

# Private Sector Participation in the Farm Input Subsidy Programme in Malawi, 2006/07 – 2011/12

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## Background and Context

The implementation of the Farm Input Subsidy Programme (FISP) has involved the interaction of the Government of Malawi, the private sector, development partners, civil society organisations (CSOs), non-governmental organisations (NGOs), traditional leaders and smallholder farmers, all playing different roles in the implementation and success of the programme. The private sector has played a critical role in the procurement, transportation and retail of farm inputs, but their involvement in the programme has changed over time. Its involvement has included the procurement of fertilizers, the transportation of fertilizers to various markets, the retail sale of fertilizers, and the production and sale of improved seeds.

Benefits from the inclusion of the private sector in the implementation of a large and nation-wide agricultural input subsidy programme include efficiency and less bureaucracy, strategic development of the private market system, cost saving on the part of government, shared investment finance and costs, and reduction in displacement of commercial sales of inputs.

## Nature of Private Sector Participation

The relative roles of the private sector in the fertilizer component of the programme have varied over time as regards their participation in and exclusion from retail sales, while they have remained important partners in the procurement of fertilizers for the programme, and in unsubsidised commercial sales. On the other hand there has been consistent private sector participation in the seed component of the programme. The private sector also

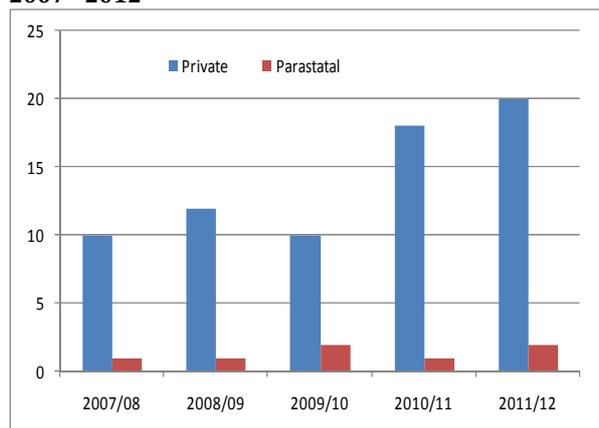
procures fertilizers for commercial sales in various market outlets across the country and provides transport services for uplifting subsidized fertilizers from the depots to unit markets across the country.

There are four main types of formal private sector involvement in the FISP. The procurement of fertilizers has been the major mode for increasing private sector participation, with it procuring most of the subsidy programme fertilizers relative to state marketing agencies. Second, the distribution and transportation of fertilizers is entirely handled by the private sector with a number of contracted transporters. Opportunities in retailing of subsidized fertilizer have been more mixed, with inclusion of four supplier networks in the programme only in 2006/07 and 2007/08. Small scale input suppliers, agro-dealers, have never participated in retailing of subsidised fertilisers. However, the private sector has enjoyed full participation in improved seed production and (including agro-dealers) in seed retailing, with a number of new entries in seed supply to the subsidy programme.

## Private Sector Fertilizer Activities

Over the life of the programme there has been a decline in the supply of fertilizer to the subsidy programme by state-owned enterprises and a substantial increase in private sector participation. The number of private sector bidders increased by 170 percent between 2009/10 and 2011/12 with a corresponding 100 percent increase in the number of companies awarded contracts as shown in Figure 1. Nonetheless, during the period there have been exits, including National Association of Smallholder Farmers of Malawi, Rab Processors and Yara (who participated in 2006/07 but have since not continued to participate in the programme).

**Figure 1 Number of Fertilizer Contracts Awarded, 2007 - 2012**



These contracts have brought about between US\$51 million and US\$110 million worth of business to the private sector in terms of new fertilizer procurement. In addition to subsidy fertilizers, the private sector also continues to import fertilizers for commercial sales, and NSO import figures show increasing availability of commercial fertilizers in spite of the subsidy. For instance, a small reduction in subsidized fertilizer between 2007/08 and 2008/09 is associated with a substantial increase in imports and hence in the quantity of fertilizer available for commercial sales in 2008/09. The subsidy programme in the 2010/11 season excluded tobacco fertilizers, and the increase in the available commercial fertilizers may reflect lower displacement due to the focus of the programme on maize fertilizers. Except for bad years for tobacco, there has been an overall increase in fertilizer importation and consequently an increase in fertilizers available for commercial use, suggesting that after an initial decline the subsidy programme might have stimulated fertilizer use.

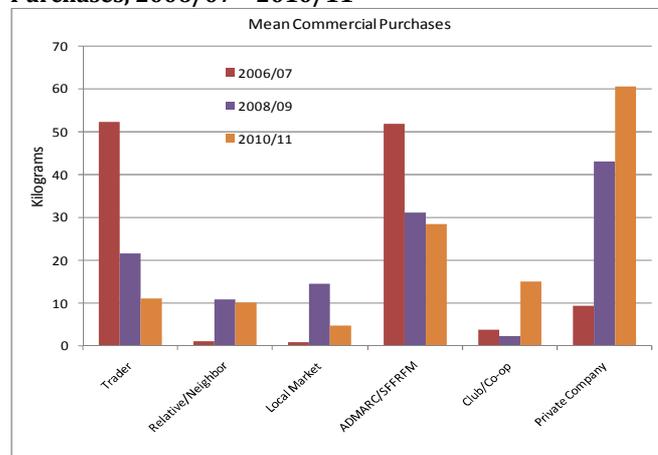
The participation of the private sector in the retail marketing of subsidized fertilizers has been the most difficult aspect in relation to the development of private input markets across the country; the private sector was allowed to redeem fertilizer vouchers only in the 2006/07 and 2007/08 seasons. In these years the private sector retailed about 28 percent of subsidized fertilizers while 72 percent were retailed by Agricultural Marketing and Development Corporation (ADMARC) and Smallholder Fertilizer Farmer Revolving Fund of Malawi (SFFRFM).

The buoyant picture above with an increase in available commercial fertilizers is also revealed from survey data about smallholder

farmers' commercial purchases. There is a general increasing trend in the use of private sector input outlets in procurement of commercial fertilizers by smallholder households and a declining trend for commercial purchases from parastatals. One reason for this decline is the withdrawal of ADMARC from commercial sales, stocking only subsidized fertilizers. The proportion of farmers making commercial purchases from large retailers' outlets increased from 5 percent in 2006/07 to 30 percent in 2010/11.

The average purchase of commercial fertilizers from private sector retailers is somewhat mixed. While households' average quantity purchased from small scale traders has declined, there is a substantial increase in average purchases from large retailers' outlets, from 10 kilograms in 2006/07 to 60 kilograms in the 2010/11 agricultural season as Figure 2 shows. Although international fertilizer prices almost tripled in the 2008/09 season, there was an increase in the reported purchase of commercial fertilizers from private company retail shops. This is also consistent with the lower estimated displacement in 2008/09 and 2010/11 seasons and a decrease in average subsidy fertilizers received by households.

**Figure 2 Mean Quantities of Commercial Fertilizer Purchases, 2006/07 - 2010/11**



## Private Sector Seed Activities

The private sector has consistently participated in the seed component of the subsidy programme, providing improved maize seeds and legumes to smallholder farmers. At production level the seed industry is highly oligopolistic. Hybrid maize seeds that have become popular with farmers are produced by three international companies, one of which also participates in open pollination variety (OPV) maize seed production. The number of firms supplying various seeds to the programme increased from 6 companies in 2006/07 to 12

companies in 2011/12. New entrants have occurred mainly in legume seeds supply, but the competition brought by new entrants in improved maize seeds remains fringe. The two largest suppliers of seeds to the subsidy programme account for 71 percent of maize voucher redemption and the three largest suppliers account for 87 percent of the maize voucher redemption. Similarly, in the legume seed market, the two and three largest suppliers to the subsidy programme account for 65 percent and 75 percent of voucher redemption, respectively.

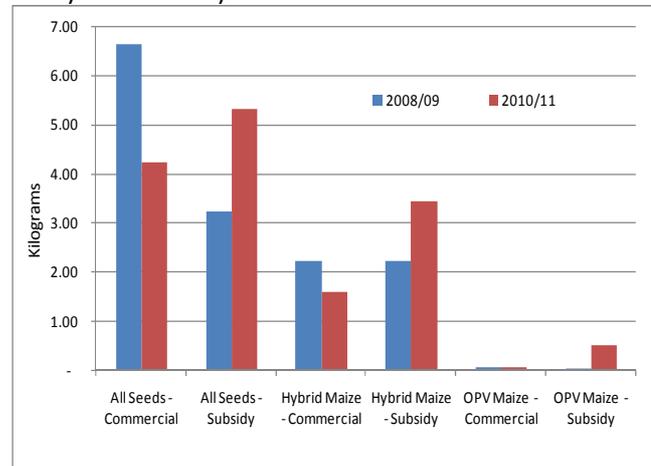
There is, however, an increase in the level of competition at retail level in terms of the number of competitors in the local communities. Agro-dealers reported a 15 percent increase in competitors between 2005/06 and 2008/09 while distributors reported a 3 percent increase in the number of competitors. However, community surveys revealed that only 22 percent of the communities believed that the number of seed sellers accessible in their community had increased while 57 percent maintained that the numbers had remained the same between 2006/07 and 2008/09.

On average, the programme has distributed to smallholder farmers 5,852 metric tons of hybrid maize seeds, 1,839 metric tons of OPV maize seeds and 2,280 metric tons of legume seeds per year between 2007/08 and 2011/12. There was a steady increase in hybrid seeds obtained by smallholder farmers from 2007/08 until a fall in 2011/12. OPV maize seeds dropped substantially in 2008/09 but then increased steadily from the 2009/10 season. After an initial drop in the share of OPV maize seeds, in the past 2 season there is increased purchase of OPV maize seeds. In 2009/10, OPV maize seeds accounted for 12 percent of maize seeds, but the share rose to 32 percent in 2011/12 while hybrid maize accounted for 89 percent and 68 percent, respectively. In terms of costs, private sector business promoted directly by the seed subsidy amounted on average to US\$19.1 million per year in the past five agricultural seasons.

The data from household surveys reveal that in 2008/09 and 2011/2011 most smallholder farmers do access improved maize seeds markets from ADMARC and SFFRFM retail outlets (more than 70%), followed by private companies' retail outlets (15%) and agro-dealers (8%). However, there was a decrease in commercial purchases of seeds

while subsidy seeds sales increased between 2008/09 and 2010/11 (Figure 3), suggesting possible displacement of unsubsidised seed purchases by subsidised seed.

**Figure 3 Volumes of Seeds Purchased by Households, 2008/09 and 2010/11**



Farmers are also purchasing more hybrid maize seeds under the subsidy programme compared to OPV maize seeds. While commercial purchases of OPV maize seeds have remained the same, for hybrid maize seeds commercial purchases declined from an average of 2.1 kilograms in 2008/09 to 1.6 kilograms in 2010/11 per household. In both cases of hybrid and OPV maize seeds, there is an increase in subsidy redemption. These trends suggest that the subsidy programme is to some extent crowding out commercial purchases, although the overall use of improved seeds has been increasing.

Although the proportion of households accessing the private market system is small, the average purchases of seeds from the private market outlets are higher than average purchases from parastatal outlets. Agro-dealers have played a particularly important role in facilitating access to inputs in rural areas.

## Challenges of Private Sector Participation

Although there have been positive developments in the participation of the private sector in the implementation of the subsidy programme there are challenges that need to be resolved to improve its efficient contribution to the programme. First, despite improvements over time, there are still considerable delays in the award of tenders, particularly for the supply of fertilizers. This increases the risk of price rises, necessitating protracted negotiations about supply prices and at

times failure by companies to supply at tender prices.

Secondly, there is a problem of trust between the private sector and government, leading to continued exclusion of the private sector in retailing of subsidized fertilizer. Government believe that the private sector is more driven by profit motives and pursues rent-seeking opportunities, redeeming coupons for other merchandise, rather than fertilizers, as the sector is unable to self-regulate. The private sector dislikes the inconsistency in Government's decision making which creates uncertainty for private input market development.

Thirdly, the subsidy programme has attracted new entrants that were hitherto not interested in the fertilizer business, particularly from domestic companies: some have been created just to bid for contracts to supply fertilizers to the programme. Some of these companies were closely connected to the political establishment, such that when awarded contracts they were unable to deliver on time, no punitive measures were imposed, and they continued to be awarded tenders to supply in the following season.

Fourthly, in the seed component, there is collusive behaviour of seed suppliers in deciding the supply price of seeds offered to the subsidy programme. Although the subsidy programme has attracted a number of players in seed production and supply, the pricing arrangement is tantamount to collusive pricing due to the desire by Government to have a uniform top-up for farmers.

There is also evidence that the payment system by the Government for supplies and services rendered to the programme by the private sector is inefficient. In the 2011/12 programme the Government still owed seeds, fertilizer companies and transporters for supplies and services provided during the 2010/11 subsidy programme.

## Opportunities from Private Sector Participation

Greater involvement of the private sector in the subsidy programme not only promotes private sector development in input markets but can also improve efficiency in the implementation of the programme. First, this can be accomplished by increasing the number of outlets from which smallholder farmers can

redeem their input coupons and broadening their choice of markets. The increase in the competition may consequently improve the quality of services at market outlets and reduce the incidence of queues and demands for 'tips' at the markets.

Secondly, the involvement of the private sector can also encourage private investments in rural input markets. This requires consistency and transparency in Government decisions in order to build the confidence needed for private investments in rural markets.

Thirdly, there are also opportunities for designing future private sector participation on the basis of performance based indicators such as verifiable expansion of retail outlet coverage.

Fourthly, the subsidy can exploit opportunities for private sector involvement in storage facilities. With the exclusion of the private sector in fertilizer retail, all programme fertilizers have to be delivered at SFFRFM depots for uplifting to markets and their congestion then causes delays.

Fifthly, better methods of targeting can reduce displacement and therefore increase demand for commercial purchases.

Sixthly, improvements in the timing of coupon distribution, by distributing earlier, can help farmers to plan for commercial purchases and thereby help commercial sales. Earlier distribution of coupons can bolster input sales as those that do not receive coupons and those that receive coupons but want to top these up would be certain about the subsidised supplies and hence their need for commercial purchases.

Finally, there are also opportunities that may arise with the use of electronic vouchers which could enable the private sector to invest in electronic system resulting in shared costs, benefiting both government and private suppliers.

## Conclusions and Lessons

The main conclusion of the study is that although the subsidy has had some negative impacts on private sector development in the form of displacement in the short-run, in the medium to long term it appears to have been catalytic in raising the demand for fertilizers and improved seeds. The private sector is increasingly the main supplier of fertilizers to the programme, and their exclusion from the retail market for subsidized fertilizers has not prevented growing demand for commercial fertilizers in the medium term. In the seeds market, the increase in the seed subsidy in from 2009/10 seems to be crowding out commercial sales to some extent. However, like the fertilizer market, in the medium to long-term it may

stimulate demand for improved seeds as farmers witness the benefits of technology adoption.

Both in the fertilizer and seed markets, there is an increase in the number of private sector players, although exits especially in the fertilizer market are evident. However, the challenge is to translate the increase in competition into reasonably priced inputs and quality of services offered to smallholder farmers in under-served areas.

There are benefits for expanding the role of the private sector in reducing programme costs, increasing efficiency and alleviating problems of storage capacity in parastatal markets, but the involvement of the private sector will require mutual trust among stakeholders, systems of transparency and accountability, and policy consistency and credibility.

Volumes of subsidized fertilizers have been relatively constant, and the growing demand for commercial purchases by smallholder farmers should also provide incentives for the private sector to strategically position itself by expanding their networks in underserved areas. This could be achieved by developing sustainable partnerships with the agro-dealer network that exists in rural areas. There is also scope for increasing private participation in the fertilizer retail market through performance based contracts to supply underserved areas.

It is also important to continuously monitor the impact of the subsidy programme on private sector markets and monitor the integrity and efficiency of the private sector. Improving the efficiency and competitiveness of input suppliers is one of the conditions that can facilitate graduation from the subsidy programme at household, area and national levels. The efficiency of the private sector also needs to be studied from the lens of the structure of the market (players, their market power and vertical restraints), their behaviour in the market, and resultant benefits in terms of efficiency and smallholder welfare.

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