The Tea Sector In Malawi

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Contents

1 Introduction

This short brief provides an overview of the current situation facing the Tea Sector in Malawi, as at June 2002. It has been written at the request of the World Bank as part of the development of an Integrated Trade Framework for Malawi.

2 Overview of the Tea Sector in Malawi

Tea has been grown commercially in Malawi since the 1880s and the country is the second largest producer in Africa after Kenya. Malawi accounts for around 4% of annual world exports (c. 40,000 tonnes) compared to Kenya, which has 18% (c.180,000 tonnes). Traditionally, Tea has been the second most important export earner for Malawi after Tobacco and has been increasing as a proportion of export sales over the last three years, despite poor average prices realised. This is mainly due to the relative drop in tobacco value over that period.

Table 1 Value of Exports (Fob) of Agricultural Commodities, 1999-2001, Million US$, as a proportion of all exports

	1997		**1998**		**1999**		**2000**		**2001**	
	US $ m	**%**	**US $ m**	**%**	**US $ m**	**%**	**US $ m**	**%**	US $ m	**%**
Tobacco	351.5	***62.1***	331.7	***61.6***	274.7	***61.2***	219.9	***56.1***	304.6	***66.8***
Tea	42.6	***7.5***	40.2	***7.5***	39.3	***8.8***	37.4	***9.5***	46.4	***10.2***
Sugar	23.9	***4.2***	50.3	***9.3***	23.1	***5.2***	38.8	***9.9***	*87.3	***19.1***
Coffee	12.7	***2.3***	10.5	***2.0***	8.9	***2.0***	6.0	***1.5***	5.3	***1.2***
All Exports	565.7	***100.0***	538.6	***100.0***	449.0	***100.0***	391.9	***100.0***	455.8	***100.0***

Source: NSO quarterly statistics.
* Sugar exports should be read with caution as there is an ongoing investigation by the Anti-Corruption Bureau into a Surtax/Export rebate scam.

The United Kingdom has traditionally been the most important export destination for Malawian tea and it continues to be so, though the proportion of exports has fallen from around 60% to 45.9% in calendar year 2001. There has been a deliberate attempt in Malawi to diversify export destinations, partly due to the risks of over dependence on one market, but also to reflect the need to get better prices for tea. One outcome is that Pakistan has also been growing as an export destination and is now the fifth most important market by volume.

Table 2 Main Export Destinations of Malawi Tea, 2001

Country	**Volume of Tea**	
	Metric tonnes	**%**
United Kingdom	17,613	45.9
South Africa	8,666	22.6
Kenya	2,726	7.1
USA	2,476	6.5
Pakistan	1,664	4.3
Total Exports*	38,363	100

Source: TAM.
* All other destinations take less than 1,000 tonnes p.a.

Employment numbers are difficult to estimate as there is a relatively large proportion of seasonal workers. According to the Tea Research Foundation, there are approximately 42,000 employees in the estate sector and almost 7,000 smallholders. At a mean six persons per household, the total number of people directly reliant on tea for the major part of their cash incomes is almost 300,000.

3 Tea Growing and Production in Malawi

The latest available data on tea growing and production suggest stability in the overall hectares under tea but a wide variation in tea production.

Table 3 Hectares and Production of Tea, 1995-2001

Year*	Hectares ('000 ha)	Production (m. kgs)
1995	18.9	34.5
1996	18.8	37.2
1997	18.8	44.1
1998	18.8	40.4
1999	18.8	37.9
2000	18.8	42.1
2001	18.6**	36.8

Source: Hectare Data - Tea Association of Malawi (TAM), Production Data National Statistical Office, Quarterly Bulletins.
* Calendar year
**Estimated through adding data from several sources – this is probably an under-estimate of the actual hectares under tea given that there is no other evidence of a reduction of the area under tea.

According to the above figures from TAM, total area under tea has been stable over the last 10 years. The estate data that feeds into the above totals is relatively reliable, whilst the data on smallholders is more difficult to verify.[1] Anecdotally, there are indications that the number and area of smallholder production has been growing over the last ten years, though probably not between 1998-2000 when the Smallholder Tea Authority was experiencing its greatest difficulties.

The data on production shows considerable variation due primarily to fluctuations in rainfall. Virtually all the tea crop in Malawi is rain fed, thus production volumes are directly related to weather patterns.[2] As a result, it is very difficult to determine whether there is an underlying trend to the above production data independent of rainfall. Based on discussions with key informants, it is probable that there is a gradual improvement in yield and underlying production because:

1. underlying estate productivity is likely to be increasing due to adoption of better technologies and practices over time, whilst the area under tea is stable
2. there is a gradual replanting of old seedling varieties with higher yielding clonal teas
3. there has been some investment in irrigation that yields significant increases in yields, especially of clonal and new clonal teas
4. there appears to have been an increase in smallholder land under tea over the last ten years

[1] Smallholder data is difficult to obtain as STA/MATECO is going through the
[2] Peak production is from December to May.

5. smallholder yields appear to be improving based on anecdotal sources due to an increasing number receiving assistance (fertiliser loans, extension help and more regular collection/processing of their crop) from the estates that they now sell direct to

3.1 Average Yields

Tea is grown in three districts of Malawi: Mulanje (Southern Region), Thyolo (Southern Region) and Nkhata Bay (Northern Region).[3] The Estate sector accounted for 84.6% of land under tea and 92.8% of the production in the year to the end of June 2001. Average yields are considerably higher in the Estate Sector (2,465 kgs/ha) compared to Smallholders (1,049 kgs/ha), as might be expected. The higher average yield for Nkhata Bay reflects data from one estate that has undertaken considerable replanting of the new clonal varieties, which are significantly more productive. Overall hectares, production and average yields by area and type of producer are set out below:

Table 4. Hectares, Production and Average Yields by District and type of Producer, Y/End June 2001

District	Hectares under tea		Average Yield	Production	
	Ha	%	(kgs/ha)	(m. kgs)*	%
Mulanje	6,249	33.6	2,939	18.37	43.9
Thyolo	8,864	47.6	2,041	18.09	43.2
Nkhata Bay	652	3.5	3,669	2.39	5.7
Sub-total, Estates	**15,765**	**84.6**	**2,465**	**38.86**	**92.8**
Smallholders, All Districts	2,862	15.4	1,049	3.00	7.2
Total All Producers	**18,627**	**100.0**	**2,247**	**41.86**	**100.0**

Source: Tea Association of Malawi.
*Calculated from Hectare and Average Yield data

3.2 Comparisons of Yield with Kenya

Data on average yields can be a misleading measure of productivity as it is considerably influenced by rainfall patterns, which vary from year to year and from district to district. Average yields for all producers have ranged from a low of 1,825 kgs/ha in 1995 up to 2,345 kgs/ha. This compares with the average yield range for Kenya from 1,995 kgs (2000) to 2,372 kgs (2001) per hectare. The data is not directly comparable as Kenya has a much higher proportion of smallholders (61.7% of production in 2001), which brings down the average yield, but also more highland areas with better rainfall (helped by two rainy seasons) that increases the average yields. More comparable, but still unreliable data can be obtained from separating the average yields of smallholders and estates for Kenya.

Table 5 Estate and Smallholder average yields for Kenya, 1999-2001, kgs/hectare

	1999	2000	2001
Estates	2,803	2,688	3,332
Smallholders	1,817	1,719	2,012
All producers	2,120	1,995	2,372

Source: The Teaboard of Kenya, Website.

[3] There is just one estate in Nkhata Bay that accounts for all the production in this district

There appears to be a significant productivity gap between the estate sectors in the two countries and an even greater productivity gap between the smallholders in the respective countries. Part of this may be due to the geographical factors mentioned above. More detailed analysis would be required to establish the relative productivity of the two countries.

4 The Tea Market

4.1 Routes to Market and Prices

There are two methods by which tea gets to the market. The first is through the Limbe Auction, which is the only tea auction in Malawi and the second is through direct sales to buyers.

Estimates for the relative sales through both routes, suggest that sales through the Auction account have stabilised in recent years at one third of all tea sales.

Table 6 Sales of Tea through the Auction and Direct Sales, 1996-2001

Year*	**Auction**		**Direct Sales**		**Total**
	(m kgs)	***%***	**(m kgs)**	***%***	**(m kgs)**
1996	13.5	*36.3*	23.7	*63.7*	37.2
1997	17.2	*39.0*	26.9	*61.0*	44.1
1998	17.4	*43.1*	23.0	*56.9*	40.4
1999	13.4	*35.5*	24.3	*64.5*	37.7
2000	13.7	*32.5*	28.4	*67.5*	42.1
2001	12.8	*34.8*	24.0	*65.2*	36.8

Source: NSO quarterly statistics
* Calendar Year

There are 28 registered tea buyers, but between five and eight active buyers in Malawi, representing the major international tea buying firms, such as Unilever and Lyons Tetley. These buy through the Auction, but also directly from the estates.

The Auction tends to attract the higher grades of tea and a disproportionate amount of clonal teas, whereas direct sales will tend to include large volumes of lower grades. Tea is sold in 20-40 bag batches/lots at Auction, with samples distributed at least 14 days before the Auction. According to some estate and broker sources, there may be a cashflow benefit in selling direct, given that the settlement date for sales through the auction is a further 14 days. It also seems that the low batch/lot sizes at Auction may be a deterrent to selling large volumes of lower grade tea as some of the larger buyers are looking for hundreds or even thousands of tonnes at a time. These buyers will approach the estates directly and buy whatever grades they have at a price negotiated directly with the particular estates.

A recent trend has been for estates to transport more tea to the Tea Auction at Mombassa, Kenya. The Mombassa Auction is one of the largest in the world, given that Kenyan tea accounts for 18% of world exports. It therefore attracts more buyers than the much smaller Limbe auction and has the advantage that tea can be shipped immediately from the port after auction. According to TAM, a total of 2,726 tonnes of tea was 'exported' to Kenya in calendar year 2001 (7.1% of all exports), all of which is likely to have been destined for the Mombassa Auction and onward export.

It is difficult to establish whether sellers can achieve better rates for selling tea through Mombassa than through Limbe. Higher prices at Mombassa also reflect the higher quality of teas going through that auction. Much depends on the availability of comparable teas for auction on a particular day, but anecdotal sources suggest price premiums range between 5-20 US cents/kilo. The fact that over 7% of the crop is being sold through this route suggests that a considerable proportion of sellers think it is a viable route to market.

Most of the estates rely on direct sales as the main method of selling their crop. The role of the tea broker is important to bring together buyers and sellers. The tea broker assesses the quality and the likely price of the tea. They then make the connections between buyers and sellers. Tea Brokers take a commission of 1.5% from the seller and 0.5% from the buyer. There are two brokering firms operating in Malawi at present[4]; both have international owners and therefore have access to information on tea prices and crops from around the world. Brokers also help the estates sell through the auction, by distributing the samples from each batch to the potential buyers prior to the Auction. The brokering role is important for the smooth functioning of the market and appears to limit the selling and marketing costs of the estates and STA/MATECO.

4.2 The Price of Tea

As with any commodity market, the price of tea is critical to the health of the industry. Prices vary from week to week and year to year according to normal market factors of supply and demand. The last four years have seen average prices dip below $1.00 per kilo as the world supply of tea has continued to grow and there has been an absence of a major crop failure in any of the large producing nations.

Table 7 Average prices for Malawi Tea sold at the Limbe Auction, All Grades

Year	Kwacha/Kilo	Exchange Rate Kwacha:US $	US Cents/Kilo
1997	19.61	16.44	119.28
1998	31.43	31.07	101.16
1999	37.63	44.09	85.35
2000	57.07	60.29	94.66
2001	57.38	71.81	79.91
2002*	65.87	76.27	86.36

Source: NSO Quarterly Reports
*Year to date based on Limbe Auction.

The price premium for clonal teas over seedling teas is considerable, running at 23-26% since July 2001.[5] Details of the main categories and proportion through the Limbe Auction indicate the continued relative dominance of seedling grades over clonal grades, accounting for 49.4% of Auction sales, compared to 21.1% for clonal.[6]

Table 8 Relative volumes and Prices of Clonal and Seedling Grades, 2002 Year to Date.

Grade	Volume		Average Price
	Tonnes	%	US Cents
Clonal Main Grades	2,181	21.1	116.40

[4] Tea Brokers Central Africa Ltd.and Tea and Commodity Brokers Ltd.
[5] According to Tea Brokers Central Africa Ltd.
[6] Other Grades would represent a mix of Seedling and Clonal in rough proportion to the main grades.

Seedling Main Grades	5,113	49.4	92.19
Other Grades	3,061	29.6	55.20
Average for All Grades	10,355	100.0	86.36

Source: Tea Brokers Central Africa Ltd.

The consensus in the industry is that there needs to be a shift to 'new' clonal varieties, which are of higher quality and more productive than the bulk of the clonal teas being grown now. Prices will continue to be dependent on factors outside the industry's control, but shifting to a greater proportion of clonal teas will increase the average prices achieved by the industry.

5 The Estate Sector

5.1 Structure of the Sector

The Estate Sector comprises a mixture of large-scale family owned and international businesses involved in tea, coffee, macadamia nuts and tobacco. Each organisation has a different structure and mix of businesses; most have several 'estates' for tea and other crops either conjoined in one area and/or in multiple separated locations. There are ten main groups of estates involved in the tea sector, with over 40 distinct tea estates. The most significant in terms of scale are Makandi (part of Africa Plantations), Eastern Produce, Naming'omba (family owned) and Lujeri/ Nchima;[7] Conforzi Estate is also a large firm, currently in receivership. In addition the other groups are Chitakale (Government owned), Zoa and Satemwa (both family owned) and Koalazi Estate in Nkhata Bay, run by the Sable Group.

5.2 Dis-investment and Investment

The main dis-investment over the last ten years has been by Lonhro, which has beenselling all its agricultural interests throughout Africa. The tea estates were sold to Africa Plantations in the mid 1990s and now form the Makandi Estates. Mandala/African Lakes also sold their Chitakale Estate to the Government. As mentioned, Conforzi is in receivership and there are suggestions that it might be taken over by a South African group in due course. Africa Plantations has invested in its factory since taking over the estates from Lonhro and built a 400 cubic meter dam for irrigation. Lujeri have been the other main 'processing' investors in their Bloomfield and Nchima factories.

5.3 The Tea Association of Malawi

The Estate organisations belong to the Tea Association of Malawi (TAM), which acts as a representative body in discussions with government and other stakeholders. TAM also gathers data on the sector and determines a range of issues including rates of pay for estate workers and other conditions.[8] These are contained in a Management Guide that is issued to all tea estate organisations and apparently adhered to by the industry. This ensures that there is no out bidding between players in the industry and avoids the need for local negotiations by each estate.

5.4 Employment Conditions

The current industry rate of pay for pluckers is a minimum daily wage of K48 for a fixed 'task' of 44 kilos of plucked leaf. Thereafter, leaf plucked in excess of 44 kilos is paid at K1.09/kilo. Mean daily wages are usually in excess of the minimum wage, typically K73 at one estate over

[7] Lujeri and Nchima are owned by the same group, but have been operating independently

[8] This includes things like providing coffins for workers and their near family, transportation of the bereaved family to the home area etc.

the last year, which included the trough period when leaf is scarcest and plucking rates are lower.

For historical reasons, the system of employment is very 'paternalistic' with the wage being supplemented by a whole package of other benefits, for example food and beverages to the field workers, housing and water, medical costs (consultation and drugs/treatment) and sometimes education and schooling for children of workers. In many cases, the estates run clinics and schools for employees and their families. These social facilities are used by nearby communities in the absence of government funded and run facilities. There seems to be increasing recognition of the social welfare functions that the estates are providing for employees and local communities. For example, DFID has funded VSOs in health and education to help two estates to organise their facilities. Overall, it is estimated that the total value of the 'package' is likely to be in excess of K3,000/month (US $ 40/month).[9]

The industry also has many migrant workers who have settled in the tea growing areas mostly from the Northern Region or Mozambique, the latter particularly in the Mulanje area close to the border. These are often permanent employees with the local population employed as pluckers/weeders during the peak season. Once the maize harvest is in, the Thyolo and Mulanje indigenous people tend to quit the estates, creating short-term problems for the last couple of months of the growing season.

There is sensitivity in the industry around the subject of employment practices because there is a powerful 'Developed Country' lobby that is raising questions about employment practices in developed countries generally,[10] particularly child labour. This makes it is difficult to gather data to determine whether this is a live issue or not. However, it is recognised in the industry that employment practices need to be fair and not exploitative. The evidence available suggests substantive compliance with the published guidelines on child labour[11] and substantial packages of social welfare benefits being provided to employees.

5.5 Production Costs in the Estate Sector

Production costs in the estate sector are difficult to ascertain for reasons of commercial confidentiality. Production costs will vary between estates according to a range of local factors, including the scale of the operation (yielding different economies of scale), whether there is local power generation or bought in power, availability of water, distances for transporting, treatment of overheads and investment etc. Based on anecdotal sources, production costs, including overheads, but excluding investment costs are currently in the range of $0.75-0.90/kilo, suggesting that the industry is barely profitable at current average prices. The industry consensus is that most producers are struggling to make sufficient profits for adequate reinvestment in factories, irrigation and replanting. The limited investment that is taking place at present supports this the view.

5.6 Critical Issues facing the Estates

The Estate sector reports a number of key issues affecting profitability:

1. Low prices for the last four years

[9] According to Business Consult Africa a firm that provides social accounting services to some estates.
[10] Though not Malawi or its tea estates specifically at this point in time.
[11] Based on ILO definitions of child labour.
[13] The Kwacha depreciated in 2000/1 during the time of purchasing inputs to K80:$1 and then appreciated to K66:$1 when the crop was being sold. It has since depreciated to c K76:$1

2. Unstable exchange rate for the Kwacha: US Dollar that moved against the industry[13]
3. High local interest rates on borrowings, at around 50% compared to inflation at 17%
4. High levels of taxation for businesses
5. Maximum demand tariffs for electricity, means that all electricity is charged at peak rate
6. Filling social welfare gaps left by government, including housing, water, education and health for estate workers

There has been one prominent failure over the last five years, that of the I.Conforzi Estate. This estate is currently operating in receivership pending its sale. This failure appears to have been partly due to the difficult operating environment, but there were also special internal factors. There has been one other estate, owned by Mandala, that was converted from tea to rubber. Again there may have been special factors, as this occurred at an early stage in the prolonged fall in tea prices.

Other critical issues identified by the industry, comprise the new Land Policy and the proposed establishment of a 'Teaboard'.

The new Land Policy specifies that land can only be owned by citizens of Malawi, with other land converted to leasehold. There are gaps in the coverage and interpretation of the policy such as which crops might be exempt, what happens with corporate bodies, what rents might be payable on land converted to leasehold land, to whom is it payable etc. There are many concerns on the Land Policy as it stands, for example the proposed leaseholds are for 50 years, which is an insufficient period for investment purposes. In addition, the very vagueness of the Policy is also affecting willingness to invest. Clearly this is a sensitive issue stimulated by the situation in Zimbabwe and highly 'political', but it is already deterring investment in this and other sectors.

The creation of a Malawi 'Tea Board' has recently been proposed by the new Minister of Agriculture following his visit to Kenya. The function of the proposed Board is as yet unclear, but broadly it would seek to promote and regulate the industry, plus gather statistics. It would also control the Tea Research Foundation (TRF), which is currently independent and funded by donors and the industry. It has also been proposed that a minimum of 50% of all tea would have to be sold through the Auction but it is still unclear whether these ideas will come to fruition and how it would be funded. There is an overlap of functions with the TAM and there is no clarity on how these would be resolved as yet.

6 The Smallholder Sector

Smallholders have to register with the Smallholder Tea Authority (STA) and to sell their tea to it. STA previously sold the Smallholder tea to MATECO, which has a very old factory in Mulanje, capable of processing up to 22 tonnes of tea per day.[14] Both organisations are owned and controlled by Government, but are now in the process of merging to be owned initially by an independent Trust.

The number of registered Smallholders at 6,657 probably underestimates the actual number as those in Nkhata Bay are excluded from the STA remit and the figures are probably not up to date. The anecdotal evidence suggests that the number of Smallholders is growing, but STA was unable to provide historic data due to the level of recent retrenchments in the organisation.

[14] Approximately 110 tonnes of Green Leaf.

Virtually all of the Smallholder tea is sold through the Limbe Auction and prices will broadly reflect the going rates for each grade. It is possible that MATECO will be getting better prices than the Auction averages as it has a high proportion of poly-clonal material which is better generally of better quality, but it is not possible to get separate information on prices for reasons of confidentiality.

6.1 STA/MATECO Merger

This is the most critical event affecting the health of the Smallholder Sector. There have been persistent problems with the STA and MATECO over the recent past with considerable deficits being accumulated and very late payment to Smallholders as late as six months at one time. According to the STA, the payments are currently running at three months overdue.

A diversity of arrangements for Smallholder green leaf sales has emerged over the last three to four seasons. Partly due to limited processing capacity at MATECO and limited availability of transport to collect the leaf, Smallholders around three estates were allowed to supply leaf to be processed in the estate factories, thereby also taking advantage of spare non-peak capacity. The green leaf was collected by the estates and the Smallholders received fertiliser loans and technical support from the estate. The estates paid the STA for the leaf and the STA were meant to pay the Smallholders monthly, though in practice there have been long delays in payments.

In the current 2001/2 season virtually all the Smallholder tea in Thyolo has since April been sold to the local estates under this arrangement[15] with payment still via STA. In Mulanje, several 'Blocks' of Smallholders are now supplying one of the major estates directly and being paid directly at the insistence of that estate, due to the considerable delays in onward payment by STA experienced in the past.

6.2 Smallholders Growing Costs

Smallholders currently get five Kwacha per kilo of collected plucked green leaf through whatever method it is sold which is the standard price set by STA for all grades. Most of the Smallholder tea is poly-clonal material, an improved seedling variety and better quality than most of the estate tea. It therefore brings up the average quality of tea being processed and so is valued by the estates. However, the STA does not set a premium for Smallholder clonal tea, thus there is no incentive to separate this from other varieties, even though MATECO and the estates would be able to gain a selling premium by so doing.

The average Smallholder tea grower has 0.4 hectares of tea, typically alongside 1-1.5 hectares of maize and other subsistence crops. This might yield 1,600 to 2,200 kilos of green leaf equivalent to around US $150/year minus the costs of fertiliser, giving up to a net $100 annual income.[16] It requires around 4.5 kilos of green leaf to produce one kilo of tea. The tea is picked using family labour, with an optimum 11-13 day plucking cycle. There is a requirement for weeding and pruning by rotation. Tea is a relatively easy crop to grow and manage, with the advantage for Smallholders that it yields a cash income for most months of the year, rather than the one harvest for other crops like cotton. The disadvantage is that it takes several years to reach maturity and peak production, but thereafter the bush can continue yielding a crop for several decades if managed appropriately.

[15] The MATECO factory is in Mulanje and the distances from Thyolo to the factory are up to 90 kms making less economic to collect the green leaf.

[16] Based on 1,000 kilos of tea per hectare. With fertiliser and technical assistance from the estates, reported yields are much higher.

The cost of planting tea has been subsidised by the provision of free seedlings by the Malawi Tea Research Foundation (TRF) under a funded programme from the European Union (EU). The Smallholder still has to carry the cost of land that produces no yield for up to two years and limited yields thereafter. They also have to apply fertiliser each year, but the economics of Smallholder tea growing is regarded as favourable to other cash crops though the balance does change. The main proviso has been that the STA had such a bad payment record that some growers felt that it was not worth the labour to collect the leaf, particularly in the 1998-2000 period.

7 Current Areas of Support to the Tea Sector

There are two important initiatives that support the Tea Sector. Firstly, an EU programme that provides support for the TRF and replanting using new clonal varieties. Secondly a more recently introduced facility from the European Investment Bank (EIB) that provides Euro loans for investment in estate infrastructure such as irrigation, factory upgrading etc at relatively low rates of interest between 6-9%, which vary according to average prices achieved for tea.

7.1 EU STABEX Programme

The EU has been supporting the Tea Sector since the 1980s. The emphasis has been on increasing the area under tea and improving the quality of the varieties available to growers. The €.1 million programme for Smallholders has sought to increase Smallholder tea growing by providing free seedlings via the TRF of new clonal varieties. There has also been funding for access roads and general support for the TRF research and support for the STA. The aim was to increase Smallholder tea growing by 600 hectares over a four-year period, but the programme is behind schedule. At present around 300 hectares has been planted and the programme extended to six years, with circa three years remaining.

There has also been a €4 million programme for the estate sector with the focus on replanting with new clonal varieties. The funding for this programme has almost been exhausted and is likely to finish once the EU assessors have checked the area replanted this season. The aim was to increase the rate of replanting to 4% per year, but the maximum rate achieved has only been 2%. The EU has a formula for calculating the costs of replanting from seedlings to land preparation and tending through to maturity. The aim is that it should cover 50% of the calculated cost of replanting, which is specified at c.$2,500 per hectare by the EU. The original scheme envisaged that the land would be replanted and then the estate would reclaim the calculated share. However, this leads to a very slow uptake due to the cashflow implications and therefore the scheme was changed to allow for a 40% advance payment to cover upfront cash costs, with the remaining 60% paid once replanting has been completed. The scheme does not however cover the opportunity cost of the lost and reduced revenue from taking land out of cultivation and the build up of yields to the old level of productivity.

Replanting is seen as an issue critical to the long-term health of the industry as it will improve quality (and most importantly, average prices) as well as output per hectare. The returns are much quicker and higher if replanting is combined with irrigation. It is calculated that replanting produces acceptable yields within three instead of four to five years, if the land is irrigated.

7.2 EIB Loan Facility

The EIB has made available a facility for Tea and Coffee growing for the renewal of infrastructure in several African countries, including Malawi of approximately € 8.3m . The fund has so far made loans to a number of estates for irrigation related work and for factory refurbishment. The loan term is 12 years, with a grace period on capital repayment for the first

four years. The rate is variable between six to nine percent and linked to the auction price for tea. It is currently at the low end of the range at 6.25%. As such, the fund has received a very positive welcome from the industry, despite the small numbers of estates that have so far benefited.[17]

The EIB was looking for local banks to take on the administration and some of the risk of repayment during a recent visit in June 2002. However, there appears to have been no local banks unwilling to accept the risks and thus a reluctance to take on this scheme, despite the enthusiasm with which the scheme has been received. This seems to have stalled the processing of applications for loans and according to the EIB, the facility will not continue without a local provider.

[17] Understood to be four or five estates with several applications pending.

8 SWOT Summary for the Tea Industry

An outline SWOT has been summarised below. Strengths and Weaknesses are based on Internal Factors that are within the control of firms or the industry working together. Opportunities and Threats are based on External Factors, beyond the control of the industry, but which it might take advantage of or needs to find ways to avoid the negative effects of. Ways in which the industry can respond to these internal strengths and weaknesses and external opportunities and threats are set out in the next section, with an emphasis on where external interventions might be useful.

8.1 Strengths

1. Long established estate sector that is well organised and functions well
2. Well established efficient routes to stable export markets (specifically UK, US and South Africa)
3. Newly evolving mutually beneficial relationships between the estates, which have technical and processing capacity, and Smallholders, who have higher quality green leaf available
4. Improving returns to Smallholders through assistance from the estates (fertiliser loans and technical assistance) and more regular collection of leaf
5. Gradually increasing Smallholder area under tea due to improving returns and regular income, where linked to the estates
6. Good quality research facility developing new higher yielding varieties suitable for Malawi

8.2 Weaknesses

1. Production is too dependent on rainfall making it vulnerable to poor rains
2. Production is very concentrated with 80% of green leaf available in 20 weeks, making poor use of capacity
3. Predominant 'seedling' variety is relatively low yielding, compared to Kenya and other competitors
4. Predominant 'seedling' variety produces low to medium quality tea resulting in relatively low prices compared to other competitors
5. Estate production costs are relatively high due to limited historic investment in new processing plant
6. Continuing low profitability over the last four years has limited re-investment
7. Limited access to finance at viable rates with real interest rates currently 33% p.a.
8. Relatively ineffective lobbying with a Government that views the Sector as a source of revenue
9. Smallholder Sector is relatively inefficient compared to Kenya, due to structural factors and limited access to inputs (fertiliser) and technical support
10. STA has been subject to political interference and weak management resulting in substantial losses
11. MATECO is operating with very old processing equipment and has very limited operating resources
12. STA/MATECO has not been able to collect green leaf consistently enough nor provide technical support nor pay Smallholders on-time discouraging Smallholder production
13. Auction does not attract sufficient buyers on a regular basis, thus limiting the competition for Malawi tea and depressing prices

8.3 Opportunities

1. Replanting programme of 'new-new' clonal varieties suitable for Malawi with higher yields and quality to improve long-term viability

2. Increasing sales of tea through the Mombassa Auction might improve immediate profitability
3. Continued development of other export markets to provide more diversified and more profitable markets
4. Investment in small-scale dams and river fed irrigation to increase production of tea and reduce production costs
5. Investment in new processing equipment to improve yield and quality of tea
6. Improve the infrastructure for getting product to export markets to reduce marketing/selling costs resulting from landlocked position of Malawi

8.4 Threats

1. Deteriorating macro-economic instability in Malawi further increases costs and limits investment
2. Continuation or worsening of high interest rates has an adverse effect on profits and investment
3. Continued instability of, and distortions, in the exchange rate reduces profitability and willingness to invest
4. Continued and worsening taxation regime increases costs leading to reduced profitability and investment
5. Continued high and increasing maize prices that drives up the cost of labour
6. Implementation of the Lands Policy results in even weaker incentives to invest
7. Pressures on Government revenues combined with the weakness of the Tea lobby to influence policy leads to adverse policies that affect the efficiency and profitability of the industry
8. Continued implementation of 'Ethical Trading' initiatives in Europe increases costs and leads to loss of sales by Malawian producers who cannot prove compliance
9. Loss of export sales through dependence on a limited number of export destinations, particularly where there is instability (e.g. Pakistan), leading to a further fall in prices
10. Continued weak or declining world prices for tea undermines sector profitability further
11. World supply grows at a higher rate than demand, with no major disruptions to competing country supplies, putting pressure on prices

9 Potential Areas for Intervention

Below are listed a number of areas where intervention could improve the prospects for the industry and impact on poverty. These are drawn from playing to strengths, redressing weaknesses, taking advantage of opportunities or avoiding/minimising threats or a combination of these.

The main priorities for the estate sector seem to be investment in irrigation, investment in factory refurbishment and replanting. The first two of these will lead to relatively short-term returns, particularly irrigation. The replanting takes around 8-10 years to recover the costs and lost revenues from taking land out of production. However, replanting is a necessary activity for long-term survival and health of the industry and will have to be undertaken in due course.

The continued development of the relationships between estates and Smallholders has considerably more potential for both parties.

For the Smallholders, the main concerns centre around the operation of the newly merged STA and MATECO. The STA has not been able to pay Smallholders regularly enough, even where funds specifically for the Smallholders have been paid over monthly by the estates that have

been buying from their local Smallholders. The functioning of the merged organisation is critical to the vitality of the Smallholder sector, whilst the STA retains responsibility for Smallholder production. The MATECO factory is in desperate need of refurbishment and there is a desire by the merged organisation to have a factory in Thyolo to take Smallholder tea. The STABEX funds have proved useful in increasing the Smallholder land under tea.

The industry needs to consider how it can secure continued access to developed country markets by 'certifying' that it meets required labour and ethical standards. Finally, the industry needs to find ways to improve the effectiveness of its lobbying with government.

These are not the only initiatives that could or should be pursued, but they are the ones where some external intervention and support could be beneficial. The method of providing that support is not addressed at this stage.

9.1 Investment in Irrigation

As noted above, most of the land under tea in Malawi is rain-fed. Volumes of green leaf are very dependent on rains at the right time of year[18] and over the right period. Some of the estates have invested in small-scale dams (e.g. Makandi) and irrigation, particularly where they have clonal teas planted. In Mulanje there is more scope for using rivers for irrigation, but in Thyolo irrigation would require small-scale dams (circa 2-3 million cubic metres) sufficient for 3-400 hectares. Some survey work has been conducted and identified 27 possible locations in Thyolo.

The big advantage of irrigation is the speed with which it can improve yields, particularly where there is clonal tea already planted. The infrastructure can be installed quickly and the yields show almost immediately. There are secondary benefits, in that the irrigation can improve production in the trough months (June to November) when rain is absent, therefore utilising existing factory capacity more fully. Because tea grows in a series of 'flushes', irrigation can have the added benefit of reducing the scale of the peak and therefore the level of peak processing capacity required.

In several estates, there is not sufficient processing capacity to handle all of the peak production, which is roughly 80% of annual production, in only 20 weeks. This results in leaf being wasted or sent to other factories for processing at reduced profit to the particular estate. Reducing the peak would therefore enable better use of the current processing capacity and improve profitability.

If water is available then the investment in irrigation is in the order of $1,500 per hectare. If there is a need to build a small dam then the costs are increased and dependent on the particular area. However, the industry seems to believe in the viability of this type of investment if it could borrow at more realistic rates. The question of what is realistic is difficult to determine in the abstract.

9.2 Investment in Factory Refurbishment

Much of the capacity in Malawi is relatively old and the productivity and output potential of the existing plant is limited. The factory costs may account for between 15-25% of total production costs including energy. A number of the estates and STA/MATECO have prepared proposals for refurbishment with new more efficient plant that improves the quality of the tea produced.

[18] Rains during the warmest months are more valuable, thus late rains in November/December last year adversely affected production.

One of these estate proposals has been funded by EIB and others appear to be in the pipeline, though possibly stalled by the problems EIB are having in finding a local lending partner.

Each situation is different, but the indicative returns are for a minimum 10% price premium through enhanced quality as well as reduced operating costs through energy and other savings. It is difficult to give accurate returns on investment as these are commercially confidential and estate specific, but an indicative payback based on discounted cashflow rates suggests a return within five years. Further work would be required to determine the actual viability of specific investments.

MATECO is looking for an investment of $1-2m to upgrade its Mulanje factory, which is still using the original equipment installed in 1974. It is also looking to establish a factory in Thyolo using the old equipment from Mulanje, at around $1-1.5m. The difficulty with the STA/MATECO situation is the history of political interference in the organisation. Industry commentators indicate that the following planned changes appear to be steps in the right direction:

1. the current steps to merge the two organisations;
2. the establishment of a trust that owns the joint entity;
3. reducing operating costs significantly through retrenchment;
4. improving financial performance through better management; then
5. privatising through a sale to Smallholders and other interested stakeholders.

However, there are lingering doubts about the susceptibility of the organisation to interference and there is little chance that Government can make available the resources needed for investment.

9.3 Replanting with New Clonal Varieties

There is considerable interest in replanting, which is regarded in the industry as necessary for long-term viability through increased output per hectare and better quality, resulting in price premiums of around 25%. The EU programme to support replanting is about to end and the rate of replanting is therefore likely to drop from its current 2% rate.

As already indicated, most of the tea in Malawi is seedling tea, which has inferior quality and output compared to clonal varieties and even the poly-clonal varieties grown by Smallholders. There are clonal teas already planted on the estates, but most of these are the 1960s and 1970s generation of clonal tea. The 'new' clonal varieties that are available offer significantly better yields over seedling variants and the 60s/70s clonal variants. There is also work under way on a newer generation of Clonal teas ('new-new' clonals). The industry clearly needs to keep up with the latest developments in clonal teas to ensure its long-term competitiveness. The concern at present is that the low prices for tea reduce profits available for reinvestment. Ironically, the best time to replant in terms of minimising lost revenues is when prices are relatively low. But it seems that the underlying strength of the industry is too weak to take full advantage of the timing.

The EU base their assistance on a replanting cost of $2,500/hectare, which was calculated at the outset of the STABEX programme and does not appear to have been linked to inflation or exchange rates. One estate indicated that direct replanting costs are nearer $2,900 to $3,000/hectare in 2002. In addition there is the lost output of green leaf from taking land out of production for replanting and then the lower yields achieved in the early years. For irrigated land, which is where most estates would intend to plant new clonal material, it is estimated to take six to seven years before the green leaf output is back to the original levels. This is offset

by the better prices obtained for new clonal teas, which enables the value of production to reach the original level within five years. After ten years the value of the output is double the original level for seedling teas.

9.4 Developing the Role and Function of the merged STA/MATECO

This issue is subject to a process that is underway and is intended to lead to privatisation. Details of the process are set out in a report by O&M Associates Ltd, 'Privatisation of Smallholder Tea Authority, Final Preparatory Stage Report', August 2001. This is an evolving situation and there are some doubts expressed by industry commentators about the ability of the newly merged organisation to recruit and reward a General Manager who can turn the organisation around and who can resist the political pressures from local politicians. There are also some doubts expressed about the willingness of the Smallholders to buy shares in an organisation that many consider as belonging to them already. This process is unfolding but needs continued attention to ensure the best outcome is achieved for the industry and the Smallholders in particular.

9.5 Stimulating the development of Smallholder Tea

Smallholder tea has the potential to deliver poverty reduction benefits. As a crop, tea has the attraction of a regular income and being relatively easy to grow, once established. The success of the Kenyan Smallholder sector indicates the potential to impact on a significantly greater number of households.

The functioning of the newly merged STA/MATECO will have a direct bearing on the future of Smallholders. Ideally, the further development of local arrangements for buying and collecting Smallholder tea by the estates, with **direct** payment, would have a significant role in encouraging more Smallholder production. The role of the merged organisation could still be to negotiate the prices for green leaf on behalf of all Smallholders.

The introduction of a premium for sorting poly-clonal from seedling green leaf would improve returns to Smallholders and processors alike. Funding for fertiliser loans and technical support through the estates could also make a significant impact on productivity of Smallholders at relatively low cost.

9.6 Compliance with Ethical Trading and other Buyer/Consumer initiatives

A number of initiatives relating to 'fair' and 'ethical' trading have emerged in the UK, which is still Malawi's main export destination, and in Europe. Whatever the actual employment practices on the estates, there will be an need to verifiably 'prove' that they comply to the emerging standards in export destination markets, particularly the UK. The industry will need technical assistance to show it is meeting the requisite standards and help to make any transitions required. Two of the estates have already begun the process of 'social auditing' using a locally based consultancy organisation, but cost is proving a barrier given the extreme pressures on profitability of the sector at present. Medium-term access to markets could be restricted if Malawi tea is 'shut-out' because it cannot demonstrate compliance.

9.7 Strengthen the Tea Lobby

For a number of historical internal and extraneous reasons the tea industry has not been very effective at getting change from lobbying Government. The Government has not generally been sympathetic or responsive to concerns raised by the industry and policies have generally not favoured the growth and continued health of this important sector.

If the industry is to prosper then it needs to persuade government that it has a valuable role to play in terms of export earnings, taxes remitted, employment and provision of social welfare functions. Consideration needs to be given by the industry, particularly the estate sector, on how to improve its lobbying capacity.