

Policy Brief

Introduction of a Farmer Company Model for Empowerment of Smallholder Farmers in Sri Lanka



Main Research Report

Policy Research in Farmer Producer Organization Models

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(Available at www.asmp.lk)

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AGRICULTURE SECTOR MODERNIZATION PROJECT

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for Empowerment of Smallholder Farmers in Sri Lanka**

Agriculture Sector Modernization Project

Ministry of Agriculture, Livestock, Lands, and Irrigation

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Executive Summary -

Agriculture Sector Modernization Project (ASMP) focuses on establishment of Farm Producer Organizations (FPOs) for empowerment of smallholder farmers, for collective decision making in commercial agriculture.

Organizing farmers into formal groups for collective activities was started in Sri Lanka in 1906, with the introduction of Cooperative Society system. Cooperative Societies Ordinance No 7 of 1911 was enacted to provide guidance and supervisions.

Farmer Organization Concept was introduced to Sri Lanka in the Gal-Oya water Management Project (1979 – 1985). Declaration of the Agrarian Services Act No 4 of 1991 was a landmark in the history of Farmer Organizations in Sri Lanka, which was repealed by the Agrarian Development Act 49 of 2000. National Development Council (NDC) of the Government of Sri Lanka in 1995 recommended unification of small farmers into Farmer Companies registered as People's Companies under the Companies Act. Even though about 80 such companies registered by 2007, none of them are in operation now. Cooperative Societies and the Agrarian Societies are the prominent model of Farmer Organizations operate in Sri Lanka at present, but none of them are legally empowered to operate as autonomous bodies.

ASMP approach recognizes FPOs should be legally empowered to operate as autonomous bodies and capable of effective Agri. Business Management. Policy research study conducted by the ASMP was to identify appropriate legal, regulatory, organizational and management structure to establish appropriate FPOs. A two-tier structure is identified as a suitable model for FPOs to establish farmer societies first in ASMP crop clusters and then in the district level, under the Societies Ordinance No 16 of 1891 plus the amendments and convert the societies into Farmer Companies by registering them as Public Unlisted Companies under the Companies Act No 7 of 2007 of the Department of Registrar of Companies, Sri Lanka.

Special committee appointed by the Ministry of Agriculture reviewed the proposed model and considering time limits of the ASMP, possibility of establishing informal farmer groups in crop clusters first and then to register them as Public Unlisted Farmer Companies, was identified as the suitable approach.

ASMP is undertaking the formation of the identified model of Farmer Companies in all crop clusters established by the project. Department of Agriculture was initially identified as the suitable organization to guide the established Farmer Companies after the ASMP involvement is over.

The study further recommend to continue training of farmers on operation of the Farmer Producer Organization, to enact a custom designed statute (similar to in India) to establish and operation of Farmer Companies by eliminating or minimizing disadvantages find in the identified Farmer Company Model and the Department of Agriculture and the Registrar of Companies (ROC) were identified as the two candidates for the formulation and administration of the Act.

1. Introduction

Concept of the Agriculture Sector Modernization Project promotes, empowerment of smallholder farmers to participate in commercial agriculture and to engage in Agriculture Business through the value chain development approach. Facilitate this approach, farmers are to be trained to establish, operate and manage appropriate Farmer Producer Organizations (FPOs).

Literature on Farmer organizations in Sri Lanka evidences that organizing farmers into formal groups for collective activities was started in the country, in 1906 with the introduction of Cooperative Societies system, for the purpose of fulfilling economic needs of the rural farming community by granting loans. With the increase of the number of societies, Cooperative Societies Ordinance No 7 of 1911 was enacted to provide guidance and observations. The Government also involved in the cooperative movement of the country in the same year.

Farmer Organization Component was first included in the Gal Oya water Management Project (1979 – 1985) funded by the United State Agency for International Development (USAID).

With the repeal of the Agrarian Services Act No. 58 of 1979 and declaration of the Agrarian Services Act No 4 of 1991 was a landmark in the history of Farmer Organizations in Sri Lanka. Agrarian Services Act No 4 of 1991 was repealed by the Agrarian Development Act No 49 of 2000 and further strengthen the operation of Farmer Societies / Agrarian Societies.

National Development Council (NDC) of the Government of Sri Lanka in 1995 recommended unification of small farmers under farmer companies with the provision of the Companies Act of Sri Lanka , to register Farmer Companies(FC) as People's Companies, prior to repeal of the Act in 2007. About 80 Farmer Companies have been established by 2007, but none of them are in operation at present.

Cooperative Societies and the Agrarian Societies are the prominent model of Farmer Organizations operate in Sri Lanka at present but none of them are legally empowered to operate as autonomous bodies as required under the ASMP concept.

ASMP required to identify Farmer Organizations model that can operate independently as per the interest of the members to undertake market-oriented agriculture & related business and finally share benefits of the organization among members or the shareholders of the organization.

ASMP undertaken a review on “Assessment of Available Models of Farmer Organizations” in Sri Lanka (ASMP study 1, 2018) and identified Farmer Cooperatives is the closest possible model for establishment of Farmer Producer Organizations under ASMP.

Considering the limitations in Cooperative model, policy research was undertaken to identify appropriate Farmer Producer Organization Model that can be established within the existing legal set up of Sri Lanka, to meet the empowerment requirement of ASMP beneficiary farmers. (A Policy Research in Farmer Producer Organization Models - ASMP study 2- 2020). This brief focuses on the outcome of the ASMP study 2.

2. Approach and Results

2.1 Approach

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

1. To identify appropriate legal and regulatory setup for establishment of the FPOs / Farmer Companies (FCs) 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 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.

This short-term study (03 months from January 2020) 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

A critical review was undertaken to assess the Laws, Acts, Statutes that facilitate establishment and operation of Farmer Organization in Sri Lanka.

2.2 Results : Organizational structures of the following Farmer organizations has been considered

- i. Farmer Cooperatives
- ii. Tea Smallholder Development Societies
- iii. Mahaweli Farmer Organizations
- iv. Agrarian Societies and
- v. Farmer Organizations established under ASMP pilot crop clusters,
- vi. Farmer Companies were to be included in the study, but none of them are in operation at the time of the study was conducted.

Organizational factors required to be in an appropriate farmer organization are identified as follows:

- a) Institutional factors
- b) Governance factors
- c) Management Factors and
- d) Product handles and the Market factors, have been analyzed and identified characteristics of an ideal organizational structure required for the FPO model of the ASMP as explained below.

The ideal organizational structure should have the characteristics given below.

- The ability to handle large shareholders /membership (each ASMP farmer cluster has more than 100 member farmers) – ***Institutional factor***
- Separation of ownership from management (to hire professional management for the FPO) – ***Management Factor***
- Minimal regulatory interference (to operate as an autonomous organization)- ***Management Factor***
- Incentivizing investment through a consistent dividend policy (to increase the income earning capacity of the shareholders)- – ***Institutional factor***
- Robust audit and management controls to ensure sustainability of the organization - ***Governance factor***
- Secondary market for shares – for expansion of the organization. – Institutional Factor - ***Institutional factor***

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

A review of legislations, Acts & regulations on establishment and operation of farmer organizations in Sri Lanka was undertaken to find out the suitable legal structure that accommodated a farmer organization with the above characteristics.

Table 1 gives the available Legislations /Acts that support farmer organizations, and the organizational structures that can be established under each of the legislations.

Table 1 Analysis of Legislations/Acts that facilitate Farmer Organizations in Sri Lanka

	Legislation/Act	Possible Organizational Structures	Limitations in these structures
1	The Agrarian Development Act, No. 46 of 2000	<ul style="list-style-type: none"> Farmer Organizations /Agrarian societies 	<ul style="list-style-type: none"> Inability to engage in business Inability to distribute profits
		<ul style="list-style-type: none"> Agrarian Development Councils 	<ul style="list-style-type: none"> Federated organizational structure Inability to distribute profits Geographical limitations
2	The Cooperative Societies Law, No. 5 of 1972 (as amended)	<ul style="list-style-type: none"> The Cooperative Society 	<ul style="list-style-type: none"> Multiple regulatory frameworks and multiple regulators Scope for regulatory interference Difficulty in issuing dividends Absence of divide between management and ownership
3	The Mahaweli Authority Act, No. 23 of 1979	<ul style="list-style-type: none"> Incorporated corporation 	<ul style="list-style-type: none"> Incorporation by a gazette Multiple legislative framework Possibility for regulatory interference Geographical limitations
4	The Societies Ordinance, No. 16 of 1891 (as amended)	<ul style="list-style-type: none"> The Registered society 	<ul style="list-style-type: none"> Act envisages mutual provident societies and not business entities Limit on sharing annual benefit to a single member
5	The Companies Act, No. 9 of 2007	<ul style="list-style-type: none"> The (unlisted) public limited company 	<ul style="list-style-type: none"> The requirements of a “public offer” Complexity of the procedural and regulatory requirement High compliance costs
		<ul style="list-style-type: none"> The private limited company 	<ul style="list-style-type: none"> Cannot have in excess of 50 members as shareholders

Review of the above organizational structures found none of the above considered farmer organization models are having more than one or two of the considered organizational factors together.

An elimination process has been followed by strict analysis of the above organizational structures in order to identify appropriate organizational structure for ASMP Farmer Organizations that could be established under any of the above legislations or Acts. Limitations given in the Table 1 were considered in the elimination process and the organizational structure with minimum limitations together with additional advantages was identified as the suitable organizational structure for ASMP Farmer Producer Organization.

Accordingly, Registered Society establish under the Societies Ordinance, No. 16 of 1891 (as amended) and the (unlisted) Public Limited Company structure establish under the Companies Act, No. 7 of 2007 found to be suitable for ASMP - FPO structure as less limitations found in these structures.

Furthermore, these two structures are having additional advantages as given in the Table 2.

Table 2. Advantages of Society and Public Unlisted Company models

Advantages in the Registered Society Structure	Advantages in the Unlisted Public Company Structure
Corporate Body	Separate legal personality
No restriction on membership	Ability to raise capital through issue of shares and ability to pay dividends
Relative ease of creation and registration	Limited liability of the members
Lesser regulatory and compliance requirements	Democracy in ownership
Fairly robust audit procedures	Capable of being managed by professional Board of Directors
Capable of conversion to a company	Legally required stringent audit process

3. Conclusions

The study found there is no legal framework that caters specifically to establish farmer producer organizations in Sri Lanka and none of the organizations established under the above existing Legislations/Acts are entirely suitable as a structure for a FPO expected to be established under ASMP.

4. Recommendations

Having analyzing the possible alternatives the following recommendations were made;

- I. Establishment of two tier structure of FPO by making use of the provisions available in the Societies Ordinance No 16 of 1891 and the Companies Act No 7 of 2007.
 - a. Initially, established “Cluster Societies” Registered under the Societies Ordinance No 16 of 1891 at each crop cluster level. There will be 3-4 societies per one district (One ATDP)
 - b. After successful functioning of Cluster Societies, amalgamate cluster societies in to one District Society per each district and register under the Societies Ordinance then the cluster level societies will be ceased to exist.
 - c. After successful functioning of the District Society, it will be converted to a “Public Unlisted Company”, Register under the Companies Act No 7 of 2007.
 - d. If necessary, these Public Unlisted Companies (PUC) have the possibility of forming a “Private Limited Company” at the provincial level and Register under the Companies Act No 7 of 2007.
- II. Create a custom designed statute that would meet the specific needs of farmer producer organizations appropriate for commercial agriculture. The Department of Agriculture and the Registrar of Companies (ROC) were identified as the two candidates for the formulation and administration of the Act.

4.2. Advantages of the proposed model:

- All cluster farmers can become shareholders when the PUC is formed as there is no limitation over the number of Shareholders.
- Any PUC is a separate legal entity, functioning as an autonomous body empowered to undertake business and share profit.
- Match with the requirement of ASMP, FPO requirements

4.3. Disadvantages of the proposed model:

- As the initial step, the proposed “Agriculture Societies” will have to follow a long process to get register under the Societies Ordinance.
- The Act envisage mutual provident societies, as such societies have a limitation in engaging in business activities fully and any member is entitled to have only limited benefit sharing.

4.4 Implications and recommendations -

Comparison of the advantages and disadvantages of the proposed model, the findings were reviewed by a Special Committee appointed by the Ministry of Agriculture to reconsider most feasible model of FPO to establish within ASMP period. The special committee consisted representations from Ministry of Agriculture, Department of Agriculture, Dept. of Registrar of Companies, Consultants of ASMP on Institutional Development and ASMP staff.

The committee reviewed the findings of the study reports and all possible options and the implementation strategy was identified as to form a farmer group in each crop cluster and mobilize them to operate as a society or association (without any registration or with registration under DOA) at the initial stage. After giving them basic training on Farmer Producer Organization (FPO) and working as an organization for few months, form a PUC for them by getting necessary registration with ROC. Registration process is to be facilitated by employing a company registrar (a legal firm).

4.5 Facilitation of PUCs after ASMP

The committee also considered that, in order to achieve long term sustainability of Farmer Companies (PUCs), some facilitation is required in terms of advisory capacity for technical advancements and business management especially at the end of ASMP involvement.

Considering the nation wide spread and strength of the Department of Agriculture (including the

provincial set up) and having the availability of Agribusiness counseling service already initiated, the Department of Agriculture is identified as the most appropriate government linkage to facilitate the Farmer Companies -PUCs in Sri Lanka.

At present the Division of Agribusiness counseling (DOAgbiz) also known as Agro Enterprise Development and Information Service is available under Extension & Training Centre of the Department of Agriculture at Peradeniya (www.doa.lk)

The committee proposed the available facility of the DOA could be developed as the focal point for coordinating and facilitation of the proposed Farmer Companies (PUCs).

4.5 Policy Recommendations for Establishment of FPO (Farmer Companies) in Sri Lanka

Findings of the studies done by the ASMP and the review of those studies by the Special Committee, the following policy recommendations are proposed.

- Smallholder farmers especially operate in the food crop sector needs be empowered to undertake commercial agriculture and agri. business management as experienced under the ASMP.
- These farmers should be encouraged to operate within an appropriate Farmer Producer Organization that can be finally converted into “Farmer Companies”.
- Farmer companies could be established for “willing farmer groups” to undertake commercial agriculture with collective decision making and farmers should be given famer organization training by the ASMP.
- If such farmer producer organizations are with membership of more than 50 farmers, Farmer Companies can be registered as Public Unlisted Companies under the Companies Act No 7 of 2007, until create a custom designed statute for establishment and operate farmer companies in Sri Lanka.
- A new statute has to be created to overcome if any kind of limitations experienced with the Public Unlisted Companies established under the Companies Act No 7 of 2007.
- Department of Agriculture and the Department of Registrar of Companies could be entrusted the task of creating such a new Act/Law.

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