PD-AAZ-568

EVALUATION OF THE DIVESTITURE PROGRAM OF THE AGRICULTURAL DEVELOPMENT AND MARKETING CORPORATION

"ADMARC"

MALAWI
1986 - 1989

Report by

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NOTE ON CURRENCY

The unit of currency in Malawi is the Malawi Kwacha. It has slowly declined in value over the period the Admarc Divestiture Program has been underway. The current exchange value is US $1 = MK 2.67.

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NOTE ON CASE STUDIES

In connection with the Evaluation, case studies were prepared for and submitted to the USAID Mission, Malawi, describing in detail the following transactions mentioned herein:

Kavuzi/Mzenga Estates
National Seed Company
Grain and Milling Company

These case studies have not been included as a part of this report.

ABBREVIATIONS USED IN THE TEXT OF THIS REPORT

Admarc	The Agricultural Development and Marketing Corporation
CDC	Commonwealth Development Corporation
DH&S	Deloitte Haskins & Sells
EEC	European Economic Community
FMO	Netherlands International Finance Organization
GOM	Government of Malawi
Gramil	Grain and Milling Company Limited
IC	Investment Coordinator
ICO	Office of the Investment Coordinator
IFC	International Finance Corporation
IMF	International Monetary Fund
Indebank	Investment & Development Bank of Malawi Limited
MDC	Malawi Development Corporation
Noil	National Oil Industries Limited
NSCM	National Seed Company of Malawi Limited
Oilcom	Oil Company of Malawi Limited
PTC	Peoples' Trading Company
RLDC	Relatively Least Developed Country
Sucoma	The Sugar Corporation of Malawi
UNDP	United Nations Development Program
USAID	U.S.Agency for International Development

ADMARC DIVESTITURE EVALUATION

EXECUTIVE SUMMARY

The Agricultural Development and Marketing Corporation (Admarc) was established as a Malawi parastatal in 1971 to engage primarily in crop marketing for smallholders and assist agricultural development. Until the early 1980's it enjoyed substantial profits, which were invested in agricultural estates (large farms), industrial and financial enterprises. Operating losses in these entities coupled with adverse crop marketing developments in the early 1980's led to a deterioration in the liquidity necessary to Admarc's basic functions. In 1986, as a part of a structural adjustment program funded by the World Bank, the decision was made to divest some of Admarc's investments to restore its liquidity. The goals of this program were (1) to restore Admarc's liquidity to enable it to fulfill its basic crop marketing function and (2) to enable Admarc management to focus its efforts on that primary responsibility, relieved of the necessity of managing a wide variety of unrelated assets.

USAID offered to provide funds to support the privatization of the entire Admarc portfolio through balance of payments credits in recognition of asset sales completed. To carry out this program the GOM entered into a contract with Deloitte Haskins & Sells (DH&S) to provide technical assistance also financed by USAID. DH&S developed a strategy for the program and provided an Investment Coordinator (IC) who began work in July, 1987.

Admarc assets designated to be divested under the program had a book value as of March 31, 1985 of MK 47 million. As of March 31, 1989, after a little over two years of actual work on the program, sale of nine estates and three companies had been completed and sales of a further seven states were in process. At that date the aggregate value of the assets divested totalled MK 34.6 million and Admarc had received net cash proceeds of MK 14.7 million; USAID had provided the GOM with US $11.55 million in balance of payments support. A further US $ 3.45 million is expected to be disbursed before June 30, 1989. Work is continuing with respect to preparation of other assets for sale.

In January, 1989 the USAID Malawi Mission requested an evaluation of the program by the Center for Privatization and the team to carry this out was selected. The Scope of Work for the team embraced all aspects of the Admarc divestiture program.

Based on extensive interviews in Malawi and in Washington, London and elsewhere in February and March, 1989, and on our own considerable experience with divestiture and privatization in other developing countries, it is the team's conclusion that the Admarc divestiture program has been a success to date. While the program has at least another year to go, its success may be measured chiefly by the already visible improvement in Admarc's liquidity and the manifest improvement in the ability of management to concentrate on Admarc's basic function. Other evidences are the growing interest of GOM officials in privatization and the private sector, and the significant injection of capital and technical and management skills in many of the properties sold or to be sold.

The team has also concluded that:

1. The interest of USAID in the divestiture project and the Mission's financial support have been important to its success, both in getting it underway and sustaining GOM attention. However, the lack of any requirements or conditionality in its contract with the GOM for financial support has limited its ability to impose or influence objectives and standards in the divestiture process.

2. DH&S have handled the Admarc divestiture contract well; we believe their excellent systematic approach is responsible for much of the success achieved to date. They have worked hard under their host country contract to maintain high standards.

3. The pace of privatization of Admarc investments has been relatively rapid compared with experience elsewhere, and should be commended.

4. The Government of Malawi (GOM) is committed to the private sector and divestiture of Admarc holdings, although in certain instances the GOM has insisted on keeping a minority interest in properties where they feel there is a continuing concern for the national interest. GOM officials are generally well satisfied with (1) the technical assistance received from DH&S and (2) the progress to date in terms of assets sold and arrangements for other sales under way. Although some feel it has been slow, they appear to tend to count from first discussions in 1986, and are influenced by early expectations which experience in Malawi and elsewhere has demonstrated were overly optimistic and unrealistic.

5. The visible progress of the Admarc program has led to an increased interest among GOM officials in the private sector and in the prospect of other future privatization projects.

6. The proposed unit trust is an idea well worth developing to take advantage of the availability of Admarc assets, assuming securities sold to the trust will be of high quality and well diversified (including securities obtained from sources other than Admarc). It is timely for investing institutions and appears to have real potential as a first step in creating an equity capital market accessible also to individuals, and facilitating future GOM privatization undertakings.

7. The Contract between the GOM and DH&S should be extended for another year, and the present Investment Coordinator (IC) should be retained. He is widely respected in government and private circles for his energetic and impartial conduct of the program on behalf of Admarc.

8. It is important that financial support be continued by AID, consisting of:

(a) Continued technical assistance, and there may be some merit in increasing the budget for short term services. Remaining expected needs for short term consulting include policy studies associated with certain divestitures yet to be completed, establishment of a holding company for residual investments, and further capital market work, including establishment of a unit trust or mutual fund holding some of Admarc's investment quality securities and some of those of other national Malawi institutions.

(b) Continued provision of a "carrot", such as the original grant of balance of payments funds payable with respect to completed sales. There is no question that the Finance Ministry has focused on rewards provided by USAID and with their leadership the GOM became firmly committed to the program. It is important to maintain an incentive which will assure continuing senior financial attention and support. Whether this should be balance of payments support or some other form of "carrot", how it should be triggered, whether some conditionality can be introduced to influence performance standards, and by what donor assistance should be provided can be best determined by the Mission in the light of its overall programs in Malawi and those of other multilateral and bilateral donors (but it is important that a hiatus not occur). We have found the cooperation and coordination among donors in Malawi to be excellent and commendable.

(c.) Whether through (a) above or otherwise, AID might wish to consider, possibly with IFC or other donor(s), providing financial support for the establishment and initial operation of the proposed unit trust, and possibly for a local currency liquidity line of credit. Objectives and standards for these could be negotiated. We also suggest that USAID consider providing local currency co-financing facilities to finance the purchase of industrial companies.

9. The Divestiture Committee is an effective body for inter-ministry consultation, supervision and government policy direction of the divestiture process. We feel it is not necessary, and possibly undesirable, for USAID to be represented in its meetings. It is important, however, that the IC (and/or the GOM) keep USAID informed of developing issues as they arise so that it can engage the GOM in policy dialogue on a timely basis.

10. Divestiture in Malawi is severely hampered by the lack of a developed capital market and a very small number of potential buyers with sufficient capital to take on Admarc assets. A commendable effort has been made to identify new buyers and to consider means of involving smaller purchasers or joint purchases to broaden ownership. However, many sales represent (sometimes unnecessarily) a continuation of the concentration of ownership of farms and industrial enterprises, with its potential for abuse of monopoly power. While there has been a willingness to seek foreign technical partners, the reluctance to sell to resident Asians has precluded access to an important source of capital and management expertise.

11. Sales to the Press Group represent continuation of the pattern of concentrated ownership in Malawi. The Press Group, the largest enterprise in Malawi, is a conglomerate with extensive holdings in many sectors of the economy, and has a special relationship with government which may lead to preferential treatment. It has been a major purchaser of Admarc assets of which in some cases at least a partial share could have been sold to other buyers. It clearly does not meet any test of diversification of ownership. However, on the plus side, its interests lie within Malawi, it is efficiently and profitably managed, it commits a considerable amount of managerial resources to its subsidiaries and has an active program of bringing Malawians into senior positions.

12. In some cases sales will not represent a transfer of control to the private sector meeting the classic definition of privatization. This will have to come as a gradual process, in which the proposed unit trust is a significant next step. Another step should be the creation of a holding company for all remaining Admarc investments, with independent directors and only passive investment supervision at arm's length. A separate holding company to be transferred to the Ministry of Finance (or Statutory Bodies) might be considered, if it appears administratively feasible, to complete Admarc's divestiture of securities not being retained to protect national agricultural interests.

The detailed report which follows describes the background of the Admarc program, the strategy and techniques of the divestiture process, the results to date, the roles of USAID and the various interested entities and the lessons to be learned about the privatization process from the Admarc experience to date. Chief among the latter are:

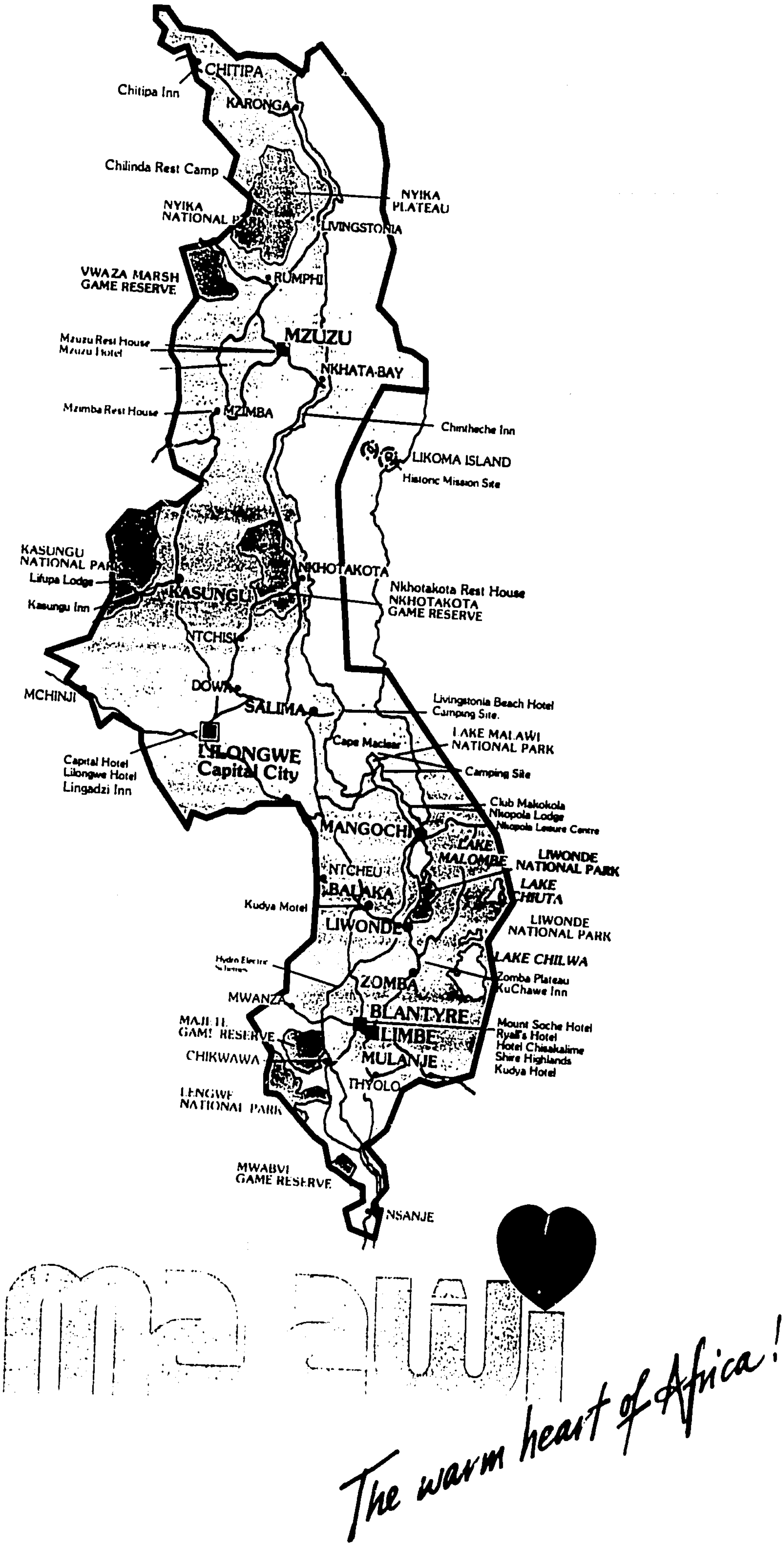
Strong commitment at the top of government is crucial to success.

A systematic approach to the divestiture process can contribute materially to effectiveness.

Divestiture can be most effective (and least controversial) when undertaken in the context of solving a problem.

Valuation is less likely to be a problem when specific business and economic goals are the focus of a privatization program.

USAID can materially assist the process through provision of technical assistance and an incentive.


CHITIPA
Chitipa Inn
KARONGA
Chilinda Rest Camp
NYIKA NATIONAL PARK
NYIKA PLATEAU
LIVINGSTONIA
VWAZA MARSH GAME RESERVE
RUMPHI
MZUZU
Mzuzu Rest House
Mzuzu Hotel
NKHATA-BAY
Mzimba Rest House
MZIMBA
Chintheche Inn
LIKOMA ISLAND
Historic Mission Site
KASUNGU NATIONAL PARK
Lifupa Lodge
Kasungu Inn
KASUNGU
NKHOTAKOTA
Nkhotakota Rest House
NKHOTAKOTA GAME RESERVE
NTCHISI
DOWA
MCHINJI
SALIMA
Livingstonia Beach Hotel
Camping Site.
Capital Hotel
Lilongwe Hotel
Lingadzi Inn
LILONGWE
Capital City
Cape Maclear
LAKE MALAWI NATIONAL PARK
Camping Site
Club Makokola
Nkopola Lodge
Nkopola Leisure Centre
MANGOCHI
LAKE MALOMBE
LIWONDE NATIONAL PARK
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LIWONDE
LIWONDE NATIONAL PARK
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KuChawe Inn
ZOMBA
MWANZA
BLANTYRE
LIMBE
Mount Soche Hotel
Ryall's Hotel
Hotel Chisakalime
Shire Highlands
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ADMARC DIVESTITURE PROGRAM

MALAWI

EVALUATION REPORT

Introduction

In January, 1989, the Center for Privatization was asked by the USAID Mission in Lilongwe, Malawi, to organize a team to evaluate the program of divestiture of the investment properties of The Agricultural Development and Marketing Corporation (Admarc) which has been carried on since late 1987 under a host country contract with Deloitte Haskins & Sells (DH&S) financed by USAID. Members of the team were in Malawi from March 7th to April 1st and made a careful and detailed study with extensive interviews with government officials, DH&S personnel, USAID officers, Admarc officers and directors and a large number of representatives of the parastatal and private business sectors. The team's conclusions make up the body of this report.

BACKGROUND AND GENESIS OF THE PROGRAM

Malawi

Malawi, located in south central Africa, is the former British Protectorate of Nyasaland (later a member of the Federation of Rhodesia and Nyasaland) and has been independent since 1964. It consists of 45,750 square miles with a population estimated at 7.9 million (1987) and an annual growth rate of 3.7%. Average population density is 610 persons per square mile of arable land. Per capita income is about US $150. Malawi's main resources are favorable climate conditions (generally adequate rainfall), fertile land and a hard working labor force. The population engages predominately in small-scale subsistence agriculture. Principal exports are tobacco, tea, sugar, confectionary grade groundnuts (peanuts), cotton and coffee.

Malawi is a republic with a unicameral parliament and a single political party, the Malawi Congress Party. It has been governed since independence by His Excellency the Life President Ngwazi H. Kamuzu Banda, who is also President of the party and Minister of several key ministries including External Affairs, Agriculture and Justice. His rule has been firm but benevolent and his basic policy approach has been highly pragmatic, not ideological, and is generally recognized as successful in bringing about major improvement in one of the poorest of the relatively least developed countries (RLDC). His regime has been marked by political stability since independence, and Malawi's foreign policy has been anti-communist and pro-Western. While it deplores apartheid, it maintains diplomatic and trade relations with, and accepts investment and financial help from South Africa. The country is highly dependent on concessionary financial assistance from the international and bilateral donor communities.

Malawi has had a generally good economic performance, resulting from the GOM's agriculture-based and free market-oriented approaches to development. From 1965 to 1980 GDP grew at 5.8% per annum. Droughts and other developments mentioned below have brought this rate down to 2.0% in recent years. Major steps have been taken in the past several years to improve management of agriculture and key industries, with renewed emphasis on the private sector.

Admarc Background

During the 1970's the Government of Malawi (GOM) grew increasingly active in the economy, establishing a series of parastatals to participate in or control various production, marketing and investment functions. Reflecting the overwhelming importance of the agricultural sector to Malawi and its development prospects, Admarc was one of the first of these. It was established by Act of Parliament in 1971 to assume crop marketing activities of the Farmers Marketing Board. Admarc was charged with buying, storing, processing, grading, transporting and selling smallholder produce, and has a legal monopoly to do so for tobacco and cotton. Parliament also authorized Admarc to invest in or lend to any private, public or Government "works, undertakings, projects, schemes or enterprises relating to the development or improvement of the economy of Malawi".

Until agricultural producer prices were raised in the late 1970's and the early 1980's, Admarc enjoyed substantial profits from its market trading accounts. Producer prices were low relative to selling prices. These profits were ploughed back into the economy in the form of investments in agricultural estates (large farms), agro-businesses, finance and industry. Unfortunately, much of the investment portfolio acquired by Admarc consisted of loans and assets which have had a history of poor performance.

With the narrowing of the differential between producer and crop selling prices, Admarc had fewer financial resources to underwrite the losses and meet the loan requirements of its investments. Admarc's difficult financial situation was exacerbated in the early 1980's by the rapid increase in transportation costs of exports and imports resulting from the closure of the rail links to the sea through Mozambique because of civil war.

Adoption of the Divestiture Program

In early 1986, as a part of the supplement to the third structural adjustment program funded by the World Bank, the decision was made to divest some of Admarc's investments to improve its liquidity situation and enable it to fulfill properly its basic crop marketing responsibilities. After some initial productive work by the Bank-supported financial controller of Admarc, USAID offered to provide funds to support a broadened program for privatization of all of the Admarc portfolio, and a Grant Agreement with the GOM was signed in August under which for each MK 3 (at the greater of book value of the asset or sales price) divested by Admarc, the GOM wouldreceive US $1 in balance of payments support to a total of US $10 million. An additional US $5 million of foreign exchange can be disbursed against either (1) further divestiture or (2) the adoption of a strategy for dealing with assets remaining unliquidated with maximum participation of the private sector in the ownership and management of equity shares and financial and managerial independence from Admarc.

To carry out this program the GOM entered into a host country contract with DH&S providing for technical assistance financed by USAID, under which an Investment Coordinator, Mr. Charles Twyman (IC), has been in residence in Malawi since July, 1987 as a representative of DH&S. The two-year (renewable for a third year) contract also provides for short term technical assistance. Performance under the DH&S contract and the Grant Agreement is the subject of this evaluation, the Scope of Work for which embraces all aspects of the Admarc divestiture program.

The genesis of this program, whereby USAID stepped in to help implement a key aspect of the World Bank structural adjustment activities, is an excellent example of the close donor cooperation and coordination which prevails with regard to Malawi among the Bank, the IMF, IFC, UNDP and the EEC as well as bilateral donors. We find this donor cooperation highly commendable and all too unusual. Donors keep abreast of each other's activities through periodic meetings of their representatives, in most of which the GOM participates on a regular basis. At the outset of each new major project, the Ministry of Finance convenes a donor meeting to review it, and similar meetings are held at the conclusion of new IMF agreements. Bank representatives strongly supported the USAID successful efforts to gain positive acceptance of the program by Admarc's General Manager, and continue to keep informed on progress in the divestiture program through frequent meetings with the IC and other senior DH&S personnel. The two initial sales of Admarc assets, Lever and P.E.W., resulted from the Bank's earlier work.

When the intention to divest Admarc assets was first discussed in government circles in Malawi, considerable resistance was encountered in the Ministry of Agriculture and in Admarc itself, neither of which had been a part of the initial GOM policy dialogue. They were concerned to assure that (1) they would have a say in whether and to whom certain estates and agro-industrial enterprises would be divested and (2) there would not be "fire sale" pressure by the Ministry of Finance to obtain the balance of payments credits. However, a period of consensus building coupled with the complete endorsement of the program at the highest political level, expressions of concern gradually ceased and there is now wide support for the program.

We find there is a strong commitment to the program now throughout the GOM, starting at the highest level. This is reflected in a general and growing commitment to the private sector, because there is an increasing recognition that it is in that sector that the needed management skills, motivation and finance are found and that government's role can be to work with the private sector on policy concerns and fulfill merely a regulatory role rather than trying to run productive enterprises themselves. The GOM pragmatically considers privatization as a powerful tool to accomplish its goals, rather than an end in itself.

THE DIVESTITURE PROCESS

Strategy Considerations

At the time the Admarc divestiture program was undertaken the book value (as of March 31, 1985) of the investment assets of Admarc was determined to be MK 46.9 million, excluding loans but including share capital and direct investment in unincorporated entities. Holdings included:

- 13 Agro-industrial Corporations
- 3 Financial Institutions
- 6 Transport and Industrial Corporations
- 17 Estates
- 4 Development Projects

Three agro-industrial corporations (Sucoma, Dwangwa and David Whitehead), together with Kavuzi Tea Estate, accounted for over 70% of invested share capital. Return on equity averaged 7.22% on total holdings; including borrowings the return on capital employed was about zero. Only one of the nine corporations wholly owned and managed by Admarc had a positive return.

Because of the absence of a capital market in Malawi the potential sources of funds for purchasing the assets was limited. These included existing shareholders (many foreign) and a very small number of new active investors. Management and employees would be an additional source, but lack of financial capability and management expertise were severely limiting factors. To avoid transfer to or creation of a monopoly position in the private sector, promote Malawian ownership and develop a more diverse capital market, new passive investors (and existing lenders such as insurance companies and pension funds) were targeted. There was, however, an excluded class of potential investors, the Asian community.

Categorization of Admarc Assets and Priorities for Sale

At the outset of their assignment DH&S determined that the Admarc assets needed to be categorized in the light of the aims of the divestiture program. This had the effect of providing a logical framework for understanding the nature of the asset and directions for its eventual disposition. The IC first prepared reports summarizing the condition of each asset. He then graded them against five tests developed by DH&S to enable the Divestiture Committee to consider a rationale for the future of each asset. The tests were:

1. <u>Core test</u>: is the asset part of Admarc's core business?
2. <u>Strategic test</u>: does the asset perform a strategic function related to Admarc's core business?
3. <u>Buyer test</u>: are there buyers interested in purchasing all or part of the asset?
4. <u>Kwacha test</u>: can the asset be sold for at least as much as an auditor's independent valuation?
5. <u>Timing test</u>: can the asset be held and sold in the future for a greater amount (in net present value terms) than can be realized now?

After this grading, DH&S working with Admarc placed each asset in one of five "tiers", or categories, as follows:

I. Full divestiture through negotiated sale or competitive bid
II. Divestiture through negotiated sale or a public share offering
III. Partial divestiture through negotiated sale
IV. Restructuring prior to divestiture
V. Retention by Admarc

The Divestiture Committee, which ultimately approved the categorization, has retained the authority to make changes and has done so on more than one occasion. Plans for several companies first scheduled for total divestiture will now involve Admarc retaining a minority interest, indicating that the system is being applied with some flexibility. Giving effect to changes the listing is now as follows:

<u>Tier One</u>
All farms and estates
Cattle Feedlot Company Ltd.
Maldeco Fisheries Limited

<u>Tier Two</u>
Finance Corporation of Malawi Limited (Fincom)
National Bank of Malawi
Optichem (Malawi) Limited
United Transport (Malawi) Limited

<u>Tier Three</u>
Auction Holdings Limited
National Seed Company of Malawi Limited (NSCM)
Kavuzi Tea Estate
Grain and Milling Company Limited (Gramil)
David Whitehead & Sons Limited
National Oil Industries Limited (Noil)
Cold Storage Company Limited
Sugar Corporation of Malawi Limited (Sucoma)

<u>Tier Four</u>
Admarc Canning Company Limited
Dwangwa Sugar Corporation Limited

<u>Tier Five</u>
Investment & Development Bank of Malawi Limited (Indebank)
Malawi Tea Factory Company Limited
Manica Freight Services (Malawi) Limited
Cotton Ginners Limited
and
Income Notes of Press Corporation Limited

While the categorization process was going on, the IC contracted for the valuation of the estates, all in Tier I, so that the divestiture process could begin promptly. As the other entities were categorized, auditors were retained to value them. The process, however, has directed efforts toward readying Tiers I and III assets, since other considerations must be dealt with before entities in Tiers II and IV can be divested. Through this process a functional form of prioritization has been achieved, although work is proceeding simultaneously with regard to all tiers.

The review of each entity and its subjection to the five tests, represented a first comprehensive review of the Admarc portfolio by Admarc officials and the Divestiture Committee. It had the effect of developing a consensus that Admarc is better off concentrating on its marketing responsibilities, and cast the divestiture program as a positive step toward a positive objective, rather than the punitive result of the mismanagement of assets. These procedures could very well be replicated elsewhere in the developing world where assets of government entities similar to Admarc are to be divested.

Valuation of Assets for Sale

The valuation placed on assets to be sold did not, in the Admarc case, become the critical political issue it has been in many countries undertaking similar programs. This may well reflect the goals of the Admarc program, which appear to have been, or developed to be, obtaining a reasonable price in a sale that would:

- Recover as soon as possible the liquidity required for Admarc's core crop marketing program
- Give preference to Malawian buyers
- Obtain a technical partner where appropriate and desirable
- Assure efficient use and development of assets divested
- Avoid transformation of a public monopoly position into a private monopoly
- Broaden the ownership of estates and companies

It was also important that the book values for the Admarc assets were conservative. They had not been extensively written up to artificial values as has frequently been done elsewhere. At the same time, the USAID balance of payments credits provided a cushion by assuring the GOM that the benefit to it of a sale would never be less than book value. This benchmark had been set to avoid "fire sales" to obtain the credits.

The approach to valuation as a basis for determining possible sale prices has been professional. The IC felt that, given his role, he should not be involved in the actual preparation of valuations but rather assure quality control of the process. Experts were selected carefully and their work reviewed.

In the case of the agricultural estates, it was found that the National Bank of Malawi, a respected institution, had a subsidiary with a highly qualified staff specializing in performing estate valuations for outside clients. Their work was accomplished promptly, consistent with the perceived need for speed, and a standard of uniformity was maintained which avoided risks of manipulation.

In the case of the commercial, financial and industrial companies, outside accounting firms were employed. The review of their valuations for purposes of this report is included herein as Exhibit II. It showed that their quality varied widely. Those for the most valuable assets, prepared by DH&S, are of high quality and involved highly sophisticated computer models, particularly useful in negotiations. Several of the others were found to provide insufficient detail of information to substantiate the values at which they arrived. These will be redone before negotiations start, since the valuation is an important tool in that process. At the same time, since there are a number of valuations yet to be done, we recommend that the IC make clear to outside auditors undertaking valuations what data he expects to find in their valuations. A sample check list is included in Exhibit II.

Restructuring and Rehabilitation

The Admarc divestiture program is a fundamental departure from earlier parastatal restructuring activity in Malawi. While the goal of efficient use of productive assets is the same, the Admarc strategy is to place the properties as soon as possible in the hands of the private sector, since it is more capable and motivated and has the money to make the necessary changes. This strategy has been largely embraced even by those in the GOM who do not necessarily agree philosophically with the advantages of private ownership. They have accepted that Admarc is not able to supply sufficient inputs of capital and technical and managerial expertise to its investments.

The earlier restructuring of parastatals in Malawi had some success. The Malawi Development Corporation (MDC), another large parastatal with commercial interests, has enjoyed a substantial turnaround under the direction of strong professional management. Similarly, the Press Group (described elsewhere herein) has been transformed from the largest drain on the Malawian economy to the most efficient and profitable Malawian-owned enterprise, without a change of ownership but with a new management team.

Press and MDC had certain advantages when they were restructured that are now not open to Admarc. The Press restructuring was financed largely by the GOM (including Admarc), which assumed MK 54 million of debt to the commercial banking system, leaving the Press Group with a clean balance sheet (except for parent company income notes owing to Admarc). Furthermore, Press and MDC appear to have come out ahead of Admarc in their 1984-85 swap of assets; they transferred weak holdings to Admarc (e.g., Gramil, Sucoma, Maldeco and Noil) and received in exchange Admarc's stronger investments (Bata Shoe, Oilcom and Commercial Bank of Malawi).

The DHS divestiture strategy report of December 1987 listed five investments to be restructured prior to sale (Tier IV). However, the Divestiture Committee later reduced the list to two, namely, Admarc Canning and Dwangwa Sugar. Restructuring plans for these have not been finalized. Efforts relating to Admarc Canning are likely to be confined to balance sheet cleanup, although liquidation remains a possibility. Plans for Dwangwa await the outcome of proposed GOM domestic sugar pricing policy review and ensuing discussions between GOM and the World Bank. Similarly, sale of David Whitehead and Cotton Ginners will have to await resolution of government cotton pricing policy to make accurate valuation possible. Both depend on factors outside the control of the divestiture process.

In essence the DH&S team have concluded, largely because of the Gramil experience (see "Results Achieved to Date"), that a major restructuring before sale should be avoided wherever possible because of the difficulty of establishing and maintaining commercial orientation without an independent board and profit-oriented management.

Identification of Potential Purchasers

Because of the narrowness of the potential market for any of the properties and the lack of sophistication of many potential Malawian estate buyers, efforts to seek out and interest buyers were important.

<u>As to industrial and commercial Admarc properties</u>, only a few have been advertised in the Malawian press. The ICO rarely saw a need for such publicity. Furthermore, a public offer of shares of a private limited company is not legal. Admarc management initially, and the ICO later on, approached the process of identifying buyers on an informal basis. Discussions with existing foreign shareholders and lenders (including international development finance companies), some on ICO initiative, were held in Malawi, London and Harare. Similar

discussions were held with potential new buyers, generally limited to the well known players in the economy who were already making inquiries about Admarc properties. Discussions were held in London with the Southern Africa Association, a group of businesses with interests in the region.

A formal public outreach to business organizations representative of a broad range of Malawian interests, which might have attracted buyers as well as broadening public support for the program, started late, well into 1988, and has been limited. For example, the first presentation to the Malawian Chamber of Commerce and Industry was made in May, 1988, nearly a year aftyer the establishment of the ICO.

Marketing of farms and estates has come to be handled more systematically. At first, desire for a quick sale drove the sales decisions, and sales agreements for three tobacco estates were negotiated with the Press Group before any advertisement was run in the Malawian press. Apparently, an advertisement was run before the signing of the sales agreement but after negotiations; no other bidders emerged.

In August, 1987 a very general advertisement ran in the newspapers giving notice that the Admarc estates and farms were available for purchase. Neither valuations nor title checks had been completed, nor had a systematic way of evaluating offers been developed. By late 1987 a buyer/offer evaluation system was established and as valuations, title checks and other necessary documentation was completed groups of estates were advertised in the newspapers.

The prospective buyers are not given much time between advertisement and the offer closing date. For example, the first cluster of estates was advertised on November 25, 1987 with a closing date of December 9, allowing little more than two weeks to respond. The ICO maintains that in practice more time has been given; closing dates specified are not strictly adhered to and any serious bidder could delay the final offer consideration date. In fact, (with the exception of the first three sales) there were four to 20 bids for each estate, suggesting that lack of publicity probably did not significantly affect the outcome. Nevertheless, the ICO's primary mandate to sell the estates quickly may have influenced the process.

In our view, based on local private sector comments (including resident multinationals) more could have been done to publicize the availability of the Admarc assets, both estates and companies. Also, the co-financing facility to assist purchasers of estates was not adequately promoted. A more thorough and formalized public outreach program could have achieved two goals; a broadening of the range of qualified purchasers and avoidance of the feeling among many Malawians that the divestiture process was somehow unfair and reserved for insiders.

Buyer Selection

The process of selecting the buyer of a property being divested has been a mixture of formal and informal mechanisms. In general, the Divestiture Committee has provided broad guidlines to the ICO as to what types of buyers are acceptable. The ICO identifies buyers (and requests bids if appropriate) through the process described above. The ICO then submits a short list of buyers with a synopsis of the pros and cons with respect to each bidder. Except in the case of estates, the Divestiture Committee makes the inal selection. In practice, the selection process has been heavily influenced by informal discussions with key members of the Divestiture Committee, who have suggested certain buyers, and vetoed other buyers or classes of buyers.

In the case of the estates and farms, the ICO has used a formal, systematic method of selecting a buyer that has been followed closely, although other criteria have also been applied (see below). The IC has had the authority to make the final selection. In all but one case the high bid submitted was accepted. In that case several bids were disqualified for various reasons (not all entirely clear from the files) and the property was awarded to the fourth highest bidder. This decision was reviewed with certain members of the Divestiture Committee; however, we feel the IC should maintain more complete written records to protect himself and the Committee from the appearance, if not the fact, of favored dealing.

Constraints on Selection of Buyers: There have been a number of hurdles to be faced at one time or another on final selection; some are criteria that have not been made explicit, but nevertheless are extremely important. The constraints and criteria that have been applied are:

Desire for a quick sale: The pressures of Admarc's desperate cash situation and the GOM's desire for rapid disbursement of the balance of payments financing narrowed the list of purchasers considered for the first few properties to known players with cash. Examples include the three tobacco estates sold to Press mentioned above. Recognizing the harm this might do to the other goals of the divestiture, the Divestiture Committee in May 1988 gave clear policy guidance to minimize the emphasis on urgency.

Pre-emptive rights of existing shareholders: In at least 12 of the companies in its 1987 portfolio, Admarc was not free to sell its shares to outside buyers because of rights of first refusal of other shareholders. This has caused delays in divestiture and to some extent narrowed the choice of buyers. A good example is the planned divestiture of Cattle Feedlot, a private limited company owned by Admarc (50%), Indebank (25%) and Sucoma, which is controlled by Lonrho, (25%). Both the latter holders must agree on the party who will buy Admarc's shares; Indebank, as a passive investor, has not taken a position. Ultimately, the Divestiture Committee (while it can influence the selection of buyers) must accept whatever partner is acceptable to Sucoma or not authorize sale of the Admarc holding.

Pre-emptive rights may be a greater problem in sale to a unit trust of some of the more attractive Tier II properties.

Limit on number of shareholders: Malawian law limits private limited companies to 50 or less shareholders. To convert to a public limited status requires the assent of holders of 75% of all shares. This has proved to be a practical constraint for Auction Holdings, where the goal of spreading ownership over the maximum number of tobacco planters has been frustrated. Other Admarc holdings (of less than 75%) face the same problem. Short term technical assistance could perhaps be used to assist in conversion of Admarc companies such as United Transport and David Whitehead, and to explore whether a change in the law might be feasible to facilitate broadened ownership in future privatization.

Distribution of Ownership: The goal of distributing ownership to African Malawians wherever possible limited the search for some otherwise qualified buyers, i.e. Asian Malawians and international firms. In general, Asian Malawians with cash have been told that unless their proposals are overwhelmingly superior in terms of price, management and technical inputs they have little chance of success.

We believe the exclusion of certain groups with capital, management skills and an interest in developing industry in Malawi can have far reaching consequences. The short run loss of opportunities to put these resources to constructive use could aggravate concerns about the long run effects of concentration in certain sections of the economy. There has been one case, and two are pending, where the exclusion of even a minority holding by members of such a group has sent a clear signal for the future that their participation in the economy is unwelcome.

Efficiency: A primary objective of the Admarc divestiture program is to improve operating performance of the divested assets. In the instances where the need for inputs of capital and technical and management skills was particularly acute, as in the case of National Seed (see "Results Achieved to Date"), the search for new owners has has been tightly focused.

Conflict of Interest: In Malawi, senior civil servants are encouraged to become involved in businesses, even in sectors within their direct responsibility. Such individuals are often valuable business partners because of their education, administrative and technical experience and contacts. Nevertheless, there has been a conscious effort to minimize even the appearance of conflict of interest involving GOM officials' participation in Admarc sales. While this may not have narrowed the choice of buyers in any specific case, it helped assure that transactions were conducted on a commercial basis. See also discussion of the role of the IC in "Administration of the Program".

Not surprisingly, in the search for buyers the ICO had to balance conflicting goals and deal with a number of legal constraints. In the light of experience the GOM might consider some modification of the law governing private limited companies, or abolish the cost and other distinctions which render a public limited company unattractive. Alternatively, waivers might be considered in deserving cases consistent with privatization policies.

Selection of Press Group as a Buyer: While it represents continued concentrated ownership, Press Group has from the beginning been considered as a potential buyer. It has purchased the largest number of estates and is the final contender for at least two industrial properties, Gramil and Maldeco.

Press has grown into a large conglomerate with a diverse array of industrial, commercial and agricultural interests. It has a dominant, if not monopoly, position in many of the sectors in which it operates, although to date there is no evidence that it has abused its position in any sector. Until recently the Group had a poor record of earnings and poor management, but in the past several years it has been extensively restructured.

Press is held by His Excellency the Life President "in trust for the nation" and now operates strictly according to commercial principles with an independent board (which includes some GOM ministers and party leaders) and experienced business managers (many expatriate) for all its holdings. It earns returns on total capital exceeding 30% and is regarded by the business community as a member of the private sector, although with a special relationship to government and a concern for the national interest more than may be customary in the private sector. It is reported that Press presently accounts for some 40% of total Malawian GNP. While Press is efficient and well managed, it clearly does not meet any test of diversification of ownership. Hence we believe it is important that each proposed sale to Press be considered in the light of the long term consequences for the Malawian economy of the concentrated ownership Press represents.

Sale of certain properties to Press will increase its domination and vertical integration in certain sectors of the economy. The potential in the case of Gramil is mentioned elsewhere herein. If Press buys Maldeco it will own both the only commercial fishery in Malawi and a major wholesale and retail distributor of fish (PTC). While we understand that alternative buyers with the necessary capital and management resources have not been found, we are not completely clear that interest expressed by possible Asian buyers failed to meet that test. We do recognize that the importance of fish as a national resource introduces a national security consideration.

We have also a concern that were the Malawian private sector to perceive that Press was receiving preference in sales, others might lose interest in bidding, prices could be adversely affected and opportunities for broadened ownership lost.

In sum, we believe that these concerns suggest that more effort should be made by the ICO and the Divestiture Committee to select other buyers, even if only as minority partners and even if the process is slowed. While Press is an outstanding contributor to economic development, there should be room for others.

Assistance to Buyers

It has been the practice of the ICO to provide potential buyers with assistance well above and beyond the normal commercial obligation to provide impartially adequate information on the properties and bidding procedures. While there is no formal program of buyer assistance, this has included suggestions on the preparation of offers, recommendations as to sources and availability of finance, identification of technical expertise and how to contract for feasibility studies. The presumption has been that, if this assistance were not given, otherwise qualified buyers of Admarc properties might be excluded from the process. This was found most likely to be true for prospective estate buyers, and hence most, if not all, those who responded to newspaper advertisments offering Admarc estates were personally interviewed by the ICO. The office walked the prospective buyer through the steps necessary to make an acceptable bid, and explained the checklist of criteria that were to be used to rank buyers' bids.

The ICO had little time, resources or budget to provide the assistance required to compensate for the lack of sophistication of buyers. Some budget support for this activity might have been helpful. In retrospect, it is possible that time would have been saved if the ICO had drawn up a buyer assistance packet for estate purchases.

Negotiated Sales and Public Bids

Bids for purchase of the farm estates were solicited on 14 of the 16 units. (It has been noted elsewhere that three were solicited after an agreement with Press had been negotiated.) Of the two estates not advertised, one was incorporated and Admarc's local partners exercised their pre-emptive rights to purchase the Admarc shares; the other transfer had to be negotiated with a lessor of the property. In evaluating the bids the ICO considered such criteria as local ownership, concentration of ownership, operating ability and ability to finance the purchase. In every case but one the high bidder evidencing satisfactory ability to pay was selected. All winning bids were at or above the valuation price set on the basis of independent appraisals.

Only a few corporate share transactions have been completed; several more have been negotiated but await final documentation or fulfillment of conditions. The Kavuzi/Mzenga sale, described elsewhere herein, is an example of the simplification of negotiations through use of an expertly prepared and very thorough valuation. CDC and at least one other buyer were involved in discussions with Admarc until CDC (who were advised by Morgan Grenfell & Co. Ltd.) indicated they were prepared to meet the valuation price, at which point the competitors dropped out.

In the National Seed case, also described herein, negotiation centered not on price so much as on the GOM's view of the company as a high priority national asset. Since Cargill insisted on a majority position, the GOM negotiated the requirement that export sales require the unanimous vote of the

Board to assure the security of seed supply to the Malawi market.

While reliable valuations are key in most cases, there will be other negotiations beginning soon, such as those relating to the sugar companies, where the perceived national interest will again affect the form and price of the transaction

Alternative Means of Sale

Reflecting the growing desire of USAID and the GOM to see the Admarc assets distributed as widely as possible, the IC has taken pains to examine each asset to assess whether it is suited to multiple ownership, however obtained or constituted. The following alternatives have been weighed; generally they have not been found to be adaptable to current Malawi circumstances:

> Employee Ownership Arrangements: While this possibility has been reviewed in two instances (Cold Storage and Noil, where Admarc's 100% holdings mean shareholder approval is not a problem) it has not yet been found feasible. Except for executives and white collar employees, workers in Malawi generally do not have sufficient disposable income to permit investment in the shares of a company for which they work, nor are they likely to understand the concept. It is probable that the most effective form of this concept would be a program for employee purchase of limited ownership shares through salary deduction (which is not uncommon for postal bank or other savings). The IC would like to see USAID provide a local currency pool to be held in trust by a bank to purchase company shares for employees who would pay for them through salary deductions. We believe this suggestion has merit. More ambitious ESOP-type schemes (larger percentages of ownership with special tax forgiveness arrangements based on special GOM legislation) will have to await further study on this subject.

> Management (Leveraged) Buyouts: A management buyout has been discussed by the IC in at least one case of an industrial sale, namely Noil. This is a small but well managed and profitable firm producing edible oils which will probably be divested shortly. The current general manager has expressed interest but questions whether financing could be found. The possibility is still under discussion with the IC; here again the concept is a new one for Malawi.

<u>Joint Holding of Estates</u>: The question has been raised as to whether the estates would have been available to larger numbers of small purchasers through joint purchases. We were told, however, that many Malawians traditionally are reluctant to go into partnership with persons outside their extended family for lack of trust. Whether bank financing could be made available is also a question.

<u>Debt/Equity Conversions</u>: In two instances, National Seed and Kavuzi/Mzenga Estate, the exchange of debt for equity has been an important factor in putting together a deal. In both cases a sterling debt obligation to Commonwealth Development Corporation (CDC) was cancelled against the transfer of equity; in the Kavuzi case a guilder loan from FMO, the Dutch international development bank, may also be swapped for equity.

<u>Public Offerings of Shares</u>: For discussion of basic distribution of securities to the public see "Capital Market Development and the Proposed Unit Trust" elsewhere herein.

RESULTS ACHIEVED TO DATE

Effects on Admarc

We have limited our investigation of the effects of divestitures to date on Admarc to attempts to measure the achievement of two key goals which were defined when the program was adopted*:

Whether the program enabled the corporate management of Admarc to focus on its core crop marketing functions, and

Whether the sale of assets has brought about the increased liquidity determined to be required to meet crop marketing requirements

Management: At the time the divestiture program was adopted Admarc had 71 people employed in the Development and Investment Division (DID), charged with overseeing the estates and industrial properties. The DID micro-managed the smallest expenditures and management details in these units in the inevitable bureaucratic tradition, which accounted for the losses being experienced in the units and high costs for Admarc itself. As a result of the divestiture program an overall restructuring of Admarc has been undertaken; in particular DID has been dissolved and many of the senior staff and accountants have been reabsorbed into the marketing or corporate divisions. A few ex-DID employees are involved with the final details of winding down the estate portfolio and some managerial time will still be devoted to looking after estates retained for demonstration and training purposes.

Currently, Admarc managerial involvement with the industrial properties is generally limited to senior managers who are board members participating in quarterly board meetings**. The ICO, which consists of the IC and three other persons, has taken over divestiture functions. We understand an average of four days a year of Admarc senior managers' time is now required per board membership. As Admarc's investments are sold, or percentage ownership is reduced, fewer Admarc managers will spend less time on board duties.

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* An evaluation of changes in Admarc's crop marketing activities by a World Bank mission is currently underway.

**One senior manager has been seconded to Gramil as General Manager and will return after it is divested.

It is clear, and Admarc senior managers interviewed agree, that the sales of the estates and agricultural development projects that have taken place under the divestiture program have enabled them to shift their attention to, and concentrate more effectively on, Admarc's basic crop marketing activities.

Admarc Liquidity: Admarc divestitures since the USAID grant in August 1986 and up to March 31, 1989 have generated a positive cash flow of MK 14.7 million, reflecting completed sale of three companies, two development estates and seven small agricultural estates. This includes MK 7.4 million on the recent completion of the sale of Kavuzi/Mzenga. Completion of sale of seven estates currently being concluded will net Admarc another MK 3 million. Admarc is beginning to realize the benefits of the effort to improve liquidity, which should show up when its fiscal year-end (March 31, 1989) balance sheet is published. It is impossible at this point to judge the ultimate effectiveness of the program in reducing these debts, but it must be kept in mind that the almost complete elimination of the operating losses on Admarc investments has already occurred.

Divestment to Date under the Program

As indicated immediately above, since the approval of the USAID grant to assist the divestiture in August, 1986 three companies and nine estates have been completely divested, resulting in the release by USAID of a total of US $11.55 million in balance of payment support (relating to gross sales values calculated at MK 34.6 million). In addition, sale of seven more estates is being completed. It is expected that the remainder of the grant funds (US $3.45 million) will be applied against these estates, Grain & Milling, Admarc Canning, Maldeco and Cattle Feedlot, largely before June 30, 1989.

Estate Sales: All of the estates were sold to Malawians, three of them (adjacent to or near its existing estate holdings) to the Press Group. While Press expressed interest in other Admarc estates, the rest were sold to individuals with no purchaser permitted to buy more than one to broaden estate ownership. One of the estates was sold to an Admarc employee at a bid price more than one third higher than the valuation of the estate. Careful investigation indicated to us there was no favoritism shown. This and three others are being financed by the Commercial Bank of Malawi under a local currency co-financing facility arranged by USAID.

The sale of the <u>Kavuzi and Mzenga development estates</u> in the north has just been completed as a package at a price of MK 25 million. These estates were wholly owned by Admarc, Kavuzi having 1000 hectares of tea just entering production and a modern tea factory, and Mzenga with 503 hectares of macadamia also just entering production. The purchaser is the adjacent Kawalazi estate managed by CDC with a Malawian parastatal and FMO (the Dutch international development bank) as minority partners. Conversion of loans into equity or cash (without money supply implications) as part of the purchase price is mentioned elsewhere.

It is expected that this transaction will lead to less industry concentration, since Kawalazi intends to install a macadamia processing line and export directly in competition with the current (private) sole processor and exporter. This should make other investment in macadamia plantings in the north more attractive.

Although the Divestiture Committee gave instructions to divest up to 100% of Kavuzi/Mzenga, Admarc has negotiated an option to reacquire a 10% interest in Kawalezi within a year after the sale. This appears to make little sense, either from a development point of view (since Admarc is no longer needed), a strategic view (not related to their core function) or a financial standpoint (Kawalazi is not likely to be cash positive for up to 15 years).

The IC was able to negotiate a favorable price for the combined estates; internal valuation was about MK 18 million and a final price of MK 25 million was obtained, Admarc realizing MK 7.4 million in cash.

<u>Sales of Companies</u>: Divestiture of two companies was completed early in the program to foreign owned local companies. In both cases, the other partner in ownership exercised its pre-emptive rights to buy Admarc out. Lever Bros. (Malawi) Ltd. was sold to a subsidiary of Unilever PLC (a U.K. company) and P.E.W. Ltd. was sold to Maltraco, also a subsidiary of an offshore company. Admarc recently divested part of its ownership of National Seed Company. Additional sales of companies are nearly completed or being negotiated. Among the more complex is Grain & Milling Company (see below).

<u>National Seed Company of Malawi</u> (NSCM) was established in 1978 to ensure the supply of high quality seed for Malawi agriculture. Its major product has been maize seed, with subsidiary production of tobacco and various legumes. Its ownership was Admarc (72.5%) and CDC (27.5%). CDC had a

management contract with NSCM but worked in close cooperation with the Ministry of Agriculture. NSCM had a sales agreement with Admarc wherein Admarc purchased seed from NSCM and distributed it to the smallholder sector. In 1986, however, only 40% of NSCM's sales were accounted for by smallholders, the balance having been exported. Due to the GOM regulation of seed prices, the shareholders' agreement required Admarc to make a contribution (sales premium) to NSCM to ensure that profit before interest expense and taxes exceeded 15% of average capital employed. Thus the NSCM operating results were artificial.

By 1987 NSCM was in serious financial difficulty, with outstanding loans from CDC of 800,000 pounds sterling and other borrowings from GOM, together aggregating 79% of capital employed and due in 1988. Exchange rate losses were compounded by declining sales, but the GOM felt the company had to be saved for national food security reasons.

The IC recommended that Admarc accept the need for financial reorganization and that CDC seek a suitable partner with the ability to produce a substantial injection of capital. Investigation revealed that the only suitable partner was the Cargill firm in the U.S., which had other seed operations in Africa and the necessary capital and technical know-how. Cargill already had a Malawi presence through part ownership in Cotton Ginners. Having sold its seed operations in South Africa and seeking expansion opportunities elsewherein Africa, Cargill was interested in Malawi because the climate is regarded as ideal for seed production.

Negotiation led to a deal whereby Cargill would obtain a 55% ownership share in NSCM, would inject at least $1 million of capital and have a management contract. Admarc and CDC would each have 22.5%. The five person board would have three Cargill members and one each from the others*. Cargill took over management of NSCM in October, 1988 (before final sale). In March, 1989 the transaction was completed. Cargill received new shares in exchange for an infusion of foreign capital and Admarc reduced its ownership to 22.5% through dilution. To maintain a certain level of ownership, CDC converted part of its debt to equity. The resulting arrangement maximized the benefits to NSCM. Its financial structure was strengthened and it obtained foreign technical and managerial assistance.

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*There is an arrangement whereby a Ministry of Agriculture representative sits in on all board meetings. The Ministry and Admarc jointly decide how to vote on board issues.

Grain & Milling Company (Gramil), 100% owned by Admarc, is involved in maize and wheat milling and livestock feed production. The Divestiture Committee has approved sale of a majority interest to Press Group and a significant minority interest to the South Africa-based Premier Milling as a technical partner, with Admarc retaining 10% to guard the national interest.

A Press subsidiary, Press Bakers, is the largest wheat flour importer in Malawi and has bought some independent bakers in Malawi. While there have been new entrants to the business able to compete effectively on quality grounds, with the Gramil acquisition Press might be in a position to dominate the wheat milling and baking industries.

To complicate matters, South Africa-subsidized wheat flour is being imported from South Africa by Press Bakers and others in an effort to control inflation. Wheat milling has been a major contributor to Gramil's profitability, and continued flour imports may have a significant adverse effect on Gramil. On the other hand, imports of subsidized flour are beneficial to Press Bakers and Premier Milling's operations in South Africa. Under current circumstances, it may not be in the long run interests of the Press Group or Premier to maintain Gramil's wheat milling operations.

The USAID Mission had proposed to the IC that a portion of Gramil be sold to passive investors, such as millers and bakers, including potential Asian investors. It was reported that such an approach would have been acceptable to Press and Premier, although they strongly preferred no other partners. However, the Divestment Committee, while it recognized the implicit potential for abuse, concluded that Gramil's financial and operating needs were paramount, and that Press was the only Malawian firm financially able to buy Gramil and with enough muscle to control the technical partner who will manage it.

Prior to the work on the Press/Premier arrangement, Admarc attempted to restructure Gramil by bringing in a strong technical partner, with divestiture of Admarc's controlling interest to come only after two years of operating experience. Largely because of a highly politicized Gramil board of directors, this earlier attempt at restructuring was unsuccessful.

Effect of Divestment on Employment

As a result of the adoption of the divestiture program and in its implementation, a general program of retrenchment in 1988 resulted in personnel reductions of up to 30% or more throughout the organization.

Also, with GOM approval because of its sensitivity, a decision was made to reduce immediately all non-essential employees in the Admarc estates in anticipation of their sale. This was carefully discussed with Congress Party officials and local chiefs to assure that it was understood as a measure to reduce employment inefficiencies and that some recruitment would follow sales. By March, 1988 the reduction in most of the individual unincorporated estates prior to divestiture ranged from 23% to 56%; only five showed little decline or some increase.

Estates under new management have been re-employing members of the work force declared redundant by Admarc. In effect, Admarc had assumed the generally modest costs of their accumulated redundancy credits payable on discharge, so they could be re-hired without liability for past employment. However, no reliable information is yet available to indicate the net change in employment attributable to the sales and change of management, although improvement in efficiency is anticipated. Consultation on the point with CDC, purchaser of the Kavuzi Estate, revealed that they anticipate re-employment and additional recruiting beyond the levels at the estate before divestiture. It is too early also to obtain useful employment information on industrial and trading companies sold. In the case of Lever Bros. and P.E.W., the earliest sold, the lack of a change of management suggests inquiries would not show a meaningful change in staff.

As indicated elsewhere herein, the Admarc divestitures have focused a considerable amount of national interest on the merits of improving efficiencies in the use of resources. It is too early, however, to detect any measurable national impact.

CAPITAL MARKET DEVELOPMENT AND THE PROPOSED UNIT TRUST

The capital market of Malawi is largely undeveloped. The debt market, such as it is, is dominated by government obligations although, despite the effect of distortions caused by interest rate policy reflecting economic and development priorities, we understand that a tight fiscal stance adopted in early 1988 has meant that private borrowers are not crowded out. There is, for all practical purposes, no equity securities market and equity securities are ordinarily not available. For individuals to enter this market, the assurance of ability to readily resell is essential, but nonexistent in Malawi. In the absence of a capital market, access to equity capital is only through direct (and usually illiquid) investment, as in the purchases of Admarc assets.

An excellent memorandum on the Malawi capital market was prepared by DH&S with J. Henry Schroder Wagg & Co. (U.K. merchant bankers) and Sacranie Gow & Co. (Malawi counsel) under the USAID technical assistance contract. After reviewing the present state of the capital market it explores the options which might be available to begin development of an equity market and achieve broader ownership of the Admarc holdings to be divested. The study found that realistically, of four options cited, only a unit trust is presently feasible. An investment trust (closed end) or a conventional investment company would not provide the necessary liquidity for individuals, nor would private placements of the Admarc securities. Establishment of a stock exchange at this juncture would be meaningless, since there exists no significant distribution of securities to be traded. The development of an over-the-counter market (i.e., informal trading as principal among a limited number of holders) should ordinarily precede the need for a stock exchange, and it does not yet exist.

The proposal for a unit trust (known in the United States as a mutual investment fund) contemplates that four or five attractive and demonstrably profitable holdings of Admarc, in amounts not exceeding (as a maximum) 20% of the outstanding equity of any company, be sold to the trust at prices (determined by formula) which would assure a reasonably prospect of attractive dividend returns to trust holders. At the same time, in order to (1) provide adequate diversification and (2) assure that it is not thought to be an "Admarc trust" (which might be regarded as a dumping ground for unsold investment assets), the trust would purchase several similarly high quality blocks of stock of mature companies from existing investment institutions such as Press, Malawi Development Corporation (MDC) and Investment & Development Bank of Malawi (Indebank). The intent would be that no company's securities would account for more than 10% of the total portfolio value. In their study the consultants estimated that such a trust might commence with investments of about MK 20 million, of which MK 5.8 million would be purchased from Admarc and the remainder largely from MDC and Indebank (the estimate for Press Group being relatively small).

Once the portfolio is established, units (shares of stock of the trust) would then be sold to institutional investors such as insurance companies, pension funds, building societies and banks, and an aggressive public educational program would be undertaken. Under current conditions of high liquidity in investing institutions there should be a substantial initial market, although individual interest will be modest at the outset. The trust would be "open-ended", that is, when a holder wishes to sell, the trust would buy offered units, at a published formula price changing monthly. Liquidity would be provided from a fund of perhaps 10% of the trust retained as a reserve in cash or high quality money market instruments, or available through a bank line of credit (perhaps funded by a donor such as USAID).

We agree with the consultants' view that this is the most practical first step toward establishment of a capital market and that it is feasible and timely. We expect that it will turn out to be a success, assuming that:

(1) it is undertaken with the advice of a prestigious firm experienced in the unit trust field,
(2) a competent manager can be identified,
(3) donors will defray the substantial costs of establishment
(4) an appropriate and adequately diversified portfolio of securities (not just Admarc holdings) can be purchased at reasonable prices designed to produce an attractive yield, and
(5) appropriate liquidity can be provided to handle transfers.

The proposal is being studied carefully both by the Government and the private sector in Malawi, and we consider it to be an attractive and innovative solution to the problems associated with trying to (1) find appropriate buyers for some of the Admarc investments, (2) broaden equity ownership and (3) take an important step toward developing an equity capital market in Malawi. We recommend that USAID support this project through provision of funds to cover some of the "up front" design and promotional costs which could otherwise make it uneconomic for initial purchasers. We also suggest that a public awareness program be undertaken at an early date, with the private sector business community and GOM officials as primary targets.

ROLE OF USAID

Clearly USAID played the catalytic role in bringing about an effective program of divestiture of Admarc investment assets. In an excellent example of donor cooperation USAID took over responsibility for facilitating the program from the World Bank, which originated the approach. The Bank first undertook the program itself, and USAID stepped in to assist. The Grant Agreement described elsewhere herein was the key. There is no question that the potential infusion of balance of payments support concentrated the attention of the Finance Ministry, and caused the Chairman of the Divestiture Commmittee to assume the leadership of the program and inspire the firm government commitment which in due course pervaded almost the entire bureaucracy. The technical assistance also provided by USAID made possible the appointment of DH&S who were able to provide the services of the IC. He has had excellent support and backing from GOM and Admarc officials and from USAID.

In addition USAID, using the local currency equivalent of the initial balance of payments credits to the GOM, provided a co-financing facility for estates up to 1,000 acres through the Commercial Bank of Malawi (CBM). This was done out of a concern that a broader cross section of the population be able to finance estate purchases. [USAID also had the broader intent of influencing the CBM to liberalize its loan practices generally. This has not yet occured.] The arrangement facilitated loans up to 90% of the purchase price, instead of the regular CBM limit of 50%; CBM taking 30% of the purchase price and the co-financing fund the balance. The term of the loans was set at eight years compared with the CBM's customary three to five. The cost is a blended rate of 16% for the CBM portion and 11% for the co-financing portion. Four buyers have taken advantage of this facility so far; buyers have been informed of its availability only after they have expressed an interest in bidding. Its availability should be published in the advertisement for bids, as a signal that the GOM is anxious to encourage people who otherwise would not be able to purchase an estate.

While USAID provided the "carrot" or mainspring for the program and paid for the costs of technical assistance, USAID was not part of a formal mechanism by which it could be assured of regular influence on the activities of the GOM and the ICO under a host country contract with DH&S. Informally, close relationships developed with the various parties quickly enabled USAID personnel to keep abreast of divestiture developments and engage in policy dialogue with the GOM. As a result of a number of recent changes of personnel both in the GOM and USAID there has been some (presumably temporary) diminution in communications. It is important that USAID be kept informed of developing issues in the program so that they can engage GOM officials in dialogue and make their views known before Divestiture Committee decisions are made. We recommend that a regular schedule of briefings, and reports on meetings of the GOM Divestiture Committee, be adopted by the IC to assure that USAID is kept up to date. We also urge that an attempt be made to improve the mechanism for dealing with Delivery Orders. An advance budget may be the key; DH&S already has a clear idea of the topics for short term technical assistance that will be required over the additional year of their contract, if it is extended, and could cost them out. They have suggested five topics:

1. Analysis and implementation of the proposed unit trust
2. Establishment of a holding company for residual assets
3. Assistance with the sale of the sugar assets
4. Analysis of cotton pricing
5. A study of employee stock purchase arrangements

USAID might wish to finance the first three, which are necessary to complete Admarc divestment. The cotton study might be better financed by the World Bank. In addition, however, to the above list USAID might consider providing technical assistance for a study of a local currency co-financing facility to assist purchasers of non-estate assets.

Continuation of USAID support: We understand the GOM is prepared to extend the contract with DH&S for the final year and we believe this is urgently required in order to complete the process. We believe it is equally important that USAID renew its agreement with the GOM and provide both technical assistance and the "carrot" of balance of payments support keyed to divestiture progress. As mentioned elsewhere, one of the most remarkable things about the Admarc program, in contrast to almost every other privatization program with which we have been acquainted, is that valuation has not been a critical issue. Target prices have been modest, and have often been exceeded. The usual political problem associated with the perceived sale of national assets at less than written-up book values has been absent here. We believe an important reason for this is the "carrot" which, in effect, from the GOM's point of view can be said to nearly double the conservative book value or sale price. In view of the relatively small amounts for which many of the assets are being sold, it is the "carrot" that rewards the extensive work required. The initial US $10 million tranche has lasted for two years or more of work; we understand the remaining balance of the original $15 million grant is likely to be fully used by June 30, 1989. The importance to the GOM of access to foreign exchange has increased over the past two years and continues. While it may be that some alternative form of "carrot" could be designed, and should certainly be explored, the balance of payments credit seems particularly appropriate, whether provided by USAID or another donor.

Completion of the program: It must be recognized that privatization is a process, and the Admarc program is not yet near completion. However, its success to date has sparked GOM interest in other privatizations to come, such as Wood Industries, electricity, telecommunications and transport. These are difficult undertakings for a small RLDC, and may well require continued encouragement by USAID coupled with some financial support. With the increasing USAID policy emphasis on grants which lead to future economic progress, these offer excellent new opportunities to create circumstances which lead to improved infrastructure for development. To make way for them, we believe it is important that the Admarc program over the next year be structured so that it will be completed in that period. To achieve this, we visualize several steps that will totally remove Admarc from ownership of all but those minority agriculture-related holdings which it is electing to retain to protect the national interest. They are as follows; all but the suggested second holding company are steps already contemplated, but we feel a timetable should be established:

1. Complete sale of those assets scheduled for direct sale

2. Create the unit trust and transfer to it the appropriate holdings, limited as provided in the plans for the trust.

3. Rather than the single holding company presently planned, create two holding companies, as follows:
   (a) A holding company to be owned by Admarc that would be the owner of the minority agriculture-related holdings mentioned above (to be held to protect the national interest). Except for national policy matters, Admarc would act only as a passive holder.
   (b) A holding company for all other assets remaining unsold. If it appears administratively feasible, this company, with holdings such as National Bank of Malawi, Indebank, and others, could be transferred to the Ministry of Finance (or the Ministry of Statutory Bodies) in exchange for cancellation of existing Admarc debt to the GOM, to be managed by them with the intention of making further sales if and when feasible.

ADMINISTRATION OF THE PROGRAM

The Divestiture Committee is composed of representatives (usually at the Permanent Secretary level) of the Treasury, the Ministries of Agriculture and Trade and Industry, and the Office of Economic Planning and Development of the Office of the President and Cabinet. In addition, there are representatives of the Department of Statutory Bodies, which oversees the parastatals, and of Admarc. The IC is also a member. A representative of the Contractor, DH&S, sits in on meetings with regard to certain issues. The Secretary to the Treasury is Chairman. The Committee meets quarterly to hear a progress report from the IC and to take decisions on action plans and requests for policy guidance from the IC. Documents are circulated in advance and informal consultations before the meeting help to assure consensus on most matters in the meeting.

The IC makes recommendations to the Committee which are consciously "politically blind", that is, the political implications of any course of action are regarded as being outside his scope. The Committee occasionally changes or rejects proposed action without explanation. The process takes place within a framework approved initially by H.E. the Life President.

USAID has only once been represented in meetings of the Committee, the GOM having insisted that since this is a host country contract, the IC's responsibility is to the GOM through the Committee. We are of the opinion that the GOM position is correct. The Committee, as a GOM body, has a right to confidentiality; USAID presence could inhibit airing of sensitive issues. The structure of the relationship is such that the IC's responsibility is to the GOM and the USAID role should be focused on the key areas of policy dialogue and insuring distribution of grant funds in accordance with a specified formula. USAID has on occasion found its non-participation in the Divestiture Committee frustrating. An attempt (which we encourage) is being made by the IC to formalize better communication to avoid this.

The Contractor, Deloitte Haskins & Sells, has in our opinion performed well. Senior personnel in Washington and London, particularly Mr. Robin McPhail and Ms. Joyce Erony, have supported and monitored the program with diligence and, more important, have made major and imaginative contributions to the design and course of the process and the future planning for it. Their familiarity with the details of the program is impressive. We encountered some feeling, however, in the GOM and USAID, that the IC should be left more on his own.

The Investment Coordinator, our investigations confirm, has gained the full confidence and respect of the Committee, his performance being regarded as thorough and professional (as the comment immediately above suggests). His broad merchant banking and deal making background in Africa make him ideally suited for the assignment as IC, which we agree he has been carrying out in an organized way with great skill, diplomacy and, most important of all, effectiveness. Committee members give him considerable leeway in finding buyers and negotiating prices. An important part of his success has been his maintenance of absolute neutrality on issues that may divide the various principals. Committee members have consequently come to accept his guidance even on questions of potential conflict of interest.

At first glance some of the Admarc sales might suggest conflict of interest, and/or give the appearance of so-called "crony capitalism". Three of the 16 Admarc estates for which sales have been negotiated so far were purchased or are to be purchased (alone or with partners) by prominent officials or businessmen. By U.S. standards there would be a concern that such buyers may have benefited from inside information or the ability to wield influence.

We believe it is important to recognize that in the Malawian context there are a very limited number of individuals with the financial ability to make purchases. All such persons have close personal relations with each other and serve on various boards with inevitable interlocking relationships in an economy comparable in size to Memphis (TN) in the U.S. The IC has served as an impartial arbiter in such cases, and has sought to assure that price and ability to pay were the essential considerations in every case. This primarily has related to sale of the estates; in sale of businesses other criteria have also been applied, such as the need for a technical partner or new capital infusion, or where national security concerns are perceived. We have found no evidence of corruption; we are satisfied that the instances mentioned were handled with propriety and cleared with the Divestiture Committee.

Training and institutionalization: Training in the techniques of divestiture has been part of the IC's task. He has had three Malawians assigned to him for training, the first of whom has been since promoted through the Admarc organization. She was executive assistant to the General Manager and is now a product head; another has moved on to the Admarc Planning Department. The latest has been seconded from the Ministry of Planning. The IC's junior staff has become highly proficient.

Institutionalization of privatization in Malawi is not yet evident. It cannot be said that the ICO has developed any capacity to handle privatization over the long term without Mr. Twyman. In at least one other country, a cadre of qualified local businessmen directly charged with responsibility for restructuring and sale of similar investments have developed into a self contained "mini" merchant bank. It will be a while before capable Malawians develop this expertise. On the other hand, members of the Divestiture Committee have been exposed to the documentation and problems, and have extensively argued the merits of alternative courses to determine what is best for the country and how to get the most out of the assets being sold. The General Manager of Admarc has become versed in the techniques and strongly committed through his close work with the IC; it is not clear, however, in what organization the responsibility for future divestitures of other GOM parastatals will be placed. We think that more consideration should be given to this in the coming months to take full advantage of the IC's presence, and suggest the Finance Ministry may be the appropriate locus. (See the holding company discussion under "Role of USAID - Completion of the Program").

What was originally perceived by GOM officials as the rationalization of Admarc's activities and effective realization on its resources, has led to recognition that privatization is a worthwhile tool to accomplish these goals. It is now widely felt within the GOM that, when the Admarc program is completed, the lessons learned about privatization should be applied to other sectors of GOM activity for which the private sector could assume responsibility. H.E. the Life President has been reported as saying that "...government should only do those things that it can do best".

<u>Special studies</u> undertaken by DH&S or its associates as short term technical assistance have been very valuable in providing professional assistance to the ICO on topics requiring specialized expertise. The quality of the six studies produced has been generally high, but not uniformly so.

The analysis of Admarc's portfolio and the financial modelling for the valuation of the Dwangwa and Sucoma sugar estates was well done and useful to the divestment process. An initial study of the sugar estates was not well conceived nor necessary.

The Capital market study referred to elsewhere is excellent, although it seemed deficient in its treatment of the potential for purchase of the unit trust by individuals. No attempt appears to have been made to quantify this potential; while it is manifestly small, reaching individual buyers should be the primary purpose for adopting the unit trust mechanism.

LESSONS LEARNED AND REPLICABILITY

A number of lessons which may be drawn from the Malawi experience may be of use as the Admarc program continues and perhaps of value in other countries where privatization is being undertaken. They could include:

Strong commitment to divestiture at the highest political level is essential to success

A systematic approach to privatization strategy can contribute materially to the effectiveness of such a program and accelerate its progress

Divestiture can be seen as most positive, and can be most effective, when undertaken in the context of solving a problem (in this case the financial distress of Admarc)

A inter-ministerial committee (such as the "Divestiture Committee") can facilitate consensus-building and the handling of policy questions and can diffuse responsibility. It can also expedite the process

A privatization program involves many time-consuming elements which must be taken into account in estimating the length of time required to complete

Valuation is less likely to be a problem when specific goals, both business and economic (such as, in the Admarc case, the financial cushion provided by balance of payments support), are the focus of a privatization program

Sales of investment assets represent opportunities for broadening ownership and increasing competition, and help to build a capital market

In the absence of a capital market a unit trust (mutual fund) should be considered as a way of using assets being divested to contribute to development of an equity market

An independent holding company is a way to tie up loose ends while accomplishing the divestiture of assets from a functioning parastatal

Strong administration of the process can facilitate privatization, provided person(s) in charge have the total confidence and public commitment of senior government officials

USAID can materially assist and guide the privatization process through continuing policy dialogue. It takes time and energy of Mission staff. The provision of a financial incentive and technical assistance, however, can be the key to success of such efforts. A "carrot" works best when a stick is not needed; the GOM was committed at the outset. The design of a privatization program by USAID must explicitly address long range goals (such as broadening ownership participation and investment opportunity) if policy guidance in such areas is to be effective

It is likely that USAID can be most effective if it keeps a low profile. A host country contract (as distinct from a direct USAID contract) may make this more feasible

A privatization expert functioning as a line officer, not just an advisor, can be crucial to success; he can carry out the mechanics of divestiture while staying out of policy and political questions

Short term privatization goals can run into conflict with long term economic growth prospects dependent on a broad based economy. In the Malawi case, the design of the program unfortunately encouraged concentration of ownership to "get the job done"

CONCLUSION

As indicated at various points in this evaluation review, we believe the Admarc Divestiture Program, while not yet near completion, is already an outstanding success. That this is true may be measured by a variety of results:

The improvement to date in Admarc liquidity

The management restructuring of Admarc and the manifest improvement in the ability of its management to focus on its primary responsibility for crop marketing

The interest (reflected in price) of buyers in the estates

The growing interest of GOM officials in the private sector and privatization in general

The significant injection of capital, technical experises and management skills in many of the assets sold

The efficiency and dispatch with which the divestiture process has been conducted since the appointment of DH&S, compared to progress of similar undertakings elsewhere in the developing world

We do not hesitate to recommend that the program be continued, through renewal of the GOM contract with DH&S and a new grant from USAID providing adequate technical assistance to complete the program (embodying one or two holding companies for residual assets) and an adequate grant or "carrot"to keep the attention of the GOM on the Admarc divestiture and the privatization process in general. The formula has worked and it is risky to assume that any element contributing to the success so far is no longer necessary. Mr. Twyman should be retained; he has been another essential element.

In declaring the program successful it is important to mention that a number of people have contributed significantly to getting it started and keeping it on track. The list starts with H. E. the Life President and includes (in no particular order) Samuel Kakhobwe, Secretary to the President and Cabinet, Justin Malewezi, Secretary to the Treasury, Gilton Chiwaula, Accountant General and Acting Secretary to the Treasury, Alfred Upinde, formerly Secretary for Economic Planning and Development, Office of the President and Cabinet, B. M. Ndisale, Secretary for Agriculture, Harry Mapondo, General Manager of the Reserve Bank of Malawi, Francis Pelekamoyo, Deputy Governor of the Reserve Bank of Malawi, G. A. Armstrong and Christopher Morgan of Statutory Bodies, Brenda Killen, Financial Analyst in the Ministry of Finance; Robin McPhail, Joyce Erony and Charles Twyman of DH&S as well as Gerry Gaunt and Sean O'Neill of the DH&S Blantyre office; John Magombo, General Manager, and Eunice Kazembe of Admarc; John Hicks, former Mission Director, Carol Peasley, present Mission Director, Richard Shortlidge, Deputy Mission Director and Richard Day, Project Officer, of USAID Malawi.

All the foregoing, and others too numerous to mention, share the credit for the success of the divestiture program to date.

Appendix:	Persons Interviewed
Exhibit I:	Admarc's Development and Investment Portfolio
Exhibit II:	Report on Valuation of Assets by Mr. Robert E. Laport

PERSONS INTERVIEWED

MALAWI

Government of Malawi

Harry M. Mapondo, General Manager, Reserve Bank of Malawi
Justin C. Malewezi, Principal Secretary, Treasury
Brenda Killen, Financial Analyst
Gilton B. Chiwaula, Accountant General
and Acting Secretary to the Treasury
Z. T. Soto, Ministry of Agriculture
M. Jere, Ministry of Trade
Garth Armstrong, Comptroller, Department of Statutory Bodies
Charles Nthenda, Deputy Controller
Christopher I. Morgan, Financial Advisor
Mr. Chinthochi, Ministry of Economic Planning and Development

U.S.A.I.D. Mission

Carol Peasley, Director
Richard Shortlidge, Deputy Director
Richard Day, Project Officer

Private Sector

Keith N. Roberts, Managing Director, Lonrho (Malawi) Ltd.
John E. Smith, Finance Director, Lonrho (Malawi) Ltd.
Derry MacIntyre, General Manager, Press Bakeries Ltd.
Nitina Patel, Company Secretary, K.K. Millers Ltd.
Mr. Chadwick, General Manager, Press Agriculture
Mr. Clark, Press Agriculture
Austin D.C. Chilembwe, Group Finance Director, Maltraco
David Ludley, Finance Director, Kawalazi Estate Ltd., (CDC)
Colin Dickinson, Deputy General Manager, Commercial Bank of Malawi
Chris Barrows, Managing Director, Naming omba Estate
N. W. Mbekeani, Managing Director, Mkulumadzi Farm Bakeries Ltd.
G. N. Mbekeani, Operations Director, Mkulumadzi Farm Bakeries Ltd.

Private Sector

Sean O'Neill, Partner, Deloitte Haskins & Sells (Malawi)
Joyce Erony, Manager, Deloitte Haskins & Sells (London)
A. P. Stevens, Director, Economic Resources Ltd.
Robert Martin, Director, Economic Resources Ltd.
R. A. Stumbles, Partner, Stumbles and Rowe
John E. Smithyman, Manager, Old Mutual Malawi
John H.M. Carter, Director of Operations, Press Corporation Ltd.
John Z.U. Tembo, Chairman of the Board, Commercial Bank of Malawi
John Mason, Coopers & Lybrand (Malawi)

ADMARC

John Magombo, General Manager
Charles Twyman, Investment Coordinator
E. B. Salifu, General Manager, Grain & Milling Co. (on secondment from ADMARC)
G. S. Galimoto, Deputy Investment Coordinator
D. M. Harawa, Financial Controller
M. J.M. Phiri, Assistant General Manager (Finance)
E. G. Shaba, Assistant General Manager (Administration)
Eunice Kazembe, Financial Analyst

LONDON

John C. MacMillan, Managing Director, Africa Division, Cargill U.K. Ltd.
George Wadia, Director, J. Henry Schroder Wagg & Co.
Alistair Boyd, Director of Operations, Commonwealth Development Corporation
Peter R. Lawrence, East, Central and Southern Africa Department

WASHINGTON

Roy Southworth, World Bank
Fred King, World Bank
Rick Scobey, Country Economist for Malawi, World Bank
Robin McPhail, Partner, Deloitte Haskins & Sells

ADMARC'S DEVELOPMENT AND INVESTMENT PORTFOLIO

	Name	Business	% of Issued Shares Held	Sale Date
A.	COMPANIES			
1.	Admarc Canning Co. Ltd.	Food Processing	100	-
2.	Advanx (Blantyre) Ltd.	Tire Remolding	50	3/86
3.	Auction Holdings Ltd.	Tobacco Marketing	58	-
4.	Cattle Feedlot Co. Ltd.	Cattle, Cotton Farm, Livestock Breeding	50	-
5.	Cold Storage Co. Ltd.	Food Processing,	100	-
6.	Cotton Ginners Ltd.	Cotton Ginning	49(ord.) 50(pref.)	-
7.	David Whitehead & Sons Ltd.	Textile Manufacturer	49	-
8.	Dwangwa Sugar Corp Ltd.	Sugar Processing Factory	38	-
9.	Finance Corporation of Malawi Ltd.	Finance & Transport Holding Co.	100	-
10.	Grain & Milling Co. Ltd.	Maize & Wheat Flour Milling	100	-
11.	Investment and Development Bank of Malawi Ltd.	Development Bank	22	-
12.	Lever Bros. (Malawi) Ltd.	Consumer goods	20	12/86
13.	Maldeco Fisheries Ltd.	Industrial Fishing	100	-

	Name	Business	% of Issued Shares Held	Sale Date
14.	Malawi Tea Factory Co. Ltd.	Tea Processing & Marketing	40	-
15.	Manica Freight Services (Malawi) Ltd.	Freight Handling/ Forwarding	50	-
16.	Nat'l Bank of Malawi	Commercial Bank	33	-
17.	Nat'l Oil Industries Ltd.	Edible Oil Processing	100(ord.) 100(pref.)	-
18.	Nat'l Seed Co. of Malawi Ltd.	Agricultural Seed Supplier	72.5	3/89
19.	Optichem (Malawi) Ltd.	Fertilizer Distributor	33.5	-
20.	P.E.W. Limited	Trailer Manufacturer	87	8/87
21.	Sugar Corp. of Malawi Ltd.	Sugar Processing Factory	49	-
22.	United Transport (Malawi) Ltd.	Passenger Transport Services	35	-
B.	ESTATES			
1.	Buwa Tobacco Estates Ltd.	Tobacco, Maize	100	9/88
2.	Chasato Estates Ltd.	Tobacco, Maize	40	2/89
3.	Chirambe	Pig	-	6/88
4.	Chitale	Tobacco, Maize, Beans	-	OFS 8/88

EXHIBIT I

	Name	Business	% of Issued Shares Held	Sale Date
5.	Ekwendeni	Tobacco, Maize, Beans, Cattle	-	9/88
6.	Homboli	Tobacco, Maize, Beans	-	OFS 7/88
7.	Kasikidzi Estates Ltd.	Tobacco, Maize, Cattle	100	9/88
8.	Livilidzi Estate Ltd.	Tobacco, Maize	100	9/88
9.	Mangani Estates Ltd.	Tobacco, Maize	100	OFS 8/88
10.	Mfumba	Tobacco, Maize, Cattle, Pigs, Poultry	-	OFS 10/88
11.	Mlambe	Development Estate - Cashew Tobacco, Cotton, Maize, Sheep	-	OFS 10/88
12.	Nakawale	Tobacco, Maize	-	OFS 8/88
13.	Rathdrum	Tobacco, Maize, Dairy Cattle	-	OFS 5/88
14.	Tikondane Estate Ltd.	Tobacco, Maize	100	11/88
15.	Tobacco Estates Ltd.	Tobacco	50	est. 4/89
16.	Toleza	Tobacco, Maize, Cotton Estate to be retained by Admarc for training purposes		
17.	Viphya	Development Estate - Tung, Coffee, Poultry Estate to be divided up		
18.	Kavusi	Development Estate - Tea	100	3/89
19.	Mzenga	Development Estate - Macadamia	-	3/89
20.	Kwenengwe	Horticultural Products	-	-
21.	Sangalala	Poultry	-	-

	Name	Business	% of Issued Shares Held	Sale Date
C.	OTHER INVESTMENTS			
1.	Central Grading and Packing Co. Ltd.	Non-operating Co.	55	-
2.	Cory Mann George (Malawi) Ltd.	Shipping/Forwarding	50	-
3.	Hotels and Tourism Ltd.	Hotels	25	-
4.	Malawi Railway Holding Co.	Rail Transportation	-	-
5.	Spearhead Holdings Ltd.	Holding Co. of Commercial Investments	4	-
6.	Tobacco Marketing Co. of Malawi	Non-operating Co.	100	-

NOTES:
sale date - date of sales agreement
OFS - offer for sale; sales agreement not signed

Source : ADMARC Annual Report for year ended March 31, 1985

ADMARC DIVESTITURE PROGRAM

VALUATION OF ASSETS

The DH&S representative, Mr. Charles G. Twyman, has chosen to remove himself from the actual preparation of valuation documents. Given his role as Investment Coordinator (IC), he feels that he should instead, assume the responsibility for recommending the individual or entity most able to provide a reasonable and defensible valuation of a firm or estate property and provide quality control of the entire valuation process. Upon its selection the contracted individual or firm will proceed to value the asset.

A. Estate Valuation

The estate properties have been valued using the adjusted appraisal method. This is essentially an appraisal of land value by size, location, soil quality, drainage, and improvements, such as fencing, wells, and catchments, etc. The estimated value of dwellings, and other farm buildings and storage facilities, are added to the land valuation. The valuation of tractors, trucks, and other farm vehicles is separately arrived at, along with gasoline and other stores, since these can be sold as part of the estate package, or apart. New crops are only taken into account in terms of their cost of planting. Mature crops are also valued separately so that they can either be stripped from the estate valuation, in which case the present owner will harvest and sell the crop independently, or included in the purchase price, in which case the new owners will harvest and sell the crop.

The valuation of the estates posed the IC with a delicate problem. The Admarc executive committee decided that a minimum of 75% of the estate sales be to Malawi citizens. The price realized for the properties had to be fair and reasonable to Admarc. The system for selling the properties, considered to be highly desirable by the public, had to be beyond reproach; favoritism, or conflict of interest had to be eliminated from the process.

Rather than select from among several well known estate valuing firms, it was decided that all of the properties would be valued by one group in order to achieve a uniformity of approach. The National Bank of Malawi had within it a group of specialists, formed during the tobacco crisis of several years ago, which specialized in working out, or foreclosing on and selling, estates which had fallen into arrears with the bank. This group had, since, become a subsidiary of the bank and developed the valuation of estate properties as a product line. Admarc contracted their services. As sale of the estates was given high priority, the valuations were promptly accomplished.

The selection of the National Bank, a respected institution, to do the estate valuations was an inspired choice, in retrospect. In addition to a uniformity of appraisal criteria applied to the various property valuations, it also meant that the valuations of any one particular property could not be easily manipulated by collusion between an independent appraiser and a prospective buyer.

B. Valuation of Share Corporations

The IC has contracted with outside accounting firms to value the entities which fall into this category.

The corporations include the commercial, financial, and agro-industrial holdings in the Admarc portfolio, as well as the agricultural properties organized in corporate style such as Tobacco Estates Ltd., Sugar Corporation of Malawi, and Dwangwa Sugar Corporation.

The quality of the sample taken from the valuations thus far completed, about 35% of the total to be done, varies widely. The three complex valuations performed by DH&S which have been reviewed by this evaluator, Kavuzi/Mzenga Tea Estates, Sugar Corporation of Malawi and Dwangwa Sugar Corporation, are detailed financial projections and discounted cash flow models prepared on computer. These are large firms, and since together they represent a substantial portion of the total which Admarc expects to receive from the proceeds of the divestiture program, their valuation requires a highly sophisticated approach. The use of a computer model permits the assumptions, key to the preparation of financial projections, to be changed at will if successfully disputed by a potential buyer, and the resultant amended financial projection and valuation can be derived quickly and with little difficulty. The work reviewed is thorough and credible. Their calculations have included a range of desired rates of return (discount factors) which, in turn, gives a range of values.

Several valuations reviewed are unsatisfactory, in the opinion of this evaluator, in that they are incomplete and do not offer sufficient detail of information to substantiate the values that have been derived. These should be redone.

For instance, in the case of Grain and Milling Company Ltd., no projections have been prepared, yet the valuation derived is based upon future actions by the potential buyers. The IC anticipates that negotiations will begin with a wide divergence between his asking price and the buyer's bid. He has asked that the valuation be redone, as in its present state it will give him little support in negotiating a good price for Admarc.

The price/earnings ratio approach has been used based upon a spread of historical financial data. There has been no effort to project these numbers, yet the valuation is based upon an improved future performance discussed in the text. These is no way that a reader can make a logical bridge between the performance of the prior years and the valuation which has been derived, almost as an amount pulled from the air in an arbitrary fashion. The summary of the historical data is also too condensed; the textual coverage of trends, or changes in costs which are discussed cannot be followed in the spread sheet, since the spread omits cost data, jumping directly from revenues to operating profit. Salient information on revenues and costs discussed in the report as having impact on the past and future operating experience of the company should be shown in the financial spread sheet so that their impact on earnings can be readily seen.

There has been a textual attempt, but no numerical financial projections, to describe future operations of firms operating under new management outside of the Admarc environment. Economies that can be realized, and increased revenues that can be gained are foreseen, but the entire presentation is weakened by the lack of financial projections which should be accompanied by the assumptions on which they are based. Similarly, there is no justification in individual valuations giving reasons for the use of a multiple of three times or five times pre-tax earnings as the asking price.

C. Conclusions and Recommendations

The valuations examined by this evaluator fall into three categories, the estates which have been completed (and the properties sold, or in the process of closing), valuations of stock corporations prepared by DH&S, and those prepared by others. The DH&S valuations reviewed are complex, and consequently the firm has utilized sophisticated computer modelling to derive its valuation based on a discounted cash flow method. The financial projections and the underlying assumptions utilized are presented in great detail. In contrast, other valuations reviewed have not bothered to project financial results, therefore, the valuations derived are unsupported.

Since well over half of the valuations of corporate entities remain to be completed, it is recommended that the IC make it very clear the type of data he expects in the valuations prepared by outside auditors. This can be accomplished by preparing a checklist and providing it to the auditors at the time that the work is contracted. An appropriate list might include the following requirements:

- A brief history of the firm
- Comments on the environment and competition
- Balance sheet and discussion of balance sheet items
- Calculation and explanation of adjusted book value
- Discussion of historical operating results and changes foreseen as a result of internal or external factors
- Portrayal of operating results and financial projections
- Discussion of specific assumptions for projections
- Valuation based upon methods used and discussion of criteria employed for selecting the earnings multiple, percentage of adjusted book value, or relating the two

Use of historical and projected earnings, combined with the adjusted net asset value, should be sufficient for valuing most of the remaining companies, particularly those which are relatively uncomplicated. Computer generated cash flows should be used, however, when dealing with major firms and sophisticated buyers due to the facility of performing sensitivity analysis of key variables.

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