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# Japanese Assistance for Capacity Building of Social Businesses through Grass-roots Technical Cooperation in Sri Lanka:

Performance, Opportunities and Challenges

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## **Abstract**

Social Business (SB) defined as a business which has the social and economic rather than only the profit maximization objective, is said to address socioeconomic problems of developing countries. Japan, under its grass-roots technical cooperation has furnished support in establishing SBs through capacity building of a large number of rural people and organizations in Sri Lanka. This paper investigates the effectiveness of the SBs supported by Japan by analyzing their impact on rural poor and challenges that arose from such activities. This paper employed the case study approach to gain a deeper understanding of the socio-economic dynamics of the poor people involved in the SBs. These cases included SBs involved in coffee production, organic agriculture, and rice processing and the study was based on both field surveys and secondary data.

A Japanese NPO, a Sri Lankan private company, and the Sri Lankan

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government have respectively invested and promoted these SBs focusing on poor, underprivileged, and vulnerable groups in rural areas. The investors have facilitated capacity building of their resource endowments through the formation of capital which has directly resulted in better access to local and foreign markets and subsequently a higher income for the villagers. Human resource development; collective behavior of the entrepreneurs as well as networking with other organizations; financial and material gains; improvement of micro financing systems maintained by the SBs, and gaining access to better formal credit sources; infrastructure development and improvement of technology used were the capacities built by the Japanese grass-roots technical cooperation with respect to these SBs.

## **I. Introduction**

It is a commonly known phenomenon that the traditional capitalistic approach based on profit maximization efforts and piecemeal development approaches of consecutive governments and non-governmental organizations have not found an effective or satisfactory solution to overcome acute human suffering of poverty, unemployment and inequality in developing countries. Many scholars criticized that these numerous poverty alleviation approaches have cast various negative impacts on the society and economy rather than relieving poverty in developing countries. The most serious negative impact of these approaches is that people in developing countries have gradually fostered dependence or the so-called 'dependency syndrome' rather than providing productive opportunities based on their entitlements to contribute to the national economy. Today, most of the people in developing countries believe that it is a government responsibility to provide basic needs free of charge for the needy people in the country. As noted by Yunus (2010:6) 'Poor people who become dependent on charity do not feel encouraged to stand on their own feet'. Moreover, Peredo and Chrisman (quoted from Easterly and

Miesing, 2007:4) also stressed that many poverty reduction programmes operate as charities that foster dependence rather than rebuilding communities. These kind of unacceptable social norms are created by the above noted development approaches because their poverty alleviation strategies intended to provide temporary solutions to satisfy the society and donors in the short-run rather than using their capabilities and resources towards raising the income of the poor in the long-run. On the other hand, many of these strategies have not been changed according to changes in the world economy, diverse societies and their policies. This is not an exception according to the development experience of Sri Lanka during the last six decades of the post-independence period.

The development history of Sri Lanka in the last 60-year period is testimony to the fact that it did not gain a lasting solution to people's acute suffering of poverty, unemployment and inequality despite its countless attempts at following the traditional capitalistic approach of profit maximization through open market policy as well as inward-looking policy based on a mixed economic policy. In addition, Sri Lanka has implemented a large number of piecemeal strategies towards poverty alleviation under both domestic and foreign assistance, labeling such approaches under different names. However, poverty and other acute socioeconomic problems still remain without any visible lasting solution. According to the World Bank (World Bank, 2012), 29 percent of the population lives on less than \$2.00 per day<sup>3</sup>, despite the country gaining the lower middle income status in world national income rankings in 2012. Moreover, its income and wealth inequality remained comparatively at high level, particularly in the rural sector<sup>4</sup>.

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<sup>3</sup> Poverty head count ratio at \$2 per day (PPP) in 2007. According to the Central Bank (2010) about 7.6percent of the people live below poverty line (Based on Poverty Head Count Index at \$1.25 per day)

<sup>4</sup> Gini co-efficient in Sri Lanka in 2007 is 0.47.

The improvement of income levels of poor people in the society thus has to be given high national priority if the country is expecting to achieve sustainable development acceptable to all social strata of the society. This can be achieved if people can get a fair price for their goods, services, capital assets, and capabilities. It pushes them to become self-reliant people and provides an opportunity to rural people to contribute to the national economy through participating actively in the ongoing open market economy. There is no doubt that this approach contributes to empowerment and a genuine, long-term solution to poverty, inequality and oppression of the people.

A new approach to traditional capitalism or so-called social business (SB) is one of the newly emerged strategies to achieve this decisive expectation of human society. A social business<sup>5</sup> could be defined as a business designed to meet a social goal rather than a financial objective (Yunus, 2007:xvi; Yunus Center, 2011). It generates a modest profit, but this will be used to achieve social objectives and goals – e.g. education, health, the environment, or whatever is needed to address the problems faced by society<sup>6</sup>. According to Yunus Center (2011), there can be two types of social businesses. Type I focuses on businesses providing a product and/or service with a specific social, ethical or environmental goal only. Type II can take up any profitable

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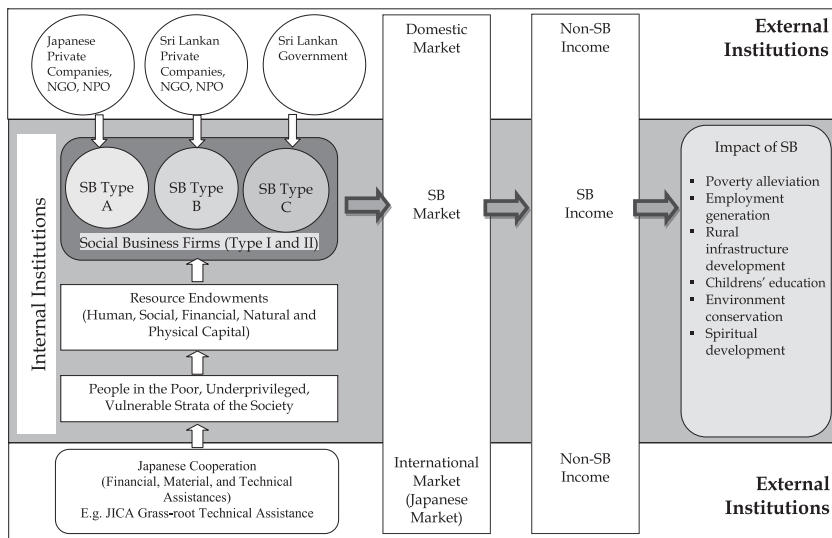
<sup>5</sup> Social business was first defined by Nobel Peace Prize laureate Prof. Muhammad Yunus and is described in his books as *Creating a world without poverty – Social Business and the future of capitalism* and *Building Social Business – The new kind of capitalism that serves humanity's most pressing needs*.

<sup>6</sup> According to Prof. Muhammad Yunus and Hans Reitz there are seven principles of social business: Business objective will be to overcome poverty, or one or more social problems (such as education, health, technology access, and environment) which threaten people and society, not profit maximization; Financial and economic sustainability; Investors get back their investment amount only; no dividend is given beyond investment money; When investment amount is paid back, company profit stays with the company for expansion and improvement; Environmentally conscious; Workforce gets market wage with better working conditions; and Do it with joy

business so long as it is owned by the poor and the disadvantaged parts of the society, who can gain through receiving direct dividends or by some indirect benefits. These two types of social businesses can be further divided into three types based on external institutions involved in initiating, investing and promoting the business: Type A – by a foreign private company or non-governmental/non-profit organization (NGO/NPO); Type B – by a local private company or NGO/NPO; and Type C – by the local government. All these types focus on uplifting people's income level through enhancing resource endowments and capabilities of people in the poor strata of the society.

Japanese cooperation for capacity development of social businesses has taken different forms in Sri Lanka. One such approach is capital formation (human, social, natural, financial, and physical) of social businesses at the grass roots level. The capital can be transformed into different income generating activities including smallholder agricultural, manufacturing and service units. The products of the SBs are sold to domestic and foreign markets. Another common form of Japanese assistance is to become a major market for the products of the social businesses. In a social business income is generated both from the social business itself and non-social business sources. Consequently, this system facilitates to help the rural poor not only by the reduction of unemployment and poverty of the owners of SB but also the whole community by enhancing their access to health, education, spiritual and environmental benefits (Salam, 2009; Kader, et al., 2009). The success of a social business is measured by the impact of the business on poor people and /or the environment, rather than the amount of profit made in a given period of time. This paper investigates the effectiveness of the social businesses supported by Japanese cooperation by analyzing their role in capacity building towards rural poor. The conceptual framework of the research is presented in Figure 1.

Figure 1: Conceptual Model of Japanese Cooperation in Capacity Development of Social Businesses in Sri Lanka



## II. Methodology

This study employed the case study approach to gain a deeper understanding of the socio-economic dynamics of the poor people involved in the social businesses. For Type A, a coffee producing social business in Piliwela village, which was supported by a Japanese company, was selected (Case Study 1). Type B social business was analyzed using a business involved in production of organic agricultural products in the Kandy district (Case Study II). Although there is no direct Japanese cooperation in this business in terms of business initiation, investment, or capital formation, Japan has been one of the major markets of their products. For Type C, a rice processing social business in the North Central Province was selected (Case Study III). Rice processing villages were initiated by the Institute of Post Harvest Technology (IPHT)<sup>7</sup>. Some of these rice processing villages were supported by Japanese technical cooperation through JICA. The study

was based mainly on surveys conducted in the respective areas. Primary data was gathered using interviews and in-depth key informant discussions, focus group discussions, and observations. Relevant secondary data about the social businesses was collected from the records of external supporting institutions and investors. The information gathered in this study yielded mainly qualitative data and is presented in descriptive form.

### **Social Business Type A: Sri Lanka-Nippon Friendship Organic Coffee Village**

Coffee was first introduced to Sri Lanka in 1503 by the Arabs. It was developed as a cultivation in 1658 by the Dutch colonial rulers. During the British colonial rule, coffee was developed as a commercial crop and by 1856, there were about 100,000ha land under coffee plantations, exporting about 50,000 MT. Sri Lanka coffee continued to play a prominent role in the world coffee supply until 1868, when the crop was devastated due to the coffee rust disease. As a result, most of the coffee plantations were converted into tea by the British. Thereafter, coffee was grown mainly as a subsistence crop in the Mid Country home gardens.

After the establishment of the Department of Export Agriculture<sup>8</sup> (DEA) in 1972, again the systematic cultivation of coffee, as a mono crop and/or mixed-crop with pepper, clove, fruit crops, tea, etc. was started. Coffee was identified as a high priority crop in the DEA cultivation program and was included in the national subsidy program, as well as in the home garden subsidy program of the DEA (Seneviratne, undated). Nevertheless, Sri Lanka

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<sup>7</sup> The IPHT, operating under the Ministry of Agriculture, functions as the main Institution in Sri Lanka engaged in improving the post harvest technology of rice/other grains, field crops, fruits and vegetables, spices through research, training and extension, consultancy, advisory and other development activities such as providing & creating opportunities for rural sector (<http://www.ipht.lk/>).

<sup>8</sup> The formal government organization for development of coffee in Sri Lanka

is still struggling to regain its lost status in the world coffee market. The total export of coffee<sup>9</sup> in Sri Lanka was only 157 MT, at a value of Rs. 38 million<sup>10</sup>, in 2010. The share of coffee supplied by Sri Lanka to the world market is less than 1 percent. At present the main coffee producing countries are Brazil, India, and Indonesia. A substantial gap exists between the average national production (154 kg) in Sri Lanka and the potential yield (809 kg). Sri Lanka's competitiveness in the world coffee market is weak due to lack of production as well as poor quality.

The Fair Trade Commission (FTC) is a non-profit organization based in Japan which is involved in fair trade activities (FTC, 2011). K. Kiyota, a businessman representing the FTC, having a vision of 'Reviving Sri Lankan coffee: The lost heritage of the nation', initiated a JICA funded project in Ravanagoda village in Kotmale, a remote mid country hilly area of Sri Lanka, in September 2007. The aim of the project was to produce high quality coffee which could make a significant contribution to the world coffee market. Through community development, rural peasants were mobilized to grow *Arabica* coffee. The partner organizations were the Japan Fair Trade Commission, the Department of Export Agriculture (DEA), the Export Development Board, and JICA. About 225 farmers were grouped into a farmer organization (*Dahemi* farmer organization) and financial assistance was given to grow coffee. The DEA staff members were given training and exposure visits to Japan. A central processing unit was established, housing all facilities to process quality coffee beans.

In 2009, the FTC initiated its second phase of the coffee production program by extending it to another village called 'Piliwela', close to Kotmale. Piliwela

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<sup>9</sup> Where as in 2010 total export volume of tea was 314.3 million kg valuing Rs. 155,376 million.

<sup>10</sup> 1 Sri Lankan rupee (Rs.) = US dollar (\$) 0.008784 = Japanese Yen 0.6748



village was selected with the help of the DEA, and the main criteria were the presence of a low income underprivileged population; the availability of land which could be used to grow coffee; and the closeness to the central processing unit established in Kotmale Ravanagoda village. Piliwela village was named as the 'Sri Lanka-Nippon Friendship Organic Coffee Village' (SNFOCV) with the agreement of all stakeholders. The aim of the social business was to initially plant 3000 *Arabica* coffee plants, and expand up to 10,000 plants within four years. The investment was mainly through money raised from Japanese well-wishers, both companies and individuals. The raw coffee berries produced by the farmers will be bought back on fair trade principles, processed, and then exported to Japan. The roasted coffee will be sold mainly to the investors (donors) of the social business, and other consumers in Japan. In the following section the case study investigates the outputs and outcomes of the social business in SNFOCV, two years after its inception.

*Human capital:* In SNFOCV, initially 32 village families (about 80 percent of families in Piliwela village) that expressed willingness to plant coffee were identified. Most of them were farmers (58 percent), casual laborers working in nearby towns (19 percent) and unemployed housewives (12 percent). Ten out of the 32 members were women. Their main agricultural products are tea and spices, while coffee is grown as a subsistence crop. Table 1 shows the socio economic characteristics of member farmers. They represent a poor stratum of the population having an average monthly income of Rs. 3,000 (about 2,300 yen) and low education standards. Several meetings were conducted by the FTC and DEA to explain the concept of social business to farmers, to mobilize them and to build their capacities.

Planting material and other inputs were distributed among the farmers. Three thousand coffee plants were distributed among the members. Each

Table 1: The Socio-economic characteristics of the members of the SNFOCV, 2012

	<i>Number</i>	Minimum	Maximum	Mean	Std. Deviation
Age of the respondent	29	28	72	47. 24	12. 37
Education level (years)	29	0	13	7. 38	4. 19
No. of family members	29	2	8	4. 28	1. 46
Income per month (Rs.)	29	0	8000. 00	3000. 00	1841. 97
No. of coffee plants	25	50	175	100	33. 85
No. of banana plants	24	12	50	23. 96	9. 01

Source: Field Survey, 2012

member received 50 to 175 plants (100 on average) depending on their land availability and preference. Banana plants were also distributed (ranging from 12 to 50) to intercrop with the coffee as a shade crop. Traditional biodynamic principles were used to find the auspicious times to plant trees, which was done in May 2009. The farmers were trained on soil conservation; the establishment of temporary shade (banana) and permanent shade (*gliricidia*); the planting and maintaining of plants; shade manipulation; fertilizer application; organic manure production and pruning, conducted by the DEA (Senevirathna, et al., 2011).

*Social Capital*: A farmer organization was formed and it was given the task of monitoring soil conservation; the distribution of inputs; planting and maintaining of plants; management of shade; production of organic manure, and processing and marketing of the produce. It is linked mainly to two organizations, the FTC and the DEA. The FTC raises funds; bears the costs of land preparation, planting materials, transporting of inputs, etc.; purchases the coffee beans for processing and subsequently exports to Japan for value addition. The DEA acts as the coordinating agency and bears the responsibilities of giving technical advice, arranging planting materials and means of input transport, and conducting training programs.

*Natural Capital*: There are several advantages in the village with respect to

coffee production in terms of natural resources. Piliwala is located in a picturesque terrain in the Central Province, in mid country close to the Kotmale dam facing the Mahaweli river on one side and paddy fields on the other. The Central Province is the main coffee-growing region of Sri Lanka, mainly due to its climatic conditions (rainfall, temperature, wind, altitude, etc.). As a mono crop, depending on the variety and management practices, 1500 to 3000 plants per hectare can be grown. With proper cultural practices, and good soil and environmental conditions, an average of 1000 – 1500 kg of coffee per hectare can be produced. Also, the main natural capital of the Piliwela farmers was the abundance of unused arable lands.

*Financial Capital:* The DEA has a subsidy program for coffee growers. The total subsidy given to one hectare of coffee is shown in Table 2. The DEA supplies free seedlings to farmers who wish to establish new coffee plantations, and a financial reward for maintaining the plantation according to the expected standards.

Table 2: Coffee subsidy program of the Department of Export Agriculture (Rs. per ha)

Crop	Planting material subsidy	Maintenance subsidy
Arabica coffee	16, 500 – 25, 000	35, 000
Robusta coffee	8, 250	20, 000
Catimor coffee	22, 500	35, 000

The DEA also provides a subsidy for existing plantations to improve the productivity of the crop. This subsidy is given in three installments amounting to: 1.) Rs. 10,000, 2.) Rs. 5000, and 3.) Rs. 5000 per hectare. In addition to supporting cultivation, the DEA has a subsidy program to promote coffee processing. Financial assistance is given for a manual pulping machine (Rs. 5,000); electric pulping machine (Rs. 15,000); huller (Rs. 10,000) and dryer (Rs. 10,000). The subsidies are given to farmer associations to establish group processing centers, central processing centers, and to

individuals to establish private processing centers.

In the Piliwela social business, the FTC raises 1000 yen per coffee plant from Japanese well-wishers through a campaign called “Plant Your Coffee Tree in Sri Lanka”. There are individual well-wishers as well as large companies<sup>11</sup> that invested in the social business as charity, and/ or as a Cooperate Social Responsibility (CSR) activity. Thus each plant has two custodians, Piliwela farmers who nurture the coffee plants and harvest the crop, and those donors who invest in the social business and finally drink coffee produced out of their trees. A donor’s name-tag is fixed to each coffee tree to show his/her ownership.

Out of the money collected from donors, farmers receive Rs 100 (about 75 yen) per plant for soil conservation activities, shade establishment, planting, maintenance of coffee plants and organic manure production (Senevirathna, et al., 2011). This amount is three times more than the current subsidy scheme of the DEA. It is paid in three installments. The first installment (Rs. 30) was released soon after planting, the second installment (Rs. 30) was paid six months after planting and the final installment (Rs. 40) was paid 18 months after planting. An assessment of plant growth level, shade manipulation, weed control and organic manure production was done before payments of assistance by an independent group were made. The DEA has also conducted a training program on pruning and supplied a pruning knife to each planter using donor funds.

*Physical Capital:* The development of the physical capital of Piliwela village was a necessary condition to run the social business sustainably, as it lacks basic infrastructure facilities. The initial idea was to process the coffee in

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<sup>11</sup> For example Maeda Corporation Co., Ltd. (Tokyo) which constructs the Upper Kotmale Dam.

the central processing unit established in Rawanagoda village, which is about 20 km away. This processing unit is equipped with all the necessary machinery: pulping machinery, huller, dryer, weighing scale, sorting machine, and packing machines to process and pack coffee for export. However, the unit still does not have access to water and three-phase electricity, which is necessary to operate the machines. Another major limitation to using this processing unit is accessibility. The main road to the Piliwela village is narrow and not in a satisfactory condition. Commuting and transporting is a real barrier for development of the social business. The DEA is planning to supply a small coffee processing unit through their support scheme to the Piliwela village.

### ***Marketing of Piliwela coffee***

In Sri Lanka, tea has become the main beverage in the last 150 years, and coffee is drunk occasionally as a medicine for stomach ailments and bleeding. Since most of the coffee is produced on a subsistence basis for home consumption, Sri Lanka still uses traditional technology to process coffee powder. Unlike tea, there are neither popular coffee manufacturing companies nor local coffee brands, and hence the coffee market is rather weak in Sri Lanka. Japan is one of the world's largest importers of coffee<sup>12</sup>. Fair trade practice of the FTC allows rural villagers to sell their coffee at about Rs. 160.00/kg more than the average market price<sup>13</sup>.

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<sup>12</sup> In 2009, Japan was the eleventh largest importer of coffee extract in the world, amounting to 17,990 MT in volume and \$120.096 million in value.

<sup>13</sup> In 2011, farm gate price of dry coffee in Sri Lanka was about Rs. 250/kg. The FTC paid about Rs. 410/kg (about Rs. 160/kg more). However, since they use the dry processing technique, the cost of production of the former is about Rs. 200, which results in inferior quality coffee beans, but hardly any additional cost except family labor. For fair trade coffee, the farmer organization claims that cost of product is quite high, which uses a lot of additional labor, electricity, and other inputs needed for sorting, wet processing technique, and packaging.

The coffee beans produced in SNFOCV are purchased and exported to Japan where necessary value addition, such as roasting, grinding and packaging, is done. The finished product produced in Ravanagoda village seems to have good quality and taste on par with Japanese and international standards. Brand name is a major component which decides the marketing cost, the price for the product and the demand. The company has created a good collective strategic brand name called Sripada coffee. Sripada (Adam's Peak) is a mountain 2,243m above sea level in the central highlands of Sri Lanka, which was added to the World Heritage list (Natural Heritage) in 2010. The company is selling this value added coffee mainly through the Japan Fair Trade Commission's online store (<http://www.fairtrade-japan.org>). Coffee is sold to the donors, customers and consumers in most parts of Japan through this web-site. Product differentiation is done by highlighting chemical-free coffee, eco-coffee, and organic coffee with organic JAS certification. Coffee is sold in different forms including Sripada coffee beans – 1000 yen, Sripada coffee powder – 1000 yen, and the Eco-drip coffee pack – 3600 yen. About 10 percent of the sales revenue is donated to the farmer organizations in Sri Lanka.

Coffee is still manufactured in small quantities, perhaps due to the lack of demand. Promotion is done by advertising, and a book published by the main investor K. Kiyota of FTC under the title “As Seen Through Fair Trade Coffee”. In addition, the aforementioned home page is used to raise funds promoting charity work to help and improve the lives of poor people in Sri Lanka, as well as contribute to mitigate global warming by planting a tree somewhere in the world since Japanese have limited space in their home gardens.

### ***Outcome of the coffee producing social business***

The first installment of financial assistance from the FTC to grow coffee

plants was received by 32 farmers. The farmers voluntarily chose to grow coffee, despite the prevailing low prices of coffee compared to tea, and the lower cost of growing tea, perhaps due to the influence of the DEA and Japan's FTC. The success rates of the second and third installments were 79 percent and 66 percent respectively<sup>14</sup>. Seven members were excluded from the social business, mainly due to non-adherence to advice and negligence of cultivation (Senevirathna et al. 2011). By mid 2011, plants reached the reproductive state and started bearing fruits. Financial assistance from donors was terminated according to the agreement. However, assistance from the DEA continued. A coffee pulping machine will be supplied to the farmer organization by the DEA to pursue the wet processing of coffee.

At present, the coffee beans produced are processed using the dry processing technique and sold to village collectors at about Rs. 250 per kilogram of dry coffee beans. Fresh beans could be sold at Rs. 40/kg. The sustainability of the business is determined by the quality of the coffee beans produced, which requires the plucking of only ripened berries, sorting and using the wet-processing technique. However the FTC is neither collecting nor purchasing their coffee at the moment, perhaps due to lack of supply. One of the benefits received by the Piliwela farmers is frequent monitoring of the social business by the DEA and FTC. These remote villages are often neglected and there are hardly any government officers visiting such places otherwise. A considerable success in coffee production has been achieved due to the constant and active involvement by all stakeholders.

Japan FTC organizes "Fair Trade Tours" to Sri Lanka. In addition to popular tourist destinations such as the Pinnawala elephant orphanage, the temple of

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<sup>14</sup> The failure is mainly attributed to drought, twig borer attack, grub attack, inability to follow extension advice and non-attainment of the plants to the required growth level.

the sacred tooth relic, Kandy Perahara, upper Kotmale dam, Dambulla and Sigiriya, SNFOCV is also included in the package. Three groups of Japanese donors and other tourists, along with the main investor, have so far visited SNFOCV during the three-year project period to see the progress. The visits, which are accompanied by cultural events, exchange of gifts, traditional Sri Lankan food like milk rice, rice cake, *kokis*, etc., give great opportunities to rural villagers to interact with Japanese and learn their culture. Some women have been able to sell some of their handicrafts and earn extra money.

This social business is an ongoing one and it is too early to look at its real impact. Although there are many potential benefits to the rural farmers, the business has already faced some serious challenges. Farmers are disappointed, since the FTC has not been able to purchase any coffee from them yet. Since the FTC is not purchasing their coffee, farmers have already started blaming the DEA for promoting coffee, due to which they lost so much income than if they had cultivated tea in their lands. They also say that due to the FTC, they had to grow *Arabica* coffee, which gives a much lower yield compared to the *Robusta/IMY* variety. Though coffee beans resulting from the wet processing method are superior to the dry processing method, only a few farmers (10-20percent) adhere to wet processing. Dry processing seems to be preferred by farmers mainly due to its convenience, low labor involvement, long-term storability, and easiness in milling. Unless there is a significant price difference, farmers will harvest immature and over-maturated berries, not sort the berries, and rely on the dry processing method which will lead to inferior coffee, but does not affect the local market price.

The FTC has also become involved in various social work in Ravanagoda village. The FTC has made promises that they would become involved in similar social work (e.g. building of a community center, pre-school, etc.) in the



SNFOCV as well. Since the FTC is a foreign investor villagers have also expected more financial benefits. These broken promises have seriously affected the sustainability of the social business.

### **Social Business Type B: Social Business of Organic Products**

There is a growing demand for organically produced foods in the world market. This demand is supported by increasing health awareness and environmental concerns. In the early years of the organic movement, producers were isolated and dispersed. With the aim of developing and promoting organic farming social businesses in Sri Lanka, three organizations have taken part in a joint intervention. This intervention started with the partnership of the Department of Export Agriculture (DEA), Bio Foods (Pvt.) Ltd (Bio Foods) and the Small Organic Farmers' Association (SOFA)<sup>15</sup>. At present, about 330 registered organic home gardens are functioning in 679 hectares of land area in the Kandy district.

Bio Foods is the main private sector organization which is investing and coordinating the dedicated farmer groups who produce organic spices under the fair trade concept. The main objective of Bio Foods is to work in partnership with its suppliers to support the rural poor farming community. This general objective is achieved through developing the land of producers conforming to organic agricultural methods, enhancing the socioeconomic standards of the members, helping to improve the educational facilities of family members of the producers, contributing to activities related to religion, culture and society in the area and conducting programs to protect the environment.

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<sup>15</sup> SOFA is a dedicated farmer group, which is producing organic spices under fair trade concept. Closely located small producers are gathered into small blocks and their agricultural fields are inspected and certified as organic by the Control Union – The Netherlands.

These objectives are achieved through the establishment of small organic farmer societies which are federated to form the SOFA in the central region, and which have already been recognized as a sustainable model in Sri Lanka. The objective of the SOFA is to facilitate Bio Foods to achieve its specific objectives stated earlier, and to help their farming communities. The SOFA is a 100 percent independent farmer organization, managed by a Board of Management. This Board of Management consists of the representatives / presidents of smaller societies of organic farmers. The SOFA consists of 26 small farmer societies with a total of 1,536 individual organic farmers. At present, SOFA is registered as a Fair Trade certified tea and spice producer under the Fair Trade Labeling Organization (FLO).

Bio Foods purchases organically produced raw materials from SOFA. These raw materials are processed in their processing centers in Doluwa and Matale. These processed organic spices are exported as bulk and consumer packs under different certifications. The DEA takes all the responsibilities regarding the provisioning of advisory services, training, and provisioning of quality planting material, promotion of the usage of organic fertilizer, and arranging markets. Farmer training is an important part of this intervention.

The majority of producers attached to SOFA are poor farmers. The average land extent is below one hectare. These farmers need assistance to enhance their socio economic standards. Bio Foods conducts awareness programs on agriculture and health through SOFA. Financial assistance for the development programs is mainly given by Bio Foods. It also gives financial aid to farmers to buy spice dryers, two-wheel tractors<sup>16</sup>, etc.

The main advantage for the producers who are involved in this social business is getting an assured market and a higher price than the market price. Though there is no contract between suppliers and Bio Foods, there is

a pre-agreed price for each product in each season. Almost all the spices and tea, which are produced organically, are supported through this social business. Export of organic spices, tea and herbs and other products is done in the forms of bulk and consumer packs under different certifications such as the Japanese Agricultural Standards (JAS), Bio Suisse, Control Union, EU organic, etc. The Demeter logo is used for all biodynamic products. Quality plays a very important role in the export market of organic spices. Regular field inspections are done by authorized officers in order to assure that the producers are maintaining their fields organically. Quality assurance is done through proper documentation and following the process of HACCP<sup>17</sup>.

These organic products are available in both the local and export market under organic labels. As there is a huge demand for organic products in the export market, whatever the amount produced by farmers are purchased by Bio Foods if they are of proper quality. Therefore, farmers do not have to waste time searching for other markets to sell their products. Products are mainly exported to European, Asian and Scandinavian countries, while Japan is one of the main buyers. Product diversification is another important outcome of this social business. Producers cultivate vegetables among their organic spices. These organically grown vegetables have a good demand in the Sri Lankan market. They are being sold at high end markets in a flagship store in the Kandy City Centre, a large shopping mall in Sri Lanka.

Each year, SOFA receives more than Rs. 5 million as a fair trade premium to develop the living standards of their producer members on top of the funds allocated by Bio Foods for development. This is eventually spent on various

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<sup>16</sup> A six hp two-wheel tractor is provided per every third farmer for a very subsidized price of Rs 1,40,000.00. As a result farmers have been able to reduce their labor costs and time for land preparation as well as use it as a means of transportation.

<sup>17</sup> Hazard Analysis and Critical Control Points certificate

development programs prepared by the Board of Management and approved by producers at the Annual General Meeting. Development programs are mainly targeted at affairs related to agricultural development, improvement of land productivity and social welfare activities in the villages, such as drinking water supply projects, education support programs, donation of agricultural tools, religious work, etc.

### **Social Business Type C: Rice Processing Villages**

Rice being the staple food, paddy is the major agricultural crop cultivated in Sri Lanka. Paddy was cultivated on 1,065,000 ha of land in 2010 yielding 4,301,000 MT of paddy (Central Bank, 2011). Paddy farming is a direct source of income for the rural farmers, and many other players in the value chain including input suppliers, transporters, paddy millers and traders of paddy and rice.

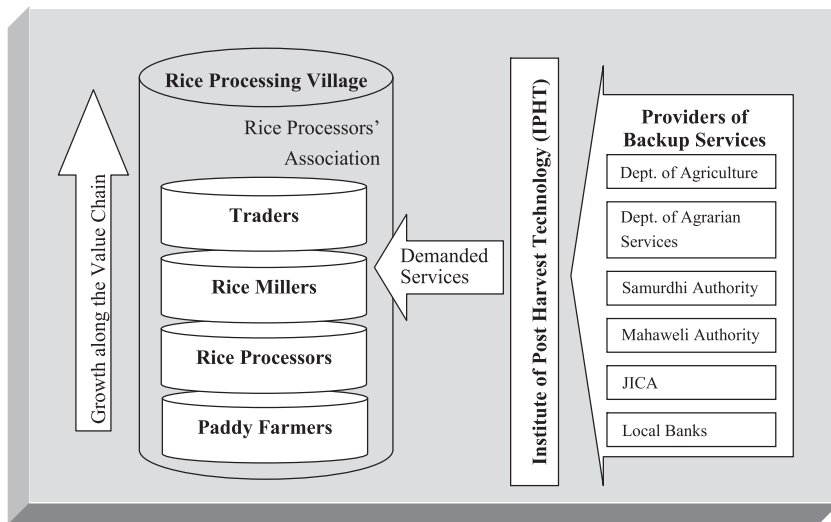
However, particularly small scale paddy farmers in Sri Lanka face several problems. Because of high production costs, farmers are severely indebted at the time of harvesting. This compels them to sell their unprocessed paddy at whatever the price offered by the middlemen (village-level collectors or millers) to repay their loans, taken mainly from informal sources at very high interest rates. The low price offered during the harvesting season results in hardly any income left to reinvest in the next cultivation season, forcing them to rely on more loans. This vicious cycle keeps small scale paddy producers underprivileged, indebted, and poor forever. The middlemen on the other hand, who process paddy into rice in separate large scale rice mills and sell in the market, gain most of the profit. In order to break this vicious cycle, farmers should store their paddy until they get a higher price, or they themselves should process their paddy into rice and sell at a higher price.

Furthermore at present, there are a number of middlemen involved in

between the paddy farmer and the consumer. As the number of middlemen involved is high, the supply chain becomes longer and the share of the consumer rupees that goes to the farmer declines. By shortening this supply chain consumers can get high quality rice at a reasonable price (Gamawelagedara, et al., 2010), while farmers get a higher proportion of the consumer price. In order to break the small scale paddy farmers' vicious cycle by shortening the supply chain, the Research and Development Center of the Institute of Post Harvest Technology (IPHT) in Anuradhapura introduced rural level rice parboiling and processing units to the rural community through the Rice Processing Village (RPV) program.

This RPV program, established as a social businesses of high quality rice processing at the farm level, has led paddy farmers to increase the market value of their produce by selling rice instead of paddy, and thereby increase their income whilst creating self-employment among the rural farming sector. The RPV program initiated at the pilot scale in 2005 (IPHT, 2006) was found to be successful, and thus it was scaled up to cover major paddy cultivating districts in Sri Lanka including Anuradapura, Polonnaruwa, Kurunegala, Ampara, Kandy, Hambantota, Puttlam, and Moneragala. At present there are about 4,000 farm families involved in the program. In addition to training, IPHT's services include facilitating organizational change processes and building linkages among different value chain actors and other back-up service providers (Figure 2).

Figure 2: A value chain approach<sup>18</sup> to RPV development



The IPHT assists small-scale paddy farmers and other players in the rice value chain to increase their access to markets and secure benefits from commercialization through the enhancement of their resource endowments by the formation of five capitals, from the funding of various donors. In this case study focus was given to the RPVs established using JICA funds<sup>19</sup>. The following section elaborates the five capitals formed using JICA funds, in order to develop the RPV social business.

*Human capital:* As shown in Figure 1, villages and areas are initially identified and selected in collaboration with the agriculture-based governmental and non-governmental organizations (e.g. Dept. of Agriculture, Dept. of Agrarian Services, etc.) operating at the grassroots level in the

<sup>18</sup> Adopted and modified from Neuchatel Group, 1999

<sup>19</sup> Funds have been provided through JICA's PEACE Project – Pro-poor Economic Advancement and Community Enhancement Project implemented by the Ministry of Irrigation, which has a total loan amount of Rs. 5039 million.

selected districts. An average of 10 to 20 experienced farm families per RPV are selected in collaboration with these organizations. Most of the members in the RPVs have two acres or less in paddy lands. They generally belong to the low income groups in the villages. An important feature of the RPV is the inclusive targeting of poor rural women in the program. There are also one or two entrepreneurs selected per village who may be comparatively better off, to run the rice mill. They too are members of the Rice Processors' Association and are more entrepreneurial than their counterparts, and act as demonstrators of a successful operation.

Training on theoretical and practical aspects, mainly through demonstrations, is conducted by the IPHT at cottage level, on high quality rice processing (paddy cleaning, soaking, parboiling and drying), milling and marketing, to the selected members. Improved paddy parboiling methods<sup>20</sup> have been introduced to the farmers to produce high quality parboiled rice at the cottage level. Special market oriented training is given to two selected members. Market oriented advisory services, including understanding markets, business planning, record keeping, improving production, as well as advice on legal, regulatory and certification issues, are continuously provided to the members. Know-how to enable value chain players to meet market or value chain quality requirements (e.g. post-harvest handling and storage, product value addition, processing and packaging technology, meeting food safety and agricultural practices standards, consumer rights) is also provided. These members act as the trainers of fellow members and monitoring officers of the RPV. The IPHT also facilitates and stays on par with changes in the value chain management including coordination of production and establishment of collective marketing, negotiation of contracts, legal aspects,

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<sup>20</sup> This improved method has overcome the drawbacks of conventional parboiling such as incomplete parboiling which results in a product with white bellies and poor milling qualities.

and brand development by linking producers to supply chains.

Supervision and follow-ups are carried out to ensure high quality rice production and proper implementation of the project after commencement of rice parboiling and processing activities. Cross-learning also takes place as these competencies on rice processing are transferred to other villagers in an informal way, and so there are farmers who have started their own business after learning the processing techniques.

***Social Capital:*** The IPHT facilitates linkages among different actors along value chains (e.g. convening multi-stakeholder forums to understand market trends and drivers; to foster better mutual understanding and trust; to identify bottlenecks along value chains and devise solutions, and to assist traders and processors to link up with reliable producers). The IPHT conducts awareness programs on the Rice Processing Village program for the selected farm families in the village. Interested people are then grouped into a Rice Processors' Association and established as a community based organization. Social capital can be observed in activities such as procurement, processing, transporting, marketing and branding, and other social activities of the Association. This social capital has facilitated the entrepreneurs to gain other capital assets. Brand name (e.g. *Parakum* rice), another outcome of social capital, is a major component which determines the marketing cost, price for the product and demand.

The RPVs are linked to many local institutions including private, governmental and non-governmental organizations. The IPHT provides technology for quality rice processing and other technical knowledge required. Other organizations such as the Department of Agriculture, the Department of Agrarian Services, the Sri Lanka Samurdhi Authority, the Sri Lanka Mahaweli Authority, local banks, international organizations like JICA,



and NGOs like World Vision, provide various other assistance to the members.

***Natural Capital:*** There are several advantages in the villages in terms of natural resources with respect to rice processing. The RPs are located in paddy cultivating rural areas mainly situated in the dry zone of Sri Lanka. The raw material is either produced by the farmers themselves or easily accessed from neighboring producers. To support par-boiling, firewood and paddy husk are easily available either at their home gardens, nearby forests or their own mill. Paddy drying is facilitated by sunny dry weather, which exists during most parts of the year.

***Financial Capital:*** The improvement of financial capital of the village can mainly be seen in the subsidies given to members, access to formal credit, and establishment of the rural financing system through the Rice Processors' Association. The IPHT provides steam parboiling equipment, which is the main processing equipment used in these villages. An IPHT parboiling equipment set is worth Rs. 4,700.00 (per individual farmer), and is provided under a 100 percent to 50 percent subsidized rate. The funding is given by various donor agencies. JICA's PEACE project provides the parboiling equipment, and IPHT sponsors the establishment of the RPs in addition to developing other infrastructure facilities in the village (agricultural roads, irrigation channels, tree planting etc. The total budget for the establishment of the 10 rice processing villages with 150 farm families is estimated at Rs. 1,002,500.00, which covered equipment supplied to the beneficiaries, awareness and training programs, and follow-up and supervision activities.

As mentioned before, most of the small farmers are indebted at the time of harvesting. Therefore they do not have sufficient funds to process paddy by storing their own paddy or by purchasing paddy. In addition, they lack

sufficient funds to contribute 50 percent of the equipment cost. For each RPV, one or two small scale rice mills are also identified, and these are developed and the technical know-how on the extra machines necessary is provided. However, farmers have financial limitations to purchase the necessary equipment to upgrade their mills. To overcome these problems the IPHT has intervened and established a link with the Rajarata Development Bank, so that farmers and processors can access credit at low interest rates in less time. Members have used these funds to purchase the necessary equipment to parboil and dry paddy and/ or repay the loans obtained, and to keep their paddy for processing. The established Rice Processing Associations also maintain their own micro-finance programs for their members. This has eased accessibility to credit compared to formal financial institutions.

**Physical Capital:** The RPV has not only focused on micro enterprises by providing the necessary processing equipment to villagers but also fosters other support services to run the RPV program sustainably. The roads to the villages are not in a satisfactory condition, which is a necessary requirement for the improvement of the social businesses as well as the development of the village. Assistance was given by the JICA to reconstruct agricultural roads with the help of villagers, which facilitated better transportation

The IPHT parboiling vessel has a capacity of 35kg per batch. In addition, they are given paddy soaking tanks, an energy saving stove, and a drying floor/carpet. The technology they use is mainly manual, and/ or small scale power-driven machines, which is cost effective and more appropriate for cottage industries. A typical rice mill is equipped with a rubber roll sheller, separator, polisher, de-stoner, grader/sifter, and flour milling machine. Several RPV members have also purchased bicycles, motorbikes, 3-wheelers and 2-wheel tractors, used for transportation. It was observed that members

now had access to improved telecommunication facilities, which is important to run an efficient business.

### ***Market for rice and rice based products***

This RPV social business enables the cottage level production of parboiled rice with good colour, no bad odour, and less black grains or broken rice. Having de-stoned, it is also of high quality and high nutrition. The cost of production is significantly less, since processing is undertaken by farmer families using simple technology. The simplicity of technology places itself at the discretion of anyone, also allowing for much less consumption of time. Thus, quality rice can be continuously supplied to the market at a low price by the members of the RPV, instead of just selling unprocessed paddy.

The major rice selling methods in the RPVs are loose and packed forms at home, weekly fairs, offices, retail shops and wholesale shops. The established RPVs supply rice ranging from 500 kg to 3000kg per month to the market. Local customers purchase this rice at the members' houses. Some members collect members' rice and take it to various markets. Some RPVs have created a good collective brand image among their customers and consumers in their respective areas. Rice produced in the RPVs is growing in popularity, witnessing a rapid increase of demand as a result. Shop owners and consumers assert that the rice does not have a bad odor; has a good appearance, and the cooked rice has a good taste. Since the paddy is fresh, the rice produced can be kept for a longer time without spoilage. Some members are involved in the further processing of this rice into various value added products, including rice flour and food items. Farm women in particular prepare various local food products such as hoppers, string hoppers, *laveriya*, etc., and sell them at the local markets.

***Impact of the social business***

The major objectives of the RPV social business are to support underprivileged small scale poor paddy farmers through increasing their income level by promoting and selling rice instead of paddy; initiating agro based self-employment opportunities at a rural level; processing high quality rice at the cottage level; developing small/medium scale rice mills to produce high quality rice; and supplying high quality rice at a lower price to consumers (IPHT unpublished). The IPHT has conducted this program in many of the major paddy cultivating areas of the country, and presently around 4,000 farm families are engaged in rice processing. Employment generation results in better living conditions and higher satisfaction, not only among the employees but also within the family, which are necessary conditions for a sustainable social business. They earn a monthly income of Rs. 10,000 to 20,000. (about Rs. 16,000 per month per farm family). This has proven to be a very successful income generation program at the rural level (Table 3).

Table 3: Economic Benefits of Rice Processing Activities, 2012

Description	Amount (Rs.)
Cost of production for one kilogram of rice	
(a) Paddy (Price of 1kg paddy @ Rs. 30.00; and Rice yield 68 percent)	44.50
(b) Parboiling and milling	4.00
(c) Packaging	1.50
Total cost (a+b+c)	50.00
Sales revenue from one kilogram of rice	60.00
Profit margin per kilogram of rice	10.00
Extra revenue per month by processing and selling rice (assumptions: 35kg of paddy per batch can be parboiled using an IPHT vessel. If a member works 20 days per month	
- Parboil 03 times per day (100kg paddy)	13,600.00
- Parboil 06 times per day (200kg paddy)	27,200.00
Monthly salary of a graduate teacher	17,500.00

Source: Field Survey, 2012

Some of the RPV families have maintained their rice processing as an extra income generating source, which has enabled them to better use their free time available, family labor and other resources. The RPV program thus provides an effective social business to uplift the economic status of the rural farming community. There is considerable improvement in the living conditions of the RPV members, making it possible for them to afford better housing conditions (better roofing, floor and wall types), household equipment like televisions, radios and refrigerators, means of transportation, and telecommunication facilities. The RVP program has also been a useful tool in the generation of team spirit and cohesiveness, and creating social harmony among the farming community.

### **III. Concluding Remarks: Problems, Opportunities and Challenges**

This research was aimed at finding the strengths and weaknesses of capacity building of social businesses through Japanese cooperation in Sri Lanka. Three cases of Type A, B, and C social businesses, having either direct or indirect Japanese cooperation, were studied to achieve the objectives of this research. A Japanese NPO, a Sri Lankan private company, and the Sri Lankan government have respectively invested and promoted these social businesses focusing on poor, underprivileged, and vulnerable groups in rural areas. The investors facilitate capacity building of their resource endowments through the formation of five capital assets (human, social, natural, financial and physical) which have directly resulted in better access to local and foreign markets and subsequently a higher income for the villagers. Human capital development could be observed, with better trained human resources and improved knowledge and skills. Development of social capital was clearly evident by the collective behavior of the entrepreneurs as well as networking with other organizations. The financial capital has improved by direct financial and material assistance; micro financing systems

maintained by the social businesses, and better access to formal credit sources. Infrastructure development and improved technology used reflect the standards of the physical capital of the businesses. Japanese cooperation spearheaded the development of these capitals, empowering the villagers to start social businesses which benefited not only the rural poor, but also their communities. There is a significant difference between traditional micro businesses and social businesses in terms of final outcomes and impacts. Social businesses aim at business development and employment generation, targeting poverty alleviation of the underprivileged vulnerable people in rural areas. Better employment, better monthly income, and higher living standards were the main economic impacts observed in the three cases, with respect to the rural poor. The income generated is reinvested in rural infrastructure development activities such as improving drinking water supplies, building pre-schools and road development. The social businesses have contributed to improving educational facilities for the children of members, and activities related to religious and cultural activities such as alms giving, *pirith* chanting and offering free food and refreshment for pilgrims; and conducting programs to protect the environment, such as soil conservation and tree planting.

Therefore, it could be concluded that social business is a sustainable approach for the development of rural people in Sri Lanka. However, caution should be taken not to mislead rural people, which would take them 'out of the frying pan into the fire'. Endeavoring to make private profit in an ostensible social business is a very likely occurrence in Type A and B social businesses, which could lead to reduced benefits for the poor and threaten the sustainability of the business.

The key ingredient for the success of a social business is education for both producers and consumers. Proper backward and forward linkages in the

supply chain would also be important for the sustainability of the social business. Since a considerable portion of money earned is reinvested for social benefit, appropriate impact assessment tools and indices to measure the performance of the social business will be needed. As this research was conducted using only three case studies, the results cannot be generalized to other similar social business development programs. However, it will be a good trigger to researchers, administrators and policy makers, who are seeking sustainable approaches for rural development in Sri Lanka.

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