

AGRICULTURAL POLICY ANALYSIS PROJECT, PHASE III

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**SMALLHOLDER
SUGAR AUTHORITY**

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1 INTRODUCTION

1.1 Terms of Reference

The Government of Malawi, through the Department of Statutory Corporations, have commissioned Mr J M O'Neill of Imani Development Limited to conduct a study of the Smallholder Sugar Authority (SSA). The main objectives of the study are

- to define an alternative form or a new vision for SSA that would reduce and/or end any financial and administrative relationship with the Government
- to review the original mission statement and objectives and to redefine them commensurate with the proposed organization
- to identify or map out steps or an action plan to transform SSA into a new organization

The terms of reference for the study are as follows

- (a) Determine the form the Authority should be transformed into in order to make it more or completely financially and administratively self sustaining. A minimum of three options, including just restructuring the status quo, and a buyout by staff and farmers, should be investigated and the best suitable one recommended
- (b) Review the original mission statement and objectives and redefine them to suit the proposed new organization
- (c) Assess whether the existing organizational structure and human resources would be suitable for the new organization, proposing if need be any changes. If retrenchment is envisaged, propose a suitable compensation package
- (d) Propose an appropriate management system to run the new organization
- (e) Assess the Authority's current financial status and propose a proper financial structure for the new organization. Investigate the possibility of the new organization acquiring shares in Dwangwa Sugar Factory
- (f) Take inventory of the Authority's assets and propose how best they can be used or disposed of based on the recommendation in (a) above

- (g) Develop steps or an action plan for transforming SSA into the proposed new organization
This should clearly outline what actions are to be taken, when, and by whom

In accordance with the Terms of Reference an interim report was submitted to a Review Committee comprised of Government officials, management of the Authority, and growers' representatives. This final report incorporates the feedback received from that committee.

2 PRESENT STATUS OF SSA

2.1 Background

SSA was established by the Smallholder Sugar Authority Order issued by the Minister of Agriculture under the authority of the Special Crops Act (Cap 65:01 of the *Laws of Malawi*). The objectives of the Authority are set out in Section 4 of the order which states "There is hereby established an Authority to be known as the Smallholder Sugar Authority for promoting and fostering the development of sugar cane grown by smallholders in such areas as the Minister shall decree."

To date SSA have established one smallholder cane growing scheme in Nkhosakota district on land sub-leased at a peppercorn rent from Dwangwa Sugar Corporation. Initially, 663 hectares of cane were planted in 1978 which was farmed on a commercial basis for two years prior to settlement of smallholders on plots of approximately 2.0 hectares each.

The number of smallholders in the scheme reached a high of 345 before it was decided that the minimum viable plot size was 3.0 hectares and some 150 smallholders were removed from the scheme in 1986/87. Currently there are 192 smallholders farming approximately 580 hectares of cane.

In addition the Authority operates a commercial farm of 113 hectares of sugar cane. The total initial hectareage of cane has expanded by approximately 60 hectares through land reclamation carried out by the Authority from 1978 onwards.

There is considerable scope for expansion of smallholder sugar cane growing areas. The Authority has already secured land at Liwaladzi in Nkhosakota district but there are a number of factors inhibiting development. Prior to any development, the problem of squatters now settled on the land must be addressed. It will also prove difficult for the Authority to finance establishment costs. Internal resources do not exist and development finance institutions are reluctant to lend to parastatals. Management of the Authority are now actively investigating the possibilities for rain-fed cane growing which has a much lower capital cost. Even greater potential exists for development of smallholder cane growing in the Lower Shire Valley where the SUCOMA sugar mill has considerable excess capacity.

In the absence of sugar mills elsewhere in the country, development potential is presently confined to Nkhosakota and the Lower Shire Valley. It is not considered economically viable to transport cane from beyond a 50 kilometer radius of the sugar mill.

2 2 Functions Performed by SSA

The present functions of SSA fall into five broad categories, management of the smallholder sugar scheme, provision of farming related services to growers, provision of social services to growers, running a commercial sugar farm, and initiating projects to further develop smallholder sugar cane growing in Malawi

2 2 1 Management of the Smallholder Sugar Scheme

It is critically important that the smallholder sugar scheme is managed in a coordinated manner. It is not possible to permit growers to manage their individual plots according to personal preference, in isolation of the needs of the scheme in its entirety

The Dwangwa Sugar Company (Dwangwa) sugar mill is only able to process smallholder cane in accordance with a pre-agreed delivery schedule for the season. Effectively this means that individual smallholders are obliged to grow different varieties of cane, some being early ripening and others late ripening. The cane planting and cane harvesting programme must therefore be carefully coordinated. The sucrose content of cane harvested, and hence proceeds received, varies throughout the harvesting season. The Authority operate a "relative cane payment system" which seeks to equalize the returns to growers irrespective of time of harvesting, i.e. compensating those growers who are obliged to harvest lower sucrose yielding cane because of the requirements of the Dwangwa delivery quota

Cane irrigation also requires careful coordination. The irrigation infrastructure would not permit all growers to irrigate their crops at will. Again, the management of the Authority coordinate the irrigation process, to the extent of physically testing the moisture content of cane in individual plots to determine the optimum time to irrigate

Management also coordinate the cane replanting programme according to a cycle which results in approximately one-seventh of the cane being replanted each season

2 2 2 Farming-related Services

The Authority provide or organize a variety of services to assist smallholders farm their plots. These include land preparation, provision of inputs, irrigation and drainage, road maintenance, extension services, and cane cutting and haulage. Services which are not provided directly by the Authority such as cane haulage are hired from Dwangwa

The cost of all services provided is recovered from growers either on an actual basis such as is the case with inputs supplied or as a uniform charge per hectare (e.g. irrigation and road maintenance) or per tonne of cane (e.g. cane cutting and haulage). In addition to specific direct costs, a management charge is levied on growers to absorb the Authority's overhead costs. The cost of replanting is recovered from all growers by way of an annual charge thereby spreading the cost of replanting for an individual grower over the seven year replanting cycle.

The commercial farming operation (discussed below) bears an allocation of costs consistent with the smallholder plots allocation, i.e. based on relative hectareage/tonnage or actual inputs supplied.

Charges to smallholders are initially debited to their individual smallholder accounts which bear interest, currently at 15% per annum, significantly below prevailing commercial rates. Proceeds of sales of smallholder cane to Dwangwa are credited to growers' accounts and the net balance paid over to growers in two lump sums in the January (70%) and July (30%) following the end of the growing season.

2.2.3 Provision of Social Services to Growers

The Authority have developed an impressive array of social amenities for smallholder growers including a clinic, a clubhouse comprising hall, bar, and library, a welfare shop, and a homecraft center. In addition the Authority contribute (together with Dwangwa and Ethco) to the upkeep of the local school. The costs attached to these services are effectively passed on to growers within the management charge they bear.

On allocation of a sugar cane plot, the grower is also entitled to occupy a land holding at Mowe settlement area on which food crops are grown. Assistance is given to growers in the form of provision of necessary inputs to enable a maize crop to be grown. This is dealt with through the smallholder current accounts in a similar manner to sugar cane inputs.

The Authority also rear chickens which are sold to growers and Authority staff.

2.2.4 Commercial Sugar Farm

The Authority also grow on a commercial basis 113 hectares of sugar. Costs are allocated to the commercial farm on a basis consistent with that used to allocate costs to the smallholder plots. The profits of the farm accrue to the Authority and are held in a price stabilization reserve (currently standing at K8 million) which is intended to be used, at the Authority's discretion, to supplement smallholders' incomes in times of low sugar prices.

Initially the commercial farm was made up of training plots and scattered plots of land from which it was not possible to create the requisite 3 hectare plot areas. However, it would appear that the farm size has expanded considerably in recent years and that there ought to be scope for settlement of further smallholders within the area currently designated as commercial.

2.2.5 Development Projects

As discussed in Section 2.1 above, there are several possibilities to further develop smallholder sugar cane growing within Malawi. The Authority continues to actively pursue these possibilities and have secured land at Liwaladzi in Nkhosakota and conducted preliminary research into developing schemes at Kasitu and Alumenda.

A major constraint on development is the inability of the authority to raise the necessary finance to fund the initial establishment costs. One possibility is to seek private sector involvement in the development phase with the private sector receiving their return in the form of proceeds of cane sales in the initial years of the project prior to settlement of smallholder growers on the scheme.

2.3 Relationship between SSA and Dwangwa

SSA presently occupies an area of 1206 ha of land sub-leased at a peppercorn rent from Dwangwa in terms of a 1977 agreement between Dwangwa and the Government of Malawi.

In terms of an agreement dated June 1996 between Dwangwa and SSA, SSA have agreed to deliver and Dwangwa to accept for manufacture into sugar all cane grown on the sub-leased land.

SSA are paid 60% of the market proceeds of sugar and molasses produced from the cane delivered in accordance with a formula (common in the sugar industry) which takes account of the sucrose content of the cane delivered. At the beginning of the season Dwangwa estimate the average ex mill price of sugar for the coming season. Within 15 days of the end of the month, Dwangwa pay SSA 70% of the estimated amount due in respect of that month's cane deliveries. A further 10% provisional payment is made following the last month of the milling season (November). No later than the end of the following May, an independently audited statement determining the actual proceeds of sugar sales for the season is prepared and within 15 days thereafter payment of the final balance due is made.

SSA and Dwangwa enjoy a good working relationship. The cane price formula is subject to review every three years to ensure equity and, should agreement not be reached, is subject to the binding arbitration of the Minister of Agriculture. Dwangwa also provide a variety of services to SSA at cost including electricity, water, earth moving equipment, land preparation, cane haulage, and building and machinery maintenance.

It is worthwhile noting that the cane agreement is between Dwangwa and SSA as a principal and not as an agent for the smallholder. Dwangwa do not wish to enter into any direct agreement with individual smallholders. Dwangwa also retain the right to cancel the agreement in the event that SSA cease to control the growing of smallholder cane on the sub-leased lands.

Discussions were held between the Consultants and the senior management of Dwangwa and Lonrho Sugar Limited (the managers of both the Dwangwa and Sucoma sugar estates). They are committed to supporting smallholder sugar growing and to whatever extent practicable are willing to assist to expand the area planted to smallholder sugar. Obviously, an increase in smallholder output increases factory throughput and hence, efficiency and profitability of the factory.

On the issue of the existing sub-lease, Dwangwa have no objection, in principle, to surrendering their rights to the land presently sub-let to SSA. They might however, require certain safeguards to ensure the continued use of the land for its purpose of cane growing.

2.4 Relationship Between SSA and Smallholder Growers

Smallholder growers occupy their holdings (and the related area of settlement land) in terms of temporary licenses valid for a period of one year only. The license gives the Authority sweeping powers to control the activities of the smallholder. There are fourteen conditions attaching to the license ranging from empowering the Authority to regulate farming practices, including at the food plot, to undertakings by the smallholder not to be absent from the scheme without the express permission of the Authority and not to do anything which will undermine the Authority and other smallholders' discipline.

The management of the Authority are often required to rigorously apply their powers under the growers licensing arrangement with a view to obtaining maximum productivity from the scheme. Indeed, anecdotal evidence suggests they actually go as far as physically locating growers and requiring them to attend to various duties on their plots such as weeding and irrigation work.

The relationship between management of the Authority and growers has been strained in recent years to the degree that the growers have engaged legal counsel to demand amongst other things the immediate refund of all charges previously deducted from growers and the handing over of the Authority's assets to the growers. The official mouthpiece of the growers is the Farmers Association which was recently formed and a committee elected, though the Association as yet has no constitution or formal legal status.

Discussions with growers suggest that there are three main areas of grievance

- Growers consider that they have effectively paid for the assets of the Authority through various charges for development levied on them over the years. They therefore believe that these assets, including the developed lands, should be handed over to them. There is a certain amount of merit in the argument as development charges levied over the years have at least equaled the cost of developments undertaken. However, a counter argument is that the development charge is no more than an annual rental. Further complications arise when one considers former growers who have also contributed by way of development charges. It is also necessary to consider the extent to which assets have been funded by the charges levied on the commercial farming operation and the retained profits of the commercial farm.
- Growers resent the various charges imposed by the Authority and, in particular, the management charge levied to recover the overheads of the Authority. They consider there is no transparency in the manner of determining the charge and as the charge is subject to arbitrary change based on actual overheads it constitutes a “blank cheque” to management with no incentive for efficient performance. It is quite apparent that the lines of communication between the Authority and the growers are not working effectively, despite the growers having representation on the Board of the Authority.
- Growers accept the need for management of the scheme but consider that they should recruit and direct the management. Because of the historical relationship between growers and management it seems unlikely that, given the power to hire and fire management, growers would elect to continue to employ the present management team. However, the specialized expertise necessary to manage the scheme is probably not available in Malawi outside present management unless, perhaps, headhunter at a significantly higher cost from one of the two commercial sugar estates.

2.5 Financial Status of SSA

Financial performance of the Authority has been largely satisfactory, apart from a period in the middle of the 1980's when a depressed world market for sugar severely impacted income of the Authority, and hence growers to the extent that a Government subvention to supplement their incomes was required. The subvention took the form of a loan which was subsequently repaid out of the profits of the Authority. At present smallholder growers enjoy relatively high levels of income, the Authority has built up substantial reserves and SSA has no need for recourse to Government subvention.

2.6 Operating Performance

Operating accounts for the past two financial years are set out in Table 2.1 on the next page

The average income per smallholder (based on the current 192 smallholders) is therefore in excess of K50,000 for 1996 and just under K50,000 in the previous year. The major area of concern for the growers is that the management charge has more than doubled over the period from K3.2 million to K6.9 million and expressed as a percentage of cane proceeds, has increased from 19.4% to 32.4%.

The profits of the commercial farm are augmented by other income, principally interest, such that the profit of the Authority for 1996 was in excess of K3.5 million before appropriations to reserves.

Table 2 1 Smallholder Sugar Authority

Operating Accounts	Commercial farm		Smallholders	
	1996	1995	1996	1995
	K	K	K	K
INCOME				
Proceeds on sale of cane	4 001 062	2 714 300	21 253 488	16 735 756
EXPENDITURE				
<i>Crop costs</i>				
Pest and weed control			20 149	
Salaries and wages	523 797	296 865		-
Cultivation and fertilizer	534 708	281 225	2 747 541	1 720 823
Insurance	40 011	27 143	212 535	167 358
Cutting and haulage	439 306	237 179	2 333 572	1 464 903
Irrigation	31 155	39 108	310 470	186 787
Sundry	1 554	2 389	57 246	63 955
Motor hire	55 176	45 304		-
	1 625 707	929 213	5 681 513	3 603 826
<i>Other costs</i>				
Development Charge	30 938	27 866	157 594	161 240
Management charge	910 540	531 742	6 894 313	3 250 326
Replanting	153 480	81 741	785 434	465 662
Road maintenance	11 100	11 685	51 176	35 916
	1 106 058	653 034	7 888 517	3 913 144
Total costs incurred during year	2 731 765	1 582 247	13 570 030	7 516 970
Growing crops brought forward	1 133 811	570 587	3 494 688	2 545 273
Growing crops carried forward	(1 699 419)	(1 133 811)	(6 782 833)	(3 494 688)
Total costs for the year	2 166 157	1 019 023	10 281 885	6 567 555
Operating profits for the year	1 834 905	1 695 277	10 971 603	10 168 201
OTHER EXPENDITURE				
Medical and other expenses			287 033	162 532
Interest charges			518 844	458 969
Total other expenditure	-	-	805 877	621 501
Net profit for the year	1 834 905	1 695 277	10 165 726	9 546 700
Appropriation to capital redemption reserve			136 869	136 869
Net surplus for the year	1 834 905	1 695 277	10 028 857	9 409,831

2.7 Assets of SSA

Based on the latest audited balance sheet of SSA at 31st March, 1996, the estimated present financial status at the Authority is set out in the Table 2.2 below

Table 2.2 SSA Financial Status at 31st March 1996

	K'000	Notes
Land and buildings	4,904	1
Other fixed assets	5,347	2
Land development	2,003	3
Forestry	368	4
Net current assets	7,107	5
	19,729	
Financed by		
Government capital	2,281	
Government loan	3,011	
Reserves	14,437	6
	19,729	

- 1 A valuation of land and buildings was carried out by MPICO in August, 1996. There are 23 staff houses ranging in value from officers houses valued at K23,600 each to the recently constructed proposed guest house valued at K450,600. The total value attributed to staff housing is K5,713,200. The club house complex is valued at K583,000, the welfare shop at K156,000 and the clinic at K66,800. Office buildings are valued at K1,283,350. The balance of the total valuation is an amount of K524,000 attributed to various stores, warehouses, workshops, etc.

It is important to note that the basis of valuation used by MPICO was depreciated replacement cost as there is no evidence of any property transactions within the area. It is highly likely that the open market value of these assets is much lower, if indeed they have a value to anyone other than the sugar authority or its successor.

- 2 Other fixed assets include 8 motor vehicles and 5 motorcycles with a written down value of K3.5 million. Seven of these are less than two years old. The computer installation is valued at K700,000 and the remainder of other fixed assets is composed of numerous items of agricultural, office and domestic plant, equipment and furniture.
- 3 The original cost of land development dating back to 1978 was K2 million. The current cost of developing land could be as much as K100,000 per hectare. It should however be borne in mind that growers have been consistently paying an annual development charge for the land they occupy.
- 4 Forestry consists of numerous small scattered plots throughout the Authority's land.
- 5 Net current assets comprising bank balances, stocks, growing crops, and debtors less creditors would appear to be realizable at their stated carrying value.
- 6 Included within reserves is a cane loss reserve (K1,362,000) which is an amount set aside to insure against fire losses. K1,141,000 of this reserve has been created out of "insurance charges" on the growers and therefore accrues to them. Similarly, the replanting reserve of K183,000 in respect of smallholder plots also accrues to the growers.

The price stabilization reserve of K8,318,000 represents the accumulated profits of the commercial farm and interest income though the accounting policies of the Authority state that it may be used at the discretion of the Board to supplement smallholders' income in times of low sugar prices. In reality though, this reserve is not represented by liquid deposits but instead the reserve has been used to finance fixed assets and working capital of the Authority.

3 OPTIONS FOR THE FUTURE OF SSA

The Government of Malawi, in terms of an accepted fiscal restructuring and deregulation programme, has agreed in principle to remove any legislative obstacles to participation in the production and marketing of special crops. To this end, the schedule of special crops was removed by Government Gazette of 19 January 1996. The Special Crops Act remains in place solely to maintain the legal status of crop authorities established under the Act until such time as an alternative appropriate legal form for these authorities is established.

The terms of reference for this study require the investigation of various options for transforming SSA into a financially and administratively self-sustaining entity. In actual fact, the Authority is to a large extent already financially and administratively self-sustaining. The Authority is profitable and provides adequate returns to smallholder growers without need for government subvention. Government investment in the Authority is modest, consisting of capital of K2 million and a long-term loan of K3 million. Direct government administrative involvement in the Authority is limited to the participation of government appointees and ministry representatives on the Board of Directors.

Any proposals for the future form of the Authority must consider a number of criteria including the aspirations of the smallholder grower, the need to maintain a working relationship with the sugar milling company, and the responsibility to fulfill obligations to the existing staff of the Authority. Also any proposed change must be within the overall Government policy framework, considering in particular the desirability of further development of smallholder sugar schemes as a means of increasing rural incomes and contributing to national export earnings. In addition, Government has committed itself to withdrawing from ownership of public enterprises with one of several objectives being the promotion of participation by the Malawian public in these enterprises.

3.1 Restructuring of the Status Quo

As Government is committed to the eventual revocation of the Special Crops Act, it will, as a minimum, be necessary to create a new legal form to take over the present assets and operations of SSA. Establishment of a replacement parastatal would not be in accord with the privatization programme. It is suggested that the most appropriate entity would be a commercial, limited liability company in which the Government holds 100% of the issued share capital. This could also be viewed as an interim step towards eventual privatization as the Government could subsequently offer the shares in the company for sale to the growers or management or private entrepreneurs or some combination thereof.

The option of maintaining the status quo through the transfer of assets and operations to a different legal entity has a number of positive features. The existing management and staff of the Authority would continue to perform their present functions and the relationship with Dwangwa would not be jeopardized. The entity would provide a vehicle through which future smallholder sugar scheme development could be coordinated.

The major problem with maintaining the status quo is that the aspirations of smallholder growers may not be met. It should however be possible to address some of their concerns within the new structure.

Although growers would not assume ownership of the assets of the Authority, steps could be taken to give them a more secure tenure over the holdings they presently occupy. Instead of the present one year temporary license to occupy a holding, a formal 99 year transferable sub-lease could be granted, subject to the lease containing certain safeguards such as covenants that the plot must be used for the growing of sugar cane and the plot cannot be subdivided. There seems no reason why growers cannot be given unrestricted leasehold title to the lands they occupy at the settlement areas. It might also be possible to transfer the non-commercial assets of the Authority (clubhouse, welfare shop, etc.) to the Farmers Association once that has been properly constituted from a legal viewpoint. In this manner growers can be "compensated" for their contribution by way of development charges over the years.

Growers grievances over the level of other charges levied need also to be addressed. To the extent possible, growers should be free to source their inputs and farming services wherever they wish but it must be recognized that certain services must be provided by the Authority (or its successor), for example, cane haulage and irrigation. Provided these charges are agreed in advance of the season and subject to independent arbitration in the event of a dispute, growers should have no cause for concern. There is also a suggestion that the annual replanting charge be discontinued and actual replanting costs borne by growers in the year incurred. It is likely that growers would have difficulty in funding replanting costs if the present system is discontinued and therefore, the possible consequences should be carefully explained to growers before a decision is arrived at.

The major controversy arises from the annual management charge, presently a "blank cheque" for Authority overheads. The management charge presently equates to 25% of cane proceeds. It may be more transparent and would certainly provide an incentive for management to control overheads if the management fees were fixed as a percentage of cane proceeds.

3.2 Buyout by Growers and Management

A buyout by growers and management is an apparently logical extension of restructuring the status quo as outlined above.

Even if growers become shareholders in the new entity there will be need to clearly differentiate their returns as growers and their returns as shareholders, especially if staff members also become shareholders. Accordingly, it is expected that the various restructuring measures discussed in section 3.1 above would be implemented prior to sale of shares in the new company.

The present net asset value of the Authority is in the region of K17 million. After transfer to the smallholder growers (for no consideration) of developed smallholder plots and non-commercial assets, the net asset value would remain in the region of K15 million. Profits of the Authority before appropriations to price stabilization reserve were in the order of K3.5 million for the accounting year ended 31st March, 1996. The Authority presently enjoys tax free status which would not be the case if its operations were transferred to a commercial limited liability company. Maintainable after tax profits of the company are therefore estimated at K2.2 million. An earnings based valuation of the company would, given the risk attaching to an agriculture sector investment, use a price/earnings ratio in the range 4 to 6, valuing the company at K10 million approximately.

Potential shareholders in the company are the 192 smallholder growers, some 30 permanent monthly paid staff of the Authority and, to a lesser extent, 230 'permanent' daily paid staff of the Authority. The daily paid staff might be in a position to acquire 5% of the shares in the company valued at say K0.5 million. The remaining 95% could be offered in equal individual shares to growers and monthly paid staff. Unless significant discounts were given, each individual would be required to contribute K45,000 which is clearly beyond their individual means, unless the shareholdings could be acquired piecemeal over a long period.

In discussions with the growers, they indicated that they did not wish management to become shareholders in any privatized successor to SSA. In the scenario outlined above growers would collectively become the majority shareholders controlling some 80% of the shares in the company. This might possibly be sufficient to allay any fears they may have about management controlling the newly privatized entity. To ensure that the growers remain the dominant shareholders, two classes of shares with equal voting and participation rights might be created with one class only available to growers and the other class only available to staff.

A profit-oriented privatized company cannot be expected to undertake the developmental role of the Smallholder Sugar Authority. Given the huge scope to develop smallholder sugar schemes it would prove necessary for Government to create a vehicle to fulfill this development role. This does not rule out the hiring on a commercial basis of the expertise available among the management of the privatised smallholder scheme.

3.3 Separate Management Company

It has been suggested that a separate management company could be created, owned by existing Authority management and staff in order to clearly differentiate the roles of cane growing and management of the scheme

In this scenario the disposition of the Authority's commercial assets (i.e. the commercial farms, administration buildings, plant, vehicles, and equipment) needs to be considered — it is assumed that the smallholder plots and non-commercial assets would be transferred to growers and the Farmers Association respectively

The commercial assets might be sold to a company owned by growers in which case the management company would become consultants selling their services to growers on the basis of an annual fee or a percentage of cane proceeds. The management company would also be available to provide their services to government for a commercial fee to assist, evaluate, and develop future potential smallholder schemes

It is difficult to see what advantages such an arrangement might offer beyond allowing growers to own 100% of the assets of the Authority. There would be inefficient duplication of administrative effort between the growers' company and the management company as presumably both would require their own management and accounting staff

The management company would be a particularly risky venture as their continued income stream would be dependent on securing a long term contract with the growers. It is certainly not inconceivable that the growers would headhunt the necessary expertise from the management company to enable them to manage the scheme themselves without the need to employ a management company

If the commercial assets were sold to a company owned by management there would be enormous resentment by growers. They would be justifiably aggrieved to see the Authority's assets transferred to management who have made no financial contribution to the Authority over the years

There is also a risk that the management company would devote the majority of their resources to their main source of income - the commercial farm - to the detriment of the management of the smallholder plots. There would certainly be no incentive for the management company to introduce further smallholders onto areas presently farmed commercially. Again the growers might be inclined to dispense with the services of the management company but might in this case be unable to entice any required management expertise away from a company owning a lucrative commercial cane holding in excess of 100 ha

3 4 Further Development of Smallholder Sugar Schemes

As outlined earlier in this report there is tremendous scope for increasing the hectareage of land planted to smallholder (or outgrower, as holdings may not necessarily remain small) sugar. Suitable areas include Liwaladzi, Kasilili, Alumenda, the Shire River Valley ranch land and the almost defunct Kasintulu Rice Scheme. The potential contribution to rural income and the national economy as a whole is enormous - a possible 2,000 further ha of smallholder cane would yield net income to growers of as much as K50 million per annum.

The Authority's present status and mandate under the Smallholder Sugar Authority Order makes it the vehicle through which this development potential should be exploited. Any change to the status of the Authority, particularly to that of a privately owned, profit-oriented organization will surely inhibit its activities in the development field.

At present the major factor inhibiting expansion of smallholder cane areas is the inability of the Authority to provide or raise development finance. It would therefore appear logical to seek to involve the private sector in this development process. One possibility is to investigate whether the existing sugar milling companies, Dwangwa and Sucoma, would be willing to undertake the development work which could then be repaid through the proceeds of the cane harvest in the first few years of operation before settlement of growers commenced. It is appreciated that there are political sensitivities arising from past resettlement of people to facilitate sugar estate development. However, these are not insurmountable provided appropriate civic education is undertaken to explain that the ultimate beneficiaries and owners of the cane development will be the local population.

There will be need for a suitable vehicle to initiate and progress further smallholder cane growing developments and indeed to hold the title to cane areas under development prior to the handover to individual growers. It is suggested that such a body need not have an elaborate management structure if the private sector are involved in development and necessary independent expertise can be hired in from the newly privatized Dwangwa smallholder scheme. A trust with a Board of Trustees drawn from, say, Ministries of Agriculture and Finance and the sugar industry could carry out this role. Direct employees of the trust could be limited to one executive officer and secretarial support to ensure the decisions of the Board of Trustees are executed.

Such a trust could serve a further useful purpose in warehousing the shares in newly privatized smallholder sugar companies during the period when they are acquired piecemeal by growers and staff.

With the prior approval of the Minister of Finance, part of the proceeds of privatization of the existing smallholder scheme could be used to provide initial funding to the trust if it is

deemed to be a project falling within the Government development plans (Section 39(2)(e) of the Public Enterprises Privatization Act) Thereafter the cost of individual development projects, appraisals, etc could be recovered from the eventual beneficiaries of the developments

3 6 Acquisition of Shares in Dwangwa

In principle, there would be no objection to growers and staff at the Authority being given the opportunity, either individually or jointly through a company, to acquire part of Government's shareholding in Dwangwa upon privatization of Dwangwa Indeed they should be given priority in such a privatization exercise

The privatization of Government interests in Malawi's two sugar mills, Dwangwa and Sucoma, will not take place until a number of issues are addressed The companies are managed by the same multinational Lonrho, who also hold a significant equity stake in both companies The Privatization Commission are therefore anxious to ensure that appropriate measures are in place to guard against risks attaching to a non-competitive local sugar industry, before Government relinquish their shareholding It would therefore be premature to allow growers to acquire shares at this stage as the decisions of the Privatization Commission may significantly impact pricing or even sugar industry structure

It is however, important to note that smallholder growers and management are unlikely to have the financial resources to acquire more than an insignificant shareholding in Dwangwa, which based on latest financial statements has an open market value of perhaps K500 million As such, the shareholding eventually acquired would not be sufficient to guarantee any influence such as a seat on the Dwangwa board

3 7 Recommended Option

Various options for the future form of SSA have been discussed above There is no single option which will entirely meet the aspirations of all the present stakeholders in the Authority The recommended option is that which hopefully achieves the best fit with the sometimes conflicting needs of growers, management, the sugar mill and the Government of Malawi

- A restructuring of the status quo will meet the needs of management and the sugar mill Growers, however, aspire to become owners of the assets of the Authority and indeed Government policy is to divest itself from public enterprises through a privatization program A restructured status quo would, nevertheless, continue to provide a vehicle through which Government could pursue opportunities for further development of smallholder sugar schemes

- The creation of a separate management company would place existing management and staff into an extremely risky venture unless they were permitted to take over the commercial farm which would not be acceptable to growers

It is therefore considered that the best option is a restructuring of the status quo followed by a privatization through a buy-out by growers, management and staff. Although growers had expressed the very strongly held opinion that they did not see why management and staff should become shareholders, it would be consistent with other privatization initiatives to reserve for staff a proportion of the shares in a privatized company in recognition of their contribution in past years and to enhance their commitment to the company in the future.

The past contribution of existing management and staff of the Authority has been significant. The mean period of service of the 28 monthly paid employees is in excess of ten years. Of the permanent daily paid staff complement of 230, some 40 have periods of service in excess of ten years.

It is suggested that growers become owners of by far the greatest proportion of the existing assets of the Authority. They would be given title to the lands they presently occupy, the non-commercial assets would be transferred to the Farmers Association and growers would hold approximately 80% of the shareholding in the remaining commercial operation.

It is also recommended that a trust be established, initially to hold the shares in the restructured company which succeeds SSA. These shares would then be acquired piece-meal over a fixed time period by growers and staff. The trust would however continue in existence with the objective of identifying and developing further smallholder or outgrower sugar schemes. As schemes become fully established the trust would play no further role and the schemes should pass into the private ownership of growers and staff.

3.8 Action Plan

The action plan presented assumes the implementation of the recommended option detailed above. It is important to note that the representatives of the growers have been consistently opposed to certain aspects of the recommendations. Meetings were held with the growers and their legal counsel subsequent to the Steering Committee meeting which considered the interim report and their position remains unchanged. Essentially, the main stumbling block is an absolute refusal by growers to countenance any participation by existing management in a privatization of the Authority. There is also an inferred risk that, should control pass completely into the hands of the growers, the present management might not be retained which would have an undoubted impact on the sustainability of the scheme.

The Public Enterprises (Privatization) Act, requires that the Privatization Commission approve any proposed restructuring or privatization of parastatal bodies. It is imperative, therefore, that their approval of the proposed course of action is obtained as soon as possible and, in particular, their agreement be received on the proposed pricing of shares to be sold to growers and staff. Additionally, the Privatization Commission could play a vital public relations role in sensitizing the growers, in particular, to the advantages of the proposed new structure.

The immediate steps which can be carried out towards achieving the desired option are set out below.

- 1 Obtain immediate approval of the Privatization Commission for proposed restructuring and ultimate privatization
 - A paper outlining the proposed method of privatization to be submitted by the Review Committee for this study to the Privatization Commission
- 2 Farmers Association to be properly constituted as a legal entity
 - The Farmers representatives to instruct their lawyers to draw up a constitution for approval by the body of Farmers as a whole and election of office bearers to be carried out in accordance with that constitution
- 3 Negotiation of acceptable and transparent basis of charging growers for services
 - Authority management to draw up proposals for initial approval by the Board. Proposals to be discussed and agreed with the Farmers' representatives. Provision to be made for arbitration by an independent party acceptable to both growers and the Authority in the event of an impasse in negotiations

On the assumption that the Privatization Commission approves the proposals, then all other steps in the process become the responsibility of the Privatization Commission or their agents, should they wish to appoint independent agents to carry out the work on their behalf. The various steps to be performed are set out below. These are in approximate chronological order but many of the tasks can be performed contemporaneously.

UPON RECEIPT OF PRIVATIZATION COMMISSION APPROVAL

- 1 Public Relations campaign
 - The Privatization Commission to initiate measures to sensitize growers and staff to the proposed changes in structure

2 Stamp duty implications to be resolved

- Discussions to be held with the Ministry of Finance to assess the stamp duty implications of property transfers contemplated in the proposed restructuring. Where necessary stamp duty exemptions to be sought

3 Formation of Company and Trust

- Lawyers to be instructed to proceed with formation of trust (trustees to be determined in advance) and also the incorporation of a public, limited liability company to take over the commercial assets of the Authority

4 Transfer of lands and other assets

- Formal consent to be obtained from Dwangwa to cede their title to the lands presently subleased to SSA
- Ministry of Lands and Valuation approval to be sought and new leases to be issued to the commercial company, the Farmers Association and individual growers as envisaged in the proposed restructuring
- Remaining commercial assets to be transferred to the company

5 Issue of company shares to trust

- Shares in the newly incorporated company will be issued initially to the trust in exchange for property and other assets take over. The nominal value of the shares to be issued would be a matter for the Privatization Commission to decide. It is suggested in Section 3.2 of this report, that the commercial operation may be worth in the region of K10 million

6 Offer for sale of shares

- An offer for sale document (essentially an abbreviated company prospectus) will be required. This document to be circulated amongst potential shareholders, farmers and management, should detail pertinent financial information and details of the terms of the offer such as price, payment terms, number of shares available to each category of applicant etc. It would also be useful to include in the document, the intentions of the Privatization Commission with regard to any share subscription entitlements not taken up

7 Disposition of proceeds of share issue

- It is assumed that some proportion of the proceeds will be required to fund the activities of the trust established to take over SSA's development role with the balance to be paid over to the Privatization Revenue Account

8 Settlement of retrenchment benefit entitlements

- Due to the change in legal status of the Authority, an obligation arises to pay retrenchment benefits to staff. This may have adverse cash flow implications and therefore, the timing of events which trigger this entitlement is important. Firstly, it is suggested that the actual operating activities of the Authority are retained within the Authority until after the allotment of shares when hopefully proceeds are available to finance retrenchment benefits. Secondly, retrenchment benefit entitlements of staff should be applied, at least in part, to enable them to acquire shares in the privatized company.

9 Winding up of the Authority

- After all retrenchment benefits are paid the privatized company takes over the operating activities of the Authority and the Authority can then be wound up.

3.9 Human Resources

Again, the required management and staffing structure is dependent on the option chosen for the future of SSA. If the recommended option is chosen, the present operational activities will remain largely unchanged. There will not, therefore, be any requirement for radical change to the management structure.

However, due to the change in legal status of the Authority, a legal obligation to pay retrenchment benefits will arise irrespective of whether staff are physically retrenched.

There are 28 permanent paid staff on the present Authority payroll. In addition there are some 230 permanent daily paid staff and 300 temporary/seasonal employees. The monthly salary bills of the three categories approximate K100,000, K150,000 and K130,000.

It is extremely difficult to establish to what extent the Authority's successor organization might be over staffed due to the nature of the present relationship between the Authority and smallholder growers. Most of the daily paid and seasonal workers are labourers engaged on activities such as maintenance of infrastructure, land preparation, cane cutting etc. These tasks could well be performed by the farmers themselves together with their families and hired labour. Growers do, of course, bear the cost of services supplied by the Authority.

It will be a decision for the growers in the newly privatized Authority to decide whether they wish to have more independence in organizing these various tasks themselves or whether they wish to continue the present system where management engage labour on their collective behalf. The possibility of a change to the system does not really present a major problem as Government will already have discharged their responsibilities through paying retrenchment benefits to all existing Authority staff. Any subsequent decisions on staffing levels will be taken by the new organization, presumably on a totally commercial basis.