



**FARMERS PERCEPTIONS**  
**ON THE INTEGRATED PRODUCTION SYSTEM (IPS) IN THE TOBACCO VALUE**  
**CHAIN IN MALAWI**

**RAPID STUDY REPORT**

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September 2016

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## **ACRONYMS**

AHL	Auction Holdings Limited
ARET	Agriculture Research and Extension Trust
IPS	Integrated Production System
JTI	Japan Tobacco Incorporation
SAP	Structural Adjustment Program
TCC	Tobacco Control Commission
WHO	World health Organization

## **1. INTRODUCTION**

### **1.1 Background to the Tobacco Industry in Malawi**

The Malawi's economy continues to be agrarian based with Tobacco ranking as one of the most important and strategic crops for the country. According to Makoka, Appau and Lencucha (2016), Malawi's economy is regarded as the most Tobacco dependent economy in the world. In 2012, Tobacco contributed about 52% of the total export value to the Malawi's economy.

Tobacco production in Malawi is bi-modal comprising estate and smallholder sub-sectors. Prior to the introduction of the Structural Adjustment Programs (SAPs) in the late 1970s and 1980s, Tobacco production was largely under the firm control of the government. The introduction of the SAPs liberated the Tobacco industry in the early 1990s leading to an exigency for smallholder involvement in the production of the leaf especially Burley and Virginia. Burley and flue-cured Tobacco are the most widely grown varieties in Malawi. Grean (2012) estimated that Malawi has around 360, 000 smallholder farmers directly involved in cultivating Tobacco. The industry is regulated by the Tobacco Control Commission (TCC).

Until recently, Tobacco marketing in Malawi has largely been characterized by an auction system controlled by the Auction Holdings Limited (AHL). The AHL operates its four auction floors situated in Limbe, Lilongwe, Chinkhoma and Mzuzu. Under this marketing system, smallholder farmers are self-reliant in shouldering all the production and transportation costs to the point of sale at the auction floors. The system is also characterized by inclusion of other intermediaries who are believed to, somewhat, compromise smallholder farmers' efforts by reducing the latter's marketing margins. This notion gave rise to the introduction of the Integrated Production System (IPS).

### **1.2 Background to the Integrated Production System (IPS) in Tobacco industry in Malawi**

The IPS is a relatively new phenomenon to the Malawian Tobacco industry. The IPS is a form of contract farming and it was only fully implemented in 2012. Today, most smallholder farmers are now producing Tobacco under this system (Makoka, Appau and Lencucha, 2016). Under the IPS, the smallholder farmers enter into contractual agreements with

Tobacco leaf-buying companies for the companies to provide all the necessary support required during production (in form of inputs on credit). As part of their obligation, smallholder farmers are committed to sell their leaf exclusively to the companies they entered into contract with. Ideally, smallholder farmers and the Tobacco leaf-buying companies agree on the saleable quantities prior to the on-set of the agricultural season. It is estimated that 80% of Tobacco leaf is sold under IPS in Malawi. The IPS in Malawi is regulated by the Tobacco Act (CAP.65:02) Tobacco (Integrated Production System) Regulations, 2014. It is worth noting, however, that the AHL continues to operate the auction marketing system for farmers that opt otherwise other than the IPS arrangement.

A recent study on the farm level economics of Tobacco production found that Tobacco production and marketing under the contract-based IPS is more profitable than the individual-auction arrangement. However it has to be noted that most of the data the study in question used were for the years 2013 and 2014. This study also in our observation did not do a thorough political economy analysis of the system to further explain why there was such a difference in profits. Furthermore, there is still a gap in Tobacco related literature on the actual tenets guiding the IPS in the Tobacco industry in Malawi. The rapid study that CISANET conducted was aimed of understanding smallholder farmer perception of the IPS.

## **2. DATA COLLECTION AND ANALYSIS**

The study collected and analysed qualitative data in relation to the themes that were coming out in relation to the study. Focus group discussions were conducted with smallholder Tobacco farmers in Kasungu, Lilongwe and Dowa districts. This data was augmented and triangulated with a desk study of the relevant literature on IPS and the general Tobacco industry in Malawi.

## **3. STUDY FINDINGS**

### **3.1 Profitability of Tobacco: Contract-IPS versus Independent-auction system**

As aforesaid, an earlier study done by Makoka, Appau and Lencucha (2016) found that Tobacco production under the IPS is more profitable than individual-auction system of production. These findings were consistent both with the inclusion and exclusion of labour costs in the total cost of production. Using data from the 2013/2014 agricultural season, the study found that Tobacco farmers cultivating under IPS made a perceived profit of US\$630.1 per acre while those cultivating independently and under auction made a perceived profit of

US\$417 per acre. Factoring in the cost of labour reduced the profit to US\$224.3 per acre for farmers under the IPS. On the other hand, farmers producing independently made a loss of – US\$37.3 per acre after factoring in the cost of labour. However when this was triangulated with the farmers perceptions, it was noted that in its first two years, whose data the Makoka study used, The IPS performed very well. The farmers noted that the companies gave good prices to those under IPS and increased the rejection or downgrading of tobacco under auction (This is despite the originally set higher grades by TCC) in order to discredit the auction system and to attract more farmers to be under IPS. When IPS was being introduced there was a promise of increased returns on investment for the farmers as a shorter value chain due direct farmer-company contract will mean more returns for the farmer. This looked true in the first two years of the program but not anymore.

Noteworthy, however, the Makoka study found that the total cost of production for the leaf was 27 percent higher for the contract based IPS system compared to that of independent-auction system. Smallholder farmers under IPS incurred a total cost of US\$326.32 while independent-auction system farmers incurred US\$256.19 per acre. This however did not significantly reduce the quality of tobacco independently produced. The higher profits that are accrued to contract based IPS farmers were thus attributed to the higher prices that these farmers get at the auction floors relative to smallholder farmers on independent auction system.

### **3.2 Farmer perceptions on the tenets of the current IPS system**

The rapid study further attempted to establish how the IPS system is currently being operated in the Tobacco industry in Malawi. The sequence of IPS related activities was thus sought from the farmers and it was established that usually the farmers enter into funded contracts with respective Tobacco lead-buying companies and these agreements are made prior to the following growing season. Through their Field Extension agents, Tobacco leaf-buying companies court the farmers to establish the contractual obligations between themselves for the growing and marketing of the required Tobacco volumes. The general understanding is that contracts are drafted by the Tobacco leaf-buying companies in English and are presented by the companies' Field Extension agents to the farmers only for adoption and signing. This suggested lack of compliance to the Tobacco Act (CAP.65:02) Sections 4.4.(a) and 4.4.(b)<sup>1</sup>.

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<sup>1</sup>Section 4.4 reads Contracts between Tobacco buyers and Tobacco growers who are illiterate shall be invalid unless (a) a written translation is made into a language the illiterate grower understands and (b) the English

The farmers echoed that, at times, they do not understand some of the clauses that are presented in the contracts due to high illiteracy levels among the farmers. The farmers also pointed out that at times explanation to the contracts are done while the farmers have already been made to sign. This dynamic gives rise to fears that the farmers may be entering into contracts that they do not fully understand hence undermining their power in negotiations. These findings augur well with Makoka, Appau and Lencucha (2016) who reported that 25.6% of farmers reportedly join the IPS without being adequately informed. For instance, the farmers reported that the contracts that they sign do not adequately explain the total cost of inputs that they obtain on loan. This has led to a confusion by farmers who claim that at times total deduction goes up to MK600, 000.00 for the inputs they could buy for MK200, 000.00 on the market. This is against a background that farmers under IPS are not allowed to buy own inputs. Furthermore, the companies are said to defend this position of not disclosing the buying price of tobacco because they wait for the Government to set minimum buying prices for tobacco, however the farmers wondered as to why these companies never follow the minimum buying prices that are set by Government? At the same time it is reported that the companies ignores the gross margins analysis provided by ARET in deciding the cost of production and pricing of tobacco.

Farmers also complained that they have observed that there are benefits by third parties in their contractual agreements with the companies. For instance the farmers wondered as to why the barcodes they place on their tobacco bales be sold to them for up to MK8, 000.00 when this was not part of the contractual agreements? The farmers also feel that others within the system benefit from the remainder of the tobacco volume left on their contract. On this one farmers recalled that he only sold 300kg out of the 1500kg he agreed with one company because he was told to sell the remainder under auction, however when he checked to verify how much is remaining on his contractual allocation with company he was told that his allocation has been used up. He wondered who has used the remaining tonnage? Yet another farmer recalled that he had mysterious money that entered into his account and he started receiving calls from some company officials to go and withdraw that money and give it to them.

Further to that, the study sought to understand the conduct of the Tobacco leaf-buying companies relative to honouring the contracts that they sign. The study found that all

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version of the contract is explained to the illiterate grower in a language he understands by a person who is independent of the buyer

Tobacco leaf-buying companies operating in the study area were not fully honouring the contracts they signed with farmers. First, the study found that the Tobacco leaf-buying companies do not usually honour their contracts relative to the agreed saleable volumes. According to The Tobacco Act (CAP.65:02), Section 4.1.b, Tobacco leaf-buying companies are required to commit to buy the entire crop by the grower within an agreed production variance of 10%. To the contrary, the farmers reported that the buying companies usually buy volumes only up to the level where the proceeds will cover their contracted loans. The potential production per hectare can go up to 25 or 30 bales but farmers under IPS are only allowed to give out 16 bales at most, the rest of the bales farmers are forced to sell at the auction (which of late in most cases is rejected). The study also found that the agronomical practices that farmers are forced to use under IPS are contrary to the standard practiced prescribed by ARET. This compromises on quality and output per hectare for the farmers. This finding was also tied to the production potential for the farmers. It was reported that the contracts that the farmers sign stipulated saleable volumes that are lower than their potential productivity. Depending on land fertility, the farmers reported that their production levels are much higher than the agreed quantities in the contracts. Although, it was noted that the increase in productivity was beyond the 10% threshold provided by the Tobacco Act (CAP.65:02), the buying companies tend to buy the leaf only up to the extent where they are able to recover their loans from the farmers, making farmers to be 'private' producers of the companies in an arrangement similar to the Tenant System. *'In the last growing season, I entered into an agreement to produce 2, 000kgs of the leaf, but the company bought only 1,200kgs and the other 800kgs was rejected. Selling at that level, I was only able to repay my loan to the company. I did not realize any profit'* [Male JTI contracted farmer, FGD, Kasungu]. This scenario clearly shows that the company bought lower than was agreed and well outside the 10% variance that is allowable by legislation guiding IPS in Malawi. The status quo remains even in the instance where the Tobacco farmers grant the Tobacco Leaf-buying companies the first option to buy their crop which is in excess of the agreed variance in compliance with Section 4.1.(c). Other farmers in similar situations have opted for suicide under pressure to meet other costs and settle debts they incurred during production.

Similarly, farmers reported dissatisfaction with the way their Tobacco leaf is classified and graded for sale at the Auction Floors. The farmers reported that the majority of the Tobacco leaf-buying companies do not comply with the classification and grading systems done by the TCC. The farmers have the perception that the buying companies deliberately shun buying

the leaf at the initial classification and grading levels done by the TCC to allow for reclassification to downgrade the leaf before they offer to buy it. These findings agreed with Makoka, Appau and Lencucha (2016) who reported that an average of 37% of farmers interviewed expressed satisfaction with the grading and classification of their leaf. The report further suggests that the buying companies used the farmers' unawareness of specific classification and grading systems for pricing gains and also to dupe them. With the downgrading of the leaf, the buyers tend to offer lower prices for the leaf which actually is of high quality.

### **3.3 Perceptions of the Tobacco farmers on the Auction system**

Data collected on the farmer perception on the auction system suggest that there is a very high rejection rate on the auction system relative to the contract based IPS system. The farmers are of the view that their leaf is rejected albeit the leaf is of high quality. Similarly, the average prices offered on the auction system are much lower compared to those offered to farmers under IPS. *'I wonder why my Tobacco leaf at the auction system was offered lower prices despite it being of the same quality with that of a contract farmer'* [Male farmer, FGD, Dowa]. These sentiments agreed with Makoka, Appau and Lencucha (2016) reportedly made by a Government Extension worker in Mchinji. Based on these two factors, the farmers were of the view that the Tobacco leaf buying companies are deliberately frustrating the auction system in order to silently force all the farmers to be cultivating their tobacco under the IPS.

### **3.4 Farmer perceptions on recommended agronomical practices**

According to the Tobacco Act (CAP.65:02), contracts made under IPS need to make a commitment to comply with good agricultural practices and minimum standards in Tobacco growing as specified by the Agriculture Research and Extension Trust (ARET) or the Tobacco buyer. Asked on their perceptions about the agronomical practices that they follow, the farmers reported that they at times get conflicting messages from the ARET and Tobacco leaf-buying companies' Field Extension Agents. The farmer noted that the extension advice they get from the Field Extension agents for the companies usually tend to deviate from the common messages that they get from ARET extension workers. In their view, this has the potential to confuse the farmer resulting in a decline production quality and quantity. At the same time the messages that they get from the Field Extension agents of the companies tend to change almost every year, for instance spacing of tobacco has never been consistent under IPS, harvesting procedures also keep on changing.

### **3.5 Frustrating farmer associations**

There is also a general feeling among most association leaders we met that IPS is also a way of frustrating the spirit of farmer association. Unconfirmed information that we have is that companies in most cases use divide and rule tactics as they prefer to deal with individual farmers than the whole group. Some farmers in Kasungu also felt that the formation of the Central Region Tobacco Association, which they believe some tobacco companies had a hand in is a way of countering big associations like TAMA.

### **3.6 Control of the Tobacco value chain**

The Tobacco IPS which was seemingly introduced with good intentions is becoming a big burden on farmers. The farmers were attracted to the system on the promises of good prices and surety of good marketing arrangements and prices. However our observation is that the system is becoming a Trojan horse for the companies to control the entire tobacco value chain. For instance as pointed out, the farmers under the system are not allowed to buy own inputs but to perpetually depend on the companies regardless of their ability to buy on their own. At the same time the unfair buying practises makes the farmers to be in perpetual debt and dependent on the companies. The farmers are given chemicals, seeds and fertiliser among others whether they like it or not. At times farmers are delayed in being provided with chemicals for the tobacco nurseries but are still given even after the tobacco has already been transplanted just to ensure that they have taken a loan from the company. There is a feeling that the companies are also promoting other businesses of chemicals and fertilisers which are used as part of the contract package thereby systematically taking out the small agro-dealers and other traders of these inputs out of the tobacco value chain. At the same time most of the tobacco seed under IPS is imported despite the fact that ARET has high quality seed that suits our growing environment. The companies also have the power to decide as to who must transport the contracted tobacco thereby controlling the transport sector of tobacco. The tobacco companies are also indirectly determining how much tobacco a farmer should produce by controlling how much tobacco they buy at the market, rendering TCC allocations to the farmers of no effect. One tobacco farmer complained that he was told to stop growing tobacco and switch to growing soya beans if he will not accept these conditions. (They are deciding whether a farmer can grow tobacco or not)

## **4. CONCLUSIONS AND RECOMMENDATIONS**

### **4.1 Conclusion**

Based on the major findings, the study concludes that:

- The IPS was found to be more profitable relative to the Auction system in its maiden years but that is not the case now
- IPS is currently operating in the interest of the tobacco companies and not the farmers
- The IPS, as it is being implemented in the Tobacco industry now, is not complying with some of the critical tenets of an otherwise efficient and effective IPS system
- The perceptions echoed by the Tobacco farmers suggests that Tobacco leaf-buying companies are exercising full control of the Tobacco value chain. This gives rise to fears in CISANET that the Tobacco leaf-buying companies will tend to have full control of the value chain giving room to manipulation and locking farmers into continued cultivation to ensure reliable supply and make outrageous profits.
- The penalties for companies violating the provisions of the IPS regulations is MK500,000.00. We feel this is too little for the size of the companies operating in the tobacco industry. We believe this has also given the companies the vigour to ignore the regulations as can easily pay when charged.
- IPS has brought fear among the farmers as the tobacco buying companies are becoming too powerful as they can decide on almost anything happening along the chain

### **4.2 Recommendations**

Even in the wake of the Anti-smoking lobby campaign championed by the World Health Organization (WHO), CISANET believes that Tobacco continues to make a significant contribution to the economy of Malawi, which cannot be ignored. It is, thus, in the interest of CISANET to ensure that Malawi has a Tobacco industry that is fair, effective, efficient and profitable to all players in the value chain. Based on the findings from this rapid study, we therefore, recommend that the IPS to be temporarily suspended in its entirety to review the issues raised in this and other related reports. Upon satisfactory revision of these issues and coming up with a stronger legal framework, the IPS stands out as an excellent way of ensuring the development of the Tobacco industry in Malawi.