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## MAHAWELI ENTERPRISE DEVELOPMENT PROJECT

# PRE-INVESTMENT ASSESSMENT FOR COMMERCIAL AGRIBUSINESS POTENTIALS

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## ACRONYMS

CTC	Ceylon Tobacco Company
EIED	Employment, Investment, and Enterprise Development Division
HA	Hectares
ISTI	International Science and Technology Institute, Inc.
MARD	Mahaweli Agricultural and Rural Development
MASL	Mahaweli Authority of Sri Lanka
MED	Mahaweli Enterprise Development
PIP	Pre-Investment Program

## **PRE-INVESTMENT ASSESSMENT FOR COMMERCIAL AGRIBUSINESS POTENTIALS**

### **I. ASSESSMENT ASSIGNMENT ABSTRACT**

Ag West Resources, as a potential private investor, was contracted to visit the Mahaweli project (Systems B and C) to assess its potential for attracting foreign private business investments in the agricultural and agribusiness sectors. Specifically requested was the following:

- Review local business interest in outgrower schemes in the Mahaweli;
- Review land and water availability for outgrower schemes in the Mahaweli;
- Identify potential outgrower projects; and
- Recommend steps to be taken under the MED project to develop the potential of these projects.

### **II. ASSESSMENT PURPOSE**

After a preliminary briefing by several project staff members in Colombo, a site assessment trip was made to Systems B and C. During the briefings, it was made clear that one purpose of Ag West's assessment was to evaluate the potential for developing the nucleus farm (commercial farm) concept as an integral part of the resettlement of outgrowers (small 1 HA farmer/farm families) in the project area. Also, in the effort of creating greater farm-gate income for the outgrowers, the Mahaweli Authority would like the nucleus farm concept to include equity foreign investments and produce exportable fresh and/or value-added exports.

The purpose of this on-site assessment was to conduct an actual private sector/foreign equity business pre-investment feasibility evaluation of the Mahaweli project. The intent was to identify crops with integrated agribusiness/food processing potential to produce commercial fresh exportable and/or value-added food products. This report is based on limited preliminary observations and interviews during a nine-day (Dec. 3 - 12, 1990) site visit to Sri Lanka. Personal interviews were conducted with the following project-related people:

- Various MED I project staff;
- System B MARD personnel;
- Mahaweli Authority personnel;
- Systems B and C outgrowers;
- Systems B and C nucleus farmers;
- Staff of the pilot demonstration farm in System C established by Nippon Koei Co., Ltd. and the Government of Japan;
- Local Sri Lankan nucleus farm/investors (project area);
- Local food producers and agribusiness companies established both in and outside the Mahaweli project;
- Local food processors;

- Local food exporters; and
- Both MED I and MARD consultants.

### **III. PRE-INVESTMENT EVALUATION OF THE MAHAWELI FOR COMMERCIAL PROJECTS IN SYSTEMS B AND C**

On-site observation of Systems B and C indicates fairly good grower outreach support by MARD for the resettlement of the individual small farm family. Small-scale paddy rice production (subsistence farming with little or no farm-gate cash crop income) is predominant in the area. The non-paddy crop activity is very limited and any commercial production results are inconclusive at this time. MARD personnel are conducting some crop trials and outgrower assistance to teach paddy farmers to grow alternative cash income crops. Their efforts are commendable as a good beginning, but with only two years of trial experience with outgrowers and a couple of trial nucleus farms in gherkin production, the results indicate that at the present level of development it will take three to five years to establish baseline data to evaluate the potential for a true commercial diversified agricultural investment project in System B.

There seems to be a lack of Mahaweli Authority commitment and policy direction to help establish viable (cost-effective and profitable) private sector commercial nucleus farms. The predominant comment made by most project-related personnel is that the nucleus farm must be used to establish an outgrower network to have outgrowers produce the crops, thereby creating non-paddy cash crop income for the small farmers. In theory, this is true and will eventually happen in the course of agricultural development. However, currently, the Mahaweli Authority has not provided the financial commitment and policy support to demonstrate that a private sector commercial venture can be successfully operated in System B or C.

Indications are that many local companies and some foreign companies have ventured to establish a nucleus farm in the Mahaweli but not one of them can be identified as a successful commercial venture. In fact, almost all of the projects have stopped after one or two years or are currently only on hold with subsistence operations and on a wait-and-see mode. Lack of aggressive commitment by the local private sector to start new commercial ventures when the Mahaweli Authority is providing irrigation and undeveloped land at nominal cost indicates the project is not ready to attract foreign equity investments for commercial ventures. In fact, the pilot demonstration project in System C developed with Government of Japan assistance is an indication of a good beginning but lacks commitment beyond facility construction.

Frankly, I did not see or even hear of a successful commercial venture nucleus farm in System B or C. I asked each of the key personnel I met at the project site and some project consultants to show me a good commercial venture nucleus farm, or if they knew of a successful commercial venture, and we found none. The Volanka (Sunfrost, Ltd) and CTC orchards are only initial attempts to start a commercial venture on a very limited scale. But both are far from demonstrating to any foreign or local private investor that the Mahaweli project is an attractive area for private commercial investments. Agricultural business investment risk is directly associated with investment uncertainties and the lack of demonstrated production results.

It is not practical to promote either Mahaweli System B or C to potential foreign investors when there really is no successfully demonstrated investment potential available there. Any number of promotional campaigns and incentives will not convince a true equity investor with long-term employment and export income generating capability to make an investment commitment now.

#### **IV. MAHAWELI AUTHORITY SYSTEMS B AND C ASSESSMENT**

During the course of the Mahaweli Systems B and C tours, it was made quite clear that the project was deficient in infrastructure development for nucleus farms to produce horticultural crops.

Both Systems B and C need considerable improvement in the following areas:

1. A better managed land distribution (lease) program taking into consideration agronomic requirements to grow horticultural crops, soil types, drainage, and so on.
2. A twelve month irrigation water management and distribution program considering the irrigation requirements for both paddy rice and horticultural crop production.
3. More agricultural extension staff to help train outgrowers to integrate horticultural cash crops with paddy rice farming.
4. Better availability of agricultural supplies including seeds, agricultural chemicals, complete balance commercial fertilizer, and other farm supplies required for horticultural crops.
5. System B totally lacks a planned system of collecting and disposing of irrigation drainage water. The natural drainage cannot handle the current drainage flow.
6. Communications facilities are lacking in both Systems B and C.
7. Electrical power supply is undependable and lacking in wide areas of both Systems B and C.
8. Fifty acres of recently cleared jungle land without utilities, water source, drainage, communication facilities, improved roads, and so forth are of little value for a commercial farm or value-adding/export-oriented agribusiness venture.
9. The Mahaweli Authority lacks commitment to establish nonfarm enterprises to support any kind of farming. Support services (cottage industries) for farmers must be established to provide: 1) farm input supplies; 2) nonfarm employment for second generation residents to produce value-added agricultural goods; and 3) transportation facilities to get the farm goods to market.
10. The project lacks practical, experienced agribusiness people, commercial farmers, food packers/processors, and food merchandisers to help develop an integrated agribusiness masterplan for the Authority in Systems B and C. Without viable vertically integrated commercial ventures, it will be very difficult to improve farm-gate income for the outgrowers in the systems.
11. The Mahaweli project lacks a demonstrated successful commercial farming enterprise to show any potential private sector investor that leasing 50 acres of cleared raw jungle land is a commercially viable undertaking.
12. The Mahaweli project needs a well-planned, well-financed and privately-managed "Commercial Agribusiness Venture" to demonstrate to foreign equity investors that such ventures can be developed within the Mahaweli project area.

## V. MAHAWELI AUTHORITY MANAGEMENT BRIEFING

After meeting with Mr. K.H.S. Gunatillake, Director General, Mahaweli Authority of Sri Lanka, and his senior staff, the concept of a joint Mahaweli Authority and private sector "Commercial Agribusiness Demonstration Project" was agreed upon as a very positive undertaking to demonstrate to private investors that the Mahaweli Authority of Sri Lanka is committed to supporting medium- and large-scale commercial development within the project area. Subsequent meetings with Mr. W.A.J. Anton Fernando (Director, Employment Investment and Enterprise Development Division of MASL); Mr. Indra Phillips (Manager, Investor Services, EIED/MASL); and Mr. Jim Finucane (Project Manager, ISTI/MED-I Project), supported the establishment of a commercial, vertically integrated agribusiness demonstration project as a first step to promoting MASL to foreign private equity investors. In the meeting, Mr. Phillips requested that Ag West Resources submit a nonsolicited proposal to develop and operate an integrated commercial agribusiness demonstration project for the Mahaweli Authority of Sri Lanka.

## VI. RECOMMENDATIONS

- After touring both Systems B and C, Ag West recommends that horticultural crop production be concentrated in System C for the following reasons:
  - System B (low land) is better suited for paddy rice production;
  - System B land seems to be mostly resettled with small paddy rice-producing outgrowers;
  - The soil in System C is better suited for horticultural row crops and fruit/nut crop orchards;
  - System C is at a slightly higher elevation, creating a greater differential temperature between daytime and nighttime mean temperature, which helps fruit-set;
  - System C has larger unused areas for possible commercial farm operations;
  - MARD is doing a good job of helping resettlement growers in System B diversify crop production, but it will be at least five years before they will be ready to commercially produce exportable fresh crops or process quality value-added crops of any volume; and
  - Utilities/roads/infrastructure development in System C seems to be better suited for commercial agribusiness projects.
- It is recommended that the average size land holding for commercial ventures involving private equity investment be increased to a minimum of 250 HA of farmable land, with a suitable quantity of irrigation water, drainage access, roadway easement, electrical power supply, and access to rural/agricultural credit (production loan) and long-term capital improvement credit.
- Major recommendations related to the Mahaweli Authority projects are as follows:
  - As requested by EIED/MASL, Ag West Resources will prepare a proposal to develop an "integrated commercial agribusiness demonstration project" for MASL;
  - The pilot demonstration project in System C originally developed with the help of Nippon Koei Co. Ltd. and the Government of Japan should be used as an integrated commercial agribusiness demonstration site;

- The project should start during this first quarter of 1991;
- The demonstration project should be a totally privately managed and operated commercial venture. The private sector should be made up of a joint venture between a privately owned local company and Ag West Resources (as requested by EIED/MASL). The joint venture will be the lessee of the project;
- The Mahaweli Authority of Sri Lanka will be the lessor of the project; and
- To develop the preinvestment plan and the economic feasibility assessment for the project, the project should be done with grant assistance from MED's PIP fund.

## VII. ASSESSMENT SUMMARY

In summary, I believe the Mahaweli Authority of Sri Lanka (MASL) agricultural resettlement project has a great potential to add nonurban employment for the rural population. Also, if the project is properly developed and managed by the Mahaweli Authority, it will add greatly to the rural economy of Sri Lanka. The major project development investments in dams, reservoirs, and canals already have been made; therefore, it is of paramount importance to follow through and create an attractive private investment environment. By fostering private sector investments (both domestic and foreign) in cost-effective commercial agribusiness ventures, the Government of Sri Lanka's financial requirements will greatly reduce to a point of managing various lease-holdings and reinvesting the return-on-investment into other related development projects.

There has been a fairly well-planned effort by MASL to help resettled farmers start on the road to self-sufficiency by providing one HA of land and some technical assistance in paddy rice farming. However, small plots of land per head-of-household (outgrower) in paddy rice farming only fosters a subsistence existence for the first generation family. As families grow and children become young adults, there must be a well-planned means of employment in the area or the second generation will migrate to the already overcrowded cities. Also, farming only paddy rice on a small scale does not provide any cash farm-gate income to purchase farm supplies, consumer goods, transportation and foodstuffs not grown in the immediate area.

The support of outgrowers with the introduction of a nucleus farm concept to the area to create a commercial contract farming arrangement is sound in principle. However, thus far the concept has not taken hold in Systems B and C, mostly because of MASL land-holding restrictions, lack of infrastructure and lack of MASL support for private sector commercial agribusiness ventures. This has not created enough of an economic incentive to attract true long-term equity investors.

There seems to be a lack of concern and demonstrated commitment by MASL and its advising contracted consultants to help the nucleus farms get established in Systems B and C. The various hired consultants are only interested in the success of their own "pet projects" without much concern for the local commercial nucleus farms investors. This is the predominant feeling of most private sector investors I met during the assignment.

Most local commercial investors are reluctant to make any major investment in any MASL project in Systems B and C. However, they are making their own investment in successful ventures outside the project area. Most private company managers and owners I met agree that the MASL/EIED needs to financially and politically support a true vertically integrated commercial agribusiness venture (nucleus farm) to demonstrate that such a venture can be successfully created within the MASL project area. Without a successful demonstrated commercial venture privately managed to model future ventures and show private investors its possibilities, the MASL will have a very difficult time promoting the project to private equity investors, let alone foreign private companies.

Everyone I interviewed, including MASL and EIED officials and all consultants, agree that thus far the nucleus farm concept has been a major disappointment. Local private investors believe thus far it has been a failure and will not make any major financial commitments into nucleus farms. The MASL cannot hope to improve the

outgrower's small paddy rice farming conditions, his farm living standards, or the rural community life without the creation of many private sector commercial ventures. There needs to be both integrated farm/agribusiness and local cottage industries supporting and serving the farm communities. In addition, MASL must foster a commercial linkage with regional and international markets for the goods produced by future commercial agribusiness ventures.

Ag West Resources and its multinational associates are willing to contract the task of developing the Commercial Agribusiness Demonstration Project and manage the development during the demonstration phase (three years). Ag West Resources, at the end of the third year, will make major private equity investments and become the foreign joint venture partner and the joint lessee for a period of 17 years. The joint venture will repay the depreciated value of the initial three years capital real property assets investment made by MASL on the basis of an amortized 17-year schedule as part of the annual lease payment.