
SRI LANKA

Social Enterprise Needs Assessment and Advisory



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1. Executive Summary

Recovering from its 26-year conflict, Sri Lanka has recently achieved lower middle-income status. While this is encouraging, inequality is exasperated by its economic development approach and failure to address the underlying socio-political causes of war. New approaches and interventions are needed to provide post-conflict support that is appropriate to the nation's level of economic growth, while addressing the emerging risks and vulnerabilities. Within this context of strong growth, social entrepreneurship is seen as an important area for Oxfam (and other International NGOs) to achieve long term, sustainable impact. With about a third of the Sri Lankan population engaging in agricultural activities, the agriculture sector carries the promise of enhancing economic development in Sri Lanka through successful social enterprises (SEs).¹

In 2014, Oxfam and Shujog worked with diverse SEs and key stakeholders in the agricultural ecosystem in Sri Lanka to analyze the challenges faced in agricultural value chains and identify appropriate strategies of support by development actors.²

1.1 Key Findings

Agriculture SEs in Sri Lanka exist in the form of Farmer Organizations (FOs), Farmer Cooperatives (FCs), and Small and Medium Enterprises (SMEs), and are established to help farmers and other rural producers. These SEs aim to facilitate access to finance and technology, identify relevant market opportunities, improve bargaining power, and act as a catalyst for rural economic development. However, they face significant challenges such as:

- Inconsistent access to finance
- Limited use of technology and lack of appropriate technical skills for farming
- Lack of business management skills
- Organizational structures that inhibit growth
- Lack of skilled and unskilled labor
- Limited market access and ability to know daily market price information

As a result of the findings, Oxfam and Shujog outline five main areas for intervention: training and capacity building, leadership development, market and supply chain linkages, strategic market coordination, and access to finance.

1.2 Recommendation

Based on the research, we advocate for the creation of an early-stage accelerator service, focused on SEs in agriculture value chains. The aim of this accelerator program would be to strengthen agriculture SEs and help them access different types of investment capital. The accelerator would provide SEs with key resources such as trainings and workshops in management, marketing, financial planning, and business development; mentorship and advisory by experts; and connections with investors.

The accelerator plans to target early-stage agriculture SEs in Sri Lanka for three main reasons:

¹ Shujog defines SEs as either non-profit or for-profit organizations that use business methods to achieve a social or environmental mission that benefits a poor, underserved or otherwise disadvantaged group or population.

² Agriculture value chain includes (but not limited to) organizations in agriculture related R&D, technology, input providers, producers, processors, warehouses, distributors, wholesalers, retailers, and marketers.

- They play an important role in the agricultural value chain by facilitating access to markets for farmers, transferring latest agricultural technologies, and coordinating the value chain.
- The challenges faced by early-stage enterprises can be addressed by an incubator/accelerator service.
- It is both financially and operationally feasible to support early stage SE through an accelerator service in Sri Lanka.

Global research demonstrates that attending an incubation program greatly improves the survival and success rate of enterprises that lack the support needed for their growth.

Our experience and findings indicate that in the short term, the agriculture incubator will empower high-potential entrepreneurs, create jobs, increase farmer incomes and opportunities, and help bring systemic efficiencies to agricultural value chains. In the long term, it will help develop an ecosystem for entrepreneurship and catalyze widespread economic development in Sri Lanka.

2. Introduction

Sri Lanka has experienced dramatic changes to its economy since 2009 when its brutal 26-year civil war ended. Since then, the economy has continued to develop with GDP growing at 6.8 percent per annum.³ Sri Lanka is a middle-income developing nation with 8.9 percent of the population living below the national poverty line.⁴ About 80 percent of the population live in rural areas, and the rural poor account for 95 percent of the country's poor.⁵ However, the majority of Sri Lankans enjoy basic infrastructure and access to electricity. Most areas have access to telecommunication facilities and a rapidly growing road infrastructure.

Since 2009, the government has promoted an open investment climate and financial system. The government has been pursuing large-scale reconstruction and development projects in its efforts to spur growth, especially in war-torn and disadvantaged areas in the Northern and Eastern provinces of the country. This has led to better access to all parts of the country.

Sri Lanka ranks higher than its regional cohort of South Asia on both the World Bank's Doing Business Rankings and the Heritage Foundation's Index of Economic Freedom. This indicates a clear regional advantage for the country with respect to business environment and economic access. However, the prolonged state of war and the aftermath of a devastating tsunami in 2004 have contributed to a culture that seeks financial stability and is highly risk-averse, dissuading youth from pursuing entrepreneurship as a career. The country also suffers from a shortage of labor as a large number of its skilled and unskilled people have migrated abroad to seek stable employment opportunities. This shortage of supply also makes existing labor costly as compared to other countries in South Asia.

The main economic sectors in Sri Lanka are agriculture, apparel, and tourism. Sri Lanka also depends heavily on foreign assistance and remittances from workers, primarily in the Middle East. However, agriculture stands out as one of the most important sectors in the Sri Lankan economy. An overview is provided in the next section.

3. Agriculture in Sri Lanka

3.1 Overview

The agriculture sector employs about 32 percent of the Sri Lankan labor force and contributes about 11 percent of the country's GDP.⁶ The contribution of agriculture to GDP has decreased over the last few decades despite government efforts to increase agricultural productivity. There are two main types of farming practices in Sri Lanka: plantation farming and field crop farming. Plantation farming accounts for roughly half of all the farmed land in Sri Lanka, with tea, rubber, and coconut being the major plantation crops. Plantations largely serve the export market. However, a majority of the coconut produced is used for domestic consumption. Field crop farming is largely practiced by smallholders for domestic consumption and comprises paddy, fruits, vegetables, and other food crops. Smallholders in Sri Lanka had an average landholding of 0.42 hectares according to the 2002 census (latest available) and account for roughly two-thirds of the agricultural labor. Most small holders grow paddy – one of the staple crops in the country which accounts for roughly a third of the cultivated land.

³ ADB. 2013. Asian Development Outlook. 2013.

⁴ CIA World Factbook. 2010 estimate.

⁵ World Bank. 2011.

⁶ CIA World Factbook.

Forestry, fishing, and livestock, while present, account for a relatively minor part of both the subsistence and trade economy in Sri Lanka. Unsustainable practices and prolonged conflict have led to significant depletion of forest reserves. Coastal communities have traditionally relied on fishing for livelihood, but the country has been unable to exploit the full potential of its fishing resources⁷. This is largely because the government curtailed fishing activity for security reasons during the time of war. Furthermore, the fishing industry was deeply affected by the tsunami of 2004, which destroyed or damaged over 75 percent of the fishing fleet. While dairy, meat, and eggs are the main livestock products, Sri Lanka is a net importer of dairy products for domestic consumption.

3.2 Government Policy and Approach

According to the National Agricultural Policy, the government of Sri Lanka aims to increase domestic agricultural production to ensure the food and nutrition security of the nation, improve agricultural productivity, maximize benefits and minimize adverse effects of globalization on domestic and export agriculture, improve agricultural techniques to reduce the unit cost of production and increase profits, and enhance the income and livelihoods of farming communities.⁸

New agricultural policies also promote efficient use of natural resources. Programs such as the National Agribusiness Development Program (NADP), and Smallholder Plantations Entrepreneurship Development Program (SPEDP) are financed by international development agencies such as the International Fund for Agricultural Development (IFAD) and the United States Agency for International Development (USAID), and implemented in partnership with the government. NADP aims to increase smallholder incomes by providing technical assistance and micro-finance. SPEDP helps poor farmers lease unproductive tea estates, improve their productivity through technical assistance, and improve access to finance, information, and markets.

Although these policies aim to benefit the farmers and agriculture businesses, their implementation has been challenging and reach is often restricted due to the bureaucratic system. A number of agencies are present both at the provincial and national levels, which have overlapping authority for drafting the implementation procedures of these policies.

⁷ Ceylon Chamber of Commerce: Fisheries Sector in Sri Lanka.

⁸ National Agriculture Policy, Ministry of Agriculture, Sri Lanka.

4. Social Enterprises

4.1 Definition and Overview

Social Enterprise (SE) is “an organization or venture that advances its primary social or environmental mission using business methods,” according to the Social Enterprise Alliance (SEA). While most of such enterprises in Sri Lanka do not formally use this definition, they exist in all major agricultural value chains. SEs exist in various forms based on their legal statuses. The challenges faced by SEs also vary by the organization type. For the purpose of this report we have classified social enterprises into three major types of organizations as shown in Figure 1.

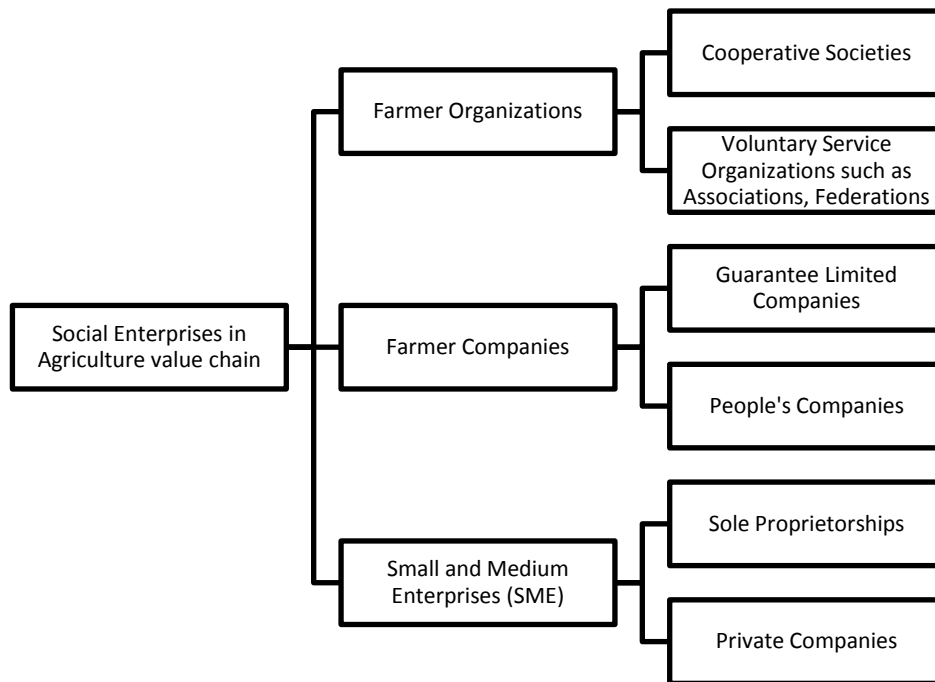


Figure 1: Social Enterprises in Agriculture Value Chain in Sri Lanka

4.2 Farmer Organizations (FOs)

Farmer Organizations (FOs) in Sri Lanka fall under the administration of the Ministry of Cooperative and Internal Trade of Sri Lanka. The Cooperative Societies Act regulates their operations.⁹ FOs are supported by government agencies such as the Department of Irrigation, INGOs such as Oxfam and IFAD, and large private companies such as Hayleys and Nestle. They act as independent, collective units that promote economic, social and cultural growth. The primary economic activities facilitated by FOs are: input supply to farmers, credit provision for farmers, value-added processing, marketing, branding, and packaging.

According to the ICA Committee on Consumer Cooperation for Asia and the Pacific report, there are more than 10,000 FOs with more than 6 million members at present in Sri Lanka. FOs are democratically controlled and are managed by an elected committee, which comprises a president, a secretary, a treasurer, one or two vice presidents, and several committee members.

⁹ ICA Committee on Consumer Cooperation for Asia and the Pacific: Sri Lanka Report.

FOs are further classified into two types:

- **Voluntary Service Organizations** – A farmer-based Voluntary Service Organization exists in the form of an Association or Federation and has a not-for-profit structure. Its main sources of funding to carry out activities are public contributions, government grants, and local or foreign donations.¹⁰
- **Cooperative Societies** – A cooperative society is an independent organization, which is owned and managed by its members, and is formed to serve the needs of its members. The autonomy and power of managing the cooperative always lies with its members. Even when a cooperative is involved in economic activities with private companies, it ensures that the autonomy and power of the cooperative is not affected. A cooperative society may be involved in credit provision, input supply, establishing market linkages, and technical training to improve the livelihoods of its members and employees. While a cooperative society is established to benefit its members, it also has to keep in mind the sustainable development of the society or community in which it exists.¹¹ Shujog research shows that some cooperatives are very influential in the communities in which they work. For some communities, cooperatives are the only source of commercial activity. They engage, for example, in non-farming related trade services such as running small grocery shops in the villages.

Case Study: Nuwara Eliya Agricultural Cooperative Society

Nuwara Eliya Agricultural Cooperative Society comprises of prominent potato and vegetable cultivators in upcountry. It is a statutory body registered before the Commissioner of the Cooperative Development under the Cooperative Societies Act No. 05 of 1972 of the parliament and consists of 55 founder members. There are about 20,000 members of Upcountry Independent Farmers Association who obtain various services from this voluntary organization. The Society originated in 1994 with a mission to assist those who are not properly supported by government programs. Today, the Cooperative Society is quite effective in selling farmers' produce to supermarkets and hotel chains, and is planning to construct a mini hydropower plant in its backyard. This mini hydropower project is expected to give rise to other sub projects of the society:

- 1. Construction of a Cooling House: A cooling house would facilitate the storage of excess vegetables during harvest season. The ability to sell produce during the off seasons at a higher price ensures a more stable income for the farmers.
- 2. Construction of a Dryer: A dryer helps preserve excess crops. This would provide substantial income to the growers and ultimately enhance the livelihoods of the people in the area and contribute to national income.

Nuwara Eliya Agricultural Cooperative Society also expects to start a broadcasting service, which would facilitate market information exchange among farmers.

Government and INGOs provide the majority of funding to FOs (notable exceptions include Milk Breeders Cooperative Society and Nuwara Eliya Agricultural Cooperative Society) and therefore have considerable influence in how they are run. For example, every cooperative has a government representative as a part of its management committee, providing active input with regards to the cooperative's activities. In order for FOs to become more adept players in the free market, they need to be increasingly independent of outside influence.

¹⁰ The Department of the Registrar of Companies, Sri Lanka.

¹¹ International Year of Cooperatives. [7 Cooperative Principles](#).

4.3 Farmer Companies (FCs)

Farmer Companies are collective groups formed to benefit small farmers by providing better market linkages and greater bargaining power.

Farmer Companies are further classified into:

- **People's Company** – People's Companies are FCs established under the Companies Act, which has restrictions on membership and share trading to safeguard against possible private ownership. Only farmers and other stakeholders involved in agriculture living within a particular geographical region can become shareholders, and shares cannot be traded except among farmers eligible for membership.¹²
- **Limited by Guarantee Company** – The government abolished the People's Company structure in 2007 to pave way for a Limited by Guarantee Company. According to the Department of the Registrar of Companies, a limited by guarantee Farmer Company must apply its profits, if any, and other income to the promotion of its objectives, and is prohibited from paying out dividends to its members.

Case Study: Cooperation for Industrial Development Lanka (COOPID Lanka)

COOPID Lanka is an agriculture-based foreign investment company and an international and local commodity trading and marketing company that specializes in Ceylon spice-related products. It has a strong farmer base that produces dry cocoa beans, cinnamon, pepper, cloves, cardamom, nutmeg, ginger, mace, turmeric, vanilla beans, and dry chilies. It adds value by creating all kinds of spice powder for the hotel industry, leading restaurants, and retail buyers. It was set up to assist farmers in securing the best price for their products and identify relevant markets for them. All COOPID's products and out-grower farms are organically certified by ICEA Italy and Control Union, Netherlands. Presently, apart from identifying market opportunities, COOPID assists farmers with technical know-how, land development, and new methods for organic farming. Shortage of labor and quality control are some of the challenges that the company is facing currently. To resolve quality issues, COOPID has set up an internal control system with farmer leaders who receive regular guidance from internal control systems officer. It has established a database for members to track supplies capacities, yield forecast and expected sales.

Farmer Companies are considered to be more independent than Farmer Organizations, and are therefore believed to be more effective in leveraging capital, establishing market linkages and decision-making. Shujog assessment of Oxfam-supported FCs and other People's Companies suggests that the leadership of such companies were more inclined to focus their efforts on income generation than on achieving their social mission. Having a focused approach may make them more economically effective than cooperatives, which often spend time and resources on social development activities at the cost of business development.

Some of the FCs interviewed are only recently formed. These FCs lack the management and leadership skills that are essential for developing and implementing new strategies for growth and becoming self-sustainable in the long term. New and relatively young FCs also lack the influence and social capital that cooperatives have in their communities.

4.4 Small and Medium Enterprises (SMEs)

SMEs are defined in a variety of ways by different countries using parameters such as number of persons employed, amount of capital invested, and turnover. In Sri Lanka, the Department of Small Industries defines a SME as an enterprise with member fewer than 50 people and capital investment of less than LKR 5 million; the Export Development Board defines a SME as an

¹² The Department of the Registrar of Companies, Sri Lanka.

enterprise with capital investment of less than LKR 8 million and less than LKR 50 million annual turnover.¹³

As per Government estimates, around 80 percent of businesses in Sri Lanka that fall under the SME umbrella contribute over 50 percent of the country's Gross Domestic Production (GDP).¹⁴ Of the total employment in the country, SMEs account for a share of 35 percent.¹⁵ According to the Ministry of Planning and Finance, SMEs in Sri Lanka play an important role in economic development by creating employment opportunities, mobilizing domestic savings, promoting poverty alleviation, income distribution and regional development, training of workers and entrepreneurs, contributing to export earnings, and creating an environment in which large firms flourish.¹⁶ SMEs are further classified into:

- **Private Companies** - The articles of a Private Company include provisions which -
 - a) prohibit the company from offering shares or other securities issued by the company to the public
 - b) limit the number of shareholders to fifty, not including shareholders who are –
 - i) employees of the company; or
 - ii) former employees of the company who became shareholders of the company while being employees of such company and who have continued to be shareholders after ceasing to be employees of the company.¹⁷
- **Sole Proprietorships** - Sole proprietorship companies are run by a single individual and have no nominal value of shares.

The government has assigned high priority to the SME sector. According to the Ministry of Traditional Industries and Small Enterprise Development, under 'Mahinda Chintana – Vision for the Future', 5,000 small-scale enterprises will grow to a medium scale and 200 medium-sized enterprises will grow into large scale enterprises every year.¹⁸ One of the strategies the Ministry will employ to achieve this goal is providing loans up to LKR 10 million at a subsidized rate to small and medium enterprises.

SMEs are believed to have better institutional capacity as compared to FCs and FOs. Based on our research, we assert that SMEs have immense potential to achieve sustainable growth within agricultural SEs because their governance and organizational structures are familiar to traditional lenders and investors, which therefore, facilitate greater access to capital. Despite this potential, our research suggests that SMEs still suffer from several challenges including insufficient access to capital, technology, technical skills, market access, and managerial skills. Depending on the respective value chain, SMEs may face one or more of these challenges. This is distinct from our finding that FOs and FCs were likely to face similar challenges regardless of the respective value chain.

¹³ Ministry of Finance and Planning. Sri Lanka. [Government Policy and Strategy for SME Development](#). Apr 2013.

¹⁴ Ministry of Planning and Finance.

¹⁵ *ibid.*

¹⁶ Ministry of Finance and Planning. Sri Lanka. [Government Policy and Strategy for SME Development](#). Apr 2013.

¹⁷ The Department of the Registrar of Companies.

¹⁸ Performance Report 2013. Ministry of Traditional Industries and Small Enterprise Development, Sri Lanka.

Case Study: Lahiru Mushrooms

The local and international demand for mushrooms in Sri Lanka is increasing day by day. As a result, the popularity of mushroom farming has also increased.

Upali Narangaspitiya, an entrepreneur from Kulugammana, Kandy is engaged in the growing of Abalone and American Oyster mushrooms and aims to satisfy international and local demand. Upali, the sole proprietor, has his own mushroom cultivation lab in Kulugmmana, which he set up with 100,000 LKR from GTZ (now GIZ) in 1998. The seed cultures required for mushroom cultivation are produced in this lab. Today, he has a network of 200 out growers throughout the country and has built a mushroom franchise system under his brand. He supplies to Keels, Aapigo and five star hotels.



Mushrooms bags in a controlled environment ©Rashi Agrawal/IIX-Shujog

According to Upali, both Oyster and Abalone mushrooms are in high demand in Sri Lanka due to their nutritional value. The cost of mushroom production is relatively low. The climatic conditions (high temperature of 25-35 degree C and 85-90 percent relative humidity) and easy availability of raw materials such as paddy straw and sawdust are favorable for mushroom cultivation in Sri Lanka.

During a visit to Korea, on a scholarship from Department of Agriculture, Upali realized how the use of modern technology in mushroom farming can improve productivity and quality of mushrooms. He says "The rejection rate of our mushrooms is 90 percent compared to 20-30 percent in Korea. In Korea, they use water as a medium whereas we use paddy. The use of paddy as a medium is one of the reasons for the high rejection rate of our mushrooms; it can lead to a fungus called Tycodama that affects the quality of mushrooms."

Upali believes that his production is insufficient and he needs to increase it. Currently he employs three people to make mushroom bags and produces only 1,200 mushroom bags a day. He cites lack of capital as a major constraint for buying machinery to increase daily volumes. He needs 20 -30 million Sri Lankan Rupees for new technology to semi-automate the cultivation process, but high interest rates and collateral terms have prevented him from accessing this capital.

Upali is confident in his ability to sell the mushrooms and says that marketing is not a challenge for him. Today, under his brand he supplies 50,000 mushroom bags, priced at LKR 60 for Oyster mushrooms and LKR 80 for Abalone mushrooms. He supplies to supermarkets and hotel chains every month, and if given access to capital and expertise to identify fungus growth, he can very well double the volume as there is more than enough unmet demand. His vision for the future is to become the leading producer of Abalone and Oyster mushrooms in Sri Lanka.

5. Agriculture Value Chain and its Ecosystem

The agriculture ecosystem in Sri Lanka is characterized by a number of stakeholders as shown in Figure 2.¹⁹ SEs are most prevalent in production, harvesting, processing and packaging. There are also a few SEs that produce input seeds, and provide storage and warehousing facilities.

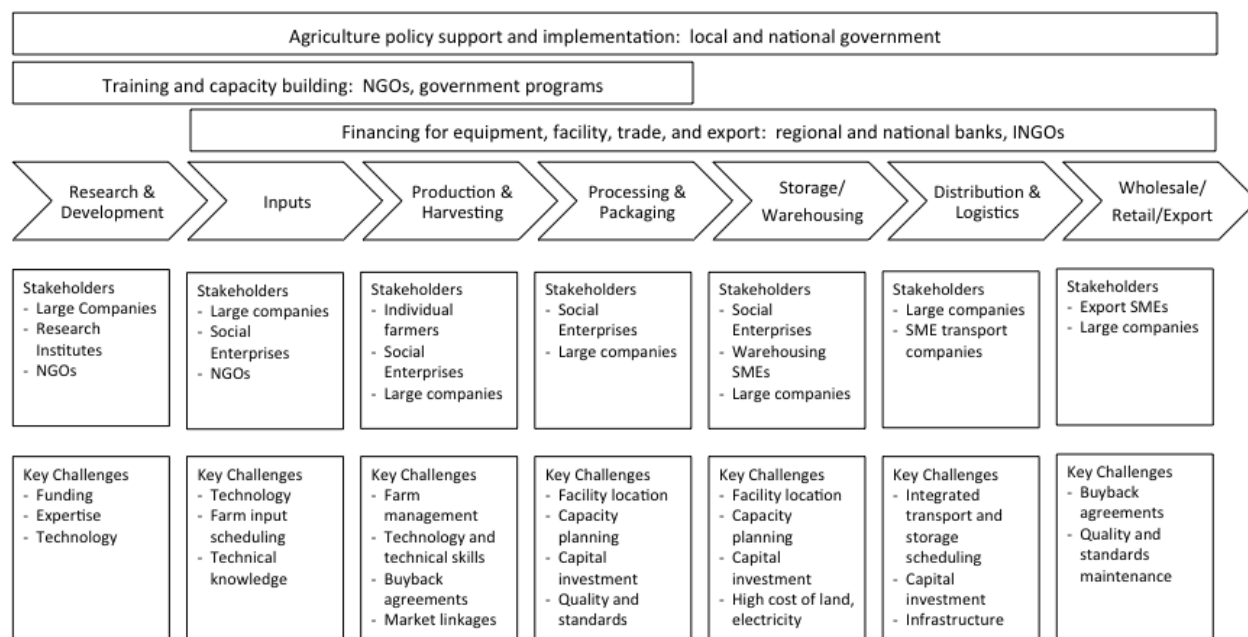


Figure 2: Supply Chain Stakeholders and Challenges

5.1 Role of Social Enterprises

Agriculture SEs in Sri Lanka exist in the form of FOs, FCs and SMEs and are established to help farmers and other rural producers. They facilitate access to finance and technology, identify relevant market opportunities, improve bargaining power and act as a catalyst for rural economic development. We believe their role is pivotal in the following five key areas:

- **Entrepreneurship Development Services:** SEs improve entrepreneurial skills of small farmers by facilitating access to technical training and business management skills. These trainings are often funded by government agencies, international NGOs, financial institutions, and/or private companies. Enhanced technical and management skills help farmers improve their productivity and create better quality products.
- **Access to Finance:** SEs, depending on their legal structure, can facilitate access to finance. Since cooperatives and some established FCs are highly influential in their communities, they can facilitate access to finance by recommending small farmers to financial institutions. Some financial institutions also use the recommendation of cooperative leaders as criteria for evaluating credit-worthiness of small farmers. Cooperatives help expand the reach of financial institutions in rural and remote areas.

¹⁹ Primary research observation.

- **Access to Technology:** Most small farmers or rural producers do not have access to technology and knowledge of efficient production techniques. SEs help such farmers and producers access information about new technologies and growing, harvesting and processing techniques, which not only helps them to create better quality products but also improves their efficiency.
- **Market Access:** SEs, such as cooperatives, help farmers and rural producers identify the right market for their products and overcome marketing challenges. Working with SEs provides farmers and rural producers with bargaining power, which helps them obtain better prices for their products and services.
- **Value Chain Coordination:** SEs, such as cooperatives, federations and associations, also lobby the government on behalf of producers. They also promote dialogue and supplier linkages among different stakeholders in the value chain.

While SEs are providing valuable service to small farmers, the extent of such support needs to grow significantly to catalyze growth in agricultural value chains. In later sections of this report, we highlight some of the specific ways in which this support can be improved and intensified.

5.2 Role of donors and INGOs

INGOs such as Oxfam have largely been involved in the training, capacity building, and organizational development of SEs. They sometimes also work with existing government programs to ensure effective implementation of national and local programs. Some NGOs have also been involved in providing inputs to farmers such as high quality seeds and farm equipment. Donors and INGOs have played a significant role in creating the foundation for active social entrepreneurship in Sri Lanka, particularly in war and tsunami affected areas, where SEs were often the only source of commercial activity in communities. Future programs could build on this success by investing in enterprise development services to grow SEs, thus both widening and deepening their impact.

5.3 Competition from large companies

While sometimes SEs are engaged by large companies as producers in the value chain, other times they may have to compete with these companies for domestic and international markets. In either case, SEs often fall short – in comparison to large companies - on the technology, skills, and resources necessary to meet quality standards. Currently, large companies control a significant part of the domestic agricultural market. They dominate the export market in Sri Lanka. SEs will need to adapt, and equip farmers with the latest technologies and methods used by these companies in order to compete. In addition, SEs currently capture a small part of the agricultural product value chain. It is large companies that control most of the value addition such as processing, packaging, marketing, and export. Building capacity and equipping SEs with the necessary resources to help them become more competitive may lead to a greater penetration of SEs providing value added services in agricultural product value chain.

6. Women in Social Enterprises in Sri Lanka

Women represent only a small minority of leadership positions at SEs. Approximately 10 percent of SMEs in Sri Lanka are women owned and managed.²⁰ Representation of women may be higher in FOs and FCs than in SMEs. However, data for women in leadership positions in FOs and FCs is not available. Lack of financial literacy is one of the reasons why the presence of women in the SE sector is so low. Due to this reason, women leaders are often unable to avail concessional schemes, loans and other sources of financial assistance necessary to develop their businesses. Also, culturally, it is expected of women to be homemakers rather than start their own businesses. However, our research shows that this is beginning to change. Due to inherent labor challenges, and high wages for agricultural labor, more women are choosing to work in fields and subsequently organize themselves into SEs. Oxfam and other INGOs have focused on developing women's leadership skills. We believe that future endeavors should leverage this investment by empowering more women as leaders of organizations, through women-specific leadership and development training programs.

Case Study: Sustainable Agriculture Resource Center – Farmer Company, Batticaloa

The Farmer Company in Batticaloa was established with the support from Sustainable Agriculture Resource Center (SARC), as part of SARC's activity with conflict affected women. The company was registered in September 2013 and has made tremendous progress in the past six months. Today, it has 128 active members and supports 1,500 families in the region and is led by a capable woman, Nandini. The farmer company is involved in paddy production and value addition and currently processes paddy into rice flour and rice flakes. The other crops that the company procures and sells from its members include maize, kurukam, green gram, black gram, etc. Although the education level of members in the company is low, they have been forward thinking. The company today owns 5 rice milling machines for value addition purposes and focuses on branding and market linkages. According to Nandini, the company is currently using its income to pay for machinery and operational cost but the limited capital doesn't allow it to expand rapidly. She also cites market linkages and transport as other major challenges.

7. Challenges faced by Social Enterprises in Agriculture

The challenges faced by SEs in agriculture in Sri Lanka can vary by value chain, geography, and legal structure of the organization. In the following sections, we will first highlight the challenges faced by SEs across value chains, and then highlight challenges in specific crop value chains.

7.1 Access to Finance

Access to finance is one of the most significant and persistent challenges for SEs in Sri Lanka. The government has taken several steps to improve access to finance for SEs in the form of budget allocation and special loan schemes. However, high interest rates and collateral requirements prohibit SEs from securing funding from mainstream financial institutions. A number of international and local NGOs have also provided finance to SEs in the past in the form of grants. However, these grants are seldom accompanied with enterprise development services to ensure that the SEs are able to raise commercial capital in the future. A large number of SEs remain dependent on donor money for carrying out their activities. Most banks at national and state level consider SEs to be at high risk of default. SEs have to pay higher interest rates as compared to large scale enterprises, which are considered to have better risk

²⁰ Sanasa Development Bank, Sri Lanka

profiles because of a more robust organizational and management structure and available immovable collateral to pledge. Access to finance is particularly difficult for SEs located in the Northern and Eastern provinces due to the limited presence of financial institutions in these areas. This is beginning to change as peace and stability in these areas has attracted a number of financial institutions to open new branches.

7.2 Technical Challenges

Technology

Limited use of technology and lack of appropriate technical skills for farming affects SEs in agricultural value chains in two ways. First, SEs are often unable to use their time, capital, and resources efficiently. Farmers may overuse certain inputs such as fertilizers and pesticides, without knowledge of their effects, raising overall cost of production. In some cases, farmers are unaware of the latest techniques that promise higher yields per hectare, and use smaller quantities of natural resources such as water. Second, lack of technical knowledge also affects the product quality and innovation required to compete with large-scale private enterprises and foreign companies. During our research, farmers often cited their inability to keep up with the quality standards of large companies as a key constraint to market access.

We have also found that availability and knowledge of technology varies with the geographical location of SEs – those located in remote areas are, not surprisingly, less aware of the latest farming techniques, placing them at a further disadvantage. While some SEs do receive assistance from state universities, institutions and government agencies to learn about the application of new technology in product development and business operations, the reach of exchange programs and bilateral conferences is limited.

Management

Some of the SEs interviewed currently lack the business acumen needed to sustain or grow their operations – these SEs typically come from farming families and often have no training in business economics, finance, or marketing. Many of the SEs did not have a business or operations plan that they could follow. Very few reported any concrete or actionable plans for future growth. A number of SEs interviewed did not have a clear understanding of their cost of production, operations, profits margins, and growth opportunities. Several reported their inability to market their produce as a key constraint to growth.

The reasons for this lack of business management skills could be twofold. First, there is a shortage of talented youth in the agricultural sector. Traditionally, many Sri Lankans perceive entrepreneurs, particularly outside of urban centers like Colombo and Kandy, as individuals who are forced into entrepreneurship because of their inability to secure jobs in the government, NGO, or private sector. As a result of this misperception, many youth choose not to pursue entrepreneurship as a career. Second, there is a lack of education in business management. Most entrepreneurs we met did not have proper training in business principles and management skills.

Governance and Organization Structure

As highlighted above, SEs in agricultural value chains have varied organizational structures. Some of these governance structures, such as those of cooperatives, are not suited for rapid business growth. These organizations hold the view that involvement in business would compromise their social mission. Training to highlight strategies that maximize social impact while growing the business could be valuable for such organizations.

In the case of SMEs, we found a generally centralized management approach, whereby the

owner of the company manages various functions such as production, marketing, supply chain, logistics, finance, and operations. Mid-level or junior employees are seldom vested with key duties within the organizations. This could inhibit the growth of the businesses in the long term as the owner is stretched for time and capability. Banks may also see such enterprises to be risky as business operations rely solely on one person.

Human Resources

Lack of skilled and unskilled labor is a major challenge for Sri Lankan SEs because it significantly affects both their ability to produce and their cost of production. A number of SEs that we visited cited lack of agricultural labor as a major challenge restricting their production and selling capacity. Due to limited labor availability, the cost of labor has gone up significantly. The daily wage rate has elevated from LKR 60 in 1992 to LKR 405 in 2010.²¹ During our research study, the 2014 daily wage is reported to range from LKR 800 – 1200.

Sri Lanka has seen large-scale migration of unskilled labor to the Maldives and the Middle East. These migrant workers are typically youth and women, who seek stable employment opportunities abroad in the tourism and hospitality industries. In addition to this, a large number of the country's educated professionals have migrated to developed countries like Australia, UK, and USA for more lucrative employment opportunities.

Market and Information Access

Lack of market access and inability to know daily market price information puts SEs at a significant disadvantage. Since they do not have the personal and professional networks in national and international markets, most SEs are forced to sell their products in local and regional markets. These markets often do not offer the best price for their produce. Most SEs expressed that they do not have the skills and technology necessary to access international markets.

Inability to access price information also affects SEs, particularly those in remote and rural areas. Farmers are forced to sell at the prices quoted by the middlemen who come to purchase their produce. They do not have the knowledge of sources from which they can verify market prices. Farmers, who travel to town to sell at the market bear the risk of price volatility caused by over-supply on certain days. If farmers could find out market prices before leaving their villages, they could choose to postpone sales to a later day, which would help moderate supply and price volatility over the long term while leading to better incomes for farmers. Currently, there are no such mechanisms for farmers to access price information.

Infrastructure facilities

Infrastructure, while fast improving in Sri Lanka after the end of the war, remains a key impediment to the growth of all businesses, including agriculture SEs. The country is blessed with sufficient water sources to meet its agricultural needs. It has an ancient canal irrigation system, dating back hundreds of years that continues to effectively serve farming communities. Mobile telephones have also been successful in connecting rural and isolated communities to the rest of the world.

Roads have enabled access to Northern and Eastern provinces that were isolated until recently. However, some rural areas, particularly in these provinces, remain difficult to access. A journey of 10km from the highway to the village may take up to an hour. Some areas are flood prone and often cut off from access to towns for weeks during monsoon months. This leads to

²¹ RAM Ratings (Lanka) report, 2010 and primary research

significant losses and drives these communities further into poverty.

High cost of electricity is a major hindrance for agricultural productivity. It limits the establishment of necessary value-add infrastructure such as cold storages, milk chillers, or processing facilities because the economics are unfavorable.

8. Specific Challenges in Key Value Chains

There are five key agricultural value chains that account for a majority of the agricultural production in Sri Lanka: tea, coconut, paddy, spices, and fruits and vegetables. SEs play an important role in all of these value chains. In addition to the challenges highlighted in the previous section, SEs in these value chains face difficulties that are unique to the respective value chain. In this section, we aim to shed light on such value-chain specific challenges.

8.1 Tea

Tea is one of Sri Lanka's main agricultural exports, accounting for 15 percent of total commodities exported in dollar value²². Although Sri Lanka is the world's fourth largest producer of tea, it is the largest exporter and earns the highest price per unit. Export-quality tea is predominantly produced by large tea estates and plantations that often own their processing and packaging factories. However, SEs play an important role in the tea value chain. Estates and plantations buy raw or semi-processed tea from small producers and blend it with tea from their estates. The National Development Bank (NDB) of Sri Lanka and Commercial Bank have encouraged greater participation by SEs in the tea value chain by funding small and medium factories, exporters, and cultivation projects.

Key Challenges in the Tea Value Chain

- *Comparatively low yields* – Tea yields in Sri Lanka are lower than that of industry competitors such as Kenya and India. In addition to other factors, tea yields depend on soil health. In order to maintain soil fertility, periodic replanting and in-filling are required. Sri Lanka Tea Board (SLTB) recommends a replanting rate of 3 percent to obtain a sustainable improvement in yields. However, currently the replanting rate is only 0.5 percent; the rate has been relatively low due to the large capital investment required.²³ To address this issue, the Ministry of Plantation Industries recently announced its intention of making replanting and in-filling mandatory. The government has also indicated that provision of concessionary loans will be considered to finance the replanting schemes.²⁴
- *Inability to engage in multi-origin blending* – Sri Lanka's current import restrictions on tea allow imports of only specialized tea such as green tea; which prevents the country from engaging in multi-origin blending. Tea exporters believe that the relaxation of such import restrictions would encourage multi-origin blending. Export of blended tea would be a great source of foreign income.²⁵

²² UN Comtrade Data.

²³ RAM Ratings (Lanka) report, 2010

²⁴ *ibid.*

²⁵ *ibid.*

8.2 Coconut

The coconut crop has several aligned products in the value chain: food products such as raw coconut, oil, and coconut milk; products from coconut waste such as coconut fibers and shells; and crops that are inter-cropped with coconut such as bananas and rambutan. There are several SEs working across the coconut value chain as small plantation owners, waste aggregators, processors, retailers, and fiber extractors. They supply materials to larger factories and processing units.

Key Challenges in the Coconut Value Chain

- *Shrinkage in area cultivated* – The land area under coconut cultivation has declined significantly in recent years due to the conversion of coconut lands for housing and industrial uses. Although some regions have seen an increase in the land area under coconut cultivation, overall the extent of new cultivation is much less than the area lost. Coconut farming is perceived to be less financially attractive among farmers because the sale price of coconut is low relative to other crops, and the crop also has a long gestation period during which does not yield any income. Experts, however, believe that this is a misperception and farmers can gain additional value from value-added products and inter-cropping cash crops.
- *Limited technical knowledge* – As is the case with tea plantations, in order to maintain soil health replanting and inter cropping is required. Lack of sufficient technical knowledge about high yielding plants, inter cropping techniques, pest control and limited land has further reduced coconut yields.

8.3 Paddy

Paddy production in Sri Lanka is largely for domestic consumption. Rice (paddy) is grown both in large plantations as well as on small farms by poor small holders who grow rice as a staple for subsistence. Key actors in the value chain, other than farmers and input providers include rice mills that process the rice for consumption, warehousing companies, wholesalers, distributors and retailers.

Key Challenges in the Paddy Value Chain

- *Technology transfer* – Technology transfer in the case of paddy cultivation is a key challenge as the extension network is weak and usually one extension officer covers 10-15 villages.²⁶
- *Variation on agro-climatic zone* – Varied agro-climatic zones and climate along with variable soil conditions make it difficult to identify suitable technology for paddy cultivation.
- *Lack of feedback from farmers* – There is not enough feedback received from farmers about the success of the technology introduced. This makes it difficult to validate technologies for mass adoption.
- *Land ownership* – Paddy lands are being converted to industrial lands because farmers are choosing to sell their lands to real estate developers. This is either because they do

²⁶ Primary research observation

not want to engage in farming as a career, or because they do not find it financially lucrative to farm. The average farmer landholding is gradually decreasing.

8.4 Spices

Spices cultivated consist mainly of cinnamon, pepper, cloves, cardamom, nutmeg and mace. In Sri Lanka, 80,000 hectares, equivalent to 6 percent of land used for perennial crops, is used for spice cultivation.²⁷ Over 200,000 small-scale growers are involved in spice cultivation; 70 percent of production comes from smallholder farm units of less than one hectare of land.²⁸ The spice industry in Sri Lanka is characterized by decentralized purchasing, low-quality product purchases and sales, and the presence of a number of intermediaries such as travelling collectors, village traders, wholesale buyers, commission agents, and auction brokers. While these intermediaries are sometimes the only link to markets for some farmers, there are instances where they exploit the farmers by buying their produce at significantly below market rates.

Key Challenges in the Spice Value Chains

- *Low productivity* – Due to a lack of technical knowledge, spice growers pay little attention to soil health, which deteriorates gradually, and greatly affects both the quality and yield of spice crops. Productivity improvement programs have so far been unsuccessful in implementation – largely because they are labor intensive.
- *Sub-par quality of product* – The quality of spices produced by small holders is generally lower than that expected by large domestic buyers and international buyers. This is due to a combination of lack of technical skills, as well as lack of appropriate infrastructure to store and process spices.

8.5 Fruits and Vegetables

Sri Lanka produces more than 800,000 metric tons of fruits and vegetables annually and exports both fresh and processed varieties to many destinations around the world.²⁹ Ninety percent of the fresh product is targeted at the Middle East and the Maldives. Nearly 75 percent of the processed products are for the European market.³⁰

Key Challenges in the Fruits and Vegetables Value Chains

- *Inputs and Technology Adoption* – Imbalanced fertilizer use, improper pesticide use, inadequate availability of new high yielding varieties, and inadequate use of modern techniques have resulted in low yields.
- *Value addition* – Lack of capital and farmer group activities to set up processing facilities have resulted in low value addition.
- *Wastage* – Inadequate availability of post-harvest storage and transport facilities, high incidence of pest and disease result in a significant amount of wastage.

²⁷ Institute of Policy Studies of Sri Lanka, Regoverning Markets report, 2006

²⁸ *ibid.*

²⁹ Sri Lanka Export Development Board.

³⁰ *ibid.*

9. Opportunities for Oxfam and Other Development Agencies

There have been significant efforts by Oxfam and other INGOs to develop the livelihoods of millions of families that rely on agriculture in Sri Lanka. Existing programs have provided training, capacity building, organization building, access to farming technology and equipment, and access to financing. These efforts have been particularly beneficial to war and tsunami-affected communities in the Northern and Eastern provinces. Several communities had lost their means of livelihood multiple times due to the war and the tsunami. These communities have only recently begun to thrive in a stable social and economic environment.

We believe that a continuation and intensification of this effort will accelerate the journey of these communities from a life of poverty and instability to one of financial self-sufficiency and dignity. The opportunity for intervention lies in five key areas: training and capacity building, leadership development, market and supply chain linkages, strategic market coordination, and access to finance. Oxfam's current programs have been working in all of these five areas. We have aimed to highlight opportunities that could supplement or augment the impact of current interventions.

9.1 Training and Capacity Building

Latest farming techniques to improve productivity and labor efficiency

Improving productivity and efficiency is an essential step to improving farmer incomes in any community. It is even more crucial in the context of Sri Lanka where labor is expensive compared to other regional competitors. Identifying, developing and spreading the use of the latest farming technologies that reduce reliance on manual labor and other expensive resources such as electricity, while improving yield, could significantly increase farmer incomes, and make Sri Lanka more competitive as an agricultural export market.

Improved farm management skills

Interventions to improve farm management skills could significantly improve agricultural product quality and farmer incomes, while reducing wastage. Due to a lack of knowledge about inputs, such as chemical fertilizers and pesticides, farmers often misuse these products on their farms. This not only increases their costs but also adversely affects the quality of produce. In addition to this, there is tremendous potential for complementary farm income sources such as dairy, compost making, and biogas production. This potential currently remains untapped. Farmers also lose a significant percentage of their produce to spoilage and wastage. Small investments, such as crates for vegetables or refrigeration of milk at the appropriate time, can reduce spoilage significantly. Many small farmers are currently unaware of these modern farm management techniques that yield tremendous economic benefits. Oxfam and other development agencies have provided technical skills to farmer organizations they work with. These efforts can be intensified by offering additional trainings and learning opportunities to farmers. Farmers can also be encouraged to travel to neighboring countries in the region to study best practices.

9.2 Leadership Development

Strong leadership skills at organization and community levels

Identifying and developing promising leaders that can unify farming communities could yield significant power to producer communities. Leaders of large cooperatives and farmer companies have the potential to unify and coordinate a large number of farming families to achieve greater benefits for the community. Identifying people with leadership potential in each of these organizations, and mentoring them over an extended period to develop strong

leadership skills can help organizations achieve their full potential. Specific training in business principles, marketing and communication, negotiation skills, and organizational governance will be highly beneficial.

9.3 Market and Supply Chain Linkages

Accessing markets for their products at attractive prices was reported as one of the major inhibiting factors to growth of agricultural SEs. This held true for community-based cooperatives, farmer companies, and privately owned SMEs alike. While some organizations struggle to find markets at the right time, others struggle to command the right price. We believe this issue can be addressed through two main interventions:

Improved access to price information

Increased access to market price information of various products will help reduce volatility in market prices, increase farmer incomes, and reduce wastage. Information about daily prices can be relayed to farmers through mobile phone-based applications. This can help farmers negotiate with the middlemen that buy their produce, and make the decision to sell at a date when prices are more attractive. Over time, with information asymmetry reduced, the market will also be less volatile.

Wider access to markets

Community organizations and small businesses are currently only able to access local or regional markets for their products. In the north and east, access is often limited to small vendors in nearby towns. Vendors and middlemen exploit their monopsony to buy at low prices from farmers, capturing a disproportionately large share of the product value. Creating channels for wider market access through coordinated fair-price purchasing and marketing of produce, and potential linkages to export markets could help significantly increase farmer incomes.

9.4 Strategic Market Coordination

Better coordination among farmers to control supply

Farmers often receive lower prices for their produce because there is an over-supply in the market. Simultaneously, other essential food products may be in short supply, forcing farmers to sell their produce cheap and buy expensive food products for survival. Educating farmers about basic market demand, supply, and pricing economics would help them make better decisions about the crops they choose to produce. Cooperatives and FCs can then discuss their production plans and take collective decisions on production from each member farmer. This could significantly reduce wastage due to oversupply, control price volatility, and increase farmer incomes.

9.5 Access to Finance

Better financing terms

While farmers and SEs have access to credit through various regional development banks via linkages from cooperatives, the terms of credit are difficult. High interest rates and requirement for land as collateral are prohibitive for some smallholder farmers. Development agencies could work to create special credit products for farmers that cater to their needs and constraints.

10. An Agribusiness Incubator As the Solution

We believe the opportunities highlighted above can be realized by strengthening the ecosystem to support SEs. An integrated agriculture SE support service that aims to strengthen SEs and help them access different types of capital (including impact investment) could catalyze the growth of SEs in agriculture value chains. In the long term, this would include SE ecosystem building activities such as advocacy, research, sources of local investment capital, and capacity building for practitioners and intermediaries, as shown in Figure 3.

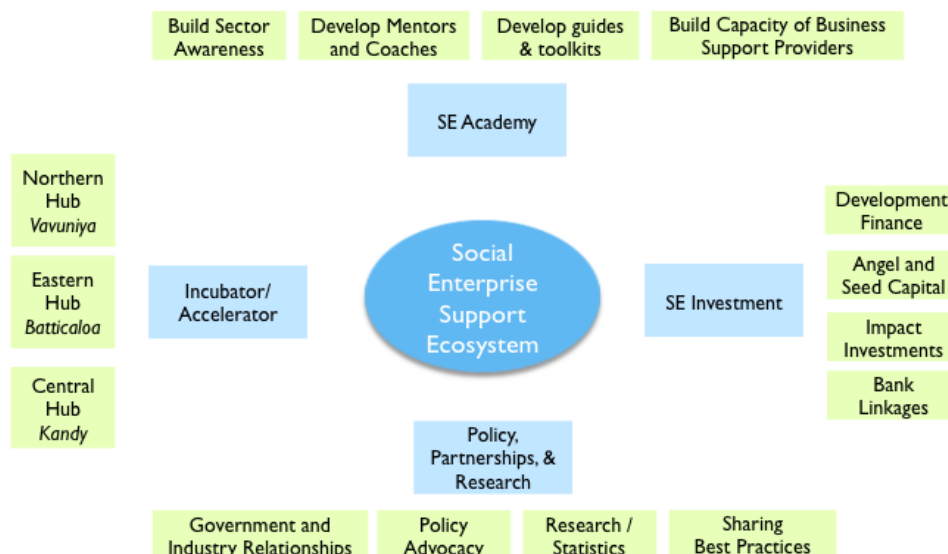


Figure 3: Vision for SE support ecosystem

Central to this vision is an SE incubator/accelerator offering that could strengthen high-potential SEs from across the country. We believe that this should be the first step in strengthening the ecosystem support of SEs because it can have direct impact on the ability of SEs to achieve growth and success. An incubator may also be operationally and financially the most sustainable strategy for supporting SEs.

10.1 What is an Incubator?

There is no uniform definition for incubators - they vary in design and service offering. The main objectives of an incubator are to help SEs achieve scale, financial stability, and investment readiness.

Incubators typically provide support to SEs through a combination of four approaches: advisory centric, facility centric, investment centric, or management and governance centric. It is important to note that the business model and financial stability of an incubator depends largely on the approach it takes and the institution that houses it. To varying degrees, depending on which of the four approaches mentioned above they follow, incubators provide SEs with key resources such as working space and supporting infrastructure, management support, investor connections, marketing, financial planning, and business development.

10.2 Why are Incubators important?

Incubators and accelerators serve as an important part of the enterprise development ecosystem. In developed economies, such as the US, incubators and accelerators have formed the testing ground for many successful and disruptive innovations. Most incubators work closely with the investor community to raise investments for the enterprises they incubate. Investors also see reputed incubators as reliable sources for generating quality deal flow. Incubators and accelerators are most valuable for first-time entrepreneurs and those with limited personal and professional networks. Through their focused support and network of mentors and investors, incubators help entrepreneurs refine their ideas and bring them to investor-readiness. Global research shows that attending an incubation program greatly improves the survival and success rate of enterprises that often lack the support needed for their growth owing to the difficult market conditions that they work in. Incubators also help the economic development of a country by promoting self-employment and creating jobs.

10.3 Incubator Service Offerings

Based on the overall approach they take, incubators can offer a range of services to the enterprises they work with. Please see below for a selection of services typically offered by incubators within each of the four approaches.

Business Advisory-Centric Services

SE incubators often provide advice in the following aspects of business:

- *Finance:* Financial management is an important aspect of business that incubators address. They help SEs with bookkeeping, payroll and tax reporting, evaluating financing proposals, financial planning for scaling and due diligence, credit/risk assessment, and managing their costs effectively.
- *Legal:* Incubators help SEs with regulations and compliance and assist them with intellectual property management and other legal issues. For SEs, incubators also assist in identifying the right legal form for the enterprise – for-profit, not-for-profit or hybrid and help them establish an appropriate membership and share structure.
- *Business Plan Development:* Incubators help evaluate and refine the business and operational models of the enterprises they support.
- *Business Development:* Incubators and accelerators help enterprises with their business development by connecting them to new markets and potential customers, and identifying new revenue streams.
- *Marketing, Branding and Communications:* Incubators help enterprises with market sizing, branding, marketing communications, and go-to-market strategies for their products and services.
- *Impact Assessment:* Impact measurement is an important aspect of being an SE. Impact investors and donors frequently require third-party verified assessments of a SE's impact during the capital raising process. SE incubators often also provide support in establishing basic frameworks for impact measurement.

Investment Centric-Services

Investment support is a crucial service provided by incubators and most of them provide investment support through the following ways:

- *Direct seed capital:* Some incubators provide seed capital upon graduation, or stipends during incubation to help enterprises pilot or launch their ideas.

- *Connections to investors:* Incubators also connect enterprises to seed-stage, angel, private equity, and venture capital investors. In the case of SEs, incubators focus on connecting enterprises to impact investors or showcase SEs through a platform where accessibility to impact investors is high.
- *Investment-readiness services:* Some incubators also include “investment-readiness” assessment and support, advice to enterprises on the appropriate amounts and type of capital they need, and identification of ideal sources of capital. Incubators also help enterprises develop the appropriate communication materials needed for capital-raising.
- *Investment terms advisory:* Incubators also provide guidance on formulating and negotiating investment terms that are fair to the enterprises.

Governance and Management-Centric Services

Early-stage enterprises often need support establishing the right governance and organizational management systems. Some incubators provide such services:

- *Governance:* Incubator partners or management committees take a position on the advisory board or board of directors of the enterprise, either as a volunteer or with a minority ownership and voting rights, to guide enterprises through their journey to scale.
- *Management:* Incubators support key management functions such as hiring, leadership training, and team building through workshops and trainings. For example, Dasra, an incubator based out of India, provides executive training programs for SEs, empowering them with the networks and skills to help them scale.

Infrastructure and Facility-Centric Support

Early-stage enterprises sometimes lack basic infrastructure to support operations as they establish their businesses. Some incubators focus on providing business support facilities in the form of office space, meeting rooms, conference facilities, training rooms, computer, library of professional literature, fax, telephone, printer, scanner, internet, copier, etc. Some incubators also provide laboratory support for product testing and development.

10.4 Legal Structure

The legal structure of a SE Incubator depends on the type of SEs it chooses to support, and its funding sources. Incubators that support only not-for-profit SEs are generally registered as non-profit-organizations with public charity status. Incubators that are housed in a university or receive support from university in the form of grants or infrastructure are also generally registered as not-for-profit organizations or run independently as university-supported centers. Incubators that work with for-profit, not-for-profit and hybrid enterprises are usually set up as limited liability companies (LLC). The following table lists the advantages and disadvantages of the possible legal forms in Sri Lanka based on our interviews with various organization types. This can be studied in more detail in the next phase as we undertake a feasibility study:

Legal Structure	Advantages	Disadvantages
Non-profit organization with Public Charity status	<ul style="list-style-type: none"> • Can raise grant money from international NGOs, development agencies, government agencies, individual donors, and CSR programs of companies more easily than private limited or limited liability companies 	<ul style="list-style-type: none"> • May be more focused on meeting impact metrics of donors than the efficacy of services in creating sustainable businesses • May have to spend more time fund-raising as that is the only source of income

	<ul style="list-style-type: none"> • Services focus largely on ensuring success of SEs, and not profitability of the incubator 	<ul style="list-style-type: none"> • Number of companies supported solely depends on external funding available • Cannot have income from sale of equity in the incubated enterprises as one of its revenue streams
For-profit organization with Private Limited status	<ul style="list-style-type: none"> • Can raise money from donors as well as investors • It can also generate income from sale of equity in the incubated SEs 	<ul style="list-style-type: none"> • Obtaining grants from development agencies, government agencies and international NGOs may be difficult. • Usually more selective due to limited resources and capital; may support fewer SEs as compared to not-for-profit incubators • Focus on profitability – may limit ability to serve those SEs which most need assistance
Limited by Guarantee Companies	<ul style="list-style-type: none"> • Cannot raise money from investors that seek financial returns. Profits can only be distributed to members • Can generate income from sale of equity in the incubated SEs 	<ul style="list-style-type: none"> • A limited liability incubator has the same disadvantages as a private limited organization
University or Research Center Initiatives	<ul style="list-style-type: none"> • Can be non-profit or for-profit • Can raise money from all sources – donors and investors. However, separate legal entity may be required for investments • Direct access to academic professionals and resources 	<ul style="list-style-type: none"> • Must comply with the general strategy, approach, and ideology of the university or research center

10.5 Operational Models

Incubators engage with SEs in different ways depending on the objectives and resources of the incubator, and fit with the needs of the SEs. The following are some of the common operational models for incubators globally:

Residential or Brick and Mortar model

Some SE Incubators offer residential programs in which the incubation process is carried out at a co-working space provided by the incubator. Residential programs offered are usually 2-3 months long and are conducted either once or twice a year depending on the needs and availability of SEs. Some programs last as long as 6-12 months. Enterprises are typically selected for incubation through a cyclical application process. Each cohort of SEs then “resides” within the office space provided by the incubator for the duration of the program. During this program, they are typically provided a combination of classroom knowledge of business, finance, and marketing concepts and mentorship from industry experts and professionals. For example, the Entrepreneur-In-Residence program offered by Villgro, an SE Incubator based out of India, offers a 12-month residential incubation program. Through dedicated incubator staff and mentors the program offers full-time support to incubated enterprises.

The most significant advantage of this model, as cited by entrepreneurs, is peer learning. Since all SEs are housed in the same facility, there is an opportunity for regular interaction. This also gives entrepreneurs the opportunity to engage with other enterprises as business partners,

suppliers or buyers of their products and services. Some entrepreneurs believe that being in an incubation program also gives them the opportunity to analyze and refine their business models in an environment that is isolated from their regular business activity. However, sometimes, it is not possible for SEs, particularly those working in agriculture, to attend a residential incubation program and spend 2-3 months or more away from their places of work. Due to this constraint, agricultural enterprises are generally under-represented at residential SE incubator programs. Also, since residential incubators are constrained by space and human resources, they can only provide support to a small percentage of SEs that applies.

Excubator model

Excubator models exist in situations where it is not feasible or necessary for entrepreneurs to physically spend an extended period of time at the office space provided by the incubator. Excubators provide bundled services based on the needs of SEs. Excubators pair SEs with mentors and service providers based on their specific needs and establish a steering committee to support and oversee the progress of the enterprises over a period of time for which the services are provided. Mentors and service providers in this model are usually employed full-time. An excubator largely works like an advisory firm or mentorship program that renders specific services for a fee. Typically, excubators do not take equity stakes in companies and are not mandated or incentivized to raise capital. Chicago-based Ensemble is an example of an excubator – albeit in a different context and geography. Ensemble provides basic startup services such as startup consulting, technology development, search engine optimization, social media marketing, and public relations. Entrepreneurs do not have to work with multiple vendors and can get all the support they need from one source.

One advantage of excubators over residential models is that an excubator can support a company from ideation to expansion stage as long as the company is willing to pay for the services. Residential models support enterprises for a limited duration of time after which the enterprises receive only minimal support. Another advantage is that excubators are relatively less resource intensive than residential incubation programs. Disadvantages are that such a program has enterprises working in isolation and does not provide networking opportunities with other enterprises.

Virtual or Online model

Virtual or online incubation models take various different approaches to providing support services. In some cases, SEs attend a “boot camp” that typically lasts 1-2 weeks, and are then supported by the incubator virtually – through mentorship and online service provision – for a further period of 4-6 months. At the boot camp, enterprises are typically introduced to key business and financial concepts, fundraising strategies, and marketing and business development strategies. The incubation process is not carried out at a physical facility but support and services are offered over the internet. SEs get access to workshops, networking events, quarterly gatherings, and are supported through experts on different aspects of business. For example, Global Social Benefit Incubator, based out of USA, organizes a 10 day in-residence program for entrepreneurs as part of the incubation process and then supports SEs for the next 10 months online by pairing them with two Silicon Valley executive mentors and one local mentor. In other models, SEs may only be supported virtually by a network of mentors, complemented by a network of local service providers such as lawyers, accountants, and recruiters. For example, VC4Africa is an open and accessible online platform for entrepreneurs in Africa and investors across the world whose primary focus is to let the members of the platform tap the combined knowledge and resources available that exist across the member base. To ensure quality, VC4Africa screens member, investor and venture applications before they are approved or given access to the site.

The main advantages of this model are that such incubation programs can be accessed by SEs from different regions and that such programs do not require entrepreneurs to relocate to receive incubation support. In addition to that, the support can be tailored to the specific needs of the enterprises. Participation in boot camps can provide some peer learning and networking benefits of longer residential incubation programs. Enterprises can receive customized support and services and do not have to go through a pre-set incubation program. However, this model requires a high level of computer literacy and access to the Internet – which may not be a reality for agriculture enterprises in developing countries.

10.6 Revenue and Funding Sources

Incubators and accelerators can generate revenues and other sources of funding through many different sources, based on their organizational objectives and the services they provide. Globally, only a small percentage of incubators are financially sustainable through revenues generated by fees and equity returns. Regardless of their operating model, most incubators fund their operations through a combination of the following sources:

Grants

Grants from foundations, such as the Bill and Melinda Gates Foundation, Ford Foundation, Lemelson Foundation, and government agencies, are major sources of funding for SE Incubators. SE Incubators that are part of academic institutions are also funded by grants from the institution, its backers, or are supported by the institution in the form of free or subsidized access to workspaces and other infrastructure facilities. Development Finance Institutions (DFIs), such as the World Bank and Department for International Development, UK (DFID), play an important role in establishing incubators in developing countries. DFIs provide grant funding for the initial establishment and operations of incubators until the incubators attain financial sustainability. For example, the World Bank provided a grant of USD 500,000 to establish the Agri-business and Innovation Platform (AIP) in partnership with International Crops Research Institute for the Semi-Arid Tropics (ICRISAT) and the Department of Science and Technology (DST) of the Indian government. The AIP is a financially sustainable program today with operating revenues of INR 50 million (~USD 800,000). Grant support can also come from successful entrepreneurs or professionals with keen interest in the field of social entrepreneurship. For example, Unreasonable Institute, a successful SE Incubator based out of the United States, currently covers 25% of its budget through fees paid by the ventures attending the institute and the remaining 75% through grants and donations from Halloran Philanthropies and individual mentors.

Corporate Sponsorships

Corporations play an important role in both establishing and operating incubators globally. Some global corporations such as Microsoft, Philips, and Samsung run in-house innovation centers that accept idea-stage companies for incubation. These incubators are completely funded by the host corporation as a part of their corporate or research and development budgets and provide valuable services such as product development and testing for low or no cost to incubated enterprises. Other corporations offer support through sponsorships, donations, or assistance in the form of key products or services. For example, Microsoft supports 1M/1M, a virtual incubator based in Silicon Valley, through its Bizspark grant program. Through this program, Microsoft offers key enterprise services and technologies free of cost to participating enterprises for one year. Hewlett Packard, along with other large corporations provides monetary support through sponsorships for selected enterprises at the Unreasonable Institute.

Program Fees

Some incubators are able to cover all or part of their operating costs through revenues generated from fee-based programs and services. The enterprises that join the incubation program pay fees for the services they receive. This is typical for excubator and virtual incubation models as well as for facility-centric incubation models where the incubator provides services that the enterprise would otherwise need to acquire elsewhere. Incubators may also earn revenues by organizing fee-based workshops, seminars, training sessions, and networking events. These events can be open for all enterprises and entrepreneurs regardless of whether they are part of the incubation program. SEs may also pay an annual membership fee to access events and services. Incubators may also earn advisory and transaction fees from investors when they decide to invest in an SE supported by the incubator.

Equity

An equity-based model for funding SE Incubators can exist in cases where for-profit companies participate in the incubation process. In an equity-based model, a SE Incubator takes equity stakes in incubated enterprises and generates income from successful exits from these equity stakes. This is most often seen in residential incubator models, and rare in excubator and virtual incubation models, which rely primarily on fees for revenues. The equity based revenue model is rarely the prime source of revenues even for residential incubators. This is an unpredictable revenue stream because successful exits are not guaranteed. This source of revenue is also unable to sustain operations in the first few years when there are no exits. However, an equity-based revenue model may be expected to produce the most high-quality enterprises because the revenues of the incubator are directly aligned with successful investments in the enterprises incubated.

10.7 Considerations for Incubator design in Sri Lanka

Based on our research and interviews with SEs and other organizations in the ecosystem, we understand that the agribusiness incubator service in Sri Lanka cannot be modeled after similar services in developed countries. In the following section, we aim to highlight the constraints, needs, and outreach goals that should be considered while designing the incubator services.

- **Geographical prevalence of organization types:** While FOs and FCs are present throughout the country, they are more prevalent in the north and the east where in some cases they are the only source of commercial activity for the communities in which they work. SMEs tend to exist in larger numbers in the south and the west, which have been economically more stable over the last few decades.
- **Location of organizations:** While there are a few SEs located in urban areas with access to highways and roads, the majority work in rural areas. Commuting to urban centers to receive support and services can prove tedious and expensive for these organizations. Also, most SEs are led by people who are farmers themselves and need to tend to their field on a regular basis.
- **Attitude toward farming as a business:** Several FOs and FCs have traditionally relied on government and grant funding for support. This is particularly true in the north and the east where aid continues to pour in. It will require an attitude shift for farmers to see farming as a self-sustaining business. It needs continuous and intense support over a relatively long period of time (1-2 years) to bring about such an attitude shift.
- **Women entrepreneurs:** Women have only recently started participating in the leadership of SEs. Several of these women are war or tsunami affected widows. In addition to earning their livelihoods they need to care for their children. The incubator model will need to adapt to the specific needs and constraints of these women.

- **Ability to pay for services:** Most SEs are resource and capital constrained and would not be able to pay a large sum of money for services. While entrepreneurs reported investing in technical trainings to up-skill themselves, these were relatively smaller amounts (less than LKR 10,000 for 6 months).
- **Academic institutions as partners:** Agriculture focused academic institutions in Sri Lanka have traditionally not been integrated with practitioners. While financial resources for contribution to a program will be less feasible for them, knowledge and implementation partnerships could be practical.
- **Types of challenges faced:** Generally, challenges faced by FOs and FCs are similar in nature and related to technical skills, management skills, market access, and organizational structure. Challenges faced by SMEs are less homogeneous and vary depending on value chain, geography, and entrepreneur background.

11. Present Incubators in Sri Lanka

Incubation is still a novel concept in Sri Lanka, and there are few established incubators at present. In the agriculture sector, incubators can be found supporting enterprises with market linkages, retailing, branding and packaging. The following are descriptions of some of the current and past incubator programs operating in Sri Lanka:

11.1 Ruhuna Business Incubator, University of Ruhuna

Ruhuna Business Incubator was established in 2003 with funding from Southern Development Authority, Ministry of Commerce, UNIDO and support from the university's agriculture faculty. The incubator was established as a residential model and was spread across 5 acres with 11 independent buildings within the university campus each housing one SE. The incubator also provided seed capital for computers, technology and facilities such as printer, scanner, telephone, etc. SEs being incubated were charged LKR 500 per month for electricity, water and rent. Other operating costs of the incubator were covered through grant funding. The incubator was registered as a public company under the Companies Act. After an initial operation period and exhaustion of the grant support, the incubator had to shut down. In 2007, it was converted into an R&D center for the coir (coconut fiber) industry with grant support from the World Bank. Those associated with the incubator cite several reasons for the incubator's inability to sustain operations and revenues. Inability to attract quality enterprises, lack of willingness to pay for higher fees to cover the cost of providing services, distance of the incubator from Colombo, and inability to attract necessary human resources were cited as some of the key reasons. Moreover, being housed in different offices did not make the environment conducive for peer learning, encouraging interaction between the enterprises, and keeping the entrepreneurs motivated.

11.2 Rural Enterprise Network

Rural Enterprise Network (REN) was set up as a micro-enterprise support pilot project of Practical Action in 2004, to develop micro and small enterprises. REN is set up as a guarantee limited company that operates as an incubator to support SEs. It offers business incubation services for rural producers facing the challenge of accessing markets, both locally and internationally. It provides a suite of services such as marketing, branding and packaging technology for food processing. It also advocates pro-poor and pro-rural policies with local and national government agencies. It supports SEs in business idea generation, business management, quality maintenance, production technologies and farmer mobilization. It works with over 1000 farmers engaged in different crops. Until 2008, it provided its services to only farmer groups but now works with individual farmers too. Currently, it engages over 82 farmer

organizations and 500 individual farmers. REN works as an aggregator, marketing agent, and export agent for the agricultural produce for its supported farmers. While the REN does not directly charge for the services provided, it does keep 15-20% of the export revenue earned to cover its administrative costs. Ninety percent of revenues earned by participating farmer groups is generated from export markets. This is a proven model that has potential to scale and support thousands of more individual farmers and farmer groups in Sri Lanka. REN staff told Shujog during research interviews that the incubator needs additional funding for scaling its operations.

11.3 SABAH Association

SAARC Business Association of Home Based Workers is a network of Sri Lankan women food producers funded by the SAARC Development Fund (SDF). It is being facilitated by Practical Action – an organization that aspires to develop trade facilitation on behalf of home-based workers. SABAH operates in an incubator-like model where it provides local trainings to home-based producers in food technology and business and management skills, marketing and branding support, and information on market prices and quality standards. It offers home-based producers an opportunity to engage with a network of producers, marketers, retailers, financiers, and exporters. SABAH also offers its members opportunities to market their products under the umbrella network of SABAH and increase their competitive edge as producers. SABAH works in 10 districts across the country and supports home-based 858 members. SABAH gives the members access to export markets and supermarket chains. It generates revenues from the LKR 10 million worth of goods it sells. SABAH earns a 10% margin on the sale of this merchandise.

11.4 Sri Lanka Agriculture Incubator Success Factors

Based on our conversations with the management of the three incubators discussed here, the following are some of the key success factors in ensuring sustainability and effectiveness of incubators.

- Donors provided the initial capital for setting up the incubator but empower and enable the incubator staff to manage the incubation process.
- Incubation program is implemented by individuals with significant business, entrepreneurial, and investment-raising experience.
- Incubators are effective in providing network and connections, business planning advice, and access to capital, in addition to basic facilities and infrastructure.
- Incubators are able to provide international market linkages and training support for export quality production when needed.
- Incubator is located in an urban center with convenient access to the right talent and markets.

12. Current Needs and Constraints of SEs by Company Type and Stage

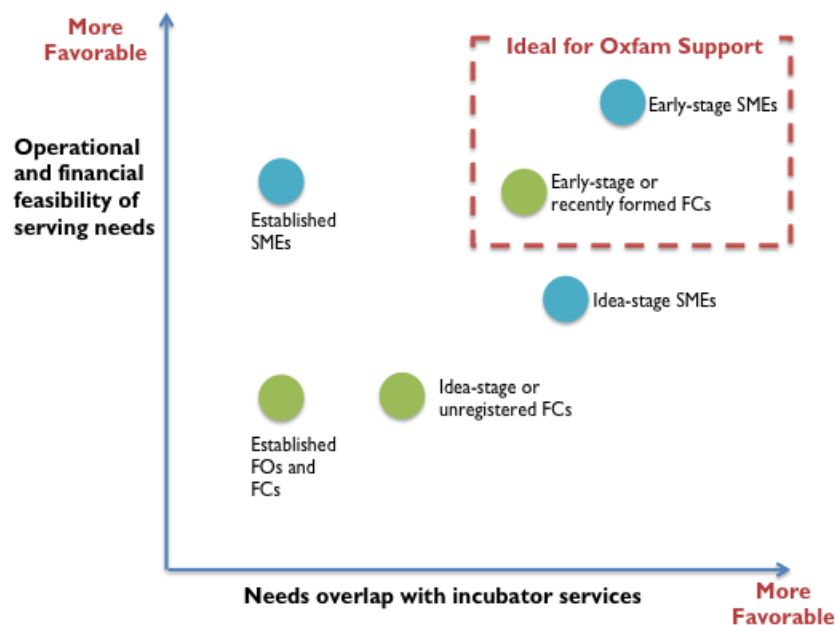
The challenges and needs of SEs in Sri Lanka vary by the types of SEs and the stage of operation – established, early-stage or recently formed, and idea-stage or unregistered. The following table summarizes the challenges and needs of the six types of SEs:

	Established	Early-Stage	Idea-Stage
FOs and FCs	<i>(Mostly FOs)</i> <i>Needs:</i> <ul style="list-style-type: none"> • Market-orientation and business awareness 	<i>(Majority FCs)</i> <i>Needs:</i> <ul style="list-style-type: none"> • Farming technologies training 	<i>(Mostly FCs)</i> <i>Needs:</i> <ul style="list-style-type: none"> • Farmer mobilization and group formation

	trainings <ul style="list-style-type: none"> • Farming technologies training • Market linkages <i>Challenges and constraints:</i> <ul style="list-style-type: none"> • Located in remote areas • Political motivation of leadership may hinder business progress. 	<ul style="list-style-type: none"> • Market linkages and business development support • Business and financial training • Leadership and organizational development <i>Challenges and constraints:</i> <ul style="list-style-type: none"> • Located in remote areas 	<ul style="list-style-type: none"> • Farming technologies training • Business and financial training • Leadership and organizational development <i>Challenges and constraints:</i> <ul style="list-style-type: none"> • Located in remote areas • Long time before company is operational
SMEs	<i>Needs:</i> <ul style="list-style-type: none"> • Access to finance • Access to farming technologies • Access to export or high value markets <i>Challenges and constraints:</i> <ul style="list-style-type: none"> • Financing is key constraint – may have exhausted current financing options. Would require new sources of capital 	<i>Needs:</i> <ul style="list-style-type: none"> • Farming technologies training • Market linkages and business development support • Business and financial training • Leadership and organizational development • Access to finance 	<i>Needs:</i> <ul style="list-style-type: none"> • Farming technologies training • Product development and testing services • Market linkages and business development support • Business and financial training • Leadership and organizational development • Access to finance <i>Challenges and Constraints:</i> <ul style="list-style-type: none"> • Product or service development is one of the key needs and may be an expensive process

An incubator approach may not be appropriate or feasible for all the six SEs categories discussed above. The chart below maps each of the six categories according to the two key criteria used to select the types of SEs most appropriate for incubator support services – the operational and financial feasibility of serving their needs, and the overlap between the type of support they needs and the services an incubator can provide.

Established FOs and FCs that have traditionally been supported by government grants and NGO programs may not have the business orientation and progressive outlook required for incubation support. It will require regular market and business awareness programs over a long period of time to orient some of these organizations toward taking a business approach to agriculture. On the other hand, idea-stage FOs and FCs (the ones that have not been formed or registered) require support for farmer mobilization and group formation. This is a long process and has traditionally been done by NGOs who might still be best suited to provide such support.



Established SMEs – those that have been in existence for over 3 years – require mostly technology support or access to financing. Established enterprises have the resources to access such support from government SME support programs, agricultural departments of universities, and financial institutions. Their main constraint seems to be access to financing, as they may have exhausted any available financing options. Hence, supporting these enterprises would mainly

require identifying new sources of capital – while this is one of the functions an incubator could offer, other forms of incubator support are less useful for established SMEs.

Early-stage enterprises are most favorable for incubator support because supporting them is most financially and operationally feasible. These enterprises are more likely to be in a position to pay for support services than either idea-stage enterprises or FOs or FCs, and can be supported by a relatively lean incubator team. Most of the assistance they need is in line with the services that can be provided through an incubator model. Idea-stage enterprises are also favorable for incubator support for similar reasons. However, supporting them may require additional resources such as laboratory and scientific facilities – making it relatively more expensive and operationally challenging to support them.

Recently formed FCs could also be supported by an incubator model because their needs overlap with the services that can be supported by incubators. However, their rural remote locations, inability to relocate, and need for long term support makes it operationally challenging to support them.

13. Potential incubator models for Sri Lanka

Based on the discussion above, we believe that incubators might best serve the needs of early and idea-stage enterprises, and recently formed FCs. The following are illustrative models to support each of these three types of SEs:

Model 1	Idea-Stage SME Incubator
Description	Invite entrepreneurs at idea-stage of their ventures through an application process or competition. Help develop their ideas through interaction with business and agricultural experts. Provide training and capacity building support for entrepreneurs and founding teams. Help entrepreneurs identify and procure key resources to start the business – including personnel, technologies, and investments. Provide business support services to assist with company formation, etc. The incubator would take a combination of

	facility centric, business centric and investment centric approaches to providing services.
Type of Interaction	Residential program with entrepreneurs spending 12-16 weeks with a cohort of selected participants. Entrepreneurs would also receive support from mentors over a period of 1-3 years after initial incubation.
Location of Incubator	Major urban center with access to agricultural enterprises, universities, experts, mentors, and investors.
Target SEs	SEs at idea-stage: Entrepreneurs with innovative ideas in the agricultural sector that articulate clear objectives of social impact and financial sustainability. These entrepreneurs could be in any crop value chain, and their products or services could apply to any part of the value chain. However, they should be innovative, business-oriented, geared toward financial sustainability, and demonstrate clear social impact.
Resources Required	<p><u>Program development:</u> Pre-launch program development with advisory team to design service offerings, develop content, develop relationships with experts and mentors, and liaise with partners and donors.</p> <p><u>Implementation:</u> Office space and equipment; Agriculture experts; Business expert and coach; Program staff for management, marketing administration, training, and monitoring; Marketing channels and resources; Laboratory and scientists for scientific testing and product development</p> <p><i>Estimated staff requirements:</i></p> <ul style="list-style-type: none"> - One FTE Program Manager - Two FTE Program Implementation Staff (conduct trainings, provide business support) - One FTE Admin (office maintenance, organizing logistics for trainings) <p><i>External in-kind or low cost support requirements:</i></p> <ul style="list-style-type: none"> - Mentors and field experts – at least one per enterprise incubated - Laboratory and product development facility
Comparable Models	<p><u>Y-Combinator:</u> a technology incubator based in the Silicon Valley selects the most promising ideas in digital technology to support from idea-stage to launch. Selected companies move to Silicon Valley for 3 months, during which the incubator provides the mentorship needed for entrepreneurs to turn their ideas into businesses. Entrepreneurs are also introduced to startup founders, venture capitalists, lawyers, accountants, journalists, investment bankers, and executives from big technology companies, who may provide investment or other support. Y-Combinator provides seed funding and services to these enterprises in exchange for an equity stake in their company. It is considered one of the most successful incubators worldwide.</p> <p><u>Agribusiness and Innovation Platform (AIP):</u> an agri-business incubator based in Hyderabad in India, AIP was started in 2003 with the support of World Bank, the Department of Science and Technology, and ICRISAT – an agricultural research institute. The incubator is housed in the ICRISAT research center campus, and provides various business support services to idea and early stage startup enterprises in agriculture for a fee. After the enterprises have been selected for support, they can access ICRISAT lab facilities, business experts, co-working space, and advisory services for a fee. The incubator is completely financially sustainable with revenues from fees and consulting services to other incubators globally.</p>

Assumptions	<ul style="list-style-type: none"> • Presence of entrepreneurs with innovative ideas in agriculture, who are willing to leave their place of business to join a residential program • Availability of experts and mentors to execute program services
Illustrative Costs	<ul style="list-style-type: none"> • Residential, idea-stage incubators in developing countries typically spend an average of USD 30,000 – 50,000 per enterprise incubated, depending on their location and types of assistance provided. This is an operational cost in addition to an initial startup cost. Operating costs typically include the following: <ul style="list-style-type: none"> ◦ Marketing and outreach costs for identifying quality enterprises, mentors, advisors, and investors ◦ Program management and administrative costs ◦ Equipment and space rentals ◦ Facilities for prototyping and lab testing ◦ Human resource costs – management and trainers
Proposed Revenue Sources	<ul style="list-style-type: none"> • Grant money for program development and initial setup costs • Corporate sponsorship from large corporations working in agriculture (Nestle, CIC, Hayleys) • In-kind support such as space from agricultural university or corporation • Equity stake in enterprises • Fee for services
Depth and Breadth of Potential Impact	<p><u>Direct impact:</u></p> <ul style="list-style-type: none"> • The program could reach 5-20 entrepreneurs in one application cycle (depending on budget and demand). It could have tremendous impact on the early success of these entrepreneurs. Once they graduate from the program, these entrepreneurs will be equipped with the knowledge and resources to launch their ventures. These early-stage enterprises could provide employment to 5-20 people each in the first two years of operation. • The program will actively seek ideas with potential for high social and environmental impact through innovative technologies or approach. • This model also has tremendous potential for impact at the agriculture ecosystem level if disruptive and innovative technologies are discovered and developed through this channel. <p><u>Indirect impact:</u></p> <ul style="list-style-type: none"> • In the agriculture sector they are likely to engage a large number of producers – increasing the potential for indirect impact.
Advantages	<ul style="list-style-type: none"> • Path to discovery of innovative and disruptive ideas in agriculture • Located in urban area where there is better access to human resources and infrastructure to make the incubator feasible and successful • Proven and replicable models in developing countries • Sustainable and investor-friendly path to enterprise development
Disadvantages and Risks	<ul style="list-style-type: none"> • May be slow to reach and achieve high level of social impact in Northern and Eastern provinces where there is limited economic activity and entrepreneurship ecosystem is underdeveloped • There may not be a stable pipeline of innovative entrepreneurs in agriculture • Agricultural enterprises may be unable to relocate to the urban center

**Preliminary
View on
Feasibility**

This program has moderate to high financial feasibility and moderate operational feasibility assuming there is a steady pipeline of innovative enterprises in agriculture.

Financial:

Residential incubators in developing countries typically incur a cost of USD 30,000 – 50,000 per enterprise incubated. For an incubator that targets 10 enterprises this could imply an operating budget of USD 300,000 – 500,000 per year. From case studies of incubators in developing countries, such an amount seems feasible to fundraise through grants and corporate sponsorships if there is a demonstrable need for services. Incubator may be able to achieve financial sustainability through fees charged for support and services and investment advisory in the long term.

Operational:

An idea-stage incubator typically requires enterprises to relocate to a common facility where one selected cohort resides for the incubation period. This may not be feasible for some entrepreneurs – particularly if they currently rely on farming for income.

Operations rely on availability of quality resources to conduct the training and support services. Mentors and experts will be key to making the incubator successful. Availability of such mentors and experts at a relatively low cost per enterprise will be essential for the operational feasibility.

Marketing and outreach will also be key to making the incubator feasible. Continuously attracting highly innovative enterprise ideas with high potential for social and environmental impact will be key to making the incubator operationally and financially sustainable in the long term.

In addition, the incubator needs to have established relationships with angel and seed-stage investors who can provide the capital needed to turn the ideas into operational enterprises.

Model 2

Early-Stage SME Accelerator

Description

Invite early-stage enterprises to apply for an accelerator program that provides them the assistance they need to grow their enterprises from pilot or early stage to scale. The accelerator will provide a combination of business advisory centric and investment centric support. Technical assistance would aim to refine their business and operational models, identify new markets and marketing strategies, establish proper governance structures for growth, bring enterprises to investor-readiness, and connect enterprises to early-stage investors.

**Type of
Interaction**

Excubator approach with boot camp: Leadership from enterprises spend 1-2 weeks at an early-stage agriculture enterprise “boot camp” that addresses training and development needs across enterprises. Within this cohort, each enterprise is then assigned a mentor/champion that assists with challenges specific to that enterprise over the next 12 months. Mentors will meet with the enterprises periodically. Mentors and champions will also help the enterprises raise any necessary funds for their growth plans over the 12 months following the boot camp.

Location of Accelerator	Major urban center with access to agricultural enterprises, universities, experts, mentors, and investors.
Target SEs	Early-stage SEs: Enterprises that have pilot tested their business models and established proof of concept. Typically these enterprises are registered and have been in existence for 6 months to 3 years. They have a measurable social impact, and are either financially sustainable or moving toward financial sustainability.
Resources Required	<p><u>Program development:</u> Pre-launch program development with advisory team to identify service offerings, develop content, develop relationships with experts and mentors, and liaise with partners and donors.</p> <p><u>Implementation:</u> Office space and equipment; Agriculture experts; Business expert and coach; Program staff for management, marketing administration, training, and monitoring; Marketing channels and resources;</p> <p><i>Estimated staff requirements:</i></p> <ul style="list-style-type: none"> - One FTE Program Manager - Two FTE Program Implementation Staff (conduct trainings, provide business support) - One FTE Admin (office maintenance, organizing logistics for trainings) <p><i>External in-kind or low cost support requirements:</i></p> <ul style="list-style-type: none"> - Mentors and field experts – at least one per enterprise incubated, though each mentor / expert may support several enterprises
Comparable Models	<u>UnLtd India:</u> Supported by UnLtd UK, a charitable organization set up to support social entrepreneurs, and other strategic partners and donors in the social enterprise space, UnLtd works on a franchise affiliate model in India – setting up regional incubators across the country. UnLtd provides one-on-one coaching, networking opportunities, and seed capital to a selected group of SEs through a one-week intense accelerator program, which is followed-up with mentorship and advisory over an extended period.
Assumptions	<ul style="list-style-type: none"> • Presence of early-stage enterprises in agriculture with proof of concept • Availability of experts and mentors to execute program services • Availability of domestic and international sources of investment capital to fund the growth of enterprises supported through the program
Illustrative Costs	<ul style="list-style-type: none"> • Early-stage incubators in developing countries typically spend an average of USD 10,000 – 30,000 per enterprise incubated, depending on their location and types of assistance provided. This is an operational cost in addition to an initial startup cost. Operating costs typically include the following: <ul style="list-style-type: none"> ○ Marketing and outreach costs for identifying quality enterprises, mentors, advisors, and investors ○ Program management and administrative costs ○ Human resource costs – management and trainers ○ Equipment and space rentals
Proposed Revenue Sources	<ul style="list-style-type: none"> • Grant money for program development and initial setup costs • Corporate sponsorship from large corporation in agriculture (Nestle, CIC, Hayleys) • In-kind support such as space from agricultural university or corporation • Equity stake in enterprises

	<ul style="list-style-type: none"> • Fee for services
Depth and Breadth of Potential Impact	<p><u>Direct impact:</u></p> <ul style="list-style-type: none"> • The program could reach 5-20 enterprises in one application cycle (depending on budget and demand). Enterprises that receive support in the early stage have a much better chance of succeeding in the long term than those that do not. At 5-20 jobs per enterprise, these enterprises could collectively create hundreds of jobs within the first 2-3 years after incubation. • The program will actively seek ideas with potential for high social and environmental impact through innovative technologies or approach. <p><u>Indirect impact:</u></p> <ul style="list-style-type: none"> • In the agriculture sector, they are likely to engage a large number of producers – increasing the potential for indirect impact.
Advantages	<ul style="list-style-type: none"> • Relatively low cost per enterprise incubated – administrative and management costs lower than that of idea-stage incubator because the program is not a residential program and does not need laboratory testing or prototype support • Does not necessarily require support from agricultural university since early-stage incubation model does not need laboratory services • Located in urban areas where there is better access to human resources and infrastructure to make the incubator feasible and successful • Proven and replicable models in developing countries • Sustainable and investor-friendly path to enterprise development
Disadvantages and Risks	<ul style="list-style-type: none"> • May be slow to reach and achieve high level of social impact in Northern and Eastern provinces where there is limited economic activity and entrepreneurship ecosystem is underdeveloped. • There may not be a stable pipeline of early-stage enterprises in agriculture
Preliminary View on Feasibility	<p>This program has relatively high financial feasibility and high operational feasibility assuming there is a steady pipeline of innovative enterprises in agriculture.</p> <p><u>Financial:</u> Incubators in developing countries typically incur a cost of USD 10,000 – 30,000 per enterprise incubated. For an incubator that targets 10 enterprises, this could imply an operating budget of USD 100,000 – 300,000 per year. From case studies of incubators in developing countries, such an amount seems feasible to fundraise through grants and corporate sponsorships if there is a demonstrable need for services. Additionally, early-stage enterprises may also have existing revenue streams, allowing them to pay for some of the services provided by the incubator. Long term sustainability can be achieved through fee for services and/or returns on equity stakes in supported enterprises.</p> <p><u>Operational:</u> An early-stage incubator does not require enterprises to relocate to a common facility. After an initial training, support can be provided on-site to enterprises via visits from incubator team, and regular interaction with mentors.</p> <p>Operations rely on availability of quality resources to conduct the training and support services. Mentors and experts will be key to making the incubator successful. Availability of such mentors and experts at a relatively low cost per enterprise will be essential for the operational feasibility. Marketing and outreach will also be key to making the incubator feasible.</p>

Continuously attracting early-stage enterprises with high potential for social and environmental impact will be key to making the incubator operationally and financially sustainable in the long term.

In addition, the incubator needs to have established relationships with early-stage investors, impact investors, and financial institutions that can provide the capital needed to scale the enterprises that graduate from the program.

Model 3	Farmer Company Accelerator
Description	Invite recently formed Farmer Companies (FCs) to apply for accelerator support. A FC accelerator would take a business services-centric approach. It would provide technical and business capacity building services for individual farmers, leadership development program for the organization leadership, and marketing and business development services for the organization. A FC accelerator would also be responsible for setting up appropriate governance structures to ensure continuity post-exit from the program.
Type of Interaction	Similar to an Excubator model: One program implementation staff to be dedicated to supporting 2-3 farmer companies, depending on logistical feasibility (distance, travel time), over a period of 2-3 years. Program staff will conduct business trainings and will identify experts to conduct technical trainings over the incubation period. They will also conduct leadership development trainings for the FC management. Program staff will monitor the growth of individual members as well the organization. They will also be responsible for identifying suitable markets and business development opportunities for farmer cooperatives.
Location of Accelerator	Program Management could be located in an urban location, but will support the implementation field staff located in rural areas.
Target SEs	Recently formed FCs: These are FCs that have organized themselves into a producer group, and have registered as an FC. FCs supported through the program will have clearly articulated goals for social impact and financial sustainability.
Resources Required	<p><u>Program development:</u> Pre-launch program development with advisory team to identify service offerings, develop training content, develop a timeline and work plan for support, and liaise with partners and donors.</p> <p><u>Implementation:</u> Vehicles for field staff; Personnel with experience working with FCs, business acumen, and marketing connections; Program administrative staff for management, FC outreach, training, and monitoring; Marketing channels and resources; Agriculture experts for technical training</p> <p><i>Estimated staff requirements:</i></p> <ul style="list-style-type: none"> - One FTE Program Manager - 5-10 FTE Program Implementation Field Staff (conduct trainings, provide business support) - One FTE Admin (office maintenance, organizing logistics for trainings) <p><i>External in-kind or low cost support requirements:</i></p> <ul style="list-style-type: none"> - Technical and field experts as needed for technical trainings

Comparable Models	<p><u>One Acre Fund (OAF)</u>: Started in 2009, OAF is a non-profit that supports farmer companies and individual farmers by providing farm inputs on credit to farmers' doorsteps, technical training to improve productivity, and market access through aggregated sales and storage facilities. The organization works with over 130,000 farmers in East Africa, and is funded by individual, corporate, and foundation donors worldwide. OAF also relies on repayment of credit given to farmers and small service fees charged to farmers for their support.</p> <p><u>Rural Enterprise Network (REN)</u>: described earlier.</p>
Assumptions	<ul style="list-style-type: none"> • Presence of recently formed progressive and growth-oriented FCs • Availability of qualified program implementation staff willing to locate to semi-urban or rural locations close to FCs
Illustrative Costs	<ul style="list-style-type: none"> • While there are no benchmarks for such a program, NGOs like Pradan and Technoserve that run programs to support farmer groups over a long period typically need large program teams to offer such support. Rough estimates for such a program suggests that this could cost USD 100,000 – 150,000 per FC (each FC can have hundreds of members) over a period of 2-3 years, and would typically include: <ul style="list-style-type: none"> ○ Human resource costs – management and trainers ○ Program management and administrative costs ○ Vehicle and other field logistics costs ○ Marketing and business development costs ○ External technical training cost
Proposed Revenue Sources	<ul style="list-style-type: none"> • Grant money for program development and initial setup costs • Corporate sponsorship from large corporation in agriculture (Nestle, CIC, Hayleys)
Depth and Breadth of Potential Impact	<p><u>Direct impact</u>:</p> <ul style="list-style-type: none"> • The program could work with 10-20 FCs at time (depending on budget and demand). The intervention would lay the foundation for long term financial sustainability of the organizations, that would collectively provide improved incomes and employment to thousands of farmers. • The program will actively seek FCs that aim to increase farmer incomes and commit to environmental sustainability. <p><u>Indirect impact</u>:</p> <ul style="list-style-type: none"> • Improved standard of living for thousands of families
Advantages	<ul style="list-style-type: none"> • Effectively reach the most economically underdeveloped provinces in the North and East • Large-scale direct impact on farmers
Disadvantages and Risks	<ul style="list-style-type: none"> • High program costs • Limited options for long term financial sustainability of the program – likely need to continue to rely on donor funding • FCs may not be oriented toward business and financial sustainability • Ability to achieve financial sustainability and social impact relies on the capability of the organization leadership • Not attractive for traditional or impact investors
Preliminary View on Feasibility	<p>This program has relatively low financial feasibility and moderate operational feasibility.</p> <p><u>Financial</u>:</p> <p>This program is likely to have high cost per organization supported (upwards</p>

of USD 100,000). In addition, it is unlikely to gain financial sustainability over the long term because the FC structure is not conducive to external equity investment, and farmers are unlikely to be able to pay fees for external support.

Operational:

The FC Accelerator brings support services to the leaders and members of such organizations close to their homes and fields. The quality of services provided by the program will rely heavily on the ability to recruit quality implementation staff. The field staff will need to be proficient in doing business, and have experience working with farmer groups. In addition, they should have substantial experience in marketing agriculture goods. Finding personnel with appropriate experience who are also willing to relocate near the FC locations may be difficult – particularly in the Northern and Eastern provinces.

14. Incubator Recommendations

14.1 Proposed Business Model

Our recommendation is to launch an Early-Stage SE Accelerator along the lines of Model 2 above. Our key objectives are to design a program that is appropriate for the level of post-conflict growth in Sri Lanka, to intensify its support for SEs in agricultural value chain, and to increase the financial self-sufficiency of its programs and activities in the country. An early-stage SME incubator has the potential to meet these objectives because (1) it harvests the potential of SMEs, that form the backbone of developing economies like Sri Lanka, and empowers them to contribute to the economic growth of the country, generate employment, and fuel innovation; (2) supporting early-stage SMEs can have positive effects for the entire value chain because, as they grow, these enterprises work closely with farmers as suppliers, and transfer knowledge and best practices to farming communities; and (3) it is the model with the highest potential for operational and financial feasibility, which makes it ideal as a pilot program given the long term objective of creating a financially self-sufficient support model in Sri Lanka. Based on the success of this model, Oxfam can both increase the support to early-stage enterprises, and extend services to other types of SEs.

We believe an early-stage SME accelerator has the highest potential for operational and financial feasibility. As an incubator, it requires the lowest amount of internal resources and external in-kind support for its operations. An early-stage SME accelerator also has the most potential for generating revenues from fees for services and from equity in enterprises. While the demand for early-stage SME support is more in the Central and Southern provinces at present, as the program grows and there is increased commercial activity in the Northern and Eastern provinces, the program may be expected to benefit enterprise nationally.

The social impact of an early-stage SME accelerator will be tremendous. In the short term (3-5 years) the program will empower high-potential entrepreneurs, help create jobs, increase farmer incomes and opportunities, and help bring systemic efficiencies to agricultural value chains. In the long term, such a program will help create a supportive ecosystem for entrepreneurship in Sri Lanka, and contribute to the economic development of the country.

Proposed key services to be offered by early-stage SME accelerator:

- 2-week “boot camp” training on key business and finance principles, investor pitching, marketing for agribusiness, and impact assessment

- Mentoring and advisory support for 1 year
- Marketing and business development support – including linkages to key markets, product packaging, and branding support
- Investment support services such as “Demo Days” to showcase enterprise to investors; development of investor-ready business plan and investor communication documents

Proposed operational features of an early-stage SME accelerator:

- Bi-annual application cycle to invite high-potential early-stage startups in agricultural value chains. 5-10 enterprises selected for incubation support in each cycle based on their innovative approach, strength of management team, potential for social impact, and growth prospects. The incubator should focus on SEs that are either financially sustainable or have a clear path toward financial sustainability in the future. The Incubator team will need to cultivate relationships with potential investors to ensure that they are selecting SEs for which the market is likely to provide funding
- Selected enterprises invited to a common location (ideally, Colombo or Kandy) for a 2-week boot camp. Each enterprise is matched with a mentor and technical expert during this time
- Mentors and experts work with incubator staff to develop a customized service and interaction plan for each enterprise with clearly outlined deliverables, milestones, and task owners
- Enterprises receive additional remote support by mentors, experts, and incubator team for 1 year. Incubator team monitors the support and services provided by mentors and experts
- Enterprises from one cohort showcased to investors upon graduation from the incubation program through a “Demo Day” at which entrepreneurs pitch their companies
- Incubator team provides certain transaction support services for investments in incubated enterprises

Proposed revenue streams:

- Initial setup: grants from development organizations, in-kind support from government department, university or research center
- Operating revenues: initially through grant and corporate sponsorship; long term sustainability through fees for services provided and equity stake in enterprises

Expected costs and external resources needed:

- Comparable programs spend USD 10,000 – 30,000 per enterprise they support. Shujog will develop more accurate estimates of the costs in the final phase of the research
- The program will rely heavily on pro-bono or low cost support from business and agricultural experts as mentors, and business service providers such as lawyers, accountants, and marketing professionals

14.2 SE Selection Criteria

Academic studies and practitioner experiences suggest that establishing and implementing robust screening criteria can be pivotal to the success and sustainability of incubators and accelerators.³¹ Shujog, based on consultation with Oxfam, recommends the following four criteria for the early-stage agriculture incubator:

- **Early stage enterprises that are already generating revenue and seeking to scale**
 - Enterprises that are legally registered entities in Sri Lanka;
 - Have been operational for more than 6 months, but less than 3 years;
 - Are generating revenues (although may not be generating profits); and
 - Have a vision for achieving growth and scaling operations
- **Can achieve significant social and environmental impact through operations in one or more of the following ways:**
 - Increase assets or income of low income stakeholders or stated beneficiaries
 - Produce direct health benefits or increase knowledge of stated beneficiaries
 - Improve the security or mobility of stated beneficiaries
 - Build social capital through positive impacts on the community in which it works
 - Quantifiable impact on the environment
- **Are able to achieve financial sustainability and investment readiness through incubator support:**
 - Enterprises that demonstrate potential for long term financial sustainability
 - Demonstrate need for professional assistance in achieving growth and sustainability
 - Have potential to grow and offer reasonable financial returns to investors
- **Demonstrate fit with Oxfam values:**
 - Enterprises that help in Oxfam's mission of poverty alleviation
 - Enterprises that promote gender equality and justice by empowering and equipping women as contributors to economic growth
 - Enterprises that believe in and support basic human rights for all

15. Conclusion

Social Enterprises in agriculture value chains play a significant role in economic development and poverty reduction in Sri Lanka. However, currently, these enterprises face various financial and technical challenges. We believe an early-stage SME accelerator can address these challenges and empower agriculture SEs by helping them become competitive with large organizations and capture a larger part of the agricultural product value chain. We are also confident that the accelerator would be an important step in deepening and strengthening the Sri Lankan social enterprise ecosystem.

³¹ Such as: "Incubation Best Practices That Lead to Successful New Ventures" by the US Department of Commerce and National Business Incubation Association

16. Appendix

Annexure I: List of Interviewees

Name	Title	Organization
Farmer Cooperative Societies		
Krishnapillai Senthil Chelvan	General Manager	Palmyrah Development Cooperative Society
K Mudukumara	President	Agriculture Development Cooperative Society
P.G. Wijerathne Dutuwewa	Operations Manager	Cooperation for Industrial Development Lanka (Pvt) Ltd. (COOPID)
Kuganeswari	President	Nuwara Eliya Agricultural Cooperative Livestock Breeders Cooperative Society
Padmabhini	President	Small and Medium Entrepreneur Cooperative Society in Trincomalee district
Thiruganam	President	Sustainable Agriculture Resource Center (SARC), Muttur
Shiloshna	Treasurer	Sustainable Agriculture Resource Center, (SARC), Verugal
Nandini	President	Sustainable Agriculture Resource Center, (SARC), Batticaloa
Farmer Associations/Federations/Companies		
Kandasamy	President	Union of Livestock Breeders Cooperative Society
Premila	President	Protected Agriculture SARC Federation
Kularatna	President	SARC Federation
Chopadithya Edirisinghe	CEO	Hurulu People's Company
		SABAH Association
Small and Medium Enterprises		
Nilanjith Kuruppuarachchi	Agri Business Manager	Ceylon Tea Services Plc
Dr. Kapila G.A. Goonasekera	CEO	Bio Foods (Pvt) Ltd.
Nelson Nagasinghe	MD	Lanka Bio Energies (Pvt) Ltd.
Upali Narangaspitiya	MD	Lahiru Mushrooms
Maliek De Alwis	CEO	MA's Tropical Food Processing (Pvt) Ltd.
Financial Institutions		
C.L. Pihillanda	Regional General Manager	Regional Development Bank
S. Wijayasiri	Assistant Regional Manager	Ruhuna Development Bank
Asantha G Punchihewa	Manager	Sampath Bank
Ranjith Abeykoon	Relationship Manager	Sampath Bank
Gamini Swarnapala	Deputy General Manager	Deshodaya Development Finance
Dulan De Silva	Chairman	Berendina Development Services (Guarantee) Ltd

Government Agencies		
Chandrarathna D Vithanage	Senior Assistant Secretary General	The Ceylon Chamber of Commerce
Rohitha Nanayakkara	Chairman	National Agribusiness Council
Mohan Thilakasiri	CEO	SIYB Association of Sri Lanka
Bandara Basnayake	Manager	Ministry of Fisheries & Aquatic Resources
Non-Governmental Organizations		
S Thevathas	Senior Program Coordinator	Oxfam
K. S. Senthuran	Programme Officer	Oxfam
Amina Yoosuf	Director	Nucleus Foundation
Nilantha Athapattu	Manager	Rural Enterprise Network, Practical Action
Gregory Brady	Country Director	Care International, Sri Lanka
Educational Institutions		
Prof. K.D.N. Weerasinghe	Professor	Faculty of Agriculture, University of Ruhuna
Dinidu Endaragalle	Consultant	Institute of Development Alternatives and Reconciliation Ltd.

Annexure II: Cooperative Movement in Sri Lanka

State of co-operatives³²

Overview	
Sectors	<ul style="list-style-type: none"> • Agriculture • Consumer retailing • Insurance • Banking • Medical • Fishery • Garment production • Wholesaling • Printing • Transport • Funeral services
Administrated by	Ministry of Cooperative and Internal Trade of Sri Lanka
Regulated by	Cooperatives Societies Act
Number	10,002
Members	6,303,306
Apex body	National Co-operation Council of Sri Lanka
Registration	Minimum of 10 persons in case of primary cooperative and minimum of 3 cooperatives for a secondary cooperative are needed for registration.
Multi-purpose Cooperative Societies/Consumer Co-operative Societies	
Number	305
Members	4,033,607
Businesses	<ul style="list-style-type: none"> • Retailing

³² ICA Committee on Consumer Cooperation for Asia and the Pacific

	<ul style="list-style-type: none"> • Insurance • Medical • Banking, etc.
Apex body	Sri Lanka Consumer Cooperative Societies Federation Ltd. (COOPFED)
Functions of COOPFED	<ul style="list-style-type: none"> • Wholesale trade • Retail trade • Packaging • Development of Co-op brand products • Distribution of products
Popular items in Co-op shops	<ul style="list-style-type: none"> • Tea, Coconut, Fish, Clothing, etc.
Market share of Co-op retail trade	More than 35 percent
Problems	<ul style="list-style-type: none"> • Lack of finance • Lack of knowledge of MPCS employees about the super market system • Knowledge about new business techniques • Severe competition with private retailers • Lack of profitability in store business

Principles of cooperatives³³

	Description
Voluntary and open membership	Generally, membership is open to everyone and there is no discrimination on the basis of gender, race, religion, cast and class. However, sometimes, the cooperative might be formed to serve a particular group of people to fully benefit them.
Democratic member control	One vote for one member and all members have the authority to select their representative by using vote and they can involve in the decision-making process.
Members' economic participation	Members equally contribute an amount of capital for cooperatives and the dividend they get will be based on the amount of business they do with the cooperative.
Autonomy and independence	Cooperatives are independent organizations managed by its members. If cooperatives make any agreement with other private business, it should not affect the autonomy of cooperatives and power of managing the cooperatives has to always lie in the hands of its members.
Education, training and information	Trainings and educational workshops have to be conducted to improve the efficiency of the members and employees. Members have to be well informed about the mission of the cooperatives.
Concern for community	By helping its members to meet their needs, cooperatives also have to focus on the sustainable development of society or community.

³³ International Cooperative Alliance, <http://usa2012.coop/about-co-ops/7-cooperative-principles>

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Shujog is the non-profit sister entity of IIX. Shujog's programs magnify the impact that Social Enterprises deliver, scale the quantity of SEs and broaden the knowledge base in the Social Enterprise and Impact Investing space.

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