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Vanilla Industry Development in Sri Lanka

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EXECUTIVE SUMMARY

Vanilla is a promising crop for Sri Lanka and is ideally suited for small farmers, i.e., it has almost non-existent cultivation costs yet uses labor for pollination and harvesting, it is grown as a home garden crop and is relatively free of pests and diseases, the associated value added process in curing the bean requires simple low cost technology, it isn't perishable once cured and therefore can be shipped by sea freight and it has a high value-weight ratio and there is a healthy stable world market.

Vanilla can be grown in Sri Lanka and initial quality tests have identified the product as good quality with good levels of vanillin.

The local affiliate of a major multinational firm with a vanilla purchasing subsidiary is interested in developing the industry and is willing to give a marketing contract with a bank guarantee for up to 5 - 6 MT of cured vanilla per year for the initial period of 3 - 5 years. They may also be willing to invest or grant fund some of the costs of developing the industry.

Several estate management companies have shown an interest in growing vanilla as a plantation crop and at least one has begun preparations for planting 10 to 20 acres.

Plants have been given out and farmers are being trained in hand pollination. A vanilla buying station has been set-up at Perideniya near the University and AgEnt and Levers have both hired and assigned field people to the Kandy area to promote the industry, line-up sources of planting materials and interested farmers.

Given the above development, it is time to put together a complete feasibility analysis and business plan for further industry development. A structure based on local collection cum curing centers and a national private limited liability company are outlined herein and based on this structure, a detailed feasibility analysis could be prepared. A vanilla specialist is required to complete this work as well as several local consultants and an international specialist in farmer organizations/agribusiness.

Depending on the results of the feasibility analysis and business plan, if demonstrated to be an acceptable investment with reasonable returns and profit levels, AgEnt should finance the vanilla industry development program using the facility of Agri-DEV as the implementing organization and key equity investor on behalf of the yet to be identified local organizations, individuals and farmers who would own and operate the collection/curing centers.

Once several local organizations have been identified and signed-up, a national vanilla marketing company should be organized as a private limited liability company.

OBJECTIVE, LEVEL OF EFFORT AND SCOPE OF WORK

The objective, initial level of effort and scope of work for this consulting assignment reported-on herein is as follows:

Objective

Provide farmer organization advisory and consulting services to the AgEnt project resulting in a doable strategy for putting together a farmer owned vanilla marketing company which would cure and market vanilla beans for both the Sri Lankan tourist market and for export.

Initial Level of Effort

Five field/office days, one travel day. Depending on the results of this assignment there may be some potential for continued advisory services in farmer organizations as the vanilla project moves forward.

Tasks

1. Review the objectives the AgEnt project and those of their client, Lever Brothers, and clearly establish the end of project scenario that is being sought.

2. Review the current state of development of the vanilla growers, both existing and potential, and any planned activities or strategies for the near and medium term.

3. Review and compare current incorporation strategies/options and suggest alternatives AgEnt might wish to consider for the marketing company.

4. Prepare a vanilla marketing company development strategy laying out the following:

   a. Suggested incorporation strategy and requirements.
   b. Recommended characteristics and structure of a vanilla marketing company including possible company activities, initial staffing patterns, marketing strategy and approach.
   c. Possible liabilities.
   d. How the company should function; as a profit center remitting second tier profits back to farmers or as a non-profit center or company.
   e. How the farmers should be remunerated and when (bearing in mind that the company could well hold a high/on-going product inventory.
   f. What costs the company would have to bear or carry, such as office, curing facilities, inventory holding areas, product and marketing costs, staff, etc.
   g. What top management/production/marketing structure will be necessary to make the company successfully work.
   h. Implementation methodology, timetable and recommended inputs (material/ financial, human resources, training, extension, etc).
   i. Risks and constraints in undertaking this type of farmer development program.

5. Prepare a brief trip report summarizing the overall findings and recommendations.

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TECHNICAL REPORT

End of Project Scenario (EOPS) Being Sought

As per AgEnt expatriate staff, they envision fifty tons per year of good quality, properly treated/processed dry vanilla beans being exported by a viable, professionally managed, wholly or partially farmer owned vanilla marketing company by March 31, 1998. They also envision a major multinational corporation initially buying the entire export crop, but later, as production grows to exceed their marketing requirements increasing amounts would find their way to other international marketing channels.

But why vanilla?

Vanilla fits the Sri Lankan agricultural milieu because it's a perennial crop requiring little care, is relatively disease and pest free, uses a fair degree of labour, is processed/cured, requires low capital investment and simple technology, does not require refrigeration or sophisticated post harvest handling and can therefore be shipped via sea long distances without perishability problems - the value/weight ratio is high, and lastly the market seems to be there. All this makes the crop ideally suited to small scale, low resource rural peoples — a Sri Lankan dream crop.

Planned Activities/Strategies for Near & Medium Term

Presently there seems to be a parallel effort going on as relates to vanilla. Firstly there is a *Levers program* involving a relationship between Levers, R.P.K. Management Services Ltd. (John Keells Group of Companies) and their Etana Estate in Warakapola (Kegalle District). About 20± acres of vanilla will probably be planted in old partially thinned rubber and there is room to add another 80 - 100 acres in the future. But in discussions with a senior manager at Keells (albeit not involved directly in the vanilla project), it was revealed that they were waiting for some unspecified action from Levers and were uncertain as to the marketing arrangements and whether or not they would in fact go ahead with the planting.

As part of the Levers/AgEnt program, there is the out-grower effort and other assistance being provided in a cost sharing agreement. Levers, with some assistance from AgEnt has distributed planting material and is lining-up approximately 500 out-growers to grow for them. They are also spreading the word that they'll pay Rs. 1,000.00/Kg for dried beans and Rs. 150.00/Kg for green beans from their out-growers. At a pollination training session I attended, a Levers outgrower promotion person announced a "mudalali" or AgEnt would be given a 5% commission on any vanilla he is able to line-up. The University of Perideniya has opened a vanilla buying station on the Kandy road itself near the Department of Export Agriculture and they are reportedly registering vanilla growers. Other project activity centers may also be in the pipeline. The apparent Levers commitment currently is for 6 - 7 tons of dried beans *per year* over a four to five year period. This seems to have been scaled-down from earlier and much higher targets approaching the 50 ton level mentioned above and reported in the press some time ago.

Secondly, *AgEnt* has an *out-grower development* person stationed in Kandy who is collaborating with Levers but who is also apparently developing "AgEnt outgrowers" in a

drive to reach a thousand or so, surpassing the vanilla requirements of Levers and reaching toward the 50 tone/year goal discussed above. There was mention of "AgEnt out-growers" and "Levers out-growers" and the impression is that there are two levels and two parallel tracts of vanilla development activities going-on. It is with this second group of out-growers that AgEnt appears to be focusing attention toward farmer owned business (FOB) development.

Is this an accurate picture? From discussion in the AgEnt office, it seems that AgEnt believes vanilla is an excellent crop for Sri Lanka (it is!) but there is a certain amount of uncertainty as to Lever's commitment to developing a broad-based vanilla industry in Sri Lanka. The same impression was given by the Keells executive interviewed.

The Levers commitment is being financed (at least partially) from a public relations budget and has not been taken to the board nor elevated to project status within the multi-national parent company. As such, the *company* commitment doesn't seem to be there for a "real main-line" vanilla development program, although Dr. Aruna Bandaranayake, commercial director, and most probably other company executives are interested in doing what they can to develop the industry without elevating the whole project to international and board levels. Dr. Bandaranayake mentioned several times in the meeting that they did not want to commit to anything more than he was sure could be achieved as they had their name to protect. He spoke about a cost sharing arrangement with the Export Development Board (EDB) as a kind of insurance in case the market flopped. He clearly didn't want Levers to be blamed if due to actions beyond their control the floor went out from under the price structure, as has happened before in Sri Lanka, e.g., passion fruit and ginger. To what extent the Levers commitment may really be a PR project useful to achieve some other company goal is unknown. However, even if it is, AgEnt should still do what it can to develop what appears to be a promising line of agribusiness endeavor for the small farmers in Sri Lanka. This is what agribusiness development is all about and what a development project such as AgEnt is here to do! The question is, how to accomplish the goal of 50 tons of export quality vanilla per year?

As part of the whole vanilla industry development program, and recognizing the commitment of USAID toward farmer development and farmer owned business (FOB) development programs, AgEnt is interested in developing a "long-term" marketing and growth strategy for the Sri Lankan vanilla industry which includes the producers. As the financial and economic benefits of any agricultural industry accrue to the value added component more than to the farming segment, it has been determined to try and involve the farmers in a business which would process (cure) and market vanilla initially through Levers and as quantities expanded beyond the interests of Levers, on the world market.

Current Incorporation Strategies/Options

I have written several articles on farmer organizations and farmer owned business/[1] which lay-out differences between association- and business-type organizations. Each form of organization is incorporated under a different structure and legal framework.

Specifically in the case of vanilla marketing, I believe *either* an association-type organization *or* a company-type organization could be created, so long as the association-type organization didn't go into "heavy" asset acquisition that should be supported by share/equity capital. A vanilla growers marketing association or a vanilla marketing company as a logo message conjures different images to a potential business partners, however. An association is generally a non-profit service oriented entity while a company clearly telegraphs the for-profit message.

To actually incorporate any organization, an attorney with experience in the particular company structure will be needed to put together the Memorandum and Articles of Association (Articles of Incorporation and By-Laws in the U.S. system). For incorporating under the Companies Law, a person used by ACDI/Agri-DEV is:

Mr. S. R. Shelton Perera
169/3, Maha Buthgamuwa
Mulleriyawa New Town
Tel: 578263

Shelton is a former Deputy Registrar of Companies and has excellent contacts and relationships with the Registrar of Companies. He will draft the Memorandum and Articles, get them cleared in principle by the Registrar of Companies, advertise in the local papers (company limited by guarantee), undertake the name search, register the name and logo of the company and actually register it once the *proponents* or *sponsors* obtain all the necessary signatures on the documents. In addition, Shelton will obtain all the legal registers required (share register, corporate seal use register, minute book and required formal accounting records), file the specific paper work required to register the board of directors, prepare the bank account resolutions, have the corporate seal made, and whatever else is needed for incorporation and start-up *of a company*. Unfortunately he doesn't use/have a computer so the AgEnt office will have to assist here to facilitate editing and use in the future. Shelton's charges for these services should not exceed Rs. 20,000, unless he has increased his rates since CSFD used him.

If another form of business or association is selected as the preferred form, a different person would probably be required; a person with specific experience in registering cooperatives or organizations incorporated under Section 56A and/or 56B of the Agrarian Services Act should be sought. I do not have any contacts in these departments.

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[1] "Farmer Organizations," April 9, 1994; "Farmer Organizations in a Modern Agribusiness Sector," August 1992; "Capital Accumulation Mechanisms for Farmer Owned Businesses," November 1991, all by R.C. Flick, Chief of Party, CSFD Project ACDI, Colombo.

To incorporate any organization anyplace in the world, I believe the proponents or sponsors must sit at length with an attorney to outline the objectives and purposes to be accomplished. What will the organization do? How is it envisioned that it's mission will be achieved? Who are likely to be the shareholders or members, where do they live/do business and what is their socio-cultural matrix? How will the organization be financed? You should write-up these basic parameters and then consult with an attorney to ascertain what the best way to incorporate would be, *given the specific and overall objectives of the undertaking*. Even though I may make specific recommendations herein, my knowledge was current a year or so ago and changes may have occurred, or there may be some provision of a law or a new law which I was not aware of at the time.

Sri Lanka has a legal and commercial system based primarily on the British, however, it is also the only country in the world other than South Africa itself to have a South African business practices/code. This apparently dates back to the Dutch period. As such, the basic premiss upon which organizations are created is quite different than in the U.S. In contrast to the U.S., where Articles of Incorporation are short and sweet and By-Laws don't go into great amounts of detail, in Sri Lanka you must list *every* possible activity the company or organization might ever hope to carry out and spell-out everything else in great detail. If an activity or function is left out, the company can't do it. In the U.S., Articles of Incorporation list purposes of the company in very general and vague terms generally and it is presumed if it isn't specifically excluded, you can do it. In Sri Lanka, if it isn't mentioned, you can't do it.

The Companies Law of 1982, the main incorporation statute, has model Articles and Memorandum of Association included as examples. If one of these formats are used, your organization may be too narrowly configured and not have sufficient flexibility in the future. Likewise, if you wish to operate in some special way, you'll need to spell it out yourself and then the attorney can put it into legal jargon. Even so, legislation here is still very inflexible.

An example. If one wants to structure a company to promote member business with the firm, one way to do this is pay low dividends on the share capital (say 3% - 5%) but then divide gross margins based on the volume of business each member does with the company. This can be accomplished by treating the pay-out not as dividends or allocated profits, but as a final liquidation of raw material acquisition. Initially, upon receipt of the product, the company pays a partial price. Two months later, as the company begins to sell cured/processed product, it pays the farmers a second price. Then, shortly before the close of the financial year and once the company has a good idea as to anticipated profits, it pays a final liquidation. At the end of the year, expenses for procurement of crop from farmers are higher than they might have been if the company was an investor owned firm trying to maximize returns by procuring cheap and selling dear.

Following such a methodology, for example, and instituting a capital accumulation plan or capital check-off system, farmers delivering more product to the company will end up owning more shares. If anticipated profits are paid out as price adjustments on farmer accounts, these are based on volumes of product delivered. However, as share capital acquisition is also a function of commodity delivered, a larger farmer doing more business with the company will automatically have a greater investment in share/equity capital than a small farmer and will also receive a greater amount of the anticipated profits.

If a price guarantee fund were to be created to guard against price failure on the world market, it could be capitalized in this manner and expanded through the use of creative insurance policies. Dr. Bandaranayake was concerned of potential price failure in the future as volumes increased and the other producing countries took notice of Sri Lanka and began to discount the world price or flood the market with quantities being held in stock. A new producer such as Sri Lanka would be defenseless in such a scenario. But by operating with a delayed raw material acquisition mechanism and using a check-off to capitalize a price stabilization fund, some degree of protection could be obtained. This type of system should be instituted from the very beginning and carefully explained to all those concerned. It will have to be "sold" to the farmers and others involved in the industry.

Another idea is to have each member own only *one* ordinary, voting share and accumulate equity through a check-off as *preferred non-voting shares* with some sort of guaranteed dividend, albeit minimum. Then, through the marketing pay-out for commodity procurement, prices could be adjusted so commodity acquisition is higher than it need be thereby reducing taxable profits and maximizing returns to the farmer owners.

If it is desired to operate in a similar fashion, for example, specific wording might be required in the Memorandum and Articles of Association. Then again, it might be recommended not to have specific operational methodologies in the Memorandum and/or Articles but only as a board approved resolution. Yet a board resolution is easily changed whereas changing the Memorandum and Articles is more difficult.

It might also come to pass that you cannot operate in the above fashion as the law does not permit such methodology. Specific items such as the above, need to be worked out by the attorney before incorporation, a trial balloon floated with the appropriate incorporation authorities and finally the incorporators need to learn the why's and wherefore's of what is happening. Good legal assistance is a must to properly structure the company or association.

Normally, the lead incorporators will put all the above together with attorneys selected by them. However, as relates to small farmers in Sri Lanka, *incorporation will never happen if allowed to their initiative!*

As might be expected, there are different laws in Sri Lanka which could be used to incorporate a legal entity composed totally or partially of farmers. A discussion of several known options follow.

Cooperatives

In reality, for the purpose of establishing a farmer owned organization capable of doing business, a cooperative is usually the appropriate structure. It's main purpose is to improve the financial and economic return to farming or to the firms forming the business.

Here in Sri Lanka cooperatives have been around for a long time but two general constraints impact on the usefulness of incorporating as a cooperative: a) heavy government and political involvement at all stages of development/incorporation and operations, and b) the term cooperative has been completely discredited in the eyes of farmers, the commercial sector and the public in general.

Nevertheless, given the "devolution" process and reported recent changes in the cooperative law, it is recommended to review the legal/organizational requirements of organizing a cooperative and document current levels of government involvement-manipulation in 1994. From a technical perspective, a cooperative is the preferred corporate form, I believe.

Usually cooperatives are incorporated with sometimes as few as 10 - 12 members, which in theory at least could be juridic or natural persons. Their focus on service to members to improve member income through joint action is a basic premiss of farmer cooperatives. If structured properly, they are able to adequately capitalize themselves and undertake a wide variety of business activities. They are farmer/member owned, controlled and directed, usually are professionally managed and do not seek a lucrative return on capital invested by members but operate on a reduced profitability basis to pass-on as much profits as possible to member/stockholders. If properly organized and managed, cooperatives retain equity from dealings with members sufficient to bring their financial statement ratios into balance with similar firms and make them credit worthy.

As opposed to public limited liability companies, cooperatives can usually only raise money from the banking sector or members. By floating captive share issues among the membership (and potential membership), by retained margins/profits and/or by holding back on payments to farmer/members delivering product for value added processing and/or marketing are about the only way open to most agricultural cooperatives to raise equity. In the U.S. at least, some agricultural cooperatives have floated bond issues or offered certificates of deposit to the general public, however, operations such as these are likely to be beyond the bounds of local cooperative legislation and practices. This limiting factor can often times retard growth, especially when small low resource farmers are concerned.

One of the major failings of the A.I.D. promoted cooperative organizations around the world is that they violated the "Flick zero sum rule" and tried to create a business with zero... small farmers without capital to invest, with little socio-cultural equipment, small amounts of product, and usually very little value added component precisely because resources were just not available to properly capitalize such a business. These types of small farmer firms (cooperative or otherwise) are extremely fragile, are subject to all the viscidities of the market place yet instead of facilitating flexibility and operability of these kinds of farmer organizations/businesses, governments straight-jackets them.

One alternative is to form cooperatives with middle class farmers or business persons with resources - capital, socio-cultural wherewithal and farming business acumen. Unfortunately, few vanilla growers seem to fit this pattern. But if the minimum number of full-time business oriented vanilla farmers can be identified, and if these persons are willing to incorporate and invest in a vanilla marketing cooperative, it would be an alternative, providing a review of current legislation and government practices vis-a-vis the Registrar of Cooperatives turns up a favorable opinion.

As discussed below, the recommended business development strategy is to work with existing organizations to operate vanilla curing cum marketing centers as adjunct appendages. If this recommendation is adopted, then perhaps a business cooperative of these legal entities could be formed to undertake international marketing. A progressive name and logo could be adopted to mask the cooperative image. An idea worth considering!

The Agrarian Services Act #58 of 1979 and the 1991 Amendment

This legislation created a method to incorporate farmer organizations. Commonly known as "Sections 56A and 56B," these facilitate the legal registration of farmer organizations by the Commissioner of Agrarian Services. In practice, organizations registered under section 56A are considered to be organizations passing through a period of probation and organizational development until they "qualify" for 56B registration. Under 56A, farmer organizations have somewhat limited authority/powers, while under 56B, farmer organizations are clearly body corporate, can sue and be sued, may operate bank accounts, etc. The law is silent with regard to share capital but given the Dutch/South African-British legal tradition in Sri Lanka, I suspect since it specifically is not sanctioned or mentioned in the law, it *would not be possible to issue shares.* This point requires verification.

Up to date, most farmer organization development has been focused on irrigation management associations, although recently the GSL has organized quite a few general farmer organizations under Section 56A/[2] of the Act.

Under 56A, the purposes of farmer organizations for which registration may be given are:

(a) formulation and implementation of the agricultural program for the area;
(b) carrying out village level construction and repairs;
(c) marketing of produce and distribution of seed, fertilizer and agricultural chemicals;
(d) promoting cooperation between and coordination of agricultural activities of government organizations and farmers, and
(e) *any other activity approved by the Commissioner beneficial to the farming community.*

Farmer organizations registered under this provision of the law must also abide by such regulations as the Commissioner may make and their accounts are subject to audit by the Commissioner. I have *not* been able to obtain copies of the regulations adopted by the GSL in relation to 56A/56B organizations. This should also be followed-up on.

Farmer organizations registered under Section *56B* are given the same general powers as organizations registered under Section 56A, I believe. But this section also states that a 56B organization must have: (a) actively promoted agricultural activities in its area or has such abilities; (b) enjoys the trust and confidence of the farming community, and (c) the financial viability and resources to undertake repairs of irrigation works. All of these provisions indicate a 56B organization should have several years of experience doing its thing before 56B registration is granted.

Another *noteworthy* reality of Section 56B is that it clearly states that organizations registered under 56B are "body corporate with perpetual succession" and operate under a common seal and can sue and be sued. As Section 56A is silent on this matter, it apparently has been interpreted that organizations registered under 56A *are not* body corporate, do *not* have

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[2] This farmer organization development activity is a recent effort of the Agrarian Service Department without a clear purpose as far as I can tell. More information should be gathered regarding these organizations in the farmer organization study hopefully to be undertaken by ACDI and Agri-DEV later this year.

perpetual succession, do *not* operate under a common seal and *cannot* sue and be sued. *This interpretation should be verified!* Therefore, it seems in practice that 56A organizations effectively cannot open organizational bank accounts, undertake a contract as an organization, etc. In effect, they couldn't operate a vanilla marketing activity as if they wished to hire a manager or store clerk as an organization they wouldn't be able to, nor could they operate a bank account for the business. But they could be a village-level association to coordinate production, proper harvesting/quality, and collect vanilla beans, delivering them to a curing center/business.

An issue with FOs incorporated under Section 56A/56B is whether or not they can (or should) go into other kinds of business such as sales of farm supplies and/or processing and marketing of agricultural commodities, as up to now they are association-type organizations without share capital.

Another issue with these FOs relates to the jurisdiction over which they can operate; they seem to be local organizations which must operate *entirely* within the command area of one Agrarian Service Center or within a D-canal area. Can farmers from different divisions, districts or even provinces organize a farmer organization under sections 56A/56B of the law? This question also needs clarification.

Apart from farmer organizations organized under the Agrarian Services Act and the 1991 amendment, the Agrarian Service Committees (ASC) themselves are corporate bodies/organizations and can undertake business activities such as farm supply merchandising, marketing, processing, etc. These committees are formed at each Agrarian Service Center (ASN) and are composed of up to 15 individuals: 10 elected farmers and 5 appointed government officials. As this organization can be a representative body composed of up to 10 farmer leaders from local organizations registered under Section 56A, vanilla growers in the villages could be registered under Section 56A to be limited action associations coordinating vanilla planting and security, ensuring vines are properly pollinated and cared for, that beans are harvested at the appropriate time and theft is minimized. Fifty six A village associations could also collect the vanilla beans and transport them to the ASC/ASN for processing/curing.

A recent study/[3] reported that an *average* ASC/ASN in 1988/89 encompassed approximately 30,106 people with 11,500 acres under cultivation and 3,523 farmers. If 50% of the land area of an average ASC/ASN is dedicated to paddy, this would leave between 5,000 and 6,000 acres for other crops. If only 20% of this is under-planted to vanilla, an ASC/ASN command area could include between 1,000 and 1,200 acres (400 - 480 ha.) of vanilla. At a conservative yield of 500 Kg. of green beans per hectare (200 Kg/acre) 400 ha. would theoretically produce 200 MT of green beans. At a 5:1 curing ratio (conservative) this could result in 40 MT of cured vanilla in just *one* ASC/ASN area! If we discount these estimates by 80% due to inefficiency and disinterest among the farmers, we might still be able to talk about 8 MT per year of cured beans from *only one* ASC/ASN command area. Five to six ASC/ASNs could theoretically result in approximately 50 MT per year, the original goal of the AgEnt project.

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[3] "A Survey of the Operational Situation of Agrarian Services Committees of Sri Lanka," Project No. 2, J.M. Gunadasa, Department of Geography, University of Peradeniya, December 1989, APAP Project, Ministry of Agriculture, Food and Cooperatives.

So in theory, at least, if the ASC/ASN system was used as the structure under which village level associations (56A) are registered, and if the ASC/ASN could own and operate a vanilla curing shed/service, a national vanilla marketing company formed by several ASC/ASNs might make sense. As the individual ASC/ASNs are really under the control and direction of the Agrarian Services Commissioner and her Department, a program would have to be worked-out with the national office to ensure a hands-off approach and maximum flexibility. Yet as each ASC/ASN is a body corporate with a majority of elected farmers, they could operate independently.

Recent contact with the Agrarian Service Department to undertake a study of the Department, the ASC/ASN's and farmer organizations has been a bit rough. However, if this study could be undertaken soon it might shed more light on some of the issues identified above and sort-out whether this structure offered any possibilities for developing the vanilla industry.

People's Company

A people's company is a special form of corporation under the Companies Act of 1982. It must be incorporated by no less than 50 farmers, can operate anywhere, and can undertake any legitimate business activity. As it is a for-profit company, it must follow all the rules and practices of any company, e.g., appoint an audit firm, legal advisors and a registered corporate secretary, undertake annual audits, keep official accounting records, file tax returns, hold annual general meetings, etc. The people's company is registered with the Registrar of Companies. It's shares are *not* freely traded, except among farmers eligible for membership. No one farmer can own more than 10% of the share capital and other corporate bodies are prohibited from owning people's company shares, yet people's companies can own shares in any other company.

ACDI/Agri-DEV incorporated a people's company for the gherkin joint venture and members are from a wide geographic area. The principal office of the PC is in Puttalam. Although this organization is legal it has been very frustrating trying to launch it as gherkin farmers don't identify with an organization that they cannot reach-out-and-touch; in other words a village-based organization. In more developed societies or among socio-culturally more advanced people, the village mentality is not as prevalent. For "pure villagers" and typically small, low resource farmers, participation in national or regional organizations is more problematic. As might be expected, gherkin farmers have not been enthusiastic about investing in the PC, although each member had to buy one Rs. 10.00 share. We have had a very difficult time holding farmer and director meetings and frankly unless ACDI/Agri-DEV provided or arranged transport, farmer leaders didn't attend. It is a top-down organization set-up by ACDI/Agri-DEV for our purpose. It is not a grass-roots organization and because of this it is and will continue to have teething problems.

As a people's company is a legal company, the bureaucracy, legal and tax requirements are rather involved. To think of creating five or six people's companies as vanilla curing operations would be too complicated, in my opinion. Each company must have a corporate secretary, a legal advisor, auditors, etc. Qualified persons to fill these positions are not found in most rural areas, so the company practically must be coordinated or operated through Colombo, unless the "sponsor" itself is in the rural areas and is able to import the skills needed to keep the company current on its official requirements. Most people's companies which have been successful (very few, in actuality) have had substantial government

involvement from local officials, who usually have filled key positions and ensured all the statutory requirements are regularly met.

Unless at least 50 "enlightened" more progressive farmers are located and have the necessary socio-cultural and economic wherewithal to incorporate and invest in a people's company, which might be headquartered in Kandy, I don't think this option is workable. The typical small back yard garden vanilla producer is incapable, in my opinion, of transcending the Sri Lankan village and making a PC work. To organize five or six local PC's and then another firm to undertake international marketing, would require to many human and financial resources. The vanilla industry development effort would get bogged-down in forming and maintaining these companies.

Company Limited by Guarantee

Agri-DEV is a company limited by guarantee and so are most associations. This type of company is designated as a non-profit company in that any margins must be re-invested in the activities for which it was created. It is a non-stock corporation, although it may be possible for such a company to issue shares: this needs follow-up with an attorney. At least seven persons (natural or juridic) must incorporate a company limited by guarantee. A company limited by guarantee may have a problem paying dividends or distributing profits as the *income and property* of such a company shall be applied solely towards the promotion of the objects of the company as specified in the Memorandum of Association. No portion thereof shall be paid to or transferred directly or indirectly, by way of dividend, bonus or otherwise howsoever by way of profit, to the members of the company. Another limiting factor of a company limited by guarantee is that it may not have more than 25 members, however, this can apparently be waived by the Registrar of Companies.

If such a marketing company is organized and through the price adjustment mechanism mentioned above, vanilla is acquired at a price to reflect a non-profit operation of the company, it might be able to fulfill the desired purpose. However, you would still be faced with the dilemma of how to organize, i.e., five or six village level companies and a national marketing company formed by these regional companies, or, one national company drawing farmers from different areas.

In short, I don't believe this company structure would lend itself to a vanilla curing and marketing operation, however, it might be useful for a vanilla producers association which could market internationally and represent the industry. These issues should be verified by consulting with an attorney.

Private Limited Liability Company

This company form is composed of *not more that 50 members*. Sale of shares can be restricted to a specific sub-set of persons through control of share acquisition by the board and requirements inserted in the Memorandum/Articles. This company form is usually used by family corporations and by parent companies setting-up subsidiaries. Forbes Agricultural Services (Pvt) Ltd, for example, is a private limited liability company owned by several other Forbes and Walkers companies. This company form could be used if five or six regional

curing/marketing entities formed a private limited liability company to market the vanilla or if five or six persons (natural or juridic) formed a private company in Colombo which set-up subsidiaries in rural areas as sufficient production justified installing curing centers. Farmers could buy preferred non-voting shares through a check-off system and the company could be structured and operate in such a way that declared profits were kept to a minimum to reduce taxes. A way to ensure farmer participation would be to donate funds to Agri-DEV so Agri-DEV could become one of the founding shareholders with a viable share of the equity capital (maybe 20% - 40%) which they would slowly divest to farmers delivering vanilla to the company.

Such a company could even be incorporated by employees of AgEnt (have to be careful of conflict of interest, especially if AgEnt will assist by investing through Agri-DEV or grant financing to get started) plus several enlightened farmers. Then if local organizations (cooperative, 56A/56B FO, an ASC/ASN, a people's company, or an association) were identified or formed later, they could become members by buying at least one voting share. Additional equity could be accumulated as preferred non-voting shares vis-a-vis commodity deliveries. Later as the company and industry developed, the founding fathers could divest, leaving the ownership in the hands of vanilla producers and/or their organizations. If this route is chosen, you will still confront the problem of start-up capital. Small, low resource farmers just don't have investment capital they are willing to part with. Therefore starting-up with well heeled members and a provision for farmer acquisition of a percentage of the shares makes more sense to me at this time, i.e., the Agri-DEV route.

As a company, this corporate form must follow all the legal requirements, e.g., formal accounting records, auditors, tax returns, etc., etc. But if you could find interested parties, including possibly Levers, Quest, Keels, Forbes Agricultural Services and possibly their estate management companies plus several larger farmers, who were willing to invest; and you can structure the company to include larger numbers of farmers or farmer organizations/companies (a necessity, I believe to encourage and ensure USAID assistance) in the future through Agri-DEV participation, this alternative looks attractive.

Public (listed or not listed) Limited Liability Company

This form of company is essentially the same as a private company except there are more than 50 members and trading of shares is more difficult to restrict. Of course capital and other incorporation requirements and a bit more formal than in a private company. A listed company's shares are quoted on the stock exchange while an unlisted company is not quoted. Share trading/acquisition is open to anyone and maintaining control of such a company or ensuring farmers participated with a certain percentage of shares would be almost impossible. The company could get "out of control" and decide to do fishing instead of vanilla and defeat the entire purpose of incorporating.

I am not too familiar with this corporate form and suggest an attorney or professor of business law be consulted as to the details of this corporate form. From my limited knowledge, however, I don't think this form would suite AgEnt's purposes.

Partnership/Sole Proprietorship

As in the States, there are multiple forms of this business organization here in Sri Lanka as well. Usually reserved for smaller family organizations, this business form is unsuited to AgEnt's purposes of promoting the vanilla industry.

Mutual Benefit and Aid Society

The Girls Friendly Society on Greenpath Road is such an organization and I believe the MED project used this incorporation form to create business credit and savings associations in Mahaweli regions under their business development program. I haven't explored this option very far as I don't think it would apply to a vanilla marketing organization. I suggest you check with the MED project's small and medium size enterprise development program.

Vanilla Marketing Company Development Strategy

Suggested Incorporation Strategy and Requirements

In light of the above discussion and options and given the reality of the typical vanilla grower, a national corporate structure such as a people's company, cooperative, or private company formed by small, low resource farmers is not an option, I believe. However, if the project can identify a key group of larger, better educated, willing investor-farmers who have the socio-cultural and economic wherewithal to form such a company and who are (or are willing to become) vanilla farmers, forming a national level company or cooperative would be an option.

To expect small farmers, similar to the ones I visited, to form companies or a company is unrealistic. To involve small farmers in Sri Lanka the only way is through organizations which are village based where farmers can feel and touch the organization and where they don't have to travel more than a few miles to attend meetings. This of course raises viability questions as if a business is to be formed, a manager will be required, books will have to be kept, etc. and with small volumes of business most of these organizations just are not going to be viable. Therefore, village level groups should not be formed as a company but as a Section 56A farmer organization to be registered under the Agrarian Service Act. The Agrarian Service Department could probably be enlisted to organize and register such groups, with orientation and assistance from a vanilla institutional organizer out-grower development person (IO/OG).

These village groups would coordinate planting, come together to receive technical assistance, to purchase or share vanilla cuttings, to pollinate as a village activity and to monitor each other's crop to avoid praedial larceny, ensuring harvesting is done at the right time. The elected representative from such groups would be responsible for collecting and delivering green vanilla beans to collection/curing centers set-up in nearby market towns.

As part of the development strategy, I believe AgEnt should try hard to identify *existing* local organizations willing to champion the vanilla project, organize a collection, curing and drying station and operate as a buying station. Vanilla would be acquired from the various Section

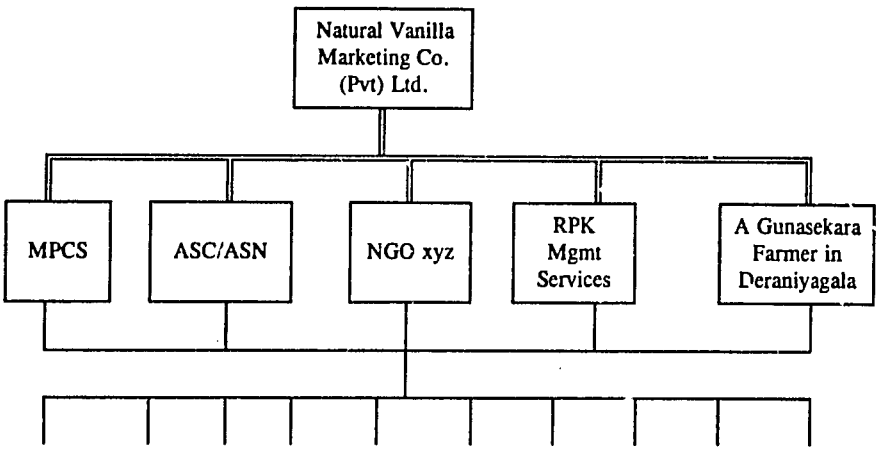
56A groups formed in villages willing to undertake vanilla growing. Each Section 56A organization set-up could send one delegate to vanilla meetings held at the local organization involved in the project.

Local organizations to search for would be those entities or individuals willing to operate a business-like curing/buying station for vanilla and which are operative in a "market town" around which vanilla growing areas with at least 5,000 - 6,000 acres of *potential* vanilla land are found. They could be a Multi-Purpose Cooperative Society, an Agrarian Service Committee/Agrarian Service Center, a local or international non-governmental organization working in such a town, an estate management company willing to plant at least 10 acres of vanilla and operate a buying/curing station, or even a larger lead farmer willing to plant a minimum of 10 acres of vanilla and operate a buying/curing center.

AgEnt would work with and through these organizations to develop the 56A organizations in the villages, develop an advisory committee (pseudo board) of 56A leaders around each local organization, provide TA/T to the local organization so management, accounting and operations are streamlined and geared for service to farmers.

Once at least three such groups are "operational" in the vanilla program, a national marketing company could be created as a *private, limited liability company* whose members are the local organizations or individuals. Alternatively, a non-profit company limited by guarantee to operate as an association-type organization could be created but I would favor the private company route if for nothing else but image. This national level company would undertake the vanilla marketing and representational functions in Colombo and Kandy, apply a registered seal of quality to export shipments, own the brand/trademark and be the interface with the outside world. It's office could be either in Kandy or Colombo. If the Kandy spice auction becomes a reality, the logical place for the company would be in Kandy, I believe.

AgEnt (or Agri-DEV on contract) would be required to identify local organizations to enroll in a program of institutional strengthening and to assign institutional organizers equipped with motorbikes to each organization to promote vanilla growing and organize the 56A organizations. TA/T would also be required at each local organization to ensure systems and organizational development progressed together with out-grower and 56A development. At the appropriate time a curing shed would be put-up with partial AgEnt financing as an equity investment through Agri-DEV. Once several local organizations are "ready" and each had several 56A's going, the national company could be incorporated. In the meantime AgEnt (or Agri-DEV with TA from AgEnt) could develop the name, do the name search, prepare the model Memorandum and Articles, register the vanilla trade mark and quality seal and work on any vanilla legislation required. The corporate structure would look like the following:



56A farmers organizations incorporated under the Agrarian Service Act as amended

Recommended Characteristics and Structure of the Marketing Company

The national vanilla marketing organization would be a private limited liability company organized and operated in such a way as to maximize returns to stockholders based on volumes of vanilla delivered Member/stockholders would be local organizations operating a vanilla buying/curing station and could be any of the organizations listed above. Capital would be accumulated through an initial investment by each organization (possibly through Agri-DEV) and later vis-a-vis a check-off on each kilo of cured vanilla marketed through the organization. If legislation could be obtained to establish an export cess for vanilla development and/or a price stabilization fund this would add to the availability of funds for industry development and consolidation. The cess would be a sensitive issue and depending on the profitability of vanilla growing and curing it might be advisable to go slow on its establishment.

1. **Possible Company Activities**

   As mentioned above the company would market cured and dried vanilla under a brand and a seal of quality. It would also represent the vanilla industry in certain issues requiring a national voice. These activities would be minimal and related to promoting the industry, e.g., working with banks to ensure short-term working capital is available for the local buying and curing stations.

   Members of the company, i.e., local organizations, plantations growing at least 10 acres of vanilla and large individual farmers, would each have to own and operate a vanilla buying and curing station with an exclusive marketing agreement with the national company. The national company would supervise curing and quality control, ensure only approved packaging was used and provide vanilla growing technology, T/TA and supervisory extension services to farmers through its local corporate or individual member companies.

   Members (companies, individuals, coops, ASC/ASN, NGO, etc.) would operate vanilla buying and curing operations under the technical supervision of the national company and

work with farmers growing vanilla and organized under Section 56A of the Agrarian Service Act, as amended. These local companies or members would be headquartered in a market town or at least would have to operate a buying/collection station in the town to facilitate vanilla delivery. The actual curing station could be located out of town where land is more readily available. They would develop and manage the outgrower operation, ensuring growers received T/TA, financing where necessary, etc.

2. **Initial Staffing Patterns**

Starting at the bottom of the above diagram: the 56A organizations in the villages would not have any paid staff. The local buying and curing company, whether or not an adjunct to an existing organization such as a MPCS, ASC/ASN, would require one institutional organizer/vanilla out-grower (IO/OG) development person equipped with a motorbike and sufficient operating funds to develop groups of vanilla growers in the villages within his/her command area. This might be between 10 and 20 villages so each village could be visited at least once every two weeks.

As more outgrowers are added, additional IO/OGs may be necessary. In addition to the IO/IG function, certain office functions will be required. Each vanilla farmer will be registered and issued an ID card with an identification number. The number of vines and planting particulars (distance between plants, age of vines at planting, acres planted, etc.) will also be recorded together with the exact location of the planted land and the residence of the farmer. This office person will take care of the "inside" functions while the IO/OG person will deal with the "outside" functions. Initially, the IO/OG can perform both functions.

If the organization is an existing entity, actual employees could be assigned office functions but the program should select the IO/OG persons.

As the curing shed and buying station is built, a curing manager and a clerk will be required. If the buying/collection station is located away from the curing shed, an additional employee may be required to manage the station, receive and weigh the vanilla and issue the corresponding receipt to the farmer. The IO/OG could be assigned some office, collection center and/or curing shed duties during the harvest period but he/she must ensure beans are opportunely harvested and do not escape the system into the "mudalali market."

At the national level, initially the vanilla company will require a general manager equipped with a double cab (4x4?) and a secretary. If attached to an existing organization like AgEnt or Agri-DEV, the general manager probably could obtain clerical or accounting assistance from this entity. Additional staff would have to be added as vanilla marketing activities increased. The general manager would travel frequently to supervise the vanilla development and IO/OG performance, etc. The GM would also accumulate data nationally and maintain a national register of vanilla growers.

AgEnt should assign a person to become the vanilla industry development officer who would coordinate all the activities of the project under the supervision of the COP. This person should also be equipped with mobility, although he/she could share the GM's vehicle as well. One alternative would be to hire the GM as the AgEnt (or Agri-DEV) person responsible for the program and after a specific period, this person would actually switch and become the first employee of the national company.

In summary, the following people will be required to undertake a proper vanilla development effort:

a) An IO/OG at each local organization identified - Rs. 5,000/mo + 20% social benefits. A motor bike for each with running costs plus petty cash funds for miscellaneous bike repairs and expenses.

b) An office person, part-time initially, at each local organization - Rs. 3,000/mo + 20% social benefits.

c) A GM for the national company to organize it and supervise the vanilla program - Rs. 20,000 - 30,000/mo plus commission and 20% social benefits. This person would also require a 4x4 double cab plus appropriate running costs, petty cash and minimal office furniture, etc. Initially this person could be an employee of AgEnt or Agri-DEV but later shifting to the vanilla company.

d) Secretarial and accounting support personnel on a part-time basis - Rs. 4,000 to 5,000 per month of allocated time shared with other activities. If not attached to AgEnt or Agri-DEV where these support persons already exist, the vanilla marketing company would require a secretary/accountant/office manager and a messenger - basic cost Rs. 12,000 - 15,000 plus 20% social benefits for the secretary and Rs. 5,000 for the office messenger/helper.

Within AgEnt, a person must be assigned responsibility for undertaking this project. Depending on how the effort is implemented, an international consultant might be required from time to time to undertake management audits of the progress, institutional assessments, etc.

3. Marketing Strategy and Approach

Vanilla from Sri Lanka must be marketed as superior, guaranteed quality material at competitive costs. A brand should be registered and the national company should apply a seal of quality, hopefully supported by an analysis certificate. There should be no variation from high standards. Sri Lankan vanilla must be differentiated from other Bourbon-type vanilla.

Initial strategy would be to fill the Levers commitment as a way to "sell" the first production. A two-way exclusive marketing contract should be signed with Levers restricting the company from marketing to anyone else until the Lever's commitment is satisfied and at the same time, restricting Lever's vanilla acquisition from other sources, unless the national vanilla company waived its right as sole supplier. Likewise, in a range above a specified quantity, Lever could be given the right of first refusal at an agreed upon price. If they refuse, the vanilla company could sell to anybody. Lever would have to exercise this right early in the season so alternative marketing plans could be developed if they declined to purchase above the minimum level. But then as quantities increase over and above the basic level and the right of first refusal level, sales to other firms could proceed outside the Lever agreement.

During program development, appropriate contacts should be maintained with Quest and any other vanilla buyers so they are informed of potential future availability, quality, etc. As the

vanilla development program advances, the GM and directors should visit appropriate trade fairs seeking opportunities to tell their story and seek marketing contacts.

Basic Modus Operandi of Company

As mentioned above, I am proposing local companies or existing organizations such as ASC/ASN, MPCS, an NGO or individuals would be contacted and encouraged to become a vanilla buying/curing operation within their existing structure. From these organizations IO/OG persons, partially or fully paid and supervised by the vanilla project, would organize and register Section 56A associations in the villages designated "Vanilla Producers Association of (*xyz village*)." These village level groups in the command area of the local organization (MPCS, ASC/ASN, etc.) would nominate one delegate to a local advisory committee functioning as a quasi board for vanilla development/marketing activities.

Vanilla growers would be registered and issued an identity card. They and their 56A organization would sign a membership cum marketing agreement in which the responsibilities of the members and the local organization are spelled out. The local organization would only purchase vanilla from registered 56A groups. The marketing agreement would specify pricing, quality, payment schedules, approximate delivery time and acreage/number of vines the grower is committing to the effort.

The local organization would be a shareholder/member in the national vanilla company, either a private limited liability company or a non-profit company limited by guarantee.

The national company would be the vanilla development group through which all vanilla development activities and financing would flow. It would initially have a small office with a general manager and a part-time secretary. This team, preferably attached to Agri-DEV, would be responsible for project implementation and would be financed with funds from AgEnt through Agri-DEV and from the other shareholders. These could include companies which grow vanilla such as Forbes Agricultural Services (or their plantation company), the Keells plantation management company and the local vanilla collection and curing organizations, plus any other company willing to plant vanilla, invest and participate in the project. Equity from the local vanilla collection/curing organizations might partially be contributed by Agri-DEV (donated by AgEnt) later to be bought back by the local organization as product deliveries begin and the check-off system starts generating capital for the producers.

Remuneration of Farmers

This is likely to be a delicate situation. The whole operation must work on a competitive pricing structure. It must be anticipated that as the industry is launched, competing buyers and exporters will no doubt surface. The only question is when. Ideally, the product should be acquired from farmers or farming companies who are "members" and stockholders in the national vanilla company. As such, marketing should be on a semi-consignment basis where final liquidation isn't received until the end of the year once the company pretty much knows what its profit/loss situation is.

Usually in these situations the initial payment, upon delivery of acceptable product, is 70% - 80% of the estimated final sales price. Then after curing and handling costs are known and the product has been turned over to the national marketing company, another 10% to 20% is paid. Then, at the end of the year after the vanilla has been exported and money received from the sale, the final liquidation is made of the remaining 10%. It is from this final payment that the check-off sums are withheld. The farmer's end-of-the-year bonus depends on the profitability of the national company. Yet in some circles, marketing organizations prefer to make the deductions from the first payment so the percentages are smaller and capital is added initially (so it is available to the company as soon as possible) instead of later. The importance of a very good management information system (MIS) so estimates and forecasting are accurate cannot be underestimated. It would be a disaster to end up paying the farmers and then discovering that income is underestimated or expenses exceeded projections appreciable.

But this system is sophisticated and needs careful explaining to all those involved. They must understand this system and management must have a good grower relations program to constantly explain and sense grower and local company or organizational objections or concern.

Company Costs Structure

Before doing additional work on the national vanilla program, a detailed feasibility study complete with financial analysis, pro forma financial statements, cash flows, a marketing plan, etc. must be prepared. In this study all costs would have to be laid out, including costs of constructing curing sheds, vehicle acquisition, working capital costs, etc. With this preliminary report a start has been made but a much more detailed feasibility analysis is required. This feasibility report should be divided into components.

First, a farm budget to document all the costs and returns a farmer could expect. Conservative yields and exaggerated costs should be the norm. Then a feasibility report for individual collection/curing companies should be calculated. Finally, a report for the national vanilla company. All of these could be combined into one document and if this report illustrates a good IRR, ROI and other financial indicators at all three levels, the project could go forward. Following the feasibility study, a good business plan will have to be written.

I haven't seen such a document in the files - except for a sheet titled "Financial Analysis of the Project on Commercial Cultivation of Vanilla (Extent 20 HA.)" prepared by Levers, I believe.

This feasibility report and accompanying business plan for the development of an integrated vanilla industry and company structure in Sri Lanka should be undertaken by a vanilla expert, an economist/accountant with experience in these studies, and possibly a marketing person/general agribusiness development person to put together the business plan.

1. **Office**
   As mentioned, the local organizations would function out of existing organizations. No offices would be required. The national vanilla development program should ideally be attached to an organization, preferably Agri-DEV. This national office would require furniture, equipment including a good computer to maintain the data base of registered growers, a few chairs, a filing cabinet or two and meeting facilities for board meetings, etc. The general manager or managing director would require a 4x4 double cab vehicle.

2. **Curing Facilities**
Each local vanilla organization would be a vanilla buying and curing station to ensure top quality premium vanilla with the maximum value added at the local level. From a visit to Tonga many years ago, I remember these facilities being rustic tin-covered sheds (fans??) with extensive racks inside to stack the sweating boxes. Outside, many wooden drying racks had been constructed to spread the vanilla for sun drying. These wooden racks were continually rotting and required replacement frequently as during most of the year they were exposed to the weather. During this visit to Tonga I remember the local company executives repeating the quality control problem and I believe they "blanched" the beans at the vanilla curing sheds instead of allowing villagers to perform this function. Another issue will security. A vanilla curing shed could have hundreds of thousands of rupees of vanilla inside and will require round-the-clock security by professionals when product is inside.

Exact design of these sheds will be required and should be provided by a vanilla specialist so a costing and BOQ can be prepared. I have no idea as to what a reasonable cost may be, but each local organization with a command area of 1,000 to 1,200 acres of registered vanilla and a production of 8 - 10 MT of dried beans may be a minimum to break even. This must be verified in the feasibility analysis mentioned above.

3. **Inventory Holding Areas**
Once cured by the local vanilla collection and curing organizations the product, packaged for export, would be delivered to the national vanilla company for storage and marketing. This implies holding areas, probably in proximity to the airport and/or port. As cured vanilla is a high value product, this facility would require adequate security so long as vanilla is in storage.

Again, I do not know the technical requirements of such storage so it should be designed by a vanilla expert and with assistance from a local engineering/construction firm, the BOQ could be prepared and this structure costed.

Initially, Lever will buy all the product so a storage and/or holding area will not be required. If and when production exceeds the capacity of Lever to procure the crop, this facility could be a future acquisition. At most, space could be rented in the interim, probably in the Colombo vicinity.

At the local level, once vanilla has been properly cured and packaged for export, it should be rapidly transported to Colombo to ensure proper storage and security.

4. **Product and Marketing Costs**
The main cost in this category will be the inventory holding costs. If payment is made at the time green beans are delivered to the collection/curing station, and beans are cured and kept for up to 10 - 12 months, this carrying cost will be substantial, especially if local working capital interest rates of around 25% are worked into the formula.

Example:

INCOME

♦ Sale of 8,000 kg dried beans @ Rs. 1,000 per kg.	Rs.8,000,000

COSTS

♦ Procurement of 40,000 kg green beans @ Rs. 150/kg	Rs.6,000,000
♦ Interest on Rs. 6.0 million @ 25%/year for 6 months	Rs. 750,000
♦ IO/OG wages @ Rs. 5,000/mo + 20% for 13 months	Rs. 78,000
♦ Office/clerical wages @ Rs 3,000/mo + 20% for 13 months	Rs. 46,800
♦ Fuel, etc. for motorbike @ Rs. 3,000/mo.	Rs. 36,000
♦ Misc. costs @ Rs. 5,000/mo	Rs. 60,000
♦ Curing costs, labour, materials, security, packaging, etc.	?
♦ Depreciation of motorbike - 3 yr life	Rs. 40,000
♦ Depreciation of facilities	?
TOTAL *COSTS* (without curing costs & facilities depreciation as these are unknown)	Rs.6,970,800
Gross margin	Rs.1,029,200

This gross margin must cover the curing costs (mostly labour), packaging costs, depreciation on the curing facilities, farmer bonus (3rd and final payment) and profit. Will it? I have no idea at this time. This is why a good feasibility analysis is urgently needed.

Critical elements will be to reduce initial payments to farmers to approximately 70% or perhaps Rs. 100.00/kg (possible in face of competition??), this would reduce the interest costs on the working capital by Rs. 250,000 approximately. Likewise, if the curing ratio could be improved to 4.5 to 1 instead of 5.0 to one estimated here, this would result in an extra 888 kg of cured beans, increasing income by another Rs. 888,000. Following this financial and operational model will generate an additional Rs. 1.0 million of revenue leaving a total of Rs. 2.0 million to be used for the items not costed above, i.e., curing costs, packaging costs, depreciation and the farmer bonus.

The farmer bonus, if paid at Rs. 20/kg of green beans delivered, results in Rs. 800,000, one half of which could be paid out in cash and 1/2 capitalized as farmer equity.

5. **Staff**
Staffing levels have been explained in section 2. ii. above.

Top Management/Production/Marketing Structure

As explained above, the vanilla industry development effort is a project undertaken as a development project in a business format. AgEnt will require a person responsible for the effort who would work as the counterpart to the general manager of the national vanilla marketing company. Alternatively, the AgEnt paid person could become the general manager once the company was organized, capitalized and set-up.

If the deal is organized by/through Agri-DEV, the general manager of Agri-DEV would supervise the vanilla development specialist and both would receive T/TA from AgEnt in vanilla production, curing, marketing and enterprise management.

Implementation Methodology, Timetable and Recommended Inputs

Step 1.
Undertake a detailed and complete feasibility analysis within the next three months of growing and processing vanilla at the three stages:

a) At the farm level - a farm budget.
b) At the collection/curing enterprise level.
c) At the national vanilla marketing company level.

All stages individually and combined must be financially viable and provide adequate return on investment. Sensitivity analyses should be undertaken at different levels of yields, pricing at the farm level, curing costs, curing ratios, international prices, etc. This will be important to determine marketing and pricing strategies. A vanilla expert capable of designing the curing sheds and who can provide all the parameters such as curing ratios, time schedules, materials requirements, storage requirements, packaging specifications, growing requirements, etc. will be required. He/she should be paired-up with a good local financial analyst/accountant capable of running the numbers and producing the financial tables, schedules, etc. and with an institutional development specialist to structure the company, design the legal requirements, and generate company parameters necessary for the costing in the feasibility study. From time to time this three person team may require assistance from specific local staff to visit villages, identify local organizations which might be incorporated into the program, etc.

Step 2.
Prepare an integrated vanilla industry development business plan with accompanying proforma financial statements, cash flows, etc. This should be completed NLT August 31st. by the above mentioned team.

Step 3.
Based on these studies and as part of the business and vanilla industry development plan, prepare the institutional structure for implementing the plans. NLT August 31st and it should form part of the Business Plan. An attorney will be needed here to determine what is actually the best corporate form(s).

Step 4.
Identify up to five local organizations, estates, or individuals willing and capable of becoming vanilla collection/curing centers and prepare specific business plans for each. This will entail contacting potential "investors" who would be willing to become stockholders of the national vanilla marketing company *and* growers of vanilla. *Need a core group.*

Step 5.
Depending on the strategy chosen as part of the feasibility and business plan development, recruit a general manager, one or two IO/OGs, purchase the vehicles and get started. This should be NLT October 1994 so farmers could be signed-up and the whole effort gotten off the ground before the next flowering season in 1995.

The above strategy has several basic assumptions: a) That growing vanilla, collecting and curing it is a viable undertaking for both farmers and the local collection/curing centers. b) That local organizations, lead farmers, estate management companies, etc. can be located *who are willing to invest* and form part of the national vanilla development program. c) That the costs necessary to develop such an effort are in fact within the range of the AgEnt project and/or that additional resources can be raised and that the project will be willing to undertake such an effort. d) That *everybody* is capable of standing the heat if the whole effort fails due to unexpected and unknown market or other forces.

1. *Material/Financial Resources Required:* The cost of the feasibility analysis and business plan, probably not less than US$ 50,000, including local logistic and administrative support.

2. *Human Resources Required:* One vanilla expert (minimum 1 month), one local accountant/financial analyst (minimum 1 month), one international business development expert (minimum 1.5 months) plus interpreters, drivers, secretarial support and a couple of good field people knowledgeable of local rural areas, government agencies, etc. An attorney will be required as well to determine the corporate structure required. His legal design recommendations should form part of the business plan

3. *Training Requirements:* Once the effort is formally launched, training will be required in four distinct areas: a) vanilla production, b) vanilla curing, c) accounting, business management, and grower relations for the local firms, d) marketing and enterprise management for the national marketing company.

4. *Extension Requirements:* At each local collection and curing center one or more IO/OGs will be stationed. These people will be the basic providers of extension services to the farmers. He/she will be supported by vanilla specialists organized by the national marketing company from the local pool of experts and will be supported by international vanilla specialists brought in by the AgEnt project periodically.

Risks and Constraints

Risks and constraints can be divided into two main categories: *international and national* generally outside the control of the project and *national* under the control of project and enterprise management.

International

The vanilla cartel based in Madagascar could drive the international price down through release of supplies in storage if they fear Sri Lankan vanilla. By keeping the total marketed under 40 - 50 MT per year, initially at least, this shouldn't upset the international market. Another real risk is that through bio-technology vanilla flavoring can be produced under laboratory conditions in Western countries much cheaper than could ever be grown naturally. Some work is reportedly going-on in the U.S.

National/Local

Success would depend on a series of local risks some of which can be controlled. Such issues as the real value of the rupee, inflation, peace and tranquility and a government favorable to private sector development will be important. A vital commodity will be *money*. Can sufficient financial resources be raised to adequately finance the operation in the short- and long-term? Will the thousands of small farmers really produce and dedicate themselves to the industry or will they fail to respond over the long-term. If they plant and then neglect the vines and/or refuse to honor their commitments to the local collection/curing company the whole operation could stumble. While Sri Lankan small farmers are plentiful, their attitude is generally *not* conducive to this type of business operation. hey tend to become jealous of each other and try to drag each other down. Will praedial larceny defeat the whole effort? Dr. Bandaranayake from Lever is recommending these small growers only plant a dozen or so vines close to the house so theft will not be a problem, or, plant 20 acres where commercial security can be put in place. These social-cultural peculiarities will be important and must be overcome to succeed.