# AGRICULTURAL POLICY ANALYSIS PROJECT, PHASE III

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# THE FUTURE OF ADMARC: A POLICY ANALYSIS

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APAP III
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## LIST OF ACRONYMS

| | |
|---|---|
| ADD | Agriculture Development Division |
| ADMARC | Agricultural Development and Marketing Corporation of Malawi |
| AHL | Auction Holdings Ltd. |
| AIHCL | ADMARC Investment Holdings Company Ltd. |
| APAP III | Agricultural Policy Analysis Project, Phase III |
| ASAP | Agricultural Sector Assistance Project (APAP III Project) |
| ATC | Agricultural Trading Company |
| DWSM | David Whitehead and Sons Malawi Ltd. |
| FBS | Fertilizer Buffer Stock |
| MOALD | Ministry of Agriculture and Livestock Development |
| MK | Malawi Kwacha (currency) |
| MOU | Memorandum of Understanding |
| MRFC | Malawi Rural Finance Corporation |
| NSCM | National Seed Company of Malawi |
| SFFRFM | Small Farmer Fertilizer Revolving Fund of Malawi |
| SGR | Strategic Grain Reserve |
| SIP | Supplemental Inputs Program |
| TCC | Tobacco Control Commission |

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## PREFACE

This project was carried out for USAID/Malawi under Phase III of the Agricultural Policy Analysis Project (APAP III), Abt Associates, prime contractor and Development Alternatives Inc., subcontractor. Field work was performed between May 16 and June 24, 1996 by a two-person team consisting of Richard Abbott of Abt Associates and Roger Poulin of Development Alternatives Inc. Oversight of our work was the responsibility of an interministerial steering committee chaired by Mr. C.K. Tony Mita, Principal Secretary of the Ministry of Agriculture and Livestock Development (MOALD), and including representatives of the Department of Statutory Corporations, the Privatization Commission, and the Ministries of Economic Planning and Development, Finance and Commerce and Industry, and ADMARC. While in Malawi, the consultants coordinated their work closely with Mr. Scott Simons of the Economic Policy Support Unit, Ministry of Agriculture and Livestock Development through the Agricultural Sector Assistance Project (ASAP), an on-going activity of the APAP III Project in Malawi.

Terms of reference for the analysis called for the consultants to develop a strategy and action plan for the privatization of the commercial and social/developmental activities of the Agricultural Development and Marketing Corporation of Malawi (ADMARC). To carry out this assignment, the consultants held numerous meetings with the management of ADMARC, collectively and individually, and made field trips to view the Corporation's commodity purchasing and marketing activities in rural areas. Other meetings were held with donor agencies (World Bank, European Union), officials of the Malawi government (Ministry of Finance, Department of Statutory Corporations, Ministry of Economic Planning and Development, Privatization Commission), private sector agribusiness companies involved in input distribution and commodity trading and processing, and local management consultants.

The authors wish to thank especially Mr. Dye B. Mawindo, head of the Secretariat of the Privitazation Commission of Malawi, and Mr. D. Gale Rozelle, Agricultural Development Officer, USAID/Malawi, for their guidance. At ADMARC headquarters in Blantyre, the consultants gratefully acknowledge the cooperation and support of Mrs. Eunice Kazembe (General Manager), Mr. Dan Harawa (Assistant General Manager, Primary Operations), Mr. Peter Mulamba (Assistant General Manager, Finance), and Mr. Tikhala Chibwana (Assistant General Manager, Marketing), as well as the Controllers for Cotton, Tobacco, Maize, Markets and Depots, and Farm Inputs.

The final report benefitted from reviews of a draft version by the Steering Committee and ADMARC, as well as USAID and the ASAP Project. The authors also wish to thank Ms. Anne Conroy of the Ministry of Finance for her helpful comments on those sections of the report relating to input distribution.



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## EXECUTIVE SUMMARY

Under the terms of reference for this study, the consultants were to develop a strategy and action plan for the privatization of the Agricultural Development and Marketing Corporation of Malawi (ADMARC). Specifically, we were to "reassess ADMARC's commercial and social marketing functions in light of Malawi's on-going movement toward economic liberalization". Findings and recommendations in the report are accordingly presented under two corresponding headings: (1) the commercial functions and (2) the social and developmental functions of ADMARC. Briefly, we recommend the conversion of ADMARC's cotton and tobacco operations into two separate companies which would be privatized following one year's operation under the supervision of the Privatization Commission. With respect to its social role, we recommend a phase-out over two to three years of ADMARC's maize marketing and input sales functions, and the disposal to the private sector of all of its market facilities. In the more remote rural areas, the Government would contract with ADMARC to continue operations for two years pending a take-over of these functions by agencies of the Malawi government.

## I. ADMARC'S COMMERCIAL FUNCTIONS

*Cotton Trading Activities:*

ADMARC's cotton purchasing, ginning and export activity is potentially profitable but is burdened by indirect (overhead) costs charged to the trading account to cover ADMARC's very high administrative costs, marketing and depot expenses, and finance charges. It is recommended that this activity be spun off from ADMARC and established as a separate company with effect from the beginning of the 1998 fiscal year (31 March 1997). In the interim, a restructuring plan would be prepared by local business consultants, assisted by an industry specialist, in order to identify the facilities, equipment, staff, management and working capital required to make it a sustainable business enterprise, free of any government subsidies or loan guarantees, and able to compete with the other major player, National Seed Company of Malawi. The analysis would specify which of ADMARC's existing depots and marketing structures in rural areas are needed on either a lease or purchase basis and which cotton ginneries should be retained. The restructuring plan would be presented to the Secretariat of the Privatization Commission for action, namely the appointment of a general manager and board of directors to take charge of the new company for a limited time to establish profitable operation, preferably one year. After that, the company would become a candidate for privatization by the Privatization Commission.

*Tobacco Trading Activities:*

Liberalization measures have opened the tobacco market and Intermediate Buyers now account for a large proportion of sales of burley tobacco. ADMARC, which traditionally bought dark-fired tobacco from smallholders, has continued to dominate this specialized market. ADMARC's tobacco trading account, like that for cotton, is burdened by very heavy overhead charges, but the audited financial statements indicate that profit margins before allowance for overhead charges are quite respectable – 61% in 1995, 40% in 1996 and budgeted to be 35% in 1997. We conclude that a separate tobacco marketing company spun off from ADMARC is potentially profitable, provided it is free to select only those marketing facilities it needs to be competitive. We recommend a process similar to that proposed for cotton, that is, an analysis by independent consultants of what facilities, staff, and equipment are required to make the operation a sustainable business enterprise. Like cotton, the company would be established as of 31 March 1997 as a new independent company under the supervision of the Privatization Commission, and would be a candidate for privatization by 31 March 1998.

*ADMARC's Marketing Infrastructure*:

If the above recommendations concerning privatization of cotton and tobacco trading are adopted, together with the withdrawal of ADMARC from trading activities in other commodities recommended below, the question of the disposal of its properties remains. We recommend that ADMARC's extensive network of depots, parent markets, and unit markets, together with regional and divisional headquarters, be privatized over a five year period. Our proposal is that a separate property management company be spun off from ADMARC and all properties be transferred to the books of the new company. Like the other two spin-off companies proposed, a restructuring plan would be prepared for submission to the Secretariat of the Privatization Commission. The plan would include an evaluation of the market value of all such properties and would propose an appropriate management team and procedures for the disposition of these properties. Its charter would provide for a limited lifetime -- say five years -- during which it would be mandated to dispose of all ADMARC properties by sale or lease/purchase arrangements, liquidating any properties by sale to the highest bidder at the end of that period. The newly created cotton and tobacco companies would have the right of first refusal in the purchase or lease/purchase of marketing facilities before they are put on the market. The company should be established as soon as the Privatization Commission appoints management and quarters are located. It could begin immediately to market facilities which we understand ADMARC has already identified as unnecessary to their operations. This would serve the dual purpose of testing the demand by the private sector for these properties and putting the public on notice (through public announcements) that the transformation of ADMARC has begun.

*ADMARC Investment Holdings:*

Our conclusion with regard to ADMARC shareholdings in other enterprises through ADMARC Investment Holdings Company Ltd. is that the matter is already in the hands of the Privatization Commission and does not need further analysis by us. ADMARC management has abandoned its earlier position that certain of these holdings should be retained for strategic or business reasons and accepts the idea that they its holdings will be disposed of as part of the privatization effort.

## II. ADMARC'S SOCIAL FUNCTIONS

Spinning off the cotton and tobacco trading operations, as recommended above, would leave ADMARC with trading operations in maize and other commodities such as rice, groundnuts, sunflower seeds, and pulses, plus the sale of farm inputs such as fertilizer and seeds. These trading operations are carried out through an extensive network of markets and depots originally created to carry out ADMARC's social and developmental functions. Given the size and extent of these facilities, continuation of this role by ADMARC or successor organizations would be incompatible with the objective of encouraging the growth of the private sector of Malawi.

Since 1993, the Government's role in the economy has greatly diminished. It no longer controls prices for agricultural products or farm inputs. At present, its only role is to assure inter-year price stability for maize. During the current year, 1996/97, ADMARC is performing only one social function for the Government: buying 20,000 tons of maize at sixteen locations at the official floor price. In all other respects ADMARC is supposed to have a fully commercial orientation. As a commodity trading company it is completely free to determine what it will purchase or sell, in what quantities and at what price. One of its major trading activities this year will be to purchase maize on contract to the government for the Strategic Grain Reserve.

Although ADMARC's new commercial orientation has been established government policy for two years, there are continuing concerns regarding the social impact of a withdrawal of ADMARC from rural areas. These concerns have to do with: (1) how maize marketing would be carried out and the impact of changes on farmers and on consumers, (2) the low level of market development in remote areas, and (3) the adequacy of supply of inputs to smallholders.

The report's findings with respect to these three concerns are:

- First, the private sector already has the capacity to assume most of ADMARC's maize marketing activities. The most important of these are (1) buying, storing and selling maize in rural areas, (2) buying maize in rural areas and selling it in the large consuming areas, and (3) supplying maize to the Strategic Grain Reserve for the purpose of inter-year price stabilization. Private traders, including small scale rural farmers and traders, already account for a high proportion of the maize traded in rural areas, and have the capacity to move the product over long distances and store it. Likewise, private traders will supply a substantial portion of planned SGR purchases this year. Based on experience to date under economic liberalization in Malawi, and on development experience in other countries, we conclude that ADMARC's unprofitable activities in maize marketing have discouraged private sector entrance into these markets, and that the private sector can rapidly expand its level of activity once the public sector withdraws and the accompanying market distortions are no longer present.

- Second, there are regions of the country where markets are not well developed and which are perceived as being inadequately served by private traders. In these regions, ADMARC has been the only buyer of marketable surpluses, and the only supplier of farm inputs. The departure of ADMARC from these remote areas would result in some increase in private trader activity but there is no doubt that, initially, producer prices would be lower than ADMARC's and the prices of goods brought into the area would be higher than ADMARC's. Although this is not necessarily bad (some ADMARC prices were certainly sending the wrong market signals to the populations of these areas), it will be necessary for the Government to intervene in imperfectly functioning markets in some of these areas while marketing constraints are being addressed. However, this problem is best addressed directly by the Government rather than through an agricultural marketing parastatal such as ADMARC.



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- Third, the supply of inputs to smallholders is rapidly becoming a non-issue. The report finds that, with the liberalization of markets, inputs are increasingly being sold by private traders. The trend is strongest for hybrid maize seed. The largest supplier is now selling most of its seed through private retailers. The other major supplier sold 60 percent of its seed through ADMARC in 1995/96 but has expressed interest in increasing its private distribution network. For fertilizer, ADMARC remains the largest distributor, but suppliers began shifting to private traders last year. For both seeds and fertilizers, it is the opinion of the major suppliers that private traders would market their products more effectively than ADMARC is currently doing. Except for the remote areas, which were discussed above, ADMARC no longer plays a critical role in the supply of farm inputs to smallholders.

Based on these findings, we see two options for disposition of ADMARC's commercial trading operations in maize, other crops, and inputs. One has already been proposed by ADMARC: that it spin off an independent commodity trading company which would operate only in areas selected on the basis of commercial potential (which would be mainly the more populous areas of the country), that priority would be given to privatizing markets which cannot sustain the overhead of a centralized trading company, and that ADMARC operations in markets which are not commercially viable would either cease and assets be disposed of, or would continue with Government subsidies if deemed advisable for policy reasons. The feasibility of this option is discussed in Annex D to this report. However, we conclude that there is serious doubt that such a company could be competitive in the newly liberalized environment of Malawi, and we believe that its presence in the market would be a continued disincentive to private traders. Accordingly, we do not recommend this option.

A second option, which we recommend, is for ADMARC to progressively withdraw from commodity marketing and that its facilities and functions be assumed by the private sector over a period of three years. Our rationale for this approach, based on numerous visits and meetings during our stay in Malawi, is that ADMARC's very large presence in the rural economy of Malawi acts to discourage private sector investment. This would be true even of the scaled-down independent commodity trading company proposed by ADMARC, which would remain a dominant feature in the economic landscape. We recognize that this transfer of functions to the private sector would take time to achieve, especially in the more remote areas of the country, which is why we propose that the government retain a role in these areas for a limited time.

An action plan for carrying out this recommendation is presented at the end of Chapter 3 and is summarized below.

For the **non-remote areas of the country**, a phase-out plan should be prepared which would have four elements:

(1) Termination of local maize trading operations by ADMARC after the 1997/98 season, preceded by a public information campaign which would also announce that market facilities in non-remote areas which do not have significant maize surpluses will be sold to the private sector.



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(2) Phase-out of national maize marketing (movement of maize from surplus to deficit areas, mainly to Lilongwe and Blantyre) to be completed by the end of the 1999/2000 season, after which remaining market facilities would be sold to the private sector.

(3) Phase-out of farm input marketing over two years in coordination with the expansion of private supplier distribution networks in order to minimize the impact on farmers. ADMARC may decide to stock inputs in some remote areas where the private sector is not active for a year longer, possibly until 1999/2000.

(4) A plan for disposal of physical facilities, including the 13 depots, 77 parent markets, and 257 unit markets, all of which should be disposed of by the year 2000.

For the **remote areas of the country**, appropriate agencies of the Government should delineate those areas where marketing is the binding constraint, and those where additional constraints derive from a limited resource base or infrastructure deficiencies. For the first category, the Government would contract with ADMARC to continue operating its markets for two more years, that is, through the 1998/1999 season, except that prices will reflect real transportation and other marketing costs. For the second category, Government would formulate appropriate development programs for these areas and appropriate agencies of Government would assume all marketing and development function no later than the end of 1998/1999 season, at which point ADMARC would cease to operate in these areas. In the interim ADMARC operations would be fully subsidized by Government.

While it has not been possible to estimate the savings which would accrue to the Government of Malawi from the termination of loss-making activities of ADMARC, we are confident that there will be such savings. In our view, the most appropriate use of these funds would be infrastructure development in the remote areas referred to above.



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# 1. INTRODUCTION

## 1.1 Terms of Reference

The terms of reference for the present study call for the consultants to "reassess ADMARC's commercial and social marketing functions in light of Malawi's on-going movement toward economic liberalization". In choosing "The Future of ADMARC" as the title and subject of the study, USAID/Malawi indicated its desire to develop a strategy and implementation plan for the privatization of this large parastatal marketing organization which would find acceptance within the Government of Malawi and the international donor community.

With respect to ADMARC's commercial activities, the consultants are to:

(1) Examine and recommend trading activities for commercialization and eventual privatization.
(2) Prepare options for privatizing these activities for presentation to the Privatization Commission.
(3) Recommend minimal restructuring, as needed, to create the separate units appropriate for privatization within ADMARC. Identify how these units will be separated from the ADMARC corporate structure and remaining ADMARC activities.
(4) Prepare recommendations for the Privatization Commission on privatizing and selling off the ADMARC investment portfolio.
(5) Prepare a detailed Action Plan for implementing the privatization and restructuring proposals above. The plan should indicate the specific steps to be taken, who should be responsible for each action, and when each action should be completed.

As to ADMARC's social and developmental roles, the consultants are to:

(1) Determine whether and to what extent Government should continue to support these activities.
(2) Provide alternative approaches to performing whichever social functions are recommended for continued governmental support.
(3) Estimate the costs of performing the social function under the alternative approaches proposed, and indicate how these cost would be met.
(4) Prepare an Action Plan for implementing the recommended approaches, indicating specific steps to be taken, who should be responsible for each action, and when the action should be completed.

Finally, the consultants are to review the ADMARC Act and the Memorandum of Understanding for consistency with the proposed strategies and recommendations and propose changes that may be needed.

## 1.2 Organization of the Report

The layout of the report follows the terms of reference in that Chapter 2 covers the commercial activities of ADMARC and Chapter 3 deals with its social and developmental roles.

The two chapters constitute the body of the report and are self-contained in that each includes an action plan relevant to the activities covered in that chapter. The authors sought to keep the body of the report as succinct as possible by relegating all supporting information to a series of annexes. These annexes cover (1) ADMARC's structure and operations, (2) cotton trading activities, (3) tobacco trading operations, (4) maize and other commodity trading operations, and (5) input marketing activities.

Prior to departure from Malawi, the consultants presented their findings to the interministerial Steering Committee and to USAID. Subsequently, a draft version of the report was circulated within the Government and ADMARC for comment before the report was finalized.

# 2. COMMODITY TRADING ACTIVITIES

## 2.1 Overview

ADMARC trading activities carried out through its nationwide network of marketing facilities cover a wide range of agricultural commodities. The volumes and values of purchased commodities for the 1995/96 season and budgeted figures for 1996/97 are shown below to give an idea of the relative importance of these products; they do not show the sale value of the final product, which is much higher for products to which ADMARC adds value through processing, such as cotton, and to a lesser extent, tobacco.

**Table 2.1**
**ADMARC Commodity Purchases, 1995/96 and 1996/97**

| | Actual 1995/96 | | Budgeted 1996/97 | |
|---|---|---|---|---|
| | Metric Tons | 000 Kwacha | Metric Tons | 000 Kwacha |
| Maize | 87,086 | 119,300 | 130,000 | 207,510 |
| Cotton | 11,643 | 52,000 | 35,000 | 216,264 |
| Tobacco | 10,035 | 90,900 | 14,290 | 143,951 |
| Rice | 8,622 | 27,219 | 6,000 | 20,700 |
| Groundnuts | 2,342 | 14,000 | 2,500 | 18,022 |
| General Produce | 16,464 | 68,017 | 13,780 | 47,331 |
| Farm Inputs | 15,934 | 103,432 | 80,710 | 428,457 |
| Totals | 152,126 | 474,868 | 282,280 | 1,082,235 |

Maize, tobacco, cotton, and farm inputs together will account for more than 92% of purchases in 1996/97. Increased maize volumes for the coming year reflect the larger crop expected and larger purchases for the SGR than last year -- 50,000 tons, which will be sold for MK 110 million (110 million Malawi Kwacha). Large increases in purchases of cotton are expected due to much increased production, which is also true to a lesser extent for tobacco. The huge increase in farm input purchases are due to ADMARC's policy of buying fertilizer on its own account, rather than handling mostly SFFRFM (Small Farmer Fertilizer Revolving Fund of Malawi) fertilizer as in the past, for which it received a fee plus transport costs.

In the following sections, we assess the trading activities in cotton, tobacco and farm inputs and propose options for restructuring and privatization. Trading in maize and other crops is covered in detail in the following Chapter 3. While in the past, ADMARC's trading in maize, general produce, and farm inputs were in large part determined by its social and development role, trading in cotton and tobacco is strictly on a commercial basis. The assessment of ADMARC trading activities which follows takes these differing roles into consideration.

## 2.2 Cotton

### 2.2.1 Assessment of Current Operations

As described in Annex B on cotton trading activities, ADMARC competes directly with the National Seed Company of Malawi (NSCM) in that each buys cotton in producing areas and transports it to one of their three ginneries. (ADMARC owns 22.5% of NSCM but this holding is managed by a separate company, ADMARC Investment Holdings Co. Ltd. (AIHCL), and the two companies appear to directly compete.) There is only one other ginnery in Malawi, a small one in Karonga owned by a private operator.

Of the estimated 80,000 tons of seed cotton produced in 1995/96, ADMARC was expected to purchase about 60%, NSCM 35%, and others 5%. One difference between the two major players is that NSCM also processes cotton seed for oil for local sale. A recent entry into the market is ES Marketing, a family-owned company based in Limbe with links to a Zimbabwe-based company, where most of its cotton is shipped. ESM has no ginnery of its own and must pay either ADMARC or NSCM to have its cotton ginned. This company, although small, is very interested in acquiring ginning facilities and state that they can arrange the necessary financing.

In order to compete with ADMARC, NSCM buys directly from farmers but uses mobile buying stations instead of attempting to duplicate ADMARC's network of fixed marketing facilities. NSCM management would prefer to buy cotton from traders who would handle the financing of cotton purchases and its physical movement to the ginneries. The company would prefer to concentrate on its basic business, which is a processor of seed cotton for export and cotton seed and cottonseed oil for domestic sale and export. However, to compete with ADMARC, and in the absence of a well developed private trader network, NSCM is forced into engage in large-scale purchasing of cotton.

Analysis of ADMARC's cotton trading account shows that profit margins before the heavy indirect charges amounted to 37% on 1993/94, 22% in 1994/95, and 40% in 1995/96. Assuming direct costs (transport, handling, ginning, packing for export) are fairly allocated, these margins appear quite reasonable. After apportioning indirect costs among the various trading accounts, the cotton account made losses in 1993/94, a modest profit in 1994/95 and a small loss in 1995/96.

### 2.2.2 Options for Restructuring and Privatization

A potentially profitable cotton company could be established by spinning off from ADMARC some or all of the three ginneries, a small management team, some office facilities, trucks, and strategically located buying points and depots. This should be the subject of an analysis by a local business consultant, assisted by an industry specialist, with the objective of laying out -- between now and the end of the fiscal year on 31 March 1997 -- the structure of the new company and identifying key assets and staff positions. Only the staff which are deemed essential to profitable operation would be transferred from ADMARC to the new company. This restructuring plan would then be submitted to the Secretariat of the Privatization Commission, and the Commission would select a manager and board of directors of the new company and it would start independent operations at the beginning of the next fiscal year, 1 April 1997. Selection of the needed storage buildings and buying points would be facilitated by the transfer of all ADMARC's marketing infrastructure to a property management company, as described in Section 2.6. After one full year, assuming profitable operation, the company would go before the Privatization Commission for possible privatization in whatever form the Commission should decide. If the company is not profitable, the Commission could decide either to operate for one more year before reconsidering privatization, or to shut down the company and liquidate the assets.

To conclude, our recommendation is for restructuring and privatization of cotton operations over a two year period. The alternative would be liquidate ADMARC's cotton assets by sale to the highest bidder, but we do not favor this option. There is no reason to break up an established business which is potentially profitable once the burden of ADMARC's heavy overhead cost has been removed. In fact, if these assets were sold separately it could result in lessening competition in the cotton market since NSCM could potentially directly or indirectly acquire control of ADMARC assets and put itself in dominant position in the market.

## 2.3 Tobacco

### 2.3.1 Assessment of Current Operations

In the new liberalized environment of Malawi, ADMARC now competes in the market for tobacco with almost 700 growers' clubs and over 2,900 intermediate buyers. ADMARC was once the monopoly purchaser of dark-fired tobacco from smallholders, and still retains a major position in trading of this type of tobacco. Now that smallholders are allowed to grow burley, their production of this type of tobacco has increased sharply, while dark-fired -- which is more costly to produce -- has not kept pace. ADMARC's position in the tobacco market is presented in Annex C.

During the 1995/96 season, ADMARC purchased 10,035 tons of tobacco out of a projected total crop of 69,000 tons. Of this amount, 6,781 tons (68%) consisted of northern and southern dark-fired, 2,671 tons (27%) was burley, and 583 tons (5%) was sun/air dried and oriental tobaccos. Nationally, burley tobacco has made up 73% of the total, dark-fired 23%, and 4% sun-air dried and oriental tobaccos so it can be seen that ADMARC is still a major player in the dark-fired tobacco market. This type of tobacco also brings a higher price on the auction floor -- between MK 8 and 9 per kilo last year versus just over MK 5 per kilo for burley. ADMARC dark-fired tobacco is recognized on auction floors as being of good quality and commands good prices.

ADMARC's profit on tobacco trading, after allowance for all direct expenses, has ranged from 25% to 60% (averaging 42%) for the 1993/94 to 1995/96 period. ADMARC projects increased purchases (14,290 tons) for the 1996/97 year and a 35.3% profit after direct expenses. These margins, which appear quite acceptable, are however overbalanced by enormous indirect expense charges (for marketing, administration, financing costs), which have been between 35% and 69% of sales during the same period (averaging 60%), resulted in losses of MK 32 million in 1993, MK 7.2 million in 1994, and MK 2 million in 1995.

### 2.3.2 Options for Restructuring and Privatization

The ADMARC Tobacco Controller, a highly regarded tobacco expert now retiring, feels that a separate tobacco marketing company using only the market facilities and staff which are absolutely necessary, but retaining at least some of the eight grading sheds which it now has, would be profitable. As noted above, ADMARC has specialized in dark-fired tobacco, a type of tobacco with excellent market prospects, and ADMARC's staff appears to have expertise in this product.

As proposed above for cotton, we feel that a slimmed-down tobacco operation established as a separate and independent company could be profitable. While we have not been able to analyze in detail ADMARC's indirect expenses, it is quite evident from a visit to ADMARC that very substantial reductions in indirect costs could be achieved for a separate tobacco operation by eliminating the large headquarter facilities, numerous staff, and the cost of operating unneeded field marketing facilities. If the new company achieved sales of MK 222 million and profit after allowance for direct expenses of MK 89 million (40% of sales) as ADMARC did in 1996 (which is conservative since field operations can be expected to be more tightly managed), the company would make a profit if it kept indirect costs (amortization or lease of buildings and equipment, management and office expenses, and finance charges on borrowed capital) below the MK 89 million figure. This should not be difficult to achieve by a well-managed company.

Our recommendations with respect to tobacco are similar to those for cotton:

(1) A restructuring plan prepared by consultants, including identification of only those ADMARC assets and staff which are necessary for profitable operation.
(2) Submission of plan to the Secretariat of the Privatization Commission and naming of a manager and a board of directors.
(3) Operation of the company for one full year, after which the company becomes a candidate for privatization, the procedures for which are decided by the Commission.

As with cotton, the assumption is made here that ADMARC's marketing facilities are owned and managed by a new entity empowered to lease or sell the structures as the market demands. The proposed new tobacco and cotton companies should be given the option to acquire or lease these facilities before they are put on the market. We would like to point out that an important element of the restructuring plan would be a realistic cash flow analysis which would provide for sufficient working capital to minimize borrowing at the very high interest rates in effect.

## 2.4 Trading in Farm Inputs

### 2.4.1 Assessment of Current Operations

The 1995/96 season was the first in which private importer/distributors played a significant role in fertilizer distribution. Prior to that ADMARC acted as sole distributor for the SFFRFM and imported smaller amounts on its own. Dissatisfaction with the arrangement between ADMARC and the SFFRFM has developed on both sides and the two parties are increasingly going their own way. Last year, the SFFRFM began selling directly from its warehouses at prices lower than ADMARC's. For the present year's requirements, ADMARC is placing orders with importers for 67,000 tons, which will meet virtually all its estimated requirements for the smallholder market.

Past operations in fertilizer, when prices were fixed by government and sometimes were lower than cost, resulted in substantial losses to ADMARC's farm input trading account after allowance for direct expenses. In 1995/96, when ADMARC was free to set its own prices, fertilizer trading produced a very favorable 25% profit after direct expenses, even though handling costs for fertilizer distributed for SFFRFM and SIP were reportedly not fully covered. However, very high indirect charges assessed each of ADMARC's trading accounts to cover administrative, market operating costs, and finance charges, have consistently resulted in substantial losses. While data was not available on these indirect costs for 1995/96, it seems likely that there will again be bottom-line losses. For 1996/97, ADMARC will set its own prices to meet competition (though retaining the pan-territorial pricing system) and expects to least break even on these smallholder sales.

Private importer/distributors such as Norsk Hydro and Farmwise, and quasi-private organizations such as Optichem and Interrep, now account for roughly half of all fertilizer sales on their own account, not counting for amounts which are supplied to ADMARC and SFFRFM. They are vigorously expanding their distribution networks and will be increasingly capable of taking over the entire market.

ADMARC is still the main supplier of hybrid maize seed to smallholders through its market network, though competition is increasing from two other suppliers: National Seed Company of Malawi (NSCM) and Pannar Seed (Malawi) Ltd., formerly a division of Lever Bros. but separately incorporated since May 1996. These companies sell mostly through chains of stores, but also to a limited extent through other distributors like Farmwise and the Agricultural Trading Company (ATC). As in fertilizers, free distribution of seed through the Supplementary Inputs Proram (SIP), however important to farmers, is a disruptive factor in the market.

### 2.4.2 Options for Restructuring/Privatization

It does not take a lot of analysis to see that private sector distributors of farm inputs can assume in time all of the functions now carried out by ADMARC for the smallholder sector. They are already taking care of roughly half the markets for fertilizer and seeds and are expanding their distribution networks. Experience in other countries has produced a wealth of evidence that the private sector is a more efficient marketer of inputs and the result has consistently been a lowering of costs to the user. The only remaining issue is how fast and where?

It is clear to us that ADMARC's presence in the market has retarded development of a true private sector input distribution system in the more populous rural areas, which is where the bulk of the inputs are sold. While distributors like Norsk Hydro, Farmwise, and ATC have limited networks of distributors and still rely heavily on chain food stores to handle their product, several of these companies have told us of ambitious plans to expand their networks. It is equally clear, however, that it is not at present profitable for these companies to distribute in the more remote areas where distribution costs are high due to limited demand and the poor condition of roads. As proposed elsewhere in this report, the government will need to remain a distributor of last resort in these areas, probably at subsidized prices for several years yet, but such programs should have a limited time horizon and should be accompanied by developmental programs such as road building.

We recommend that ADMARC progressively reduce its purchases of inputs and allow the private sector to expand its sales. Over a two-year period, ADMARC should phase out its sales of inputs in areas not identified as remote, and should in these areas abandon the pan-territorial pricing system. This would require ADMARC to analyze its handling costs to arrive at prices which reflect true costs in the areas concerned. A public announcement of this change should include a statement that ADMARC will be phasing out of input distribution over two years.

## 2.5 ADMARC's Marketing Infrastructure

ADMARC's extensive network of depots, parent markets and unit markets are described in Annex A. Originally designed to serve the needs of a large, monopolistic marketing board, it is no longer appropriate to the restructured and privatized organizations foreseen in the preceding sections.

We have indicated above that separate cotton and tobacco marketing companies should identify only the space in these facilities they need to compete in a free market, and we have also noted that in fact the most cost effective way to buy is likely to be the use of mobile buying stations instead of fixed facilities in many locations. We also find that maize marketing functions now handled by ADMARC can readily be assumed by private traders over a two year period, except in the more remote areas, and that these areas be specifically identified as those where the government would retain for a limited time special support programs in maize and input marketing. We make specific recommendation in this regard in Chapter 3 of this report.

Our view is that retention of any of ADMARC's properties complicates the privatization process since there will be a natural tendency of management to want to retain control of certain parts of the network. Our proposal, as one option, is that all properties owned by ADMARC be transferred to a separate property management company and at the same time the properties be assessed to determine an approximate market value. Like the cotton and tobacco companies, this restructured company would go to the Secretariat of the Privatization Commission for appointment of management and a board of directors. However, unlike the others this company would be chartered for a limited lifetime, not to exceed five years. It would have the mandate to dispose of all ADMARC properties to buyers, though it could accept lease/purchase arrangements as well as long as the sale is completed by the end of the mandated period.

The newly created cotton and tobacco companies would have first call on these properties on a purchase, lease purchase, or temporary rental basis. Properties in the identified remote areas would be turned over to whatever government agency is appointed to carry out the former ADMARC functions there. Remaining properties would be offered for public sale. Properties in more populous areas with good road access would find a market first, while those in more distant regions would be difficult to dispose of and would bring lower prices. Any remaining properties on its books at the end of this period would be liquidated for whatever the market will bring. We understand that ADMARC has already identified some surplus properties and we recommend that these placed on the market immediately as a way of assessing demand and aiding in the valuation of these properties.

## 2.6 Privatization of ADMARC Investment Holdings

The consultants' terms of reference called for preparation of recommendations for the Privatization Commission on privatizing and selling off of ADMARC's investment portfolio. Following conversations with Mr. Dye B. Mawindo, head of the Secretariat of the Privatization Commission, we concluded that the Commission had already established a schedule of privatization of state-owned enterprises and parastatals which included ADMARC holdings and no recommendations on our part were required. Further conversations with the General Manager of ADMARC, Mrs. Eunice Kazembe, revealed that ADMARC had abandoned the position put forward in its document *ADMARC, A New Beginning*, that certain holdings should be retained for strategic reasons in any restructuring and privatization of ADMARC which might be undertaken. Indeed, the consultants can see no rationale for retaining any of these properties.

## 2.7 Action Plan

***ADMARC's Cotton Operations:***

(1) A consultant team consisting of a local business consultant and a cotton technical specialist (from Malawi or abroad, if necessary) are retained by the Privatization Commission (hereafter "the Commission") to prepare a restructuring plan for submission to the Secretariat by no later than 1 January 1997.

(2) The Commission reviews the restructuring plan and appoints a general manager and a board of directors in time to commence operations at the beginning of the fiscal year, 1 April 1997. The new company is incorporated and occupies quarters in the Blantyre/Limbe area but separate from ADMARC.

(3) After one year of operation, the Commission reviews performance of the company and decides if the company should be a candidate for privatization. If so, the company goes on the Commission's list for action as soon as feasible. If not, action is delayed for no more than one additional year, and if the company proves not to be viable by then, the assets are sold off by tender or auction.

*ADMARC's Tobacco Operations:*
(1) A consultant team consisting of a local business consultant and an experienced tobacco specialist (from Malawi or abroad) are retained by the Commission to prepare a restructuring plan for submission to the Secretariat by no later than 1 January 1997.
(2) The Commission reviews the restructuring plan and appoints a general manager and a board of directors in time to commence operation from the beginning of the fiscal year, 1 April 1997. The company is incorporated and occupies new quarters in the Blantyre/Limbe area.
(3) After one year of operation, the Commission reviews performance of the company and decides if it should be a candidate for privatization. If so, the commission goes on the list for privatization, and if not, action is delayed by no more than one year, and if not, assets are liquidated by tender or auction.

*ADMARC Properties:*
(1) A restructuring plan for a company to own and manage all properties currently owned by ADMARC is prepared by local business consultants, including a person knowledgeable on real estate in Malawi. As part of this process, the consultants will recommend a management structure and staffing, prepare a valuation on all such properties based on estimated market values, and propose procedures for managing the sale, lease/purchase, or lease (5 year maximum) of the properties. Provision is made for right of first refusal to the newly created cotton and tobacco companies of any marketing facilities they may need, and for the transfer of marketing properties in remote rural areas to whatever government agency is appointed to carry out social functions in these areas. The plan is to be completed by 1 January 1997 and submitted to the Commission for action.
(2) The Commission reviews the restructuring plan and appoints a manager and board of directors in time to commence operations by 1 April 1997. The company is incorporated and begins operations in new quarters in Blantyre/Limbe. The articles of incorporation specify that the company is created for the purpose of managing the disposal of all properties on its books and that it will cease to exist after five years, at which time remaining properties will be liquidated by auction or tender.
(3) The Commission reviews operations of the company on a quarterly basis to determine if its mandate is being accomplished. At the end of the five year life of the company, operations are terminated and the company ceases to exist, as outlined above.

## 3. ADMARC'S DEVELOPMENT AND SOCIAL FUNCTIONS

### 3.1 Recent Changes in ADMARC's Functions

During most of its existence, ADMARC held a highly profitable monopoly position in agricultural marketing and was expected to utilize part of its profits to perform a wide range of social functions for the Government. With liberalization, ADMARC gradually lost all of its monopolies, but was nonetheless expected to continue performing some of its traditional social functions. By 1992, it had become clear that these social functions were preventing ADMARC from becoming commercially viable. This led to the 1993 Memorandum of Understanding (MOU) which spelled out in detail ADMARC's social functions and how ADMARC would be compensated by Government for these services.

The MOU brings out how little liberalization in agricultural marketing had progressed by that time. ADMARC's responsibilities were listed as follows:

- ensuring that producer and consumer prices for maize remain within the price band set by Government, nationwide;
- maintaining the Strategic Grain Reserve (SGR) and following the Government's instructions on food importation and its distribution to deficit areas;
- maintaining the minimum producer price set by Government for "scheduled smallholder crops" other than maize;
- distributing fertilizer at maximum prices set by Government;
- for all crops other than maize and the scheduled crops, ensuring that smallholders have access to markets at "break even prices"; and
- buying and selling agricultural products and inputs as requested by Government.

The MOU never functioned as intended because: (1) prices on all agricultural products except maize were gradually decontrolled, (2) government subsidy programs for inputs were sharply scaled back, and (3) ADMARC was rarely fully compensated for its social services. ADMARC's main remaining social function was to purchase and sell maize in all areas of the country at a fixed producer and consumer price.

The present state of affairs is represented by the 1995/96 experience. The Government set the floor and ceiling prices for maize very late and looked to ADMARC to defend the price band by purchasing 200,000 tons in its parent, unit and seasonal markets. Floor and producer prices were set close together so that the newly introduced price band closely resembled the fixed producer and consumer prices of previous years. In the end, due mainly to a lack of financing, ADMARC purchased less than 90,000 tons on which it incurred slight losses, mainly because of its large overhead expenses. This quantity of purchases proved to be inadequate to protect the floor and ceiling prices in all regions of the country. ADMARC was also requested to distribute government fertilizer and small quantities of other inputs, on which they also incurred losses. Although the MOU is still officially in effect, it is no longer being applied either by Government or ADMARC.

This year, due to a major revision in the Government's maize price stabilization policy, ADMARC's social functions are more narrowly defined than ever. ADMARC's role in this year's price stabilization activities is spelled out in the *Action Plan for Maize Price Floor Support in 1996/97*, and in a letter from the Government to the ADMARC General Manager. In summary, these documents state that:

- The Government will no longer be setting fixed producer and consumer prices. Instead there will be a price band consisting of a floor price and ceiling price within which market prices will vary over time and in different regions of the country.

- At the beginning of the buying season the Government will purchase maize for the SGR by open tender for delivery at eight locations. This will tend to increase the market price. When prices rise above the ceiling, the Government will sell maize. This will increase supplies and tend to reduce market prices. The amounts to be purchased or sold will depend on the size of the harvest and the resulting price pressures. The maize will be purchased through open tenders. Both ADMARC and private traders have been invited to bid.

- In addition, because the private trading sector still lacks depth and breadth, the Government will contract with ADMARC to purchase maize at the floor price and sell it at the ceiling price at 15 direct intervention points.

- ADMARC will also be contracted to perform logistical management of the SGR.

- Government is not requesting ADMARC to perform any other social functions related to defending the maize price band.

The effect of this new policy is that, for the first time the Government is officially accepting that market prices will vary at different times and in different regions of the country. This is what characterized the private trade earlier. Much of Malawi's maize has always remained outside of ADMARC trading and the producer and consumer prices set by Government. For ADMARC, the new policy means that it will no longer be required to operate 1,200 buying and selling points to assure that smallholders can all sell their maize at a fixed producer price and consumers can all purchase maize at a fixed consumer price. In practical terms it means that ADMARC will be closing most of its seasonal markets.

### 3.2 Government's Remaining Social Functions as they Relate to ADMARC

This section examines each of government's remaining functions with respect to the marketing of agricultural products and inputs in the new liberalized environment, and explores the means by which they can be implemented. The section assumes, first, that the transition from a centrally planned to a market based economy will continue, including the privatization of public enterprises and the widening and eventual elimination of the maize price band, and, second, that the Government must carefully prioritize its social functions within the limits of its budgetary resources.

### 3.2.1 Inter-year Price Stabilization

The Government's most critical remaining function is the year-to-year stabilization of the maize price through a maize price band. The price band currently is set so narrowly that it requires the government to intervene at both the floor and the ceiling. The objective should be to widen the band quickly until the floor price is equal to the maize export price and the ceiling price is equal to the maize import price. When this is achieved, price stabilization will occur mainly through the private sector being net exporters during surplus years and net importers during deficit years. In addition, the Government will purchase maize at the floor price in years of surplus production and sell maize at the ceiling price during years of deficit production.

The specific tasks to be performed are to:

- set the floor and ceiling prices every year;
- during surplus years, purchase maize at selected locations, hold carry-over stocks and export the balance; and
- during deficit years, draw down carry-over stocks, import, and sell maize at selected locations.

This is the new role of the SGR. If the band is set properly, there should be no need for the government to purchase maize in a deficit year or sell maize in a surplus year; and in years when production is close to normal there would be no interventions.

The decisions with respect to setting the floor and ceiling prices, deciding quantities to purchase or sell, and deciding when and how much to import or export are Government's. In the new liberalized economic environment there is no reason why these decisions could not be implemented by the private sector, including a privatized ADMARC, under a competitive bidding process. At the present time, the only need for which ADMARC is necessary is to provide multiple storage points for the carry over stocks. If ADMARC were to be privatized, and the Government decides that the maize carry over stocks will be stored at multiple locations, it can either purchase the necessary warehouses from ADMARC, contract with the private enterprises who will have purchased them from ADMARC, or utilize SFFRFM warehouses. The maize stabilization function, therefore, does not by itself constitute an insurmountable reason for retaining ADMARC as a public enterprise.

### 3.2.2 The Hybrid Maize Issue

A top priority of Government is to increase maize production by shifting from local varieties to high yielding hybrid varieties. A view commonly held in Malawi is that guaranteed producer price has been an important factor in getting small farmers to shift from the low input local maize technology to the high input hybrid maize technology. Some are concerned that the elimination of a guaranteed producer price for maize will cause a decline in hybrid maize production thus threatening Malawi's food security.

Hybrid maize has in fact played an important role in the growth of maize production since the late 1980s. The area planted to hybrid maize increased from 87,000 hectares in 1988/89 to 326,000 hectares in 1992/93, and now stands at 364,000 hectares, accounting for 30 percent of total area and 51 percent of total production. This growth is attributable to a combination of subsidized inputs, subsidized credit, and a guaranteed producer price. The credit and input subsidies were eliminated in 1995 and the introduction of the maize price band has had the effect of removing the guaranteed producer price. The end result of these changes is to put hybrid maize production firmly on a free market basis.

What should the Government's role be with respect to hybrid maize? What are the implications of a guaranteed producer price and what would happen if there were no guaranteed price? The basic fact is that if hybrid maize production depends on a producer price that is above market levels, production is non-competitive and therefore non-sustainable. By liberalizing the maize market the import parity price becomes the floor producer price. This is especially true for hybrid maize, most of which is grown in the most productive parts of the country that have the most developed marketing systems. (See Annex D, Table 6.) Setting the producer price at the import parity price causes hybrid maize production to settle at an economically sustainable level. This level may not be a high as some would like, and may lead to a shift in both consumption and production patterns in some areas, but it would be sustainable and as such would make an important contribution to the country's food security.

The focus of government programs should be on increasing hybrid maize production in a context of increasing overall agricultural productivity. The Government is already moving down this path with the Maize Productivity Task Force. It is important that the Government resist the temptation to seek food security through either input subsidies or artificially high producer prices. Not only are there huge costs in terms of lost economic growth but, in the end, food security is not achieved and the actions that will achieve truly sustainable food security are postponed into the indefinite future.

### 3.2.3 ADMARC's Traditional Maize Trading Activities

A key issue facing the Government is whether there is a need for maize market interventions beyond the inter-year price stabilization function described above. Even if the Government accepts that the maize price should be allowed to fluctuate within a price band, there is the remaining problem that, due to the underdeveloped marketing system, farmers in some areas of the country will not be able to sell their maize at the floor price, even after adjusting for transportation and other costs, and consumers will consumers will not have access to maize at the ceiling price.

In Malawi, this issue is complicated by ADMARC's longstanding role as the buyer of last resort and the retailer at the maize consumer price in all areas of the country. ADMARC's maize interventions are described in Annex D. In summary, each year, based on the crop estimate, ADMARC would set purchase targets for each of its 77 market areas, and each area manager would decide how to allocate these purchases among the area's unit and seasonal markets. Since most of ADMARC's market areas are deficit in maize, ADMARC's typical maize marketing operations consisted of buying the maize at the beginning of the buying season, storing it in the area where it was purchased, and selling it to the local population during the period leading to the next harvest. In addition, ADMARC would transfer maize from the surplus areas, mostly in the Central Region, to deficit areas, mainly the large cities, where it would sell it at the ceiling price. ADMARC continued to play this role last year when it purchased 87,000 tons at 1,200 different locations.[1]

These purchases have had two purposes, both of which should be seen as having questionable social and development value. First, in maize deficit rural areas, the reason that ADMARC purchased maize, stored it, and later sold it in the same area was to prevent private traders from purchasing the maize at low early season prices and transferring it to high income deficit areas thus causing localized famine conditions later in the season. It is not obvious, however, that this should be a concern. In most areas ADMARC buys a very small fraction of the local production. Most of the maize grown in Malawi (at least 80 percent) is stored on the farm or is marketed locally by farmers and small traders. These quantities are many times what ADMARC purchases in a typical year. In the absence of ADMARC's market distorting interventions, it is likely that farmers would retain even more of their maize on the farm and local traders would store even more maize for sale between harvests. It is very likely that, far from improving maize supply and demand conditions in rural maize deficit areas, the major impact of ADMARC interventions has been to deter efficient and competitive private sector trading.

Second, ADMARC purchased maize in surplus rural areas and sold at the consumer price in Blantyre, Lilongwe and other cities. Because of the narrow margin between producer and consumer prices that have been in effect over the years, ADMARC continues to dominate this market. This year, for example, ADMARC expects to purchase 70,000 tons in the surplus areas of the Central Region. Of this quantity, 9,000 tons will be kept in the surplus areas for resale and the balance will be transferred to deficit areas: 7,000 tons to the Salima Division, 10,000 tons to Lilongwe, and 44,000 tons to the Southern Region. However, as in the case of the deficit rural areas, there is little reason to believe that this very basic marketing function could not quickly be transferred to private traders. Most of the major maize surplus areas are not particularly remote and are relatively accessible, especially during the dry season. Private traders are already purchasing maize in these areas. More importantly, their level of activity for crops other than maize, including tobacco, pulses and oilseeds, is considerably larger than ADMARC's. The combined tonnage of these crops exceeds 200,000 tons, indicating that the private trading sector already has the capacity to move the maize quantities being marketed by ADMARC. They are

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[1]See Annex D for a more detailed discussion of ADMARC's maize trading activities in recent years.

currently using that capacity to market more profitable crops. All that is needed is for maize marketing to be liberalized just as it has been for the other crops. In the short run, any storage needs could be met by the ADMARC markets through sale or lease. In the long run the private traders would provide for their own storage.

Two important lessons have been learned from the liberalization of the crops other than maize. First, competition between traders has put upward pressures on farmgate prices and downward pressures on sale prices, resulting in higher rural incomes and more competitive selling prices than prevailed before liberalization. This shows up especially in private sector purchases of pulses, oilseeds and tobacco. Second, when these private traders compete directly with ADMARC for specific commodities, (e.g., sunflower seeds, pigeon peas, burley tobacco) they are usually able to offer higher producer prices and end up taking market share away from ADMARC. Once again it appears that the private sector would be able to market maize from surplus areas to the cities more efficiently than ADMARC, to the benefit of both the producer and the consumer.

### 3.2.4 The Issue of Remote Areas

Even accepting that in most areas of the country ADMARC's maize trading activities would be more efficiently carried out by the private trading sector, there is still the issue of the remote areas that are underserved by private traders. The problem in remote areas is wide marketing margins. The main cause of these wide margins is the high marketing costs, due to poor roads, long distances, and low marketing volumes. A secondary cause is that the low levels of marketable surpluses and purchasing power in these areas lead to a low level of trading activity which in turn leads to lack of competition and excessive marketing margins. Under these conditions, many farmers are forced to turn to subsistence farming both because the price they can get for their cash crops is too low and the price they would have to pay to buy food is too high. In allocating their productive resources (land and labor), they decide that growing their own food with a minimum of inputs provides a better return than growing marketable surpluses.

For these areas, increasing market access must be part of an integrated development approach that includes: infrastructure development, agricultural production projects (extension, inputs, credit), institutional development, and programs to encourage private trading activity (credit, storage, financial incentives). The full package of interventions should be the result of a remote areas project design effort conducted jointly by donors and the Government, and should reflect what the government can afford in terms of recurrent expenditures in these areas. It is critical, however, that the approach not consist primarily of market interventions of the type currently being performed by ADMARC, or of these types of interventions as the base to which other development interventions are added. Rather, the approach should be to design a package of interventions that are based on increasing agricultural productivity and improving rural infrastructure, to which short-term market interventions to counteract monopoly rents are added. There should be an unmistakable break between the ADMARC interventions of the past and what the Government will be doing in the future.

It is important to emphasize that not all rural areas are remote. In Malawi, most of the cash crops, including maize, are grown in productive highly populated areas with developed markets and relatively good market access. These areas can always use improved infrastructure, but they do not need Government interventions to make the markets function better. Within these areas, producer and consumer prices will vary depending transportation and other marketing costs. These variations are not only acceptable, they are an indication that markets are sending the price signals that are necessary for rural producers to make optimal resource allocation decisions.

It is also important to emphasize that not all remote areas should have the same priority. Rural infrastructure development should be closely linked to development potential and should focus on areas where the lack of infrastructure constitutes an obvious binding constraint to growth. This means areas where farmers are prepared and able to produce marketable surpluses and traders are prepared to purchase those surpluses, but the level of activity is being held back by marketing constraints (roads, communications, support services). This approach assures that infrastructure investments are not wasted. The Government should avoid the opposite approach of identifying remote areas where production and incomes are low, and build infrastructure in order that increased economic activity can take place. Increased economic activity rarely follows infrastructure investment. Sometimes the necessary productive base simply is not there, and even when it is providing infrastructure is usually not enough to jump start the growth process. Investing in infrastructure in areas where the growth process has already begun, however, will allow even more growth to occur. This is the strategy the government should follow in the remote areas.

### 3.2.5 Distribution of Food Aid

Food aid to Malawi is of two types, relief and commercial. In 1994/95, the most recent drought year, these two types of aid totaled 165,000 and 179,000 tons respectively. The relief aid is distributed directly by the government departments responsible for food security and by NGOs, mostly through three national programs: food for work, school children feeding, and vulnerable group feeding. The Government's only use of ADMARC for the relief food aid is to store the imports in ADMARC depots. The off-take from these depots is handled entirely by government agencies. Even at the local level, the food is distributed under the supervision of District Commissioners without passing through the ADMARC markets.

On the other hand, commercial food aid has traditionally been distributed through ADMARC markets. Because the main purpose of this aid is to supplement the supply of food at the national level and to generate counterpart funds for development activities, its distribution is untargetted. There is no reason, therefore, why this food could not be channeled through private traders. This would help the private sector enter the national maize market where the narrow price bands of past years have been such a deterrent. A mechanism for allowing private traders to bid on government or donor-owned food has already been put in place by the SGR.

### 3.2.6 Agricultural Inputs

Government has traditionally played a very large role in input distribution in Malawi. Prior to 1993, farmers received subsidized credit through the now defunct Smallholder Agricultural Credit Administration, as well as subsidized seed (35 percent) and fertilizer (25 percent) through ADMARC. Although the subsidized credit and input programs have been discontinued, several government interventions remain. The largest is a parastatal for importing fertilizers -- the Small Farmer Fertilizer Revolving Fund of Malawi (SFFRFM) -- which, until last year, distributed over 100,000 tons per year through ADMARC markets. Next is the Fertilizer Buffer Stock which has grown to 90,000 tons and from which fertilizer is in theory rotated by the SFFRFM and private traders. Finally, there is the Supplemental Inputs Program (SIP) which distributes free inputs to farmers affected by the droughts of recent years. Last year, the SIP distributed 23,000 tons of fertilizer and 3,200 tons of hybrid maize seed.

By far the largest distributor of these government financed inputs has been ADMARC. This year, however, ADMARC plans to sell only inputs purchased on its own account. The amounts remain substantial: 67,000 tons of fertilizer, 2,000 tons of hybrid maize, and a large percentage of the pesticides used in cotton production. Since most of these inputs are destined for smallholders, it is clear that ADMARC continues to be an important supplier of inputs, especially to small maize, tobacco and cotton farmers. If ADMARC were to remain a public enterprise, it most likely would continue to play a major role in the distribution of agricultural inputs.[2]

However, since input marketing has been so unprofitable in most of its rural markets, it is highly unlikely that a privatized ADMARC would continue to sell these products at present levels. Assuming that the SFFRFM were also privatized, there is good reason to expect the private sector to fill most of the void, especially since most of the smallholder input use is concentrated in two or three relatively accessible ADDs. Section 2.5 above describes the rapid expansion of private fertilizer suppliers and small fertilizer traders in recent years. The nature of the fertilizer trade is such that, if there were no ADMARC outlets selling at a loss in rural areas, inputs would become available wherever there are private wholesalers and retailers trading in food crops and consumer goods. Privatizing ADMARC's input distribution activities would therefore be one more significant step in creating a dynamic private sector presence in rural areas.

This would leave only three government roles related to inputs: managing the fertilizer buffer stock, distributing inputs as a welfare measure following drought years, and distributing inputs as part of agricultural development projects introducing new technologies. The first of these is the responsibility of the FBS Management Committee and the other two can be carried out by the MoALD agricultural extension service.

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[2]See Annex E for a detailed discussion of ADMARC's input trading activities and prospects for privatization.

### 3.2.7 Summary

In the new liberalized environment, the Government has the following social functions as they relate to the future of ADMARC:

- Inter-year maize price stabilization. This involves setting the price band, managing the grain reserve and maize price stabilization fund, deciding the quantities to buy or sell, and deciding when and how much to import or export.

- Encourage the production of maize as the country's staple food crop. This involves moving away from guaranteeing a pan-territorial floor price to supporting improved maize technologies in a context of market-led increases in agricultural productivity.

- Address the needs of remote areas underserved by private traders. Here the focus should shift from buying and selling at guaranteed prices to removing the marketing constraints, mainly poor rural roads and low agricultural productivity. During a transition period, the Government will need to assure 1) an adequate availability of food in remote areas that have a comparative advantage in non-food cash crops and therefore have a food deficit, and 2) provide a temporary market for farmers who may have erroneously chosen maize as a cash crop because of ADMARC's presence in the area as a buyer of last resort.

- Encourage increased private sector participation in maize marketing. This requires that the Government take the initiative to widen the maize price band, phase out ADMARC's local maize trading activities as rapidly as possible, and gradually eliminate ADMARC's role in moving maize from the surplus growing areas to the large consuming areas.

- Food aid distribution. The government's role should be limited to the distribution of relief aid through its existing targeted programs. Commercial food aid should be sold through private trade channels as one way of increasing private sector participation in national maize marketing.

- Create conditions for the complete privatization of agricultural input marketing. This requires taking the initiative in reducing and gradually eliminating the large roles currently being played by ADMARC and the SFFRFM. The Government's only remaining functions would be to manage the FBS, arrange for the distribution of free or subsidized inputs following years of severe drought and provide inputs as part of agricultural production projects.

## 3.3 The Role of ADMARC

Quite aside from the issue of the Government's social functions in a liberalized economic environment is the issue of ADMARC's role in their implementation. The previous section draws three main conclusions with respect to ADMARC's past and present social functions.

First, the private sector already has the capacity to assume most of those ADMARC marketing activities that have a social function. The most important of these are (1) buying, storing and re-selling maize in rural areas, (2) buying maize in rural areas and selling it in the large consuming areas, and (3) selling farm inputs to small farmers. In some cases, the private sector would be immediately able to assume these functions; in other cases ADMARC would have to phase out gradually.

Second, the marketing activities that ADMARC has been performing as a social function have constituted a serious obstacle to private sector growth in rural areas. Specifically, ADMARC's unprofitable activities in maize and fertilizer, especially the policy of pan-territorial pricing, have effectively prevented the private sector from entering these markets. In markets where ADMARC is not subsidized by the Government, i.e., crops other than maize, the private sector has grown and in some cases surpassed ADMARC.

Third, because of its intended commercial orientation, ADMARC is not well suited to implement government social functions. Experience with the MOU has shown that there is constant disagreement between what the Government wants done and what ADMARC is willing to do and at what price. ADMARC constantly maintains that it cannot become commercially viable as long as it is required to perform social functions for which it is only partially compensated. There is no reason why functions that do not need to be carried out directly by Government cannot be contracted out competitively to the private sector.

Based on these conclusions we recommend that the Government phase out ADMARC's activities in rural areas as rapidly as possible. We estimate that with good planning and an effective public information campaign the phase out should take no longer than three years. Our specific recommendations with respect to each of ADMARC's roles are as follows:

- ***ADMARC's role in remote areas.*** ADMARC will continue to be needed in remote areas until the Government sets up an integrated development program as described in Section 3.2.4 above.
- ***ADMARC's role in local maize trading.*** ADMARC should phase out of buying, storing and reselling maize in rural areas, leaving this role to the private sector.

- ***ADMARC's role in national maize marketing.*** ADMARC should phase out of its role of purchasing maize in surplus areas for transfer to deficit areas as rapidly as the private sector can take over those markets.

- ***ADMARC's role in inter-year maize price stabilization.*** Arrangements are already underway to obtain technical assistance for restructuring the Strategic Grain Reserve. Once this process has been completed it should be possible to transfer management of the maize price stabilization stocks to a government price stabilization and food security agency (the successor to the SGR). Activities currently being carried out by ADMARC, including managing the SGR and "getting the market started" at the floor price, can be contracted out to the private sector.

- *ADMARC's role in supplying farm inputs to smallholders.* ADMARC should immediately start phasing out of input marketing.

- *Disposal of marketing facilities.* Based on the above phase-out actions, ADMARC should identify depots and markets that it will not need during the transition period and put them on the market for sale. The objective would be to provide concrete evidence to farmers and the private sector that ADMARC's reduced presence in rural areas is real and permanent.

The end result of these actions would be to phase ADMARC out of all marketing activities over the next three years. All of the Government's remaining social functions that were previously performed by ADMARC would be contracted out to the private sector.

### 3.4 The Action Plan

The proposal here is to phase out ADMARC as rapidly as possible because it is a vestige of the past and is having a significant negative impact on growth in rural areas. For this phase-out to be possible, it will be necessary for the key Government ministries -- , and Agriculture and Livestock Development (the parent ministry), Finance, Economic Planning and Development -- to agree that, as a matter of Government policy, ADMARC's commodity trading activities should be ended as soon as possible and to so instruct ADMARC.

#### 3.4.1 ADMARC Phase-Out Activities to Date

It is important to note that, from the farmers' standpoint, ADMARC's phase out from its traditional agricultural marketing roles is already well underway. As a result of liberalization, ADMARC accounts for less than 25 percent of the general produce (pulses, oilseeds, groundnuts, soybeans, etc.) marketed. For tobacco, it is still the major buyer of dark fired tobacco, but accounts for less than 10 percent of the smallholder burley market. For farm inputs, it stopped being the sole supplier to smallholders in 1994/95 and after only one year accounted for well under half of hybrid maize seed and less than two thirds of fertilizers sold to smallholders. For maize, its role is also declining but remains significant. Its maize trading in recent years has been as follows (thousand tons):

| Year | Purchases | Sales |
|---|---|---|
| 1993/94 | 383.0 | 277.4 |
| 1994/95 | 61.3 | 172.9 |
| 1995/96 | 87.1 | 88.0 |
| 1996/97 (projected) | 130.0 | 125.0 |

In 1995/96 ADMARC neither sold nor purchased maize for the SGR. In 1996/97, its projections include the purchase of 50,000 tons for the SGR. The important point to make here is that, if we assume that the large deficit areas of Malawi consume 300,000 tons that must be brought in from surplus areas, ADMARC has accounted for well under half of this market for the last two years.

Seen from this perspective, the goal of reducing ADMARC's share to zero does not seem so daunting.

### 3.4.2 Phasing out of Non-remote Areas

The Government should decide which regions of the country will be considered "remote" for purposes of agricultural market development, and ADMARC should prepare a phase out plan for non-remote areas. These are the areas that are densely populated, where productivity is high, distances are short, and the private sector is active. It should be emphasized that these areas account for most of the rural population and most of the country's agricultural production. ADMARC has two types of maize marketing operations: 1) local maize trading which consists of buying maize, storing it and reselling it in the same area, and 2) national maize marketing which consists of purchasing maize in surplus areas and transferring it to the large consuming areas. Where ADMARC purchases maize it also purchases other agricultural commodities and sells farm inputs. Its phase out plan should cover all of these activities.

*Local maize trading*. ADMARC's first priority should be to phase out of local maize trading. ADMARC began cutting back on this activity in 1995/96 because of financial constraints, and will be cutting back even more in 1996/97. A joint ADMARC-Government public information campaign, which should begin this year, should stress that 1997/98 will be the last year in which ADMARC will be carrying out local trading activities. The public information campaign should also state that all ADMARC markets in non-remote areas that do not have significant maize surpluses will be sold to the private sector at the end of the 1997/98 marketing season.

*National maize marketing.* In the large maize surplus areas where ADMARC purchases maize to sell in the large consuming areas, ADMARC should plan a phase out that is based on the private sector's capacity to take over. This means that the largest cuts in ADMARC activity would be in those areas where productivity is high, distances are short, and the private sector is the most active. For example, there is no reason why the private sector cannot supply the deficit Salima area and the Lilongwe urban area from the maize surplus areas of the Central Region. This is where ADMARC should begin the phase out of its national maize marketing activities. The purchase of maize from the Kazungu and Mzimba areas for sale in the Blantyre/Limbe urban area and in the large maize deficit rural areas of the Southern Region would be phased out over three years beginning in 1997/98. This means that the last year of ADMARC maize purchases in surplus areas would be 1999/2000. Its market facilities in these areas would be sold to the private sector at the end of that marketing season.

*Farm input sales to smallholders.* ADMARC's sales of farm inputs can be phased out on its own schedule in coordination with private suppliers. These suppliers can inform ADMARC of where they already have private sector outlets for their products and where they can easily add outlets. ADMARC should be able to stop selling inputs in these areas in 1997/98, and stop selling inputs completely in 1998/99. However, it may wish to stock token quantities in active markets as a way of minimizing any possible political impact.

***The disposal of ADMARC's market facilities.*** By the end of 1996/97, ADMARC should have a plan for disposing of its 13 depots, 77 parent markets and 257 unit markets. The geographic location of these markets is shown in Annex D, Table 3. Some will be scheduled for sale in 1997/98, some in 1998/99, and some in 1999/2000. The Government's ***Vision 2000*** for ADMARC should be that all of its market facilities will have been privatized.

It is clear that the above phase out plan will be possible only if there is well conceived public information campaign. The message should build on the changes that have already occurred, emphasizing that ADMARC has already ceased playing its traditional role and in a few more years the organization itself will cease to exist. The major changes that have already occurred make this message much more palatable than it would have been even two years ago.

### 3.4.3 Phasing out of Remote Areas

The remote areas are those where the private sector will be unwilling or unable to provide the same level of marketing services now being provided by ADMARC. The Government should divide these areas into two categories: those where marketing is the binding constraint to economic growth, and those where the marketing is not the binding constraint, i.e., areas that have a limited resource base or have other development problems that need to be addressed before marketing becomes the binding constraint. For the first category only, the Government should contract with ADMARC to continue operating its markets for two years, 1997/98 and 1998/99. ADMARC will purchase agricultural commodities at prices that reflect transportation and other marketing cost differentials, and will sell maize and farm inputs on the same basis. Once the Government has formulated appropriate development programs for these areas (i.e., after the 1998/99 season), ADMARC will cease operations, its market facilities will be sold, and the Government will take over. In remote areas where marketing is not the binding constraint, ADMARC should discontinue its marketing activities as soon as possible and sell its facilities.

# ANNEXES

## ANNEX A
## ADMARC STRUCTURE AND OPERATIONS

### 1. The Changing Role of ADMARC

ADMARC is an amalgam (in 1956) of three separate organizations, the National Tobacco Board, the Cotton Marketing Board and the Produce Marketing Board, which later (1951) became the Farmers Marketing Board, and in 1971 the Agricultural Development and Marketing Corporation. ADMARC's objectives as defined by an act of Parliament, was to increase the volume of exportable crops and to improve the standard of such produce, to maintain "an effective system of supplying the agricultural requirements of persons farming on customary land", and to "maintain and improve with a view to profitability a system for marketing of agricultural produce for export and to promote the consumption of such produce abroad and in Malawi". To carry out these functions, ADMARC was given monopoly power over marketing of smallholder produce, including cotton, livestock, dark western tobacco and any other produce grown and commodities derived from customary or public land. It purchased at prices set by Government any smallholder crops brought to its buying points, and sold this produce to consumers. This function imposed a supply balancing function on ADMARC, requiring it to move food crops from surplus to deficit areas. Maize was bought and sold at fixed prices. For tobacco and cotton, Government fixed the buying prices, while selling prices were determined on the auction floor for tobacco and by world market prices for cotton. Beginning in 1987, market liberalization measures gave private traders the right to compete in some crops, but not in maize, the principal staple food crop. Cotton was liberalized from 1993/94 and dark western tobacco in 1994/95. Local trading activities in maize were never controlled.

Government attempted to resolve the contradiction between ADMARC's commercial and social roles in a 1993 Memorandum of Understanding which defined its functions as one of acting as buyer and seller of last resort of staple food crops, and committing Government to reimburse ADMARC for all costs associated with its social role. Government fixed the buying selling prices of maize, and also fixed the selling price of maize hybrid seed in order to boost the uptake by the smallholder farmer. Any losses which occurred as a result of this policy were to be reimbursed by Government, though appears that Government has never fully compensated ADMARC for these operations. Clearly, the MOU could not and did not resolve the contradictions in ADMARC's dual roles. [3]

### 2. Current Operations of ADMARC

ADMARC is currently in a transition phase as it adjusts to the new liberalized economic environment. Management is trying to cope with the changes resulting from the new situation, but its task is complicated by a lack of consensus at the Ministerial level on its future role. Until the current year (year ending 31 March 97), ADMARC continued to use its extensive network of

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[3] Information for this section is drawn in part from an excellent report by Lincoln Bailey, *Overview and Assessment of State Owned Enterprises in the Agricultural Sector,* prepared under contract to USAID/Malawi, September 1995.

markets to buy any produce bought to it and to sell fertilizer, seeds, and other inputs -- although at market prices for all products other than maize. As of June 1996, ADMARC has received a directive instructing it to purchase a specified tonnage of maize for the Strategic Grain Reserve and to purchase maize for its own account at prices which maintain producer and consumer prices within a specified band. This will be done at 15 buying points throughout the country, a radical departure from past practices. The same directive invites ADMARC to bid on maize which is being purchased by the SGR on the open market. Finally, ADMARC will be purchasing maize on its own account. It will continue to move maize stocks around within its marketing network, buying at the official price and selling at or below the ceiling price.

As to farm inputs, ADMARC plans the purchase of 67,000 tons of fertilizer (either by tender from importers or by direct import) which will be sold at commercial prices. This is part of management's strategy to improve throughput (utilization) of the markets during the off-season -- the period during which there are no crop purchases. This is also a departure from past practice, by which most of the fertilizer distributed by ADMARC came from the SFFRFM under an arrangement which covered the cost of transport plus 5.6%. ADMARC may also distribute some fertilizer for the SFFRFM if a satisfactory arrangement can be made to make it a commercially viable operation.

## 3. Organizational Structure

Under the General Manager (Eunice Kazembe) is a Deputy General Manager (E.B. Salifu), and three Assistant General Managers with responsibilities as follows:

- Finance (P.E. Mulamba)
- Primary Operations (D.M. Harawa) - Markets and Depots, Farm Inputs
- Marketing (T. Chibwana) - all commodity trading except farm inputs

Mr. Mulamba is responsible for ADMARC's financial reporting and supervises the accounting staff. Reporting to Mr. Chibwana are "Commodity Controllers" responsible for trading activities in tobacco (H.W. Kabambe), cotton (H.E. Gulani), maize (H.M. Chimwele), and General Produce/Pulses (E.B. Kanchowa). Reporting to Mr. Harawa are Regional Managers for the South (I. Kazanga), Center (D. Maluwa) and North (E. Zakeyo), Controllers for Markets and Depots (E.Y. Sawerengera), and Farm Inputs (F. Kaima). Regional Managers directly supervise regional field staff throughout ADMARC's marketing network. The various Controllers are responsible for implementing policy. ADMARC personnel nationwide number about 6,500 permanent staff, verified by a "head count" carried out in April 1996. This includes 5,660 junior staff, of which about 3,600 are laborers and the rest supervisory personnel, and 917 senior staff. Seasonal employees hired during the cotton and tobacco marketing seasons number between 1000 and 1500.

## 4. Marketing Infrastructure

ADMARC's network of market facilities are mapped on Figure A-1 on the following page. (See Annex D for a full list of facilities by type and location.) Basically, the system consists of a four-tiered structure: a Regional Office in each of three regions of the country, twelve divisional offices, 72 Areas Offices or Parent Markets which are linked to Unit Markets located in the rural areas each serves -- a total of 277 throughout the country. Thirteen large depots serving as storage and transfer points complete the network. (ADMARC also operates seasonal markets dependent on level of production in the respective areas.) The accompanying map shows locations of the regional and divisional offices, depots and parent markets. The Center Region has the highest concentration of facilities, followed by the South, while the North has a considerably lower concentration. The concentration of infrastructure in the Central Region reflects the policies pursued in the past whereby the tobacco trading activities were cross-subsidizing the other activities, mainly the food crops.

## 5. ADMARC's Financial Performance

Profit and loss statements for 1993 through 1996, and budgeted figures for 1997, are shown in Table A-1. Evaluation of this performance must take into account three important factors: (1) greatly reduced crop production during the drought years of 1992 to 1994, (2) the effective devaluation of the Kwacha by one third when a floating rate was adopted in 1994, and (3) ADMARC's step-wise conversion from a buyer of last resort to a market-oriented operation. ADMARC's crop sales increased sharply in 1994 compared to the previous year due mainly to devaluation of the Kwacha, increased again in 1995 as the drought finished, and almost doubled again in 1996 under good weather conditions and reasonably good commodity prices which encouraged farmers to increase crop production. The 1997 budget projects another doubling of sales in 1997, but this is almost entirely due to its plans to purchase 67,000 tons of fertilizer on its own account, whereas it bought only about 12,000 tons last year (and distributed another 40,000 tons for the SFFRFM).

Gross profit on sales varied from 35% to 55% over the past three years, but was only 16.8% in 1993 when ADMARC suffered very large losses when it was directed by Government to sell fertilizer at prices below cost. Profit after allowance for direct expenses, now referred to as "Controllers Contribution", has been between 20% and 40% since 1994 and is forecast at a conservative 17.5% for 1997.

Indirect expenses include overhead costs such as market and depot expenses, administrative costs, and finance charges. They ranged of 26% to 35% of sales, resulting in substantial net trading losses in 1993 and 1995, while 1994 was little better than break-even. Only in the current year ending 31 March 1996 did ADMARC make a modest net trading profit of 7.8% of sales. After allowance for other revenue and expenses, it expects to show a profit before taxes of MK 81 million in 1996.

ADMARC maintains separate trading accounts for cotton, tobacco, maize, farm inputs, rice, and general produce (mainly beans, pulses, and sunflower seeds). Trading operations in the first four of these are analyzed in Annexes B through E to this report. Financial performance of the individual accounts is strongly influenced by the way in which indirect costs are allocated. ADMARC has historically apportioned these overhead costs in proportion to the value of the each commodity handled through the system in a given year, except that tobacco is weighted three times higher than the other commodities due

MALAWI

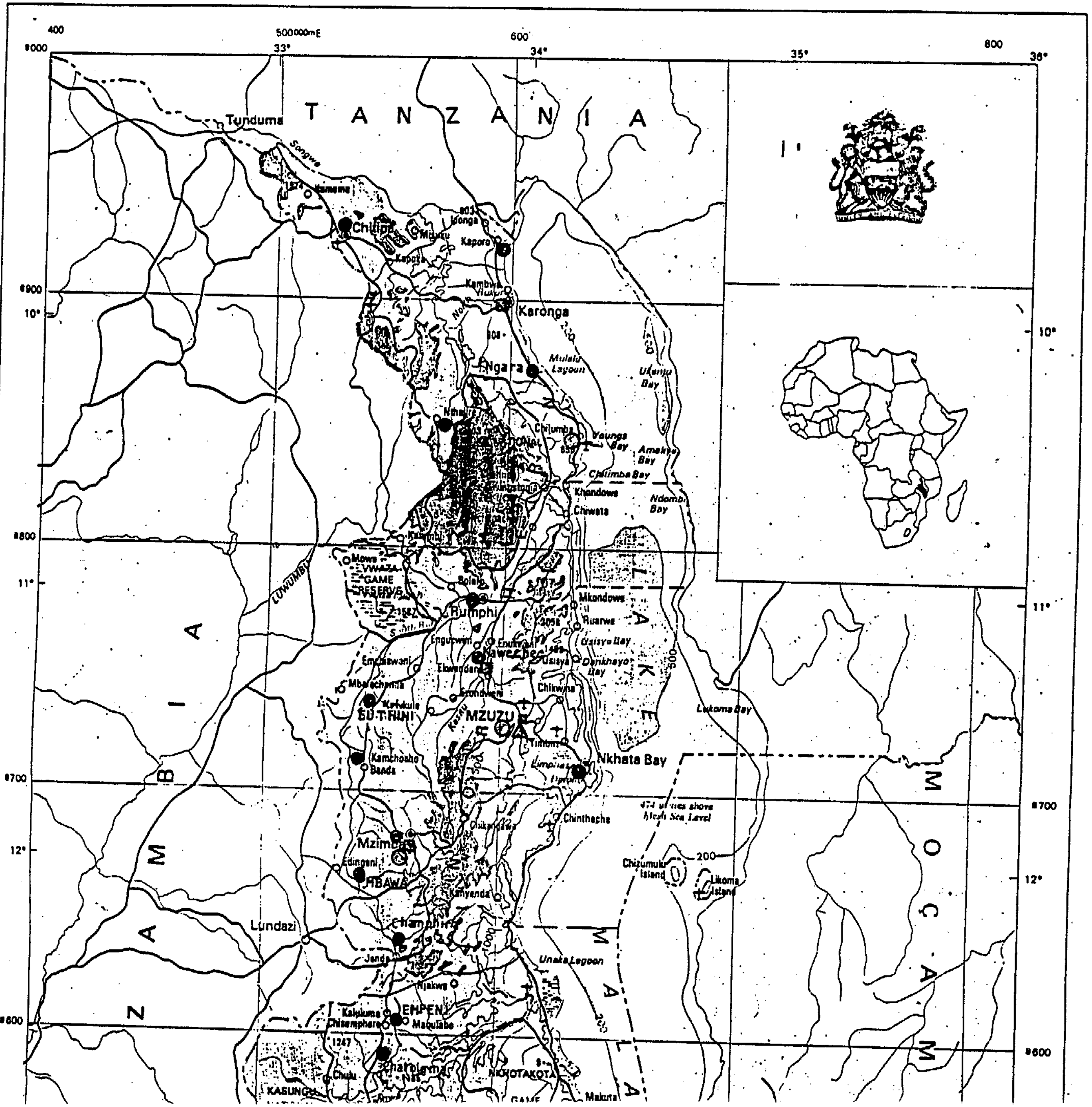
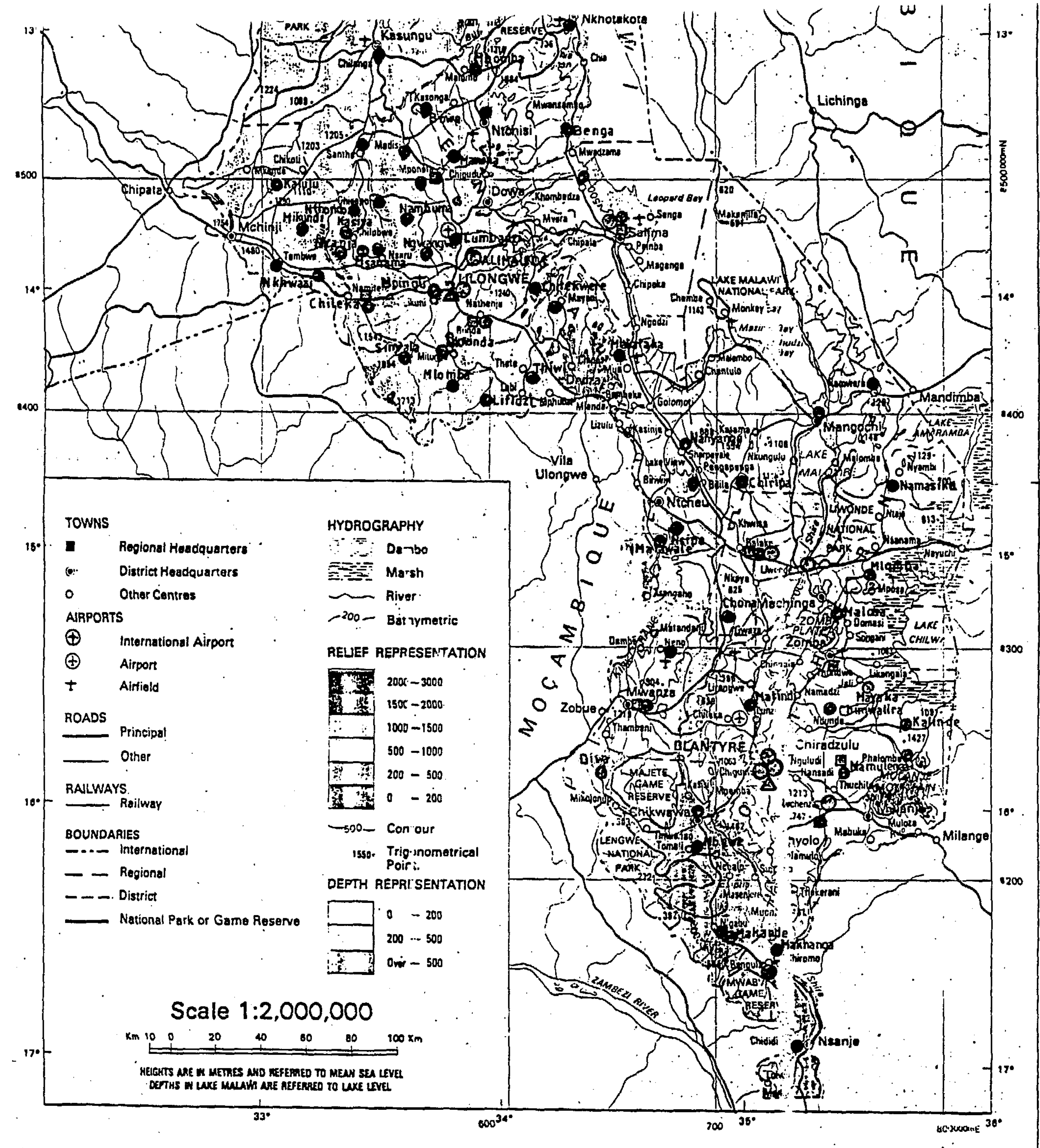



Figure A-1
ADMARC Market F

28

acilities



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KEY

△ Regional Offices

⊘ Parent Markets

▣ Divisional Offices

○ Main Depots

Table A-1
ADMARC PROFIT AND LOSS STATEMENT, 1993-1997
**(Year Ending March 31)**
**000 Kwacha**

| | 1993 | 1994 | 1995 | 1996 (Est'd) | 1997 (Budget) |
|---|---|---|---|---|---|
| Crop and Farm Input Sales | 197,893 | 324,902 | 406,386 | 759,708 | 1,603,829 |
| Cost of Sales | 164,631 | 146,065 | 266,878 | 387,160 | 1,163,185 |
| Gross Profit (Contribution) | 33,262 (16.8%) | 178,837 (55%) | 139,508 (34.3%) | 372,548 (49.0%) | 440,644 (27.4%) |
| Direct Expenses | 25,208 (12.7%) | 62,840 (19.3%) | 56,422 (13.9%) | 114,443 (15.1%) | 160,672 (10.0%) |
| Profit after Direct Expenses (Controller's Contribution) | 8,054 (4.1%) | 115,997 (35.7%) | 83,086 (20.4%) | 258,105 (40.0%) | 279,972 (17.5%) |
| Indirect Expenses | 57,550 (29.1%) | 113,588 (35.0%) | 127,410 (31.4%) | 198,550 (26.1%) | 226,340 (14.1%) |
| Net Trading/Operating Profit (Loss) | (49,495) | 2,409 | (73,544) | 59,555 | 53,631 |
| Govt Subs./Handling Rev. | 39,144 | 32,529 | 84,504 | 0 | 0 |
| Other Revenue | 20,551 | 19,744 | 88,133 | 79,461 | 39,365 |
| Other Expense | 11,264 | 21,823 | 23,444 | 58,000 | 24,133 |
| Profit before taxes and exceptional items | (1,064) | 32,859 | 75,649 | 81,016 | 68,863 |
| Taxes | 10 | 10 | 10 | 30,786 | 26,168 |
| Allowance for Exceptional Items | 0 | 0 | 53,520* | 0 | 0 |
| Net Profit (Loss) After Taxes | (1,074) | 32,849 | 22,119 | 50,230 | 42,695 |
| Retained Profit | 0 | 33,275 | 22,595 | 0 | 0 |
| Dividends Payable | 0 | 0 | 0 | 0 | 5,000 |

* Provision for David Whitehead and Sons Ltd.
Note: Figures in brackets are percent of sales.

to its higher value and labor intensity. This is due to the fact that each market handles almost all types of crops and allocation of certain costs can only be allocated on an arbitrary basis. A more precise system, already under consideration by ADMARC, would take into account the space occupied by each commodity and the labor costs associated with handling it. A new system is especially important this year since ADMARC expects to move much larger quantities of own-account fertilizer through the system and its relatively high value would cause the farm input account to bear much higher indirect costs relative to maize and tobacco than is appropriate.

## 6. ADMARC Assets

ADMARC's balance sheet shows MK 125 million in fixed assets as of 31 March 1996, approximately 60% of which is land and buildings and the balance in plant, vehicles and equipment. ADMARC was unable to provide us with a detailed list of these assets, stating that they are currently undergoing valuation. We were told that assets are currently shown at book value, which is very different than current market value. Fixed assets are budgeted to increase by MK 30 million by the end of Fiscal 1997 and the funds are to be used to rehabilitate buildings, replace computers, purchase market equipment, purchase office furniture and equipment, and establish a radio communication network.

ADMARC accounts used to consolidate the value of its portfolio investments in other companies (through AIHCL). This is no longer the practice, since, according to management, these holdings are being revalued during the process of divestiture which is being conducted by the Privatization Commission.

## 7. ADMARC Planning for the 1996/1997 Year

For the 1996/97 fiscal year, ADMARC will continue to play a role in purchasing of maize for the Strategic Grain Reserve and in the stabilization of maize prices. However, it will operate in such a way as to at least break even on maize trading operations on its own account and expects to be reimbursed promptly for any other functions it carries out for Government. As to other food crops, it will target only food crops with a ready market and avoid any stock carry-overs. Fertilizer will be sold on a cost recovery basis. Overall, ADMARC is budgeting a 110% increase in the value of crop and input purchases compared to 1996, but the increase is almost entirely due to the much larger volume of fertilizer prices. Purchases of farm inputs will increase from just under 13,000 tons to 83,000 tons, but this is misleading since ADMARC distributed over 60,000 tons last year when handling of SFFRFM fertilizer is taken into account. This year, ADMARC will minimize this type of distribution in favor of trading on its own account. Operating profits at MK 53 million are expected to be somewhat lower than this year's MK 60 million due to expected lower margins in the export markets for cotton and tobacco. Purchases in terms of tonnage will approximately double for cotton (reflecting the much larger crop this year) and increase by 42% for tobacco and maize (also reflecting larger crops).

## ANNEX B
## COTTON TRADING ACTIVITIES

### 1. Cotton Marketing

ADMARC buys cotton from smallholders at unit and area markets wherever it is grown, with the objective of purchasing within 5 to 10 kilometers of producing areas. While ADMARC was the monopoly buyer of cotton during the 1980s, it has since liberalization beginning in the 1992/1993 season competed with other buyers, the largest of which is the National Seed Company of Malawi (NSCM). A third buyer, ES Marketing, entered the market in 1994/95 and in the view of World Bank consultants[4], this additional competition has resulted in higher prices paid to farmers. NSCM management estimates that as of mid-1996, it was buying about 35% of Malawi's seed cotton, ADMARC 60%, and others 5%.

ADMARC reports the following tonnages of cotton purchased over the past four years (years ending March 31) and budgeted for 1997:

| | Seed Cotton Purchased | Lint Cotton Sold |
|---|---|---|
| 1993 | 13,203 tons | 12,706 tons |
| 1994 | 20,922 | 15,309 |
| 1995 | 4,920 | 6,328 |
| 1996 | 11,643 | 11,600 |
| 1997 | 35,000 | 34,650 (budget) |

ADMARC, formerly the monopoly purchaser of smallholder cotton, is still a major player in this market, as evidenced by the fact that its projected purchases for 1997 are almost 50% of expected national production.

Production in 1992/1993, 1993/1994, and 1994/1995 was influenced by the drought; the effect of a 60% increase in producer prices in 1994/1995 led to a recovery in 1995/1996. A very large cotton crop is forecast for 1996/97 based on increased plantings by farmers encouraged by good prices and good yields in the previous year. ADMARC will triple its purchases compared to 1995/96, a year in which almost all its cotton was sold on the domestic market to the David Whitehead and Sons spinning and weaving mills. For 1996/97 ADMARC expects to sell over 8,000 tons of seed cotton on the export market, and 23,000 tons on the domestic market.

[4] *Strengthening Malawi's Cotton Subsector,* by V. Lungu, M.W. Burgess, and J.C. Keyser, World Bank, March 1996.

## 2. Cotton Ginning

Currently, ADMARC three ginneries (at Mitole, Ngabu, Salima), NSCM also operates three ginneries (Balaka, Bangula, Karonga), and there is one independent company Mitchels) with a ginnery at Karonga. The Mitole gin is 50 to 60 years old and can produce only 2 bales/hour compared to 10 to 12 for the other newer ginneries. ADMARC's intention is to eventually close down this ginnery. Capacity of ginneries in Malawi is approximately 120,000 tons (when operating six months a year), more than adequate to handle current production of about 60,000 tons. A 1990 study by the French consulting firm SOFRECO (quoted in the above-referenced World Bank study) found that the reputation of Malawi cotton in foreign markets has suffered and was inferior to cotton produced in Zimbabwe. This appears to be more a problem at the farm level than in the ginning. Malawi ginneries use the saw type of gin to extract the seed, rather than the roller type now commonly used in the U.S. which gives a higher yield of lint but at lower throughputs. Quality of the lint produced is not a problem, and in fact most of the gins in use in Malawi are used machines imported from the United States where they were used successfully for many years.

ADMARC Investment Holdings owns a 22.5% share of NSCM but there is an arms-length relationship between the two companies. We did not find evidence of collusion on prices between the two companies, as suggested in the World Bank report. The two buyers are forced to pay similar prices in order to stay competitive. This year both were paying MK 4.5 per kg for seed cotton until the first week of June when NSCM raised their price to MK 5 per kg and ADMARC quickly followed suit. Both companies are increasing extension services to farmers in order to improve quality and to retain or increase market share. The new player, ES Marketing, is at a disadvantage since ADMARC and NSCM control virtually all the ginning capacity, forcing ESM to have their ginning done for a fee by one of these two companies. ESM management states that the company would be very interested in acquiring one of these gins, mentioning specifically the ADMARC ginnery at Salima.

## 3. Cotton Spinning and Weaving

David Whitehead and Sons Malawi Ltd. (DWSM) is the only cotton manufacturer in Malawi, operating a spinning and weaving mill in Limbe and a spinning mill in Salima. The company operated profitably in a protected market from 1967, and began exporting in 1977. Twenty percent of their production was exported in 1988/89, but since then the company has been badly hurt by lower-cost imported Asian goods and unofficial imports of used clothing. Lonrho, which formerly owned 51% of the company, has since transferred its shares at nominal value to Government. ADMARC maintains a 49% share and manages the company. The current policy of DWSM is to concentrate on production and export of "grey cloth" to Europe, a product in which it is competitive, rather than produce for the domestic market. While the company made a small profit in 1995, it has severe liquidity problems and is currently up for sale.

## 4. Cotton Seed

Cotton seed is processed for oil by NSCM and by Capital Oil Refiners Inc. (CORI), the latter company being also a cotton grower. However, most of the cotton seed is exported unprocessed since edible oil producers in Malawi (NSCM, CORI, Lever Brothers) have found it more economical to import raw sunflower oil and refine it locally, given the higher prices this type of oil brings on the local market. NSCM sells three types of oil in Malawi: pure sunflower, cottonseed, and a blend of the two.

It is noteworthy that the economics of edible oil marketing are such that even though sunflower seed is grown in Malawi very little of it processed locally, and instead unrefined sunflower oil is imported. The economics of cottonseed and sunflower seed processing would be different were it not for the fact that there is only a small local market for press cake (due to limited production of animal feed) and export is discouraged by a 20% duty on exports of press cake. We recommend that Government review this policy as it has acted to reduce the local value added in processing of cotton byproducts.

## 4. ADMARC Financial Results from Cotton Marketing

For the 1996/1997 season, ADMARC announced a price of MK 4.50 per kilo for seed cotton delivered to their buying points. At a conversion ratio of 3 to 1 for seed cotton to lint cotton, this gives an equivalent cost to ADMARC of MK 13.50 per kilo of lint cotton. The current export parity price of lint cotton in Malawi (based on the Liverpool index price) works out to roughly MK 20/kg, leaving only MK 6.5 for transport, handling and ginning. According to the ADMARC Cotton Controller, this is at best a break-even situation for the company. At the new MK 5/kg price, this would appear to result in a loss.

Table B-1 below gives a five-year history of the cotton trading account, plus budgeted figures for 1997. Purchases are of seed cotton, while sales are of cotton lint. Thus direct costs include the cost of baling at the buying points, transport to the ginnery, ginning, and export packing (or delivery to DWSM). The figures for the years 1993 and 1994 are difficult to interpret because of (1) the huge change in the Kwacha exchange rate when it was floated in 1994, causing a large increase in the export parity price of cotton, and (2) the liberalization of cotton marketing in the 1994/1995 season which caused producer prices to jump from MK 2.50/kg to MK 4.00 per kg, a 60% increase. Trading in 1996, with producer prices at MK 4.5 kg, produced a very good profit margin after direct expenses of 40.4%. Producer prices for the present (1996/97) year are currently MK 5/kg and combined with lower world market prices, profits after direct expenses are projected at only 11.6%. Very high indirect costs have produced bottom line losses for ADMARC in past years and will certainly do so for the 1996/97 year.

It is interesting to note the effect on the cotton market of ADMARC's pan-territorial pricing policies -- under which farmers are paid the same price regardless of location. To compete, NSCM must adopt the same policy, but NSCM management states this policy is clearly not economic and it will have to eventually introduce a price system which takes into account higher transportation and handling costs of moving cotton from more remote areas. NSCM's strategy is to compete with ADMARC by offering the farmers more services, such as demonstration plots using improved seed. NSCM would like to improve the quality of cotton it buys by introducing better seed, although it recognizes that it will take some time before farmers are willing to pay the higher price.

**Table B-1**
**COTTON TRADING ACCOUNT**
**Year ending 31 March**
**(000 MK)**

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 (budget) |
|---|---|---|---|---|---|---|
| Sales | 48,320 | 12,043 | 33,108 | 35,462 | 114,168 | 278,100 |
| Cost of Sales | 41,468 | 11,148 | 5,934 | 20,212 | 52,000 | 216,264 |
| Gross Profit | 6,852 | 895 | 27,174 | 15,250 | 62,168 | 61,836 |
| Direct Expenses | 4,202 | 1,709 | 14,779 | 7,592 | 15,996 | 29,620 |
| Profit after Direct Expenses | 2,650 (5.5%) | (814) (-6.8%) | 12,395 (37.4%) | 7,658 (21.6%) | 46,172 (40.4%) | 32,216 (11.6%) |
| Marketing/Depot Expenses | 2,993 | 1,989 | 2,620 | 3,758 | | |
| Admin. Expenses | 2,525 | 1,491 | 2,112 | 3,334 | | |
| Finance Charges | 1,085 | 306 | 1,377 | 1,185 | | |
| Net Profit (Loss) | (3,953) | (4,600) | 6,286 | (619) | | |

## ANNEX C
## TOBACCO TRADING ACTIVITIES

### 1. Tobacco Purchases

Although tobacco marketing was liberalized last year, ADMARC has retained its traditional role as the principal marketer of dark-fired tobacco. For the 1995/96 crop year, ADMARC bought 6,781 tons of northern and southern dark-fired tobacco combined, roughly 85% of national production of these types. Licensed intermediate buyers, who are now permitted to deal in all types of tobacco, and estate growers, accounted for the balance. Purchases of other types amounted to 2,671 tons of burley -- the first year ADMARC has bought burley -- and 573 tons of sun-cured tobacco. Prices paid for dark-fired were considerably higher than those of the other types: 9.54 K/kg for southern dark-fired, 8.09 for northern dark-fired, 7.38 for sun-cured, and 5.15 for burley.

ADMARC purchases of tobacco of all types over the past five years are as follows:

| | |
|---|---|
| 1992/1993 | 14,572 tons |
| 1993/1994 | 6,412 |
| 1994/1995 | 5,891 |
| 1995/1996 | 10,035 |
| 1996/1997 | 14,290 (budget) |

Purchases were sharply lower as a result of the drought years of 1992 to 1994, but recovered in 1995/96 and are expected to be even higher in the current year. The figure for 1996/97 is roughly 21% of expected national production of all types, so ADMARC is not a dominant buyer of tobacco other than dark-fired. Liberalization measures which permit smallholders to grow burley tobacco has led to a rapid increase in production of this type, while production of dark-fired tobacco, which is more costly for the farmer to produce, has declined.

### 2. Tobacco Grading and Selling

ADMARC is classified as an intermediate buyer, licensed to sell tobacco on the auction floors along with estates and other intermediate buyers (which the Tobacco Control Commission reports now number 2, 934). It remains the largest seller of dark-fired tobacco at the auctions, and continues to have a reputation for good quality. ADMARC operates eight grading sheds in various parts of the country where tobacco is graded and packed before moving to the auction floors. Few intermediate buyers have their own grading facilities and must have their grading done by others for a fee. The Limbe auction is the only one where dark-fired is sold, so ADMARC has to ship dark-fired bought in the other regions down to Limbe.

### 3. Tobacco Trading Account

ADMARC policy with regard to tobacco was to shift large profits from tobacco trading to cover losses on maize marketing imposed by government support of maize prices. This cross-subsidization policy was accepted by government but led to great resentment by farmers who saw that they were getting a very low percentage of the final sale price of their tobacco. ADMARC carried out this policy by the way it distributed indirect charges (administrative costs, market and depot expenses, and finance charges) among its trading accounts -- cotton, tobacco, maize, farm inputs, and general produce. These expenses were divided in proportion to the total value of the commodities handled through the system, except that tobacco was weighted three times more heavily than the other commodities.

The result of this policy is evident from the trading account figures in Table C-1, which shows very large bottom-line losses in 1992 and 1993, and smaller losses thereafter. ADMARC was unable to provide us with figures for allocation of indirect expenses for the 1997/1997 year, and we understand that allocations have not yet been made for the current year budget. Performance in 1992 and 1993 was affected by low prices for dark-fired tobacco on the auction floor; prices recovered after that and in fact it appears that profits after allowance for direct expenses in 1995 were exceptionally high. The figures indicate that ADMARC's cost of sales (the cost of purchasing tobacco from farmers) was only 19.5% of what it received for selling this tobacco. If we have interpreted the figures correctly, and there no distortions caused by carry-over stocks, then the farmer got a very bad deal indeed in 1994/1995. Since then producer prices have recovered, and the next two years indicate that farmers are getting between 40 and 47% of the sale price. ADMARC's profit after direct expenses are currently in the 35% to 40% range. Presumably these profits will be more than offset by indirect charges as long as the current allocation system prevails.

**Table C-1**
**ADMARC Tobacco Trading Account, 1992-1997**
**(Year ending 31 March)**
**000 Kwacha**

| | 1992 | 1993 | 1994 | 1995 | 1996 (forecast) | 1997 (budget) |
|---|---|---|---|---|---|---|
| Sales | 85,147 | 53,083 | 33,936 | 80,556 | 222,049 | 307,054 |
| Cost of sales | 62,157 (73.0%) | 37,264 (70.2%) | 15,663 (46.2%) | 15,690 (19.5%) | 90,900 (40.9%) | 143,951 (46.8%) |
| Gross profit | 22,990 | 15,819 | 18,273 | 64,866 | 131,149 | 163,103 |
| Direct expenses | 18,346 | 11,263 | 9,662 | 15,521 | 41,652 | 54,475 |
| Profit after DE | 4,644 (5.4%) | 4,556 (8.5%) | 8,611 (25.3%) | 49,345 (61.2%) | 89,497 (40.3%) | 108,628 (35.3%) |
| Marketing Exp. | 13,318 | 19,227 | 6,844 | 23,673 | | |
| Admin. Exp. | 11,361 | 14,252 | 5,454 | 20,881 | | |
| Finance Chgs. | 4,880 | 2,957 | 3,555 | 7,459 | | |
| Profit (Loss) | (24,915) | (31,880) | (7,242) | (2,668) | | |

# ANNEX D
# ADMARC COMMODITY TRADING OPERATIONS: MAIZE AND OTHER CROPS

This annex examines the financial performance of ADMARC's maize and other commodity trading operations since 1992/93 and projects 1996/97 performance. We also examine in some detail the potential viability of a commodity trading company which might be spun off from ADMARC and set up as an independent company.

## 1. Background: ADMARC's Operations before 1995/96

Prior to 1995/96, ADMARC's role with respect to maize and other food crops was mainly social. For food crops other than maize, referred to by ADMARC as "general produce", ADMARC was to assure a market at the floor price set by the Government. For maize, ADMARC's role was to purchase all maize at the official producer price, and sell maize in all of its markets at the official consumer price. Traditionally, the margin between these two prices was set too low for ADMARC to cover its costs. Before 1987, ADMARC's losses on maize were covered by its monopoly profits on other crops. After 1987, ADMARC's maize marketing was merged into the management of the Strategic Grain Reserve (SGR), a 180,000 ton stock of maize intended to protect the country against food shortages during drought years. In surplus years, ADMARC would purchase maize until it ran out of funds, sell some of the maize to the SGR at the official consumer price, and use the funds to purchase more maize. In deficit years, ADMARC would estimate the deficit in each of its market areas and request draw-downs from the SGR. ADMARC would sell this maize and return the funds to the SGR after retaining a fee to cover its marketing costs.

Table D-1 shows the financial performance of ADMARC's maize trading account since 1992/93. ADMARC was well compensated for its maize marketing services in 1992/93 and in 1993/94, the first year of the MOU.[5] The 1994/95 financial results were more marginal. Because 1993/94 was a drought year, ADMARC purchased only 61,000 tons and sold 173,000 tons by drawing down the previous year's stocks. ADMARC lost MK 35 million on these operations, but received MK 40 million in government subsidies.[6] In addition, ADMARC sold 179,000 tons of food aid for the Government for which it was compensated MK 45 million in handling fees.

During this period, ADMARC played a relatively minor role in marketing general produce, as private traders obtained gradually increasing shares of the market. The declining trend in ADMARC's activities with respect to these crops, as well as their marginal profitability, is reflected in Table D-2.

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[5] All figures in this annex refer to the year ending 31 March, ADMARC's financial year.

[6] These subsidies were mostly for maize marketing but also covered other social services, mainly the distribution of farm inputs.

| Table D-1: Maize Trading Account (MK millions) | | | | | |
|---|---|---|---|---|---|
| | 1992/93 | 1993/94 | 1994/95 | 1995/96 | 1996/97 |
| Sales | 71.9 | 203.0 | 132.7 | 194.5 | 297.5 |
| Cost of sales | 55.2 | 88.5 | 118.0 | 120.0 | 207.5 |
| Change in stocks | | | | | 10.0 |
| Gross profit | 16.7 | 114.5 | 14.7 | 74.5 | 100.0 |
| Direct expenses | 8.3 | 27.6 | 14.3 | 24.6 | 41.5 |
| **Profit after direct expenses** | 8.4 | 86.9 | 0.4 | 49.9 | 58.5 |
| Marketing | 2.0 | 24.9 | 16.1 | | |
| Administration | 1.7 | 20.1 | 14.3 | | |
| Finance costs | 0.4 | 13.1 | 5.1 | | |
| **NET PROFIT** | 4.3 | 28.8 | -35.1 | | |
| Govt. subsidy[1] | 17.6 | 32.2 | 39.6 | 0.0 | |
| Handling revenue[2] | 21.6 | 0.3 | 44.9 | | |

Notes: 1/ Subsidy is related to the MOU. 2/ Handling revenue is mostly for food aid.

| Table D-2: General Produce Trading Account (MK millions) | | | | | |
|---|---|---|---|---|---|
| | 1992/93 | 1993/94 | 1994/95 | 1995/96 | 1996/97 |
| Sales | 33.5 | 16.9 | 17.4 | 65.9 | 128.8 |
| Cost of sales | 27.6 | 5.6 | 10.3 | 68.0 | 47.3 |
| Changes in stocks | | | | 52.3 | -54.4 |
| Gross profit | 5.9 | 11.3 | 7.1 | 50.2 | 27.1 |
| Direct expenses | 1.9 | 2.5 | 2.0 | 9.7 | 7.2 |
| **Profit after direct expenses** | 4.0 | 8.8 | 5.4 | 40.5 | 19.9 |
| Marketing | 2.1 | 0.9 | 5.4 | | |
| Administration | 1.6 | 0.7 | 4.8 | | |
| Finance costs | 0.3 | 0.5 | 1.7 | | |
| **NET PROFIT** | 0.0 | 6.7 | -6.8 | | |

## 2. ADMARC's Current Operations

### 2.1 The Year 1995/96

The year just ended was a transition year for ADMARC. For the first time, it was not asked to perform any social functions for the Government. Its new mandate was to operate solely as a commercial trading company for agricultural products and farm inputs. Any service provided to the Government was to be under contract and fully compensated.

For maize, the Government introduced a price band within which prices were free to fluctuate. ADMARC was still the dominant factor in the maize market and was expected to purchase about 200,000 tons to defend the floor price. In the end, due mainly to financial constraints, ADMARC was able to purchase only 87,000 tons, all of which it sold later in the year. Although ADMARC was legally free to purchase and sell maize at any price within the band, it chose to purchase at the floor price of MK 1.25 per kilogram and sell initially at MK 1.80, the previous year's official consumer price, then (beginning in early December 1995) at the 1995/96 ceiling price of MK 2.50. As can be seen from Table D-1, ADMARC's maize operations yielded an estimated gross profit (profit after direct expenses) of MK 50 million. Although data on indirect expenses for 1995/96 was not available, it is estimated that after deducting these overhead expenses the maize operation incurred a slight loss. If ADMARC had sold all of its maize at the official ceiling price, it would have earned a slight profit.

For general produce, ADMARC chose to take an expansionary approach in 1995/96. After having seen purchases decline from 17,800 tons to 6,600 tons over the previous three years, it bought 16,500 tons in 1995/96, consisting mostly of pigeon peas, sunflower seed, beans, cowpeas, and soybeans. In the end, ADMARC paid too high a price for some products, especially sunflower seed and beans, and was left with large unsold stocks at the end of the year. Table D-2 shows that, in 1995/96, ADMARC's general produce sales totaled MK 66 million, the cost of sales totaled MK 68 million, and the increase in stocks totaled MK 52 million. (Note: Data on stock changes was available for only a few years.)

### 2.2 The Year 1996/97

The transition to a fully commercial enterprise is continuing this year, with the biggest changes occurring in maize. The maize price band will have a floor price of MK 1.55/kg and an expected ceiling price of MK 3.25/kg. The Government will be managing this price band through the SGR. In order to increase demand early in the buying season the SGR has issued a tender for 65,000 tons of maize to be delivered at eight separate locations. ADMARC will be bidding on this tender along with private traders. At the same time, the SGR will be contacting directly with ADMARC to purchase 20,000 tons of maize at the floor price at fifteen locations.

With 1995/96 maize production estimated at 1.7 million tons, ADMARC believes that the quantity that will go on the market will exceed 300,000 tons. Its tentative plan, which is subject to change based on market developments and competing demands for working capital, is to purchase about 130,000 tons: 80,000 tons of maize on its own account and 50,000 tons for the

SGR under the open tender. In addition it will purchase 20,000 tons for the SGR in the 15 locations as mentioned above, on which it will earn a marketing fee. This represents a 70 percent increase in purchases over 1995/96. Although it is no longer obliged to do so, ADMARC is planning to purchase all of its maize at the floor price everywhere in the country. The projected financial results of these trading activities are shown in Table 1. After allocating overhead expenses, the maize operation is expected to approximately break even.

For general produce, ADMARC is projecting a substantial increase in sales, because of the large stocks carried over from last year, but a reduction in purchases. Given the substantial increase in 1995/96 production over 1994/95, this should be seen as a major reduction in its general produce operations, probably reflecting the intense competition coming from private traders.

## 3. Next Steps for Maize and Other Crops

As is discussed in other annexes and in the main report, we are recommending that ADMARC's cotton and tobacco operations be split off as separate companies and privatized. This will leave ADMARC with the maize, general produce, and farm inputs activities, and whatever facilities and staff will not be needed by the cotton and tobacco companies. There are two options to privatizing what is left:

(1) form a commodity trading company that will keep whatever facilities it needs and have ADMARC or a successor company dispose of the remaining facilities, or

(2) discontinue these trading operations and proceed directly with the disposition of the market facilities.

In choosing between these options, the main issues are, first, whether a new company would be commercially viable and, second, whether there are social and development advantages or disadvantages to having what is in effect a scaled-down ADMARC continue to operate in rural areas. We examine these two issues in Sections 3.1 and 3.2.

### 3.1 The Commercial Viability of a Commodity Trading Company

This option has been under active study by ADMARC management and it quite far along in terms of conceptualization. To quote from a recent ADMARC document, *ADMARC - A New Beginning:*

> "ADMARC will incorporate a third specialist company to handle the remaining commodity trading. ... The performance of each market will be individually appraised. *Markets and major warehousing facilities will be profit centers.* (Italics added.) Emphasis will be placed on increasing the number of mobile marketing teams to replace fixed or seasonal centers. Appraisals will be conducted in a positive manner. [The company's] objective will be to maximize its trading activities by the most cost effective means."

"Priority will be given to privatizing markets. The lower overheads of independent operations could make units viable which would remain loss makers under the burden of corporate overheads however streamlined. The appraisal of markets will identify a number of units which are not commercially viable even to an independent business person..... "

"[The company] will invest to streamline and simplify procedures. It will seek to enhance customer services and facilities. ... The potential for renting space for retail stalls, other trading activities and, where appropriate, branches of Malawi Rural Finance Company will be positively examined."

"Remaining facilities which after due appraisal are not required by [the commodity trading company] ... will be administered and disposed of by [a property management company established for this purpose]. "

The main assets of this new company would be its extensive network of market facilities (scaled down to only those facilities that are or can be made profitable), its experienced management, and the experience and technical expertise of the staff it would retain. (See Table D-3 for details on the extent and geographic distribution of ADMARC's marketing infrastructure.) Looking at this year's planned operations as well as those of recent years, it is clear that the main throughput of this company in both volume and value terms would be maize and fertilizers. Also, looking at population densities, and the geographic distribution of maize production and fertilizer use, it is clear that its operations would be concentrated in the most productive agricultural areas of the Central and Southern Regions, and around the major consuming areas of Lilongwe and Blantyre.[7] "

However, the company's profits are not likely to come from its large volume commodities, especially maize, where competition from private traders will become increasingly intense. Instead, the company would have to exploit profit opportunities in other crops as they arise or are identified. Potentially, the company could have the economies of scale necessary to pursue export markets for such crops, establish links with producers, and provide the assurances of quality control and consistent supplies that many export markets

[7] See annex E for a detailed analysis of ADMARC's input marketing activities.

| Table D-3: ADMARC Markets and Depots | | | | | |
|---|---|---|---|---|---|
| Division | Parent Mkts. | | Unit Mkts. | | Total Capacity (MT) |
| | No. | Capacity | No. | Capacity | |
| Southern Region: | 26 | 18,200 | 103 | 26,760 | 44,960 |
| Balaka | 8 | 4,150 | 22 | 5,680 | 9,820 |
| Mwanza | 5 | 3,000 | 15 | 4,230 | 7,230 |
| Namulenga | 5 | 4,800 | 16 | 4,000 | 8,800 |
| Ngabu | 5 | 2,750 | 30 | 7,050 | 9,800 |
| Zomba | 3 | 3,500 | 21 | 5,800 | 9,300 |
| Central Region: | 38 | 72,100 | 82 | 49,722 | 121,822 |
| Chileka | 13 | 20,250 | 18 | 7,100 | 27,350 |
| Mponela | 11 | 26,500 | 18 | 11,000 | 37,500 |
| Nathenje | 9 | 14,500 | 21 | 10,200 | 24,700 |
| Salima | 5 | 10,850 | 25 | 21,422 | 32,272 |
| Northern Region: | 13 | 11,650 | 72 | 28,260 | 39,910 |
| Ekwendeni | 3 | 6,500 | 20 | 17,470 | 23,970 |
| Karonga | 4 | 3,350 | 23 | 5,800 | 9,150 |
| Mzimba | 6 | 1,800 | 29 | 4,990 | 6,790 |
| TOTAL MARKETS | 77 | 101,950 | 257 | 104,742 | 206,692 |
| Depots: | | | | | |
| Blantyre/Limbe | | | | | 25,000 |
| Blantyre/Midima | | | | | 2,500 |
| Blantyre/Chart. Rd. | | | | | 40,000 |
| Machinga/Balaka | | | | | 20,000 |
| Machinga/Liwonde | | | | | 20,000 |
| Nsange/Bangula | | | | | 15,000 |
| Thyolo/Luchenza | | | | | 15,000 |
| Lilongwe | | | | | 20,000 |
| Lilongwe/Alimonde | | | | | 40,000 |
| Salima | | | | | 39,000 |
| Karonga/Chilumba | | | | | 5,000 |
| Mzimba/Mzuzu | | | | | 10,000 |
| Mzimba/Kazomba | | | | | 5,600 |
| TOTAL DEPOTS | | | | | 257,100 |

Source: ADMARC information prepared for this report require. The *New Directions* document mentions groundnuts as one crop where there are attractive opportunities. These initiatives would take the company into crops and areas of the country that cannot be predicted at this time.

The company would clearly have to scale back from ADMARC's present level of maize and fertilizer marketing which has consistently resulted in losses. For maize, the company would operate from depots and the larger markets, and deal with smaller traders who have a comparative advantage in rural areas. For fertilizer, ADMARC already recognizes that its operations in many locations cannot be made profitable. The *New Directions* document states that the new company will sell inputs only where such sales are commercially viable.

The private sector, of course, will be following exactly the same strategy. Competition will be strong and marketing margins will be small. ADMARC's difficulties in the burley tobacco, pulse and oilseed markets, where the private sector is already active, provide an indication of how competitive ADMARC can expect its traditional markets to become. The larger private traders are already quite clear on how they would approach the maize and farm input markets once they are opened and liberalized. A comparison of ADMARC's total trading volume (Table D-4) with total agricultural production (Table D-5) brings out how small is ADMARC's share -- and how extensive the private sector's share -- of existing agricultural marketing activity.

The key feasibility issue for this commodity trading company, therefore, is whether the new company can identify and exploit the profitable niches. Assessing this likelihood was beyond the scope of this consultancy, but there is no question that these niches provide the key to whether the company is worth forming for the purpose of privatization. The company's commercial viability has clearly not yet been established, and probably can't be until it has been in operation for some time. This, of course, would complicate the ADMARC privatization process and raises the possibility that one part of ADMARC (the most significant in terms of staff and infrastructure) would linger on for the indefinite future.

## 3.2 Social and Development Considerations

### 3.2.1 The Private Sector Capacity in Rural Areas

For the Government, an issue that is even more important than the commercial viability of this company is whether it will be needed to perform marketing functions that the private sector cannot perform due to Malawi's underdeveloped rural marketing infrastructure. There are three main areas of concern.

First is what will happen to rural maize supply when ADMARC is no longer there to buy maize, store it and resell it later in the year. The fear is that private traders will purchase maize in these areas and ship it to the high demand areas thus creating localized maize shortages in some years. This local trading has in fact constituted a major part of ADMARC's

| Table D-4: ADMARC Purchases and Sales of Maize and Other Food Crops (tons) | | | | | |
|---|---|---|---|---|---|
| Crop | 1992/93 | 1993/94 | 1994/95 | 1995/96 | 1996/97 |
| Maize: | | | | | |
| Purchase | 40,548 | 383,039 | 61,280 | 87,100 | 130,000 |
| Sales | 121,816 | 277,407 | 172,893 | 88,021 | 125,000 |
| General produce: | | | | | |
| Purchase | 17,768 | 9,547 | 5,647 | 16,464 | 13,780 |
| Sales | 32,103 | 9,476 | 6,392 | 7,526 | 22,220 |
| Groundnuts: | | | | | |
| Purchase | 652 | 983 | 4,558 | 2,342 | 2,500 |
| Sales | 3,728 | 596 | 3,915 | 1,511 | 2,660 |
| Rice: | | | | | |
| Purchase | 711 | 16,256 | 4,320 | 8,622 | 6,000 |
| Sales | 683 | 845 | 13,590 | 6,387 | 4,063 |

Source: ADMARC data prepared for this report.

| Table D-5: Smallholder Production of Selected Crops (thousand tons) | | | | | | |
|---|---|---|---|---|---|---|
| | 1990/91 | 1991/92 | 1992/93 | 1993/94 | 1994/95 | 1995/96 |
| Major food crops: | | | | | | |
| Maize | 1589 | 657 | 2034 | 819 | 1328 | 1701 |
| - local | 1041 | 368 | 1032 | 534 | 659 | 790 |
| - hybrid | 522 | 283 | 985 | 284 | 686 | 874 |
| - composite | 27 | 5 | 6 | 1 | 2 | 35 |
| Rice | 63 | 24 | 65 | 41 | 39 | 45 |
| Sorghum | 19 | 4 | 22 | 17 | 20 | 53 |
| Millet | 8 | 3 | 15 | 10 | 13 | 21 |
| Cassava | 168 | 129 | 216 | 250 | 326 | 530 |
| Sweet potatoes | 177 | 43 | 210 | 165 | 318 | 561 |
| Other food crops: | | | | | | |
| Groundnuts | 31 | 12 | 32 | 31 | 31 | 38 |
| Beans | 39 | 30 | 45 | 25 | 22 | 49 |
| Pigeon peas | 29 | 16 | 18 | 36 | 42 | 60 |
| Cowpeas | 0 | 0 | 6 | 9 | 10 | 23 |
| Soybeans | 13 | 11 | 14 | 8 | 15 | 44 |
| Sunflower seeds | 5 | 5 | 9 | 7 | 50 | 16 |
| Major cash crops: | | | | | | |
| Cotton | 43 | 14 | 45 | 17 | 25 | 70 |
| Tobacco | | | | | | |
| - dark fired | 15 | 12 | 9 | 8 | 13 | 16 |
| - burley | 0 | 3 | 18 | 6 | 21 | 51 |

Source: MOALD, *National Crop Estimates* maize marketing activities. Table D-6 shows that in 1995/96 ADMARC purchased about 30,000 tons in the Southern Region. Most of this maize was kept in the market area where it was purchased and resold later in the year. When assessing the social importance of this activity, the key point is that ADMARC typically purchases only a small percentage of total production in any non-surplus market area. The remainder is stored and marketed by farmers and small traders in the area where it is grown. In 1995/96, ADMARC purchased well under 10 percent of the maize grown in the Southern Region. These activities are therefore having little impact on food security.

**Table D-6: ADMARC Maize Purchases by Division**
(tons)

| Division | 1993/94 | 1995/96 |
|---|---|---|
| Southern Region: | 84,738 | 30,605 |
| Balaka | 24,479 | 8,154 |
| Mwanza | 6,345 | 2,354 |
| Namulenga | 4,973 | 5,008 |
| Ngabu | 3,076 | 4,364 |
| Zomba | 15,292 | 8,765 |
| Other | 30,573 | 1,960 |
| Central Region: | 245,601 | 35,171 |
| Chileka | 66,780 | 10,494 |
| Mponela | 77,373 | 12,167 |
| Nathenje | 61,626 | 10,871 |
| Salima | 4,773 | 941 |
| Other | 35,049 | 698 |
| Northern Region: | 52,458 | 12,265 |
| Ekwendeni | 9,185 | 3,899 |
| Karonga | 4,952 | 3,381 |
| Mzimba | 38,320 | 4,983 |
| TOTAL PURCHASES | 382,797 | 78,041 |

Note: These figures were prepared for the consultants by the ADMARC staff. Because ADMARC does not aggregate purchase data in this manner, the totals do not coincide with their official national totals. The figures, however, are close enough to accurately represent the geographic distribution of ADMARC purchases.

The second area of concern is whether the private sector will be able to assume ADMARC's role of purchasing maize from the large surplus growing areas and supplying the large consuming markets. ADMARC role in this marketing function has changed considerably in recent years. Data for 1993/94 following a record high production year, and 1995/96 following a drought year are shown in Table D-6. In 1993/94, ADMARC purchased 383,000 tons of maize. Part of the purchases from the surplus areas (Central Region and Mzimba Division in the Northern Region) that year went to the large consuming areas, and part went to replenishing the SGR. In the following year, 1994/95, because of the previous year's drought, ADMARC was only able to purchase 61,000 tons, but sold 173,000 tons by drawing down SGR stocks. (See Table D-7.) That same year, ADMARC sold 180,000 tons of commercial food aid and the Government directly distributed 165,000 tons of free food. In 1995/96, due mainly to financial constraints, ADMARC purchased only 87,000 tons and sold 88,000 tons. Table 8 shows that ADMARC was not able to transfer a significant quantity of maize from the Central and Northern Regions to the Southern Region in that year.

**Table D-7: ADMARC Maize Purchases and Sales, Related to National Smallholder Production**
(thousand tons)

| | 1992/93 | 1993/94 | 1994/95 | 1995/96 |
|---|---|---|---|---|
| Production (prev. year) | 657.0 | 2034.0 | 819.0 | 1327.9 |
| Purchases | 40.5 | 383.0 | 61.3 | 87.1 |
| Sales | 121.8 | 277.4 | 172.9 | 88.0 |
| Purch. as % of prev. yr. production | 6.2 | 18.8 | 7.5 | 6.6 |

ADMARC's declining role in national maize marketing is continuing in 1996/97. Of the 130,000 tons that it is planning to purchase, 50,000 tons will be for the SGR. This maize will all be purchased under contract, a marketing function that would be performed by the private sector had ADMARC chosen not to bid on the SGR tender. The 80,000 ton balance will be purchased by ADMARC on its own account. This figure was arrived at by considering last year's production (1.7 million tons) and its available working capital. The quantities ADMARC plans on purchasing this year leave considerable scope for the private sector. For example, ADMARC's preliminary purchase target for the Central Region is 70,000 tons, which about 40,000 tons less than what they estimate will be available. This 40,000 ton balance will end up moving through private sector channels.

ADMARC's declining role in national maize marketing, therefore, seems to be firmly underway. The private sector will play a significant role this year and a likely greater role next year. What this means is that the Government's economic liberalization policies are beginning to have an effect on the maize market. The national maize supply and demand balancing function previously performed at such high cost by ADMARC is being increasingly performed efficiently and effortlessly by free market forces.

The third area of concern is those regions of the country that are perceived as inadequately served by private traders. In many areas of the country, private traders are competing directly with ADMARC in the purchase of agricultural commodities as well as in the sale of farm inputs. In some, areas, however, ADMARC is the only buyer of marketable surpluses, (including maize, sunflower seed, pigeon peas, soybeans, and beans), and the only supplier of farm inputs. These are generally loss making activities which are partially made up by profits from ADMARC's activities in the less remote parts of the country. The departure of ADMARC from these remote areas would result in some increase in private trader activity -- if the margins are wide enough there will always be traders -- but there is no doubt that producer prices would be lower than ADMARC's and the prices of goods brought into the area (maize, fertilizers, seeds) would be higher than ADMARC's. Although this is not necessarily bad (some ADMARC prices were certainly sending the wrong market signals to the populations of these areas), it may be necessary for the Government to compensate for imperfectly functioning markets in these areas while marketing constraints are being addressed. This issue is discussed in greater detail in Chapter 3.

A fourth area of concern, the supply of inputs to smallholders, is rapidly becoming a non-issue. The information presented in Annex E shows that, with the liberalization of markets, inputs are increasingly being sold by private traders. Here, the major initiative is being taken by the large suppliers. The trend is strongest for hybrid maize seed. The largest supplier, NSCM, is now selling most of its seed through private retailers. Pannier, the other major supplier, sold 60 percent of its seed through ADMARC in 1995/96 but has expressed interest in increasing its private distribution network. For fertilizer, ADMARC remains the largest distributor, but suppliers began shifting to private traders last year. This year, ADMARC is tendering for fertilizers which it will be selling on a commercial basis, and private suppliers are making plans to distribute their own fertilizers through private traders in direct competition with ADMARC. For both seeds and fertilizers, it is the opinion of the major suppliers that private traders would market their products more effectively than ADMARC is currently doing. Except for the remote areas, which were discussed above, ADMARC no longer plays a critical role in the supply of farm inputs to smallholders.

### 3.2.2 The Impact of Continued ADMARC Operations on Private Sector Growth

Another social issue is the impact of a continued ADMARC presence on the growth of private sector activity in rural areas. Past ADMARC activities effectively prevented the private sector from taking hold: first, ADMARC's virtual monopoly in the marketing of all smallholder crops; then ADMARC's role as buyer of last resort purchasing many crops at artificially high floor prices set by Government; and, finally, the practice of buying and selling at pan-territorial prices that bear little relationship to actual marketing costs.

These problems would be reduced in the future if the new company were to: (1) quickly identify all of the market facilities it would not need and transfer them to a property management company for disposal, and (2) abandon the policy of buying and selling at one price for a crop anywhere in the country and at any time of the year. To be commercially viable, the new company would obviously have to vary its prices geographically and over time. For example, its purchase price for maize would increase over the course of a buying season as the storage time declined and demand relative to supply increased. Also, the fertilizer price would vary geographically based on transportation costs. These very basic changes would greatly improve the conditions for increased private trading activity by the company in rural areas.

Even with these changes, there is still the problem of a large trading company needing to keep its facilities and staff occupied, and the impact that this would have on Malawi's thin rural markets. With large overhead expenses, (although much reduced from what they are currently), the company would be under pressure to make large, unpredictable purchases at any price that would help pay these non-variable costs. These transactions would disrupt markets and increase the risks faced by smaller trading businesses with limited resources.

## 4. Action Plan for Forming a Commodities Trading Company

Should ADMARC and the Government decide that, on balance, there are development benefits to be gained by creating a commodity trading company for later privatization, we outline below the steps that should be taken.

### 4.1 Laying the Groundwork

This is already taking place in 1996/97. ADMARC has already settled on a strategy of treating its markets as profit centers and taking action to cut costs and maximize revenues. ADMARC has a marketing network of 13 depots, 77 area offices and associated parent markets, and 257 unit markets; and a total staff that numbers about 6,500. Its task in 1996/97 is to cover as much the costs of this market network as possible. ADMARC projects indirect costs of MK 226 million: MK 132 million for Marketing and Depots, and MK 94 million for Finance and Administration. (See Annex A, Table A-1.) These costs will not decline much as a result of spinning off cotton and tobacco operations, so they provide a good indication of how much cost reduction and/or increased trading profits ADMARC needs to achieve to make this new company commercially viable. ADMARC's 1996/97 commodity trading plans compared to the previous year are as follows (tons):

| Commodity | 1995/96 | 1996/97 |
|---|---:|---:|
| Maize | 87,086 | 130,000 |
| Rice | 8,622 | 6,000 |
| Groundnuts | 2,342 | 3,000 |
| General produce | 16,464 | 13,780 |
| Fertilizer | 40,081 | 67,000 |
| Seeds | 1,000 | 2,000 |

What these figures indicate is that ADMARC's basic strategy is to expand its largest volume products, maize and fertilizer, to maximize throughput. Profit margins after direct expenses are low, but together, these two products are projected to contribute MK 104 million to help pay ADMARC's MK 226 million in indirect expenses. As the same time, ADMARC will be purchasing other crops at prices that will generate a net profit. The rice, groundnut, and general produce trading accounts are projected to add another MK 35 million in profits after direct expenses.

This, however, will still not be enough to cover all of ADMARC's indirect expenses. Marketing and Depot expenses and Finance and Administration expenses will both have to be reduced substantially. During 1996/97, ADMARC should analyze the financial results at each of its market facilities and categorize markets according to: (1) those the commodity trading company will definitely keep, (2) those it will definitely sell, and (3) those that require further study. In the meantime, a property management company will have been formed as described in Chapter 2 of the main report. This company will take over all of the market facilities not needed by the cotton or tobacco companies at the end of 1996/97. ADMARC's commodity trading operation will then have to lease its marketing facilities from this company.

Also at the end of 1996/97, ADMARC should hire outside consultants to conduct a pre-feasibility study of the new commodity trading company. On the basis of this study, ADMARC will operate without tobacco and cotton for one year as the predecessor of the commodity trading company.

## 4.2 Begin Commercial Operations

1997/98 should be the year in which ADMARC's streamlining efforts begin to show results. All of the markets that have no prospects of being profitable will have been closed (except those in remote areas which will continue to be operated under government contract), and staff will have been reduced accordingly. All of the facilities to be retained by the new company will be leased from the property management company.

This is also the first year in which ADMARC will be able to manage its market facilities as profit centers. Based on the pre-feasibility study, ADMARC should have prepared marketing plans for maize, fertilizer, and general produce, including rice and groundnuts. These plans should specify where and in what quantities agricultural commodities and farm inputs will be purchased and sold, as well as a pricing strategy for each commodity or product.

This will provide one full year in which ADMARC's commodity trading operations will be conducted entirely on a commercial basis. At the end of 1997/98 the commodity trading company will be formed using the same approach described in Chapter 2 for cotton and tobacco. The Privatization Commission will name a General Manager and Board of Directors.

## 4.3 Operate as an Independent Commodity Trading Company for One Year

By this time, the commodity trading company operations will be considerably scaled back from what they were in 1996/97. Presumably the company will be entirely out of local maize trading and its national trading activities will be urban based. The company will also have established links with export and domestic markets for general produce and will have selected the markets and depots needed to supply these markets. It also will have established effective marketing linkages with smallholders utilizing mobile buying teams or local traders as appropriate. At this point, this successor to ADMARC will be just one more commodity trading company competing with similar trading companies in the private sector. At the end of the 1998/99 financial year, it will be privatized.

# 5. Conclusion

As noted in Section 3 above, it is not at all certain that this company will prove to be commercially viable. Likewise, there is the danger that a scaled down ADMARC will continue to linger in the public sector as a struggling commodity trading company constantly at the beck and call of the Government.

The Government should therefore seriously consider not including a commodity trading company in the privatization plan for ADMARC. The alternative would be to transfer all of the facilities not needed by the cotton and tobacco companies directly to the property management company for sale to the private sector. In the immediate future, the ADMARC facilities would continue to be utilized for maize and other commodity trading as described in Chapter 3 (Section 3.4) of the report. Specifically, ADMARC would: (1) phase out of local maize trading as rapidly as possible thus making most of the markets in non-maize surplus areas (i.e., many of the markets in the Southern Region) available for sale; (2) phase out of national maize marketing over a three year period, thus gradually making markets in the maize surplus areas of the Central Region and the southern part of the Northern Region available for sale; and (3) continue to provide market outlets in selected remote areas for two years while the Government prepares an integrated development approach to these areas that could include continued subsidized market interventions funded by Government and implemented by the private sector, thus making all of the markets in these areas available for sale in two years.

## ANNEX E
## INPUT MARKETING

### 1. Fertilizer

#### 1.1 ADMARC Fertilizer Operations

The amount of fertilizer distributed by ADMARC for the 1995/1996 year may be derived from the following report on stock changes for the year:

| | |
|---|---|
| Opening stock | 10,608 tons |
| Received from: | |
| SFFRFM | 41,325 |
| Optichem | 13,672 |
| Drought Relief | 23,000 |
| Total receipts | 77,997 |
| Withdrawn by SFFRFM | 638 |
| Sales (as of 2.2.96) | 38,075 |
| Free Issues | 21,358 |
| Total distributed | 59,433 |
| Ending stock | 28,534 |

(Note: ADMARC figures show an ending stock of 22,001 tons, but if the other figures are correct, then ending stock should be 28,534 tons. Also, fertilizer distributed for SFFRFM should not properly be called "sales". Only the Optichem fertilizer was "own-account" stock and should be labeled as sales.)

From other data reported by ADMARC we understand that sales of Optichem fertilizer totaled 12,540 tons, which represents ADMARC's actual fertilizer sales on its own account for the year. The balance of about 46,900 tons were distributed for others.

Government policy as interpreted by ADMARC last year was that the SFFRFM should focus on importing fertilizer and ADMARC should focus on distribution. For the 1995/96 season, ADMARC initially planned to purchase 60,000 tons of fertilizer and proceeded to obtain quotes from foreign and local suppliers. Later it was decided to procure 16,300 tons from OPTICHEM, and to meet the remainder of its needs by distributing fertilizer from the SFFRFM. The arrangement with SFFRFM is that ADMARC is reimbursed for all transport costs and receives a fee of 5.6% of the value of the fertilizer handled. ADMARC management is not satisfied with the relationship with SFFRFM, noting that they had expected a bigger allocation than the 41,325 tons, that the fee paid them for distribution is inadequate to cover their costs, that the fertilizer was released from SFFRFM depots too late in the season, and finally that contrary to the exclusive distribution arrangement ADMARC had with them, SFFRFM began selling fertilizer directly from their depots at lower prices than ADMARC placed on the same fertilizer. ADMARC further claims that there were deliberate interruptions in shipments in order to undercut sales in ADMARC markets and maximize sales at their own depots. For 1996/97, ADMARC has issued a tender for 67,000 tons of fertilizer and expects to distribute much smaller amounts of SFFRFM fertilizer than last year.

## 1.2 The Malawi Fertilizer Market

The total current market for fertilizers in Malawi has been estimated at approximately 204,000 tons in a recent paper by Anne Conroy of the Ministry of Finance.[8] An approximate breakdown of fertilizer movements by distributor in 1995/96, based on information from ADMARC (the figure for Norsk Hydro was not included but was obtained directly by the authors from that company) is as follows:

| | | |
|---|---|---|
| ADMARC | 59,940 tons | (28%) |
| SFFRFM Direct Distrib. | 32,738 | (15%) |
| Drought Program | 23,000 | (11%) (Supplementary Inputs Program) |
| Interfert | 47,456 | (22%) |
| OPTICHEM Direct | 20,760 | (10%) |
| Norsk Hydro | 31,000 | (14%) |
| Total | 215,900 | |

The total shown is more than 11,000 tons higher than the Conroy estimate. We are unable to reconcile the difference.

Until 1991, all fertilizer destined for smallholders was imported by the SFFRFM and distributed by ADMARC. After liberalization of fertilizer marketing in 1994/1995, private fertilizer dealers were able to participate significantly for the first time during the 1995/96 crop year. We are aware of four importer/distributors currently active in the market: Norsk Hydro, Interrep (joint venture of Interfert and Press Corp.), Optichem (owned by ADMARC and Kanoch of South Africa, and a Malawian company, Farmwise. ATC, a subsidiary of Auction Holdings Ltd., is mainly a distributor but has imported directly in the past. (We understand that a company owned by Chief Kaomba plans to import a small amount for sale in the Karonga area.) The largest importer remains the SFFRFM. A very rough estimate of the volumes which will be imported by each for the current year is as follows:

| | | |
|---|---|---|
| | Norsk Hydro | 30,000 tons |
| | Interrep | 40,000 |
| | Optichem | 22,000 |
| | Farmwise | 12,000 |
| | SFFRFM | 30,000 |
| plus : | ADMARC tender | 67,000 (to be imported by others, not included in above figures) |
| | Total | 201,000 |

[8] *Fertilizer use in Malawi: An overview of recent trends, projection of effective demand for the 1996/97 agricultural season, fertilizer policy issues and proposed monitoring system of the private trade. (Draft for Discussion),* Anne Conroy, Ministry of Economic Planning and Development, March 1996.

Fertilizer sales are to three categories of buyers: smallholders, small estates, and large estates. The small holder sector is a large consumer of fertilizer. Anne Conroy estimates that during the 1990s, the average consumption by smallholders was 81,000 tons (roughly 60% on maize and 40% on tobacco) and by the small estate subsector 35,000 tons. Trading in fertilizer was completely liberalized in 1995/96 and subsidies were removed. Smallholder consumption declined -- when compared to the average figures for the 1990s -- in response to the 200 to 300 percent increase in prices and limited access to credit.

Fertilizer consumption is expected to rebound in 1996/97 as only minimal price increases are expected, farmers will have more cash as a result of a good maize harvest, the expansion of burley tobacco planting by smallholders, access to credit (from MRFC) should expand, and the release of new site-specific fertilizer recommendations by the Maize Productivity Task Force. Conroy estimates fertilizer consumption for 1996/97 at between 178,000 to 201,000 tons if Government maintains a free input distribution program at the same level as last year (23,000 tons). Of this amount, 73,000 to 80,000 tons would be consumed by the smallholder sector, 29,000 to 32,000 tons by small estates, and 73,000 to 83,000 tons by large estates (TAMA, Lonrho, Sable Farming, KFCTA). Fertilizer sales (excluding free distributions) could be on the order of 190,000 tons.

### 1.3 Private Sector Distribution of Fertilizer

The private sector accounted for over 50% of sales in 1995/96. Conroy believes that stiff competition from these companies with ADMARC will lead to lower prices in the future and that in time all districts of the country will be served.

According to a survey carried out by Conroy in early 1996[9], fertilizer suppliers anticipate that most of the future growth in demand will come from the smallholder sector. However, the availability of agricultural credit is seen as a constraining factor, in part because of the limited scope for expansion of credit through MRFC. High interest rates also limit their ability to finance the holding of stocks and their capacity to extend supplier credit to buyers. There is also concern about unfair competition from the SFFRFM. Suppliers feel they should be allowed to tender for procurement under the SIP, a program which they state has taken between 10 and 20% of the total fertilizer market. A study by M.J. Westlake[10] concluded that private fertilizer dealers faced considerable risk in entering the market due to uncertainty about the market size, Kwacha instability, and high interest rates. Finally, another uncertainty facing private dealers is the future of the Fertilizer Buffer Stock, which is now maintained at a level of about 90,000 tons with assistance from the EU. It is generally felt that this is more than is needed at the present time. The view of the EU is that 30,000 tons is sufficient.

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[9] *The planned fertilizer supply situation for the 1996/97 agricultural season, and issues related to the Fertilizer Buffer Stock,* Draft discussion and information paper, Anne Conroy, Ministry of Finance, May 1996

[10] *Papers on Aspects of Maize and Fertilizer Market Liberalization*, M.J. Westlake, under ASAP Project, USAID, July 1995.

## 2. Seeds and Other Farm Inputs

ADMARC sell through its marketing network, in addition to fertilizer, seeds, pesticides, farm equipment, and packing material for cotton and tobacco. In 1995/1996, these sales were valued at K. 29 million (fertilizer alone accounted for K. 80 million in sales). Hybrid maize is the main type of seed marketed. ADMARC also distributes free seed through the Supplementary Inputs Programme (SIP), amounting to 3,200 tons in 1995/1996.

Commercial seed accounts for only 7.8% of all planting in Malawi, according to 1989 data from ADMARC reported in a recent study.[11] In addition, some farmers engage in seed multiplication as a business, producing mostly maize, soya beans, and pigeon peas. The referenced data included an estimate that 63% of all planting used seed retained from the previous year's crop. Maize seed is by far the most common seed sold commercially.

Private sector distribution of seeds in increasing as there are currently three major players. Some idea of this activity in seeds may be gained from the experience of Pannier Seed (Malawi) Ltd., a subsidiary of a South African company which was incorporated in May 1996 with offices in Blantyre. This operation was formerly the seed division of Lever Brothers Malawi, which at one time bought sunflower seed for production of edible oil. When Lever decided to get out of this business it found a partner in Pannier (Pty) Ltd. of South Africa and spun off the new company, retaining a 20% share. It will be managed for a limited time by a Lever executive seconded to Pannier. Lever got into the maize seed business in 1993 and the new company is carrying on that operation. It regards ADMARC as its main customer (50% of sales) and in fact is currently making an offer to ADMARC for hybrid maize seed. ADMARC also bought seed from the predecessor company last year. Pannier management complained about slow payment from ADMARC, but more serious is their complaint of mismanagement of Pannier maize seed stock. (The Pannier manager visited one ADMARC market and found seed which was never put up for sale during the season because the local manager was not told at what price he should sell it!)

Pannier is establishing a distribution network in Malawi, but has found it necessary to rely heavily on chains of food and hardware stores and petrol stations to handle their seed. The stores include the PTC (People's Trading Center) and Hyperstores of the Press Corporation (72 stores), and McConnels Cash and Carry stores. The implication of this situation is that specialized dealers in farm inputs do not exist, nor are there many small merchants in rural areas who buy produce and sell inputs. We believe that ADMARC's presence in the rural areas has discouraged traders from going into business. This will take time to change, and in the more remote areas in may be some years before it happens. The distribution of free seed under the SIP also acts as a disincentive to private dealers.

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[11] *Study on a Strategic Plan for a Revolving Fund Covering Agricultural Inputs and Output Marketing,* by Charles Mataya *et al*, January 1996.

## 3. ADMARC Input Marketing Trading Account

ADMARC's trading account in farm inputs is shown in Table E-1. Fertilizer is a very high proportion of sales so most of the conclusions to be drawn from the figures relate to this commodity. Prices of fertilizer sold by ADMARC were fixed by Government until the 1995/1996 season. According to ADMARC, this forced them in some cases to sell at prices below cost.

This would explain the situation in 1994 (1993/1994 crop year) when the account made a loss even before allowance for indirect expenses, and in 1995 (1994/1995 crop year) when there was a small profit before indirect expenses. The situation is much improved in the year just completed (1995/1996), despite the fact that ADMARC handled some 14,000 tons of SFFRFM fertilizer which they claim they lose money on. For the present year, 1996/1997, ADMARC plans to deal predominantly in fertilizer purchased on its own account, yet profits after direct expenses are projected at only 9%. This will result in a substantial loss when indirect costs are factored in. It appears from analysis that projected lower sales prices for fertilizer explain a large part of this loss, and this may be traced to competition from private sector dealers.

**Table E-1**
**Input Marketing Trading Account, 1992-1997**
**Year ending March 31**
**(000 Kwacha)**

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|
| Sales | 26,453 | 36,674 | 34,864 | 81,607 | 108,939 | 512,038 |
| Cost of Sales | 19,820 | 27,329 | 37,093 | 70,619 | 103,432 | 428,457 |
| Gross Profit | 6,633 | 9,345 | (2,229) | 10,988 | 5,507 | 83,581 |
| Net change in stock* | | | | | +27,045 | -21,774 |
| Direct Expense | 2,033 | 1,679 | 2,326 | 3,213 | 5,095 | 15,525 |
| Profit after Direct Exp. | 4,600<br>(17.4% | 7,666<br>(20.9%) | (4,555)<br>(-13.1%) | 7,775<br>(9.5%) | 27,457<br>(25.2%) | 46,282<br>(9.0%) |
| Marketing Expenses | 1,421 | 4,630 | 11,102 | 15,792 | | |
| Admin Expenses | 1,199 | 3,498 | 8,953 | 14,010 | | |
| Finance Charges | 518 | 714 | 5,836 | 4,467 | | |
| Net Profit (Loss) | 1,462 | (1,176) | (30,446) | (26,494) | | |

* Netted out in cost of sales for years prior to 1996.

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