Factors Affecting the Performance of Farmer Companies in Sri Lanka

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Sri Lanka introduced farmer companies (FCs) to link smallholders with preferred markets. Many of these farmer-owned marketing firms failed. The twin objectives of this study are to understand the effect of internal factors - institutional, group and management attributes - on the performance of farmer companies and to make recommendations to improve their performance. The study drew primarily on the New Institutional Economics and management literature to develop a causal model of relationships between the performance of a farmer company and its institutional, group and management attributes.

A qualitative, multiple case study research design was used to gather data explaining how shareholders, directors and managers responded to the institutions that characterised their own farmer company. Pairs of successful and failed FCs in each of three core business categories were purposefully selected for in-depth case study. Institutional, group and management attributes were contrasted to test the model's propositions in a 'pattern matching' exercise conducted for each pair of companies. This qualitative analysis identified 34 attributes that affected FC performance. These attributes and seven measures of performance were then subject to hierarchical cluster analysis to triangulate the qualitative findings and to generate more information about relationships between the attributes and performance indicators.

The results indicate that FCs are more likely to attract capital and invest in value-adding assets (like brands) when they alleviate the 'horizon' problem by making benefits directly proportional to investment. This means that shares should be appreciable and that patrons should pay and receive market-related prices for their inputs and products. Growth in the number of shareholders (outreach) was constrained by a 'portfolio' problem in FCs that expected their members to invest equal amounts of equity capital. To avoid this problem, equity shares should be tradable between members and facilitators should help FCs to

establish trading platforms. Outreach was also constrained in FCs that arbitrarily limited membership to a small geographical area.

Perceptions that external facilitators, executive managers and directors who were not nominated for election to the board by shareholders could influence policy decisions against the interests of majority investors were particularly damaging to investor confidence. Such 'influence' problems were also attributed to flawed electoral procedures. All directors should be nominated by shareholders and that voting should be conducted by secret ballot. To improve accountability, the right to hire and fire executive managers should remain with the board of directors, and these executive managers should report to shareholder-directors and not to government agencies.

Despite the absence of investment-proportional voting rights, FC performance was not adversely affected by product or shareholder heterogeneity when management remained centralised. Failure to separate company ownership from control undermined company performance by exposing investors, lenders and strategic partners to a severe influence problem. Leaving decisions in the hands of directors and managers does not imply that ordinary shareholders' views are unimportant when formulating company policy and business strategies. On the contrary, the results suggest that directors and managers should establish forums and processes to elicit the views of shareholders (and other stakeholders) on policy and management issues.

Farmer company performance was compromised by the absence of well-defined and regularly observed procedures to develop and implement new strategies, and by inadequate or inappropriate management skills. These management problems may diminish if government facilitators had a clear exit plan from the time the company is established as this would focus their attention on the important task of empowering small farmers to manage a company.

Keywords: Small farmers, Sri Lanka, collective marketing, marketing cooperatives, farmer companies, group diversity, organisational arrangements, institutional problems, corporate governance, operational processes, managerial quality, and business strategies.

Affectionately dedicated

to

my loving parents,

wife Nilmini,

son Gihan and daughter Rushmi

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Abbreviations

AGM - Annual general meeting

BoD - Board of directors

CEO - Chief executive officer

DCFO - Distribution Canal Farmer Organisation

DGM - Deputy general manager

DoA - Department of Agriculture

DS - Divisional Secretariat

EDB - Export Development Board

FC – Farmer Company

FCFO - Field Canal Farmer Organisation

FO - Farmer Organisation

GDP – Gross domestic product

GM - General manager

GNP – Gross national product

GS - Grama sevaka

HEC - Human Ethics Committee

IR - Department of Inland Revenue

LKR - Sri Lanka Rupees

MASL - Mahaweli Authority of Sri Lanka

NDC – National Development Council

NGO - Non-governmental Organisations

NIE – New Institutional Economics

NLDB - National Livestock Development Board

OG - Out-grower

RoC - Registrar of Companies

TO - Technical officer

Chapter 1

Introduction

This chapter provides an overview of the thesis, its purpose and significance. This is followed by a brief outline of the research methodology used. The chapter concludes by outlining the structure of the thesis.

1.1 Background of the study

Agriculture in Sri Lanka shifted its scope and focus towards commercialisation during the colonial period and large scale, export-oriented plantations of tea, rubber, coconut, spices and sugarcane fuelled economic development in general and agricultural development in particular (Wijayaratna, 1997). Higher incomes, creation of employment opportunities and achieving food security are among Sri Lanka's top priorities. Agriculture has been, and is, a prominent industry, accounting for 17.2% and 16.8% of Gross Domestic Product (GDP) in 2005 and 2006 respectively (Central Bank of Sri Lanka, 2006). Commercialisation and diversification of agriculture and agro-industries are considered important for the country's economic development (Central Bank of Sri Lanka, 2006). Although the service and industrial sectors showed higher rates of growth and started contributing higher percentages to the nation's Gross National Product (GNP) after trade liberalisation in late 1970's (Thenuwara, 2003), Sri Lanka's economy is driven largely by agriculture. Policies that impact agriculture and agro-based industries have widespread consequences as over 70% of the country's population live and work in rural areas (Abeygunawardena et. al., 2003).

Farmer associations in Sri Lanka were empowered in the mid-nineties through introduction of a new integrated approach to rural development that focussed on the commercialisation of subsistence farming (Kudagamage et. al., 2006). The Ministry of Agriculture and Lands shouldered the responsibility for implementing this approach at the national level (Warsakoon, 1998). Farmer associations, a form of horizontal coordination among producers, were expected to play a prominent role in coordinating small farmers to manage shared resources like irrigation infrastructure, to procure inputs in bulk and - in some instances – to process and market produce (Batuwitage, 1998). From the small farmers' perspective, group action through organisations could improve access to inputs and credit through bulk discounts and, more importantly, by spreading fixed transaction costs, especially the *ex-ante* search, information and negotiation costs of economic exchange. Producer organisations can also promote investment in indivisible assets like storage and processing facilities, as well as in less tangible assets like product certification, branding and promotion – both by small farmers, for whom individual investment is often infeasible (Poulton and Lyne, 2009:164-165), and by agribusiness firms that need to contract supplies from a large number of small farmers before investing in specific assets.

The 'farmer cooperative' is a well-established concept and there are a large number of them operating in Sri Lanka. Evans and Meade (2005:1-7) define a farmer cooperative as *"an organisation in which those who transact with the organisation – patrons - also own and formally control the organisation, and derive significant benefits from those transactions over and above any financial returns they derive from their investment in the organisation"*. Such organisations are collectively labelled the 'cooperative movement' in Sri Lanka and are supervised by government officials (Winslow, 2002).

Wu and Pretty (2004) contend that rural poverty is no barrier for dynamism and innovativeness. In their study, group action by farmers increased their incomes, and participation led to increased self-reliance among rural farmers and the establishment of sustainable farmer organisations. Marketing cooperatives played an important role in this process. However, attempts to group small farmers into marketing cooperatives in developing countries have often failed (Hoyt, 1989; Ortmann and King, 2007) and their institutional arrangements have been criticised for discouraging member investment (Cook and Iliopoulos, 1999, 2000; Lyne and Collins, 2008; Sykuta and Cook, 2001).

Proponents of the New Institutional Economics (NIE) identified five institutional problems that discourage member investment in traditional marketing cooperatives; free-rider, horizon, portfolio, control and the influence problems (Sykuta and Cook, 2001). These problems are explained in Chapter 2. Institutional problems that constrain levels of equity in traditional co-operatives also constrain levels of debt as lenders prefer their loans to be covered by equity in order to reduce their exposure to loan default. As a result, traditional cooperatives have struggled to finance value-adding assets (Hendrikse and Veerman, 2001). In an attempt to resolve this problem, the National Development Council (NDC) - a body set up in 1995 by the Government of Sri Lanka - recommended that small farmers should be brought together to form farmer companies (FCs) (Esham and Usami, 2007) instead of marketing cooperatives.

In theory, FCs do not suffer from the institutional problems that disadvantage traditional cooperatives, and were seen as having greater potential to leverage capital, improve members' marketing strategies and create multiplier effects in the local economy. FCs were intended to operate like private companies, owned and patronised by a defined group of small farmers. They were expected to enhance rural livelihoods by:

1. Bringing investment to farmlands by mobilising technology and natural resources (Batuwitage, 1998).
2. Creating competitive market channels for members' produce and protecting them against exploitative behaviour of market intermediaries (Senanayake 2004).
3. Addressing some of the socio-economic problems associated with common pool resources such as irrigation water (Tuovinen, 2001).
4. Improving farm incomes by coordinating small farmers for commercial agriculture (Senanayake, 2004; Wijayaratna, 1997).
5. Transforming farmers into shareholders who benefit fully from co-ownership of value-adding enterprises (Wijayaratna, 1997).

The overall objective of an FC, like any other investor-owned firm is to maximise returns to its owners (shareholders) over time. All of the primary participants - shareholders, managers and the board of directors - bear responsibility for achieving this objective (Dess et. al., 2007:18-21). Functions performed by management can be described in terms of three distinctive and dynamic decision areas; strategic, administrative and operations. However, these decisions are constrained by higher level policy and strategic decisions taken by the board of directors on behalf of shareholders.

As of December 2003, there were 92 FCs[1] registered with the Registrar of Companies (RoC) in Sri Lanka (Esham and Usami, 2007). Despite the potential advantages of FCs over traditional marketing cooperatives, recent studies revealed that many FCs had failed despite good business opportunities (Ranasinghe 2002: p 13; Esham and Usami, 2007). Senanayake (2004) suggested that this was due to; (1) lack of managerial skills, (2) lack of entrepreneurial skills, (3) poor recruitment of managerial personnel, (4) weak plans and governance by incompetent boards of directors, (5) inappropriate mechanisms for monitoring and evaluation, and (6) lack of trust between farmer members and their FC. However, these claims were not substantiated with in-depth research of factors influencing the performance of FCs.

[1] Thirty three of these were Export Promotion Villages registered under the same legal provisions as FCs.

This study seeks to provide information about institutional, group and management factors affecting the performance of FCs in Sri Lanka. Institutional factors are important because these FCs adopted many of the (weak) institutional arrangements that characterise traditional cooperatives. The model postulated in Chapter 2 argues that these institutional arrangements influence performance directly and also indirectly through their effects on group and management factors.

FCs were originally registered under Part VII of Sri Lanka's Companies Act, No. 17 of 1982, which provided for 'Peoples Companies'. Act 17 was replaced by a new Companies Act in 2007 and all existing FCs were obliged to re-register under the new Act (No. 7 of 2007). For the purpose of this study, a farmer company is defined as an 'organisation registered under Sri Lanka's Companies Act, owned and patronised by farmers for their economic benefit'.

1.2 Research question and the purpose

FCs are a new form of rural socio-economic enterprise which, de facto, are intermediate between traditional cooperatives and private companies. Section 1.1 referred to institutional problems that fundamentally constrain the ability of traditional cooperatives to finance value-adding assets, and presented some authors' views of the reasons for FC failure. It also stated that many FCs had failed despite good business prospects. Therefore, the purpose of this study was to investigate why so few of Sri Lanka's FCs were successful as the problems which constrain their success may be relatively easy to resolve, or less evident in other developing countries where FCs could play a useful role. The central research question of this study is:

What institutional arrangements, group and management factors impact on the performance of farmer companies in Sri Lanka and how do these factors influence performance?

The focus of this thesis is to examine and analyse relationships between the three main constructs of this research; institutional arrangements, group dynamics and management factors. Therefore, this study investigates the internal determinants of FC performance. Sub-constructs related to the three main constructs are discussed in Chapter 2 and the qualitative and quantitative methods used to analyse them are discussed in Chapter 3. The two specific objectives of this research are summarised as follows:

1. To investigate the influence of institutional arrangements, group dynamics and management factors on the performance of farmer companies in Sri Lanka.

2. To make recommendations aimed at improving the performance of FCs for policy-makers, government and non-government facilitators, shareholders and managers.

1.3 Significance of the research

The findings and recommendations stemming from this investigation are expected to inform policy makers, managers and farmers about the conditions under which FCs are most likely to promote a vibrant agricultural economy. The study is also expected to make a contribution to the knowledge base in cooperative and FC studies.

1.3.1 Policy implications

Many developing countries stress the commercialisation of agriculture and attempt to transform subsistence agriculture into commercial agriculture by facilitating agribusiness ventures. The FC model is a tool for this transformation. Major development projects such as the *Mahaweli* Development Project promoted the establishment of FCs in Sri Lanka, many of which failed for internal rather than external reasons. This study intends to inform policy decisions relating to FC governance by identifying the internal determinants of their performance. Post-civil war development in the northern and the eastern provinces of Sri Lanka is essential for political stability. Therefore, outcomes of this research could be useful for policy-makers and donor agencies in Sri Lanka and other developing countries where populations are largely rural, poor and rely heavily on farming for livelihoods.

In Sri Lanka, all FCs are established with support provided by a facilitating organisation. The Mahaweli Authority of Sri Lanka (MASL) and the Export Development Board (EDB), both government agencies, are frequently appointed as facilitating organisations. The findings of this research should be of direct relevance to such organisations that are in the forefront of creating FCs.

1.3.2 Managerial implications

Management plays key roles in facilitating the strategy formulation and implementation processes of business organisations. Senanayake (2004) suggested that management problems contributed to poor performance of FCs. This study analyses important aspects of the management function in FCs and its links with institutional and group factors to identify critical areas of weaknesses for the benefit of managers, directors and shareholders.

1.3.3 Academic implications

This research uses a multidisciplinary approach in analysing internal determinants of FC performance. Much literature is available on the underlying institutional problems of traditional farmer cooperatives. However, little has been written on links between institutional, group and management dynamics, and how they affect the business performance of hybrid organisations like Sri Lanka’s FCs. This research considers these relationships, in both theory and case studies, and therefore helps to bridge this gap in knowledge. Such knowledge may be useful in establishing robust farmer organisations that can meet their objectives, especially in Sri Lanka’s war-torn northern and eastern provinces. Lessons may also be relevant to other parts of Asia and sub-Saharan Africa where socio-economic conditions are comparable.

1.4 Research methodology

The principal method of investigation used in this research is a deep qualitative analysis through case studies of FCs with each FC treated as a holistic unit. FCs possess distinguishing characteristics and each has its own unique cluster of primary, secondary and external stakeholders from which data needed to address the broad research question could be sourced. For these reasons, this study treats the FC as the unit of analysis.

Failed and successful FCs (cases) in Sri Lanka were assigned to three categories; value-adding, commodity marketing and input procurement. Data were gathered from six FCs following a multiple-case design. Semi-structured interviews were conducted with key informants and shareholders. Reports and records kept by the FCs, their facilitating organisations and other stakeholders were exploited as secondary sources of data.

Data analysis followed two main approaches; qualitative and quantitative. The qualitative analysis employed Yin’s (2003: 116-122) pattern matching and explanation building method. The quantitative analysis employed a clustering technique to identify positive links between performance indicators and variables measuring each of the constructs under investigation (institutional, group and management factors).

1.5 Outline of the thesis

This thesis is divided into four parts. Chapter 2 develops the theoretical foundation for the investigation. Chapter 2 reviews relevant literature drawing heavily on the NIE to explain the institutional problems that constrain traditional cooperatives. It also reviews governance, management and group issues related to the performance of farmer organisations. It focuses on links between these constructs and proposes a theoretical model of causal relationships.

Chapter 3 describes the research design. It rationalises the qualitative case study approach, the multiple-case design, the sampling technique and the methods used to collect and analyse data. Human ethics are also considered.

Chapters 4 and 5 present and analyse the case studies. Chapter 4 offers a brief history of each FC and describes its business objectives, core business activities, institutional and governance arrangements, management and shareholder group factors. Chapter 5 tests propositions about the determinants of FC performance by comparing pairs of successful and failed FCs. Chapter 5 also presents the results of the cluster analysis to complement the results of the qualitative analysis.

Finally, Chapter 6 presents conclusions and recommendations. The conclusions were drawn from the results of both the qualitative and quantitative analyses. Recommendations are targeted mainly at policy-makers, managers and facilitating organisations.

Chapter 2

Literature Review and Theoretical Framework

2.1 Introduction

Chapter 1 explained the context and importance of this study. It also presented the research question and key objectives of this research. This chapter reviews relevant literature and proposes a causal model of the internal determinants of farmer company performance.

2.2 Internal determinants of farmer company performance

The Comprehensive Framework for Action (CFA) set out by the United Nations High Level Task Force on global food security in 2008 prioritised greater public investment in the development of producer organisations as a long-term strategy to address global food insecurity (UN-HLTF, 2008). This recommendation is based on strong arguments that horizontal coordination by farmers can improve smallholder access to markets and technology, which - in turn - raise rural incomes and improve the food security of poor people (Dorward et. al., 2003). In theory, smallholders can gain bargaining power and reduce unit marketing, processing, compliance and transaction costs by pooling their produce, and can finance and manage value-adding assets by pooling their capital and centralising management (Holloway et. al., 2000; Reardon and Barret, 2000; Markelova et. al., 2009; Poulton and Lyne, 2009). However, experience with the 'linking farmers to markets approach' suggests that attempts to coordinate smallholders have not, in general, been replicable at scale. Shepherd (2008) attributes part of the blame for this to inappropriate organisational models. Indeed, smallholder organisations have only a mixed track record of performance (Hoyt, 1989; Chirwa et. al., 2005; Ortmann and King, 2007), including those in Sri Lanka (Senanayake, 2004).

One possible reason for this patchy performance is that farmer organisations often confer ill-defined property rights on their members that discourage their participation and investment of equity capital. The New Institutional Economics (NIE) literature has identified five institutional problems that discourage member investment in traditional marketing cooperatives; the free-rider, horizon, portfolio, control and influence problems (Sykuta and Cook, 2001). Problems that constrain levels of equity capital in an organisation also constrain levels of debt capital because lenders prefer their loans to be covered by equity in the event of default. As a result, traditional cooperatives have struggled to finance value-adding assets (Hendrikse and Veerman, 2001).

In theory, a farmer company should not suffer from the institutional problems that disadvantage traditional marketing cooperatives. As stated in Chapter 1, the financing problem experienced by traditional marketing cooperatives in Sri Lanka prompted the National Development Council to recommend a switch from cooperatives to FCs as the preferred organisational vehicle for small farmers. FCs were seen as having greater potential to leverage capital, improve members' marketing strategies and create multiplier effects in the local economy (Senanayake 2004). FCs were first registered in Sri Lanka under the Companies Act No. 17 of 1982 (Ranasinghe, 2002:13). Provisions were made under Part VII of the Act to register these companies as 'People's Companies' (Government of Sri Lanka, 1982:176-178. These organisations were intended to operate like private companies, owned and patronised by a defined group of small farmers. However, in practice, Sri Lanka's FCs adopted a mixture of institutional arrangements borrowed from traditional marketing cooperatives and investor-owned companies, creating a range of hybrid firms, as will be shown in Chapter 5. Hybrid firms that approximate traditional cooperatives more closely than they do private companies are bound to inherit some of the institutional problems that confront traditional marketing cooperatives. This explains the frequent reference to traditional cooperatives in this literature review which targets institutional, management and group factors as the three main internal constructs affecting FC performance.

2.2.1 Institutional arrangements

Traditional marketing cooperatives are useful to small farmers if the purpose is to strengthen their bargaining power. Valentinov (2007) argues that product marketing and input purchasing cooperatives have transferred considerable market power to their members. However, Lyne and Collins (2008) question the ability of traditional marketing cooperatives to finance the relation-specific assets needed to meet the requirements of discerning markets. Traditional cooperatives and investor-owned firms are alternative organisational forms. Investor-owned firms reward their owners on the basis of investment while traditional cooperatives do so on the basis of patronage (Lerman and Parliament, 1990; Parliament et. al., 1990; Ortmann and King, 2007). This is consistent with the cooperative principle of member economic participation (Lyne and Collins, 2008). Democratic ownership and control by members are other key cooperative objectives.

It is often argued that a farmer-owned marketing firm in which investment is proportional to patronage has a competitive advantage because the interests of its supplier-farmers are well aligned with the incentives of its owner-farmers (Bekkum and Bijman, 2006). The alignment of buyer and seller interests in a farmer-owned marketing firm is expected to reduce costs associated with designing, monitoring and enforcing supply contracts (Sykuta and Cook, 2001). This alignment falls away when farmers contract with a firm owned by external investors who are more interested in maximising returns on their equity capital than offering farmers favourable product prices. Marketing cooperatives would therefore appear to be a useful organisational model to promote farmer access to preferred markets. However, proportionality between investment and patronage - a feature of some non-traditional marketing cooperatives (e.g. New Generation Cooperatives) - is not a characteristic of traditional marketing cooperatives. Moreover, the institutional arrangements that underpin a traditional cooperative tend to discourage members and lenders from financing the highly specific, capital-intensive assets required for value adding. Proponents of the NIE have identified five key institutional problems in traditional cooperatives, and attribute these problems to ill-defined property (i.e. voting and benefit) rights (Cook, 1995).

2.2.1.1 The free-rider problem

A traditional cooperative limits dividends paid on equity capital, distributing most of its profits to members according to their level of patronage. As a consequence, members have little incentive to finance assets because the benefits accrue largely to other members including new members who do not contribute capital in proportion to their patronage. Sykuta and Cook (2001) refer to this as the 'internal free rider' problem.

An 'external free-rider problem' arises when non-members are allowed to transact with the cooperative on the same terms as those offered to members. O'Conner and Thompson (2001) state that, as a consequence, the non-members are subsidised, causing oversupply, and members will therefore be reluctant to provide capital, leading to a shortage of equity capital.

2.2.1.2 The horizon problem

Second, a horizon problem occurs *"when a member's residual claim on the net income generated by an asset is shorter than the productive life of that asset"* (Cook, 1995:1156). Members of traditional cooperatives are discouraged from financing durable and intangible assets because they are not permitted to trade shares at their market price and therefore cannot realise the full benefits of assets that generate returns beyond their period of membership (Cook and Iliopoulos, 2000; Sykuta and Cook, 2001). Instead, the cooperative is entitled to redeem members' shares at their original or par value. The implication is that investors cannot realise capital gains when they leave the cooperative. New members who benefit from these investments without paying market prices for their shares capture some of these gains.

The horizon problem shifts member preferences away from retaining earnings to finance long term assets towards current benefits (Nilsson, 2001). This puts pressure on the board of directors (BoD) and managers of a traditional cooperative to offer favourable prices to members at the expense of investments in additional assets (Cook, 1995; Royer, 1999; Ortmann and King, 2007). Nilsson (2001) concludes that this problem hinders capital growth and reduces the value of the firm. To address the horizon problem, a cooperative could issue a class of non-redeemable equity shares that investors can trade at market prices. Partial solutions include the issue of bonus shares to be redeemed at a 'fair price' determined by the BoD. In either of these cases, the cooperative has moved away from the traditional model towards an investor-owned firm (Chaddad and Cook, 2004).

2.2.1.3 The portfolio problem

The portfolio problem arises from the tied nature of the equity in the cooperative (Sykuta and Cook, 2001) because shares in a traditional cooperative cannot be traded. Consequently, members tend to under-invest because they are unable to diversify their individual investment portfolios according to their personal risk preferences (Royer, 1999). Again, cooperatives would have to issue a class of tradable shares to address this equity acquisition problem (Cook, 1995).

2.2.1.4 The control problem

This principal-agent problem arises in any organisation in which there is centralised decision-making and is particularly severe in cooperatives because (1) a market for exchanging equity shares is absent and (2) they are unable to establish equity-based management incentive mechanisms (Royer, 1999). The absence of equity makes it difficult for members; (a) to monitor management performance as there is no share price to signal changes in the value of the firm, and (b) to sanction management by disinvesting. The latter problem puts a cooperative at a disadvantage by restricting its ability to align the incentives of managers with those of investors (Ortmann and King, 2007). It follows that the control problem could be alleviated by issuing a class of tradable equity shares. However, tradable equity shares will not address the horizon, portfolio or control problems if the share market lacks liquidity. This is a very likely outcome when shareholding is restricted to resource poor farmers.

2.2.1.5 The influence problem

This problem is discussed in Section 2.2.2 along with literature on group factors.

In addition to these fundamental institutional problems identified by the NIE, there is also the question of 'good corporate governance'. Corporate governance regulates the relationship between shareholders, their board of directors and management. Company and cooperative legislation typically holds management accountable to the board and the board accountable to the shareholders. This accountability is realised through governance arrangements. Good corporate governance arrangements encourage shareholders to finance assets that create value (World Bank, 2002:55-60). Conversely, weak governance arrangements stifle a firm's growth.

Governance arrangements influence who gets to direct and manage the firm, who the directors and managers account to, and the ease and extent to which they can be held accountable for decisions that harm growth. The importance of these arrangements grows when a firm's shares are not freely traded, as this aggravates the control problem. Processes adopted to elect directors and to hire and fire managers are key components of governance arrangements as they have a direct impact on accountability. Likewise, procedures used to report on the firm's performance are also of key importance as they influence transparency, and transparency promotes accountability.

Codes of good corporate governance give shareholders the power to elect directors by secret ballot, to remove directors, and to appoint independent financial auditors (Norges Bank, 2006). Transparency requires the free flow of accurate information (UNDP, 1997). Hence good governance also requires that shareholders have easy access to the minutes of board meetings and receive the firm's annual report and audited financial statements well in advance of its annual general meeting (AGM). Similarly, directors should be given adequate time and information to prepare for board meetings. Channels and methods of communicating with shareholders also play an important role in maintaining transparency and accountability (McBride, 1986: 124-134).

2.2.2 Group factors and the influence problem

Disincentives created by the portfolio problem become more pronounced when risk-averse members use their democratic voting majority to pressure management into making conservative investments – the influence problem. The influence problem arises in a traditional cooperative because members are given democratic voting rights (i.e. one vote per member) (LeVay, 1983).

Institutional problems that constrain levels of equity in traditional co-operatives also constrain levels of debt as lenders prefer their loans to be covered by equity in order to reduce their exposure to loan default. In addition, for any particular level of equity, a traditional cooperative's ability to borrow is adversely affected by the influence problem, especially when the loan is needed to finance relation-specific assets that expose the borrower to a hold-up problem (Royer, 1999), as lenders' interests are more likely to align with those of majority investors than with those of majority voters. Hendrikse and Veerman (2001) further contend that the influence problem accelerates the cost of equity capital faster in a traditional cooperative than in a listed company as the level of asset-specificity increases. In theory, the influence problem falls away when voting rights are proportional to investment (i.e. one vote per share).

However, converting a cooperative into a company to improve its access to capital often brings patrons and investors into conflict, threatening any cost advantages of well-aligned buyer and seller interests. Several compromise solutions have been investigated by Bekkum and Bijman (2006) who classify these compromises as either 'cooperative' or 'non-cooperative' solutions. The latter imply conversion to private or listed company status. These alternatives are non-cooperative in the sense that investors will seek high returns on their equity capital, whereas patrons will seek favourable prices for their products. This conflict is more likely when the investors are not patrons but can still happen when there are no external investors, i.e. when the company is fully farmer owned. To avoid a trade-off between access to capital and the benefits of well-aligned buyer and seller interests, 'cooperative' solutions are found in hybrid firms that issue tradable equity shares proportional to farmer investment (like New Generation Cooperatives) or which issue preferred shares, bonds or B-class ordinary shares that carry no voting rights, or limited voting rights (investor-share cooperatives.

Poor governance can also lead to an influence problem. For example, when directors are elected by a show of hands rather than by secret ballot it is quite possible that powerful individuals or subgroups within the shareholder group could influence strategic and operational (management) decisions. Likewise, an influence problem could emerge if managers account to parties other than the board, or if the board includes influential directors who are not nominated or elected by the shareholders.

In this study, the word ‘group’ refers to a ‘number of individuals sharing a common interest’. Economic interests are involved in many cases. Marketing cooperatives and companies are horizontally integrated organisations in which members of the shareholder group sacrifice decision-making power in exchange for benefit and voting rights. Van Dooren (1982) claims that such organisations can only be successful if membership is truly voluntary. However, Olson (1971:1-8) argues that rational and self-interested individuals within a group would not act voluntarily to achieve shared objectives without selective incentives such as proportionality between a member’s contribution and his or her benefit and voting rights. If voting rights are not proportional to investment, an influence problem emerges and investment is discouraged. However, an influence problem could emerge even in the presence of proportional voting rights and sound electoral procedures if powerful individuals and subgroups with vested interests are allowed to participate directly in management decisions. A shift away from the centralised decision-making process expected in a well-governed company towards a more collective decision-making process could allow minority investors to influence company policy and operations in ways that are not in the interests of the majority investor group.

Direct participation of shareholders in decision-making implies collective action. Poulton and Lyne (2009:180) define collective action as *“action taken by a group, involving some degree of collective decision-making, in pursuit of members’ perceived shared interests”*. Under such conditions, the more diverse the shareholder group and the more services offered by a marketing firm, the greater is its exposure to an influence problem. Group size and composition are important determinants of competing interests within a group (Luthans, 2005:445-449). Whereas homogeneous membership can establish solidarity that alleviates an influence problem (FAO, 2000), disparities in age, gender, education, wealth, location and products supplied by shareholders to their marketing firm could well have the opposite effect (Heckathorn, 1993; Naidu, 2005). Other things being equal, this study proposes that group diversity is less (more) likely to harm FC performance in the presence of centralised (collective) management decisions.

2.2.3 Management factors

The overall objective of a FC, like any other investor-owned firm, is to maximise returns to its owners (shareholders) over time. All of the primary participants - shareholders, managers and directors - are responsible for achieving this objective (Dess et. al., 2007:18-21).

Managers have become increasingly responsible for exploiting and adjusting to change in the business environment in a rational and proactive way (McBride, 1986:124-134). They are also responsible for implementation of policy and strategy. Strategy is a high level decision process concerned with responsiveness to, and relationships within, the firm's business environment (Ansoff, 1969: 11-40). A firm should decide on strategies that provide advantages that can be sustained over time (Dess et. al., 2007: 4-13). Strategic choices made by a firm (or an entrepreneur) are therefore powerful determinants of its performance over time (USDA, 1997:23-24) and are central to understanding the causes of a firm's performance (Peterson and Anderson, 1996).

Administration and operations involve decisions concerned with establishing the structure and operating processes that a firm needs in order to implement strategic decisions (Ansoff, 1969:11-40). Stoner et. al. (1996: 315) define the organisational structure as *"the way in which an organisation's activities are divided, organised and coordinated"*. They contend that structure is very important for a business organisation as an appropriate structure can contribute towards performance and growth. In addition, most successful firms (and entrepreneurs) create a business plan as it provides a direction while helping the firm to attract capital (Stoner et. al., 1996: 314-323).

The Chief Executive Officer (CEO), who provides the link between (hired) management and the board, plays an important role (along with the board) in the choice of appropriate strategies for a firm. Implementation of strategies through management of operations is a major responsibility of the CEO. Operational decisions have a direct impact on output (Gray, 2005; Martin and Woodford, 2005) and hence the performance of a firm.

According to Adrian and Green (2001), managers of cooperatives should be knowledgeable in areas such as cooperative principles, responsibilities, financial analysis and business decision-making. However, the institutional problems associated with firms of a cooperative nature pose additional challenges for their managers. These include dealing with limited access to equity capital and the possibility that small, risk-averse investors may exert undue influence on strategic decisions. It is important that managers appreciate and possess the right skills to maintain proper relationships between the three players in the governance triangle (McBride, 1986:134-138). At the same time, the board needs to match these skills with the cooperative's management portfolios.

The directors of a business organisation are elected to represent shareholder interests. The board monitors the CEO, and in turn, is monitored by the shareholders. The shareholders will query the board if share prices drop, and may even unseat them. If the share prices drop or other indicators of performance show declining performance, the board will sanction the CEO. However, in a traditional cooperative, shareholders may not be able to monitor the board well as share prices are fixed and do not signal performance. It is quite possible that FCs in Sri Lanka may suffer the same deficiency. Also, the board of a FC may lack the expertise required to make good strategic choices and to monitor the performance of the company and its managers. In user-oriented firms (such as agricultural cooperatives and FCs) where the directors are farmers who may not be competent in off-farm business operations, hired managers often assume greater responsibility for strategic choices (Cook, 1994). Success may therefore depend on the board's ability to select good managers. A key proposition of this study is that the institutional arrangements adopted by a FC affect not only its access to capital but also have direct and indirect effects on the quality, accountability and performance of management.

2.3 A model of the internal determinants of FC performance

Sri Lankan FCs could be viewed as an attempt to encourage investment by farmer patrons while preserving some of the advantages of well-aligned buyer and seller interests. Although there has been no previous research on the institutional arrangements adopted by these FCs, their mixed performance and cooperative antecedents suggest the continued presence of some or all of the institutional problems that constrain access to capital in traditional marketing cooperatives. While it is true that these problems may not impair the sustainability of a firm that does not require much capital for its core business, they are certainly expected to constrain business growth and the sustainability of firms that do require significant capital.

Figure 2.1 illustrates the causal model of internal factors affecting FC performance proposed in this study. The first (upper) dark lateral arrow represents the direct effects of institutional arrangements on FC performance. Some institutional arrangements, including the firm's governance arrangements, also have indirect consequences for performance via their effects on management as they determine who gets to direct and manage the firm, who the directors and managers account to, and the ease and extent to which they can be held responsible for poor decisions. This causality is represented by the long, lightly shaded vertical arrow in Figure 2.1.

Producer-owned marketing firms represent the interests of a group of farmers as shareholders and patrons. Homogeneous membership in groups can establish solidarity that alleviates an influence problem (FAO, 2000), as discussed in Section 2.2.2. Conversely, disparities may encourage members to form subgroups that use their voting power to advance management decisions serving their own interests rather than those of the FC's investors and lenders. Decisions that favour a minority investor group at the expense of the majority investor group are more likely to happen when voting rights are democratic. Flawed electoral procedures (e.g. voting by show of hands rather than by secret ballot) and the presence of non-elected directors on the board could also expose a firm to such an influence problem. The scale of this problem is likely to grow with the range of services offered to shareholders and with the heterogeneity of the group as greater diversity is expected to increase the incidence of sub-groups with different vested interests. These group dynamics could also affect a FC's performance if ownership and control are not clearly separated (i.e., when ordinary shareholders participate directly in policy and operational decision-making) because such collective action may allow powerful individuals and subgroups to influence decisions. Failure on the part of management to separate ownership from control could usher in an influence problem that brings group diversity to bear on FC performance. These indirect effects of institutional weakness on FC performance are captured by the two short, lightly shaded vertical arrows in Figure 2.1.

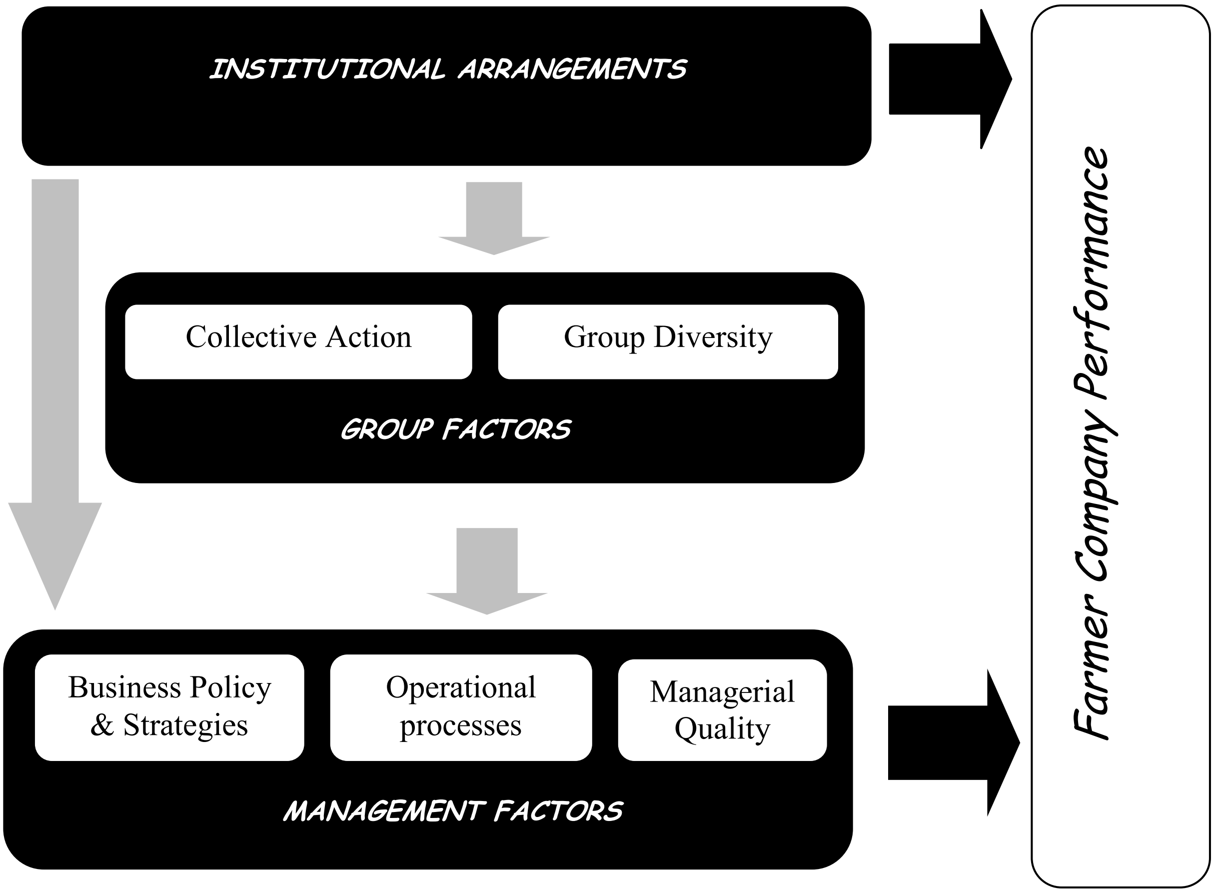

Figure 2.1: A model of internal factors affecting the performance of farmer companies

Strategic choices made by a firm are powerful determinants of its performance over time. Operational processes facilitate short-term decisions and are important in the implementation of strategy. In marketing firms where the directors are farmers rather than business managers, hired managers often assume greater responsibility for strategic choices (USDA, 1997). The quality of managers (and directors) has direct and obvious implications for company performance. In this study, management factors are considered to be a key determinant of farmer company performance and are examined in terms of business policy and strategies, operational processes and managerial quality. The second (lower) dark lateral arrow in Figure 2.1 indicates the direct effects of these sub-constructs on FC performance.

2.4 Performance indicators

In this study, the performance of FCs was measured objectively with a strong focus on sustainability and growth. The sample of case studies was designed to compare a 'successful' FC with a failed FC in each of three core business categories; value-adding, commodity marketing and input procurement FCs. Since little was known about the performance of the ‘sucessful’ FCs *a priori*, a first step in the analysis was to check that these surviving FCs were at least financially stable and therefore sustainable. This was done by examining changes in their solvency and liquidity over time. Beyond sustainability, FC performance was measured in terms of growth and benefits for the intended target group. Traditional indicators of financial growth, like growth in the value of shares and turnover, were supplemented with measures of growth in key intangible assets (brand names and relational contracts with trading partners), outreach (the number of farmer-shareholders) and dividends paid to farmer-shareholders. Gray et. al. (2004) and Gray (2005) also used a combination of financial and non-financial measures to gauge the performance of development-oriented agribusiness companies in South Africa.

Although changes in financial ratios over time are viewed as useful measures of a firm’s financial performance, these changes may not provide a sound basis for comparing the relative performance of firms that have different core business and capital requirements (Barry et. al., 1995:111). The stratifications process used in this study meant that comparisons were made between FCs with similar core business and capital intensity as value-adding FCs (processors) require much more capital than do FCs that sell commodities or inputs.

Liquidity refers to the firm’s ability to meet its current cash obligations. Poor cash flow may result in the liquidation of a solvent firm. The current ratio, measured as current assets relative to current liabilities, is a popular yardstick for assessing a firm’s liquidity position. A value of around two (2:1) is regarded as an acceptable norm for this ratio. The larger the ratio, the less likely the firm will need to borrow in order to meet its cash obligations (Wheeling, 2008:241-265). Battles and Thompson (2000:85-106) state that there is no universally established standard for the current ratio’s minimum acceptable level although a ratio of less than unity would be alarming as current assets would not cover current liabilities.

To judge the long-term financial sustainability of the firm, solvency ratios are used. These ratios measure the funds provided by the firm’s long-term creditors and owners relative to the firm’s assets (Varma and Agarwal, 1997:13.8-13.10). Solvency indicates the extent to which the assets of a firm exceed its liabilities, and hence the ability of the firm to meet its liabilities if business activities were terminated. Solvency is often measured by the debt to equity or leverage ratio. The higher the leverage ratio, the more vulnerable is the firm to insolvency. A rule of thumb is that the leverage ratio should not exceed unity (Gray et. al., 2004).

A firm's financial growth is best measured by changes in the value of its shares. For a listed company, these changes are easily observed in the price of its stock. If shares are not traded, as was anticipated in this study, changes in the value of equity have to be estimated. Gray et. al. (2004) estimated share price as the net asset value per share using information taken from the firm's audited balance sheet.

2.5 Concluding remarks

This chapter reviewed NIE and management literature explaining the performance of firms and linked their arguments in a causal model of the internal determinants of FC performance. This model postulates that institutional arrangements and management both have direct consequences for FC performance, and that institutional arrangements affect management directly and also indirectly through their impact on group factors. Chapter 3 discusses the qualitative and quantitative approaches used to test this model.

Chapter 3

Research Methods and Design

3.1 Introduction

The literature and theory presented in Chapter 2 describe institutional (including governance) arrangements that are supposed to influence the performance of farmer-owned organisations, either directly or indirectly via group and management factors. This chapter describes qualitative and quantitative methods employed in this study to collect data and to test these propositions about the internal determinants of farmer company performance.

Clearly, the fundamental research question (Section 1.3) deals with interactions between institutions and human behaviour and, in particular, how shareholders, directors and managers respond to the institutions that characterise their own farmer company. This suggests a qualitative investigation (Adams and Schvaneveldt, 1985:103-104; Corbin and Strauss, 2008:14; Silbey, 2003). Bergman (2008:12-14) also recommends deep qualitative studies to explore and describe phenomena and underlying concepts of entities that have a small population, while Dawson (2002:14-15) advocates a qualitative approach to gather in-depth opinions from respondents.

The purpose of the qualitative analysis undertaken in this study was to identify and measure elements of the institutional, group and management factors thought to influence farmer company performance, and to test propositions about these variables by comparing their levels in case studies of successful and failed companies. A subset of these variables was also subject to a non-parametric quantitative analysis to check for the presence of anticipated inter-relationships. Creswell (2003:74-76) considers it important to identify a pool of variables that can be used for quantitative analysis at later stages of the inquiry.

3.2 Choice of research strategy

3.2.1 Case studies

Creswell (2003:14-15) summarises the strategies associated with qualitative research approach as ethnographies, grounded theory, case studies, phenomenological research, and narrative research. Adams and Schvaneveldt (1985:114) identified a comprehensive analysis focussed on one or a few subjects as a case study. Yin (2003:5) recommends the case study strategy when a particular study focuses on contemporary events over which the researcher has little or no control, and seeks answers for ‘how’ and ‘why’ questions. George and Bennett (2005:19-22) argue that an in-depth analysis of organisational dynamics is a more robust method of exposing the causes of a firm’s success or failure than is a quantitative analysis of a pre-determined set of variables. Further, they claim that case studies offer high levels of conceptual validity; i.e. identification and measurement of indicators that best represent the theoretical concepts the researcher intends to measure. For these reasons, a case study approach, treating each FC as the unit of analysis, was deemed most appropriate for this research. Following Yin (2003:120-122), the case study data were used to test theoretical propositions and to build explanations where propositions were contradicted by the data.

Yin (2003:11-15) contends that case study is a useful research strategy covering the logic of design, data collection techniques, and specific approaches to data analysis when the *“inquiry copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result benefits from the prior development of theoretical propositions to guide data collection and analysis”*. While case study has been criticised for its lack of generalisation to populations (Adams and Schvaneveldt, 1985:114; Tellis, 1997), Yin (2003:11-15) argues that its findings can be generalised to theory. It is therefore important to build case studies on strong theoretical foundations.

3.2.2 Multiple-case design

The term ‘case’ in case study has no unique definition. Nevertheless, there is broad consensus on what comprises a ‘case’. For example, a case may refer to one instance or a few instances of some social phenomenon such as a village, a family or a juvenile gang (Babbie, 2008:298-300), a descriptive document based on a real life situation or event (Merseth, 1994), or an account of an activity, problem, individual or – as in this study – a firm (Dooley, 2002; Ragin, 1994:98-103). Each farmer company had its own stakeholders and its own sources of data. For these reasons, this study treated the FC as a holistic unit (Yin, 2003:52-53), thereby making it the unit of analysis. Ordinary shareholders, directors and managers – the components of a firm’s ‘governance triangle’ (Dess et. al., 2007:18-21) – were treated as sub-units within each holistic case rather than as embedded units (Yin, 2003:52-53), providing data at different levels of the organisation.

Yin (2003:47) explains that the use of contrasting cases to provide holistic answers to a particular research question adds valuable theoretical replication to a case study design. In this research, case studies were made of successful and failed FCs to generate compelling and robust evidence either consistent with, or refuting, the theoretical propositions (Herriott and Firestone, 1983). Following Bryman (2004:48-57), failed and successful farmer companies were compared to reveal common and differentiating factors thought to explain their relative performance. To strengthen these comparisons, *a priori* information about FCs in Sri Lanka was used to stratify the populations of failed and surviving case studies into three sub-groups according to their core business (Batuwitage, 1998, 2003; Esham and Usami, 2007; Senanayake, 2004): (i) farmer companies that provided inputs and services to members; (ii) farmer companies that marketed commodities produced by their members; and (iii) farmer companies that processed their members' products and marketed them as value-added products.

This stratification process yielded a sample of six farmer companies for the case study, and grouped them into three pairs (as illustrated in Figure 3.1): FIP and SIP (failed and successful input and service providers); FCS and SCS (failed and successful commodity sellers); and FVA and SVA (failed and successful value-adders). Apart from improving the homogeneity of case studies being compared, stratification by core business also ranked the three pairs of case studies in order of their demands on capital, with value-adders requiring the most capital to finance processing plants. Institutional problems impacting directly on the company's access to equity and debt capital were therefore expected to be revealed most clearly by comparing the failed and successful value-adders.

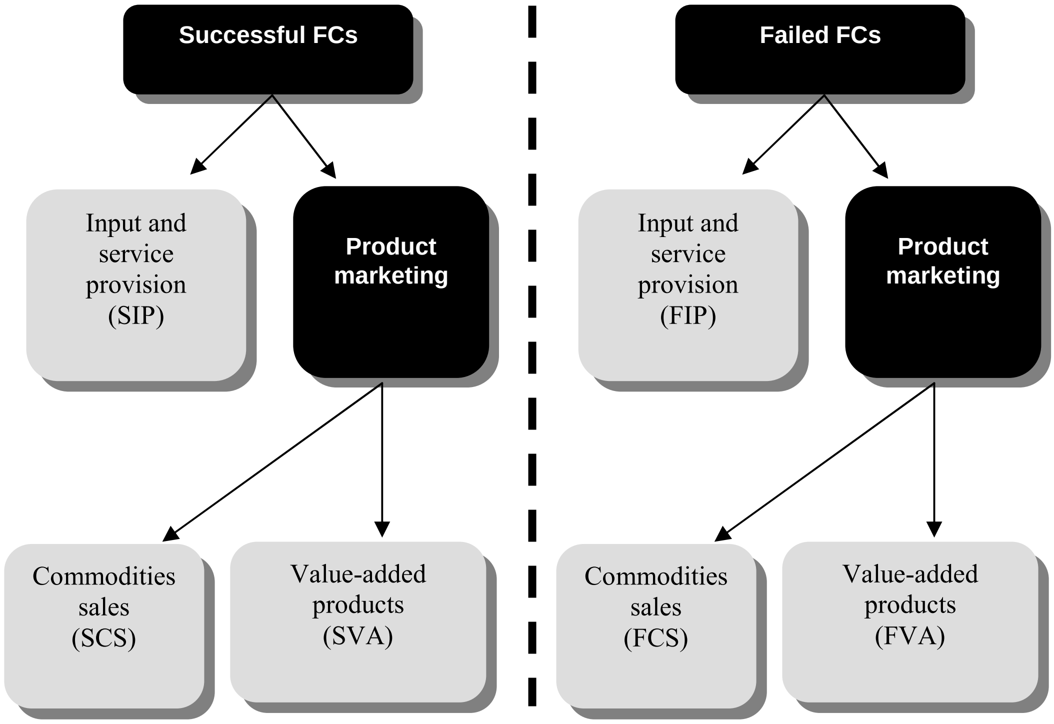

Figure 3.1: Sample design for multiple case studies

3.2.3 A cross-sectional inquiry

Figure 3.2 presents a timeline for each of the six case studies at the time of investigation in 2008. Although the FCs had gone through important stages of their corporate life cycles before this research was undertaken, this investigation examined the cases at a single point in time, making it a cross-sectional study (Frankfort-Nachmias and Nachmias, 1996:146-147). Nevertheless, the interviews explored the track-record of each case, and data were gathered from historical annual reports and financial statements. The case studies are described in Chapter 5.

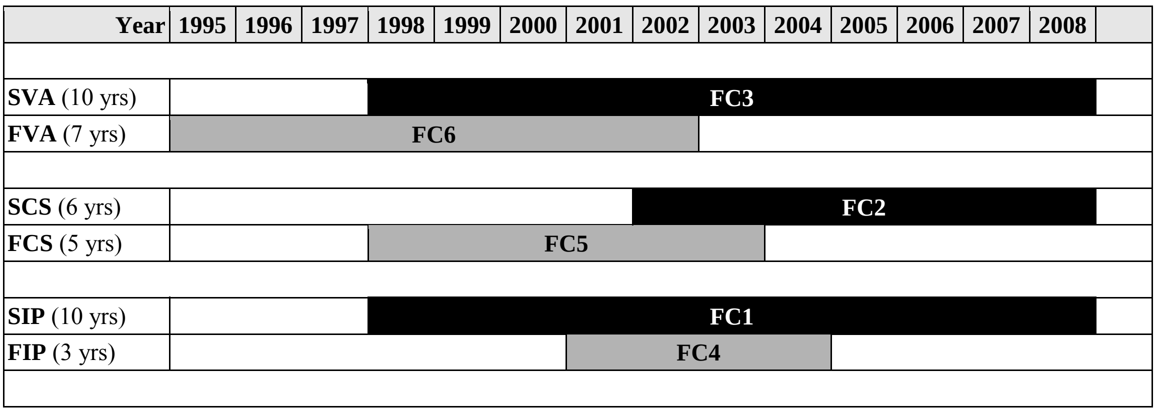

Figure 3.2: Life-span analysis of the selected pairs of farmer companies

Source: Case study data.

3.2.4 Quality of the research design – reliability and validity

Case studies have their own strengths and weaknesses. Literature lists case selection bias (Adams and Schvaneveldt, 1985:114), lack of representativeness, incorrect inferences due to measurement errors (particularly in single-case designs), and lack of independence of cases (George and Bennett, 2005:22-34) as key weaknesses. The quality of a case study research design can be judged using tests of validity and reliability that are frequently applied in social science research (Yin, 2003:34). Several tactics recommended by Yin (2003: 33-39) were employed to improve the validity and reliability of the case study data. Firstly, the inclusion of multiple cases helped to improve design validity. Secondly, data were gathered from multiple sources of complementary evidence using a logical chain of evidence to improve the internal validity. Burns (2000:419-420) and Flick (2004: 178-183 and 2007: 54-74) recommended the use of two or more sources of data to analyse a particular aspect of a case study - data triangulation - as a strategy to improve the internal validity of a research. Thirdly, reliability was improved by employing a case study protocol (Appendix 1) and by selecting case studies from sampling frames constructed for each of the six strata described in Figure 3.1. This sampling technique reduced selection bias, thus improving both the representativeness and independence of cases.

3.3 The sampling technique

3.3.1 Selection of cases in the field

Approximately 92 FCs had been registered in Sri Lanka by 2008 when this study commenced. Of these, many had failed (Esham and Usami, 2007). These FCs were identified and stratified according to the proposed research using *a priori* information sourced from the RoC, the Department of Inland Revenue (IR) and the Mahaweli Ministry of Sri Lanka. A single case study, willing and able to provide valuable information, was then purposefully selected from each stratum. Consideration was given to the accessibility of shareholders and key informants, availability of annual reports and financial records, and length of the company's track record. Seawright and Gerring (2008) recommend purposive sampling over random case selection in order to provide some degree of control for comparative case studies. The selection of cases was therefore also guided by *a priori* information about external factors that may have influenced company performance in order to control these influences when comparing each pair of failed and successful FCs. A map showing the geographic location of each case study is presented in Figure 3.3.

Figure 3.3: Map of Sri Lanka showing the location of each case study

3.3.2 Selection of respondents

Each case possessed its own sources of evidence. Initial discussions with personnel at a few FCs and their facilitating organisations identified a set of primary, secondary and external stakeholders (Figure 3.4). Suitable informants were selected from each stakeholder category at the beginning of each case study, with special attention given to respondents from the governance triangle. Following Barbour (2008:29-31), respondents were purposefully selected to reflect diversity and to obtain valuable data, as the purpose was to test theoretical propositions and not to generalise the findings to target population. The process of selecting respondents within each category is explained more fully in the ensuing sub-sections.

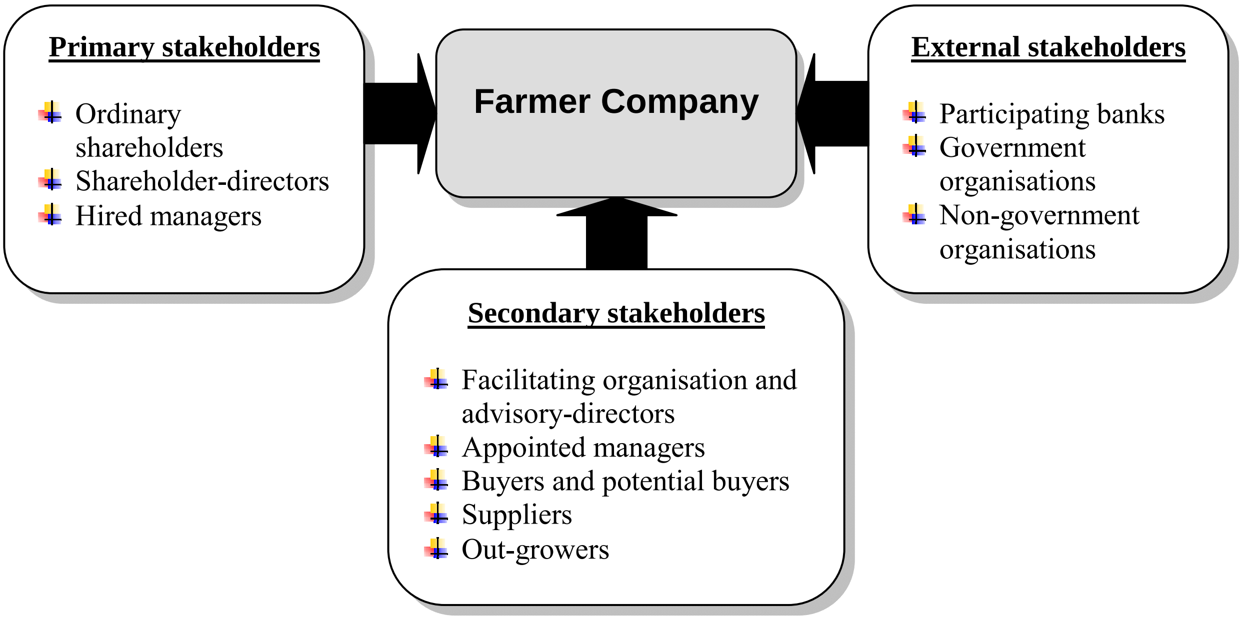

Figure 3.4: Key respondent categories within farmer companies

3.3.2.1 Selection of primary stakeholder respondents in successful farmer companies

Ordinary shareholders, shareholder-directors and hired managers were the main sources of data in the group of primary stakeholders. The shareholders register provided the frame for purposive sampling of shareholder-respondents at each successful FC. Shareholders who were cooperative and who provided useful insights in semi-structured 'pre-selection' interviews were selected for further in-depth interviews. Recommendations made by directors, managers and fellow shareholders were also used to identify shareholders for in-depth interviews. Data were also gathered from the most senior manager, chairman and some directors at each successful FC. Information elicited from these primary stakeholders related primarily to institutional arrangements, operations, patronage, management issues, and collective action within the FC. This information was gathered in semi-structured interviews using interview guidelines.

3.3.2.2 Selection of primary stakeholder respondents in failed farmer companies

The population of primary stakeholder respondents at failed FCs was largely unobserved. Sampling frames existed, but were obsolete and difficult to access. Some respondents refused to cooperate or were reluctant to provide complete answers about the causes of FC failure.

Therefore, recruiting ex-directors and ordinary shareholders as respondents to obtain informed and contextualised insights was challenging and needed special care.

Targeted sampling (Watters and Biernacki, 1989) was used to select most of the shareholders and directors interviewed. A few key respondents (primary recruits) were identified first with the help of officers from the facilitating organisation and the regional Department of Agriculture (DoA), the *Grama Sewakas* (village headmen) in the area, and key informants from local banks and agrochemical companies (Figure 3.5). Following Berg (1989:60, 66), these primary recruits were used to identify secondary recruits for the research – a snowball sample; a well known sampling technique in qualitative research. Brief pre-interview discussions were conducted with these secondary recruits to eliminate candidates who were unable or unwilling to provide new or distinctive information. In summary, purposeful mapping was used to enlist primary recruits, and a systematic informed plan was used to draw the final sample.

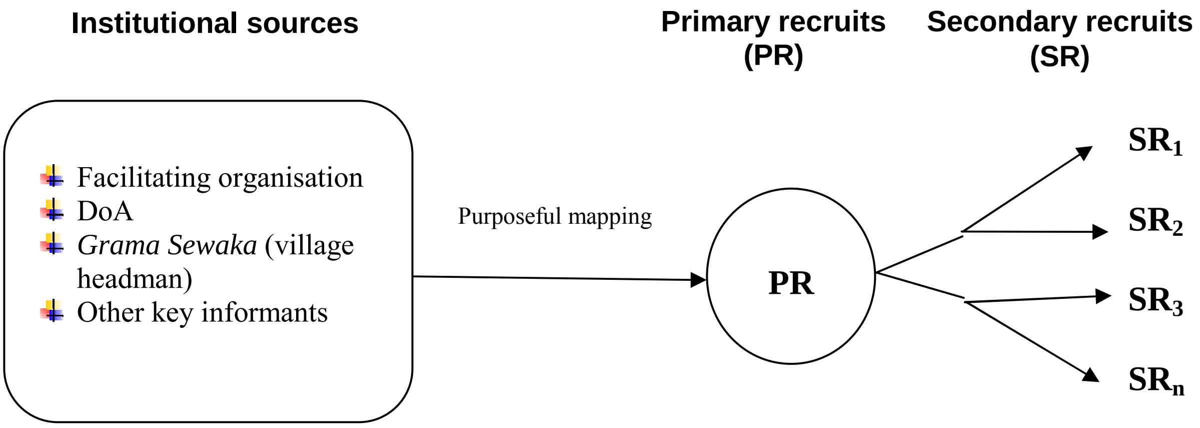

Figure 3.5: Strategy used to select shareholder-respondents in failed farmer companies

3.3.2.3 Secondary and external stakeholder respondents

Officials at the RoC and IR were interviewed to obtain their responses about legislation and regulations relating to FCs. Interviews were also conducted with advisory-directors and managers appointed by government agencies, and - where possible - with buyers and input suppliers to elicit their perceptions of the FC, its products and consistency in deliveries and payments. Out-growers were interviewed at FC2 and FC3 to explore supply history, benefits enjoyed, and the perception of their relationship with the company.

Participating banks were another important category of stakeholders. Both state and private banks financed farmer companies. Interviews were conducted with managers of local bank branches to gather data about perceptions of creditworthiness, loan types, repayment history, and repeat business.

3.4 Data collection procedure

Primary data were gathered in Sri Lanka between May and July 2008. Data from the surviving FCs were collected first. This strategy generated additional information about failed FCs worthy of case study. No pilot studies were conducted owing to the limited time available for field work.

3.4.1 Methods of data collection

This study used different sources of evidence as a strategy to achieve internal validity (Yin, 2003:85-96). The sources were integrated to test theoretical propositions. Primary data were collected in semi-structured interviews with respondent shareholders and key informants such as chairmen, shareholder-directors, advisory-directors, senior managers, facilitators, buyers, suppliers, out-growers and branch managers of banks. Respondents were interviewed individually, and the interviews were informed by interview guides (Annexes 2 to 9). Such guides are recommended to keep the interview focused and to ensure that key topics are not overlooked (Taylor and Bogdan, 1998:105-106; Burns, 2000:424-425; Yin, 2003:90). Use of semi-structured interviews provided the flexibility required to explore relevant issues raised by respondents, particularly shareholders who often mentioned incidents that provided useful insights on closer examination. Only some interviewees provided consent to record their interviews. However, this did not affect the data collection as extensive field notes were taken during all the interviews of this investigation.

Company records provided an important source of secondary data. These internal records included annual reports, minutes of annual general meetings and board meetings, memos, notices, letters and cuttings taken from newspapers. Archival records kept by the RoC, Ministry of Mahaweli Development and the IR also proved to be important sources of secondary data. These external records included organisational charts, budgets, human resource reports and registers of shareholders. Together, the internal and external records extended the chain of evidence used in this study and provided secondary data that both supplemented and triangulated the primary data.

Direct observations were made of buildings, plant, equipment, products and labels. These observations were used primarily to verify interview data, while photographic evidence lent credibility to the chain of evidence. Unfortunately, the fieldwork did not coincide with either a board or general meeting, but the researcher was able to observe respondents' reactions to questions and, in some cases, their relationships with other respondents.

Theoretical saturation is identified as the criterion for judging when to stop sampling the respondents relevant to a particular case. Glaser and Strauss (1967:61-62) and Corbin and Strauss (2008:263 and 324) argue that after that point, further data collection and analysis add little new information to the conceptualisation. In this study, the stakeholders in each FC were treated as sub-units and saturation was assessed after aggregating the data gathered from all of these sub-units. Significant variation was anticipated in only two sub-units; the farmer shareholders and historical records. Saturation occurred after interviewing approximately 15 farmer shareholders at each FC. The number of documents reviewed at each FC varied considerably depending on their content and quality.

3.5 Data analysis strategy

Digital recordings of interviews were transcribed and combined with field notes made at each case study. These narrative data were then grouped, case by case, into categories representing the main constructs of the theoretical framework proposed in Chapter 2 and illustrated in Figure 2.1 to facilitate qualitative comparisons between the successful and failed farmer company within each stratum. Since the qualitative analysis was expected to generate variables measuring aspects of company performance and its internal determinants, a quantitative analysis was also performed to check relationships between these variables. The merging, sequencing or concurrent use of qualitative and quantitative approaches in the collection and analysis of case study data has enhanced the quality and popularity of social research projects (Bergman, 2008:12-14). Apart from providing complementary insights about relationships established in qualitative analysis (Bryman, 2008:87-100; Tashakkori and Teddlie, 2008:101-119), the sequential use of qualitative and quantitative methods to analyse case study data improves research validity by introducing methodological triangulation (Flick, 2007:54-73). For these reasons, the qualitative analysis conducted in this study was followed with a cluster analysis of variables measuring aspects of FC performance and its proposed internal determinants.

3.5.1 Qualitative data analysis

Analysis of qualitative data requires a systematic approach (Taylor-Powell and Renner, 2003). While this study draws heavily on the approach recommended by Yin (2003:109-136), the qualitative analysis was preceded by two steps to check the validity of pair-wise comparisons between failed and successful FCs within each stratum. First, the financial and outreach performance of each 'successful' FC was examined to check that these companies were indeed successful (Section 5.2.2). Second, external determinants of FC performance were examined to ensure that each pair of FCs experienced similar shifts in market and climatic conditions (Section 5.2.3).

Following Yin (2003:109-111), the qualitative analysis involved examining, categorising, tabulating and re-combining narrative data. Each case study was described (Chapter 4), with emphasis given to its development and its institutional, group and management attributes (Yin, 2003:114-115). Having thus established the relevant data, theoretical propositions were checked by a process of 'pattern matching' (Yin, 2003:116-119). This entailed comparison of attributes observed in failed and successful FCs with attributes predicted by theory and best practice (Trochim, 2006). Where failed and successful FCs exhibited contrasting attributes consistent with theory, the proposition was confirmed. Otherwise, the proposition was questioned and the analysis entered its 'explanation building' phase (Yin, 2003:120-122) to account for the inconsistency or to refine the theory. Cross-case analyses, facilitated by a multiple case study design, improve the robustness of results obtained in pattern matching and explanation building (Yin, 2003:133-137).

3.5.2 Quantitative data analysis

Since the qualitative analysis would generate a set of variables measuring company performance and a set of variables measuring each of the main constructs proposed as internal determinants of company performance, there was an opportunity to explore quantitative relationships between these variables using cluster analysis. Whereas Everitt (2005:115-122) defines the purpose of a cluster analysis as being "*to discover a system of organising observations, usually people, into groups where members of the groups share properties in common*", Knight et. al. (2003) used hierarchical cluster analysis to find natural groupings of variables. A similar approach was taken in this research to triangulate the qualitative methodology and to identify relationships not revealed by the qualitative analysis. Hierarchical cluster analysis was considered appropriate as the object was to group related variables (not cases) and the variables were all binary measures showing the presence or absence of performance, institutional, group and management attributes.

3.6 Human ethics considerations

This research needed an approval from the Lincoln University Human Ethics Committee (HEC) because it involved: (i) human participants during the data collection phase; and (ii) subsequent storage of data collected from such human participants. This research followed guidelines set by the HEC to ensure that this is an ethically-sound research. Some FCs specifically requested the author to preserve the identity of the company and its associates. Actual names of FCs and respondents directly linked to them were not revealed at any stage in this thesis.

3.7 Concluding remarks

Chapter 3 explains the research approach, sampling design and methods used to collect and analyse data. A multiple case study approach as adopted with a successful and a failed farmer company selected in each of three core business strata. Both primary and secondary data would be gathered and analysed using qualitative and quantitative methods. Chapter 4 describes each of the six FCs studied.

Chapter 4

Case Descriptions

4.1 Introduction

In-depth case studies were carried-out between May and July 2008 on six farmer companies in Sri Lanka to identify and understand factors affecting their performance. Descriptive information about FCs obtained from the RoC, IR and a number of accounting firms in Sri Lanka was used to classify the population of FCs into the six strata established for this study (Figure 3.1); successful input and service providers (SIP), failed input and service providers (FIP), successful commodity sellers (SCS), failed commodity sellers (FCS), successful value-adding processors (SVA) and failed value-adding processors (FVA). One FC was selected from each group for case study. The selection was purposeful and guided by the FC's willingness and ability to provide rich data. In this chapter, the term 'FCs' refers to the six farmer companies studied in this research. This chapter introduces the case studies with a brief overview of their history, objectives, core business activities, institutional arrangements, and pertinent management and group issues.

4.2 Farmer Company 1

4.2.1 Brief history and background

Farmer Company 1 (FC1) is a surviving FC which primarily supplies inputs and provides services to its shareholders. This class of FC contrasts with input and service providing FCs that failed, and with FCs that add value to farm products and which therefore require relatively more capital.

FC1 was incorporated on 20th February 1998. The company is located within an irrigation settlement scheme (Plate 4.1) in the Sabaragamuwa Province of Sri Lanka. A government organisation facilitated its establishment as a pilot project to commercialise smallholders and to uplift living standards of farmers in the irrigation settlement area.

The facilitating organisation was mandated to manage water of major irrigation schemes; to promote business, human resource, institutional and agricultural development; and to protect forests and the environment. It supported the establishment of FC1 by providing mainly finance, buildings, transport, some machinery and land. Table 4.1 summarises key historical, organisational and performance characteristics of FC1.

Table 4.1: Key historical, organisational and performance characteristics of FC1

Characteristic	Details		
Date of incorporation	20.02.1998		
Initiation	Establishment as a pilot project was facilitated by a government organisation		
Planned share capital	LKR10 million (1 million ordinary shares at LKR10 per share)		
Financial assistance received from government	LKR1.54 million		
Degree of facilitation still present	Low		
Degree of influence by facilitating organisation at present	Moderate		
Number of shareholders	340 (as of June 2008)		
Total number of shares sold	19,835 (as of June 2008)		
Categories of key business activities	Supply of farm inputs and provision of services mainly to shareholders and sale of products and sundry items		
Nature of shareholders' voting rights	Democratic voting at the Annual General Meeting (AGM)		
Number of SH directors elected	7		
Number of advisory-directors	None[2]		
Requirements to be a shareholder director	A shareholder who is either the representative of a Field Canal Farmer Organisation (FCFO[3]) or the chairman of a Distribution Canal Farmer Organisation (DCFO)[4].		
Shareholding-patronage relationship	Shareholding is not proportional to patronage		
Basis for paying dividends	Proportional to shareholding		
Presence of non-patron investors	None. But some shareholders do not patronise FC1		
Presence of non- shareholder patrons	No out-growers (OGs) or sub-contractors. But FC1 does transact with non-investors.		
Active market for shares?	No		
External auditing of accounts	Done by a chartered accounting firm		
Value of total assets of the company	LKR4.33 million (as of December 2007)		
Possession of relation-specific assets	None		
Some performance indicators			
Year	2005	2006	2007
Total revenue (LKR millions)	4.54	12.56	1.67
Profit before tax (LKR millions)	0.19	0.42	(0.08)
Markets	Regional		
Number of buyers	Shareholders plus other farmers in the area		

Sources: Articles of association, company constitution, financial statements from 2005 to 2007 and interviews with key informants from FC1.

4.2.2 Objectives of Farmer Company 1

The key objectives guiding the company are to:

1. Uplift living standards of farmers and agro-entrepreneurs operating in the Irrigation Settlement Scheme.

[2] The General Manager (GM) is an ex-officio director who has no voting power on the board.
[3] Described in Section 4.2.4
[4] Other requirements include a clear credit history, age of 18 years or over, not convicted in the courts and not part of supply or other contracts involving the FC.

2. Supply agricultural inputs including seeds, agrochemicals and fertiliser.
3. Provide loans, other financial assistance, transport, contractor and other services.
4. Sell, lease and maintain agricultural machinery and implements.
5. Provide irrigation water, and manage and maintain irrigation infrastructure.
6. Undertake technical and research projects related to agricultural development.
7. Facilitate investment in crop and livestock processing, packaging and transport industries.
8. Buy, store and sell the agro-products produced in the area.
9. Introduce new technology and seed varieties suitable for local and export markets.
10. Promote labour intensive cottage and export industries.
11. Open fuel filling stations.

These objectives, of which some are overlapping, were identified jointly by the facilitating organisation and the collective action group of farmers in the irrigation settlement area.

4.2.3 Core business activities

FC1's portfolio of enterprises included the provision of agricultural inputs (mainly fertiliser), paddy purchasing and selling, buying and selling of other crops, and machinery, transport and contractor services. From 2004 to 2007, the company earned 53% and 41% of its income through buying and selling agro-produce and provision of inputs and services, including machinery services, respectively (Table 4.2). The buying and selling activity is on the decline and the company is promoting the provision of inputs and services as their future core business. Some of these transactions are conducted with patron-shareholders and some with non-investors. Plates 4.2 and 4.3 present photographs of one of two sales outlets and a shareholder's farm respectively.

Table 4.2: Annual income of FC1 by core business activity, 2004–2007

Business activity	Income (LKR '000s)	Share of total income (%)	Rank
Buying and selling of agro-produce	12,971	53	**1**
Provision of inputs and services	9,962	41	**2**
Miscellaneous income	1,410	6	**3**
Total	**24,343**	**100**	

Sources: Financial statements of FC1 2004–2007.

Plate 4.1: The lake that provides irrigation water to shareholders of FC1

Plate 4.2: One of two sales outlets operated by FC1

Plate 4.3: Banana and rice fields farmed by a shareholder in FC1

4.2.4 Institutional and organisational arrangements: An overview

The company's constitution restricts membership to farmers in the irrigation settlement area who own land and who are members of the FCFO[5]. This imposes a severe geographical limitation on its shareholder base. Farmer organisations[6] (FOs) registered with the government are also permitted to invest in FC1, but there were no such organisational investors at the time of the study. All shareholders in FC1 are viewed as patrons. However, some SHs no longer deal with the company and, strictly speaking, are not patrons.

FC1 has only issued ordinary shares, and the level of shareholding was not linked to the investor's level of patronage although it is compulsory to hold some shares to stand for election. A cash dividend of LKR5.00 per share (50% of the share value) was paid in 2006. Dividends were paid only once in the history of the company.

[5] Field canals that take irrigation water into the paddy fields branch-out from distribution canals. Farmers whose fields are fed with irrigation water by a particular field canal form a FCFO in that particular area. All FCFOs drawing from the same distribution canal form the DCFO with a representative from each FCFO. Distribution canals branch-out from the main canals of the irrigation reservoir.

[6] Large formal organisations of farmers registered with the DoA. All the shareholder interviewees of FC1 are members of different FOs established in the locality.

FC1 was able to attract only two percent of its planned share capital despite an increase in the membership from 52 to 340. A shareholder may transfer shares only to other shareholders, immediate family members or to persons approved by the board of directors (BoD). In reality, the market for shares is not active and they cannot be transacted freely.

Seven directors are elected to the board by shareholders at the AGM. Each shareholder has one vote regardless of his or her level of equity investment – as in a traditional cooperative – and the company had a history of 'unanimous elections' implying that nominated candidates were elected unopposed. The company has no externally appointed directors. However, the facilitating organisation designates one of its senior officers as the General Manager (GM) and a junior officer as the Deputy General Manager (DGM). Consequently, FC1 does not have full-time managers. The organisational structure (Figure 4.1) is narrow with the GM and DGM managing a wide range of business functions (purchases, marketing, credit control, accounting and human resources). As matters stand, the GM is also able to exercise significant control over decisions taken by the board thanks to his influential position at the facilitating organisation.

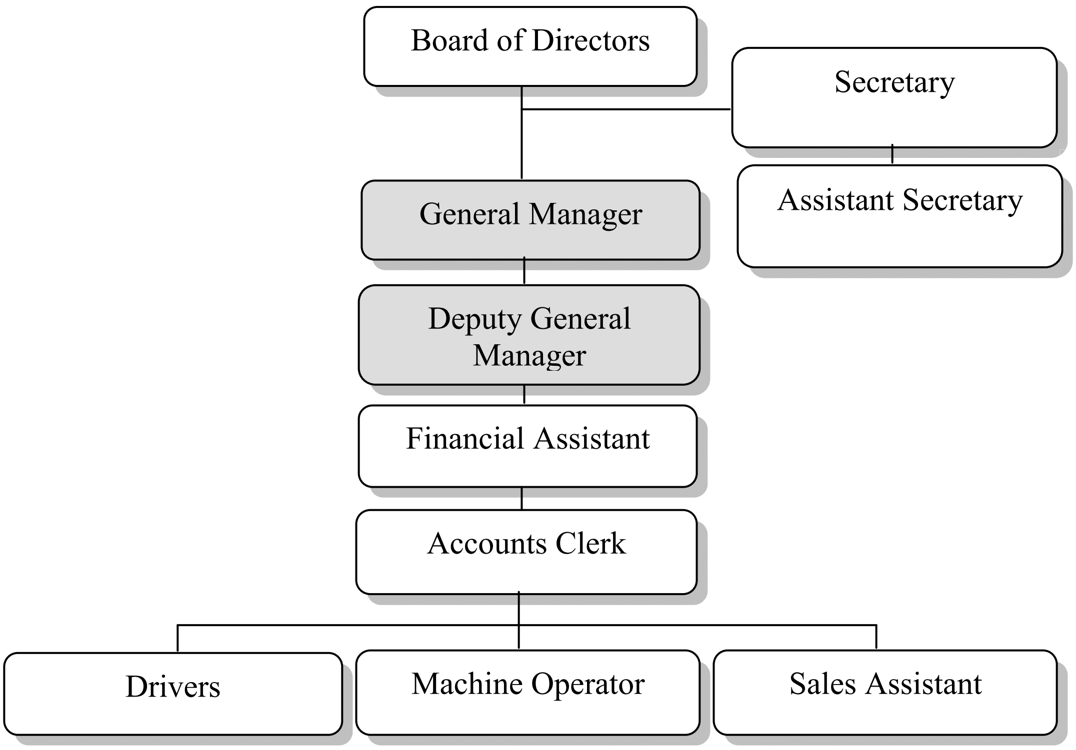

Figure 4.1: Organisational chart of FC1

Note: Shaded positions are filled with part-time officers nominated by the facilitating organisation.
Source: Interview with vice-chairman of FC1.

4.2.5 Governance

FC1 completed its external audit, held the AGM and produced the annual report on time in 2007, a record not always achieved in previous years. The AGM is organised by the FC and supervised by the regional head of the facilitating organisation. Shareholders are given 21 days written notice of an AGM. At least 25% of shareholders must attend for the AGM to be declared quorate. The GM notifies directors in writing at least seven days prior to each monthly board meeting. The GM was a non-voting director of the company. The quorum for board meetings is specified as five of its seven directors. Attendance at board meetings is almost 100%.

The BoD authorised the GM to make single payments of up to LKR5,000 subject to approval by the board. Prior approval by the BoD is required for larger payments and for all capital expenditure. The accounts clerk collects cash payments and handles petty cash. The GM, being a full-time officer in the facilitating organisation, is not actively involved in the company's day to day operations.

4.2.6 Management factors at Farmer Company 1

In the absence of a mission statement or corporate business plan, FC1's operational activities are guided by its objectives (Section 4.2.2). Consequently, strategic choices have not always been consistent with the business environment or with the company's own resources and capabilities. The business portfolio is not revised regularly and there is limited ongoing consultation with shareholders to design and implement strategies. FC1 does not own its own trademark nor has it invested in any market research.

According to the vice-chairman and some shareholders, the company's development and operations have been affected by inconsistent financial performance (Figure 4.2), dependence on the facilitating organisation for financial and operational assistance, inability to finance growth assets, inability to manage larger business operations and legal action brought against the company by its former employees. FC1 was unable to expand its business activities beyond the settlement area.

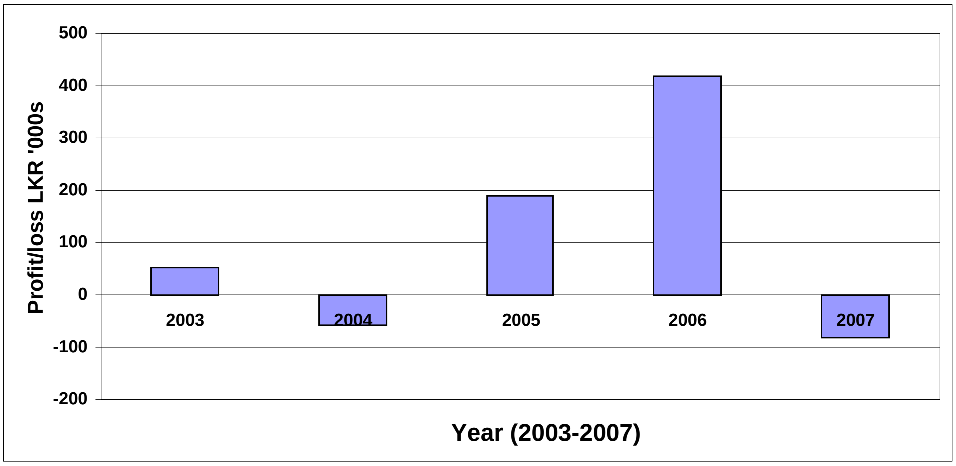

Figure 4.2: Profits and losses at FC1 based on profits/losses, 2003–2007
Sources: Financial statements from 2004–2007.

Stakeholders (Figure 4.3) were generally satisfied with the company as a supplier of inputs and services, and there is potential to broaden its market by establishing more sales depots. As an authorised agent for the government's fertiliser subsidy scheme, FC1 negotiates bulk discounts for fertilisers and sells them at competitive prices from its sales outlets. According to the GM, the company strives to be a local leader in its key business areas. However, its attempts to add value by packaging and selling grains failed, as did efforts to buy and sell bananas – a crop produced by many of its shareholders. These failures were attributed to liquidity problems.

Not only does FC1 lack long-term strategies to achieve its major objectives, it also lacks systematic processes to formulate strategies. Operational strategies are formulated and implemented by managers together with board members. However, it was observed that some strategies are not clearly linked to the company's objectives. Non-managerial employees appear to be capable, experienced and responsible in maintaining the operational tasks and processes of the company. However, the number of non-managerial staff is decreasing (Table 4.3) as a result of cost cutting. The narrow organisational structure is sometimes problematic in planning, strategy formulation and strategy implementation according to key informants.

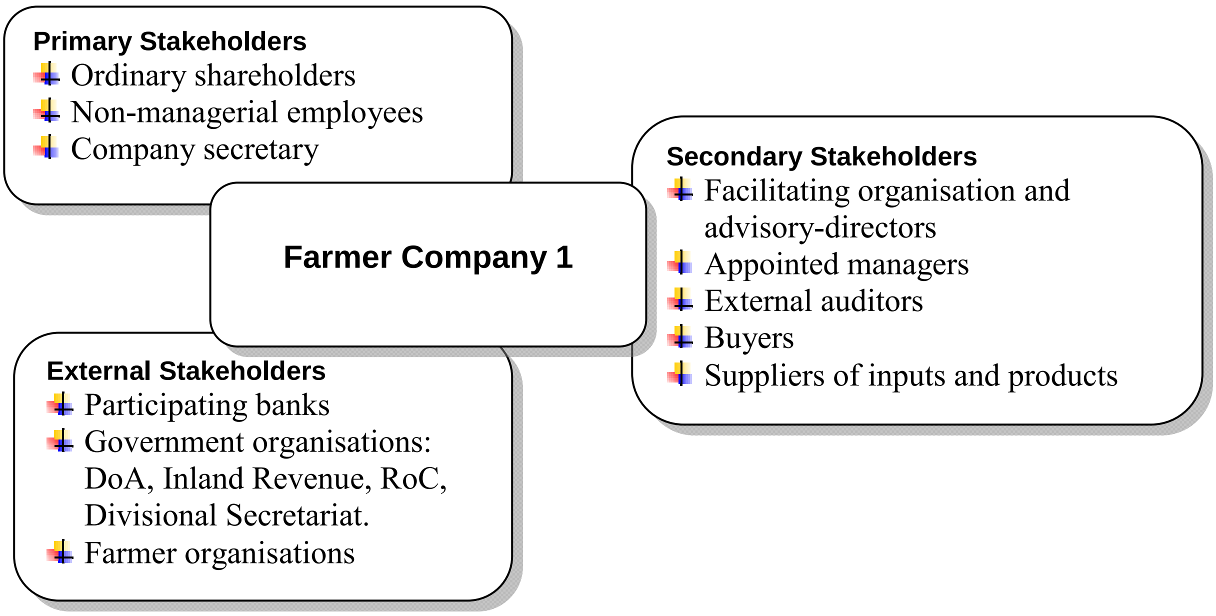

Figure 4.3: Key stakeholders of FC1

Source: Interviews with key informants.

Analysis of the company's business environment and its stakeholders is limited to rather informal gathering of information, reviewing trends, assessing shareholder and staff capabilities, and resource assessments. As a result, making changes in business and service/product portfolios can be *ad hoc*. Board members do not possess any tertiary qualifications or training in business management.

It was observed that financial recording was satisfactorily detailed. Financial processes at FC1 are supervised by the financial assistant who ensures that appropriate inputs are made available for financial statements.

Table 4.3: Personnel strength at FC1

Year	Managerial staff	Non-managerial staff	Total
2004/05	2	10	12
2005/06	2	6	8
2006/07	2	6	8

Source: Human resource records.

4.2.7 Socio-economic and group factors at Farmer Company 1

Reasons given by shareholders for joining FC1 include expectations of business benefits (58%), a market for agricultural produce (23%) and service to the farming community (19%). There had also been an extensive campaign by the facilitating organisation to popularise the

FC. The business benefits that shareholders expected from the FC included better prices and increased profits from their own farming operations, a competitive return on equity capital invested in the FC, enhanced creditworthiness and, since 2005, participation in the government's fertiliser subsidy scheme.

Table 4.4 presents some descriptive statistics computed for the shareholders sampled in FC1. The average age of shareholders is 54.3 years (range 46 to 68). Their mean level of education is 7.8 years (range 6 to 10) of formal schooling. Farming experience averages 31.1 years (range 25 to 45). Ninety-three percent of the shareholders are full-time farmers. The average shareholding per shareholder is 42 ordinary shares. Twenty percent of interviewees were women. All the shareholders interviewed were married and are sole owners of their farms.

Table 4.4: Socio-economic characteristics of shareholders interviewed at FC1, n=15

Aspect	Average	Range
Age in years	54.3	46 – 68
Years of formal schooling	7.8	6 – 10
Years of farming experience	31.1	25 – 45
Distance from farmland to FC office (km)	3.3	1.5 – 6
Number of dependents in family	4.4	3 – 9

Source: Author's analysis of data provided by interviewees.

Recruitment of shareholders into the FC at inception was undertaken by the facilitating organisation. After registration, the company was authorised to enrol members with guidance from the facilitating organisation. Membership is characterised by a network of familial and social relationships which influence shareholder decisions and activities. These relationships encouraged shareholders to establish informal and overlapping sub-groups. Five main reasons for these interest groups included membership of village level FO, alignment of business ideas and views of the company, farming experience, duration of shareholding in the FC, and knowledge about the FC and its dealings.

There are a number informal groups operating within the company. The average size of an informal group is 9.67 members. These informal groups have their own agendas and sometimes react differently towards the company's activities, strategies and overall direction. They lobby for their own interests. Informal groups meet more frequently prior to decisive forums like the AGM. There are often disagreements between them and with management and the board over business strategies and administrative processes. Although some differences are settled by voting at general meetings and at board meetings, agreements are usually negotiated informally prior to these meetings. However, respondents also mentioned that unpopular management decisions were often not contested as the GM is a high ranking officer within the facilitating organisation.

4.3 Farmer Company 2

4.3.1 Brief history and background

Farmer Company 2 (FC2) is a surviving FC that markets products grown by shareholders for the export market. This class of FC contrasts with commodity marketing FCs that failed and with FCs that add value to products and which require relatively more capital. Shareholders invested in their own assets in order to grow products assembled by the company.

FC2 was incorporated on 10^{th} October 2002. It is located in the hills of Uva province of Sri Lanka and its establishment was facilitated by a government organisation. The facilitating organisation established FC2 primarily to consolidate and supply exotic vegetables direct to exporters in order to avoid long marketing chains. Other objectives of establishment were to enhance the rural economy, introduce improved technology to traditional farmlands, negotiate favourable prices for farmers, and to commercialise the smallholder vegetable industry. The facilitating organisation was still guiding major decisions taken by FC2 at the time of this study, some six years after its establishment. The DoA assisted the establishment of this FC by identifying suitable crops and growing techniques suited to the area, and by promoting these crops amongst local farmers. Table 4.5 summarises some key historical, organisational and performance characteristics of FC2.

4.3.2 Objectives of Farmer Company 2

The main objectives of the company are to:

1. Conduct business as sellers (local and export), importers, exporters, commission agents, producers' agents, ordering agents, transport agents and promoters of products produced.
2. Organise, conduct and participate in trade exhibitions and conferences related to export promotion.
3. Attract funds and launch activities to improve social, economic and health facilities of shareholders and the locality.
4. Undertake training, research and development activities related to vegetables, fruits, flowers and medicinal herbs.

The facilitating organisation provided a significant input in framing these objectives.

Table 4.5: Key historical, organisational and performance characteristics of FC2

Characteristic	Details			
Date of incorporation	10.10.2002			
Initiation	Establishment was facilitated by a government organisation			
Planned share capital	LKR1 million (i.e. 100,000 ordinary shares at LKR10 per share)			
Financial assistance received from government	LKR17.9 million[7]			
Degree of facilitation still present	High			
Degree of influence by facilitating organisation at present	High			
Number of shareholders	154 (as of July 2008)			
Total number of shares sold	5,054 (as of July 2008)			
Categories of key business activities	Assembly and selling of exotic greenhouse vegetables, provision of inputs and sale of planting media.			
Nature of shareholders' voting rights	Democratic voting at AGM.			
Number of shareholder directors elected	7			
Number of advisory-directors	3			
Requirements to be a SH director	Any shareholder			
Shareholding-patronage relationship	Shareholding is not proportional to patronage			
Basis for paying dividends	Proportional to shareholding.			
Presence of non-patron investors	Yes (54 minor SHs)			
Presence of non-shareholder patrons	Yes (42 out-growers)			
Active market for shares?	No			
External auditing of accounts	Done by a chartered accounting firm			
Value of fixed assets of the company	LKR1.4 million (as at 31.03.2007)			
Value of total assets of the company	LKR30 million (as at 31.03.2007)			
Possession of relation-specific assets	Yes - Experimental greenhouse[8]			
Some performance indicators				
Year	2004	2005	2006	2007
Total revenue (LKR millions)	--	0.30	5.26	4.11
Profit before tax (LKR millions)	(0.52)	(1.46)	(0.87)	(0.91)
Markets	Local but export-oriented			
Number of buyers	3 exporters			

Sources: Articles of association, company constitution, financial statements from 2005 to 2007 and interviews with key informants of FC2.

4.3.3 Core business activities

Seventy seven per cent of the company's revenue was earned through marketing of exotic vegetables (bell-pepper and tomato) produced in shareholders' poly-tunnels[9] for direct supply to exporters (Table 4.6 and Plate 4.4). In mid 2007, shareholders started producing new products such as iceberg lettuce, Chinese cabbage, sage, mint, basil and parsley in open fields

[7] This includes grants of LKR7.9 million and loans of LKR10 million to the FC until May 2008. In addition, the facilitating organisation arranged bank loans amounting to LKR25.7 million for all the major shareholders for setting-up of poly-tunnels and for initial operations. Shareholders were required to re-pay these loans within 5 years. The FC is partly responsible for recovery of these loans from the shareholders. The facilitating organisation continues to assist the FC.

[8] Approximate value is LKR500'000.

[9] A large tunnel made of steel pipes or wood, covered with 500 gauge, Ultra-Violet resistant polythene. This technique to produce high quality crops is popular in Sri Lanka.

for local supermarkets. A collection space provided by the company was used to consolidate the shipments. FC2 plans to centralise this activity (quality control and assembly) into a new business venture in future. Supplying farm inputs and planting media to shareholders are also important activities in FC2's enterprise portfolio.

Table 4.6: Annual turnover of FC2 by major business activity category, 2006/2007

Category	Turnover (LKR '000s)	Share of total revenue (%)	Rank
Sale of exotic vegetables	3,160	77	**1**
Provision of agricultural inputs	746	18	**2**
Sale of planting media	205	5	**3**
Total	**4,111**	**100**	

Source: Financial statements of FC2 2006/2007.

Plate 4.4: A poly-tunnel (left) and bell-pepper crop (right) of two FC2 shareholders

4.3.4 Institutional and organisational arrangements: An overview

The company invited only 154 farmers (out of 560 initially selected) to invest in the company. One hundred shareholders bought 50 ordinary shares each (major shareholders) and the remainder bought one share each (minor shareholders). The facilitating organisation organised bank loans for the major shareholders to finance their individual assets - poly-tunnels - for production. The minor shareholders were not offered credit. According to the facilitating organisation, FC2 does not intend to expand its membership. Additional produce is purchased from 42 out-growers (Table 4.7) who were recommended by FC2 to commercial banks for loans to finance their poly-tunnels. All major shareholders are expected to patronise the company. Minor shareholders are unable to patronise the company as they do not have poly-tunnels. According to FC2's constitution, ordinary shares held by shareholders who do not patronise the company continuously for more than six months can be converted into redeemable shares. There is no relationship between levels of shareholding and patronage in FC2.

Table 4.7: Classification of FC2 investors and out-growers by production facilities

Category	Type of production facility	Number of individuals
SHs who own 50 shares each (major shareholders)	Poly-tunnels with galvanised steel frames	87
	Poly-tunnels with galvanised steel frames and poly-tunnels with wooden frames	13
SHs who own 1 ordinary share each (minor shareholders)	No production facility	54
Total number of SHs		154
Out-growers	Poly-tunnels with wooden structures	42

Source: Author's analysis of data provided by key informants.

The company's constitution restricts shareholding to any people's company and to farmers whose lands are located within 16 Grama Sevaka (GS) divisions[10] around the company's office. This command area introduces a geographical limitation for shareholding. In addition, the constitution makes no provision for the transfer of shares. There has been no change in registered shareholders since the company was established - an indication of a rigid membership and the absence of an active market on which shares can be traded freely. FC2 was able to attract only five percent of its planned share capital (Table 4.5).

The BoD comprises of ten directors. Seven of these directors are elected to the board by show of hands at the AGM. Each shareholder has one vote irrespective of his or her level of equity investment (democratic voting) – as in a traditional cooperative - and the company has a history of 'unanimous elections'. Any shareholder may stand for election. At the time of the study, only one of the seven elected directors was a minor shareholder. The remaining three directors are appointed by the facilitating organisation and all of them were senior officers of

[10] Smallest administrative unit in Sri Lanka. Known as Village Headman Divisions during the colonial era.

the facilitating organisation at the time of the study. These advisory-directors have no voting power on the board.

The facilitating organisation is responsible for recruiting the CEO - the only executive. The CEO, who has a job contract with the FC2, is closely supervised by the facilitating organisation. FC2 has a simple organisational structure (Figure 4.4) with three main functions (technical, accounting and miscellaneous).

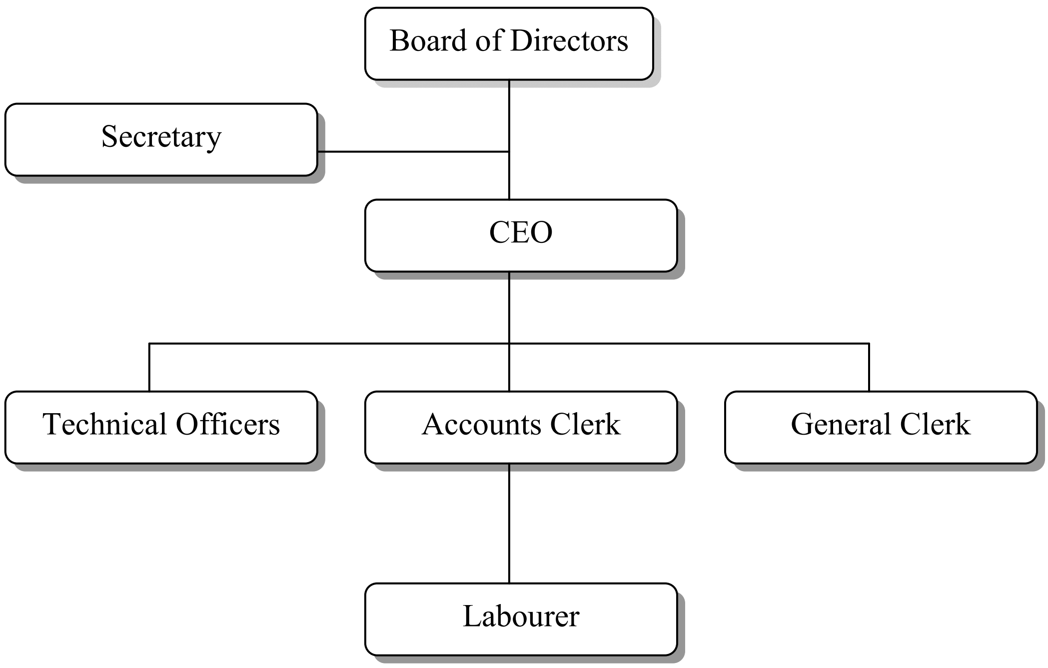

Figure 4.4: Organisational chart of FC2

Source: Interviews with key informants.

4.3.5 Governance

The facilitating organisation calls for nominations for shareholder-directors and organises the company's AGM. Shareholders are given 21 days written notice of the meeting. The quorum is specified as two-thirds of the total number of shareholders. The facilitating organisation notifies directors in writing at least seven days prior to monthly board meetings.

The facilitating organisation oversees the company's record and book-keeping, internal and external audit, annual financial reporting and capital expenditure. The CEO is authorised for a petty-cash imprest of LKR5,000. Otherwise, the facilitating organisation manages all cheque and large payments. The facilitating organisation also monitors fiduciary relationships between FC2 and its buyers and shareholders. Figure 4.5 illustrates the controlled channel for payments made to shareholders. These payments are made within 30 days of despatch of produce.

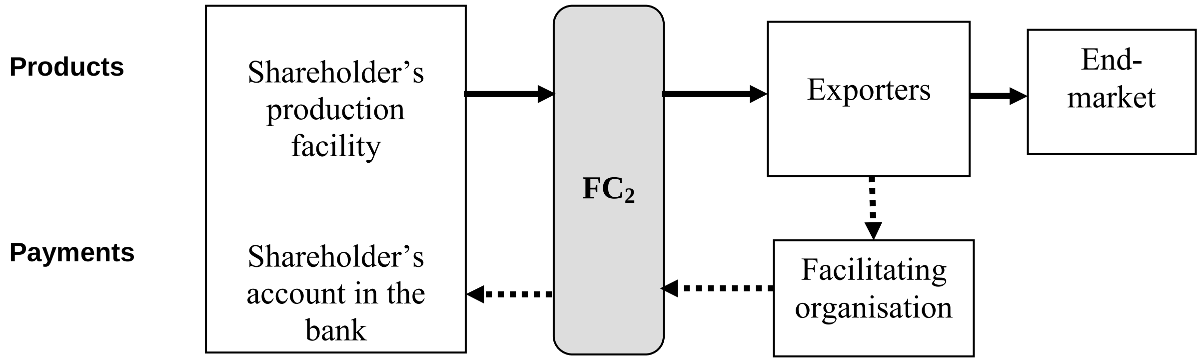

Figure 4.5: Channel for product despatch and payments in FC2
Source: Author's analysis of data provided by key informants of FC2.

4.3.6 Management factors at Farmer Company 2

FC2 does not have a mission statement or a corporate business plan. The company's organisational objectives (Section 4.3.2) are broad. The facilitating organisation uses its advisory-directors to inform and influence the board on matters of business strategy, and the CEO to implement these strategies. The board considers the company's business environment, its resources and the expertise and experience of its directors before choosing strategies. The business portfolio is maintained in consultation with the facilitating organisation. FC2 does not have its own trademark nor has it invested in any formal market research other than analysing market prices of its products.

FC2 competes by supplying superior quality product in an industry where competition to supply high quality fresh vegetables for export is intense. The CEO and Technical Officers (TOs) frequently visit shareholders' production facilities to carry-out inspections and offer on-site advice on cultivation, harvesting, quality control and grading to ensure a high quality output. The company was able to sell the full quantity produced by its shareholders.

The facilitating organisation and the company believe that they have a healthy product portfolio. The company was supplying its products to reputed exporters with a view to gaining a foothold in the export market. Although FC2 does not supply to the local end-market, it had received enquiries from local supermarkets. Agricultural inputs, especially fertiliser, were bought at favourable prices by negotiating bulk deals with input companies, and sold to shareholders at competitive prices.

FC2's core business is still linked to crop projects identified by the facilitating organisation when the company was established. The facilitating organisation clearly influences decisions about company business strategy and operations. The CEO gathers and analyses market information - mainly product prices - to assist shareholders in their choice of crops. Good relationships between shareholders, directors, the CEO and TOs are maintained through active communication. Opinions of shareholders are sought and interested shareholders are contacted regularly depending on the nature of the proposed activity. Operational strategies are implemented mainly by the TOs.

Figure 4.6 shows trends in the prices of key products marketed by FC2. Despite differences in net returns, FC2 maintains a mix of these products rather than specialising in those which are most profitable to growers (yellow and red bell-peppers). This divergence of interests suggests a control problem stemming from the facilitating organisation's strong influence on policy and management decisions. Support for this view came from admissions that both major shareholders and out-growers frequently breached their supply agreements with FC2 by side-selling red and yellow bell-peppers to other buyers and supplying green bell-peppers to the company.

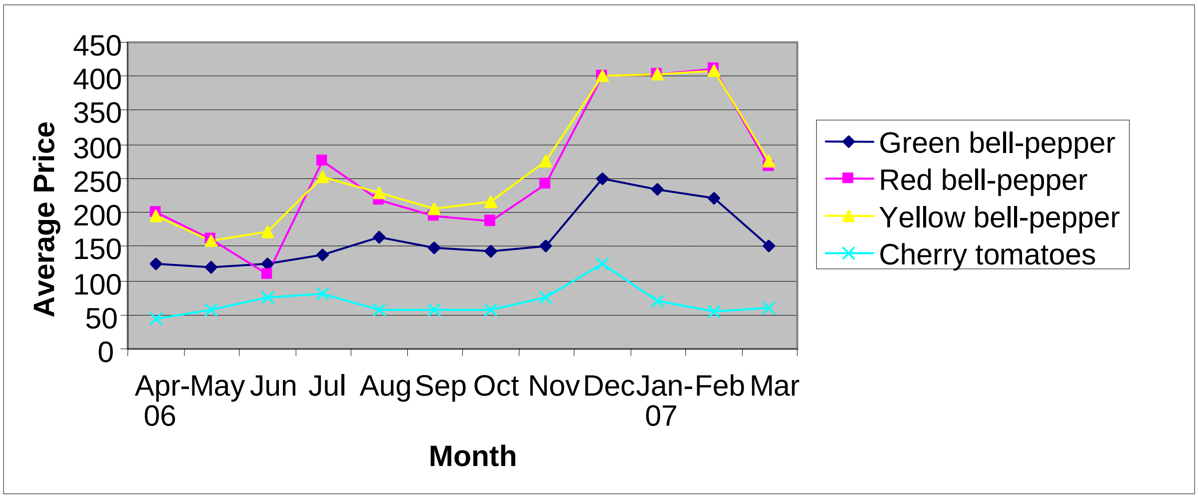

Figure 4.6: Monthly average market prices (LKR) of products sold by FC 2 - 2006/2007
Source: Author's analysis of secondary data provided by key informants.

FC2 scans its business environment and analyses relevant stakeholders (Figure 4.7) before formulating new strategies or changing its business and product portfolios. This methodical process includes gathering and analysing market information for inputs and products, assessing shareholder and staff capabilities, and reviewing external organisations and changes in the business environment. The facilitating organisation, which has a wealth of export data, makes a valuable contribution to this process. At the time of the study, none of the shareholder-directors possessed any skills or training in the discipline of business management.

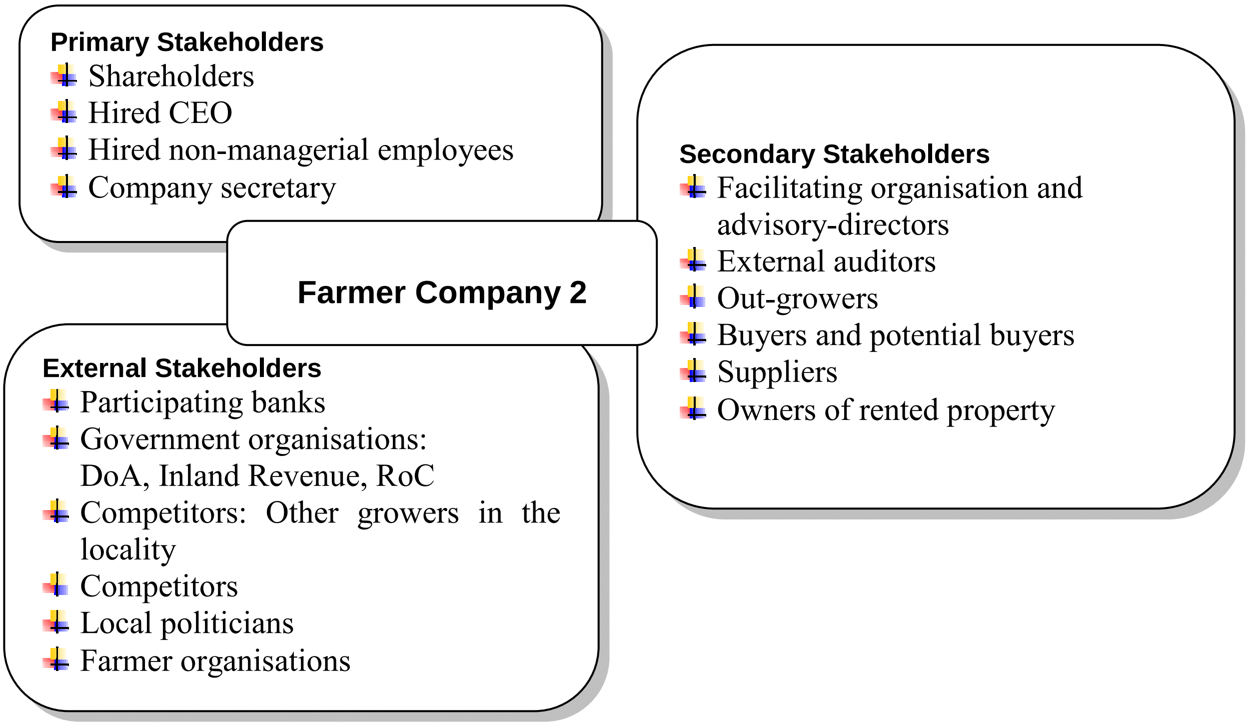

Figure 4.7: Key stakeholders of FC2

Source: Interviews with key informants of FC2.

The facilitating organisation helped to define the financial, production and marketing processes that support the implementation of strategy in FC2. The company's small workforce (Table 4.8) lacks diversity. Management claimed that FC2 could not afford additional or more qualified employees. However, some of the major shareholders argued that it was not necessary to employ five TOs to link just 142 production facilities with management.

Table 4.8: Personnel strength at FC2

Year	Managerial	Non-managerial	Total
2003/04	1	8	9
2004/05	1	9	10
2005/06	1	9	10
2006/07	1	8	9

Source: Financial statements from 2003/04 to 2005/06 and interviews with key informants of FC2.

4.3.7 Socio-economic and group factors at Farmer Company 2

Reasons given by the shareholders for joining FC2 included expectations of profits and other benefits (28.6%), introduction of new technology (23.8%), good publicity (19.0%), guarantee of market (14.3%), expectation to be agro-entrepreneurs (4.8%), access to credit to finance production assets (4.8%) and service to the local farming community (4.8%). Table 4.9 presents descriptive statistics for the shareholders interviewed at FC2. Their mean age was 46.1 years (range 38 to 60), and they averaged nine years of formal schooling (range 5 to 12) and 23 years of farming experience (range 10 to >30). All the SHs interviewed were full-time farmers. Sixty-one percent (61%) of SHs interviewed were sole owners of their farmlands while the rest were in partnerships. Seventy-eight percent of interviewees were males and 94% were married.

Table 4.9: Socio-economic characteristics of shareholders interviewed at FC2, n=15

Aspect	Average	Range
Age in years	46.1	38 – 60
Years of formal schooling	8.6	5 – 12
Years of farming experience	23.3	10 - >30
Distance from farmland to FC office (km)	2.6	0.5 – 5
Number of dependents in family	2.7	0 - 7

Source: Author's analysis of data provided by interviewees of FC2.

Strong familial and social relationships encouraged shareholders to establish informal groups. The main reasons for these interest groups included membership of village level FO[11], similarity of problems and issues encountered, age, and being neighbours. The average size of an informal group was 6.2 members.

Group action was observed in FC2. Informal groups have their own agendas and sometimes react differently towards the company's activities and strategies. They lobby for their own interests and met more frequently prior to significant events such as the AGM. Informal groups were seen persuading their preferred candidates to stand for elections. Disagreements between them and with management and the BoD over business strategies and administrative processes were common and were usually resolved through negotiation.

[11] All the shareholder interviewees of FC2 are members of different farmer organisations in the locality

4.4 Farmer Company 3

4.4.1 Brief history and background

Farmer Company 3 (FC3) is a successful FC that processes farm commodities. This class of FC contrasts with value adding FCs that failed and with surviving FCs that do not add value and which require relatively little capital.

FC3 is located in Sri Lanka's North Western Province and was incorporated on 23rd March 1998. It was established by a government facilitating organisation as a pilot project to commercialise smallholders to promote economic growth in the province and to transfer management of the regional irrigation scheme from the state to the private sector. The facilitating organisation took a proactive role in guiding FC3 through its first five years of operation. This support was phased out once the company was empowered to operate independently.

4.4.2 Objectives of Farmer Company 3

Key objectives guiding the formation of FC3, which adopted the motto 'a prosperous tomorrow for farmers through agro-products', are to:

1. Increased farmer incomes through crops and livestock.
2. To build an organisation for the farmers to find solutions for their problems and to implement their plans.
3. More involvement of farmers in public decisions about natural resources.
4. Shift farmer thinking from survival agriculture to commercial agriculture by providing market-oriented agricultural opportunities.
5. Improvement of agricultural practices, in particular the use of quality seed and timely application of fertiliser.
6. Transfer responsibility for the management and maintenance of the regional irrigation scheme from the facilitating organisation to FC3 and its farmer members.

The irrigation scheme is a regional project that includes a large number of farmers many of whom are not part of FC3. Control was delegated to FC3 by the facilitating organisation in 2000 as planned but rescinded in 2003 because the company was not perceived to be sufficiently representative of all farmers in the irrigation project area.

4.4.3 Core business activities

FC3 is engaged in nine business activities; processing and selling of commercial rice, sale of seed paddy and other seeds, sale of agricultural machinery, supply of agricultural inputs, a broiler chicken project, supply of milk and dairy products to a local dairy company, a specialised rice project, sale of seedlings and the provision of agricultural credit. Forty-seven percent of the company's revenue is earned through marketing of value-added products (Table 4.10) of which 98% is realised through value-addition within the company's own processing facility. Products finished at facilities owned by individual shareholders account for the remaining two percent.

Table 4.10: Annual revenue of FC3 by major activity and product category - 2006/2007

Major activity category	Product category	Revenue (LKR '000s)	Total revenue (LKR '000s)	Share of total revenue (%)	Rank
Marketing of value-added products	Ordinary rice	7,404	14,892	47	**1**
	Seed paddy and other seeds	6,563			
	Aroma rice	588			
	Seedlings and other planting material	337			
Sale of agricultural inputs	Fertiliser	2,954	5,390	17	**2**
	Livestock inputs	2,436			
Sale of agricultural machinery	Agricultural machinery	4,922	4,922	16	**3**
Unclassified activities	Unclassified sales	4,478	4,478	14	**4**
Marketing of primary products	Livestock products	1,860	1,860	6	**5**
Grand total		**31,542**	**31,542**	**100**	

Sources: Author's analysis of data provided by key informants and the financial statements of FC3.

Rice and seed paddy - value added products - are FC3's core products. Shareholders produce a range of paddy varieties, including the specialised Aroma variety, which the company processes and sells. FC3 also processes paddy purchased at competitive wholesale prices in the open market, and contracts to process the government's buffer stocks of paddy.

Seed paddy is produced both by shareholders and a network of 58 out-growers. This high quality seed is sold primarily to the government under FC3's own brand name for distribution to farmers in the Western, North-Western and Sabaragamuwa provinces. Various vegetable seeds are also produced and marketed under the company's brand name, as are other planting materials including seedlings of improved coconut varieties, fruits and flowering plants.

4.4.4 Institutional and organisational arrangements: An overview

All of the shareholders in FC3 are viewed as patrons. However, some SHs no longer deal with the company and, strictly speaking, are not patrons. When FC3 was established, the facilitating organisation did not permit the company to sell equity shares to non-farmers, and FC3's own constitution restricted shareholding to paddy farmers within the specified Divisional Secretariat (DS)[12] (command area) thereby introducing a geographical limitation for shareholding.

FC3 has only issued ordinary shares, and the level of shareholding is not linked to the investor's level of patronage. It is compulsory to hold a minimum of 40 shares to patronise the company and at least 10 shares to stand for election. Dividends were declared in 2003/04 but were paid as bonus shares rather than as cash. Shareholders received additional shares equivalent to 40% of the value of their paid-up shares. Dividends were therefore proportional to the investments of each shareholder. Table 4.11 summarises some key historical, organisational and performance characteristics of FC3.

FC3 was able to attract only 4.3% of its planned share capital even though the membership had expanded from 430 to 2,282. Transfer of shares by a shareholder is restricted to shareholders, immediate family members of shareholders or person/s who satisfy the selection criteria and recommendation of the BoD. There is no active market for shares and they cannot be transacted freely.

Seven directors are elected for the board at the AGM by secret ballot. Democratic voting at FC3 makes it closely resemble a traditional cooperative, and FC3 has a tradition of 'unanimous elections'. The company has no advisory-directors. The GM heads a hired management team and answers to the BoD.

FC3 has a functional organisational structure (Figure 4.8) with five main functions (accounting, crop management, livestock management, credit management and marketing) displaying a clear line of command. However, only two of the six senior positions had been

[12] The 'districts' which are sub-divisions of provinces of Sri Lanka are divided into administrative sub-units known as 'divisional secretariats'. These were formally known as 'DRO Divisions' after the 'Divisional Revenue Officer'. Later the DROs became 'Assistant Government Agents' and the divisions were known as 'AGA' Divisions'. Currently, the divisions are administered by a 'Divisional Secretary', and are known as 'DS Divisions'.

filled at the time of the study, namely the GM and the Accounting Manager. Fourteen other employees are non-executives.

Table 4.11: Key historical, organisational and performance characteristics of FC3

Characteristic	Details		
Date of incorporation	23.03.1998		
Initiation	Establishment as a pilot project was facilitated by a government organisation		
Planned share capital	LKR20 million (i.e. 2 million ordinary shares at LKR10 each)		
Financial assistance received from government	LKR10 million		
Degree of facilitation still present	Low		
Degree of influence by facilitating organisation at present	Low		
Number of shareholders	2,282 (as of June 2008)		
Total number of shares sold	85,764 (as at 28th June, 2007)		
Categories of key business activities	Sale of value-added products, sale of farm inputs and machinery, and sale of primary products.		
Nature of shareholder's voting rights	Democratic voting in a secret ballot at AGM.		
Number of shareholder-directors elected	7		
Number of advisory-directors	None		
Requirements for patronage	A shareholder with at least 40 shares		
Requirements to be a shareholder-director	A shareholder with at least 10 shares		
Shareholding-patronage relationship	Shareholding isn't proportionate to patronage		
Basis for paying dividends	Proportional to shareholding		
Presence of non-patron investors	No significant non-patron investors		
Presence of non-shareholder patrons	There is a network of 58 out-growers and another FC supplying to FC3 during peak demand periods.		
Active market for shares?	No		
External auditing of accounts	Done by a chartered accounting firm		
Value of assets of the company	LKR4 million (as of March 2007)		
Possession of relation-specific assets	Yes - Seed paddy and rice processing plants		
Some performance indicators			
Year	2005	2006	2007
Total revenue (LKR millions)	23.00	18.56	31.54
Profit before tax (LKR millions)	(2.33)	(7.28)	2.20
Markets	Local and national		
Number of buyers	Some corporate buyers, shareholders and other farmers in the area		

Sources: Articles of association, company constitution, financial statements from 2005 to 2007 and interviews with key informants of FC3.

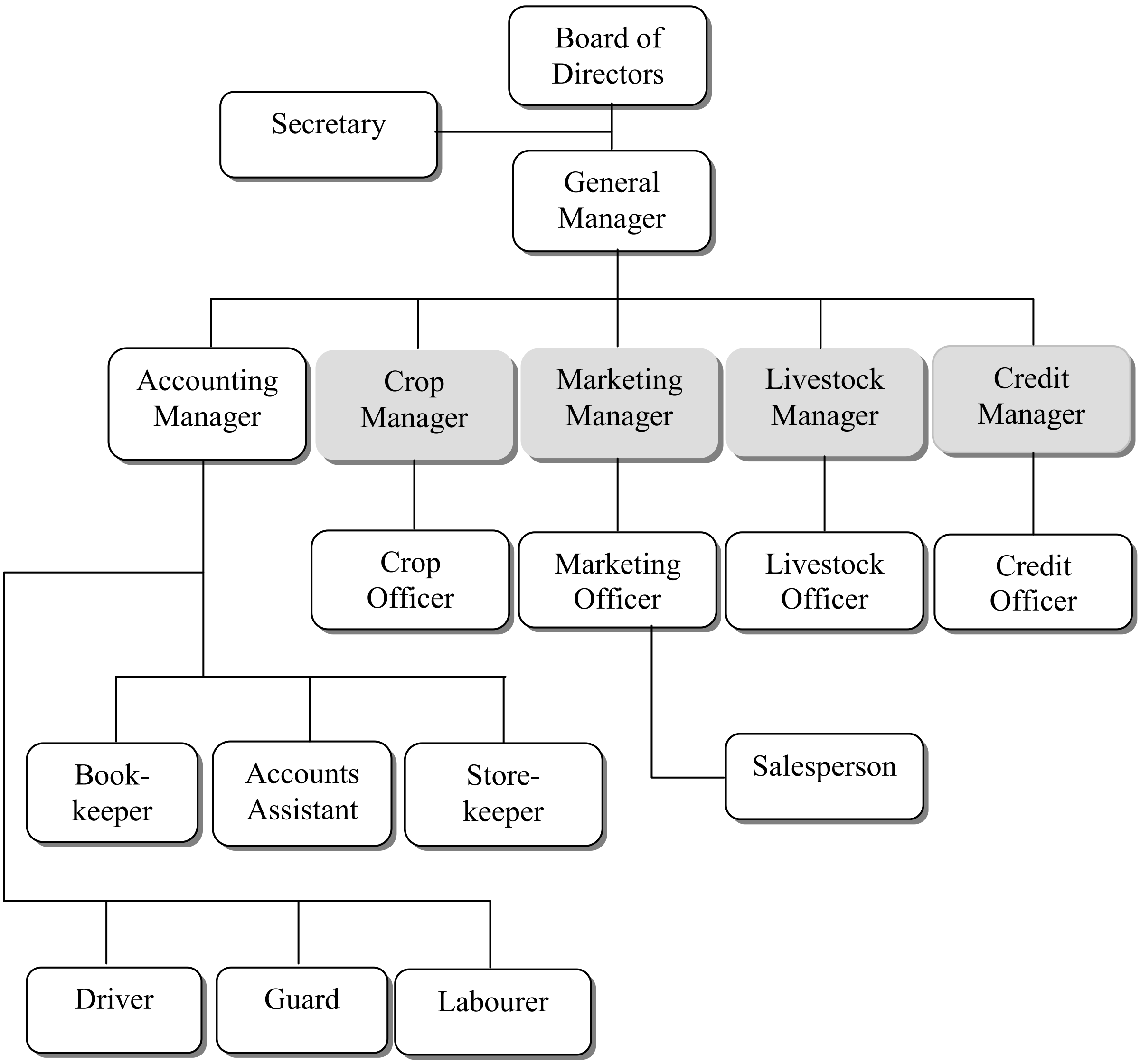

Figure 4.8: Organisational chart of FC3

Note: Shaded posts were not filled at the time of study.
Source: Interviews with key informants.

4.4.5 Governance

FC3 completed its external audit, held an AGM and produced an annual report on time in 2007. The shareholder-respondents were satisfied with these company processes. The AGM is organised and supervised by the DS and the regional head of the facilitating organisation at the FC's request. Shareholders are informed in writing 21 days prior to the meeting. AGM's were conducted even though the quorum, specified as 2/3 of the total number of shareholders, was sometimes not met. The GM notifies directors in writing at least seven days prior to each monthly board meeting. He attends the meeting by invitation.

The BoD authorised the GM to make single payments of up to LKR100,000 subject to approval by the board. Additional authorisation by the accountant and chairman is required for larger payments. All capital expenditure must be approved by the BoD. It is not general practice for personnel other than the GM to incur expenditure.

4.4.6 Management factors at Farmer Company 3

FC3 does not have a mission statement or a corporate business plan. However, the company's operational activities are guided by a set of short and medium term objectives stemming from its six key objectives (see Section 4.4.2). The company relies on short-term strategies which are fairly well-formulated. Their strategic choices are made in response to factors such as resources and the business environment of the FC. The business portfolio is revised regularly after on-going consultation with SHs and seeks to benefit as many SHs as possible. FC3 owns its own trademark but has not invested in formal market research.

Key informants claimed that the company is successful at adding value in the rice and seed paddy industries. FC3 attempts to meet the competitive threat from large public companies in the seed paddy industry by delivering a superior product to specific markets. Shareholders have also been successful in producing traditional rice varieties, mainly *Kalu-heeneti*, *Mada-thawalu* and *Suwandel*, which are difficult to grow but have promising niche markets in the cities.

Managers stated that a satisfactory footing in key markets is achieved via strong links with a number of large buyers such as the government for certified seed paddy, livestock companies for broiler chickens, and private hospitals and a local supermarket chain for branded rice. A wider local community is served by FC3 through its operation of local sales depots (Plate 4.5). It negotiates bulk discounts for inputs, especially agrochemicals, and sells these inputs at competitive prices from its local outlet. The company works towards a leadership position in its key business areas. However, it is restricted in the seed paddy and rice industries by its poor access to capital. Most of the SHs are aware of the channels used to market their products and also of changes made to their products as they pass through the marketing channels.

The FC defines its strategies as minor and major strategies rather than specific long-term and short-term strategies. Minor strategies are mostly of an operational nature, and are implemented mainly by managers. Major strategies are themed as projects such as the broiler project. The company has a good record of successful projects, suggesting selection of appropriate shareholder-friendly strategies. Opinions of shareholders are sought and interested shareholders are contacted regularly by staff to seek their advice and to make them aware of developments relating to each project. Employees appear to be capable, experienced and responsible in maintaining the operational tasks and processes of the company, which makes their approach to strategy formulation achievable. However, unfilled top and strategic positions (Figure 4.8) are sometimes problematic in planning, strategy formulation and strategy implementation.

Plate 4.5: Sales outlet of FC3

FC3's directors and the GM scan the business environment and its stakeholders (Figure 4.9) before formulating strategy and making changes in business and product portfolios. This analysis is relatively informal and limited to gathering market information, reviewing market trends and external organisations, assessing shareholder and staff capabilities, and consideration of the availability of resources. The directors did not possess any tertiary qualifications or training in the discipline of business management.

Processes related to finance, production and marketing are clearly defined and they support the implementation of strategy. However, the number of managerial and non-managerial staff is decreasing (Table 4.12) as a result of decisions to reduce costs. Financial processes at FC3 are supervised and controlled by the accountant with guidance from the GM and BoD. Stringent yet flexible financial control, informed by accurate and timely record keeping, and both internal and external annual audits, enhance the operational and strategic processes at FC3.

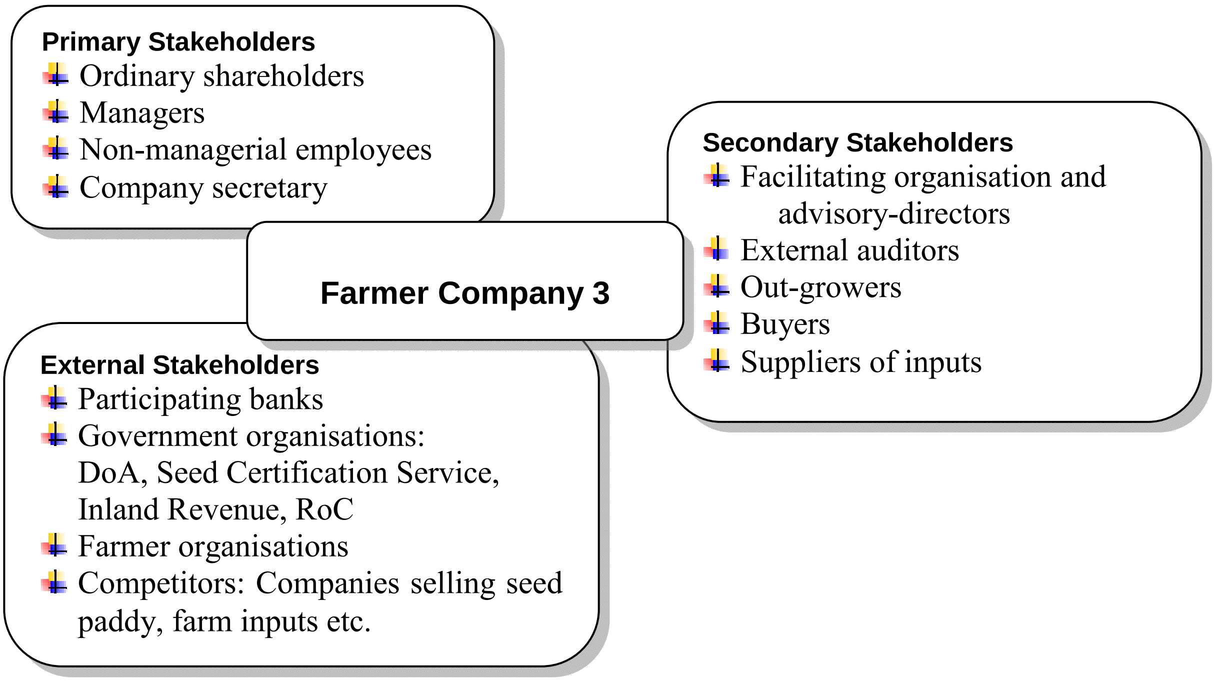

Figure 4.9: Key stakeholders of FC3

Source: Interviews with key informants of FC3.

Table 4.12: Personnel strength at FC3

Year	Managerial	Non-managerial	Total
2003/04	3	15	18
2004/05	2	15	17
2005/06	2	13	15
2006/07	2	14	16

Sources: Financial statements from 2003/04 to 2005/06 and interviews with key informants of FC3.

4.4.7 Socio-economic and group factors at Farmer Company 3

Shareholders joined the FC for a range of reasons. The most popular reasons mentioned were that it offers social benefits to the community (33.3%) and business benefits to the SH's (33.3%). The key benefits expected include mutual help, social opportunities, strength as a unit and also profit sharing. Marketing of their produce (25%) is also a key factor while expectations of 'recognition' as a shareholder in the FC (4.2%) and access to farm inputs at reduced prices (4.2%) were other factors that encouraged the farmers to join FC3.

Table 4.13 presents some socio-economic statistics computed for the shareholders sampled in FC3. The average age of shareholders in FC3 is 49.3 years (range 38 to 64) and 12% are women. Their mean level of education is 8.9 years of formal schooling (range 5 to 12). Farming experience averages 24 years (ranging from 10 to more than 30 yrs). Virtually all of the SHs (93%) are full-time farmers. Participation in business activities managed by the FC is high amongst shareholders who each own 100 or more shares. The average shareholding per member among interviewees was 118 ordinary shares.

Table 4.13: Socio-economic characteristics of shareholders interviewed at FC3, n=15

Aspect	Average	Range
Distance from farmland to FC office (km)	4.0	2 – 7
Farming experience (yrs)	24.0	10 - >30
Age (yrs)	49.3	38 – 64
Highest level of formal education (year)	8.9	5 – 12
Number of dependents in family	2.8	0 - 4

Source: Author's analysis of data provided by shareholder interviewees.

Shareholder interviewees stated that their business decisions and activities were influenced by a range of actors including family, spouse and other shareholder friends. All of the shareholders interviewed were married and 93% of them were sole owners of their farmlands while the rest were in partnerships and tenant arrangements.

Shareholder groups and group action are noticeable in FC3. The general membership (2,282 shareholders) is considered a large formal group. Recruitment of shareholders into the FC at inception was promoted by the facilitating organisation. After registration, the company gained authority to enrol members. The membership is characterised by a network of familial and social relationships among shareholders. These relationships encouraged shareholders to establish informal and overlapping sub groups. Five main reasons for these interest groups include membership of village level FOs[13], alignment of ideas relating to business and FC3, active participation in FC activities, age, and similarity of problems and issues faced. There are about 50 informal groups operating within the company, with an average size of 11.67 members. These informal groups have their own agendas and sometimes react differently towards the company's activities, strategies and overall direction. They lobby for their own interests. Informal groups meet more frequently prior to decisive forums of the company such as the AGM. There are often disagreements between them and with management and the BoD

[13]All of the shareholders interviewed at FC3 were members of different FOs in the locality.

over business strategies and administrative processes. Although some differences are settled by voting at general meetings and at board meetings, agreements are usually negotiated informally prior to these meetings.

4.5 Farmer Company 4

4.5.1 Brief history and background

Farmer Company 4 (FC4) is a failed FC that primarily supplied inputs and services to its shareholders. This class of FC contrasts with surviving input and service providing FCs, and with failed FCs that add value by processing products and which require greater investment in relation-specific assets.

FC4 was incorporated on 23rd November 2001. The company was located in a peri-urban part of Sri Lanka's Western Province. A government organisation facilitated the establishment of FC4 as a project to improve the production and living standards of neighbouring smallholders. The facilitating organisation was also responsible for managing the fledgling company until it could operate independently. During this early stage, the facilitating organisation supported the FC with finance, offices, transport and human resources. The company held its last AGM on 13th May 2004. There was no evidence of any business operations after that date.

4.5.2 Objectives of Farmer Company 4

The key objectives of the company which adopted the motto 'uplifting the living standards of farmers through improvement of agricultural production activities' were to:

1. Provide seed materials, other agricultural inputs, agricultural implements and market information.
2. Promote all agricultural and natural resource-based products produced in the area.
3. Negotiate and establish sales contracts to obtain best prices for farmers' products.
4. Take action to prevent farmers becoming labourers and to restore their identity.
5. Maintain a sales outlet to sell general merchandise and to market commodities produced by the local farming community.

The facilitating organisation worked closely with shareholders to frame these objectives. However, the FC did not survive long enough to achieve them. In particular, shareholders complained that the FC did not offer them favourable prices.

4.5.3 Core business activities

FC4's core business was the provision of farm inputs and implements. However it also managed a sales outlet that serviced the wider community. In addition to supplying inputs like seed paddy and agrochemicals, it also helped shareholders find markets for their produce. At one point, the company embarked on a compost production venture of its own.

4.5.4 Institutional and organisational arrangements: An overview

The company's constitution restricted membership to farmers and FOs registered in a particular DS Division. This eligibility criterion imposed a severe geographical limitation on shareholding. The company did not attract any organisational investors. All investors were regarded as patrons and it was compulsory to hold shares in order to patronise the company and to stand for elections. FC4 did not declare any dividends. However, the company's constitution stated that any declared dividends should be distributed proportionately to investment.

Table 4.14 summarises some key historical and organisational characteristics of FC4. The company was able to attract only 22% of its planned share capital even though the number of shareholders grew from an initial 55 to 183 when it stopped operating. Shareholders could transfer shares only to other shareholders or to immediate family members who satisfied the selection criteria and recommendation of the BoD.

Nine directors were elected for the board by show of hand at the AGM. In addition, the facilitating organisation appointed two advisory-directors who were senior officers in relevant organisations such as the DS, Department of Irrigation, DoA, banks or NGOs. It also appointed a senior official as GM. This practice, which allowed the government to exercise considerable influence on decisions taken by the BoD, was discontinued by the FC later in its short life.

Table 4.14: Key historical, organisational and performance characteristics of FC4

Characteristic	Details
Date of incorporation	23.11.2001
Initiation	Establishment was facilitated by a government organisation
Planned share capital	LKR1 million (i.e. 100,000 ordinary shares at LKR10 each)
Financial assistance received from government	LKR0.1 million[14]
Degree of facilitation at the time of failure	Low
Degree of influence by facilitating organisation at the time of failure	Moderate
Number of shareholders	183 (as of May 2004)
Total number of shares issued	21,800 (as of May 2004)
Date failed (approximately)	May 2004
Categories of key business activities	Provision of seed material, implements and other farm inputs, managing a sales outlet and finding markets for shareholders' produce.
Nature of shareholders' voting rights	Democratic voting at the AGM.
Number of shareholder directors elected	9
Number of advisory-directors	2
Requirements to be a director	Any shareholder
Shareholding-patronage relationship	Shareholding was not proportionate to patronage
Basis for paying dividends	Proportional to shareholding
Presence of non-patron investors	None
Presence of non-SH patrons	None
Active market for shares?	No
External auditing of accounts	Done by a chartered accounting firm during initial stages
Value of assets of the company	Data not available
Possession of relation-specific assets	None
Some performance indicators	
Total revenue and profit	Data not available – company failed
Markets	Inputs and services were supplied mainly, but not exclusively, to shareholders

Sources: Articles of association, company constitution, interviews with key informants.

FC4 had a simple organisational structure (Figure 4.10). No provision was made for important functions such as accounting, credit management, input procurement and marketing. The GM was appointed by the facilitating organisation.

[14] The facilitation package also included office and sales outlet space and some other services free-of-charge.

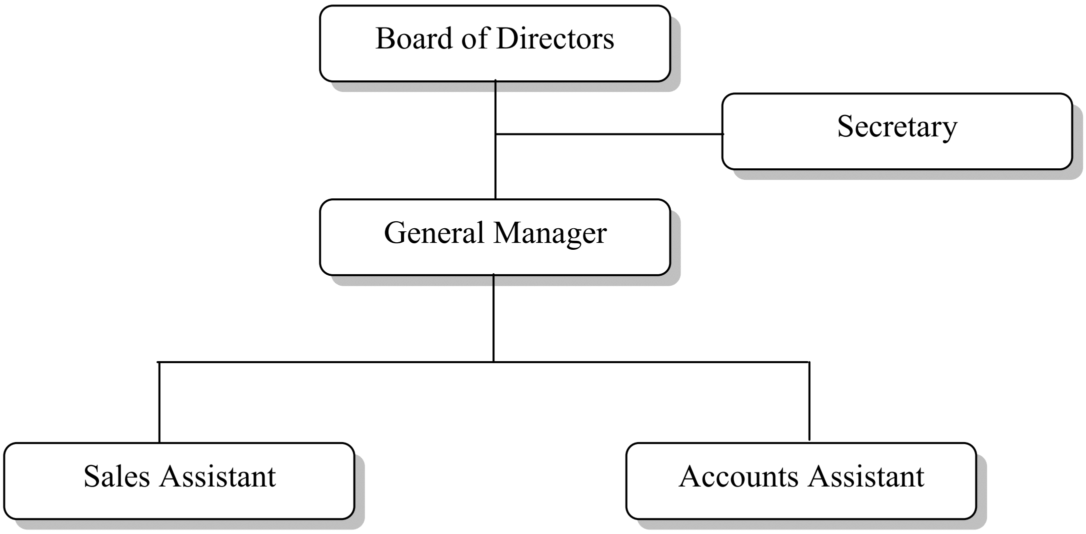

Figure 4.10: Organisational chart of FC4

Sources: Interviews with shareholders and key informants.

4.5.5 Governance

Shareholders stated that, initially, the company had complied well with its audit and reporting requirements and that attendance at board and shareholder meetings was good. The facilitating organisation and DS helped to organise and host the AGM. Shareholders were notified in writing 21 days prior to the AGM. Directors were given written notice of monthly board meetings at least seven days prior to each meeting. However, this changed some time before FC4 collapsed. Shareholder meetings became 'unfriendly' and irregular, and the advisory-directors stopped participating in board meetings. Some shareholder respondents mentioned that not all members had received notification of AGMs towards the end of the company's life. The GM was an ex-officio non-voting director of the company.

4.5.6 Management factors at Farmer Company 4

FC4 did not have a mission statement or a business plan. Key informants claimed that it pursued short-term strategies favoured by the chairman, some directors and (in the early stages) the appointed GM. On-going and active consultation with relevant shareholders was lacking. Key decisions and strategic choices were often at odds with the business environment and with the interests of stakeholders (Figure 4.11).

The company had not identified long-term strategies to achieve its objectives, nor did it follow any systematic processes to formulate acceptable strategies. Shareholder-directors and shareholders were experienced farmers but were not trained or otherwise qualified to manage a business. The chairman and some SH directors were village elites and the chairman was re-elected even when it became obvious that the company was failing.

Processes related to finance were not well-defined towards the end, although sufficient book-keeping and financial recording was done to satisfy audit requirements. During the final stages, the chairman authorised financial transactions that were administered and recorded by the Accounts Assistant.

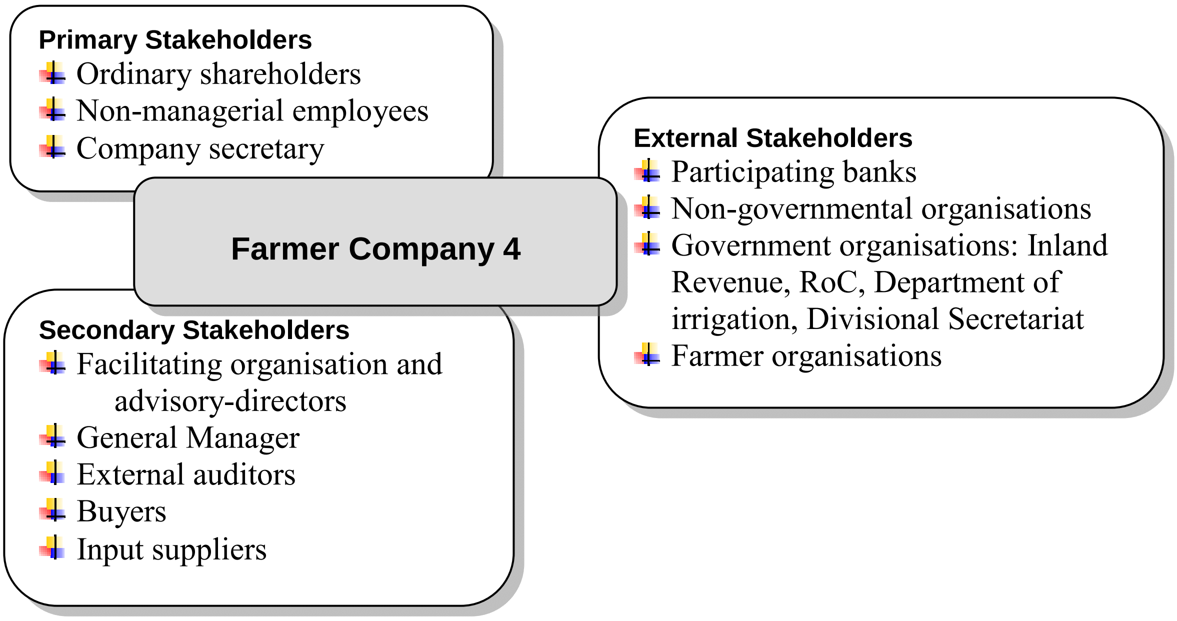

Figure 4.11: Key stakeholders of FC4 when functioning

Sources: Interviews with key informants and SHs.

4.5.7 Socio-economic and group factors at Farmer Company 4

The facilitating organisation launched an extensive campaign to popularise FC4 in the DS Division. Almost 30% of the shareholders interviewed mentioned the publicity campaign as their main reason for joining the company. Other reasons given for joining were business benefits (58%) and requests by pre-FC friends (13%). Anticipated business benefits included higher margins from transacting with the FC, better returns on investment, enhanced creditworthiness and reliable markets for their produce.

Table 4.15 presents some socio-economic statistics for the shareholders interviewed. The average age was 49.5 years (range 35 to 71). The vast majority (87%) were married, but only seven percent were women. The mean level of education was 8.9 years of formal schooling (range 7 to 10). Farming experience averaged 28.2 years (ranging from 10 to 50 yrs). Almost three-quarters of the respondents were full-time farmers. Seventy-three percent were sole owners of their farmlands while the others were in partnerships or farmed as tenants. The average shareholding was 100 ordinary shares (range 50 to 200) per shareholder.

Table 4.15: Socio-economic characteristics of shareholders interviewed at FC4, n=15

Aspect	Average	Range
Age (yrs)	49.5	35 – 71
Years of formal schooling	8.9	7 – 10
Years of farming experience	28.2	10 – 50
Distance from farmland to FC office (km)	4.9	1 – 7
Number of dependents in family	2.7	0 - 5

Sources: Author's analysis of data provided by interviewees of FC4.

Social interactions and informal groupings were reported by the shareholder-interviewees. The average size of an informal group within FC4 was 6.5 members. The main reasons for these informal groups were alignment of agribusiness ideas, membership in local FOs, age, pre-FC friendships and social relationships, and farming similar crops.

It was reported that these informal subgroups lobbied to protect their own interests and were instrumental in the election of certain directors. There was also evidence of lobbying by informal groups within the BoD. Disputes were sometimes settled by voting at the AGM although it was claimed that the election of directors was always unanimous. The shareholder-interviewees reported conflicts between subgroups, the chairman, certain shareholder-directors and management. Some conflicts were resolved by the facilitating organisation.

4.6 Farmer Company 5

4.6.1 Brief history and background

Farmer Company 5 (FC5) is a failed FC that was primarily concerned with buying and selling commodities produced by its farmer-shareholders. This class of FCs contrasts with surviving FCs that market commodities and with failed FCs that process commodities and which require relatively more capital. FC5 was incorporated on 1st October 1998 and was located in the North Central province of Sri Lanka.

The facilitating organisation provided a support package that covered basic expenses for registration, supplemented the company's initial capital and provided furnished offices, some machinery, equipment, transport and training for the directors. It also facilitated dealings with the RoC, commercial banks, state and non-government organisations, and identified suitable officers as advisory-directors during the establishment stage of the company. It also appointed, on a temporary basis, its own officers as the GM[15], advisory-directors, accountants and legal officers[16]. Table 4.16 summarises some key historical, organisational and performance characteristics of FC5.

Table 4.16: Key historical, organisational and performance characteristics of FC5

Characteristic	Details
Date of incorporation	01.10.1998
Initiation	Establishment was facilitated by a government organisation
Planned share capital	LKR100 million (i.e. 10 million ordinary shares at LKR10 each)
Funding received from government	LKR1 million[17]
Degree of facilitation at the time of failure	High
Degree of influence by facilitating organisation at the time of failure	High
Number of shareholders	453 (as of September 2003)
Total number of shares issued	36,240 (as of September 2003)
Date failed (approx)	September 2003
Categories of key business activities	Sale of primary products, supply of some agricultural inputs, managing sales outlets, provision of credit.
Nature of shareholders' voting rights	Democratic voting at the AGM.
Number of shareholder-directors elected	12
Number of advisory-directors	3
Requirements to be a SH director	A shareholder with at least 100 shares
Shareholding-patronage relationship	Shareholding is not proportionate to patronage
Basis for paying dividends	Proportional to shareholding. However, dividends were never paid.
Presence of non-patron investors	None
Presence of non- shareholder patrons	None
Active market for shares?	No
External auditing of accounts	Done by a chartered accounting firm
Ownership of relation-specific assets	None
Some performance indicators	
Total revenue and profit	Data not available – company failed
Markets	Regional and national
Number of buyers	Shareholders plus other farmers in the area

Sources: Company constitution and interviews with key informants and SHs.

[15] In addition to his usual salary from the government, the GM was paid an allowance by the FC. This benefited the FC by reducing staff cost.
[16] This includes skilled employees of the facilitating organisation being made available free of charge for short periods to formalise relevant procedures in the FC.
[17] LKR1million was offered as the initial capital plus some funding for operational activities (amounts not available). Other assistance included a tractor and trailer being made available to FC5 on favourable terms and space for office and sales outlet, and some services free-of-charge.

4.6.2 Objectives of Farmer Company 5

The objectives of the company were to:

1. Ensure markets and a fair price for the crop, livestock and fishery products of SHs.
2. Sell inputs and products on terms favourable to farming communities in the command area.
3. Provision of farm inputs and agricultural machinery services.
4. Commercialise farmers and promote local economic growth through coordinated production, provision of technical assistance and resources, and improvement of natural and human resources.
5. Take action to prevent farmers becoming labourers and to restore their dignity.

4.6.3 Core business activities

Marketing of grains, pulses and vegetables was the company's core business activity. The main products were paddy, chillies, vegetables and soybeans. Other business activities included supplying relevant farm inputs, purchasing paddy in the open market for storage and resale, providing credit and managing a sales outlet for agricultural inputs, products grown by shareholders and groceries. FC5 intended to promote the adoption of cotton, tobacco, papaw, gherkins, passion fruit and ornamental fish by shareholders but did not initiate these projects.

4.6.4 Institutional and organisational arrangements: an overview

The company was registered with 56 shareholders. These founding shareholders were recruited by the facilitating organisation and each purchased 100 ordinary shares. FC5 started recruiting additional shareholders a year after its registration. Membership had increased to 453 shareholders at the time of collapse. All the shareholders were considered to be patrons. However, some shareholders sold their products to other buyers when the FC offered prices that were not competitive and when other shareholders were given preferential treatment.

The company's constitution restricted shareholding to farmers in a particular DS division in the province. This introduced a geographical limitation for shareholding. Transfer of shares was restricted to any existing shareholder, immediate family members or persons that satisfied membership criteria and who were approved by the board. FC5 managed to attract only 0.04% of its initial intended share capital. There was no relationship between the level of shareholding and patronage in FC5.

The facilitating organisation advertised the date and venue of AGMs and invited shareholders to nominate directors. FC5 elected 12 directors democratically by a show of hands at the AGM but had a tradition of unanimity in electing directors. SHs holding at least 100 shares could stand for election. The company's constitution mandated the facilitating organisation to nominate three non-voting advisory-directors from within its own ranks or from those of other government organisations. A shareholder-director was elected as the chairman. Institutional development specialists and regional managers from the facilitating organisation, and senior research officers from the DoA, were usually appointed as advisory-directors.

The facilitating organisation appointed the company's GM. The GM also joined the board as a non-voting director and was paid an allowance by the company. Shareholder-interviewees were of the opinion that the facilitating organisation exerted a direct influence on many major decisions, activities and strategies of the company through the appointed GM and advisory-directors. Although a functional organisational structure was proposed for FC5 at the time of its establishment, the company was unable to fill key positions and attempted to operate with a structure that neglected important functions (Figures 4.12 and 4.13).

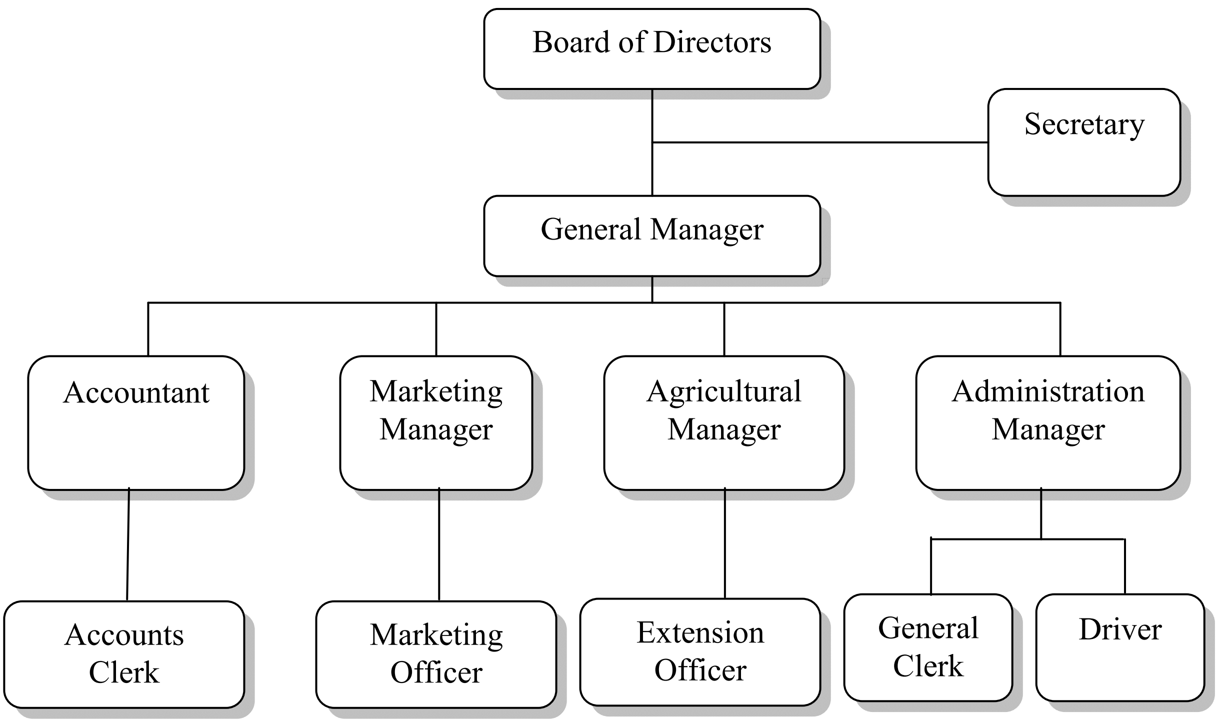

Figure 4.12: Organisational chart of FC5 proposed at the time of registration
Source: Interviews with key informants.

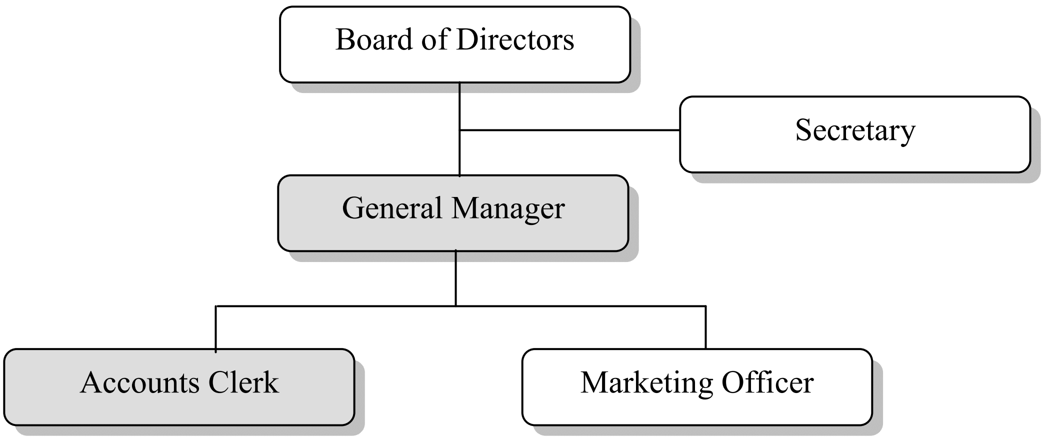

Figure 4.13: Organisational chart of FC5 at the time of its demise

Note: Shaded positions were filled with officers and employees appointed by the facilitating organisation.
Source: Interviews with key informants.

4.6.5 Governance

The facilitating organisation organised and supervised the company's AGM[18], usually with the help of the DS. Shareholders were given 21 days written notice of the AGM. The quorum was specified as one-quarter of the total number of shareholders. General meetings were held quarterly during first two years but were often postponed during the final stages of the company's life. The facilitating organisation notified directors in writing at least seven days prior to each monthly board meeting.

The GM supervised the financial processes of the company. The facilitating organisation administered these processes for the first three years, maintaining and submitting financial records for regular internal and external audit. However, some key informants and interviewees claimed that FC5 did not uphold its reporting, meeting and audit requirements over time, despite pressure from senior officers in the facilitating organisation.

4.6.6 Management factors at Farmer Company 5

Individual shareholders had expertise in a range of products, many of which were transacted with the FC. Initially, the company and facilitating organisation succeeded in coordinating the skills of shareholders and forging relationships between them and other stakeholders (Figure 4.14) such as commercial banks (who extended credit to shareholders) and the DoA (who introduced better agricultural techniques).

[18] The senior regional administrator in the facilitating organisation was responsible for appointing an officer as GM. It was contended that incumbents had different perceptions of FC5's relevance resulting in different levels of government support.

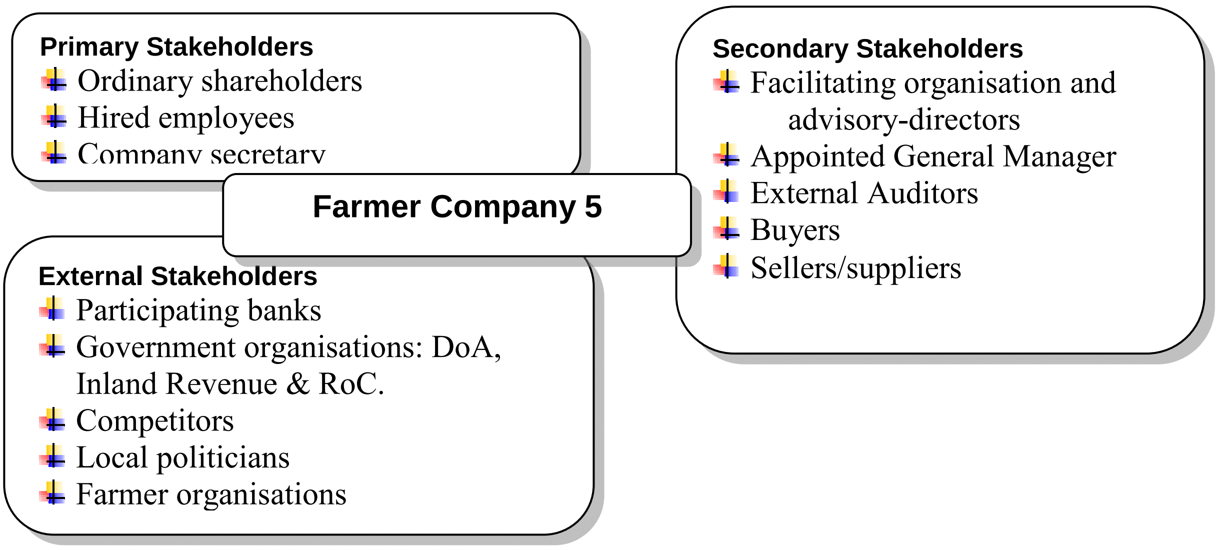

Figure 4.14: Key stakeholders of FC5

Source: Interviews with key informants and shareholders.

The company did not have a mission statement or a business plan. Some SH interviewees stated that managerial decisions were not aligned with the company's objectives. Instead, operational activities were guided by unplanned short and medium term strategies. FC5 did not have a well-defined process for formulating and implementing strategy. Intially, this task was managed by the facilitating organisation as a collaborative exercise with a cohesive group of (56) shareholders. However, FC5 did not maintain this practice as it lacked both staff and appropriate processes. According to shareholders interviewed, strategies chosen reflected the views of senior officers in the facilitating organisation, advisory-directors and the appointed GM.

The company conducted informal analyses of its business environment, resources and markets. The GM, who implemented all operational strategies, carried out these analyses. During the final stages of the company's life, when the facilitating organisation stopped appointing the GM and reduced its financial support, these tasks were sometimes performed by the shareholder-directors and marketing officer. The shareholder-directors could provide only limited support as they lacked experience and training in managing a business.

FC5 bought and sold a narrow range of local commodities. A reliable market - a corporate buyer for soya and a large number of traders willing to buy other products - helped FC5 to survive the first few years. Shareholder-respondents emphasised that FC5 did not introduce profitable crops into its portfolio and attributed this to the absence of appropriate processes to formulate strategies. FC5 bought inputs, especially agro-chemicals, at wholesale prices and sold them to shareholders and other local farmers at favourable prices. It was noted that shareholders and non-shareholders paid the same favourable prices charged at the sales outlet.

According to the key informants, some management-related factors which rendered the company unprepared to meet expanding challenges in the business environment or to exploit opportunities were the absence of well defined processes in production and marketing, poor organisational structure and a small and diminishing workforce - a strategy to reduce costs.

4.6.7 Socio-economic and group factors at Farmer Company 5

Interviewees were encouraged to invest in the company for reasons such as good publicity by the facilitating organisation (28%), potential business benefits (50%), services offered to the farming community (16%), and the influence of friends and government officials such as extension officers (6%). The business benefits expected by SH respondents included reliable markets, higher profits in farming, a competitive return on investment, access to credit, and inputs at low prices.

Table 4.17 presents a summary of socio-economic characteristics of respondents. On average, respondents were almost 45 years old (range 34 to 62 yrs), had 8.7 years of formal schooling (range 6 to 10 yrs) and cared for 3.5 dependants. They had considerable farming experience, averaging slightly more than 24 years with a minimum of 13 years. Geographical limitations on membership kept the mean distance from farm to FC5 down to 3.4 kilometres (range 0.5 to 5.5 km)

Table 4.17: Socio-economic characteristics of shareholder-respondents at FC5, n=15

Aspect	Average	Range
Age (yrs)	44.7	34 – 62
Years of formal schooling	8.7	6 – 10
Years of farming experience	24.1	13 - 40
Distance from farmland to FC office (km)	3.4	0.5 – 5.5
Number of dependants in family	3.5	2 - 5

Source: Authors analysis of data provided by shareholder-respondents

Almost 90% of the shareholder-respondents were full-time farmers and sole owners of their farmlands (the rest were in partnerships). All of them were married and 80% were men.

Shareholder-respondents and key informants noted that social relationships had produced informal subgroups within the membership. The main reasons for these informal groups were alignment of ideas relating to business and the company, membership in the village FO, frequency of participation in FC activities, and age. The average size of these informal groups was 7.9 members. According to some respondents, the informal groups had their own agendas and sometimes showed different reactions to FC activities and proposals. These groups lobbied for their own interests, persuaded their preferred candidates to stand for elections or actively proposed and seconded their names at AGMs. The respondents also stated that minor disagreements between these groups and the company were often resolved through discussions.

4.7 Farmer Company 6

4.7.1 Brief history and background

Farmer Company 6 (FC6) is a failed FC that added value to farm products. This class of FC contrasts with FCs that continue to process member products and with failed FCs that did not process products and which therefore required relatively less capital.

FC6 was located in the Southern Province of Sri Lanka and was incorporated on 16th June 1995. This company was a pilot project set-up to supply a processed product to export markets. The facilitating organisation was assisted by two more government organisations and an exporting company. The facilitating organisation tried to improve the company’s access to capital by inviting the exporting company to inject capital as debt finance.

The facilitating organisation, two assisting organisations and the private export company provided a support package that covered selection of suitable farmer shareholders, land (with a 30 year lease), buildings (with a floor area of some $500m^2$) and plant to process the product. The government also assisted the farmer-shareholders by providing them with freehold land, fencing and an irrigation system. The operating costs of this irrigation system were covered by FC5 - a source of conflict as larger farmers derived more benefit from the system than did smaller farmers.

4.7.2 Objectives of Farmer Company 6

Key objectives guiding the formation of FC6 were to:

1. Conduct business as processor, importer and exporter, agent and product promoter.

2. Host exhibitions or conferences promoting exports.
3. Gather funds and organise activities to improve social, economic and health facilities of shareholders and others in the locality.

4.7.3 Core business activities

The main business activity of FC6 was to sell an organic value-added product to the export market. Its only buyer was the exporting company which was also the company's main financier. The facilitating organisation and the DoA monitored FC6's processing activity. The processing plant was situated close to the plantations managed by shareholders, but some distance from the company's head office which was located in a central place more accessible to the exporter and most stakeholders. FC5 also supplied agricultural inputs to shareholders. However, quantities of inputs used were insignificant as FC6 was processing an organic product. Organic certification was facilitated mainly by the exporting company. Past financial records were not available to measure the contributions of each business activity.

4.7.4 Institutional and organisational arrangements: an overview

FC6 had 355 shareholders of whom 55 grew and supplied fresh inputs to the company. Of the remaining 300 shareholders, 270 worked in the processing plant and the remaining 30 did not patronise the company as suppliers or workers. They invested in the company on the understanding that they would be given land suitable for production in the future.

FC6 issued only ordinary shares and the shareholding was not tied to patronage. The constitution of the company stipulated that any dividends declared must be paid proportional to the investment of shareholders. However, the company did not make profits to declare dividends.

According to the key informants, the facilitating organisation instructed the company to restrict its membership to 355 shareholders even though it was able to raise only 35.5% of its planned share capital. Every shareholder purchased 10 shares, which was the minimum required by the company. However, many shareholders paid for only one half of this minimum allocation. The company's constitution did not provide clear guidelines for transferring shares and there was no active market for its shares. Table 4.18 summarises some key historical, organisational and performance characteristics of FC6.

Table 4.18: Key historical, organisational and performance characteristics of FC6

Characteristic	Details	
Date of incorporation	16.06.1995	
Initiation	Establishment (and operations) was facilitated as a pilot project by a set of three government organisations[19] and a private company.	
Planned share capital	LKR1 million (i.e. 100,000 ordinary shares at LKR10 each)	
Financial assistance received from the government	Assets valued at LKR2.9 million, plus operating capital	
Loan capital from exporter partner	LKR1.3 million (in the form of assets)	
Degree of facilitation sat the time of failure	High	
Degree of influence by facilitating organisation at the time of failure	High[20]	
Number of shareholders	355 (as of June 2006)	
Total number of shares sold	35,500 (approximately as of June 2006)	
Date failed (approximately)	2002	
Key business activities	Sale of value-added products and provision of inputs.	
Nature of shareholders' voting rights	Democratic voting at the AGM.	
Number of shareholder-directors elected	6	
Number of advisory-directors	4	
Requirements to be a SH director	Any shareholder with 100 or more shares.	
Shareholding-patronage relationship (This applies to patron- shareholder only)	Shareholding was not proportionate to patronage.	
Basis for paying dividends	Proportional to shareholding.	
Presence of non-patron investors	30 shareholders.	
Presence of non-shareholder patrons	The exporting company (section 5.7.6).	
Active market for shares?	No.	
External auditing of accounts	No audit until after the company had collapsed.	
Possession of relation-specific assets	Yes - the processing plant.	
Some performance indicators		
Year	2006	2007
Total revenue (LKR millions)	0	0
Profit before tax (LKR millions)	(0.29)	(0.29)
Markets	Product sold to an exporter.	

Sources: Company constitution and interviews with key informants.

Six shareholder-directors were elected democratically (and unanimously) at the AGM by show of hands. The company's constitution mandated the facilitating organisation to appoint four non-voting advisory-directors - one from its own ranks, one from the exporting company and two from the assisting organisations. The GM led a hired management team and reportedly answered mainly to the facilitating organisation. According to respondents, the shareholder-directors had very little control over management.

[19] In addition, one of the assisting organisations was directly monitoring the individual activities of 55 patron shareholders.
[20] Highlighted by the facilitating organisation arranging an auction of company assets to recover some of its own costs.

FC6 had a mixed organisational structure (Figure 4.15). The company hired three executives – a GM and two Assistant Managers. The facilitating organisation advertised these posts on behalf of the company.

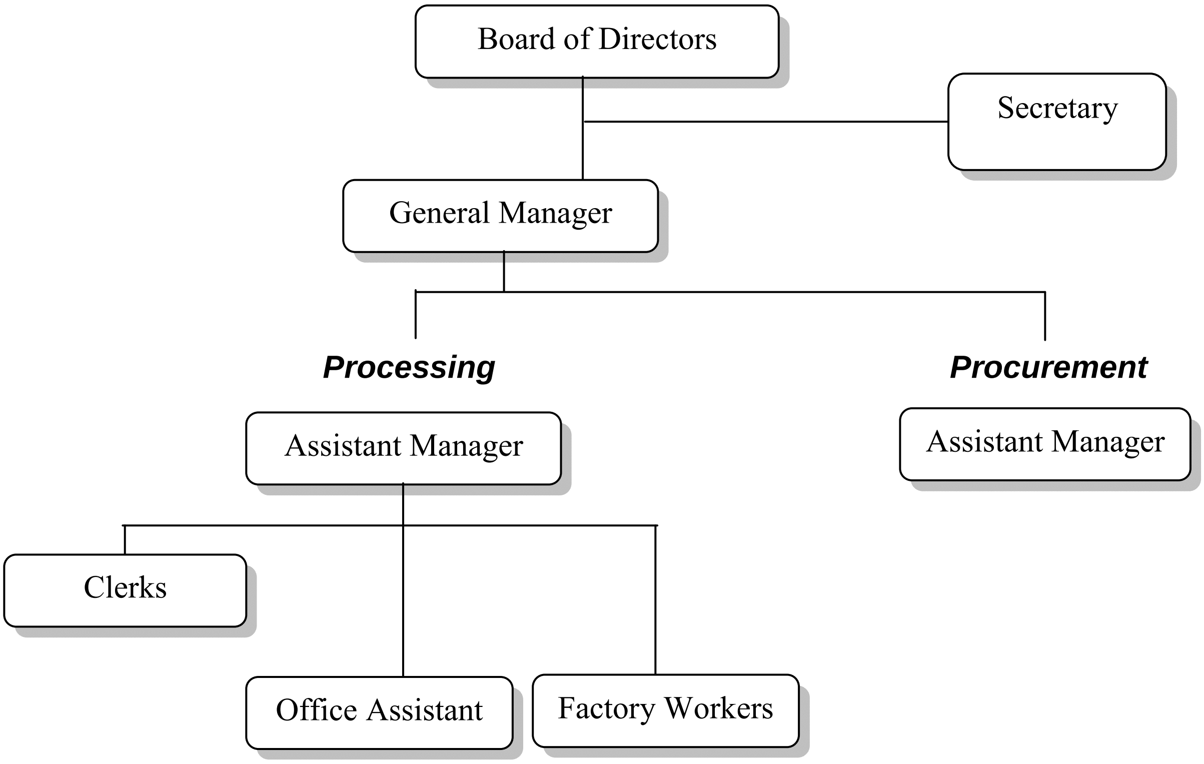

Figure 4.15: Organisational chart of FC6

Sources: Interviews with key informants.

4.7.5 Governance

According to key informants, the facilitating organisation was heavily involved in company processes such as finance and sales, and maintained pressure on the company to hold AGMs. FC6 did not produce audited accounts for several years and was warned by the RoC. The facilitating organisation contracted an accounting firm to prepare financial statements for 2006 and 2007 (after the collapse of the company) using historical records kept by the facilitating organisation. The company gave written notice of AGM's to shareholders at least 21 days prior to the meeting. AGMs were quorate if attended by more than two-thirds of the shareholders. The facilitating organisation gave directors written notice of monthly board meetings at least seven days before each meeting. The board introduced restrictions on expenditure authorised by the GM.

4.7.6 Management factors at Farmer Company 6

FC6 did not have a mission statement or a corporate business plan. Key informants claimed that the company's objectives (Section 4.7.2) were drafted by the facilitating organisation, and that the advisory-directors and GM influenced its choice of business strategy and the medium and short term objectives that guided the company's operational activities. The facilitating organisation provided the company with business and trade information from its own archives. Some key informants and shareholder-respondents stated that shareholder-directors' participation in these processes was superficial owing to their poor knowledge of business management. Lack of ongoing consultation with shareholders and their elected directors made it difficult for the company to implement its strategies. Key informants felt that the business portfolio was too narrow and the facilitation too directed.

FC6 commenced its processing operations about three years after the company was established. The exporting company undertook to purchase all of FC6's output while processing the same product grown in other provinces. FC6 also negotiated bulk discounts for inputs such as organic manure for the benefit of its shareholders. Figure 4.16 shows the company's key stakeholders.

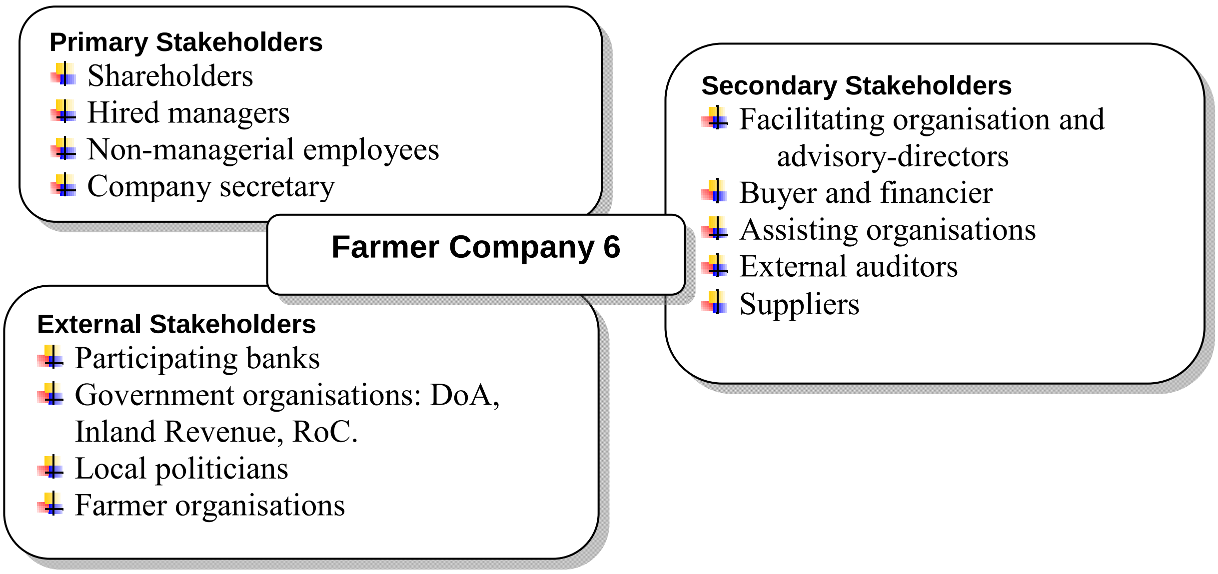

Figure 4.16: Key stakeholders of FC6

Sources: Interviews with key informants.

4.7.7 Socio-economic and group factors at Farmer Company 6

Forty-three percent of the 16 shareholders interviewed claimed that they joined the company because it was introduced to them by the assisting organisations. Others attributed their membership to general publicity (14%), business benefits expected (13%), requests by friends (11%), employment opportunities within FC (11%), enhanced standard of living (3%), benefits and welfare for the farmer community (3%), and requests by family members (3%). The respondents expected business benefits such as higher profits and a guaranteed market for their produce.

The average age of shareholder-respondents was 42.7 years (range 37 to 50) and 13% were women. Formal schooling averaged 9.3 years (range 7 to 10). All of the interviewees were full-time farmers. Farming experience averaged 18.5 years (range 6 to 30). Wages earned from working in the processing plant were regarded as supplementary income. The average distance from farmlands to the processing facility, which was also their central place of meeting, was 4.6 km (range 2 – 7). On average, interviewees had 2.5 family dependants (range 0 – 4) while the mean family size was 3.7 members (range 1 – 6). Table 4.19 presents some socio-economic characteristics of shareholder-respondents. The vast majority (93%) were married and all of them were sole-owners of their farmlands, thanks to one of the assisting organisations which granted these lands to supplier shareholders.

Table 4.19: Socio-economic characteristics of shareholders interviewed at FC6, n=16

Aspect	Average	Range
Age in years	42.7	37 – 50
Years of formal schooling	9.3	7 – 10
Years of farming experience	18.5	6 – 30
Distance from farmland to factory (km)	4.6	2 – 7
Number of dependants in family	2.5	0 - 4

Source: Authors analysis of data provided by shareholder-respondents

According to key informants, a network of social relationships encouraged shareholders to establish informal groups. Reasons cited most frequently by shareholder-respondents for these informal groupings included pre-FC relationships, alignment of ideas (relating mainly to business and FC6), farming experience, age, and gender. The average size of an informal group was 11.9 members. Conflicts between interest groups were common, even at AGMs. According to key informants, a third assisting organisation proposed by the facilitating organisation withdrew its offer of support following heated exchanges between groups at the second AGM. Shareholders complained that management did not respect the views of SH workers and SH directors. The shareholders (suppliers, factory workers and non-patrons) often disagreed with one another. Shareholder-respondents said that the objectives of shareholders, the GM and the advisory-directors were so divergent that they were reluctant to present their own views.

4.8 Summary

All of the FCs studied were established with the help of government agencies acting as facilitators. Facilitation involved more than just recruiting shareholders, formulating objectives and preparing a constitution in order to register the company. It usually included grants of financial capital and assets (such as land and machinery), provision of services such as transport and office accommodation, and the expertise and time of civil servants After identifying a suitable project, the facilitating organisations canvassed prospective farmer (patron) investors and invited them to join 'Collective Action Groups'. Members of these groups who showed continued interest were later invited to invest in the FCs. All of the FCs had registered with the RoC under part VII of the Companies Act, No. 17 of 1982, but the surviving FCs had recently lodged applications to re-register under Sri Lanka's new Companies Act, No. 7 of 2007.

All of the FCs issued only ordinary shares and the investor's level of patronage was not linked to his or her level of shareholding. Shares were not freely transferable in any of the FCs and there were no active markets for shares. Shareholding was therefore confined to a particular group of farmers who qualified for membership. In all cases, any dividends declared were to be paid proportional to the level of investment made by each shareholder. However, only Farmer Company 1 and Farmer Company 3 had paid dividends to their shareholders. All of the FCs adopted a democratic electoral process (one vote per shareholder). *De facto*, many of the key institutional arrangements employed by these companies were similar to those found in traditional cooperatives. Nevertheless, each had its own unique features.

Chapter 5

Comparative Case Study Results

5.1 Introduction

This chapter draws comparisons between pairs of failed and successful FCs to test propositions established in Chapter 2 about internal factors expected to influence the performance of these companies in Sri Lanka. Section 5.2 takes a closer look at performance indicators in order to verify (a) that the surviving FCs were distinct from their failed counterparts in terms of performance, and (b) that differences in the relative performance of the failed and surviving FCs in each category (value-adding, commodity marketing and input procurement) could be attributed to internal rather than external causes. Sections 5.3 – 5.5 present the results of qualitative comparisons made between each pair of FCs. Section 5.6 presents a quantitative analysis of variables identified in the qualitative analysis.

5.2 Reliability of the proposed comparisons

5.2.1 Introduction

The surviving versus failed status of the case studies is an important indicator of performance but may be misleading if the surviving company is not healthy. Typically, growth of a company is measured in terms of changes in the value of its net worth, which reflects company profits or losses, debt redemption or accumulation, asset appreciation or depreciation, new share offerings, and so on. In the case of farmer companies, growth in outreach is also important because farmer companies have both social and economic objectives. Section 5.2.2 presents financial and non-financial measures of growth computed for the three surviving FCs and examines the vigour of their performance. Section 5.2.3 considers the role that external factors may have played in distinguishing each surviving FC from its failed counterpart.

5.2.2 Performance of the surviving FCs

Financial performance of the three surviving companies was assessed according to trends in their net worth, revenue, liquidity and solvency over the four-year period 2004-2007 for which comparative data were available. Table 5.1 presents measures of these financial indicators at the beginning of this period (2004) and, in parentheses, the average annual percentage change in each indicator over the period 2004-2007. These rates of change were computed from semi-log trend lines fitted to the data using Ordinary Least Squares

Regression. Only one of these trend lines (for FC3's leverage ratio) had a slope significantly different from zero.

Table 5.1: Financial indicators measured at the surviving FCs in 2004 and annual percentage change in each indicator from 2004 to 2007

Financial indicator		FC1	FC2	FC3
Net worth[1]	Net asset value ≈ equity (LKR million)	0.37 (0%)	- 0.78 (0%)	14.45 (0%)
	Net asset value per share (LKR)	20 (0%)	-154 (0%)	172 (0%)
Revenue[1]	Total sales (LKR million)	2.31 (0%)	0.42 (0%)	34.24 (0%)
Liquidity	Current assets/current liabilities	1.6 (0%)	0.1 (0%)	1.6 (0%)
Solvency	Leverage ratio (debt/equity)	15.1 (0%)	- 1.1 (0%)	2.1 (32%)
Level of ongoing material support		Moderate	High	Low

Note: [1] Based on real values (2007=100).
Source: Analysis of financial statements.

Growth in outreach was measured by changes in the number of shareholders on the assumption that an increase in this indicator would reflect attractive services, prices or returns on investment. Table 5.2 presents the average annual percentage change, and total absolute change, in the number of shareholders at each surviving FC over the period 2004-2007.

Table 5.2: Change in outreach of surviving farmer companies, 2004-2007

Outreach	FC1	FC2	FC3
Annual growth in number of shareholders (%)	55	0	43
Total growth in the number of shareholders	288	0	1,852

Source: Case study data.

Analysis of FC1's financial statements revealed a company with highly variable revenue and no significant growth trend. This company did not require much capital to conduct its core business - input procurement and service provision. Consequently relatively small changes in the level of long-term debt produced large fluctuations in solvency. The leverage ratio declined from 15.1 in 2004 to a more acceptable 4.3 in 2007 but this improvement did not constitute a trend. FC1 was in its eleventh year of operation at the time of the study (2008) and was meeting its debt servicing obligations with only moderate levels of ongoing material support from its facilitating organisation. The number shareholders (Table 5.2) increased impressively from 52 to 340 shareholders, and firm relationships had been established with input suppliers to better serve these patrons (Table 5.3). In summary, FC1 was a moderately successful, if not dynamic, company.

FC3 required substantial capital to finance its value-adding assets. These assets were largely debt financed and there was evidence of declining solvency over the period 2004-2007. Nevertheless, the company's net worth remained strongly positive. Although there were no signs of growth between 2004 and 2007, there was evidence of significant growth before 2004. FC3 issued its shares in 1998 at a price of LKR10 per share. Net asset value per share increased steadily to LKR116 in 2004. Even when expressed in real terms, this represents dramatic growth. The recent increase in debt financing and subsequent decline in solvency does not necessarily mean that the company's financial health was deteriorating as higher levels of leverage promote future growth when net returns to assets exceed the cost of debt (Barry et. al., 1995: 168). In addition, FC3 had a favourable and stable current ratio and was coping with its debt servicing obligations – albeit with some ongoing material support from its facilitator. The number shareholders grew rapidly from 430 to 2,282 smallholders and the company had established its own brand names and strong links to corporate buyers (Table 5.3). In summary, FC3 - in its eleventh year of operation - appeared to be a reasonably successful and dynamic company.

FC2 was in its seventh year of operation as a commodity seller. Although its capital requirements were much more modest than those of FC3, debts were growing faster than assets as the company continued to make losses (Table 4.5). Technically, FC2 was insolvent and relied on high levels of ongoing material support from its facilitator to service its debt. Even so, the company was barely liquid. Strong relationships had been established with buyers (Table 5.3) but nothing had been done to improve the number shareholders – the number of patron-shareholders remained constant at 154. In short, FC2's continued survival was very much in doubt.

Table 5.3 compares performance indicators that were available for both surviving and failed FCs. FC4, an input procurement and service providing FC, collapsed in 2004 after just three years of operation. At that time, its surviving counterpart (FC1) was also experiencing financial problems but remained solvent and was able to service its debt with only moderate material support from its facilitator. FC4 (unlike FC1) failed to build relationships with suppliers. FC6, a value-adding farmer company, collapsed spectacularly in 2002 after operating for a period of seven years. At that time, its surviving counterpart (FC3) was growing strongly – even though it received much less in the way of material support from its facilitator. FC6 did have a strong relationship with a buyer, but this relationship had been imposed on the company by its facilitating organisation and was not one of mutual benefit.

Whilst it can reasonably be concluded that FC1 outperformed FC4 and that FC3 outperformed FC6, there appears to be little difference in the performance of FC2 and FC5, the surviving and failed commodity sellers.

Table 5.3: Non-financial performance indicators for the surviving and failed FCs

Indicator	FC1	FC2	FC3	FC4	FC5	FC6
	Input procurer	Commodity seller	Value adder	Input procurer	Commodity seller	Value adder
Status at the time of data collection	Surviving			Failed		
Level of ongoing material support at the time of failure/data collection	Moderate	High	Low	Low	High	High
Ownership of brand names	No	No	Yes	No	No	No
Voluntary links with corporate buyers or suppliers	Some	Strong	Strong	None	Some	None

Source: Case study data.

5.2.3 External determinants of FC performance

This research recognises that external factors could affect the relative performance of the FCs being compared. Although the sample was designed to control for some external factors by pairing FCs with similar types of core business, it was anticipated that the case studies would reveal additional information about external determinants of performance. This section presents and examines this information. The purpose of this analysis is to ensure that differences (or similarities) observed in the performance of each pair of FCs can be attributed to internal rather than external factors.

FC1 and FC4 provided inputs and services for shareholders to cultivate a range of crops. Most shareholders at both FCs produced paddy, rice and a range of vegetables. Both companies operated at the same time and both received ongoing material support from government agencies. Prices of the main products grown by shareholders at FC1 and FC4 increased nationally during FC4's lifetime (Census and Statistics, 2008) and there were no records of adverse external factors such as prolonged droughts, pests and diseases or localised price shifts in the two provinces where FC1 and FC4 were located. Key informants at DoA and the MASL reported that their grain stores were made available to both FCs at favourable rates to avoid price disadvantages due to seasonal price fluctuations. The DoA provided free agricultural extension in both provinces and farmers used the same technologies. External, physical and technological factors did not appear to have different effects on FC1 and FC4, although differences in the level of material support provided by government agencies may have helped to sustain FC1.

Shareholders at FC3 were mainly engaged in growing paddy and vegetables as seed crops while shareholders at FC6 grew an export crop. External factors with regard to paddy and vegetable cultivation in the North Western Province where FC3 was located were similar to those that impacted FC1 and FC4. FC6 was located in the Southern Province where its crop grew very successfully on supplementary irrigation (Mandal, 1997: 85). National production of the export crop processed by FC6 grew by five percent during the period 1995-2003 (HKARTI, 2005). A temporary setback in 1994 when some major exporters were unable to meet international quality standards did not affect FC6's buyer who had long-standing relationships with importers in Europe (Farhad, 2008). Again, there is no evidence that external factors played a significant role in the survival of FC3 or the collapse of FC6. On the contrary, FC6 received unusually high levels of ongoing material support from government agencies.

Shareholders at FC2 grew bell-pepper and cherry tomato while FC5's shareholders mainly grew paddy, maize, soybeans, green gram, black gram, chillies and a range of vegetables for their respective FCs. According to key informants, the North Central Province did not experience adverse prices or weather conditions in 2002 or 2003 when FC5 stopped trading. Weather conditions are of less importance to FC2 as the crops supplied by its shareholders are produced in greenhouses under irrigation. Key informants stated that prices paid for these crops remained competitive but had not increased significantly. Both FC2 and FC5 benefited from high levels of government support. There was no evidence to suggest that either the failure of FC5 or the survival of FC2 could be attributed to extraordinary changes in prices, technology, external support or environmental conditions.

In summary, external factors did not appear to play any significant role in the failure of FC4, FC5 or FC6. Likewise, external factors did not especially benefit the surviving FCs - FC1, FC2 and FC3.

5.2.4 Conclusions

The findings presented in Sections 5.2.2 and 5.2.3 support comparative analysis of FC3 vs. FC6 and FC1 vs. FC4 to test propositions about internal factors contributing to the success or failure of value-adding and input procuring FCs respectively. These analyses are presented in

Sections 5.3 and 5.4 of this chapter. The same approach cannot be taken with the commodity sellers because FC2 hardly outperformed FC5. However, this does not render a comparison of these two FCs meaningless. Instead, a comparison of FC2 vs. FC5 deepens the analysis by testing for internal differences where none or few were expected. Consequently, this analysis could be very useful in eliminating unimportant internal factors from the set of possible causal factors identified in Sections 5.3 and 5.4.

In terms of presentation, priority was given to the capital intensive companies, FC3 and FC6, as this analysis was deemed most likely to reveal internal problems affecting access to capital and hence company performance. Although the same depth of analysis was applied to the other pairs of FCs, the results presented in Sections 5.4 and 5.5 are limited to new findings and those that challenge the first analysis.

5.3 Comparison of FC3 with FC6 – value-adding processors

This section compares the surviving value-adding FC (FC3) with its failed counterpart (FC6). This comparison was expected to provide rich information about which of the main constructs - institutional and governance arrangements, management and group factors - may have contributed to success because these FCs required considerable capital to finance relation-specific assets.

5.3.1 Comparison of institutional and governance arrangements

5.3.1.1 The internal free-rider problem

Both FC3 and FC6 suffered from an internal free-rider problem as benefits accruing to shareholders derived primarily from patronage (services provided at favourable prices) and levels of equity invested by shareholders were not proportional to patronage (Table 5.4). In FC6, this problem was compounded by the presence of permanent, non-patron shareholders. Although FC3 did have some non-patron shareholders, this was largely a seasonal occurrence and the small proportion (less than 5%) of shareholders that had stopped supplying the company altogether were not significant investors.

At FC6, small growers, large growers, factory workers and non-patron shareholders were required to buy a minimum of 10 shares each. Despite their (roughly) equal investments, large growers benefitted more from company services than did any of the other shareholder groups, and only growers benefitted from the company's irrigation system. This created a free-rider problem even within FC6's patron group.

Table 5.4: Causes of internal free-riding at FC3 and FC6

Institutional characteristic	FC3	FC6
Non-patron shareholders were permanent	No	Yes
Shareholders must invest equity in proportion to their patronage	No	No
If no, was there *de facto* proportionality between shareholder equity and patronage?	No	No
All shareholders invested the same level of equity capital	No	Yes

Source: Case study data.

FC3 was a multi-product company dealing with five main product categories. There were no shareholders who supplied the entire range of products handled by the company. The company invested heavily in plant for processing and storing paddy and seed paddy, but several patron shareholders did not grow rice. Although FC3 did not expect shareholders to contribute equal amounts of equity capital, it was virtually impossible to eliminate an internal free-rider problem when the company handled multiple products and the operational benefits were linked to patronage.

5.3.1.2 The external free-rider problem

Respondents at FC3 reported that out-growers, who were not shareholders of the company, enjoyed the same key services provided to shareholders. These services included product certification, crop inspection, advice, guaranteed purchase, and the same price as that offered to shareholders. FC3 purchased paddy from out-growers (for processing in its plant) at the same price that it offered to shareholders, and also charged shareholders and the general public the same prices for products sold at its sales outlets. FC3 therefore faced an external free-rider problem.

Respondents at FC6 stated that the company provided processing services to its financier at the same price that its shareholders paid. As in FC3, non-members were free-riding on benefits financed by shareholders (Table 5.5). However, the management of FC3 and former advisory-directors of FC6 argued that these strategies helped to spread fixed costs and therefore benefited patron-shareholders.

Table 5.5: Causes of external free-riding at FC3 and FC6

Institutional characteristic	FC3	FC6
Non-shareholder patrons enjoyed the same services given to shareholder patrons	Yes	Yes
Non-shareholder patrons enjoyed the same price advantages given to shareholder patrons	Yes	Yes

Source: Case study data.

5.3.1.3 The portfolio problem

FC6 did not permit share trading between shareholders (Table 5.6). Consequently, share-holders were not able to diversify their individual investment portfolios according to their personal (risk) preferences. This portfolio problem was particularly relevant at FC6 because its members were highly specialised farmers. The vast majority (87%) of shareholders interviewed earned most of their income selling their produce to the company, and for 56% of these respondents this represented their only source of income.

FC3 did permit share trading between shareholders but, in practice, there was no internal market for equity shares. However, the vast majority (93%) of shareholders interviewed earned most of their income supplying products to buyers other than the company. These farmers were more diversified than those who patronised FC6, and therefore less exposed to the portfolio problem. They also reported a tendency to reduce their risk exposure by restricting further investments in the company (particularly as there was no reward for investing more, or penalty for investing less) and by influencing management's investment decisions.

Table 5.6: Causes of portfolio, horizon and control problems at FC3 and FC6

Institutional characteristic	FC3	FC6
If declared, dividends were proportional to the level of equity owned by shareholders	Yes	Yes
Dividends were declared and paid	Yes	No
Shares were appreciable[21]	Yes	No
The company permitted share trading between shareholders	Yes	No
There was an active internal market for shares	No	No
New shareholders joined the company after the initial share issue	Yes	No
If yes, new shareholders paid the same price for equivalent voting and benefit rights purchased by the original shareholders	No	Not applicable
Non-patron managers were rewarded with shares or share options[22]	No	No
Advisory-directors were able to make the company's policy and strategic decisions	No	Yes
Executive (hired) managers were able to make the company's policy and strategic decisions	No	Yes

Source: Case study data.

5.3.1.4 The horizon problem

Although FC3 permitted share trading between existing shareholders, there was no active market for its shares. It might therefore be concluded that FC3 faced a horizon problem. However, the horizon problem in FC3 was alleviated by the issue of bonus shares. This appreciation in the value of equity owned by shareholders means that capital was retained for reinvestment and that new shareholders who joined FC3 paid a higher price for benefit and voting rights equivalent to those purchased by earlier investors. The picture in FC6 was quite different. Share trading was not permitted and the company did not issue bonus shares. New entrants would therefore have benefitted from assets financed by earlier investors without contributing fully to their cost.

The absence of an active market for shares in both FC3 and FC6 meant that shareholders could not realise their initial investment or any capital gains on exiting the company. It is therefore not surprising that 56% of shareholder-respondents in FC6, and 37% of shareholder-respondents in FC3 did not want their companies to invest in long-term tangible and intangible assets (Table 5.7). Even those respondents who supported such investments did not want to finance them – stating that grants should be sought from government agencies, non-

[21] By selling them at market prices or by awarding bonus shares

[22] Constitutions didn't allow this unless the manager satisfied membership criteria.

governmental organisations or foreign donors. The higher incidence of support for durable investments such as trademarks in FC3 is consistent with the view that the horizon problem was more severe in FC6.

Table 5.7: Shareholder perceptions of FC investment in long-term tangible and intangible assets (%)

Response	FC3	FC6	Total
Strongly support	---	3	2
Support	60	41	50
Disagree	37	56	46
No response	3	---	2
Total	**100**	**100**	**100**

Source: Case study data.

5.3.1.5 The control problem

Ownership and control were clearly separated in both FC3 and FC6 creating a potential principal-agent problem due to divergence of interests. In FC3, owners were represented by shareholder-directors and control by hired managers. In FC6, control vested in both hired managers and advisory-directors (Figure 5.1). Key informants and other respondents reported a severe control problem in FC6 and attributed it to this dual control.

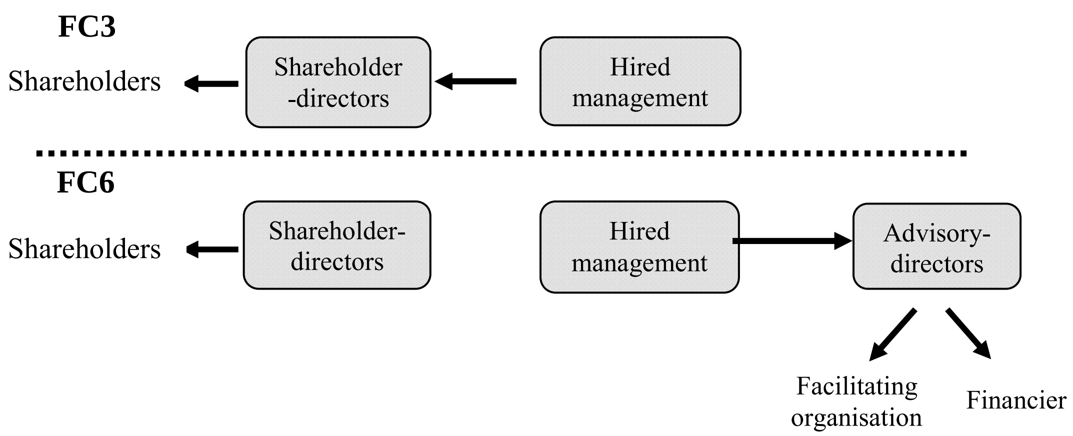

Figure 5.1: Reporting relations at FC3 and FC6
Note: The direction of arrows shows the direction of reporting

The absence of active share markets in FC3 and FC6 meant that there was no frequent and objective signal (i.e. a market-determined share price) of managerial performance to guide shareholders in their investment and voting decisions. This made it difficult for shareholders to monitor and sanction managers, and so diminished the accountability of management to owners. The absence of freely tradable shares also made it impossible to align the interests of managers and owners by remunerating managers with shares or share options. For these reasons, both FC3 and FC6 were exposed to a control problem.

An important difference observed between FC3 and FC6 was that only shareholder-directors were able to make policy and strategic decisions in FC3. In FC6, the advisory-directors (appointed) and managers played a dominant role making such decisions. This further reduced the accountability of managers to owners and a control problem emerged. In FC3, advisory-directors were also able to make policy and strategic decisions during the first five years of the company's operation. However, the respondents noted that it had been agreed from the outset that non-elected directors would be removed after a period of five years, leaving company policy and strategy in the hands of elected directors. This promise of empowerment was an incentive in FC3.

5.3.1.6 Electoral procedures and the accountability of directors

FC3 held all of its mandatory AGMs (Table 5.8). According to the shareholder-respondents and key informants, most shareholders attended the AGMs to elect directors to the board and to discuss and resolve their problems. Some shareholders did not attend the AGMs because agreements reached prior to the AGM meant that most nominees did not have to contest positions on the board. A few respondents admitted that they did not attend AGMs, some because they objected to the nominees and others because they were in a minority. Non-patrons, for example, stated that they had little interest in attending AGM's because patrons dominated proceedings. The chairman convened the AGM and officers from the former facilitating organisation were present as neutral observers.

In contrast, FC6 failed to hold regular AGMs despite pressure exerted by the facilitating organisation (Table 5.8). Key-informants reported that most shareholders, including many non-patron shareholders, did not attend the company's last few AGMs because they did not trust management and could do little to sanction directors who were not acting in their best interests. Shareholders elected only six of the company's ten directors, and respondents claimed that the company's four advisory-directors served the interests of the financier and the government via its facilitating organisation. In addition, shareholders could not sanction directors by disinvesting. The situation was quite different in FC3 where shareholders nominated and elected all of the board's directors. Zone-based elections were popular even though it skewed voting power in favour of members from smaller zones.

Both FC3 and FC6 advertised their AGM's well in advance. Notices and calls for nominations were sent to all the shareholders by post. However, ballot procedures differed between the companies. FC3's constitution provided for a secret ballot in the event that a choice had to be made between competing nominees. FC6, on the other hand, opted for voting by a 'show of hands'. All of the shareholder-respondents at FC3 felt comfortable with the prospect of a secret ballot, whereas only 19% of the shareholder-respondents at FC6 felt comfortable with the prospect of a 'show of hands' as this electoral procedure was not confidential.

In FC3, directors representing some geographic zones were elected by secret ballot while others were elected unopposed. However, all of the nominated directors were elected unopposed at FC6. The practice of unopposed elections, originally introduced by the facilitating organisation, may have been accepted by shareholders as a better option than election by show of hands. Even so, none of the shareholder-respondents at FC6 approved of this practice, and key informants also regarded it as detrimental to good governance. Shareholder-respondents claimed that advisory-directors would persuade elite shareholders to nominate candidates more sympathetic to the agencies that they represented.

In both companies, the directors served fixed terms of one year after which they had to step down. However, in FC6, the same persons were re-appointed as advisory-directors by the facilitating organisation despite the poor performance of the company.

Shareholders in FC3 could consult any director to study the minutes of board meetings or to get clarification about discussions held at board meetings. Ongoing consultation between shareholders and directors was quite common. According to the respondents, these practices helped to reduce uncertainty, promoted transparency and improved shareholder knowledge of important board decisions. As a result, shareholders developed a high level of trust in the board.

In FC6, discussions at board meetings were dominated by the advisory-directors, and shareholders did not have access to the minutes of board meetings. Key informants also reported that restrictions imposed on shareholder-directors prevented them from divulging minutes of board meetings to the shareholders. Shareholder-respondents stated that they were poorly informed about the origin of proposals brought to the board, and which of the directors had supported or questioned these proposals. In addition, they complained that their directors were not always able to provide them with information because the advisory-directors did not share information with them. For example, the rent that the financier paid to use the company's processing was decided by the financier's advisory-director and the facilitating organisation without engaging the shareholder-directors. This lack of information and the opaque electoral procedure combined to undermine the accountability of directors. Many of the shareholder-respondents did not trust the board.

Shareholders in FC3 were entitled to call interim (special) general meetings and did exercise this right. Some important decisions concerning the distribution of irrigation water were taken at interim general meetings while FC3 was still managing the irrigation scheme. Respondents noted that these meetings were amicable, and that officers of the former facilitating organisation were invited to attend – but only to provide information or advice if it was requested. Although the directors and managers of FC3 discouraged interim meetings (as they already hosted quarterly meetings and felt that the additional time and cost burden was unwarranted) they did respect and honour shareholders' right to call these meetings. The same was not true of FC6. According to the key-informants, FC6 did not make any provision for special general meetings, and shareholder-respondents complained that they did not have access to forums where they could raise issues. Table 5.8 summarises key governance attributes relating to electoral procedures and accountability of directors at FC3 and FC6.

Table 5.8: Electoral procedures and aspects of accountability of directors at FC3 and FC6

Governance attribute	FC3	FC6
AGMs convened regularly	Yes	No
AGMs advertised widely and in advance	Yes	Yes
Shareholders were given adequate notice of AGMs and supporting documentation	Yes	No
Shareholders nominated all of the directors	Yes	No
Elected shareholder-directors were chosen by secret ballot	Yes	No
Shareholders could access minutes of board meetings	Yes	No
Shareholders could convene special general meetings	Yes	No

Source: Case study data.

5.3.1.7 Board procedures

Both FC3 and FC6 elected their chairmen by a majority vote of shareholder-directors (Table 5.9). In FC3, the directors considered qualities such as leadership experience, farming and business success, negotiation skills and links with relevant public and private agencies when choosing the chairman. Knowledge of these attributes was generally good because membership was constrained geographically. Shareholder-respondents agreed that the current chairman possessed these qualities – a view supported by the author's own observations. At FC6, it was reported by shareholder-respondents that the choice of chairman was driven by the company's advisory-directors.

In FC3, the chairman was responsible for setting the agenda at board meetings. He also provided reliable information to help directors reach good decisions. The board's secretary kept minutes of the board meetings. At FC6 these tasks were performed by the advisory-directors and management.

Both companies gave 14 days notice of board meetings. FC3 also provided directors with the minutes of previous meetings in advance but key informants at FC6 claimed that shareholder-directors received selective information just before the board meetings. Table 5.9 summarises board procedures at FC3 and FC6.

Table 5.9: Board procedures at FC3 and FC6

Governance attribute	FC3	FC6
Chairman chosen by elected directors	Yes	Yes
Chairman set the agenda for board meetings	Yes	No
Shareholder-directors given sufficient notice of board meetings	Yes	No
Shareholder-directors provided with minutes of previous meeting	Yes	No
Chairman ensured that directors had reliable information	Yes	No

Source: Case study data.

5.3.1.8 Accountability of management

Shareholder-respondents at FC3 stated that they were prepared to accept the consequences of managerial decisions because their directors were responsible for hiring and firing executive managers and the GM reported directly and only to their directors. The situation was very different at FC6 where the facilitating organisation and advisory-directors played an influential role in recruiting executive managers and where senior management reported first and foremost to the advisory-directors and facilitating organisation. Shareholder-respondents indicated that this improper reporting was the root cause of conflict observed between management and shareholders. According to respondents, the relationship between shareholders who worked in the company's processing plant and the managers who supervised them was also hostile. Clearly FC6 lacked the high level of shareholder trust in management that characterised FC3. Table 5.10 summarises aspects of the accountability of management at FC3 and FC6.

Table 5.10: Aspects of the accountability of management at FC3 and FC6

Governance attribute	FC3	FC6
Board was responsible for hiring and firing executive managers	Yes	No
Executive manager reported only to the board and shareholders	Yes	No

Source: Case study data.

5.3.1.9 Financial transparency

Key-informants at both FC3 and FC6 reported that the annual financial budgets, significant expenses and all capital expenses were approved by their boards (Table 5.11). FC3's annual budgets were prepared by the accounting manager in consultation with the chairman, directors, GM and relevant board committees. At FC6 budgeting was largely an external process undertaken by the advisory-directors, facilitating organisation and managers.

Key-informants claimed that FC3 always met its statutory requirement to submit audited annual financial statements. These claims were verified by checking returns filed with the RoC. Shareholders received a copy of the company's annual report prior to the AGM (even though only a few of them could interpret the financial statements without assistance) and approved the board's choice of external auditor at the AGM.

FC6 was cautioned several times by the RoC for failing to submit audited financial statements. According to the interviewees, the main reasons for this failure were that; the chairman did not lead the company, the GM did not produce documents on time, arrangements were not made for external audits, and the facilitating organisation and GM disregarded protocol and the shareholder-directors. The facilitating organisation arranged for a final audit after the collapse of the company. The AGM approved the auditor chosen by the facilitating organisation. Table 5.8 compares key measures of financial transparency and accountability at FC3 and FC6.

Table 5.11: Measures of financial transparency at FC3 and FC6

Governance attribute	FC3	FC6
Financial budgets approved annually by the board	Yes	Yes
Significant expenditure subject to approval by the board	Yes	Yes
The company reported independently audited financial statements each year	Yes	No
Shareholders received an annual report with audited statements	Yes	No
Shareholder-directors nominated the auditor	Yes	No

Source: Case study data.

5.3.2 The influence problem and group dynamics

An influence problem arises when interest groups are able to influence policy and operational decisions that enhance their own net benefits rather than the firm's net worth. Decisions that favour a minority investor group at the expense of the majority investor group are more likely to happen when voting rights assigned to shareholders are not proportional to their level of investment. Flawed electoral procedures (e.g., voting by show of hands rather than by secret ballot) and the presence of non-elected directors on the board could also expose a firm to such an influence problem. The scale of this problem is likely to grow with the range of services offered to shareholders and with the heterogeneity of this group as greater diversity is expected to increase the incidence of sub-groups with different vested interests. Group dynamics could also affect a farmer company's performance if ownership and control are not clearly separated, for example when members participate directly in policy and operational decision-making because collective action will tend to dilute the ability of investors to influence decisions.

FC3 engaged in five core enterprises, which presented its members with a wide range of transaction opportunities. Shareholder-respondents reported that most members engaged in some but not all of these enterprises. In contrast, FC6 offered its shareholders only two transaction opportunities; they could supply a single crop for processing or they could supply labour for the processing plant.

Shareholders at both FC3 and FC6 displayed similar heterogeneity in their reasons for joining the FC; farm and family size, location and distance from the FC, length of membership, age, education, farming experience, family and membership of other organisations (Sections 4.4.7 and 4.7.7). Nevertheless, it was anticipated that FC6 would have a more homogenous membership than FC3 owing to its much smaller size (2,282 vs. 355 members). The combination of a wider range of services and a more heterogeneous membership was expected to aggravate influence problems at FC3 relative to FC6. However, this was not the case.

In the first instance, there was a clear centralised decision-making at both FC3 and FC6. Although FC3 encouraged shareholders to raise and debate issues at quarterly general meetings, key informants and shareholder-respondents emphasised that final decisions were taken by the board – even when experts were called in to offer advice. Likewise, FC6 did not engage in collective decision-making with its shareholders.

Given the centralised decision-making in both FC3 and FC6, the potential for group diversity to affect company performance depends largely on the non-alignment of investment and voting power. Both FC3 and FC6 assigned democratic voting rights (i.e., one vote per shareholder) rather than the usual company approach of assigning proportional (one vote per share) voting rights. Consequently, it was conceivable that, within either company, an interest group could influence decisions in its favour at the expense of other shareholders who collectively owned a greater share of the company's equity capital.

In practice, FC3 adopted its own strategies to minimise the influence problem. FC3 earned most of its revenue prior to 2004 through interest received on agricultural credit. Key informants stated that the majority of shareholders who received credit were from the group that did not hold most of the equity capital of the company. This group lobbied for larger loans (above the agreed ceiling of LKR10,000), interest charges below prevailing market rates, relaxed repayment periods, and for bad debts to be written off. The company initially accepted some of these demands. For example, it did not address non-repayment of loans before 2004. However, FC3 changed its strategy to better achieve its value-adding goals and now rejects lobbies that disadvantage the majority investor group.

With its much smaller membership and narrower range of services, FC6 appeared to be less prone to an influence problem than FC3. Indeed, there was no evidence of minority investors lobbying for privileges. However, the ongoing presence of advisory-directors and the important and forceful role they played in decision-making produced its own influence problem. Whereas all of FC3's directors were nominated by shareholders, four of the ten directors serving FC6 were appointed by external agents. Despite their numerical minority and lack of voting rights, these advisory-directors played a dominant role in decision-making. Key informants viewed the advisory-directors as the 'think tank' when it came to: (1) setting objectives and formulating policy, (2) defining strategies and implementing long-term plans for production, marketing and finance, and (3) employing, dismissing and overseeing managers. These directors did not answer to shareholders, let alone the majority investor group.

Particular criticism was levelled at the advisory-director who represented the interests of the exporter that transacted with the company. This exporter procured raw material from external growers, sold it to FC6 for processing and then purchased all of the company's output. In addition, this exporter provided a significant portion (30%) of FC6's capital via a term loan. Shareholder-respondents and key informants claimed that the advisory-director had influenced raw material and product prices to favour the exporter. While lenders and investors may well favour the same types of investment, it is hard to imagine this lender sacrificing margins and debt repayments in order to reinvest in the company and grow its shareholder wealth. This was just one of several conflicts that emerged between shareholder-directors and advisory-directors, and which undermined shareholder confidence in FC6. Shareholder-respondents also claimed that advisory-directors 'persuaded' shareholders to nominate directors that were less likely to challenge the facilitating organisations, and that this practice created conflict within the sub group of shareholder-directors. It is quite possible that the 'show of hands' ballot system adopted by FC6 may have made it more difficult for shareholders to contest candidates recommended by the facilitating organisations. Table 5.12 summarises potential causes of influence problems at FC3 and FC6.

Table 5.12: Causes of influence problems at FC3 and FC6

Institutional characteristic	FC3	FC6
Voting rights to elect directors were proportional to shareholding	No	No
The company purchased multiple products from its shareholders	Yes	No
Shareholders participated directly in policy-making decisions	No	No
Non-investors with vested interests in the company had representation and influence on the board of directors	No	Yes

Source: Case study data.

In summary, the case studies showed no recent evidence of an influence problem at FC3 despite democratic voting rights and significant diversity in the company's membership and services. FC3's directors consulted shareholders and experts but took the views of the majority investor group into account when making decisions. FC6 did have an influence problem. Again, this was not the result of democratic voting rights or collective action in decision-making. Instead the problem stemmed from the ongoing presence of externally-appointed directors, and may well have been aggravated by a flawed electoral procedure.

5.3.3 Management factors

5.3.3.1 Introduction

Section 5.3.1 identified the institutional and governance arrangements that have direct consequences for the performance of capital-intensive companies. Section 5.3.2 identified the prevalence of influence problems and group dynamics within the two companies. This section extends the analysis to consider the impacts of these factors on the strategies, processes and the quality of management at FC3 and FC6, i.e. their indirect consequences for the performance of these companies.

5.3.3.2 Strategies and processes

FC3's organisational structure was well-defined and throughput-based allowing it to handle its expanding enterprises and processes with flexibility. Key informants stated that this structure developed a clear line of command. There were five senior management positions responsible for particular enterprises or organisational functions. Although only one of these positions was filled, senior officers were appointed as acting managers and apparently performed well in these roles over a long period of time. There was no ambiguity in the GM's reporting line (Section 5.3.1.8). Key informants reported that the GM was given autonomy to make key management decisions. For example, he had the final authority on marketing and production strategies. These factors along with good processes to develop strategy appeared to help the company to survive. Conversely, FC6 opted for a much less specialised organisational structure with two assistant managers supporting the GM. Shareholder-respondents reported that the advisory-directors practically controlled the whole organisation without empowering owners, shareholder-directors, to make strategic decisions. Hired management did not report to the shareholder-directors instead the GM was instructed to report directly to the advisory-directors. Therefore, the line of command at FC6 was weaker than at FC3 due to ambiguous control and reporting relations.

Even though FC3 and FC6 were both value-adding FCs, they were significantly different from each other in terms of strategy. FC3 was a multi-product company. Key informants stated that therefore, FC3 required specific strategies to service a range of products and supplier–shareholders. On the other hand, FC6 processed one product for one buyer. Key informants reported that FC6's strategy mainly focused on product improvement for that one product.

The organisation that facilitated FC3 first established a collective action group to represent future shareholders in discussions about the objectives of their proposed farmer company. Those initial discussions were guided by officials from the facilitating organisation and other government agencies such as the DoA. FC3's objectives were consequently developed in a participatory way and reflected the aspirations of shareholders. Shareholder-respondents confirmed that they were familiar with the company's objectives and felt that they were still relevant to the majority of shareholders. However, FC6's main facilitator did not follow a participatory process but imposed a set of generic development objectives on the company. Shareholder-respondents and key informants reported that those objectives were not friendly to shareholders who were small-scale rural producers. Neither company had developed a formal mission statement. However, key informants stated that FC3's motto (Section 4.4.2), which was also developed through a participatory process, served to remind directors and managers of their long-term commitments and goals. Therefore, it acted as an implicit mission statement.

Key informants noted that the farmer shareholders, officials of the facilitating organisations and advisory-directors who established and facilitated the two FCs were not business specialists. This might explain why the facilitators did not encourage these companies to develop formal long-term business plans. However, key informants claimed that FC3 addressed this omission through well-defined company objectives and strategies that were subject to wide consultation. With respect to FC6, key informants stated that this company could not develop and sustain its own plans due to the control and influence of the advisory-directors – especially the one representing the debt financier. The debt financier was the only buyer at FC6. It was logical to assume that this buyer-supplier relationship did not thrive because the buyer (the debt financier) pursued pricing strategies in his own business that conflicted with the profit-maximising objectives of shareholders at FC6.

At FC3, strategies were formulated by the board through a deliberate process. The directors programmed time at each board meeting to develop strategy, and drew heavily on the GM and Accounting Manager at these discussions to ensure that proposals were resource feasible. Proposals often came from shareholders via the company's crop and livestock officers who visited growers on a daily basis. Processes to develop strategies at FC3 were therefore 'owned' by the shareholders. Although similar channels to generate feasible proposals existed at FC6, the board did not establish routine internal procedures for developing and testing new strategies. Key informants and shareholder-respondents attributed this to the influence of advisory-directors and lack of autonomy afforded to managers. As a result, processes to develop strategies at FC6 were not 'owned' by the shareholders and did not serve their interests. This may partly explain why FC6 had never succeeded beyond processing a single product for a single buyer. Enterprise diversification at FC3 provided evidence of effective processes to implement new strategy when required.

According to key informants at FC3, management supplied the board with market information that was analysed informally to assess proposed strategies. New products, production techniques, relevant technology and potential buyers were the main information made available. FC3 also appointed committees consisting of directors and sometimes ordinary shareholders to look for information and to make recommendations prior to strategic choices. At FC6, the facilitating organisation was the main source of information, and marketing strategies were formulated by the advisory-directors. No committees were appointed to make recommendations. Unlike FC3, the shareholder-directors at FC6 did not own or apply the processes used to generate business strategies.

Policy decisions taken by the board at FC3 were communicated in order to gain commitment from management and shareholders. The most popular forum for this was the quarterly general meeting where shareholder's feedback was sought after the new strategies were discussed. Clear responsibilities were assigned to managers for effective action, coordination of tasks and tracking of progress. The coordination of tasks for strategy implementation at FC3 was facilitated by favourable reporting and control relationships (Section 5.3.1.5). FC3 did not face many problems at implementation perhaps partly because its strategies were perceived to be shareholder-friendly. According to key informants, two policies were formulated to implement a recent strategy to phase out loans to shareholders. First, a cap was imposed on the total amount that could be borrowed by a shareholder. Second, quick action was taken to address non-repayment. Clear instructions were communicated to the

Accounting Manager for effective action and to monitor progress. A similar level of shareholder commitment was difficult to achieve at FC6 because most strategies were influenced by advisory-directors and were not perceived to be shareholder-friendly (Section 5.3.2). In addition, management did not have a good working relationship with employees who worked in the company's processing plant and 90% of these workers were shareholders. FC6 also suffered from vague reporting and control relationships (Section 5.3.1.5) that undermined commitment.

FC3's history of delivering audited financial statements, annual reports and minutes of board and general meetings, attested to effective administrative processes. The GM delegated financial responsibilities to the Accounting Manager who was assigned to facilitate these processes. By contrast, FC6 did not meet its administrative and legislative requirements and was even warned by the RoC for not submitting financial returns (Section 4.7.5). Key informants attributed this to ambiguous reporting and administrative processes (especially accounting processes for which FC6 relied on its facilitating organisation). According to key informants, management was unable to provide financial information due to inconsistencies in keeping records. Table 5.13 presents key features of the comparison between FC3 and FC6 in terms of strategy and processes.

Table 5.13: Comparison of strategic management and administrative processes at FC3 and FC6

Strategy and process attribute	FC3	FC6
Organisational structure was developed to facilitate the expansion of enterprises	Yes	No
Company objectives were developed with and for the shareholders	Yes	No
Management prepared a long-term business plan	No	No
Processes to develop strategies were well-established, continuously applied and informed by managers and shareholders	Yes	No
Processes to implement strategies assigned clear responsibilities to managers	Yes	No
Administrative processes produced timely information required by directors, shareholders and legal authorities	Yes	No

Source: Case study data.

5.3.3.3 Managerial quality

Employing a high quality executive manager was a challenge for FC3 because shareholder-directors did not have skills to select the right candidate. Key informants reported that the facilitating organisation selected the right candidate for FC6. FC3 avoided the challenge by promoting one of its senior employees. Retaining quality managers was difficult for both FCs, partly because good performance could not be rewarded with tradable shares in the absence of a market for shares.

The GMs employed by both companies were highly regarded for their technical, business and leadership qualities. A good working relationship was developed among the management, board and shareholders at FC3. However, FC6's management was unable to sustain a close working relationship with the shareholder-directors or to retain the trust of shareholders partly due to inadequate reporting (Section 5.3.1.8). Therefore, the management at FC6 was unable to capitalise on its technical skills and leadership qualities due to institutional problems.

Key informants reported that the senior managers at FC3 possessed appropriate skills and experience to perform their respective functions. These managers were then able to capitalise on good processes and appropriate organisational structure. On the other hand, the two senior managers at FC6 were expected to perform a wide range of functions such as production, maintenance of processing plant, human resource management, shareholder coordination, procurement and sales. Key informants reported that those managers did not have the range of skills required to perform all the functions expected of them. As a result, FC6 was unable to obtain the best output from their managers.

According to buyers and key informants, FC3 was transforming itself into a customer-centred company while retaining its shareholder-orientation. The problem of retaining high-quality managers to facilitate this transformation in FC3 was partly taken care of by providing incentives for the GM in the form of higher study opportunities which reportedly motivated the incumbent. According to key informants, FC6 did not offer incentives to its managers. Table 5.14 presents a comparison of managerial quality attributes at FC3 and FC6.

Table 5.14: Comparison of managerial quality attributes at FC3 and FC6

Managerial quality attribute	FC3	FC6
The general manager was a skilled and a dynamic leader	Yes	Yes
Skills of senior managers were appropriately matched with their portfolios	Yes	No

Source: Case study data.

5.4 Comparison of FC1 with FC4 – input and service providers

This section compares the surviving input and service provider (FC1) with its failed counterpart (FC4). Although the comparative analysis of these two companies was conducted in full, this section does not present findings that overlap with those presented in the previous section. Instead, it presents only those findings that generate new or contradictory information about the theoretical propositions under investigation. Considering that input and service providing farmer companies require fewer relation-specific assets than do value-adding FCs, it was anticipated that this section might reveal more nuanced insights into the effects of management and group factors on company performance. Each sub-section concludes with a list of internal factors that were consistent with propositions relating to company success.

5.4.1 Comparison of institutional and governance arrangements

The comparison of FC1 and FC4 produced findings similar to those revealed by the comparative analysis of F3 and FC6 in terms of institutional and governance arrangements. FC1 and FC4 both faced internal and external free-rider problems because benefits were not proportional to levels of shareholder investment, and a portfolio problem because shares were not tradable. However the analysis did reveal some interesting nuances relating to the horizon and control problems, electoral procedures and accountability of management.

5.4.1.1 The horizon problem

Both FC1 and FC4 issued tradable shares but were exposed to the horizon problem because they lacked active internal markets for their shares. In 2006, FC1 paid a cash dividend equal to 50% of the par value of shares owned by each shareholder. This should have eased the horizon problem relative to FC4 which did not pay any dividends. However, FC1 applied the same formula (50% of par value) to all shareholders regardless of when they purchased their shares. This disregard for the duration of investment meant that returns were not proportional to the level of equity owned by shareholders. Clearly, this would have aggravated the horizon problem in FC1 and further discouraged shareholders from financing long-term assets. In addition, the large dividend pay-out seriously compromised the company's ability to finance assets from retained earnings.

FC1 offered land preparation, threshing and transport services to its members, and owned machinery and vehicles valued at LKR2.93 million at the end of 2007. Key informants believed that FC1 required more such plant in order to grow. However, none of the shareholders interviewed at FC1 were willing to invest more equity capital to finance long-term assets, and expected the company to find donors to sponsor new plant. Shareholder-respondents did agree that payment of cash dividends would strengthen their incentive to contribute more equity capital to finance short-term assets (like a wider range of farm inputs). Dividends paid as bonus shares rather than as cash were a less attractive option because shareholders could not realise the value of their shares (in the absence of an active market) and neither dividend returns nor levels of patronage were linked to levels of investment.

5.4.1.2 The control problem

Like the pair of value-adding FCs, both FC1 and FC4 suffered from a control problem aggravated by the absence of an active share market – shareholders had no price signals to monitor managerial performance nor could they sanction poor performance by disinvesting. Nevertheless, the accountability of management to owners did differ between these companies owing to differences in their organisational arrangements. Figure 6.2 highlights key differences in board structure and reporting lines. Although FC1's facilitating organisation did not appoint advisory-directors to the company's board (as was the case in FC4), it did appoint one of its own officers as the GM of the company and the GM joined the board as an ex-officio member. Respondents claimed that the GM influenced policy and strategic decisions. It follows that FC1 could have suffered from a control problem of similar magnitude to that endured by FC4 with its externally appointed manager and advisory-directors. In this case it might have been concluded that a capital-extensive farmer company can achieve moderate success even if management's accountability to owners is diluted by the presence of externally appointed, influential directors. However, the respondents at FC1 believed that the GM was acting in their best interests even though some of his policy decisions were unpopular. For example, he stopped marketing bananas - a crop produced by many of FC1's shareholders. In summary, the owners of FC1 perceived their GM to be more accountable than did the owners of FC4, but perhaps only because his accountability had not been fully tested.

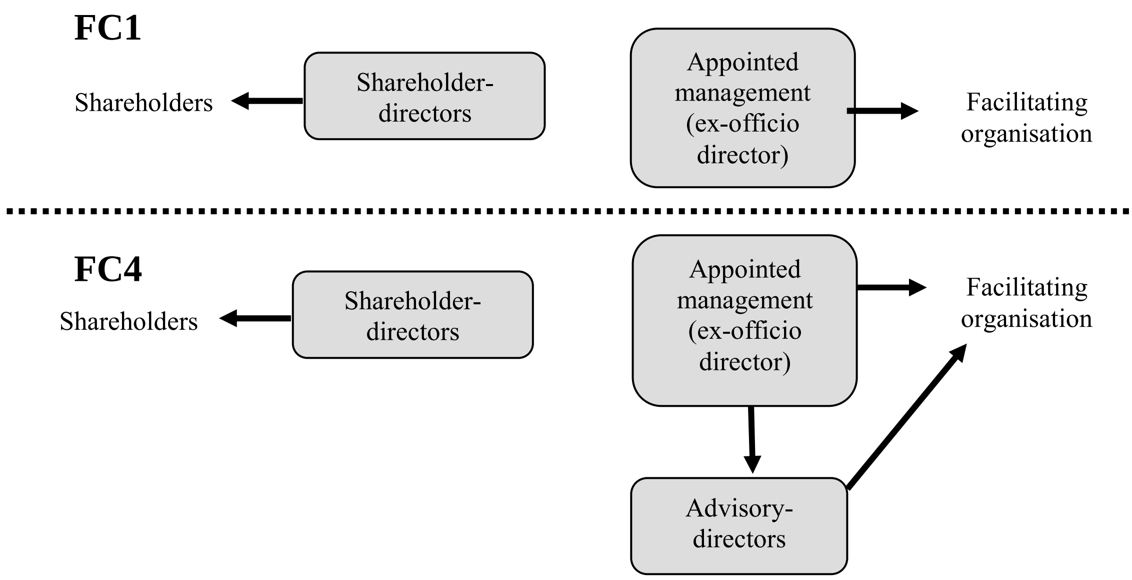

Figure 5.2: Reporting relations at FC1 and FC4
Note: The direction of arrows shows the direction of reporting

5.4.1.3 Electoral procedures and the accountability of directors

Both FC1 and FC4 chose their shareholder-directors by 'show of hands' rather than by secret ballot. Given this lack of anonymity, and that shareholders in each company knew one another, it is hardly surprising that the vast majority of shareholder-respondents at both FC1 and FC4 preferred to nominate and elect their directors unopposed. The implication is that even capital-extensive FCs should adopt sound electoral procedures if they want to achieve more than just moderate success.

5.4.1.4 Financial transparency

FC1's directors approved the company's annual budget, and reviewed it monthly. Key informants reported that, although actual flows often differed from the budgeted flows, the shareholders were confident that the board was monitoring deviances and addressing them. In contrast, FC4 did not produce annual budgets. According to key informants, the absence of annual budgets and financial statements undermined transparency and damaged the board's credibility. Respondents reported that FC4 did not produce its own documents for audit procedures and gave two main reasons for this. First, this task defaulted to the facilitating organisation because the company did not employ competent accountants. Second, FC4 did not develop relevant procedures to produce such statements. Evidence of some institutional problems unique to the failed case studies, FC4 and FC6, was reported in the Sections 5.3 and 5.4. These problems are consolidated in Table 5.15.

5.4.2 The influence problem and group dynamics

Both FC1 and FC4 were candidates for an influence problem because: (a) they did not assign voting rights in proportion to investment, (b) they did not elect directors by secret ballot, and (c) their GMs were not fully accountable to shareholder-directors. Under these conditions the scale of the influence problem is expected to increase with the range of services offered to shareholders and with the heterogeneity of this group. At the time of the research, FC1 engaged in five key business activities and 340 shareholders while FC4 focussed on four key activities with 183 shareholders at the time of its failure. FC1 therefore, showed greater potential for an influence problem than did FC4. However, the analysis revealed that these differences were swamped by the non-centralised decision-making at FC4 which allowed minority investor groups to influence management policy decisions. For example, respondents reported that a group of minority investors lobbied their directors successfully to remove the appointed GM. They also claimed that minority investor groups influenced managerial decisions relating to a compost project (Section 4.5.3) that subsequently failed. Key informants reinforced the view that FC4 did not separate ownership from control, and attributed much of the company's demise to the fact that minority investor groups had been able to influence policy and operational decisions to enhance their benefits at the expense of the majority investor group.

In summary, both FC1 and FC4 were exposed to an influence problem but the problem manifested only at FC4 where ownership was not separated from control. Apart from discouraging investors, the influence problem impaired decisive management. This appears to have been a leading cause of FC4's collapse. Table 5.15 includes influence and group problems that distinguished the failed FCs, FC6 and FC4, from their more successful counterparts, FC3 and FC1.

5.4.3 Management factors

5.4.3.1 Introduction

This section identifies and evaluates the effects of institutional and collective action problems on strategy, processes and managerial quality at FC1 and FC4. The purpose of this section is to provide new insights only, using evidence unique to these two companies.

5.4.3.2 Strategies and processes

FC1's narrow organisational structure (Figure 4.1) had sustained its initial activities for the past 11 years. However, the company faced difficulties in expanding its activities. For example, the National Livestock Development Board (NLDB), a state organisation, declined FC1's proposal to take-over a medium-scale poultry farm owned by NLDB, mainly due to the company's lack of specialised managers and its weak liquidity position. This finding suggests that moderate success may not require a sophisticated organisational structure in the case of input and service providing FCs. However, respondents at FC4 attributed some of the blame for their company's failure on an equally naïve organisational structure (Figure 4.10).

Key informants at both FC1 and FC4 stated that line management was vague because the GMs instructed some shareholder-directors and shareholders, who were not paid workers, to carry-out operational tasks that were actually the jobs of hired staff. This was possible because the GMs were powerful officers within their respective facilitating organisations. Both companies struggled to implement strategies because they could not assign responsibilities to dedicated managers. Nevertheless, the evidence suggests that an FC offering services that do not require substantial capital investment can achieve moderate success without specialist managers, clear responsibilities and well-defined processes to implement strategies.

5.4.3.3 Managerial quality

The appointed GM at FC1 was an institutional development specialist at the facilitating organisation and his skills were considered to be appropriate for his position in the company. Although respected by the shareholders as a leader, he did not have a full complement of adequately skilled staff to work with (Table 4.3). On the other hand, the appointed GM at FC4 did not possess the range of skills required of his portfolio. Shareholder-respondents ranked overall satisfaction with managerial quality as 'poor' (an average score of two on a five point scale). Table 5.15 includes the management problems that contributed to poor performance of the failed FCs, FC6 and FC4.

5.5 Causes of failure of commodity sellers - FC2 and FC5

Examination of financial and non-financial performance indicators in Section 5.2 justified comparisons of the failed and successful value-adding and input and service providing FCs. These two comparisons generated a set of internal attributes representing possible determinants of FC performance. The analysis of performance indicators also revealed that the surviving commodity seller, FC2, had barely outperformed the failed commodity seller, FC5. Consequently, a direct comparison of these two FCs would not help to identify determinants of company performance. Instead, this section seeks to explain why these two companies both performed so poorly. It was expected that this analysis would not only reinforce some of the findings already reported in Sections 5.3 and 5.4, but could also reveal new attributes that could be added to the overall list of possible determinants (of FC performance) presented in Table 5.15.

5.5.1 Weak accountability of directors and influence problems

Shareholders at FC2 had to make a considerable investment (LKR0.257 million) in fixed improvements to their own farms in order to patronise the company. To assist them, the facilitating organisation offered loans to shareholders to build and equip greenhouses. However, demand for these loans soon outstripped the facilitating organisation's budget, and - as a consequence - FC2 was not permitted to recruit new shareholders. This instruction effectively removed the company's principal source of capital and obliged the facilitating organisation to keep the company liquid by providing regular cash grants. FC2 could not raise sufficient capital to finance extensions and improvements to its storage facilities, and therefore could not accept additional supplies from its patrons. As a result, sales and company growth suffered.

Clearly, the ban imposed on hiring was not in the best interests of FC2's shareholders, and therefore indicated the presence of an influence problem. It also exposed the company to a severe internal free-rider problem as its membership included a significant number (54 at the time of the study) of founding shareholders who could not patronise the company. The facilitator's influence was also evident in FC2's pricing strategy which did not allow patron-shareholders to take advantage of seasonal price changes. According to key informants, advisory-directors appointed by the facilitating organisation decided on this strategy, and patron-shareholders complained that the advisory-directors were not serving their interests as majority investors.

Persistent side-selling provided more evidence of an influence problem at FC2. Key informants reported that some patron-shareholders breached their supply contracts and sold produce to external buyers who offered better terms (Section 4.3.6). FC2 did not impose penalties on these free-riders (who continued to benefit from company services) despite complaints from the majority investor group who wanted the company to suspend sales of inputs and planting media at favourable prices to offenders. In addition, key informants claimed that demands for subsidies on crop inputs used by non-patron shareholders, a minority investor group, were entertained by the board and rejected only because the company was illiquid.

Patron-shareholders at FC2 were quick to express their dissatisfaction with low levels of accountability and persistent influence problems, and stated that they would not be willing to increase their investment in the company. This reinforces similar findings in Sections 5.3 and 5.4, and also introduces the problem of facilitators prescribing to FCs.

5.5.2 Control problems

Key informants at FC5, where the GM was appointed by the company's facilitators, expressed the view that shareholders and their directors had limited means of sanctioning management for poor performance because the GM was appointed externally and reported to advisory-directors. A similar control problem emerged at FC2 where the company's choice of CEO had to be approved by the facilitating organisation. According to shareholder-respondents, this control problem discouraged some shareholders from further investment on the company.

Shareholders at FC2 and FC5 did not nominate all of their directors. Advisory-directors were appointed to the boards of both companies by their facilitating organisations. This created a divergence of interests within both companies as the advisory-directors attempted to pursue broad development objectives that were not well-aligned with the objectives of shareholder-directors. Shareholder-respondents at FC2 and FC5 claimed that their directors were unable to protect shareholder interests when they conflicted with proposals made by advisory-directors. Part of this problem was attributed to asymmetric information as advisory-directors had better access to information about the company's financial performance.

5.5.3 Poor governance

FC5 had serious flaws in its governance arrangements. The company failed to submit its financial statements for external audit and did not produce annual reports during the last few years of its life despite repeated warnings by the facilitating organisation. Documents did not reach shareholders in time for them to prepare for AGMs and shareholders were also unable to access minutes of board meetings. FC5 did not facilitate special general meetings for shareholders, so denying them an important forum to voice their concerns. These problems did little to promote confidence in FC5 and some shareholders stopped transacting with the company altogether.

All of the shareholder-directors at FC2 and FC5 were nominated unopposed – largely to avoid (the embarrassment of) voting by show of hands. The vast majority of shareholder-respondents at both FC2 and FC5 stated that their companies should use a secret ballot rather than a show of hands to elect shareholder-directors in the event of competing nominations. They shared the view that this weak governance arrangement had kept incompetent directors on the board.

5.5.4 Weak processes to develop and implement strategy

Organisational structures at both companies were developed by their respective facilitating organisations with minimum input from shareholders. FC2's simple organisational structure (Figure 4.4) included a strong technical wing staffed by five TOs, but excluded other important functions such as marketing. This seriously compromised the company's growth. FC5 had an organisational structure with less specialist expertise (Figure 4.13) which, according to key informants, could not handle the normal business activities of the company let alone any expansion. Neither of these FCs had long-term business plans, nor were their organisational structures geared for growth.

FC2's objectives were too broad for a small company and had not been achieved even after six years of operation. Key informants also reported that the company's objectives were not adjusted following changes in its business environment. This was attributed to the absence of routine feedback and review processes.

According to key informants, FC2 chose appropriate strategies to expand its small customer base, narrow range of business activities and product lines (Table 4.6) but struggled to implement them. This was mainly because the processes to implement strategies did not assign clear responsibilities to managers. It took management six years just to establish the processes needed to trial new product lines, and the company still had only four buyers after six years of operation. In addition, key informants claimed that the CEO did not possess general management skills required by his portfolio.

Unopposed nomination of directors at both FC2 and FC5 favoured the selection of shareholder-directors with political power rather than business acumen. Key informants at both FCs also claimed that the advisory-directors were not entrepreneurial. Respondents described the strategy process at FC5 as 'tardy' and 'poorly informed' as the board lacked business experience.

5.5.5 Inappropriate managerial skills

The executive managers at FC2 and FC5 were technically competent and well equipped to manage the production aspects of their respective companies. However, they did not possess important general managerial skills needed to analyse financial statements or to appraise proposed investments. Neither company could afford to hire additional business managers. Consequently, advisory-directors (who also lacked business experience) were frequently called on for advice. This lent authority to the advisory-directors and strengthened their influence on the board.

5.6 Quantitative analysis of the determinants of FC performance

The pair-wise comparisons of failed and successful FCs presented in Sections 5.3 and 5.4 provided evidence of several internal problems expected *a priori* to contribute to poor performance. These problems are summarised in Table 5.15. Evidence from two unsuccessful commodity sellers presented in Section 5.5 reinforced many of these findings and also added some new problems to the list in Table 5.15. Each of these problems was coded as a dichotomous (i.e. dummy) variable, scoring one if the FC did not suffer from the problem and zero otherwise. The variable names are also listed in Table 5.15.

Table 5.15: Internal determinants of farmer company performance

Construct	Problem	Variable
Institutional arrangements	Non-patrons were retained as permanent shareholders	NONPAT
	Shareholders had to invest equal amounts of equity capital	EQINV
	Dividends were not proportional to equity invested	NOPDIV
	The company did not permit share trading between shareholders	SHMKT
	New shareholders paid the same price for equivalent voting and benefit rights purchased by the original shareholders (shares were not appreciated)	SHPRICE
	Executive managers influenced policy decisions against majority investors	MGRINFL
	The board was not responsible for hiring and firing executive managers	HIREFIRE
	Non-shareholder-directors influenced policy decisions against majority investors	ADVDPOL
	The facilitator influenced policy decisions against majority investors	FACPOL
Governance arrangements	AGMs were not convened regularly	AGMREGU
	AGMs were called without adequate notice and without annual reports	AGMDOCS
	Shareholders did not nominate all of the directors	SHNOMI
	Elected shareholder-directors were not chosen by secret ballot	SECRETB
	Shareholders could not access minutes of the board meetings	ACCESS
	Shareholders could not convene special general meetings	CONVENE
	Non-shareholder-directors influenced the selection of the chairman	CHAIR
	The chairman did not set the agenda for board meetings	CAGENDA
	Shareholder-directors were not given sufficient information and time to prepare for board meetings	INFOTIME
	Executive manager reported to external agents	MREPORT
	Budgets were not approved by the board	BUDGET
	The company did not report independently audited financial statements each year	FINSTAT
	Shareholders did not receive an annual report with audited statements	ANREPT
	Shareholder-directors did not nominate the auditor	AUDITOR
	The company did not prepare financial documents for audit purposes	FINDOC
Group factors	Voting rights to elect directors were not proportional to shareholding	VOTING
	The company purchased multiple products from its shareholders	MULTIPR
	Shareholders participated directly in policy-making decisions	SHPOLICY
	Shareholders participated directly in managerial decisions	SHMGRIAL
	Non-investors with vested interests in the company had representation and influence on the board	ADVINFLU
Management factors	Organisational structure impeded expansion of the enterprise	ORGSTR
	Company objectives were not developed with and for shareholders	OBJECTV
	There was no process to review business objectives of the company	REVIEW
	Processes to develop strategies were not well-established, continuously applied or informed by managers and shareholders	PROCESS
	Processes to implement strategies did not assign clear responsibilities to managers	IMPLMNT
	There were no performance-based incentives or sanctions for appointed officers	ADVSANC
	Administrative processes did not produce timely information required by directors, shareholders and legal authorities	ADMIN
	The GM was not a skilled and a dynamic leader	GMSKIL
	Skills of senior managers did not match their portfolios	SKILPORT

The list of problems presented in Table 5.15 was drawn from evidence gathered in the case studies and therefore constitutes an incomplete list of the probable determinants of FC performance as there was insufficient variation in the sample to test some of the theoretical propositions. For example, none of the study FC's assigned voting rights in proportion to shareholding, nor did any of them possess an active share market. Conclusions and recommendations (Chapter 6) relating to arrangements that were not observed were therefore based on theory and best practice, and not on empirical evidence gleaned from the case studies. What follows in this section is a cluster analysis of the evidence-based dummy variables listed in Table 5.15. The purpose of this analysis was to identify positive relationships between the dummy variables (i.e. the absence of particular problems) and various indicators of performance. The indicators of performance, also measured as dummy variables scoring one if the FC performed well, and zero otherwise, are listed in Table 5.16.

Table 5.16: Indicators of farmer company performance

Construct	Performance indicator	Variable
Performance indicators	Equity did appreciate	GROWTH
	The company was solvent	SOLVENT
	The company was liquid	LIQUID
	Dividends were paid	DIV
	Ongoing material support from the facilitating organisation was low	MATSUP
	The company created its own brand name	BRAND
	The company developed voluntary links with corporate clients	LINKBUY
	There was growth in number of shareholders	OREACH

The six FCs studied were also ranked based on the presence of performance attributes and the absence of internal problems (Appendix 10). FC3 and FC1 showed a healthy presence of performance attributes (seven and five out of seven respectively). The other four FCs were weak as they possessed no more than two of the performance attributes. FC3 and FC1 suffered few internal problems (1 and 11 out of 34 respectively). The three failed companies and the failing company (FC2) were weak as they each suffered from 18 or more of the internal problems observed in the case studies. FC6 was particularly weak with a total of 29 problems present (Appendix 10). Together, these two rankings clearly identify FC3 as the 'best' company (i.e. the company with the most performance attributes and least internal problems) and FC6 as the 'worst' company (i.e. the company with the least performance attributes and most internal problems).

5.6.1 Cluster analysis of variables

The objective of a cluster analysis is to classify a set of variables into mutually exclusive clusters based on a measure of their similarities (Hair et. al., 1998; Knight et. al., 2003). Individuals within a group are similar to one another, while individuals in different clusters are dissimilar (Chatfield and Collins, 1980). In this study, the cluster analysis was performed on variables (not FCs) and each variable was dichotomous, with one indicating the presence of a performance attribute or the absence of a problem, and zero otherwise. Consequently, variables within each cluster (or natural group) are positively correlated. The clusters were not pre-defined; instead, they were identified using the hierarchical cluster technique available in SPSS (version 2009). A total of 41 variables (N = 41) drawn from the six case studies (P = 6) were grouped into clusters by minimising the squared Euclidian Distance within clusters.

Four of the variables listed in Table 5.15, NOPDIV, VOTING, REVIEW and ADVSANC, were excluded from the cluster analysis as they did not vary across the six case studies. The variable MATSUP from Table 5.16 was also excluded from the cluster analysis as all six FCs received some material support from their respective facilitating organisations and measurement of the level of this support was considered too subjective for quantitative analysis.

Homogeneity within clusters diminished sharply when the number of clusters dropped below four, with the agglomeration coefficient increasing sharply from 1.27 to 1.50 (Appendix 12). Figure 5.3 illustrates positive correlations found between performance indicators and the absence of institutional, governance, group and management problems. The variable MULTIPR did not correlate strongly with the performance indicators or with variables in any of the other clusters. This highlights the earlier conclusion that FC performance was not adversely affected by multiple products because both failed and successful FCs had separated ownership from control. Consequently, conflicts of interest between shareholders producing different products for their company did not add to influence problems arising from other potential sources such as the non-alignment of investment and voting power, or the presence of influential advisory-directors on the board.

Performance indicator	MULTIPR	SHPRICE	HIREFIRE	MGRINFL	ADVDPOL	FACPOL	MREPORT	SHNOMI	SECRETB	FINDOC	ANREPT	ACCESS	AGMDOCS	INFOTIME	CONVENE	AGMREGU	AUDITOR	GMSKIL	SKILPORT	PROCESS	IMPLMNT	ADMIN	ORGSTR	SHPOLICY	ADVINFLU	BUDGET	FINSTAT	SHMGRIAL	NONPAT	EQINV	SHMKT	CHAIR	CAGENDA	OBJECTIV
Cluster	**C1**	**C2**																								**C3**			**C4**					

GROWTH																																		
SOLVENT																																		
LIQUID																																		
DIV																																		
BRAND																																		
LINKBUY																																		
OREACH																																		

Key
Institutional and governance arrangements

Group factors

Management factors

Figure 5.3: Inter-relationships between variables measuring FC performance and institutional, governance, group and management characteristics

5.6.1.1 Cluster 2

Cluster 2 includes the majority of indicators in each of the performance, management, group and institutional (including governance) categories. At a cursory level, this lends support to the argument that good institutions promote company performance directly by improving access to capital, and indirectly by promoting good management and avoiding costs and conflicts associated with collective action. However, the results offer deeper insights that question some aspects of this argument.

The performance indicators in Cluster 2 are predominantly measures of financial performance; share appreciation (GROWTH), solvency (SOLVENT), liquidity (LIQUID) and the payment of dividends (DIV). These financial indicators are positively related with one another and with BRAND, the fifth performance indicator in the cluster, suggesting that companies with better financial performance had succeeded in introducing their own brands. As expected, financial performance and investment in branding (a long-term asset) were positively linked to the absence of horizon (SHPRICE), control (HIREFIRE) and influence (MGRINFL, ADVDPOL and FACPOL) problems. It is interesting that the problem of executive managers influencing policy decisions against majority investors (MGRINFL) is positively related to the board's inability to hold these managers accountable through reporting requirements (MREPORT) or by hiring and firing them (HIREFIRE).

The absence of influence problems introduced by (unaccountable) managers, advisory-directors and facilitators also correlated positively with the inability of shareholders and non-investors to engage directly in policy decisions (SHPOLICY and ADVINFLU). This reinforces the earlier qualitative finding that the centralised decision-making improved company performance by mitigating the adverse effects of group diversity. The presence of the governance variables SHNOMI and SECRETB in Cluster 2 is consistent with the view that failure to elect directors by secret ballot from a pool of candidates nominated by the shareholders could lead to influence problems that constrain access to capital.

Cluster 2 shows positive correlation between good financial performance and governance arrangements that promote financial transparency and accountability within the company. The indicators of financial transparency included preparation of financial statements for annual audit (FINDOC), distribution of an annual report containing audited financial statements (ANREPT), access to the minutes of board meetings (ACCESS) and providing adequate notice of meetings and timely information (AGMDOCS and INFOTIME). Accountability indicators included provisions to call special general meetings (CONVENE), holding regular AGMs (AGMREGU) and shareholder nomination of the auditor (AUDITOR). These quantitative results mirror the qualitative findings and are consistent with expected relationships between company performance, financial transparency and the accountability of directors and managers.

All but one of the management indicators appears in Cluster 2. While the model portrayed by Figure 2.1 is not explicit about relationships between management factors, it was not surprising to find positive associations between good leadership (GMSKIL), the fit between managers' skills and portfolios (SKILPORT), good managerial processes (PROCESS, IMPLMNT and ADMIN) and an appropriate organisational structure (ORGSTR). This result coincides with the earlier qualitative finding that good managers are better at applying provisions for transparency and accountability specified for companies.

5.6.1.2 Cluster 3

Cluster 3 shows positive relationships between just one indicator of performance (LINKBUY), two governance variables (BUDGET and FINSTAT) and one group variable (SHMGRIAL). LINKBUY indicates the presence of a long-term, voluntary relationship between the FC and one or more of its corporate clients. BUDGET and FINSTAST indicate the absence of problems that tend to reduce financial transparency, while a positive score on SHMGRIAL shows reduced exposure to the influence problem and high transaction costs that occur when shareholders participate directly in managerial decision-making. The relationships highlighted by Cluster 3 suggest that corporate clients are more likely to commit to a farmer company that displays financial transparency and management that is not sidetracked by (minority investor) interest groups.

5.6.1.3 Cluster 4

Cluster 4 includes just one performance variable, OREACH. This variable indicates growth in the number of farmers who join the company as shareholders. OREACH is positively correlated with the institutional variables NONPAT, EQINV and SHMKT. A positive score on NONPAT indicates reduced exposure to the internal free-rider problem as patrons did not benefit from investments made by non-patrons. In this analysis, a positive score on EQINV does not necessarily imply reduced exposure to the internal free-rider problem, but it does indicate reduced exposure to the portfolio problem because investors were not required to contribute equal amounts of equity capital. A positive score on SHMKT suggests reduced exposure to the horizon problem because investors were at least entitled to trade shares with other members. The results are therefore consistent with propositions that farmers are more likely to buy shares in a farmer-owned organisation that does not suffer from these institutional problems.

Cluster 4 also shows positive links between OREACH, the management variable OBJECTV, and the governance variables CHAIR and CAGENDA. The governance variables indicate that board decisions were taken by shareholder-directors and not by advisory-directors. The results therefore reinforce the qualitative finding that company objectives were more likely to be established with, and for, shareholders when the board was free of controlling influences from externally nominated directors. In addition, the results suggest that company objectives established in consultation with shareholders attracted more investors over time.

Chapter 6

Conclusions and Recommendations

6.1 Introduction

The main objective of this research was to gain a better understanding of internal factors affecting success or failure of farmer-owned marketing companies in Sri Lanka. The study drew primarily on the New Institutional Economics and management literature to develop a causal model of relationships between these factors and farmer company performance. A qualitative, multiple case study research design was used to gather data and test the model. Six farmer companies (pairs of successful and failed FCs in each of three core business categories) were purposefully selected for in-depth study.

The performance of these six FCs was measured using both financial and non-financial indicators. Trends in these indicators revealed that FC3 was a reasonably successful and dynamic company, while FC1 was a moderately successful company. FC2, although operational and selected as a 'successful' farmer company, was found to be on the verge of failure. The remaining three FCs (FC4, FC5 and FC6) had already failed. An analysis of the business environment concluded that external factors did not account for differences in the performance of the FC's in each core business category. Observed differences could therefore be attributed to the internal factors under study.

The FCs' institutional, group and management attributes were contrasted to test the model's propositions in a qualitative pattern matching exercise conducted for each pair of companies. This qualitative analysis corroborated a set of 38 institutional, group and management problems that were expected to harm farmer company performance. These problems were expressed as dummy variables scoring one if a (theoretically) favourable attribute was present, and zero otherwise. Likewise, the performance indicators were expressed as dummy variables scoring one if a favourable attribute was present, and zero otherwise. Positive (negative) associations between good performance and good institutional, group, management attributes (problems) identified in the qualitative analysis were then confirmed and elaborated in a quantitative cluster analysis of the dummy variables.

This final chapter presents the main findings and recommendations of the study. The findings are discussed in relation to the model proposed in Chapter 2 and the model is revised to reflect findings that were not consistent with its propositions. The chapter ends with a summary of the study's contribution to knowledge, its limitations and ideas for future research.

6.2 Conclusions

As surmised in Chapter 2, the case studies were all hybrid firms with different blends of the institutional arrangements that characterise private companies and traditional cooperatives. Some of the FCs were exposed to the full range of free-rider, horizon, portfolio, control and influence problems that constrain access to capital in traditional marketing cooperatives. Certain of the institutional arrangements that created these fundamental problems also created group and management problems that undermined FC performance, as anticipated by the proposed model.

Ranking the six FCs studied according to the presence of favourable performance attributes highlighted the inverse relationship anticipated between good performance and internal problems. The FC with highest number of favourable performance attributes had the lowest number of internal problems. Conversely, the FC with the lowest number of favourable performance attributes had the highest number of internal problems. These FCs were both processors with relatively high capital requirements. This finding is consistent with the argument that institutional problems have less impact on performance when good performance does not require much capital.

6.2.1 Key findings and recommendations for FC institutional arrangements

The results of the qualitative and quantitative analyses indicate that FCs are more likely to attract capital and invest in value-adding assets (like brands) when the horizon problem is alleviated by making benefits directly proportional to investment. This means that shares should be appreciable and that patrons should pay and receive market-related prices for their inputs and products - a practice that would address the internal free-rider problem and allow FCs to extend their services to non-shareholders without creating an external free-rider problem.

Growth in the number of shareholders (outreach) was constrained by a portfolio problem in FCs that expected their members to invest equal amounts of equity capital. To avoid this problem, equity shares should be tradable between members and facilitators should help FCs to establish trading platforms and to disseminate information about prices and quantities of shares traded. This information would signal company performance to shareholders and so alleviate the control problem. Outreach was also constrained in FCs that arbitrarily limited membership to a small geographical area. While geographic limitations on membership should be lifted, the right to admit new members should remain with the board of directors.

The analyses showed that existing shareholders are more likely to withdraw their patronage and support when FCs suffer control and influence problems. Perceptions that external facilitators, executive managers and directors who were not nominated for election to the board by shareholders could influence policy decisions against the interests of majority investors were particularly damaging to investor confidence. Influence problems were also attributed to flawed electoral procedures. It is clear that all directors should be nominated by shareholders and that voting should be conducted by secret ballot. To improve accountability, the right to hire and fire executive managers should remain with the board of directors, and these executive managers should report to shareholder-directors and not to government agencies.

Some of the theoretical propositions could not be tested empirically owing to a lack of variation in the case studies. For example, all of the FCs assigned democratic rather than investment-proportional voting rights so it was not possible to test the proposition that democratic voting rights (one vote per member) undermine performance. Nevertheless, FCs should consider a switch to proportional voting rights (one vote per share) because democratic voting rights could lead to strategies that transfer income from investors to patrons - even if the preceding recommendations are accepted. Proportional voting rights would be less important if all shareholders were required to purchase shares in proportion to the value of their supply contracts – as in a New Generation Cooperative. However, unlike New Generation Cooperatives, farmer companies are expected to provide a wide range of services to disparate farm households so it cannot be assumed that all shareholders will necessarily supply the company with the product or products that it processes. Despite the absence of investment-proportional voting rights, the results showed that single-product FCs did not perform any better or worse than did multi-product FCs, and that performance was not adversely affected by marketing multiple products - provided that management was centralised. The question of centralised management is taken up in the next section.

6.2.2 Key findings and recommendations for FC implementation and operation

The analyses showed that corporate clients were more likely to engage in long-term business relationships with FCs that did not permit shareholders to engage directly in their management decision-making processes. This supported the proposition that such collective decision-making would undermine company performance by exposing investors and lenders to an influence problem, and that - if present - this problem would tend to worsen with increasing group heterogeneity. Influence problems arising from management's failure to separate ownership from control were identified as a leading cause of poor performance in the case studies. This finding contradicts the uni-directional flow of causality specified by the model proposed in Chapter 2 as it shows that weak management can introduce collective action, the effects of which are likely to become more damaging as the company's outreach and range of services broadens. Figure 6.1 presents a revised model showing this bi-directional causality.

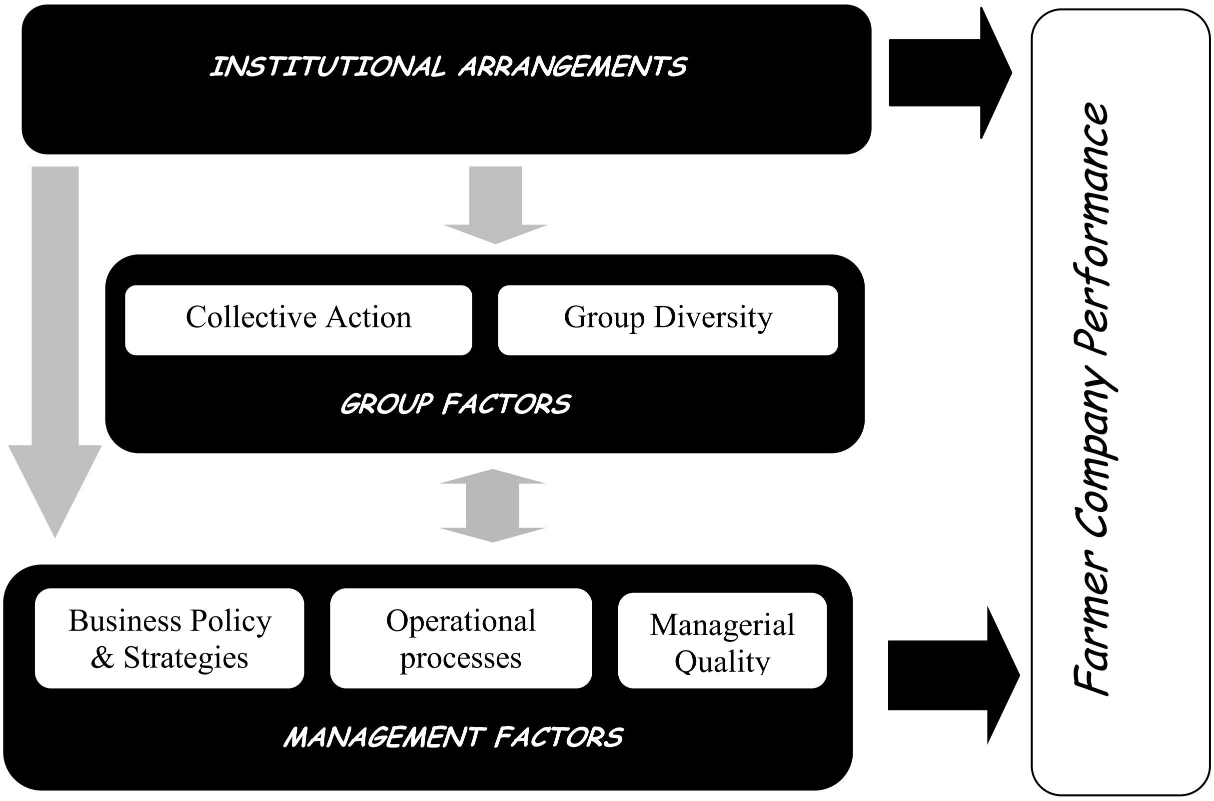

Figure 6.1: A revised model of internal factors affecting the performance of farmer companies

Leaving decisions in the hands of (accountable) directors and managers does not imply that ordinary shareholders' views are unimportant when formulating company policy and business strategies. On the contrary, the results of this study suggest that directors and managers should establish forums and processes to elicit the views of shareholders (and other stakeholders) on policy and management issues. The results also indicated that FC outreach is more likely to grow over time if the facilitators canvass prospective shareholders widely when establishing the company and ensure that there is broad agreement on its objectives and awareness of its institutional arrangements.

Viewed from an operational perspective, the analyses show that company performance (including its ability to forge long-term business relationships) is compromised when management fails to comply with standard reporting and audit requirements, and does not facilitate meetings called by shareholders. This is consistent with the model's proposition that the erosion of transparency and accountability within a company tends to undermine the confidence of investors, lenders and other strategic partners.

Performance was also compromised by the absence of well-defined and regularly observed procedures to develop and implement new strategies. These weaknesses were linked to inadequate or inappropriate management skills. The qualitative analysis suggests that these management problems would diminish if facilitators had a clear exit plan from the time the company is established. This could help to focus their attention on the important task of empowering small farmers to manage a company - something that may best be achieved by providing access to mentors from successful companies. A farmer company that is able to sustain an internal market for its shares could also offer shares as an incentive for good management. This would have the added advantage of aligning the interests of managers with those of shareholders.

6.3 Research contribution and implications for future research

This study contributed to knowledge by combining theory drawn from two distinct bodies of literature, the New Institutional Economics and Business Management, into a single model relating a firm's performance to its institutional, management and group attributes. This model offered a wide range of propositions about the internal determinants of a firm's success, and was revised as part of the 'pattern matching and theory building' qualitative analysis conducted in the study. The research also produced and documented in-depth information about six farmer companies in Sri Lanka. Analysis of this data revealed fundamental causes of their success or failure and generated strong recommendations for their improvement. Many of these recommendations are relevant to smallholder organisations in other developing countries.

The study adopted a challenging sample design to facilitate comparisons between failed and successful companies of similar type. The challenge, of course, was to collect quality information from companies that no longer existed. While it did prove difficult to locate respondents and other sources of data for the failed companies, the task was certainly not impossible and the data added rigour to the analysis. The fact that one of the 'successful' companies turned out to a 'failing' company provided an unexpected opportunity to distinguish between some more and less important determinants of performance. Although the primary method of identifying internal determinants of company performance was qualitative, these determinants were also analysed using hierarchical cluster analysis. This sequential use of a quantitative method served to triangulate and elaborate the qualitative findings, adding to their credibility.

The qualitative and quantitative techniques used to analyse the case studies were not intended to rank the explanatory variables according to their relative importance. It could not be concluded, for example, that the absence of an internal market for equity shares is a more important cause of failure than a mismatch between managers' skills and their portfolios. This type of ranking would require multivariate analysis and a much larger sample of FCs. It became evident during data collection that governance practices, management processes and leadership had changed over time within FCs. Mapping these changes to subsequent performance would shed some light on their relative contributions and so help in prioritising recommendations. A more detailed investigation of the approaches and methods used by different facilitators to establish farmer companies in Sri Lanka may also help to inform policy and practice.

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Appendix 1

The Case Study Protocol

The objective of this protocol is to establish procedures in data collection for this case study, which - if repeated in the same context - will yield the same results. Yin (2003: 37-39 and 67-77) recommends a case study protocol to improve the reliability of case study data and argues that a case study protocol is especially important in research that employs a multiple-case study design. The protocol developed for this study adopted the structure recommended by Yin (2003: 67-77) and comprised of the following key sections:

The comparison of cases

Chapter 1 explains the reasons for establishing farmer companies in Sri Lanka and proposes a methodical approach to address the underlying issue - why have so many farmer companies failed? This approach commenced with a synthesis of research objectives supported by relevant literature presented in Chapter 2. The literature provided a framework to identify the internal determinants of FC performance. These determinants were captured in a single model that informed the research design. A multiple-case study design was selected to test propositions by comparing pairs of failed and successful farmer companies with similar demands for capital.

Selection of cases

The development of a complete database of farmer companies is not possible due to unavailability of FC data in user-friendly formats and the time limitation. Therefore, a partial database of surviving and failed FCs will be prepared using data available at the Registrar of Companies, the Department of Inland Revenue and the Mahaweli Ministry of Sri Lanka. One case from each of the six categories will be selected. This selection will be based on the case itself as well as its stakeholders (Figure 3.4). Following factors will be considered in selecting cases. Firstly, companies that can provide easy access to themselves and their stakeholders will be selected. This will increase the speed of data collection. Secondly, companies which will provide relevant and rich data will be selected. This will ensure availability of data to compare cases in terms of main constructs. Thirdly, different companies which will offer variation in data while displaying specific characteristics will be selected. Fourthly, companies that were studied on previous occasions and which will be willing to invest time on in-depth interviews will be selected. Those companies are familiar with research and will be expected to allow the researcher to visit the facilities for observations and to examine past documents.

This research which will use a multiple case design needs a careful selection of sources of evidence. Table 1 explains the data collection strategies and the relevant sources of evidence.

Table 1: Data collection strategies and sources of evidence in case studies

Main construct / indicator	Sub-construct	Data collection strategy / ies	Sources of evidence
Institutional arrangements	Property rights	Semi-structured interviews, reference to records	BoD, shareholders, FC records
	Voting rights		
	Governance arrangements		
Group factors	Collective action	Semi-structured interviews	BoD, shareholders, senior manager, lenders, FC records
	Group diversity	Semi-structured interviews, reference to records	Shareholders, senior manager
Management factors	Business policy and strategies	Semi-structured interviews, reference to records	Shareholder-directors, senior manager, shareholders, advisory-directors, records kept at the facilitating organisation and FC
	Processes	Semi-structured interviews, reference to records	BoD, senior manager, shareholders
	Managerial quality	Semi-structured interviews	Shareholder-directors, advisory-directors, BoD, shareholders
Performance indicators	Financial and risk indicators, and outreach	Reference to secondary data, semi-structured interviews	Annual financial reports, FC and facilitating organisation records, lenders, buyers, advisory-directors, out-growers, suppliers, senior manager

Data collection procedure

Cases for this study will be selected during the data collection phase. This will improve practicality of data collection through the selection of cases that can supply rich data. The researcher enjoys very little control over the data collection environment which is a natural setting. However, this research process will achieve a certain degree of control through the selection of appropriate cases and respondents.

Data collection in the field will be conducted from May to July 2008. The cases will be selected from the North Central, North Western, Western, Sabaragamuwa, Uva and Southern Provinces of Sri Lanka where preliminary information shows the existence of research-worthy cases. Collection of data from the successful FCs will be done first. Financial statements for the past 3-4 years will also be collected from the successful FCs. In the failed FCs, interviews will be mainly held with ordinary shareholders, ex directors and some stakeholders. Financial statements may not be available in failed FCs but other documents of interest will be collected. The primary instrument of data collection will be semi-structured interviews using interview guides. The researcher himself will collect all the data and will observe the guidelines provided by the Lincoln University Human Ethics Committee. Extensive field notes will be made to prevent loss of data. Interviews will be recorded using a digital recorder where it is agreed by the respondent concerned.

Data analysis procedure

Field notes will be sorted and arranged into meaningful summaries. Digital recordings will be transcribed and combined with field note summaries, and collated around each case study. The data will be subjected to an in-depth qualitative analysis and a subsequent quantitative analysis.

The validity of proposed pair-wise comparisons between failed and successful FCs will be checked using financial and outreach performance indicators. In addition, external determinants of FC performance, if any, will be examined to ensure that each pair of FCs experienced similar shifts in market and climatic conditions. The qualitative analysis of data will draw heavily on the approach recommended by Yin (2003:109-136). The data will be re-combined to describe each case with emphasis given to their institutional, group, management, and performance attributes. Theoretical propositions will be checked by a process of 'pattern matching' through comparison of attributes in failed and successful companies. The propositions will be confirmed when failed and successful FCs exhibit contrasting attributes consistent with theory. Otherwise, the proposition will be questioned and the analysis will lead to an 'explanation building' to account for the inconsistency.

A quantitative analysis using a hierarchical cluster analysis will be performed on the set of variables of company performance and the set of variables representing the internal determinants of company performance – the institutional, group and management attributes. Hierarchical cluster analysis is considered appropriate as the aim is to group the variables (not cases) into meaningful groups to explain relationships possibly existing among institutional, group, management, and performance attributes.

Yin (2003:22-26) declares that an important aspect in social science research is the accurate identification of the unit of analysis. Babbie (2008:104-109) defines the unit of analysis as the 'what' or 'whom' being studied. However, Ragin (1994:7-9) proposes that there exists a perspective factor. He proposes that the unit of analysis is two-fold: observational unit which refers to the unit used in data collection and analysis, and explanatory unit which is the unit used to generalise to the pattern of results obtained. This study is designed to analyse the internal determinants of FC performance – the main constructs of this investigation. The analysis later will identify a set of indicators (variables for the quantitative analysis) to represent the main constructs. It also will identify indicators to express the performance of each FC. All those indicators will have one score for each FC. Therefore, the unit of analysis in the case studies will be the FC as a whole.

Appendix 2

Guide for interviews with shareholders

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1 Socio-economic data and shareholding and patronage details

1. Shareholder identification:…Contact details: Phone:……………Mobile:…………
2. Distance to the FC office (km) :……………………………………..……………
3. Type of farming: Part-time | Full-time Farming experience in years:…………..……
4. Gender: Male/Female Age (years):……………………..…………..
5. Highest level of education:
   Illiterate | up to yr 5 | up to yr 9 | GCEOL | GCEAL | Diploma | degree | other
6. Family characteristics:
   Marital status (optional): Unmarried | married | separated | widow/er | other.
   Whether household head, number of dependants………………………
7. Sources of household livelihood: *(rank the sources in order of importance)*
   FC | Farming-other | own off-farm business | Govt employment | private sector employment
   Rank:
8. Nature of ownership of farmland under FC operations:
   Sole owner | Leased | Rent | Partnership | Other (………………………………)
9. Why did you join this FC?......Date of joining (first purchase of shares), Founder member or not, Type of shareholding: Patron | non-patron etc., Number of shares bought initially, Price per share, Type: Ordinary/Non-patron etc., (*and also* Individual | Jointly-held etc), Number of shares currently held, Price per share (sold/bought).
10. How do you rank your patronage comparative to the other shareholders? High user | average user | low user | no response. Are there any patronage specific charges? Details….

2 Asset Holding and Investment

Land

Type of ownership	Area (Ha)	Type of land		Remarks
		Upland	Lowland	
Owned				
Shared				
Tenant				
Rented in				
Rented out				
Other				
Area cropped to products delivered or contracted to the FC?				Type of contract (e.g. quantity, quality and price specified before harvest)

Investments during Last 2-3 yrs

Investment	2005 Amount (Rs)	2006 Amount (Rs)	2007 Amount (Rs)
Land			
Buildings			
Equipment			
Machinery			

Farming Assets owned and/or available (in working order)

Asset	Own				Farmer Company		
	Qty	Replacement Value (Rs)	Whether available to others	Conditions	Qty	Replacement Value (Rs)	Conditions
Truck/Lorry/Pick up							
Tractor							
Plough/trailer/ etc							
Thresher							
Harvester/cutter							
Generator/Water pumps							
Other (specify)							

3 Shareholder Direct Benefits and Benefit Rights

1. What are the benefits you receive from your FC? *(Input provision, provision of implements etc., services such as credit, sales and marketing, advice and provision of business security etc.)*

Benefit	Share sourced from this FC (%)	Level of satisfaction(*)	Comments

(*): 1=Good, 2=satisfactory, 3=poor, 4=not applicable.

2. Has the FC declared dividends to the SHs?

Year	Yes/No	Total dividend payment	Dividend (Rs) per share	Prevailing share price (Rs)	Mode of payment	Remarks and other details
2007						
2006						
2005						
2004						
2003						

3. Do you receive more favourable prices than non-shareholder patrons? Details,
4. Is shareholding proportional to patronage? Yes/ No
5. Are the shares readily marketable (or is there an active market for shares)? If shares are not marketable freely, how will you recover your investment if you want to leave the FC? Will be redeemed | can be sold to any existing SHs | can be transferred to a family member | can be sold to any person/s who comply with selection criteria set by FC | can be sold to any outsider | disposed of through other arrangements (specify) and other comments such as prices etc., Have you engaged in any FC share transactions or other transfers? Yes | No. Details
6. Calculate capital gains if selling price of shares exceeds their initial purchase price; when applicable (use following table and use extra rows)

Month/Year	Number of shares bought	Price per share Rs/cts	Number of shares sold	Price per share Rs/cts

7. What are your current objectives of holding shares? Do you wish to buy more shares in this FC? Yes | No | no idea. Comments: (Reason, price, quantity, how to fund etc).....

Are there non-patron shareholders other than government? Yes | No, What is your view of the non-patron shareholding arrangements? What is your view about new shareholders joining the FC? Details.

4 Voting Rights

1. The nature of voting rights for electing directors: Democratic | proportional to investment. How many directors are there, how many are elected by ordinary members, how often are these elections held and how many directors' posts are up for nomination at each election? How do members vote for directors? By secret ballot, raising hand, etc., Would you say that the voting procedure is fair? Explain,
2. If there are any non-patron investors, do they have full voting rights? Yes | No. Explain.

5 External Factors

1. Can non-members use FC services? If yes, do they pay higher prices/charges than do members?
2. If the FC is dealing with contract/out growers, are these growers required to invest in the FC? What is your feeling towards the way FC is working with out-growers/ contract growers? Explain the reasons.
3. What factors outside the FC's control have helped/harmed your own agribusiness activities and your FC in the past three years (bad weather, taxes, subsidies, price changes etc.

6 Governance

1. Notice of shareholder meetings: Do you get adequate time to prepare, minutes of previous meetings on time, What is your view of the content of the minutes of shareholders/directors meetings? Adequate detail | inadequate detail | too much detail | no response
2. Under what circumstances can ordinary shareholders call a special meeting? ....
3. Is a quorum specified for shareholder meetings and is their compliance with this requirement? ……
4. Do you receive the annual report regularly? Yes | No. Your views about it:
5. What is your perception about the details that you get from the FC about its significant financial transactions and commitments? Good | satisfactory | a problem | no response
6. "The FC maintains a high degree of financial transparency". True | false. Comment…
7. Are the accounts (including annual accounts) externally audited? Yes | No | no response If yes, how often is this done? Who are the auditors? ………………………….....
8. Are you consulted by the board before FC is considering substantial investments? Yes | No *(collective action in decision-making)*, What course of action would you take in those situations?
9. Are there any FC constitutional guidelines about the attributes/qualifications a shareholder should possess to serve as a director? Yes | No
10. Have you served the FC in any role other than as an ordinary shareholder? Explain….

7 Asset Portfolio of Farmer Company

1. To what extent do the assets of the FC serve you? High extent | moderate | less extent | no response, Comment.................
2. How do you perceive your FC's willingness to acquire long-term assets? (Extremely willing | willing | reluctant | extremely reluctant | no response), Your attitude towards FC investment in long-term assets. (Strongly support | support | disagree | strongly disagree | no response) Briefly explain why? What is your perception of your FC investing on long-term intangible investments such as patent rights, market surveys, other marketing expenditure etc.?
3. Do you feel excluded from FC decisions about investment on new assets?...

8 Services

1. Have you got loans from the FC? Yes | No. Are you in arrears? Yes | No. …………
2. What other/additional services would you expect from the FC? What additional tangible and intangible assets would the FC have to acquire to provide these additional services?

Asset	Remarks: Proposal for financing (own funds, FC, joint etc.) etc.

9 Group Composition

1. Which group (FC) activities would you normally participate in and your participation? Very high | High | Moderate | Low | Very low
2. Rank the aspects you consider as decisive in your getting into informal groups within the FC?

Aspect	Age	Sex	Educa-tion	Work Experience	Share holding	Participation in FC activity	Other (specify)	Other (specify)
Rank								

10 Group Cohesiveness

1. Your perception of the group size (total membership in the FC)? Very convenient | convenient | no response | difficult | very difficult. Details ....
2. Your estimation about your physical proximity to FC activities? Very close | close | no idea | far | very far
3. Physical proximity to your preferred shareholder friends? Very close | close | no idea | far | very far. Why do you say that they are preferred? ....
4. Do you get involved with informal groups to achieve any of your aims/objectives related to FC? Yes | No ……

11 Risk Behaviour

1. Your behaviour towards business risk and agricultural risk? Risk preferred | risk neutral | risk aversive | no idea
2. What different own agricultural strategies and business strategies have you adopted during the past 3 years?................
3. Your view of your FC board's risk behaviour? Risk preferred | risk neutral | risk aversive | no idea. Details…………

12 Social Relationships

1. Do you have relatives/neighbours in this FC as shareholders? If yes, can they influence your decisions/can you influence their decisions?................………
2. Do you have any shareholders who are members of other societies, organisations etc. with you? How many?................What are the organisations?……………………

13 Lobbying

1. Do you discuss FC issues informally with other SHs? With how many SHs? What sort of FC issues? What sort of action do you take if you don't like the way business is done by the FC?..
2. What is your perception of the extent to which informal group action benefits the FC?....

14 Continuity

1. Will you continue your shareholding (how long), increase shareholding (when), buy more shares (reasons)? Yes | no Why?...
2. Your perception of shareholders leaving the FC (if this occurs)? explain..........................

3. Do you think new members will join? What features of your FC will help to attract new shareholders?......Your perception of new shareholders joining? It is good for the FC | I have no idea | It is bad for the FC, Explain...........Positive/negative effects of new shareholders joining the FC?.................................
4. Your perception of out-growers supplying / patronising products to your FC?................ Who will benefit? FC | out-grower | no idea

15 SH Participation/influence in managerial decisions

1. Which level decisions by which managers would you like to influence? Higher | middle | lower etc.
2. Are you able to (singly or with your informal group) influence decisions of directors', chairman's, managers' and other shareholders'? Yes | No If yes, how?........................
3. Do you in anyway get involved in the decision process of inputs provision etc.? Yes | No. Details……….

16 Core and non-core business

1. Your core businesses?..
2. Your perception of your FCs core business and total business portfolio? Core business: (Suitable for me | Not suitable for me | No idea), Total portfolio: (Suitable for me | Not suitable for me | No idea).
3. Match between FC business portfolio and your businesses with FC: Good match | average match | poor match | no response, Your perception of the current business portfolio of your FC? Strong | fair | weak | no idea Reasons?..
4. What are your key business objectives? (Medium and long-term) , Do you have a long-term agribusiness plan? Yes / No Details, if any……
5. Strategy match:

Aspect	a	b	c	d	e	Why/how? Details
Does the FC strategy match with your objectives?						
Does the FC strategy match with your resources?						
Does the FC strategy match with your expertise?						

(a. To a greater extent, b. To a fair extent, c.To a lesser extent, d. To a very little extent, e. No idea)

17 Operational Management

1. Perception of product sales and prices…………………….

Product (specify)	1	2	3	4	5	6
Unit						
% Quantity sold through FC						
Price (Higher than market / same / less than market)						
Reliability of the FC as a buyer (High / average / low)						
Satisfaction in relation to sales and price (High | Average | Low)						

2. Perception of input provision..........................

Input (specify)	1	2	3	4	5
Source					
Whether receive on time (always/mostly/sometimes/never/no response)					
Whether receive in required quantities (always/mostly/sometimes/never/no response)					
Whether receive in required quality (always/mostly/sometimes/never/no response)					
Satisfaction about price (Satisfied | not satisfied | no response)					
Overall satisfaction of input provision					

18 Market Channel

1. Do you know the market channel for each of your product? (mark the end-user) Explain

Product	1 Goes to	2 Goes to	3 Goes to	4 Goes to	5 Goes to
Use more rows…					

2. If you don't know clearly, why? Are some institutional arrangements blocking this?......

19 Technology

1. What is the reason for you to not to change to new technology?.....Your perception about overall technology level in your FC? Mostly use current technology | suggest that this can be improved | no idea, If it is comparatively poor, what blocks a positive change?.............

20 Managerial Quality

1. Perception of manager's knowledge and technical skills

Aspect	VG	G	P	VP	NI	Comments, if any
a. Agricultural knowledge and skills						
b. Business knowledge and skills						
c. Management and finance						
d. Decisions on investment in new assets						
e. Marketing and products						
f. Innovation						
g. Input management						
h. Group activities						
i. Facilitation of Board-SH relations						
j. Conflict resolution						
k. Other						
l. Your overall satisfaction						

(VG=very good, G=good, P=poor, VP=very poor, NI=no idea)

Performance details

21 Impacts of FC

1. How do you compare your pre-FC status and present status with regard to following aspects?

Aspect	FC helped me to achieve this		Remarks if any.
	Yes	No	
1. To increase my farm income			
2. To reduce input costs			
3. To access to credit			
4. To produce value added products			
5. To gain access to preferred markets			
6. To withstand competition			
7. To increase returns from my investment			
8. To reduce business risk			

22 Service Quality

1. Reliability of the FC as a buyer/service provider. High | Average | Poor | no response, Comments, Are you satisfied about the overall service quality? Yes | No. Comments……
2. Will you quit this FC? Yes | No. Why/why not? How?..
3. Investor-friendliness of FC strategies: Give reasons…

Suitability of the strategy	Always suitable	Mostly suitable	Mostly not suitable	Never suitable
Top level business strategy				
Functional strategy				
Operational strategy				
My response towards the strategy	**Always agree**	**Mostly agree**	**Seldom agree**	**Never agree**
Top level business strategy				
Functional strategy				
Operational strategy				

4. How friendly are the major decisions of the FC for you? (investor-friendliness). Investor - friendly | Not investor -friendly | no response. Details:……………………
5. What are the advantages and disadvantages of the FC for you? (List) ………………

26 Strength and Weakness Analysis

1. What are the perceived strengths and weaknesses (shareholder-related organisational problems/issues) within Institutional Arrangements, GF and MF that can improve/deter the performance of your FC? *(Consider the FC constitution, organisational structure, group dynamics, shareholder-management relations, other positive/negative features etc.)*………………………………………………………………………………………
………………………………………………………………………………..

Appendix 3

Guide for interviews with board of directors (chairman)

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1 Respondent's Details

1. Capacity:…………………Contact details: Phone:………………Email:…………………
2. Gender: Male | Female 3a. Age (yrs):…………………………………..…
3. Educational qualifications:
   Illiterate | Up to year 5 | Up to year 9 | GCEOL | GCEAL | Diploma | Degree | Post grad
4. Farming experience (yrs):………Type of farming: Part-time | Full-time …………..……
5. Experience in entrepreneurship | higher level organising (yrs):………Details:…………
6. Sources of household livelihood: (rank the sources in order of importance)
   FC | Farming-other | own off-farm business | Govt employment | private sector employment
   Rank:
7. Founder member: Yes | No
8. Dates of election as a director and chairperson, Number of terms completed at office and designations:………………………………………
9. Shareholding history: Initially bought:…………… Currently held:……………………..……
   Reasons if different:…………………………………………………………………….
10. Do you hold shares in other companies? Yes | No. Details:…………………………..

2 Farmer Company Data

1. Name of FC:………………………………………Website ……………………………
2. Date of registration and nature of incorporation: Public | Private.
3. Was FC established by a facilitating organisation? Yes | No Details:………………
4. What were/is the selection criteria for shareholders?...
5. Other affiliations if any[23]: …………………………………………………………
6. Shareholders' farm size (ha): Min……..……Max…..………Average………………...
7. No. of employees: Managerial:…………………………Other:…………………..……
8. Draw the organisational chart of the FC.

3 Farmer Company Assets and Recent Investments

Asset	Qty	Type of ownership or usage[24]	Replacement value (Rs) (approx)	User conditions, details etc.	Investments during last 3 yrs. Amount (Rs)			Remarks
					2005	2006	2007	
Land (ha)								
Buildings								
Implements/Plant Small Large								
Vehicles Small machinery (generators, pumps, etc.)								
Other (specify)								

1. Has there been an increase/decrease in the FC's total asset value over the past 5 years? Yes | No. Comments:...

[23] Shareholding and contractual relationships with other organisations.
[24] Owned, shared, tenant, rented in and out, other (specify) etc.

2. How do you perceive your board's willingness to acquire long-term assets?
   Willing | neutral | reluctant | no response Comments:………………………………………
3. Does your FC have own brands/product labels/patents? Yes / No. Details………………
4. Has it invested in market research? Yes | No. Details:…………………………………

4 Shareholding and Shareholder Benefits

1. What are the different kinds of shares that your FC has issued for patron, non-patron investors etc. and the rights and other attributes attached[25] to each kind?........................ ....
2. History of shareholding/transaction by FC:

Transactions	Date	Number of shares sold	Price per share	Type of shares and nature of holding[26]	Number of shares redeemed	Price per share redeemed	Remarks
1							
2							

3. What are the policies and practices related to the issue and sale of shares?.........................
4. Is patron-member shareholding proportionate to patronage: Details:………………………
5. Does the government hold shares? Yes | no   If yes, details: No. of representatives etc.…
6. Is the government shareholding useful for the FC?
   Useful | not useful | a problem | no response   Comments:..
7. Do you have non-patron shareholders other than the government? Yes | No   Details:…
8. Has the FC declared dividends to the SHs? Yes | No. Details………..

Year	Yes/No	Total dividend paid	Dividend (Rs) per share	Current share price (Rs)	Mode of payment	Remarks and other details[27]
2007						
2006						
2005						
2004						
2003						

9. Are the shares readily marketable (Is there a demand for shares, is there an active market for shares)? Yes | No | No response
10. If shares are not freely marketable, how can shareholders recover their investment if they want to leave the FC? Will be redeemed | can be sold only to existing shareholders | can be transferred to a family member | can be sold only to person/s who comply with selection criteria set by FC | can be sold to any outsider | disposed of through other arrangements (specify) | and other comments such as prices, ability to redeem etc ………
11. What is your view of the non-patron shareholding arrangements?......................................
12. Are shareholders allowed to sell produce outside FC? Yes | No If yes, details:……………
13. Can non-members use FC services? If yes, do they pay higher prices/charges than do members? Details…
14. Does the FC like to expand its services? Yes | No. …………………………………….
15. If yes, are you (FC) capital constrained? Yes | No……………………………………….
16. Your perception about the service that the FC offers to the shareholders?Adequate | not adequate | no response. Comments:...
17. Your perception about the service quality of the FC?High | moderate | low | No response. Comments:………………………………………………..
18. Has the FC been able to attract external debt and/or equity capital in the past? Yes | No. (Distinguish between debt and equity capital) If yes, strategies adopted, sources, amounts, benefits offered to external individuals/institutions etc., Percentage of outside funds (debt

[25] It is an important issue to determine if the FC issued different classes of shares (e.g. A and B shares, preference and ordinary shares) with different rights and attributes
[26] Whether sole, joint etc.
[27] Percentage of profits distributed and dividends, fate of other portion etc.

and equity) as against the farmer and government's (and possibly compare with standards): ……………………If no, why?...

19. Does the FC have plans to attract significant external financiers or investors? Yes | No. Details...

5 Electoral Procedures

1. Guidelines to select director candidates: Is/are there any criteria/conditions/requirements that a member must satisfy in order to be a board member or chairman? What is/are they?..
2. The nature of voting rights of shareholders to elect directors: One member one vote | one share one vote, etc……
3. How do members vote for directors? By secret ballot, raising hand, etc. ………………
4. In what situations other than electing directors, can the shareholders use their voting power? Comments:……………..
5. If there are any non-patron investors (such as the government), do they have full voting rights? Yes | No. Explain…………

6 Internal Institutional Arrangements

1. Who participates in the following decisions? Give details.

Type of decision	BoD (specify)	Ord. SHs (specify)	Managers (specify)	Others (specify)
Choice of new enterprises				
Acquiring of long-term and other assets				
Appoint managers				
Operational (product-related, marketing and selling etc.)				
Contracting or cancelling contracts with outside organisations				

2. How does the board reach a decision when there is disagreement? Also, discuss about special powers (veto powers, majority vote to break deadlocks, voting powers of directors, etc.). Comments...................

7 Governance

1. Composition of Board of Directors: Number of members, how many are elected from ordinary members, whether members assigned with different tasks, whether there are non-shareholder board members, government and other representatives if any, how often are the elections held and how many directors' posts are up for nomination at each election etc. ……………………...
2. Does the FC distribute the annual report every year to the shareholders? Yes | No. Comments…
3. Is this done before the next AGM? Yes | No. Comment:………………………………….
4. Are the accounts externally audited? Yes | No | no response. If yes, how often? Who are the auditors?.....................................
5. Your perception about the details that shareholders get from the FC of its significant financial transactions and commitments? Good | satisfactory | not adequate | no response.
6. "The FC maintains a high degree of financial transparency and accountability". Yes | No. Comment:……….……
7. How many board meetings each year? Are minutes of board meetings circulated among shareholders? Always | seldom | never.
8. Notice of shareholder meetings: How are shareholders notified of meetings and how many days notice do they get? Is the content of the minutes of directors and shareholders' meetings adequate in detail | inadequate | more than adequate | no response. Is a quorum specified for shareholders and directors' meetings and is there compliance with this requirement? ……

8 External Influence

4. Has the government shareholding influenced your FC business? Yes / No Details………
5. What is the benefit for the government? ……………………………………………
6. If the FC is dealing with contract/out-growers, are these growers required to invest in the FC? Yes | No.....If yes, do they have voting rights?...
7. What factors outside the FC's control have helped/harmed FC's business activities in the past three years (bad weather, taxes, subsidies, price changes, price support schemes, govt policy decisions on value addition etc.)?……………………………………………

9 Other Matters

1. Were there any recent board decisions to impose limitations on expenditure by managers? Yes | No. Details:………Are managers and SHs happy about these limitations? Happy | not happy | a problem | no response.
2. Has the BoD established guidelines to ensure that its members are not dependent on other shareholders et al. so that they can provide proper oversight and governance? Yes | No. Details……………
3. Are there any rules or flaws in the organisational structure that constrain the performance of the Board? ....
4. What are the perceived barriers and issues within Institutional Arrangements, Group Factors and Management Factors that can deter the performance of your FC?
5. What are the positive features you have observed within the FC in respect of Institutional Arrangements, Group Factors and Management Factors?...
6. What are the strengths and weaknesses of the FC?..
7. Why have other FCs in the areas you know, failed?..

10 Group cohesiveness

1. What is your perception about the group size (total membership in the FC)? Convenient | difficult | No response. Comments:…………………………………………………
2. Do you have preferred shareholders? Yes | No. Why are they preferred?...........Are there any shareholders who are with you in other organisations? Yes | No. Details:.………
3. Do you discuss about FC issues informally with other shareholders? Yes | No. Comments…Have you noticed informal groups within the FC? Yes | No. Comments…If yes, what is their effect on the FC and its performance?..
4. Do you think the membership is stable (settled) now? Yes | No. Comments……What is your perception of the overall unity among shareholders? High | moderate | weak | no response. Comments………Your perception of the overall unity between shareholders and managers? High | moderate | weak | no response. Comments…………………

11 Continuity

1. Do you want to increase SH base? Yes | No What are the strategies/tools you use to achieve this? Comments...........What are the positive and negative effects of new shareholders joining the FC?...........................
2. What is your perception of out-growers supplying / patronising products to your FC?........Who will benefit? FC | out-grower | no response. Comments…………………………………….

12 Influence

1. Are there situations in which ordinary shareholders are able to (singly or with small groups) influence activities and decisions of directors', managers', other shareholders'? Yes | No. Details................

2. Have you noticed members canvassing within FC for their interests?.......What are the various ways in which minor, average and major investors exert influence on managers' and directors' decisions?...
3. Have you noticed any informal grouping or aggregation among shareholders based on similar product / technology / assets / investments / benefit rights / interests etc. that created a certain pattern of voting at the elections? Yes | No. Details / comments………
4. Are there any informal grouping and lobbying among shareholders to influence decisions? Such as investments, Recruitment, Profit sharing decisions, Business strategy decisions etc? Details…….
5. How has this informal grouping and lobbying among shareholders affected the quality of managerial decisions and overall performance of the FC? Positively | no effect | adversely | no response. Comment …What kinds of groupings of shareholders can/will influence as above? Individuals singly | formal groups | informal groups | major SHs | minor SHs | others (specify) Details……………………………………………
6. According to your past experience at the office, which group has the greatest influence in this way? Individuals singly | formal groups | informal groups | major SHs | minority SHs | others (specify) Details……………………………
7. What aspects of the group dynamics in your FC do you perceive as barriers to effective management and that are therefore detrimental to the overall performance of your FC?................

13 Business Identity

1. Does the FC have a mission and a long-term business plan? Yes | No. Is it been achieved? Yes | not possible | will be achieved | no response. Details:…………..
2. Who were involved in making business plans, strategic choices etc? BoD | Shareholders | Senior managers Others..........................
3. Have you noticed any action by shareholders to include specific components of their interest, into the FC business plan? Yes | No. Details ………………..……
4. Your overall perception of this business plan: Appropriate | not much appropriate<>Realistic | not realistic<>Agreed by all | not agreed by all.
   Comments if any: ………………………………
5. What are the expansion plans of the FC in-brief. What additional assets should be acquired to implement these plans? What can prevent/has prevented the expansion activities of FC? What are the key objectives of the FC? Were the key objectives achieved fully? Yes | No. Details:…………………………………..
6. What are the different core and non-core businesses that the FC is engaged in? (IP supply, production, services (marketing etc.)) {these should be able to be identified as different profit centres} (Based on revenue, sales volume etc.). What is your perception of this portfolio? Satisfactory | moderate | not satisfactory | no response. Details: ………

14 Business Strategy

1. Are the board and hired management involved in strategic choices? Yes | No. Details…What are such significant strategies identified and implemented during the recent past (2 yrs)? Has the FC been successful in implementing the strategies formulated? Yes | No. Comments:…To what extent do the shareholders accept the strategies formulated by the FC? All shareholders accept | most | few. Discuss details
2. What are the business environment factors and organisations that can affect your FC? Do the strategies of the FC fit with the business environment of it? Yes | No. Reasons (Consider about competitors, buyers, suppliers, government regulations etc.)
3. Do you think that the operational processes in the FC are geared to facilitate successful implementation of strategies formulated? Yes | No. Comments:…Do you think that the shareholders have the access to resources in order to implement the FC strategies

formulated? Yes | No. Comment:..What are the resources that can be binding for your FC?.........................Explain...

4. Has the FC been able to secure/obtain financial resources to put strategies identified, into action? Yes | No. Comments/ financial tools etc……Our FC has right financial processes to assist other operational processes. Yes | No. Comments…

15 Operational Management

1. What is the range of products produced/marketed by the FC?....................................

Product	Primary / value added	Quantity sold	Unit price	No. of shareholder producers	Remarks (year started to produce, forward sales contracts etc.)

**If it is an input supply FC, we can discuss about that aspect. Add more rows if necessary.*

2. Perception of the product portfolio's ability to generate profits for the FC/shareolders: Good | Average | Poor | No response. Comment…Ability of the product portfolio to maintain FC competitiveness. High | Average | Low | No response. Comment:…What is your view about producing value-added products?...
3. Have you identified and analysed the inefficient processes within the FC? Yes | No. Details:………What is your perception of re-engineering these processes?........Are there any institutional arrangements and/or group factors that can potentially block the re-engineering?.........
4. Have you identified and analysed the new technologies that are around in your industry? Yes | No. Details:…What is your perception of changing the technology?....................
5. Are there any institutional arrangements and/or group factors that can potentially block this changing of technology? Details……………………

16 Managerial Quality

1. How effective are the managers in identifying market signals? High | Moderate | Low. Comments…
2. Have the managers found adequate marketing opportunities to sell the products? Very high / moderately / no response / poor / very poor. Comments:……
3. Your perception on managers' ability to organise the work of the FC, to coordinate the activities of the shareholders. High | Average | Low. Details:…
4. Your perception on manager-board relations, manager-shareholder relations, managers' ability to make sound decisions, managements' ability to implement the long-term business plan of the FC .Good | Average | Poor. Details:…
5. As the chairperson of the FC, how satisfied is the board about the overall quality of your hired managerial team? High | Average | Low. Details:…………

17 Other Factors

1. What are the perceived barriers within Management Factors that can deter the performance of your FC?...
2. What factors outside FC's control have helped/blocked your FC in performing well? Details…….
3. How do you explain the board of directors' behaviour towards business risk and towards agricultural risk? Risk preferred | risk neutral | risk aversive | no response. Examples of risks taken during last 2 yrs. (list) …
4. How is the managerial performance determined (when share prices do not demonstrate managerial excellence)?.......Did you declare bonus? Yes | No. What basis was used for this?.........What are the incentives for good managerial performance and sanctions imposed for poor performance? ....

5. Discuss and check whether FC difficulties reflect shortcomings in implementation rather than the organisational arrangements themselves. The logic is that they should not expand their activities beyond a certain level until they develop strong institutional and managerial capabilities.

Performance Indicators

1. In your view is the FC achieving its key objectives?
   Achieved | can be achieved within the time frame | cannot be achieved within the time frame | Objectives should be redefined | No response. Remarks………………………
2. In your view is the FC implementing its key strategies successfully? Yes | No. Details
3. Some quantifiable parameters:

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

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

Appendix 4

Guide for interviews with General Manager

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1 Introduction

1. Age (yrs):……………………………………………….. Male | Female
2. Qualifications:……………Experience in-brief:………………………………
3. Date of joining FC:…………………………Present designation/rank:………………………..…….
4. Details in-brief of other executives: Number of executives, designations, their positions in the organisational structure etc..: ……………………………………………………………….……

2 Institutional details

1. Your views about the FC's position: Comments/Reasons for your views ....

Aspect	Strong	Average	Poor	No response	Comments / reasons
Business position					
Market position					
Financial position					
Strategic position					

2. Which segment/s of the FC are you managing? Strategic Business Units, product-centred segments, market-centred segments, SH-centred segments, geographical segments etc.
3. Does the FC have a healthy organisational structure? Yes | No. Features…………………..
4. If government owns shares of the FC, is this an advantage? Advantage | No particular effect | a problem. Comment…Controlling effect does the government have through its shareholding?...........
5. Has the FC been able to attract external debt and equity capital? Yes | No. If yes, strategies adopted, sources, amounts, benefits offered etc., percentage of outside funds (debt and equity) as against the farmer and government's investments. Details/reasons.......................
6. Have external investors bought shares in the FC? If yes, government or private? Recently or long ago? ......Does the FC have a plan to attract significant external investors? Yes | No. How?.............
7. Are there any restrictions/limitations for you in following aspects? Capital expenditure, Operational expenditure, Operational decisions such as credit period to customers, out-grower decisions and purchasing, Expenditure limits:…………
8. Are there any subsidiaries for your FC? Does it have joint ventures with other companies or govt? What is your FCs stake in them?...
9. Have you worked in a company that was not registered as a FC? Yes | No, If yes, are there any important differences in institutional or governance arrangements? If yes, do they affect the performance of the FC ? If yes, how? ....
10. Does your FC have significant relation-specific assets? Yes | No. Details…………………
11. Has this affected attraction of equity and debt capital? Yes | No, Are or were there any other institutional/governance arrangements that advance/inhibit progress of your FC?
12. What was/has been done to improve institutional and governance arrangements?.............

3 Governance

1. Has the annual report been produced at right times? Yes | No.
   Comment:……………………
2. Does the FC distribute the annual report every year to the shareholders? Yes | No.
   Comment…
3. Are the accounts externally audited? Yes | No | no response, If yes, how often is this done? Who are the auditors?...
4. Were there any recommendations from the audit to resolve any financial issues prevailing? Yes | No. If yes, what were those significant issues?....................................
5. Your perception about the details that shareholders get from the FC of its significant financial transactions and commitments? Good | satisfactory | a problem | no response
6. "The FC maintains a high degree of financial transparency, financial accountability". Yes | No. Comment:……….
7. Do you attend the board/shareholder meetings? Yes | No. Are minutes of those meetings circulated among shareholders and managers on time? Yes | No
8. Notice of shareholder meetings: Do you get adequate time to prepare, minutes of previous meetings on time etc…Your view of the content of the minutes of directors/shareholders' meetings? Adequate detail | inadequate detail | too much detail | no response, Is a quorum specified for shareholder meetings and is their compliance with this requirement? ……
9. What is the procedure, ceilings etc. for an approval of expenditure?...........................

4 External Factors

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

5 Group Action

1. Are there any informal groupings within FC? Yes | No. Details…What is/are the basis/bases of segregation/grouping? …Do SHs work together within informal groupings to bring success to FC? Yes | No, Comment …………
2. What is your perception of the overall unity among SHs and managers in the FC? High | moderate | weak | no response. What are the impacts of this on managerial functions?....................
3. How easy is to play a linking role (coordination of work) among SHs? Easy | Moderate | difficult | no response, Explain……………………………………………………………
4. Are there outside individuals wanting to join this FC? Yes | No | no idea. If yes or no, why?......
5. Have you witnessed groups of shareholders (based on similar product / technology / assets / investments / benefit rights / interests etc.) voting to voice a common view/argument? Yes | No. Details...Are there any interactions among shareholders to influence decisions? Investment decisions, Manager recruitment decisions, Profit sharing decisions, Other decisions (specify)– Yes | No. If yes, details:…How has this interaction among shareholders affected the overall performance of the FC?...Positively | no effect | adversely | no response. Comments ………………
6. Have shareholders influenced your decisions in any way in the past? (in ways that are not part of the institutional arrangements) Eg. Strategy setting. Yes | No. Details…What kinds of groupings can/will influence you? Individuals singly | formal groups | informal groups | major SHs | minor SHs | others (specify), Details (which group has the greatest influence)…………………

7. What impact does this influence have on your managerial decisions/work?

Decision level	High	Moderate	Low	No response	Comments, examples etc.
Strategic / higher					
Business / middle					
Operational / lower					

8. Have you noticed collective action among shareholders to influence decisions of FC? Yes | No.
9. What are the indicators of collective action happening?…Factors that trigger this collective action?..
10. Thinking about management decision-making in this FC as a whole, what % of shareholders do you think is exerting influencing on such decision-making? …………………………………..
11. How satisfied are you with working with ordinary shareholders as part of management decision-making? High satisfaction | average satisfaction | low satisfaction | no response, Details and views...
12. Aspects of the group dynamics in your FC do you perceive as barriers to effective management and that are therefore detrimental to the performance of your FC?..............

6 Business Identity

1. Does the FC have a mission, long-term business plan? Yes | No. If yes, what? Are been achieved? Yes | not possible | will be achieved | no response. Comment:…Who were involved in drafting these? BoD | Shareholders | Senior managers | Others....
2. Have you noticed any action by shareholders to include specific components of their interest, into the FC business plan and other plans? Yes | No. Details …Overall perception of this business plan:
   Appropriate | not much appropriate <> Realistic | not realistic <> Agreed by all | not agreed by all. Comments if any:…
3. What are the key objectives of the FC? Perception of the these key objectives: Specific | Not specific, Agreed | not agreed by all, Realistic | not realistic
4. What are the different businesses that the FC is engaged in? (IP supply, production, services (marketing etc.)) {these should be able to be identified as different profit centres}, Your perception of this portfolio? Satisfactory | moderate | not satisfactory | no response. Details:………………
5. What are the perceived barriers within Management Factors that can deter the performance of your FC? (also, positive factors that can enhance the performance)……

7 Business Strategy

1. Are the hired management involved in strategic choices? Yes | No. Comments:…What are such significant strategies identified and implemented during the recent past (2 yrs)?
2. Is the FC generally successful in implementing the strategies formulated? Yes | No. Comments:…
3. What are the business environment factors (PEST) and organisations that can affect your FC?
4. Do the strategies of the FC fit with the business environment of it? Yes | No. Reasons:..(Consider about competitors, buyers, suppliers, government regulations etc.)
5. Operational processes in the FC are geared to facilitate successful implementation of strategies formulated? Yes | No. Comments:…………
6. Do you think that the shareholders have the access to resources in order to implement the FC strategies formulated? Yes | No.
   Comment:……………………………………………

7. What are the resources that can be binding for your FC? Has the FC been able to secure/obtain financial resources to put strategies identified, into action? Yes | No. Comments/ financial tools etc.
8. Our FC has right financial processes to assist other operational processes. Yes | No. Comments..
9. What are the expansion plans of the FC in-brief? What additional assets should be acquired to implement these plans? What can prevent/has prevented the expansion activities of FC?......

8 Operational Management

1. What is the range of products produced/marketed by the FC?...

Product	Primary / value added	Quantity sold	Unit price	No. of shareholder producers	Remarks (year started to produce, forward sales contract etc.)

2. Perception of the product portfolio's ability to generate profits for the FC: Good | Average | Poor | No response. Comments…
3. Ability of the product portfolio to maintain FC competitiveness. High | Average | Low | No response. Comments:…
4. Our shareholders manage inputs well. Yes | No. Comments………………………

Performance details

1. What services does the FC offer to its shareholders?..
2. What advantages does the FC offer to its shareholders? (Also ask about the disadvantages)...
3. In your view, is the FC achieving its key objectives?
   Achieved | can be achieved within the time frame | cannot be achieved within the time frame | No response.
   Remarks………………………………………………………………………………
4. What is your estimate about the achievement of key strategies of the FC?
   Achieved | will be achieved | will not be achieved | No response.

Remarks………………….

5. Some quantifiable parameters:

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

6. Why have other FCs in the areas you know, have failed?..
7. What are the strengths and weaknesses of the FC?...
8. Are there any severe organisational limitations that affect your managerial work and quality of decisions?...

Appendix 5

Interview schedule for facilitators of establishment of FC

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1. Name of Organisation:………………………………………..…………………
2. Contact details: Phone:……………..……………Email:..……………………….…
3. Affiliation, if any(UN etc.) :…………………………………………….…………
4. Respondent details:……………………………..………………………………….
5. Name of FC:…………………………………………………………….………
6. When was this FC established?...
7. Present status of FC: Failed | Surviving ………………………………………………
8. Initial total capital of FC:…………………………………………………….…
9. Agent's contribution at the beginning:……………………………………………
10. Agent's objectives of establishing the FC:…………………………………………………
11. Satisfaction/performance on those aspects:

Aspect	High performance / achievement	Average performance / achievement	Low performance / achievement	No response

12. What are the perceived factors (barriers/limitations/weaknesses and also strengths and positive features) that have enhanced/limited the performance of the FC? (Discuss about institutional arrangements, group factors and management factors...........................

Appendix 6

Interview schedule for buyers (Purchasing Manager)

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1. Contact details: Phone:…………………………Email:………………………….
2. Identification of FC:………………………………………………………………….
3. How long has your company been dealing with this FC?.......................................
4. Product details:………………………………………………………………………..
5. How would you rank this producer? Major source | average source | minor source. If major or minor; why?.................................
6. Relationship with FC:

Aspect	Highly satisfied	Satisfied	Unsatisfied	No response	
Quantity purchased					
Continuity of selling					
Price					
Payment terms (credit etc.)					
Overall satisfaction					

7. Do you have a formal purchasing contract with this FC? Yes | No.
8. What are the significant features of this contract? Duration, quantity or quotas if any, price determination, payment procedures, quality specifications, delivery arrangements etc.
9. What are the perceived positive and negative features of this FC?...................................
10. Your overall perception of this FC?

Strong company | average company | weak company | no response

11. Would your company like to invest in this FC? Yes | No. Why?.......................................

Appendix 7

Interview schedule for input suppliers (Sales Manager)

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1. Company identification:…………………………………..………………………..
2. Contact details: Phone:…………………………Email:…………………………
3. Name of FC:……………………………………………………………………….
4. How long has your company been dealing with the FC?.......................................
5. Product details:………………………………………………………………………
6. How would you rank this buyer?

Major buyer | average buyer | minor buyer. If major or minor; why?...........................

7. Relationship with FC:

Aspect	Highly satisfied	Satisfied	Unsatisfied	No response	
Quantity supplied					
Continuity of buying					
Price					
Payment terms (credit etc.)					
Payment history					
Overall satisfaction					

8. Do you have a formal selling contract with this FC? Yes | No.
9. What are the significant features of this contract? Duration, quantity or production quotas if any, price determination, payment procedures, quality specifications, delivery arrangements etc.
10. What are the perceived positive and negative features of this FC?..................................
11. Your overall perception of this FC?

Strong company | average company | weak company | no response. Comments………………..

12. Would your company like to invest in this FC? Yes | No. Why?..
13. Also discuss the strengths and weaknesses of this FC………………………………

Appendix 8

Interview schedule for contract growers/out-growers

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1. Contact details: Phone:……………………Email:…………………………..
2. Business form: Sole trader | private company | public company | cooperative | other (specify)
3. Type of farming: Part-time | Full-time Farming experience in years:…………..……
4. When did you start supplying to the FC?...
5. Do you receive the same price as shareholders of the FC?..
6. Is this FC your main source of income: Yes | No……………………………………………
7. How do you classify this FC? Major buyer | Average buyer | Minor buyer | No response……
8. Product details:

Product and specifications	Quantity produced (per yr etc)	Quantity supplied to this FC	Remarks

9. If you have more than one buyer for the type of product you produce for FC, who gets the priority? Why? ………………………………………………………
10. Are the quantities supplied to FC increasing? Increasing | same | decreasing
11. Is there a formal supply contract? Yes | no
12. What are the significant features of this contract? Duration, quantity or production quotas if any, price determination, payment procedures, recovery of advances, costs etc., quality specifications, input supply arrangements from FC, delivery arrangements etc.
13. What facilities other than buying your product, are provided by the FC? (Ex: usage rights of FC assets, material etc., advances, credit, loans etc.) ……………………….................................
14. Your perception of your relationship with FC:

Aspect	Highly satisfied	Satisfied	Unsatisfied	Remarks
Purchase security				
Price paid				
Quality standards				
Provision of inputs				
Mode of payment				
Advance, loan and cost recovery				

15. Would you like to continue business (out-grower arrangement) with FC? Yes | No. Why?..
16. Would you like to become a shareholder of this FC? Yes | No. Why | why not?.................
17. Would you like to provide financial support to this FC? Yes | No. Details:………………
18. Has FC ever refused to buy your product? Yes | No. If yes, why?..
19. Can the FC fulfil current sales obligations without you and/or other out-growers?

Yes | No. Details:……………………………………………

20. What are the factors such as Institutional Arrangements, Group and Management Factors that are prevailing in this FC that can affect your relationships with this FC?..............

(Also ask about strengths and weaknesses of this FC)…………

Appendix 9

Interview schedule for bank managers

This interview is a voluntary process. You will not be identified as a respondent without your consent. You may, at any time, withdraw your participation, including withdrawal of any information you have already provided. You reserve the right to refrain from answering any question/s. If you complete this interview, however, it will be understood that you have consented to participate in this research and consented to publication of the results of this research with the understanding that your anonymity will be preserved.

1. Bank and branch identification:………………………………
2. Contact details: Phone:…………………….. email:………………………….
3. What are your interest rates for various types of fixed and other types of savings options at your bank? (Check with other banks and financial institutions such as property developers etc.)
4. Name of FC dealing with:……………………………………………………………….
5. How long have your bank/branch been dealing with this FC?..
6. Have you released credit to this FC during the last 5 years? Yes | No. Details…

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

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

High | Medium | Low | No response

9. Has the creditworthiness increased over time?

Increased | same | decreased | No response

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

Strong company | average company | weak company | no response. Comments:………

19. According to your experience as a banker, what are the positive or negative features and also strengths and weaknesses you see of this FC?...

Appendix 10

The data table for cluster analysis of variables

Construct	Variable	FC1	FC2	FC3	FC4	FC5	FC6
Performance indicators	LIQUID	1	1	1	0	0	0
	SOLVENT	1	0	1	0	0	0
	OREACH	1	0	1	1	1	0
	DIV	1	0	1	0	0	0
	GROWTH	1	0	1	0	0	0
	BRAND	0	0	1	0	0	0
	LINKBUY	1	1	1	0	1	0
Institutional arrangements	NONPAT	1	0	1	1	1	0
	EQINV	1	1	1	1	1	0
	SHMKT	1	0	1	1	1	0
	SHPRICE	0	0	1	0	0	0
	MGRINFL	0	1	1	0	0	0
	HIREFIRE	0	0	1	1	0	0
	ADVDPOL	0	0	1	0	0	0
	FACPOL	0	0	1	0	0	0
Governance arrangements	AGMREGU	1	1	1	0	0	0
	AGMDOCS	1	1	1	1	0	0
	SHNOMI	1	0	1	0	0	0
	SECRETB	0	0	1	0	0	0
	ACCESS	1	1	1	0	0	0
	CONVENE	1	0	1	0	0	0
	CHAIR	1	1	1	1	1	0
	CAGENDA	1	1	1	1	1	0
	INFOTIME	1	1	1	0	0	0
	MREPORT	0	0	1	0	0	0
	BUDGET	1	1	1	0	1	1
	FINSTAT	1	1	1	0	1	0
	ANREPT	1	1	1	0	0	0
	AUDITOR	1	1	1	0	0	0
	FINDOC	1	1	1	0	0	0
Group factors	MULTIPR	0	0	0	0	0	1
	SHPOLICY	1	0	1	0	1	1
	SHMGRIAL	1	1	1	0	1	1
	ADVINFLU	0	0	1	0	0	0
Management factors	ORGSTR	0	0	1	0	0	0
	OBJECTV	1	0	1	1	1	0
	PROCESS	1	1	1	0	0	0
	IMPLMNT	0	0	1	0	0	0
	ADMIN	1	1	1	0	0	0
	GMSKIL	1	0	1	0	0	1
	SKILPORT	1	0	1	0	0	0
Performance attributes present (out of 7)		5	2	7	1	2	0
Internal problems absent (out of 34)		23	16	33	9	10	5

Notes: For the performance indicators, 1= acceptable performance, and 0 otherwise.
For the institutional, governance arrangements group and management factors, 1=the absence of a problem, 0 otherwise.

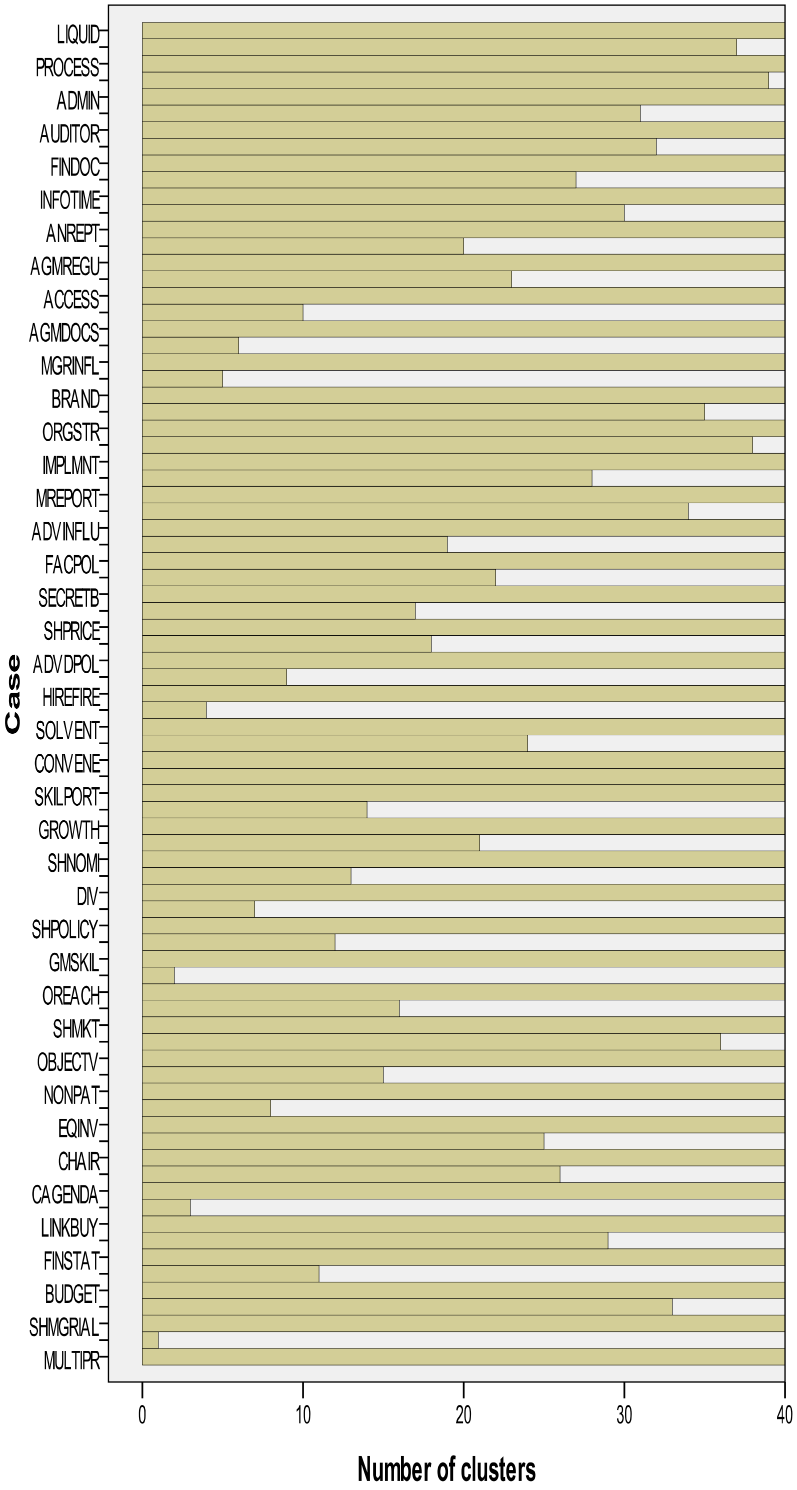
Appendix 11

Variables by cluster

Cluster	Problem	Variable
1	The company purchased multiple products from its shareholders	MULTIPR
2	The facilitator influenced policy decisions against majority investors	FACPOL
	New shareholders paid the same price for equivalent voting and benefit rights purchased by the original shareholders (shares were not appreciated)	SHPRICE
	Non-shareholder directors influenced policy decisions against majority investors	ADVDPOL
	The board was not responsible for hiring and firing executing managers	HIREFIRE
	Executive managers influenced policy decisions against majority investors	MGRINFL
	Shareholders could not convene special general meetings	CONVENE
	Shareholders did not nominate all of the directors	SHNOMI
	Executive manager reported to external agents	MREPORT
	Elected shareholder-directors were not chosen by secret ballot	SECRETB
	Shareholder-directors did not nominate the auditor	AUDITOR
	The company did not prepare financial documents for audit purposes	FINDOC
	Shareholder-directors were not given sufficient information and time to prepare for board meetings	INFOTIME
	Shareholders did not receive an annual report with audited statements	ANREPT
	AGMs were not convened regularly	AGMREGU
	Shareholders could not access minutes of the board meetings	ACCESS
	AGMs were called without adequate notice and without annual reports	AGMDOCS
	Skills of senior managers did not match their portfolios	SKILPORT
	The GM was not a skilled and a dynamic leader	GMSKIL
	Organisational structure impeded expansion of the enterprise	ORGSTR
	Processes to implement strategies did not assign clear responsibilities to managers	IMPLMNT
	Processes to develop strategies were not well-established, continuously applied or informed by managers and shareholders	PROCESS
	Administrative processes did not produce timely information required by directors, shareholders and legal authorities	ADMIN
	Shareholders participated directly in policy-making decisions	SHPOLICY
	Non-investors with vested interests in the company had representation and influence on the board	ADVINFLU
	The company was solvent	SOLVENT
	There was outreach growth	DIV
	Shares did appreciate	SHAPP
	The company created its own brand name	BRAND
	The company was liquid	LIQUID
3	Budgets were not approved by the board	BUDGET
	The company did not report independently audited financial statements each year	FINSTAT
	Shareholders participated directly in managerial decisions	SHMGRIAL
	The company developed voluntary links with corporate buyers	LINKBUY
4	Shareholders had to invest equal amounts of equity capital	EQINV
	The company did not permit share trading between shareholders	NOSHMKT
	Non-patron shareholders were permanent	NONPAT
	Non-shareholder-directors influenced the selection of the chairman	CHAIR
	The chairman did not set the agenda for board meetings	CAGENDA
	Company objectives were not developed with and for shareholders	OBJECTV
	There was outreach growth	OREACH

Appendix 12

Agglomeration schedule of cluster analysis



Clusters	Agglomeration Coefficients
40	.000
39	.000
38	.000
37	.000
36	.000
35	.000
34	.000
33	.000
32	.000
31	.000
30	.000
29	.000
28	.000
27	.000
26	.000
25	.000
24	.000
23	.000
22	.000
21	.000
20	.000
19	.000
18	.000
17	.000
16	.000
15	.000
14	.000
13	.000
12	1.00
11	1.00
10	1.00
9	1.00
8	1.00
7	1.25
6	1.25
5	1.31
4	1.27
3	1.50
2	1.25
1	2.91