital by issuing shares to the farming community at large, is that of fraud taking place. The history of Company law has many examples of unscrupulous individuals resorting to

[28] No 7 of 2007

raise capital from the public and defrauding the same. The strict requirement of publication of a prospectus and the registration of the same have been incorporated in to the laws of all modern jurisdictions to safeguard the public from such acts of fraud. The farming community being an especially vulnerable segment should therefore be adequately protected by the inclusion of sufficient safety measures to prevent or mitigate the risk of farmers falling prey to such fraudulent schemes.

Membership

One aspect that has to be considered is whether the Act should permit non farmers to own shares in the entity. An advantage of granting such permission, is that the entity could meet its capital requirements fairly easily from relatively wealthy sources of capital than ordinary farmers. These could be equity funds, angel investors, private companies etc. However, the risk in permitting such investment is that the entity stands to lose its essential character of being a farmer owned organisation and its control could be wrested away by a few non farming shareholders. One way that these competing interests could be balanced is by specifying a ceiling for the shareholding by non-farmers.

Administration of the Act

There are two candidates that seem to be obvious choices for the registration and administration of the Act. Namely, the Department of Agriculture and the Registrar of Companies (RoC). The RoC has the benefit of having a system already in place for running a registry as well as the requisite experience. But the creation of a registry within the Department of Agriculture has the advantage of ensuring the registration system remain independent and autonomous from the company law framework. However, a minimal level of communication and coordination between the two institutions would be essential for the success of the maintenance of a registry, whichever candidate is chosen as the administrative authority under the proposed Act.

Formation

The legislation considered in the main policy research can be grouped in to two categories in terms of the approach they took in the creation of the legal entities envisaged in the respective Acts. The majority of these laws permitted private persons to register the relevant business organisation with a registering authority. This approach permits virtually anybody who satisfies certain criteria and prerequisites to register and create an organisation. The alternative approach is for a government authority to create such an entity, (similar to the provisions in the Mahaweli Authority Act) with the government functionary thereafter extending an invitation to those who wish to join the enterprise by purchasing shares. It is our opinion that the former option is preferred as it insulates the farmer entity from being subjected to external influence, including that from the Ministry of Agriculture. This approach would still permit the Ministry of Agriculture to take the initiative as a promoter of the farmer entity in setting up the farmer entity by organising the farmer's in to a collective.

The Act must also make provision for existing entities established under the various statutes to re-register under the provisions of the new Act. Thus farmer Companies, farmer organisations created under the Agrarian Development Act and farmer cooperatives would be permitted to register themselves under the new Act and align their functions in conformity with the new Act, if the members of such organisations so wish.

Constitutional document

It is suggested that the Act follows the successful methodology adopted by the Companies Act in its several incarnations by including a detailed model constitution that can be adopted by the farmer entity. The farmer entity is then at liberty to suitably modify or adopt a constitution of their own design where necessary. However certain minimum requirements must be entrenched, so that their inclusion in any constitution is made mandatory.

The Executive Body

The main decision-making body of the entity would be a board of directors elected by the shareholders. It is suggested that a time bound mandatory requirement be placed requiring a portion of the board seats to be filled with professionals from various fields such as accounting and finance, management, agriculture etc. After the expiry of the said initial time period, the shareholders may appoint any person that it deems suitable without such restriction.

The General Body

The shareholders at a general meeting of the entity would resolve on appointment of board members, approval of dividends and other decisions with an annual meeting being prescribed as a mandatory requirement.

Dividends

It is suggested that the entity follows an approach that is similar to a company by declaring dividends in proportion to the shareholding of each farmer. The drafters may also consider imbuing qualities of a preference share, to the shares issued by the entity. Whilst the directors of the Entity must be given a considerable amount of freedom to navigate the business, specifying a statutory minimum rate of dividend to be declared out of the profits earned each year should also be carefully considered.

Patronage Rights and Incentives

A critical success factor of the organisation would be the amount of patronage paid by its shareholders. Whilst the fact of share ownership and the prospect of dividends may create a sense of loyalty within the farmers towards the Entity, a farmer may easily resort to sell his produce to third parties where an attractive price is offered by such party. Thus, an additional layer of incentive may be granted to the farmer shareholder by providing scope for the distribution of a portion of the profits in proportion to the patronage offered by such farmer to the organisation.

The Act may also provide for the issue of patronage rights to be sold by the farmer Entity at is discretion. This provision may not be immediately used by the Entity as the local farmer may not be mature or capable of appreciating the concept of the patronage right mechanism. But in time, as the Entity and its shareholders evolve, and it becomes successful, it may issue patronage rights to be sold in a manner similar to the manner in which shares are sold.

The Reporting Requirements

The strict requirements placed on companies by the Companies Act to file returns and to maintain records was seen as burdensome to an organisation consisting of farmers. The requirement to employ qualified secretaries was also identified as an additional, non- value adding financial burden. The new Act would have to simplify the requirements to greatest degree possible so that the requirement of trained professionals to undertake these non-core functions can be dispensed with.

The Audit Function

Our research found two distinct approaches taken in respect of the auditing of organisations created by or registered under statute. Certain laws required the organisation to be subjected to an audit by a qualified auditor. Other laws required audit by a government authority (such as the auditor general or by auditors employed by such authority). The statutes that took the second approach, contained detailed provisions as to the manner and the extent of the audit. Such detailed and exhaustive provisions along with considerable discretion granted to such authorities pave the way for abuse and undue influence. Whilst auditing would be an essential aspect and one which is critical to the farmer Entity's success and sustainability, its requirements should not be overly onerous. Thus the former approach is preferred.

Amalgamations

The basic Company law relating amalgamations may be incorporated in to the law. This will facilitate these organisations to seek synergies and also obtain economies of scale.

Dispute Resolution

It is strongly recommended that the Act creates a permanent dispute resolution board, requiring all disputes between shareholders, or shareholders and the entity be decided by such body. Such disputes should not be amenable before other courts of the country.

Finally, we wish to note that the drafting of legislation should never be pursued in haste. History is replete with instances of legislation hurriedly passed through parliament, containing serious flaws and resulting in abject failures. We recommend that the draughtsmen be granted sufficient time to conduct an exhaustive survey of prevailing legislation both local and foreign and seek the views of all stakeholders. We hope that this appendix will serve as a useful point of commencement for such future draughtsmen.