

THE STATUS OF CONTRACT FARMING IN MALAWI

By

**Ian Kumwenda
Mathews Madola**

For

Food, Agriculture and Natural Resources Policy Analysis Network

May, 2005

Table of Contents

List of Abbreviations and Acronyms.....	4
1.1 Introduction.....	5
2.1 Contract Farming in Malawi.....	6
2.1.1 Before market liberalisation.....	6
2.1.2 After Market Liberalization	6
2.1.3 Response of the Private Sector	6
2.1.4 Government Policy on Contract Farming	7
2.1.5 Current Status of contract Farming in Malawi	7
Table 1: Current Status of Contract Farming in Malawi	8
2.2 Case Studies of Contract Farming in Malawi.....	8
2.2.1 Illovo Sugar Company	8
2.2.3 Limbe Leaf Tobacco Company and Kasungu Tobacco Farmers Trust	9
2.2.4 Smallholder Tea Authority	9
2.2.5 Paprika	10
2.2.6 Smallholder Coffee Authority.....	10
2.2.7 Cotton.....	10
2.3 Pre-Conditions for successful Contract Farming.....	11
2.3.1 Partnerships.....	11
2.3.2 Management.....	11
2.3.3 Finance.....	11
2.3.4 Strategy	11
2.3.5 Benefits	11
2.4 Key Issues Constraining the Growth of Contract Farming in Malawi	11
2.4.1 Contract Default.....	11
2.4.2 Scale of farmers Operations.....	12
2.4.3 Abuse of Power.....	12
2.4.4 Lack of Facilitating Policies that are relevant to Contract farming	12
2.4.5 Macroeconomic Instability	12
3.0 Conclusion	12
References.....	12

List of Abbreviations and Acronyms

ADMARC	Agricultural Development and Marketing Cooperation
AGOA	African Growth Opportunity Act
ALDSAP	Agriculture, Livestock Development Strategy and Action Plan
CDC	Commonwealth Development Cooperation
DCGT	Dwangwa Cane Growers Trust
KFCTA	Kasungu Flue Cured Tobacco Authority
MIS	Market Information System
MPRSP	Malawi Poverty Reduction Strategy Paper
NAFAM	National Association of Smallholder Farmers of Malawi
SCA	Smallholder Coffee Authority
STA	Smallholder Tea Authority

1.1 Introduction

Following independence the Malawi government followed interventionist economic policies with government both regulating markets and actively intervening in markets through parastatals. The only legal body through which smallholder farmers sold and bought their farm produce and inputs was through the Agricultural Development and Marketing Cooperation (ADMARC). ADMARC guaranteed a market for the entire smallholder farm produce. Government was also the main provider of agricultural extension services and agricultural credit through the Ministry of Agriculture. Extension was mainly based on the transfer of technology approach, whereby information and training were disseminated through supply driven programme while agricultural credit was subsidized through the Smallholder Agricultural Credit Administration.

Since the early 1980s, Malawi has been pursuing market liberalisation policies. Market liberalisation entailed allowing the private sector to participate in input and out marketing of smallholder produce. However, the participation of the private sector in the input and produce trading through the market liberalization policy implemented has had mixed results. While prices received by farmers have been more competitive than before, the high cost of factor inputs after removal of subsidies has made several crops and livestock enterprises less attractive relative to tobacco. Restructuring of ADMARC, which was followed by closure of markets in remote areas created a vacuum, which private traders could not fill due to problems of liquidity, access and transportation to such places resulting in food security problems and a decline in household income (in real terms) (Nthara, 2004).

These economic reforms also have had a major impact on government extension, agricultural credit which in turn has negatively affected the performance of smallholder agricultural production. The reform process, which required government to undertake cutbacks in expenditure including funding to the Ministry of Agriculture greatly, affected the government provision of extension services. The commercialization of credit has resulted in high interest rates pushing out many smallholder farmers out of the credit market.

Market liberalization raises a number of issues from a poverty alleviation standpoint. It is clear that the changes that have been happened because of the economic reforms have not benefited the majority of the smallholder farmers. There is a risk that smallholder farmers will continue to be marginalized and be left out of lucrative domestic and international markets. Contract farming, which is the focus of this paper, can bring potential benefits to smallholder farmers by providing access to new markets, inputs and extension services. Although it should be considered only as one institutional option among others, contract farming is seen as offering potential in that respect.

Although the need to encourage private sector participation in smallholder agriculture has been recognized very little has been done to promote institutions like contract farming in Malawi. In this study, an attempt is made to understand policy, institutional and regulatory issues that need to be addressed in order to promote contract farming in

Malawi. In addition, despite commitments expressed by the private business sector to develop such mechanisms, in reality they seem to be reluctant to do so, particularly regarding the small-scale farming sector: hence, there is a need to investigate what the constraints are and what appropriate policy responses could be.

2.1 Contract Farming in Malawi

2.1.1 Before market liberalisation

Parastatal crop authorities which were formed in the 1970s to promote the production of sugar, tea, coffee and flue cured tobacco practiced some form of contract farming in Malawi. These crop authorities played an important role in the provision of extension services, marketing of the produce, training and information and provision of inputs to smallholder farmers. Farmers were thus assured of a market for their produce at pre-determined prices. However, the reduction in funding, coupled with weak management controls resulted in the collapse of most of the crop authorities in the late 80s and 90s. Government with technical and financial support from donors sought to address this crisis by initiating the privatization of these smallholder production authorities, handing them over and their assets to farmers.

2.1.2 After Market Liberalization

In order to encourage greater private sector involvement in smallholder agriculture, the Malawi government has in the past few years been supporting a number of initiatives which includes loan-finance programmes which it underwrote repayment. The aim was to increase food production through the provision of financial service package for growers to acquire fertilizer. The private sector role was to supply fertilizer and seed inputs and recover the loan either in cash or in kind. These programmes were greatly short-lived and the benefits of such programmes did not outweigh their costs, nether achieving higher crop productivity nor improved loan servicing.

2.1.3 Response of the Private Sector

Agribusinesses have also been reluctant to provide extension services in the context of food insecurity and falling productivity. Businesses were concerned that the risks of investment outweighed the potential benefits. The main factors affecting investor confidence were poor management of smallholder production processes, the inefficiency of under-funded government extension services, the high costs of loan financing and the legacy of loan defaulting. Since the political reforms of the 1990s, smallholder farmers in Malawi have acquired a reputation of non-payment where loans were recoverable from the farmers themselves. Investors were also fearful of market instability and its possible impact on the value of the Malawi Kwacha.

2.1.4 Government Policy on Contract Farming.

The Agriculture and Livestock Development Strategy Action Plan (ALDSAP) developed in 1995 does not explicitly mention contract farming as a strategy to address the problem of marketing in Malawi. Although in the review of the strategy in 1998 stakeholders proposed the promotion of contract farming or out-grower scheme as one way in which produce marketing can be facilitated. But up to date, not a lot has been done to translate these strategies into action. Contract farming in Malawi is still predominantly in the traditional crop.

The strategies to improve agricultural sector performance as outlined in the Malawi Poverty Reduction Strategy Paper (MPRSP) are silent on contract farming. According to the paper, the strategic actions towards addressing the problem of lack of access to domestic, regional and international markets include developing an efficient and effective Market Information System (MIS) through creating a better marketing network, which will link farmers to markets, strengthening extension in grades and standards, international linkages through trade fairs and other buyer/seller meetings, internet access, marketing bulletins and membership of local and international commodity trade associations. Government will also facilitate the development of co-operatives to improve supply development and support market development programmes to capture both domestic and export markets.

2.1.5 Current Status of contract Farming in Malawi

Despite the potential of contract farming in commercialization and diversification of smallholder agriculture, in Malawi contract farming has mainly been confined to the production of Malawi's traditional exports of sugar, tea and tobacco industries. Recently, there has been a growth in contract growing of tobacco especially flue-cured tobacco after the Malawi experienced a steady decline in the production of this type of tobacco. The other main crops that smallholder farmers are growing on contract are cotton and paprika. In the recent past some agro-processors have tried to grow different crops like soya-beans, cassava and birds eye chilies using contract farming but on a small scale. The results have been varied and mixed. This year Bakhresha Grain and Milling has expressed the desire to contract farmers to grow wheat. The major problem cited by many of these companies was side selling. The current status of contract farming that involves smallholder farmers in Malawi is summarized in the table below.

Table 1: Current Status of Contract Farming in Malawi

Raw Commodity	Final Product	Industry Size	Location of the small scale suppliers	Contact Authority
Flue Cured Tobacco	Cigarettes	584 tobacco growers who collectively produced 1,000,000 kg of leaf	Kasungu district	Limbe Leaf Tobacco Company
Flue Cured and Burley tobacco	Cigarettes	Pilot Scheme	Malawi	Dimon Malawi Limited
Tea	Tea	8,000 smallholder farmers	Southern Region	Smallholder Tea Growers Trust and Smallholder Tea Company
Sugarcane	Processed Sugar	1,070 smallholder farmers of which 210 are women	Nchalo and Dwangwa sugar estates	Dwangwa Cane Growers Trust (DCGT) & Illovo Sugar Company
Green Coffee	Coffee beans	2,800 farmers out of which 720 are women	Northern region	Smallholder Coffee Farmers Trust.
Paprika	Spice & food Colorant	60,000 smallholder farmers	Malawi	Cheetah Malawi Limited
Chilies	Spice & food additive	5,640 smallholder farmers	Mulanje	NASFAM
Cotton	Cotton lint	120,000 smallholder farmers	Southern and Central region	Clark Cotton Malawi Ltd.

2.2 Case Studies of Contract Farming in Malawi

2.2.1 Illovo Sugar Company

The Illovo sugar Company runs a smallholder out grower scheme at its mill in Nchalo, Chikwawa and another one owned by government through the Smallholder Sugar Authority at the Dwangwa factory. The company supplies seed, fertilizer, chemicals, irrigation equipment and land development costs on credit to contracted farmers. The company also provides extension services to the farmers. Smallholder out growers have

achieved good technical results and earn good income as long as their repayment of loans (associated with land development and irrigation equipments) are frozen. The structuring of these loans together with the devaluation of the kwacha in the mid 1990s have rendered it impossible for the growers to repay the loans provided by Illovo Sugar Company. The smallholder scheme at Dwangwa which is now privatized and handed over to Dwangwa Cane Growers Trust (DCGT) by government is undergoing expansion with financing from the African Development Bank. The Dwangwa Cane Growers Trust (DCGT) has the overall responsibility of promoting smallholder sugarcane production. The DCGT has entered into management agreement with the Dwangwa Cane Growers Limited to implement the project. The new smallholder scheme at Nchalo, which was funded from commercially borrowed capital, is in dire financial difficulty due to devaluation and high interest rates. Illovo indicates that unless once-off injections of low interest funds are sourced to restructure the debt burden, the scheme will be forced to close down.

2.2.3 Limbe Leaf Tobacco Company and Kasungu Tobacco Farmers Trust

The Kasungu Farmers Trust was formed in 2000. It incorporated the land and assets formerly under the Kasungu Flue Cured Trust (KFCTA) a parastatal, and gave farmers responsibility for the operation of their schemes. Limbe Leaf Tobacco Company saw an opportunity to support and revive the flue-cured tobacco grown by smallholder farmers through direct investment. The company's interest was to stabilize the production of flue-cured tobacco for Malawi. Since 1991, production of this type of tobacco in Malawi had fallen sharply from 25.7 million kg to 8.2 million kg in 2001. The fall was attributed to rising cost of production against a background of falling prices.

Limbe Leaf then entered into a partnership with Kasungu Tobacco Farmers Trust to support the production of flue-cured tobacco. The partnership was an experiment of private sector investment into tobacco contract farming, making a departure from the tenant tobacco farming. The partnership provided farmers with a comprehensive input package, covering maize and tobacco. The growers were also provided with capital to employ adult labour and maize ration to support their food requirements. Limbe leaf provided technical expertise to supervise and manage the enterprise and an administration team to manage the financial investment and oversee loan repayment.

Both farmers and Limbe Leaf achieved successes. For Limbe leaf, the partnership ensured an increase in high quality flue cured tobacco (production actually doubled) whilst loans were fully recovered. The growers benefited from higher yields and greater profit. Many growers in fact have doubled their profits.

2.2.4 Smallholder Tea Authority

Smallholder Tea Authority (STA) established in 1967. It was a partnership between government and Commonwealth Development Corporation (CDC) in which government provided the extension staff while CDC financed the planting. Initially smallholders sold

leaf to estates but in 1975, a smallholder tea factory was built financed by government through ownership of Smallholder Tea Authority and ADMARC

Key Elements of STA

Provided free seedlings to farmers to establish plantations

Free extension

Inputs and maize on credit

Lead collected and weighed near farm then transported to factory

Farmers received an initial payment normally within ten days.

Second payment was related to auction prices at the end of the company's financial year

2.2.5 Paprika

In recent years Malawi has emerged as a player in the expanding world market for paprika, which is used both as a colorant and a spice. Although there are now about five companies involved in the collection and sale of the crop, only two companies have been actively involved in promoting the crop by contract farming (through the provision of seed and extension services). The number of smallholder farmers growing paprika has increased exponentially in recent years. It is estimated that there are about 60,000 smallholder farmers growing paprika on contract in Malawi

2.2.6 Smallholder Coffee Authority

Smallholder Coffee Authority (SCA) was established in 1971 by the Government of Malawi to promote and foster commercial production of coffee by smallholder farmers. In the period 1979 to 1996, the SCA was responsible for the supply of inputs, the provision of credit and extension services and the processing and marketing of coffee produced by smallholder farmers. The SCA failed to attain commercial and financial sustainability and continued to rely on government subvention and donor support. This was caused by a number of reasons including poor management, high costs of operations, low production by farmers due poor price incentives and poor export marketing. In 1998, SCA was privatized and Smallholder Farmers Trust took over its assets.

2.2.7 Cotton

Cotton has traditionally been an important cash crop in Malawi especially in the lakeshore districts and in low-lying areas where the climate and soils are not suitable for tobacco. Declining profitability, the face of sharply reduced international prices in the past few years led to steady decline in the production of cotton in Malawi. Historically, a major proportion of the ginned Malawi cotton was sold to domestic garment or textile companies, with the balance of the crop exported as lint within and outside of the region. The downsizing of the garment and textile industries since the early 1990s has resulted in a pattern whereby the bulk of the seed cotton is ginned and then exported as lint.

The opportunities presented by AGOA and the demand for cotton in South Africa have re-kindled the interest in cotton production. The joint venture between South African

Clark Cotton and ADMARC on one hand and Great Lakes company are contracting over 100,000 smallholder farmers to grow cotton. The arrangement does not however involve a pre-agreed price although the company provides inputs and extension advice to farmers.

2.3 Pre-Conditions for successful Contract Farming

2.3.1 Partnerships

A private sector-smallholder partnership must be based on common goals, with the planned results practically defined and roles and relationships and responsibilities clearly established. The strengths of the partnership rests in a joint-stake holding, which should encompass managerial, financial, institutional and resource ownership arrangements.

2.3.2 Management

A systematic management of the production process is necessary to guarantee good crop yields, high quality and derived financial benefits. The farmer's role in management is necessary to ensure that the growers concerns are heard and that the productivity enhancement concept is accurately communicated.

2.3.3 Finance

Tight financial control should be maintained throughout, supported by accurate and transparent record keeping.

2.3.4 Strategy

Social issues including food security, labour and safety nets should be supported within the programme as these livelihood factors ensure that the grower remains capable and committed to performing his role.

2.3.5 Benefits

The partnership must provide a win-win result so that parties involved derive immediate material benefits. Early benefits provide the basis for further commitment from farmers in the pursuit of long-term common goals

2.4 Key Issues Constraining the Growth of Contract Farming in Malawi

2.4.1 Contract Default

A company may break a contract with farmers for example by failing to deliver farm inputs and services at the correct time, reduce to receive a produce or arbitrarily raising quality standards and late payments. Farmers can also default sometimes because of a production failure or simply because farmers have sold the produce to competing buyers partly to avoid repaying debts. The absence of strong legal systems, the lack of collateral held by smallholder farmers and weak insurance systems create a considerable risk for farmers entering into contracts.

2.4.2 Scale of farmers Operations

Potentially high transaction costs in for example in service delivery and monitoring tend to result in the exclusion of smallholder farmers in contract farming. Also the production risk of smallholder cultivation may also be higher especially in rain-fed marginal lands. Larger farmers may have better crop management skills and have greater access to extension services reducing the risk of crop failure. In Malawi, the production of hybrid maize seed on contract has mainly excluded smallholder farmers.

2.4.3 Abuse of Power

There is inadequate protection of smallholder farmers against firms that hold dominant market positions and corrupt behaviour of agribusiness firm employees. Corrupt employees may get kickbacks from purchases of farm inputs supplied to, and eventually paid for by, contracted smallholder farmers. Delivery may also present opportunities for corruption in different quality standards or delivery schedules are applied to different growers.

2.4.4 Lack of Facilitating Policies that are relevant to Contract farming

There is a need for government to create a desirable policy environment for contract farming including paper work for exporters, reducing some taxes and introducing specific regulations that facilitate contract farming. Government may also facilitate contract farming through training, arbitrating disputes, undertaking research and provision of extension services.

2.4.5 Macroeconomic Instability

In particular instability of the exchange rate and the reduction of the interest rates and inflation in order to improve the environment for the private sector.

2.5 Conclusion

To establish an agrarian economy that ensures food and nutrition security to its growing population, raw material for an expanding industrial base, surpluses for export and a fair and equitable rewarding system for the farming community, 'commitment driven' contract farming is in no doubt a viable alternative farming model that provides assured and reliable input service to farmers and desired farm produce to the contracting firms.

References

Malawi Government (2002) "Malawi Poverty Reduction Strategy Paper

MASIP (2001), "Agricultural Sector Priority Policies and Strategies Framework for Malawi"

Ministry of Agriculture & Irrigation (1995), “The Agricultural and Livestock Development Strategy & Action Plan” Ministry of Agriculture & Irrigation

Nthara K, (2004) “ Issues in agricultural Marketing in Malawi and Agenda for Reform – Final Report”