CREDIT DEMAND AND SUPPLY STUDY OF MALAWI'S TEA SECTOR

DEEPENING MALAWI'S MICROFINANCE SECTOR PROJECT

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Executive Summary

This study was co-funded by USAID's Deepening Malawi's Microfinance Sector Project (DMS) and the Malawi Ministry of Agriculture Food Security Joint Task Force (FSJTF) Technical Secretariat funded by the European Union. The report was produced by Kadale Consultants, under contracts with the DMS Project and the FSJTF Technical Secretariat.

The main aim of this study is to gather and make available useful credit demand and supply data to increase the flow of sustainable financial services to the tea sector. This study examines the tea value chain to gain a better understanding of how the commercial growers/ processors (estates) and smallholder tea growers finance their economic activities.

Key stakeholders in the sector were surveyed including the estates, smallholder tea growers, input suppliers, banks, leasing companies and microfinance institutions to:

1. Quantify the level of credit currently being accessed;
2. Identify financing needs that are not being met; and
3. Make recommendations on next steps for addressing the financing gaps.

Following the distribution of the draft report, estates, smallholders, banks, MFIs, input suppliers and development financiers were brought together on 22 June 2006 at the Tea Association of Malawi to discuss the report and more importantly, identify ways to improve financing flows. This final report therefore contains amendments to the draft plus the outcome of the workshop.

Commercial Producers/Processors (See Section 2)
The estates were surveyed to understand how they finance their businesses, including sources of funding and what the funding was used for (working capital, fixed asset financing etc). An important finding from this process is the high level of self-financing in these businesses. Based on data from all seven respondents, their working capital facilities (overdrafts and seasonal loans) account for between 0-51% of their annual working capital budgets, with four of the seven respondents borrowing to meet 25% or less of their annual working capital budgets. Nevertheless, more than 95% of estate borrowing, reported at $5.85 million (see Section 2.1.1), is short-term local commercial bank financing, primarily in the form of 12-month renewable overdraft facilities.

Estates are **generally able to access working capital credit from the local banking sector**. However they are reluctant to increase credit facilities due to Kwacha exchange rates and low profit margins. Small to medium-sized estates could benefit from more working capital finance, but cost versus returns (Kwacha loans) remain unattractive. In general, the estates maintain conservative borrowing practices based on past experience of interest rates and price volatility.

In terms of fixed asset and development financing, most estates self-finance to the greatest extent possible, set aside earnings from previous years and take a long-term outlook to major projects by planning up to five years in advance. Fixed asset financing accounts for $260,000 or less than 5% of total borrowing (see Section 2.1.2). This is a reflection of the current supply available, not the needs of the industry.

Overall, the estates have found it difficult to finance **longer term development projects** (three to eight years) using local commercial financing, especially in US dollars. Estate respondents reported that their **primary financing gap is longer term US dollar financing for capital and development expenditure projects**, specifically:

- Facilities that match with the tea agricultural cycle;
- Loans in US dollars (as estates sell most of their tea in US $);

- Loan terms of five to eight years with payments that coincide with the peak of sales (linked to world tea prices if possible) preferably with an initial six-month grace period on interest payments only; and
- Loans ranging from $0.5 to $4 million.

Specific loan purposes and desired terms vary from estate to estate. Estates are looking for more flexibility from the banks to design individual loan products that match the specific needs of each project.

Banks reported that the ongoing forex shortage in Malawi does limit, but not completely preclude their ability to lend in dollars for medium term financing from their own funds. However, all of them have access to lines of credit for international loans in US dollars that can be offered to the estates for medium and longer term lending. They also indicated that they could make the loans flexible to meet the main requirements raised above, including term, grace periods and variations in repayment schedules according to season and between seasons. This suggests that the main problem is an information gap between what is wanted and what can be offered.

Leasing finance was brought up by the banks as an under-utilised option for fixed asset purchases. It was not well known by the estates that this could also be forex-based. As with longer term lending, this seems to be more of an information gap, though there may be as yet undisclosed limitations.

One further option is to link estates and banks with **development finance**. In collaboration with development finance banks, local commercial banks may be able to act as the local financial intermediary for disbursement of a loan fund or line of credit. The European Investment Bank (EIB) has confirmed its renewed interest to pursue establishment of a long-term US $ facility up to 12 years that is designed to meet the specific needs of the tea sector. As the first step in the process, EIB is looking to identify one or more local financial intermediaries with potential interest to move the process forward. NORSAD offers similar loan terms and is able to work either via a local financial intermediary or directly with an estate. (See Section 4.1.1) USAID, through its DMS Project, is also exploring the use of introducing its Development Credit Authority (DCA) loan guarantee program in Malawi as a means to stimulate banks to expand their small and medium enterprise loan portfolios.

Both the tea estates and financial sector acknowledged that there has been limited dialogue in the past to share information on the financing options available or to explore solutions to address financing gaps. In short, banks need to be more proactive in understanding the estates' requirements whist estates need to take greater initiative to discuss with their banks the options for financing, and if necessary, "shop around" and see what the banks have to offer.

Smallholder Tea Growers (See Section 3)
Six estates (Conforzi, Eastern Produce, Lujeri, Makandi, Satemwa and Zoa) are actively working with smallholder tea growers. Five of these estates responded to the survey and the smallholders with whom they work represent more than 95% of the 9,500 smallholder tea growers in Mulanje and Thyolo districts. The **estates are the only value-chain actors currently extending credit to existing smallholder tea growers** for fertiliser and other inputs.

The provision of credit by the estates is closely interlinked with two critical functions. The first is the provision of extension services, including monitoring of and technical guidance in crop production, to ensure quality and quantity of green leaf produced. The second is the purchase of green leaf by the estate that is providing the extension services and credit to the smallholder. This enables the estate to deduct loan payments from smallholder green leaf monthly proceeds as well as to capture sales from the smallholders.

On an aggregate level, a total of MK 39.6[1] million was extended as in-kind credit to approximately 8,500 smallholder tea growers during the current 2005/6 season. However, the level of credit extended varies considerably from estate to estate from MK 1,600-14,000 per grower. Based on field visits, each estate follows its own practice in terms of calculating fertiliser requirements for each farmer, estimating production and establishing the level of credit risk they are willing to accept as a company.

The estates with the fewest smallholders extend a larger average loan for their growers. This suggests that **there is scope for increased absorption of credit by smallholders** as there are no reported difficulties in repayment by these estates compared to the estates providing less credit. The issue may simply be the amount of finance an estate is willing to put into smallholder lending when it has to pay for that finance and does not necessarily reflect the full cost of the provision of inputs to smallholders.

All estates **consistently achieve high repayment rates (greater than 95%), as repayment is deducted monthly from green leaf purchases**. However, as the estates are not financial service providers there is a limit to the amount of credit they can extend to the smallholders and as a result, **there is an unmet credit demand for the majority of existing smallholder tea growers**. Growers highlighted the need for financing of seedlings for infilling, which both smallholders and estates felt would yield the best returns over time. As much as 50% of the existing land used for tea could be in-filled, with the attraction of not having to take land used for other purposes.

There is a **role for MFIs/banks to extend and even replace the credit** provided by estates to smallholders, but it would involve recovering the full cost of the inputs, including the cost of financing that is not being recovered at present. There is a need for caution so as not to displace a system that works well, but the involvement of specialist financiers would both extend the credit available and release resources for the estates to utilise elsewhere in their businesses. However, any scheme must be done in conjunction with the estates that have first hand knowledge of how it can work and the capacity to assess each smallholder's need for finance and potential to repay from tea proceeds. The high on-time repayment rates achieved by the estates through the simple mechanism of deductions from monthly sales should provide an attractive prospect for MFIs seeking to extend their portfolios, with regular income flows and a closed market system to guarantee repayments. The returns from additional investment in fertilisers and in-filling also ensure the income stream is increasing.

Financing for new growers was identified as a critical need by the smallholder representatives. New growers face additional financing needs, in particular with regards to for planting material, land preparation and fertiliser for several seasons without returns. Smallholder representatives indicated that these new growers would not have sufficient resources from other activities to meaningfully service any loans received until they begin selling sufficient green leaf produced from the new bushes to cover operational costs. This presents a gap that estates, commercial banks and microfinance institutions report they are unlikely to fill, as they cannot tie up capital whilst the bushes mature.

The establishment of sustainable **nurseries** providing a reliable, quality supply of seedlings is critical to meeting the planting material needs for both existing and new growers. Both estates and smallholders alike agree that the existing nursery proposal (outlined in Section 3.2.3) is viable and provides the best means to ensure that a reliable, quality supply of seedlings is available for existing and new smallholder tea growers.

[1] At the time of the report, 1US$ was equal to 140 Malawi Kwacha

The financing of existing growers is an area that is commercially viable right now. As such, the environment is ready for the intervention of a private sector commercial financial services provider/s. However, nurseries and new growers are longer-term interventions that will likely require support from **development partners** in addition to the private sector. This needs to be explored with partners such as the EU who have been long-term supporters of the industry.

1 Introduction

1.1 Background of the Study

The main aim of this study is to gather and make available useful credit demand and supply data that can be used by various stakeholders in the tea sector to increase the flow of sustainable financial services to value chain actors. It is a result of a collaborative initiative between USAID Deepening Malawi's Microfinance Sector (DMS) Project and the Ministry of Agriculture Food Security Joint Task Force (FSJTF) Technical Secretariat funded by the European Union. The author of the report is Kadale Consultants Ltd. who was contracted by the DMS Project and FSJTF to carry out this study. The study builds upon previous agriculture value chain work undertaken by the DMS Project, implemented by Chemonics International Inc. under contract to USAID/Malawi. (See Annex 1: Value Chain Chart – The Malawi Tea Industry)

Tea is the third largest export earner for Malawi after tobacco and on a par with sugar. Malawi is the second largest tea producer in Africa after Kenya, itself one of the biggest producers in the world. This economic activity is centred in the Thyolo and Mulanje areas where the majority of Malawi's tea is grown. Most of this tea comes from estates (around 93%) with smallholders producing the rest, typically on plots of less than 0.5 ha.

This study looks at the tea value chain to gain a better understanding of how the commercial producers/processors (estates) and smallholder tea growers are currently financing their economic activities. Where credit is being utilised, it outlines the volume, nature and form of credit provided and by whom. Secondly, it identifies areas where financing needs are not being met, including circumstances where the current financing may lack sufficient scope/size, where the lending mechanism (i.e. tenure) may not match the financing needs or where there is a total inability to access financing for a given purpose. For additional details about the process followed please refer to the Terms of Reference in Annex 1.

This document was presented at a workshop on 22 June 2006 at which the *Financing Needs in the Tea Sector* was discussed. It provides an overview of the topic to stimulate dialogue between the key players in the tea sector including estates, smallholders and input suppliers as well as existing and potential financial partners such as commercial banks, leasing companies, microfinance institutions and other financial institutions. The desired outcome of the workshop was to link the relevant players together so they may identify practical solutions which address the financing gaps presented, identify where additional assistance may be needed and establish clear next steps to develop new or improved mechanisms which better meet the sector's financing needs. Findings and specific outcomes achieved through the workshop, including identified steps for the way forward have been outlined in Section 4.2.

1.2 Methodology

Due to the specific financial data required for this exercise, the methodology focused on collection of data through primary research. Key stakeholders in the sector were identified including the tea estates, smallholder tea growers, input suppliers, banks, leasing companies and microfinance institutions. A questionnaire was developed for each category of interviewee, but based around the same issues/topics. The questionnaire was shared with DMS and FSJTF for input and then tested. Following initial interviews, it was amended. The final questionnaires for the estates and banks are attached in Annex 4: Questionnaire Templates. The questionnaire for smallholders and input suppliers were variants on these and can be provided on request.

Interviewees from the tea sector included seven of the eight commercial producers/processors (estates), smallholder representatives from the National Smallholder Tea Development Committee and the smallholder tea growers associations in Thyolo and Mulanje, as well as the main input suppliers for the sector. The majority of informants were visited in-person with the balance of interviews conducted via telephone or email.

All the commercial banks (seven) and a majority of the microfinance institutions (thirteen) were contacted by telephone or email to determine whether they were currently doing any lending to the sector. In-person interviews were conducted with the three financial institutions (National Bank, NedBank and Stanbic) currently providing tea sector financing.[2]

Eight tea estates, belonging to seven companies, were contacted for the survey. These represent more than 95% of the total tea production in Malawi and include Conforzi, Eastern Produce, Kawalazi, Lujeri, Makandi, Naming'omba, Satemwa and Zoa. Seven of the eight estates provided responses to the survey.

Several meetings were held with smallholder tea grower representatives during which feedback on the current smallholder financing schemes through the estates was provided and financing gaps were outlined. Specific data on current smallholder lending via the estates and smallholder production figures were provided by the estates, as this is where the information is currently housed.

Throughout the document when exchange calculations were required, a rate of US$1 to MK 140 was used.

Following the distribution of the draft report, estates, smallholders, banks, MFIs, input suppliers and development financiers were brought together on 22 June 2006 at the Tea Association to discuss the report and more importantly, identify ways to improve financing flows. This final report therefore contains amendments to the draft plus the outcome of the workshop.

1.2.1 Limitations to the Methodology

The primary limitation to the methodology relates to the sensitive nature of the financial information being provided by the estates and financial institutions. Where the firm agreed to provide specific financials regarding its business activities and current loan portfolio, this was done on agreement that company level financial information would not be publicly disclosed. Rather, this data will be presented in this report in aggregate so that findings and recommendations may be made on a sectoral level.

Nevertheless, it should be noted that all seven estate respondents provided a sufficient level of response to complete the study. In addition to the quantitative data, qualitative information was also provided and has been included in the narrative of this report, where relevant.

The terms of reference for this activity, which include both tea and coffee, specified that data provided should be disaggregated by sector. All of the estates surveyed produce between two to three export crops, typically tea, macadamia nuts, tobacco and coffee, as well as domestic market crops such as bananas, livestock/dairy, fish and maize. Except in the case of occasional specific asset acquisition, e.g. replacing tea factory equipment, all the businesses surveyed indicated that they don't normally borrow for a specific commodity.

[2] Other interviews with select banks, leasing companies and MFIs were also conducted although not currently providing financing to the sector.

Rather the estates borrow based on their overall business' needs. For example, working capital and cash flow requirements relate not to one crop, but also to the overlapping agricultural cycles of their other crops. Similarly, for ease of operations as well as to increase the size of bulk purchases, inputs are often purchased, and as such seasonal financing often secured for more than one crop.

The banks surveyed were not able to provide a breakdown of their lending to estates by commodity because the lending extended is to a business, not necessarily for a specific crop. However, for all the estates surveyed, tea is their single largest crop and revenue source. Tea represents a weighted mean average 75% of their aggregate turnover. As such, for the purposes of this exercise, figures have been presented pro-rata based on this percentage to provide a reasonably accurate estimate of the level of credit extended to the sector.

2 Commercial Producers/Processors

2.1 Credit Supply

The estates were surveyed to understand how they finance their businesses, including sources of funding and what the funding was used for (working capital, fixed asset financing etc). For external financing, information on the financier (whether local commercial bank, foreign commercial bank or development financial institution) was also gathered.

In terms of company profile, four of the seven estates (Eastern Produce, Kawalazi, Lujeri and Makandi) are owned by multinationals. Their estimated production for the 2005/6 season ranges between 2,900 and 15,500 mT. The total tea output of these four estates represents 85% of the total production (41,810 mT) of the estates surveyed. The remaining three estates (Namingomba, Satemwa and Zoa) are privately owned local companies with an estimated production for this season ranging from between 460 and 3,423 mT. While varying in size and corporate structure, generally speaking due to the like nature of their businesses, the estates currently access and require similar types of financing. However, the level of credit accessed varies not only by company size and ability to access credit, but also on each company's business approach and willingness to borrow.

An important finding from this process is the level of self-financing that all these businesses practice. Based on data from all seven respondents, their working capital facilities (overdrafts and seasonal loans) account for between 0-51% of their working capital budgets, with four of the seven respondents borrowing to meet 25% or less of their working capital budgets. The balance of their working capital needs is being met through self-financing, that is accumulated profits and to a very small degree, parent company financing.

Within each of the broad categories of Working Capital and Fixed Asset financing, these have been further subdivided as appropriate. The financing for smallholder inputs has been further separated as a particular category of interest. This is covered in Section 3 below.

2.1.1 Working Capital and Short Term Financing

Overdrafts are the primary borrowing facility currently availed to and utilised by the tea industry. Six of the seven respondents stated that they utilise overdraft facilities through local commercial banks to help manage cash flow needs and all these respondents provided specific data on their overdraft facilities. Kwacha interest rates were reported in the range of 26 to 27% with the exception of one respondent who reported an interest rate of 35%. Dollar interest rates from local commercial banks were reported at LIBOR plus 4% fully convertible to Kwacha as required.

Seasonal loans are the second most common type of credit financing used by the estates surveyed, effectively short term loans with fixed repayment periods within a single agricultural cycle. Three of the seven respondents currently have seasonal loan facilities. The primary reason given for taking this type of facility was to purchase inputs. However, several respondents also mentioned that they use their seasonal loan facility to provide additional working capital especially at the start of the season for land preparation, application of inputs, initial plucking of green leaf, wages, fuel/transport, electricity and other factory-related expenses that are incurred before the first tea sales of the season take place. Repayment for these term loans is made in three to six monthly instalments usually following a grace period of three to five months. All the loans reported in this category were dollar denominated at interest rates between 9-10%, with two of the facilities at LIBOR plus 4%.

All respondents secure their working capital credit requirements from the local commercial banking sector.

Table 1 Working Capital Lending to Tea Sector: 2005/6 Season

Type of Short Term Loan	Approx Aggregate Value
Overdrafts (Maximum Limit)	$4,250,000
Seasonal Loans (Principal)	$1,600,000
TOTAL	**$5,850,000**

Source: Estate summary data as reported by 7 of 7 respondents: Eastern Produce, Lujeri, Kawalazi, Makandi, Namingomba, Satemwa and Zoa.
Note: 75% of lending to estates has been attributed to tea.

All the respondents, except one that prefers to operate on a cash basis to help control expenditure, operate with **trade credit**. They reported that this is typically taken for a period of 30-60 days from date of invoice with no interest charged. However, respondents did not provide specifics on the level of trade credit received because it is difficult to quantify due to fluctuations on a monthly, even daily basis.

The main exception to this is for the purchase of inputs[3], which is a major part of working capital.[4] Orders are placed in the May to July period for delivery prior to application, which commences around November. The input companies surveyed indicated that they will often enhance the trade credit terms offered on a client by client basis. One input company reported extending terms between 30-90 days from delivery date into the country, requiring financial security of between 50-100% of the order value, depending on the customer's track record. Another reported offering terms to the estates ranging from cash payment up to 120 days from date of invoice. While this supplier reserves the right to charge 3% interest per month on outstanding balances, it is not generally applied as they want to maintain the relationships with their clients. However, as they invoice in US dollars with payment in Kwacha, they stated that this provides some level of protection from Kwacha devaluation, if receipt of payment is delayed.

Three of the respondents are purchasing all or a portion of their input requirements through a tea buyer. The buyer sources the inputs in bulk based on the estates' requirements around June of each year with delivery between September and December. Payment is typically made between December and February once tea sales are realised. The buyer extends an early payment discount to encourage sales to them during the off-peak season and start of the peak season. The estates have the option to sell their tea directly to the buyer if they are satisfied with the price offered or can sell their tea at auction and pay back for the inputs in cash via their sales proceeds.

2.1.2 Longer Term Asset and Development Financing

Asset and longer term development expenditure is reported by the estates to be self-financed to the greatest extent possible. The majority of respondents practice "if we don't earn it, we don't spend it". They finance their capital expenditure budgets by setting aside earnings from previous years and taking a long-term outlook to major projects. This often results in deferring rehabilitation and replacement of assets until they can be self-financed. One estate commented on a development opportunity to build a new factory. Rather than seek external financing in the current market, they have decided to wait until their income

[3] As reported above, details were obtained from the input suppliers and buyer regarding the nature of trade credit extended. Specific figures on the level of trade credit extended were not provided.
[4] Labour costs are the biggest working capital need.

stream can support a large portion of the costs, even though it may otherwise be a viable project economically right now.

It is important to remember that major asset replacement or purchases do not necessarily take place on an annual basis. Some of the estates may have major asset requirements in upcoming years that are not reflected here. However, there is still capital expenditure each year such as factory equipment rehabilitation and replacement, vehicles, tractors and irrigation equipment.

For example, while none of the estates reported any major development projects in tea which were being externally financed currently, several are actively developing other crops, such as macadamia, and have been able to receive some medium term financing through local commercial banks for this purpose. But generally speaking, the estates have found it difficult to finance longer-term development projects using local commercial financing reportedly because it has not been possible to get financing for a term longer than three to four years, except on an extremely limited basis and due to the interest cost of kwacha financing.

Medium Term Asset Financing

Only one respondent reported a medium-term loan through the local commercial banking sector. Two respondents reported medium-term financing through foreign banks. In all three cases, the facilities ranged between three to five year terms with annual payments and interest rates at LIBOR plus 4% or fixed between 5% and 8%, repayable in dollars.

Of the estate respondents surveyed, medium to long term financing through commercial banks represents less than 1% of their borrowing. This is a reflection of the current supply available, not of the needs of the industry as outlined in Section 2.2 below.

Table 2 Medium Term Lending to the Tea Sector

Type of Bank	Original Principal Amount	Est Outstanding Balance
Local Commercial Banks	$127,500	$50,000
Foreign Commercial Banks	$277,500	$210,000
TOTAL	**$405,000**	**$260,000**

Source: Estate summary data as reported by 7 of 7 respondents: Eastern Produce, Lujeri, Kawalazi, Makandi, Namingomba, Satemwa and Zoa.
Note: 75% of lending to estates has been attributed to tea. Loan tenures vary from three to five years with repayment starting between 2003-2005 and ending between 2007-2009.

The aggregate value of the estates' capital and development expenditure budgets for this season was over $3.6 million of which more than 90% has been self financed.

Leasing

None of the estates reported utilising any leasing facilities, which might typically include vehicles and machinery/equipment. This information was confirmed by the banks and leasing companies surveyed. To date, estates have not seen the benefit of utilising kwacha based leasing as a financing mechanism. One respondent commented that it has not been perceived as a viable option in light of Kwacha interest rates in recent years.

2.1.3 Total Commercial Bank Financing

The following data was reported by the local commercial banks as the current level of financing to the tea sector. Although a breakdown by financing type (i.e. short-term or medium-term lending) was not provided by all the banks, all but one bank confirmed they are currently only extending short-term financing (12 months or less) to the tea sector. It should be noted that a portion of this financing may have been extended to other actors in the value chain, including buyers. However, based on a comparison of the data collected from the estate sample and data collected in aggregate from the banks, it can be assumed that the majority of the financing reported through the banks has been directed to the commercial producers/processors, perhaps between 85-90%.

Table 3 Summary of Current Lending to the Tea Sector

Type of Loan	Approx Aggregate Values: As Reported By Local Commercial Banks	Approx Aggregate Values: As Reported By Estates Surveyed
Short-Term Loans (Overdrafts/Seasonal Loans)	$7,200,000	$5,850,000
Medium-Term Loans		$50,000
Local Commercial Banks SUBTOTAL	**$7,200,000**	**$5,900,000**
Medium-Term Loans	NA	$210,000
Foreign Commercial Banks SUBTOTAL	**NA**	**$210,000**
TOTAL LENDING	**$7,200,000**	**$6,110,000**

Source 1: Local commercial bank summary data as reported by 3 of 3 respondents: National Bank, NedBank and Stanbic Bank.
Source 2: Estate summary data as reported by 7 of 7 respondents: Eastern Produce, Lujeri, Kawalazi, Makandi, Namingomba, Satemwa and Zoa.
Note: 75% of lending to estates has been attributed to tea.

2.2 Credit Demand-Supply Gaps

2.2.1 Working Capital and Short Term Financing

In general, estates are able to access the working capital credit they require from the local banking sector. (See Section 2.1.1 for details on the nature of these facilities, terms received, etc.). Although additional levels of working capital credit may be beneficial to the estates, those queried seemed reluctant to increase their credit facilities in light of Kwacha exchange rates and the rather tight profit margins that exist in the tea industry.

The larger estates and multinationals tend to manage their working capital needs through a combination of self-financing topped up by their existing short-term facilities. The constraint has more to do with the cost of short-term financing than the availability of such financing.

The small to medium-sized estates have more difficulties securing financing as they will be constrained by provision of the necessary guarantees. It appears that they could benefit from more working capital finance but once again the cost of capital versus the returns makes it very difficult to get a viable return.

In general, the industry is quite conservative in its borrowing based on past experience. The industry has experienced multiple years of poor production and prices have been generally poor over recent years. Most estates would prefer to cut their working capital budget, even cutting the level of inputs purchased to below optimal levels, rather than overextend themselves when production may not allow for loan repayment.

2.2.2 Longer Term Asset and Development Financing

Accessing longer term financing for assets that matches with requirements of the agricultural cycle is a major constraint that limits development of the sector. All the respondents reported that the lack of longer term financing options was their primary financing gap.

This includes financing for replanting[5], irrigation, major upgrades/replacement of factory equipment, development of new factories, replacement of transport fleets, etc.

Respondents say they are looking for US dollar loan terms of between five to eight years with annual payments that coincide with the peak of sales. Some mentioned a desire to have repayment amounts linked to world tea prices so that they have some protection when prices are low. Conversely, in seasons when prices are high a larger portion of the loan could be repaid. Due to the nature of the tea business, all the estates effectively operate as dollar businesses and as such, they are looking for US $ loans. As well, with the additional risks and high interest costs associated with Kwacha loans they are not willing or able to borrow long term in Malawi Kwacha.

To date, this is not an area that the local commercial banking sector has been able to support except perhaps on a limited scale. One bank reported they “don’t go beyond twelve months” for lending in US dollars. Several other banks echoed this reluctance to extend longer term US $ loans due to the severe shortages of forex and excess Kwacha liquidity in the Malawi market, stating this would result in a funds mismatch. Another bank stated that it could in fact lend US $ on a long-term (i.e. up to seven years). However, when probed further, it acknowledged that it currently does so only on an extremely limited basis. For this bank, longer term forex lending is handled on a case-by-case basis and would, in practice, likely only be available to the larger estates.

Two development finance institutions have expressed interest in providing long term financing to the tea sector. These options are explored in Section 4.1.1.

[5] Replanting requires up to five years from clearing before the land yields a breakeven return on newly planted bushes.

3 Smallholder Growers

Of the eight estates contacted for this survey, six are actively working with smallholder tea growers. Five of these six estates (Eastern Produce, Lujeri, Makandi, Satemwa and Zoa) responded to the survey and the smallholders with whom they work represent more than 95% of the total number of smallholder tea growers.

Grower Profile

These estates reported working with most of the 9,500 growers in Mulanje and Thyolo districts growing some 2,400 ha of tea on plots of 0.1 - 3 ha, with an overall average plot size of 0.25 ha per smallholder tea grower. This represents about 15% by area and 8% by production of the total tea for the estate respondents.

Tea plays a significant role in monthly rural income generation among communities in the two districts since it is harvested for most of the year. In 2004, a total of MK 120 million and MK 38 million were injected into the rural economies of Mulanje and Thyolo, respectively, by buyers of smallholder tea green leaf.[6]

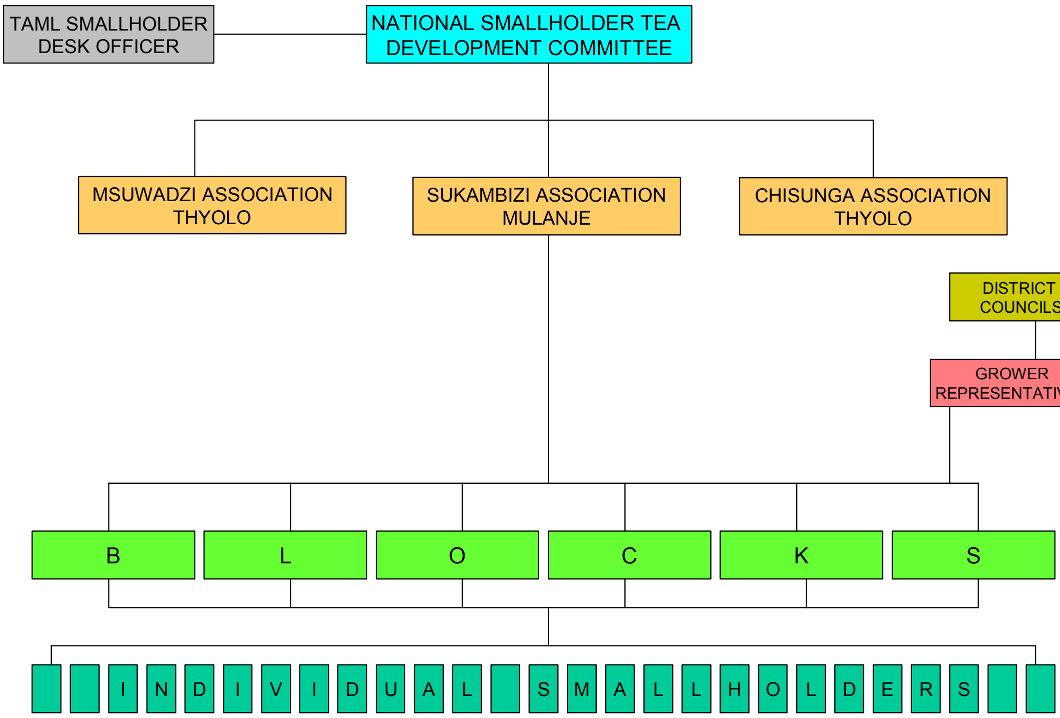
The smallholders are currently organised through the National Smallholder Tea Development Committee (NSTDC) under which there are three associations. The largest by far is the Sukambizi Smallholder Tea Growers Association that covers the Mulanje area. Its growers, nearly 8,000, are currently selling their green leaf to Eastern Produce and Lujeri estates. The Msuwadzi Smallholder Tea Growers Association covers the Thyolo area and sells to Conforzi, Eastern Produce, Satemwa and Zoa and estimates membership of more than 1,300 farmers. The Chisunga Smallholder Tea Growers Association numbers more than 300 growers and sells its green leaf to Makandi's Chisunga factory. The organisation of the Thyolo associations is similar to Sukambizi (see Figure 1 below).

With the smallholder tea factory (MATECO/STC) in Mulanje now closed down completely after several years of low production, inefficiency and mismanagement, including delays of up to six months in paying smallholders for green leaf, virtually all smallholder tea growers have shifted to selling their green leaf to the estates. Most of the estates surveyed reported that they have had out-grower programmes since 2002/03.

[6] *The Smallholder Tea Sub-Sector in Malawi: New Strategy for Development*, National Smallholder Tea Development Committee, November 2005.

Figure 1 Organisation of Smallholder Tea Growers

Source: Adapted from *IFC Tea Sector Supply Chain Development Project Proposal*, July



2005.

3.1 Credit Supply

3.1.1 Financing for Existing Growers through Estates[7]

The estates are the only value-chain actors currently extending credit to smallholder tea growers and this credit is currently only being extended to existing growers already producing green leaf.

The provision of credit by the estates is closely interlinked with two critical functions. The first is the provision of extension services, including monitoring of and technical guidance in crop production, to ensure quality and quantity of green leaf produced. The second is the purchase of green leaf by the estate that is providing the extension services and credit to the smallholder. This enables the estate to deduct loan payments from smallholder green leaf monthly proceeds as well as to capture sales from the smallholders in whom they are investing by providing extension services.

[7] This section expands upon information first presented in *Private Sector Sources of Finance in Rural Areas*, Kadale Consultants Ltd, February 2006.

Estate Smallholder Programmes

Although there are variations in the programmes from estate to estate, the general principles are the same:

Smallholders have traditionally approached the estate with whom they would like to work, typically the closest. In some cases, the estate asks the grower to provide a letter of referral from their block or association stating that the farmer is a tea grower in good standing.

The smallholder signs a contract with the estate (annually, every three years or open-ended depending on the estate) in which the smallholder agrees to:

1. Sell his green leaf to the estate;
2. Supply green leaf of a specified standard, with the estate having the right to reject poor quality leaf (damaged, burnt, over withered, etc.);
3. Transport green leaf to the designated collection point in his area for pick up by the estate; and
4. Have up to 50% of his green leaf earnings deducted from monthly payments, to recover any credit extended by the estate, e.g. for fertiliser provided to the smallholder.

At the same time, the estate commits to buying the tea from the smallholder at the industry agreed rate, which is updated periodically by negotiation between the estates and grower representatives.

Then, estate staff visit the smallholder's plot to assess the current state of the crop and estimate production. Data on the field size (hectares), number of bushes, quality of bushes and level of management are taken. All of the estates surveyed maintain some type of record or database on their smallholders. This data forms the basis for estimating both individual farmer and overall smallholder green leaf production as well as for calculating fertiliser requirements.

During the season, the estate provides extension services to the registered smallholders. As the smallholder land is normally in geographic proximity, often on the perimeter of estate land, the estate encourages the smallholder to follow the same schedule and practices the estate uses on its land, such as timing of fertiliser application, weeding, pruning, etc. The estate also sends selected smallholders to the Tea Research Foundation for courses. These farmers are then responsible for disseminating information to the others.

Once the tea is plucked, the estate collects it at appointed days/times from the designated collection points and transports it to its factory for processing.

Loan Methodology

All credit extended by the estates is in-kind, the most common being fertiliser. In this growing season, based on data reported, 97% of credit extended to smallholders is for fertiliser. Only one estate reported extending plant material for infilling on credit as well, which makes up the remaining 3% of credit provided. Some of the estates make planting material, pruning knives and protective clothing available to the smallholders, selling these items at cost on a cash basis.

Fertiliser is usually distributed in November or December at the start of the main cropping season. Estate staff (out-grower manager, estate manager) calculate the amount of fertiliser needed based on the smallholder's plot size (# of bushes/ground cover) and past production. Most smallholders take fertiliser at the level recommended.

It is important to note that fertiliser recommendations are based on the previous production level of the land, not necessarily its potential. This may tend to maintain the status quo.

However, as businesses, the estates are only able to disburse credit at a level that they know the season's production will be able to repay. As well, fertiliser is only one factor in production and increasing the level of fertiliser will not single-handedly guarantee increased production. Other factors including weather conditions, farm management practices, number of bushes and percentage of ground cover, etc. also play a role in the actual production level.

The fertiliser loan is recovered throughout the plucking season after a one to two month grace period, usually starting with the first green leaf sales in January and continuing through May-June or until the loan is recovered. Farmers are paid monthly within specified timescales, with the scheduled loan repayments deducted at up to 50% of the farmer's earnings per month. A simple statement of account is provided.

None of the estates charge interest on the loans. Some estates recover a proportion of the administration and transport costs as a handling fee, although the cost of financing is not factored in. Among those surveyed, two estates sold the fertiliser at cost (adding no handling fee). One estate added MK 15 per 50-kg fertiliser bag and one estate added a 15% handling fee. It is unclear what the true cost of handling is and whether these amounts are realistic. In most cases, it does not appear that the true cost of handling has been costed in and recovered.

Default is reported at less than 5% and can only really occur if the smallholder reduces or ceases production for some reason (death/illness, catastrophic loss). Effectively on-time repayment is therefore greater than 95% as all payments are deducted monthly at source. Side selling was not reported as a problem by any of the estates. This is mainly because tea needs to be collected and processing commenced within the same day, so it is difficult to enter into side-selling especially as it is a regular transaction not a one time sale (as occurs with crops like tobacco or cotton).

A smallholder can only apply for a fertiliser loan in the following year if the total credit amount has been recovered, thereby encouraging and incentivising full repayment.

Variation in Loan Methodology

One significant variation in loan methodology between the estates was observed. Based on an industry agreed practice, all smallholders are eligible to receive a bonus on every kilogram of green leaf sold. The amount of the bonus is agreed to by the industry collectively at the end of each season once sales are realised. Most estates pay out this bonus in cash. However, one estate's practice is to apply the bonus earned by the smallholder to their cost of inputs for the next season, thereby significantly reducing the amount of credit required. A second estate occasionally follows this practice as well, depending on the size of the bonus and desire of its smallholders in a given season.

The smallholder programmes with the estates mark a big turnaround from the prior situation where the smallholders were required to sell to the Smallholder Tea Company (STC) for processing at the smallholder MATECO factory. Although this also ran a limited input credit scheme, the main problems for smallholders were that the leaf was not being regularly collected in all areas and the smallholders were not being paid until many months later, if at all by the end. Many simply stopped plucking and let their bushes run wild.

Government attempts to revamp the smallholder company foundered when it was not provided with the necessary working capital to be able to buy leaf and thus could not operate effectively, as smallholders were not willing to provide tea without a sufficient prospect of being paid. Smallholders then negotiated in their association blocks with different tea estates for purchase of their leaf. The estates saw that there was a need to rehabilitate the tea bushes for many growers, which had been neglected in many cases due to the lack of a market. This led to the design and offering of an integrated input and extension package combined with a guaranteed market. This arrangement has reportedly worked well by all parties.

3.1.2 Total Smallholder Grower Financing

On an aggregate level, a total of MK 39.6 million was extended as in-kind credit to approximately 8,500 smallholder tea growers during the current 2005/6 season.

Table 4 Lending to Smallholder Tea Growers by Estates: 2005/6 Growing Season

Type of Loan	# of Borrowers	Average Loan Size	Approx Aggregate Value
In-Kind Fertilizer Loans	8,473	MK 4,544	MK 38,500,000
In-Kind Plant Material Loans (Subset of Above)	325	MK 3,385	MK 1,100,000
TOTAL	**8,473**	**MK 4,674**	**MK 39,600,000**

Source: Estate summary data as reported by 5 of the 6 respondents that work with smallholders: Eastern Produce, Lujeri, Makandi, Satemwa and Zoa.

However, it is important to state that the level of credit extended varies considerably from estate to estate. The estate that applies its smallholder bonuses earned from the previous year as a credit to purchases of fertiliser for current season has the lowest average loan size for that reason. The average loan size between estates ranges from MK 1,600 to MK 14,000. This is due in part to variations in the average plot size of their smallholders that range from 0.22 to 0.53 ha. Smallholder yields, as projected on an estate to estate level, range between 1,100–1,700 kgs Made Tea per hectare. Each estate follows its own practice in terms of calculating fertiliser requirements, estimating production and establishing the level of credit risk they are willing to accept as a company.

The estates with the lowest number of smallholders (up to 325) extend a larger average loan for their growers at the upper end of the scale presented above. This also results in a higher average credit load for their smallholders estimated at between 30-54% of projected average smallholder's income. The other estates have a lower average credit load for their smallholders estimated at between 8-30% of projected average income. This disparity suggests that there is scope for increased absorption of credit by smallholders as there are no reported difficulties in repayment by estates extending the highest levels of credit compared to those extending the lowest levels of credit.

Otherwise, the current system and loan methodology established between the estates and smallholders is strong and has a beneficial symbiosis. The smallholders are provided with a reliable local market, timely payment, access to credit and extension services, while the estates are able to buy quality green leaf, utilise excess factory processing capacity and be assured that loans can be recovered through direct deduction on purchase of green leaf from smallholders.

3.2 Credit Demand-Supply Gaps

3.2.1 Financing for Existing Growers

Additional working capital was established as a priority need among the smallholder representatives surveyed.

Leaders of the smallholder tea associations expressed satisfaction with the current programmes and partnerships with the estates and felt that this understanding was shared among their members. At the same time, they felt there was need for additional financing and/or support in several areas, namely:

1. Plant material to in-fill existing fields and expand their tea growing area, estimated at up to 50% of a smallholder's plot;
2. Additional fertiliser when the plot conditions, including the farmer's demonstration of proper management techniques, justify it;
3. Pruning knives and protective clothing; and
4. Cash loans whether for working capital to cover tea production costs, such as casual labour, for non-tea related enterprises or personal needs.

Estates acknowledge that these needs exist and have been able to assist on a limited basis with provision of plant material[8] and tools sold at cost, but for the most part, only a cash basis. From a business perspective, they are not willing to extend credit beyond their ability to be repaid through green leaf sales or to front additional working capital that they must divert from other activities or borrow at commercial rates. The availability of inputs may therefore depend partly on the individual estate's availability of finance.

While smallholder tea growers will be able to benefit from additional credit, there is also a risk that some may become overextended, borrowing beyond their ability to repay and potentially losing all income to loan repayments. In short, the financing needs of each grower need to be considered individually. In practice, the estates are probably the best placed organisations to determine this capacity.

3.2.2 Financing for New Growers

Financing for new growers was identified as the second critical need by the smallholder representatives. In relation to the world market, Malawi is a relatively small player – although it is the second largest in Africa, it produces less than 2% of world tea production and as such the world market could easily absorb additional green leaf produced by an increase in smallholder production (which itself only represents 7% of Malawi's production). All of the estates surveyed are looking for additional green leaf to process. The estates would handle this additional green leaf through existing excess capacity at their factories and in some cases by development of new factories, as the production warrants it.

Since commercial tea estates do not have idle land to expand tea growing, increases in tea area can only come from smallholders. Soils in many areas of Mulanje and Thyolo Districts are degraded or are highly susceptible to degradation and erosion. Many of these areas are not suitable for food crops such as maize. The planting of tea offers an economic alternative for food security, against environmental degradation and potential income for smallholder growers. Over 3,000 new farmers in Mulanje and Thyolo have shown interest in growing tea.

Smallholder land for tea expansion is also available in Nkhata Bay district in the Kawalazi Valley. Farmers in the area are interested in growing tea on 1,500 hectares of virgin land next to Kawalazi Estate Company.

New growers face the same financing needs as existing growers, but on a much larger scale, in particular with regards to their requirements for planting material and the costs of initial land preparation.

The main challenge to supporting the development of new growers is that they will not realise an income stream from their crop for three seasons when the bushes are mature enough to produce green leaf. Even then the quantities will not be fully economic. It is believed by the smallholder representatives that these new growers would not have

[8] Only one estate provides plant material on credit.

sufficient resources from other activities to meaningfully service any loans received until they begin selling sufficient green leaf produced from the new bushes to cover operational costs.

This presents a gap that not only estates, but also commercial banks and microfinance institutions report they are unlikely to fill as they cannot tie up capital with no return whilst the bushes mature.

Possible solutions will be presented in Section 4.

3.2.3 Financing for Nurseries

The establishment of sustainable nurseries providing a reliable, quality supply of seedlings is critical to meeting the planting material needs mentioned above for both existing and new growers.

All the estates currently produce their own planting material for estate purposes and often have surpluses (or plan surpluses) that they make available for sale at cost to smallholders. However, when there are shortfalls or the estates have increased need for their own planting material, there is no outlet for the smallholders. Without external financial support, the estates are not able to produce seedlings at the level the smallholders require.

A programme, with funding from the European Union STABEX fund, was developed which contracted selected estates and local enterprises to produce quality planting material for distribution at a subsidised cost to smallholders, although a credit component was not included. Several estates began expanding their nurseries and started growing seedlings for this purpose. However, with STABEX funding at a national level recently suspended (not linked to the tea activities) pending review and restructuring, this project is now on indefinite hold.

3.2.4 Other Smallholder Grower Needs

Additional smallholder needs are presented below, but represent projects that are at the conceptual level or require intervention by the Government of Malawi (GoM) before they can be implemented. Access to credit does not represent the binding constraint at this time, but may become a requirement in the future.

Long-Term Smallholder Tea Development Project/s

The National Smallholder Tea Development Committee is currently advocating to the GoM for:

a) the restructuring of the Smallholder Tea Growers Trust Deed under which ownership of the MATECO smallholder tea factory currently rests; and
b) the transfer of the factory and all its assets to the new Trust (similar in structure to the Mzuzu Smallholder Coffee Farmers Trust) through the establishment of a National Smallholder Tea Development Agency.

An extensive process lies ahead involving various government ministries and agencies. There will also be a considerable need for financing, probably including outright grants to the new entity to provide it with base capital. It is not yet clear whether the government shares the proposed vision and if so, how long this restructuring process will take to lead to fruition.

Nevertheless, smallholder leadership remains positive that the proposal will ultimately move forward. At that point, financing gaps may present themselves specifically as relate to rehabilitation of the factory equipment and start-up working capital to make the MATECO factory operational. Until this matter is progressed at a political level and a decision is made and implemented, there is little that can be addressed in this study and process.

Roads Network and Transportation of Smallholder Green Leaf

Both smallholders and estates mentioned the poor state of infrastructure and particularly roads and bridges as a constraint in the development of the tea industry, especially for smallholders. Lack of adequate roads prevent some areas from being fully developed for tea growing, significantly raise the cost of production (higher transport costs, vehicle maintenance, etc.), reduce the quality and ultimately the value of the tea because of the increased transport times from plucking to processing. While not a direct credit need for the smallholder, this issue should be considered as an important area for government and/or donor support that will enhance smallholder returns and open up new areas for tea development.

Due to the challenge of transporting smallholder green leaf, a few respondents have proposed the development of micro, small and medium enterprises (or smallholder association-run entities) that could handle transport of green leaf from the smallholders to the tea factories. However there were also questions raised about whether this could be done in a cost effective manner, considering the high upfront cost of the assets (vehicles) as well as the high maintenance and working capital requirements.

Transport of smallholder green leaf is expensive for the estates and an area that some might prefer to handover. But the estates do have the economies of scale in transport due to their own needs which might otherwise prevent the task from being viable. As well, some expressed concern that vehicles intended for this purpose might be diverted to other more profitable ventures such as public transportation. At this point, this concept has not yet been established as a clear need, but remains an idea that could be further explored by the sector, if warranted.

4 Key Findings

4.1 Addressing Credit Gaps and Financing Needs

4.1.1 Commercial Producers/Processors

Based on the information reported by the estates surveyed, their primary financing gap is longer term financing for capital and development expenditure projects. Although the value of this gap was difficult to quantify, three estates provided some approximate figures based on their capital/development expenditure plans over the next three to five years. In aggregate the financing need totals between $5-6 million. On a sectoral level this figure may be estimated at between $6-10 million. This does not necessarily mean the entire projected amount would be required at once, but needed in tranches for projects over this period. Estates commented that a loan term of between 5-8 years would be desired, ideally with a six-month grace period (interest payments only) followed by quarterly or annual payments.

Considering the current financial sector environment in Malawi, the local commercial banking sector needs to review its willingness to lend longer term. In some cases there are policy constraints within the banks on lending beyond the short-term period. The wider environment, in which banks have lent to government via Treasury Bills, has reduced the attractiveness of commercial lending for many years. However, with the drop in base rates and real interest rates in the last two years, and the reduction in the T-bill rates due to reduced government appetite for borrowing, the commercial banks are becoming more interested in commercial lending.

There is a need for the banks to provide medium and long term loans, especially those denominated in US dollars, as this seems to be the key financing gap for the estates. Another key factor for all parties will be a fall in real interest rates, which are still relatively high and make it hard to earn a sufficient return. There will also need to be greater confidence that if rates do come down, due to the improving macro-economic stability, they will stay low due to continued stability. Unfortunately, this will probably have to be based on government's track record, which although improving is not yet proven.

However, one further option is to link estates and banks with development finance institutions. In collaboration with development finance banks, local commercial banks may be able to act as a local financial intermediary for disbursement of a loan fund or line of credit. There are two main options at present – NORSAD and EIB.

NORSAD

NORSAD[9] is a joint Nordic/Southern African Development Community (SADC) initiative, started in 1991, whose purpose is to contribute to the development of the private sector in SADC countries including Malawi. This is done through direct or indirect financing of companies for start-up or expansion of activities.

NORSAD has no specific industry focus, but rather seeks to support the specific development needs of each of its SADC member countries. NORSAD is already active in Malawi. To date it has funded several projects in tourism and one fish farming project, all directly as it has not yet partnered with a local financial intermediary. However, it is NORSAD's preference to work through local financial intermediaries and one Malawi bank is currently being considered.

[9] NORSAD website: www.norsad.org

Although NORSAD's focus tends to be on supporting traditional small and medium enterprises, they have expressed interest in supporting the tea industry and have expressed willingness to expand their normal company size criteria to a level that would likely accommodate most small and medium-sized tea estates.

Normally, NORSAD financing for projects is between Euro 250,000 and Euro 2.5 million. NORSAD financing should normally not exceed 50 to 60% of the total project cost.

Interest rates on loans depend on a number of factors such as currency of the loan, country risk and project risk. Normally the interest rates vary between 7-11% per annum. A front-end fee of 1% is payable, half at commencement of a detailed project appraisal, and the balance on acceptance of a loan offer. The maximum loan repayment period is seven years with a grace period of not more than two years. A NORSAD loan requires suitable securities, which may include fixed and floating charges on assets of the project, company, mortgages, bank or promoter guarantees, etc.

Banks interested in being considered as a local intermediary for NORSAD and tea companies looking to apply for financing should contact the country representative for Malawi based in Blantyre (see Annex 2 Persons Contacted for specifics).

European Investment Bank

The European Investment Bank (EIB) provides another source of development finance that could be potentially availed to the commercial producers/processors for long term financing of capital and development projects such as rehabilitation/replacement of factory equipment, new factories, irrigation and replanting activities.

Five years ago EIB first expressed willingness to work in Malawi and specifically to support capital development to upgrade facilities, improve processing capabilities, etc. in the tea sector. However, the process stalled when they were unable to secure a local financial intermediary. This left a significant level of disappointment in the sector as several proposals were prepared but could not be progressed.

This year EIB is has expressed renewed interest in Malawi and in particular for the tea sector if the necessary groundwork can be laid and an appropriate local financial intermediary secured. An EIB mission to Malawi is being planned later this year to continue the process.

EIB loan terms vary depending on the country's specific risk factors, nature of the banking sector and needs of the industry for which the scheme is being designed. Typically EIB financing is channelled through a local financial intermediary. Project size usually ranges from Euro 0.25 - 2.5 million with EIB financing up to 50% of the total project cost. For the tea sector, EIB has considered loan terms of up to twelve years. Their base interest rate is linked to the EIB reference rate (around LIBOR) with additional points added based on the country's risk factors and the local financial intermediary margins, so that the lending the tea estates would likely be at or around commercial rates (e.g. around LIBOR plus 4%). EIB has expressed willingness to structure loan repayments linked to world tea prices, for example possibly offering lower interest rates, smaller payments or even deferment in seasons when world prices are low.

The key difficulty with development finance credit is that it has not been perceived as attractive to commercial banks, especially if it reduces their opportunities for lending. Commercial banks in Malawi are not short of (Kwacha) capital to lend, but rather are looking for good margin opportunities relative to other best alternatives such as Treasury Bills. The more likely option is that smaller commercial banks, perhaps as a syndicate might be interested, but based on some management fee package or being able to make a similar margin as on higher interest loans.

4.1.2 Smallholder Growers

Three priority financing needs exist for smallholder growers:

1. Additional seasonal and in-filling financing for existing growers;
2. Medium-term financing for new growers; and
3. Financing for nurseries to source planting material.

Additional Seasonal and In-filling Financing for Existing Growers

Existing growers have a reliable income stream. Through their partnerships with the estates, there is monitoring of and technical guidance in crop production to ensure quality and quantity of green leaf produced. As well, this system allows for direct deduction of loan payments from smallholder green leaf proceeds.

The existing estate-smallholder programmes demonstrate that credit can be effectively extended and recovered through this model. The primary limitation is the scope and scale with which the estates can extend credit.

The estates are not in a position to significantly increase the scope of their lending to smallholders both due to the cost (interest) of their working capital, which is not being recovered and also due to the fact that the estates are not financial institutions, that is their current extension of credit is ancillary to their core business.

Smallholder association leaders have begun to realise that if additional financing is made available, it may come at an additional cost, i.e. interest to be charged on loans. This is something they are willing to consider because they see access to credit as a potential means of smallholder tea development.

Working within the existing system, a microfinance institution in partnership with the estates, may be able to extend and potentially even replace the level of credit currently being extended by the tea estates to meet the additional seasonal financing needs of existing growers.

This study recommends that interested microfinance institution/s should work with interested smallholder groupings and estates to develop and test a scheme of smallholder financing that extends the current finance available to smallholders through the estates. This collaboration is critical to ensure an appropriate credit system is put in place which will factor in all the risks, balance the need for credit for development with the current income stream of the smallholders and ensure the finance costs are sustainable for all parties involved so that the system is commercially viable and can be maintained over the long-term.

In terms of quantifying the financing gap, a starting point may be to increase the average loan size availed to existing growers to MK 10,000 from the current average loan size of less than MK 5,000. This alone represents a 2 ½-fold increase in the aggregate value of smallholder credit from the current level of MK 39.5 million to approximately MK 100 million, and represents a gap of about MK 60 million. An average loan size in this range is currently being offered to about 500[10] of the 9,500 existing growers. This increase could provide the majority of smallholder farmers with access to plant material credit, an increased level of fertiliser credit, as appropriate, and/or potentially allow tools, such as pruning knives to be purchased on credit. It would provide more smallholders with the option to increase their credit load to a level currently received by only about 5% of all smallholder growers, while

[10] Two of the estates have an average loan size of more than MK 14,000. A third estate's average loan size is about MK 8,700. Their smallholder programmes range from 69 to 325 farmers.

still being able to service their loans based on current production. An average loan of MK 10,000 represents an average credit load of about 55% based on current projected smallholder production and income. As infilling is a critical need for smallholders, access to increased credit for plant material and, as appropriate, additional fertiliser would also result in improved productivity and yields so that this credit load would gradually come down as their land's profitability increased.

Medium-Term Financing for New Growers

As outlined in Section 3, the medium-term financing needs of new growers present challenges for the commercial lending sector similar to those that the estates face in this area. To reiterate, the primary challenge is the need to providing financing for at least three years before the new grower starts producing sufficient green leaf to make a return and begin servicing the loan.

This may be an area that a microfinance institution could become involved with under certain conditions. For example, for those smallholder farmers with other income streams, a microfinance institution may be able to extend a loan for new tea development that the farmer could service through his other income-generating activities. The ability of smallholder farmers to develop as tea growers could be enhanced by the supply of subsidised plant material from designated nurseries (see below).

In the absence of other income that would cover loan repayments over the three-year period when new tea bushes are not yet producing sufficient green leaf, additional financing support will be required.

For example, if a donor is able to extend a concessionary credit line to the estates or to a microfinance institution acting as a financial intermediary, this may allow extension of loans to new tea growers with an extended grace period (e.g. up to two years) followed by small initial payments that gradually increase as the level of new green leaf production increases.

However, this type of longer term smallholder lending adds additional levels of risk which must be carefully considered and mitigated. Effective, regular monitoring of new tea growers would be integral to ensure tea bushes are planted in the designated area, planting follows recommended practices, plots are correctly managed, bushes are not uprooted for subsistence crops due to severe interim need, etc. As well, over this period of time, there is a risk of health problems, even death of the farmer, so that succession of the land and carry over of debt must also occur if the loan programme is to be viable. The close involvement of the estates on the technical issues would be critical to success.

Specific data was not available in terms of the financing gaps to support new grower development, although smallholder representatives expressed that there are more than 3,000 smallholder farmers interested in entering the tea sector in Mulanje and Thyolo alone.

Based on the data available, an illustrative example of the financing gap is presented below. This example is based on an average plot size of 0.33 ha per new smallholder tea grower.

Table 5 Illustrative Example of the Financing Gap for New Smallholder Growers[11]

Approximate Cost for Fertiliser and Seedlings Only: Season 1 Based on a New Smallholder Grower with 0.33 ha Tea Planting Area	
One 50-kg bag of fertiliser @ MK 3,000/bag	MK 3,000
4,000 seedlings @ MK 5/seedling	MK 20,000
TOTAL	**MK 23,000**

Aggregate Cost Based on Same Assumptions		
# of farmers / # of hectares	Total Cost	# of bushes required
750 farmers = 250 ha	MK 17,250,000	3,000,000
1,500 farmers = 500 ha	MK 34,500,000	6,000,000
3,000 farmers = 1,000 ha	MK 69,000,000	12,000,000

As there is no current financing for new growers, the current gap represents 100% of the financing need. Depending on the number of new tea growers the financing gap is estimated at between MK 17 million (for 750 farmers/250 ha) and MK 69 million (for 3,000 farmers/1,000 ha). This estimate is for the costs of fertiliser and seedlings only for season one. It is important to note that the nursery programme would need to be integrated with any financing programme to new growers to ascertain the quantity of plant material that could be reasonably produced by the contracted estates/local enterprises in a given season.

The minimum[12] per season cost of fertiliser for seasons two and three would be between MK 4.5 million (for 750 farmers/250 ha) and MK 18 million (for 3,000 farmers/1,000 ha). This translates into between MK 9 million and MK 36 million for the combined fertiliser cost for seasons two and three. Therefore, the total estimated cost for this three-year programme (fertiliser/seedlings in season 1 and fertiliser only in seasons 2/3) would be between MK 26 - 105 million.

Financing for Nurseries to Source Planting Material

Both estates and smallholders alike agree that the existing nursery proposal (outlined in Section 3.2.3) is viable and provides the best means to ensure that a reliable, quality supply of seedlings is available for existing and new smallholder tea growers.

Estates and local enterprises with proven ability to produce plant material at the required standards would be contracted to produce a given number of seedlings (per specifications provided) by a given time. These “contractors” would be paid market rates for their seedlings so that the initiative can be commercially viable and sustainable beyond any donor supported phase.

At the outset, to stimulate a significant level of development of smallholder tea, especially by new growers, seedlings may be initially sold at a highly subsidised price. Over several cycles, perhaps this subsidy could be gradually reduced and eventually phased out.

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[11] This example is for illustrative purposes only to demonstrate the scale of the financing gap. It is based on planting 12,000 bushes per hectare and applying three 50-kg bags of fertiliser per hectare for the first year. Fertiliser application should scale up in subsequent years based on the plot's specific requirements and the agreed upon agronomic practice. For example, this growing season, existing growers working with the estates surveyed received an estimated seven to thirteen 50-kg bags of fertiliser per hectare.

[12] For illustrative purposes, this has been estimated at six 50-kg bags of fertiliser per hectare at MK 3,000 per bag (inflation costs not factored in). See previous footnote for additional details.

This is an area where targeted support from a development partner over a fixed period would be essential to allow the programme to scale up. Key to a successful project would be a system that ensures the estate/local enterprise nurseries are paid by the project in a timely fashion based on a payment schedule and written contract. Otherwise production of new planting material may cease until payment is received with delays potentially impacting on overall new tea development, for example if a season is lost. As well, as in the current proposal, contracted nurseries must be required to keep comprehensive auditable records regarding the seedlings produced and sold.

As many of the new growers would need access to credit to purchase seedlings, even at a subsidised cost, a well-managed credit programme through an established microfinance institution may need to dovetail with the nursery programme. The contracted nurseries should not be put in the position of managing sales or credit to the smallholders, but should serve as the supply chain for the plant material needed.

4.2 The Way Forward

On Thursday, 22 June 2006, the *Financing Needs of the Tea Sector Workshop* took place at the Tea Association of Malawi offices in Blantyre. 43 participants attended the workshop representing 28 institutions, including producers/processors (estates), smallholder farmers, input suppliers, the financial sector and development partners.

Table 6 Tea Workshop Participants

Tea Workshop Participants		
	Number	
Category	Individuals	Institutions
Estates	10	5
Smallholder Associations	7	3
Input Suppliers	2	2
Banks	8	7
MFIs	7	5
Development Partners	6	4
Other	3	2
Total	**43**	**28**

The workshop was structured in two sessions. The morning session was devoted to the financing needs of the commercial producers/processors, with the afternoon session focusing on the financing needs of the smallholder tea growers. Each session followed the same format. First, the report findings were presented in summary, then a plenary discussion took place during which participant feedback on the report findings was provided. This led to the main focus of each session: identification and discussion of the priority financing needs. Emphasis was placed on identifying potential solutions, key players and next steps required in order to address these priority financing gaps, as presented in summary below.

4.2.1 Commercial Producers/Processors: Workshop Outcomes and Next Steps

1. **Kwacha Loans**: Estates confirmed their reluctance to borrow in Kwacha. As tea is an export commodity, the estates operate as dollar businesses and are uncomfortable taking on the exchange risk of borrowing in other currencies whether Kwacha or other foreign currencies such as Euro. However, the binding constraint with Kwacha borrowing is pricing. The cost of Kwacha borrowing (interest rates) is simply too high for it to be a viable option for long term loans at present. If macroeconomic conditions in Malawi stabilise and the pricing situation improves, a drop in real interest rates may allow estates and other businesses alike to increase their Kwacha borrowing both in terms of value and loan tenure. However it is not just the current cost of borrowing that the lender and borrower look at, but the expectations of interest rates.

2. **Longer Term Forex-based Financing:** The estates that participated in the workshop confirmed that their priority financing gap is access to medium to long-term US $ financing with terms that better meet the needs of the sector (see Section 4.1.1). They estimate that the size of loans would range from $0.5 - 4 million with preferred loan terms from five to eight years, with grace periods and flexibility of payments according to season and prices. This need can be addressed by a combination of increased commercial bank and development financing lending as discussed below.

3. **Flexible Loan Products:** Estates further commented that although financing is needed generally for capital/development expenditure, specific loan purposes and desired terms would vary from estate to estate. In short, they stressed the need for banks to design individual loan products that match the specific needs of each project.

4. **Forex lending:** Banks explained that the persistent forex shortages in Malawi do limit medium term finance based on their own forex deposits, but they can lend in dollars for longer terms based on external lines of credit, which is what the estates are looking for. Several banks indicated that they can meet the loan requirements specified by the estates, such as grace periods, term, variable repayments according to season, etc.

5. **Information Gaps**: Whether regarding leasing, longer term commercial bank financing or the development financing options, both the tea estates and financial sector agreed that there has been insufficient dialogue in the past to share information on the financing options available or to explore solutions to address financing gaps. Rather, there has been a tendency to maintain the status quo on both sides.

6. **More Bank Outreach**: It was concluded that the banks should be proactive in understanding the estates' requirements. Follow-up should take place at the bank-estate level. If a financial institution has information it would like to distribute to the sector as a whole, this can be routed through Kadale Consultants[13] for dissemination. To complement this, a follow-up event to this workshop, such as a finance fair or "meet and greet" might be beneficial to bring together the financial institutions with members of the tea sector and provide a forum for sector level dialogue to continue.

7. **Estate Information Gathering:** Similarly, as one participant commented, this process has demonstrated the need for the estates to also take the initiative with their own bank to discuss what is now being offered, and if necessary to "shop around" to see what other banks can offer.

[13] kadale@africa-online.net

8. Development Finance

a. **NORSAD:** Information about what NORSAD can offer was presented at the workshop. Contacts were established between the NORSAD Country Representative and several interested estates with plans for follow-up on a firm level[14].

b. **European Investment Bank:** The EIB has confirmed its renewed interest to pursue establishment of a long-term US $ facility (up to twelve years) that is designed to meet the specific needs of the tea sector. As the first step in the process, EIB is looking to identify one or more local financial intermediaries with potential interest to move the process forward. It is possible, even preferred, to have more than one bank involved in the deal. Pricing will be determined by a thorough assessment of the risk factors (country, political, project, etc.) as well as the profile of the bank/s and the potential structure of the facility. In general terms, risk sharing would be expected, although EIB can normally take on more of the risk as the tenure of the loan progresses. As well, to provide the necessary commercial incentives, local banks are given a reasonable degree of flexibility in setting their own interest rates, fees and loan structure for on lending to clients[15]. The USAID DMS Project has established contacts with EIB representatives and is available to facilitate the process between EIB, interested local financial partners and the tea sector going forward. The next step envisioned is an EIB mission to Malawi to be scheduled later this year to meet with potential local financial intermediaries to secure interest and move forward with the application process.

c. **USAID Development Credit Authority (DCA) Loan Guarantee Program:** As discussed at the workshop, the DCA Loan Guarantee Program is currently being investigated by the USAID DMS Project for potential application in Malawi to increasing financing flows to agriculturally linked small and medium enterprises (SME).

   The goals of DCA are two-fold:
   - Mobilise private capital to finance economic growth in targeted sectors and geographies;
   - Demonstrate the economic viability of such investments to the local banking sector and to other sources of private capital.

   The DCA programme's aim is to stimulate local commercial banks to increase their lending both to new SME clients and sectors, as well as to existing borrowers who have been previously underserved (e.g. those who may lack sufficient levels of collateral, but are otherwise viable businesses). Among these are clients in the SME and agricultural sectors, as well as micro finance institutions who have traditionally found it difficult to raise finance from commercial banks. DCA gives the USAID Mission the authority to issue loan guarantees to local private lenders covering up to 50% of the risk of qualifying loans.

   Malawian banks are risk adverse especially in regard to lending to new ventures and SMEs unable to meet stringent collateral requirements often amounting to 100% and more of the amount of the loan needed. However, due to dramatic reductions over the past two years in the interest rates paid on government treasury bills coupled with an intensified competitive banking market, banks are looking for ways to diversify their revenue streams and are seeing the SME financial services market to be more attractive.

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[14] See Annex 3: Persons Consulted for the NORSAD Country Representative's contact details.
[15] Client interest rates via an EIB facility are expected to be at or around commercial interest rates.

One common tool utilised under the DCA is called the Loan Portfolio Guarantee which provides financial institutions with partial coverage on a portfolio of loans that they extend to their customers. USAID agrees to share in the risk of a broadly defined category of bank loans with a view toward inducing local banks to extend credit toward underserved sector/s. The credit decision and risk evaluation rests with the local commercial bank. As noted, the bank must assume at least 50% of the risk on each loan. This is a net guarantee meaning that any payments (due to default) made by USAID under the guarantee are net of any recoveries. As well, unlike a development finance credit line, the local bank lends out its own capital (Kwacha or US dollar) and sets the loan terms in accordance with its own lending policies and practices, typically at market rates.

In short, DCA can be used to encourage greater financing flows by both commercial banks and MFIs to all of the tea value chain actors. The DMS Project is currently assessing the viability of implementing a DCA Programme in Malawi and will provide additional information to the tea sector as the process continues.

9. **Leasing:** As reported by survey respondents, leasing is not currently being utilised by the tea sector, but is available for asset financing including generators, irrigation equipment, factory equipment, not just vehicles as is commonly perceived. As a relatively new and small segment of the financial sector, leasing companies are keen to expand their financing base and enter new markets. As a result, they expressed willingness to develop new products and adapt existing products, such as sale and lease back, to better respond to client needs. Again the issue of US $ versus Kwacha lending was raised. Although virtually all leasing is currently done in Kwacha, the leasing representatives indicated that leasing in US dollars is possible. The participants agreed that a lack of information has been a factor in the limited usage of leasing in the tea sector to date. Direct outreach and information sharing by the leasing companies is recommended to better inform the estates about the leasing options available. This is an area for further study.

10. **Credit Line/Insurance for Inputs:** YARA (fertilizer input supplier) shared information with the workshop participants about a new credit rating and insurance programme they are looking to implement. The scheme is offered by a South African-based company called Coface[16]. YARA clients who wish to purchase inputs on credit would have their financials independently assessed by Coface. Coface would then authorise a line of credit to the client and extend insurance coverage to YARA up to this limit. This system would provide protection to YARA and extended trade credit terms, both in duration and size to the client. If payment is extended beyond 30 days a fee of 0.7% per month of the invoice value would be applied. YARA is currently exploring this scheme with Coface to determine whether they will roll it out in Malawi.

The key recommendations for estate financing are therefore:

- That banks meet individually with estates to better understanding their specific medium to long-term financing requirements.
- That banks and leasing companies internally evaluate their US $ lending policies and practices and develop longer term facilities that respond to the estates' needs.
- That leasing companies meet individually with estates to share information about the specific leasing options available and their potential applications in the tea sector.

[16] For more information on the Coface scheme, please visit www.cofaceza.com.

- That estates also take the initiative with their own bank/s to discuss what is now being offered, and if necessary to "shop around" to see what other banks can offer.
- That EIB meet individually with commercial banks to discuss their potential involvement, garner interest and negotiate a loan facility with interested partners, with DMS facilitation if required.
- That EIB meet with one or more estates representing the sector to better inform the process and development of a scheme which responds to the sector's needs, with DMS facilitation if required.
- That the NORSAD Country Representative and interested estates meet individually or collectively regarding the possible utilisation of the NORSAD facility.
- That commercial banks directly contact the NORSAD Country Representative if interested in becoming a local financial intermediary for the facility.

4.2.2 Smallholder Growers: Workshop Outcomes and Next Steps

1. **Strengths of Existing Estate-Smallholder Production & Credit System:** The workshop highlighted the report findings regarding the strengths of the existing estate-smallholder programmes. In this system, the smallholder makes a commitment to sell his green leaf to one estate in exchange for extension services, access to fertiliser credit and a reliable market. In contrast with other sectors, none of the tea estates are experiencing any problems with side selling and, as a result, they consistently achieve high repayment rates (greater than 95%), as repayment comes as a deduction at the point of smallholder green leaf purchase. The only case of default is when there is sickness or death of the farmer resulting in loss of green leaf. The system works well because there are commercial benefits for both sides.

2. **The Opportunity:** However, there is a limit to the amount of credit the estates are willing and able to extend to the smallholders and as a result, there is an unmet credit demand for the majority of existing smallholder tea growers, as confirmed at the meeting. This is particularly so for fertiliser and infilling (plant material). The infilling need is reported to be up to 50% of the existing tea smallholder hectarage. For the fertiliser, the variances in lending between the estates suggest that there is scope for more lending (MK 14,000 lent by some estates, with no differences between repayment rates for those lending the highest amounts compared to those lending the least).

3. **Financial Sector Learning Curve:** Most of the microfinance institutions at the workshop were not very familiar with the structure of the existing estate-smallholder programmes. This process (report and workshop) provides exposure to the financial sector of the opportunities that do exist and highlights that there is a significant opportunity to expand and potentially replace the credit already provided by the estates.

4. **Potential Role for Financial Institutions:** Involvement of a financial partner in the provision of credit could ensure the long-term viability of this type of system and provide a sustainable way for smallholder tea growers to increase their access to credit. Key to this success would be the integration of the financial partner into the existing system. The estates must continue to be involved as they ensure the production quality through extension services, the mode for loan recovery and the market access. In this context, **this is a market opportunity for a financial institution that is worthwhile exploring**.

   Some of the MFIs commented on the smallholders' lack of sufficient traditional collateral (titled land, etc.) which they felt could be a constraint to the extension of smallholder credit. As such, there may be scope for a well formulated credit guarantee scheme, such as the USAID Development Credit Authority loan guarantee programme, which could be utilised by qualifying MFIs for on lending to smallholders. However, others felt that this was not a binding constraint because the structure of the estate-smallholder programmes ensure loan repayment through deduction at the point of green leaf sale, much like a salary loan.

5. **Charging for Financing:** Although the estates have not been reflecting the full cost of the input provision in the loan repayments, including not charging for the financing, the smallholders concurred that any extension of financing, particularly through financial institutions, would require charging of interest to cover financing costs.

6. **Need for Development Partner Support:** The financing of existing growers is an area that is commercially viable right now. As such, the environment is ready for the intervention of a specialist financial provider. On the other hand, the other financing gaps identified, nurseries and new growers (see Section 4.1.2 above), are longer-term interventions that require support from development partners in addition to the private sector.

   In discussing the need for nurseries, the workshop participants acknowledged that the project should be scaled up gradually. The emphasis should be first placed on meeting the seedling needs of existing growers (for infilling and expansion) before expanding the programme to meet the needs of new growers. As the nursery concept is new, it is important to ensure its success by proceeding in stages. In order to rollout a successful new grower programme, the system of supplying seedlings must already be well established and reliable.

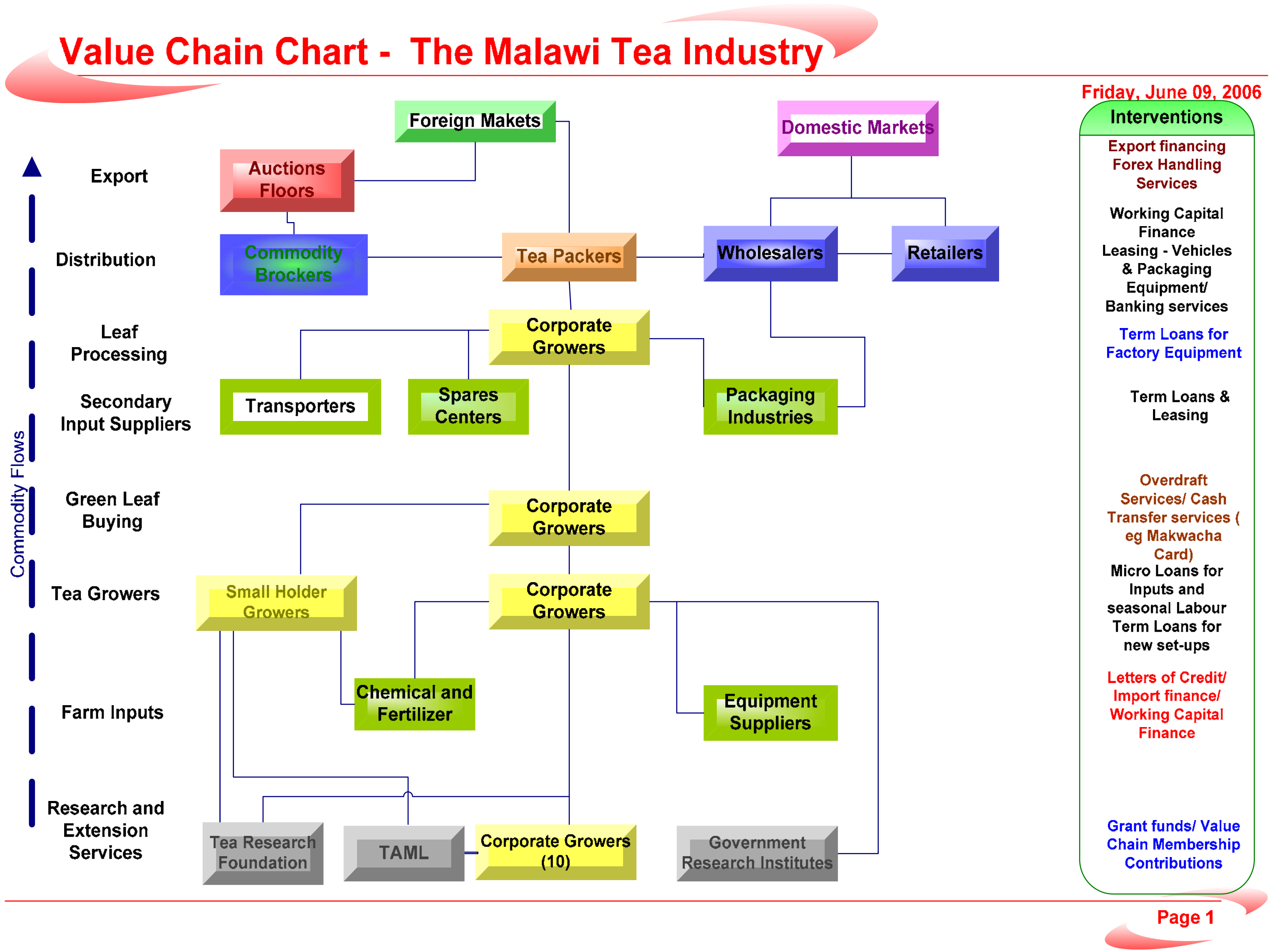
   The European Union has announced its intention to release a Call for Proposals to support private sector development in areas such as smallholder tea. As such, this report recommends that the tea sector submit for consideration its proposal for a pilot nursery programme with an initial focus on meeting the plant material needs of existing growers.

   A nursery programme should be linked with any financial institution/s' credit programme/s (see #4 above) for existing growers so that in addition to meeting smallholder credit needs for fertiliser, credit can also be extended for plant material.

The key recommendations for smallholder financing are therefore:

- That interested financial institutions visit estates and smallholders to determine the viability of and options for an enhanced smallholder credit scheme for existing growers.
- That smallholder and estate representatives further develop the nursery proposal with technical support from DMS/FSJTF and submit to the EU and other potential development partners for funding.
- That smallholder and estate representatives develop a proposal to support new grower activities with technical support from DMS/FSJTF.

Annex 1: Value Chain Chart – The Malawi Tea Industry



Annex 2: Terms of Reference

Demand for and Supply of Credit in Tea and Coffee Sectors in Malawi

Food Security Joint Task Force (FSJTF) Technical Secretariat
USAID Deepening Malawi's Microfinance Sector (DMS) Project

1.0 BACKGROUND

More than 80% of Malawians depend for their livelihoods on rural-based farm, off-farm and non-farm activities. Most microfinance operations and financial services in general are urban or peri-urban focused. When there is microfinance supplied in rural areas, the beneficiaries are usually traders and to some extent farmers involved in the traditional cash crops like tobacco. This situation has limited the ability of farmers in the country to diversify into a variety of other cash crops such as coffee, paprika, and tea.

Micro lending activity through specialised financial institutions is often based on group lending, typically around 10-15 members per group. Drop out rates are reported to reach as high as 50% in some cases and on-time repayment is reported to be very variable and sometimes too low to be sustainable. Concerning loans issued by non-financial institutions such as crop and produce processors, input suppliers and others, few studies have been done that describe the precise credit product, its terms and conditions, and the repayment rates.

The demand and need for financial services, primarily credit but also savings and money transfers, is generally considered very high in comparison to the actual supply from specialised and informal providers that serve Malawi's rural agricultural sectors. The opportunities available in this regard are not known as most lending from microfinance institutions (MFI) is assumed to be for working capital. However it is conjectured that a sizeable portion of MFI loans are used to finance crop production and the weekly repayment terms are being covered from other revenue streams. As mentioned earlier, lending by non-financial institution value chain actors is also not quantified.

In rural areas, the cost of delivering credit and the associated risks of agricultural lending are often perceived to be too high to attract formal financial service providers, particularly since many MFIs are unable to intermediate savings and are thus constrained by inadequate capital for lending. Hence, most MFIs concentrate on urban and semi-urban clients. In this gap between rural financial service demand and formal financing from banks and MFIs, non-specialised financial providers such as input suppliers, producers/processors (including commercial farms/estates), traders and others have extended credit, mostly in-kind, to value chain actors.

A study that quantifies the nature of existing credit demand and supply in specific agricultural sectors would go a long way towards enabling formal credit providers (both specialised and non-specialised financial service providers) to fully understand the opportunities and risks that exist in the sectors. Also, such a study would help to enable credit providers to develop demand-driven products for high potential sectors to increase the financing flows to value chain actors thereby creating growth in agricultural productivity and employment. The services of a consulting firm are therefore required to provide the relevant credit demand and supply data for coffee and tea in Malawi.

2.0 MISSION

2.1 Specific Objectives

The main aim of the study is to gather and make available useful credit demand and supply data that can be used by stakeholders in the tea and coffee sectors to increase the flow of sustainable financial services to value chain actors.

Specifically Kadale Consultants will:

- Quantify the current supply of credit: to smallholder farmers in the tea and coffee sectors in Malawi by producers/processors (including commercial farms/estate growers) and farmer associations; and to smallholder farmers, farmers associations and producers/processors, (including commercial farms/estate growers) in the tea and coffee sectors in Malawi by financial institutions and input suppliers;
- Outline the gaps in supply and demand that exist; and
- Provide recommendations as to how best these gaps can be lessened from the financial sector;

2.2 Results

The study report should include:

- Detailed data on credit currently supplied to smallholder farmers, farmer associations, and producers/processors (including commercial farms/estate growers) in the coffee and tea sectors. Separately by sector, and (where possible, subject to commercial confidentiality) for each firm and/or organisation providing credit, the consultant should provide the following data:
  - A list of the firms and organisations that are currently providing credit, credit guarantees and other financial services to the list above;
  - Volume of credit extended by each supplier;
  - Nature and form of credit by supplier to the sectors (whether in kind, cash etc);
  - Credit terms (term of the loan, payment mechanisms, allowable grace periods, interest rates, processing fees and collateral requirements if any);
  - Profile of credit recipients/borrowers in the sectors (characteristics of supported clientele);
  - Geographical distribution of clients supported; and
  - Experiences and trends seen in the market: repayment rates, defaults and losses. Particular note should be taken of suppliers that have significantly increased or reduced credit activity to the sector over the years with explanations as to why and capturing lessons learned.
- Listing of factors that constrain the supply of credit to each sector;
- An estimate of the credit demand-supply gaps in the each of the sectors; and
- An outline/recommendation of the steps that need to be followed to expand credit to the sectors, including the players that would be responsible for the implementation of the strategies and their respective roles.

2.3 Activities

The following activities will be implemented to achieve the above-mentioned results:

- Prepare questionnaire(s) to be used for collecting the data from suppliers of credit in the given sectors;
- Identify MFIs and commercial banks, non-bank financial institutions and input suppliers that provide credit to the given sectors;
- Prepare a detailed work plan to be approved by FSJTF/DMS;
- Administer the questionnaires to the identified institutions;
- Conduct initial analysis of the data for the determination of the demand-supply gap and the factors that have been limiting supply;
- Undertake a mid-point briefing with the client to get feedback;
- Outline/recommend steps that need to be followed to expand credit to the sectors, including the players that would be most interested and able to implement;
- Draft a report that will give detailed information on credit supply and demand in the given sectors as described in Section 2.1 and 2.2 above;
- Facilitate a workshop to discuss the findings with interested stakeholders leading to the identification of what next steps are required to improve the flow of finance into the sector; and
- Prepare a Final report.

Annex 3: Persons Consulted

KEY:
Source Contacted
Source Contacted & Workshop Attendee
Workshop Attendee

Category	Organisation	Location	Contact Person/s	Position	Office	E-mail
Tea	Eastern Produce	Mulanje	Mr Rick Tilley Mr Daron Naidoo Mr R Palichina	Managing Director Technical Dev't Mgr Extension Mgr	01 466377	r.tilleykwacibi@africa-online.net; dnaidoo@easternproduce.co.mw;
Tea	Kawalazi Estate Co. Ltd. (Global)	Nkhotakhota	Mr Dick Mtegha Mr Kamran Mohsin	Financial Controller Operations Mgr	01 930082 01 334446	dmtegha@kawalazi.com kmohsin@kawalazi.com
Tea	Lujeri Tea Estate	Mulanje	Mr Jim Melrose Mr Craig King Mr Austin Changozi	Managing Director Finance Director Outgrower Mgr	01 460009 01 460266	Jim224@africa-online.net fdlujeri@africa-online.net
Tea/Coffee	Makandi Tea & Coffee Estate Ltd (Global)	Thyolo	Mr Laurence Lawrence Mr Farrukh Parvez	Gen Mgr/CAMAL Chair Deputy Gen Mgr	01 471001 01 916870	lawitte@africa-online.net; fparvez@makanditea.com
Tea/Coffee	Namingomba Tea & Coffee Estate	Thyolo	Mr Stephen Mullan	Managing Director	01 473300	namingomba@malawi.net
Tea/Coffee	Satemwa Tea & Coffee Estates Ltd	Thyolo	Mr Rob Emmott Mr Alexander Kay Mr Cathcart Kay	 General Mgr Financial Mgr	 01 473233 01 473500	 robemmott@malawi.net; ack@satemwa.com
Tea	Tea Association of Malawi (TAML)	Blantyre	Prof Lewis Mughogho Mr Gilbert Chirwa Mr Sangwani Hara	Smallholder Tea Desk Officer TAML Chief Executive TAML Chair	01 671182	lkmugho@globemw.net; taml@malawi.net; sjhara@africa-online.net
Tea/Coffee	Zoa Tea Estate	Thyolo	Mrs Janet Doran Ms Rica B David	Managing Director VSO	01 479102 09 288093	zoateaestate@malawi.net
Tea SHs	Chizunga Smallholder Tea Growers Association	Thyolo	Mr Dines Elisha	Chairman	Via Mr Khoza	
Tea SHs	Msuwadzi Smallholder Tea Growers Association	Thyolo	Mr Wilfred Kasitomu	Chairman	09 634614	
Tea SHs	National Smallholder Tea Development Committee	Mulanje	Mr Armstrong Khoza	Chairman	01 467041	khoza@malawi.net
Tea SHs	Sukambizi Smallholder Tea Growers Association	Mulanje	Mr Aubrey Tungama Mr M Chedwe Mr DB Kulisewa Mr Stephen Lazaro	Chairman	Via Mr Khoza	

Category	Organisation	Location	Contact Person/s	Position	Office	E-mail
Banks	First Merchant Bank Ltd (FMB) Leasing & Finance Co. (LFC)	Blantyre	Mr S Srinivasan Mr Sean O'Neill Mr George Kamvuluvulu	Deputy MD/General Mgr Director Marketing Mgr	01 820352 01 821942 01 835713	s.srinivasan@fmbmalawi.com; sean@cfmalawi.com; g.kamvuluvulu@fmbmalawi.com
Banks	Indebank Indefund	Blantyre	Mr Alex Chigwale Mr James Undi Ms Julia Mvula	Head of Credit	01 820055	achigwale@indebank.com; indefundbt@malawi.net
Banks	Loita Investment Bank Ltd	Blantyre	Mr Brian Kampanje	Assistant Credit Mgr	01 820437	bkampanje@mw.loita.com
Banks	Malawi Savings Bank (MSB)	Blantyre	Mr George Sibale	Microfinance Manager	01 825111	sibaleg@msb.mw
Banks	National Bank of Malawi, Corporate Banking	Blantyre	Mr Harold Jiya	Sr Corporate Banking Mgr	01 823117	hjiya@natbankmw.com
Banks	National Bank of Malawi, Asset Finance	Blantyre	Mr Oswin Kasunda	Head, of Asset Finance	01 823670	okasunda@natbankmw.com
Banks	NBS Bank Ltd	Blantyre	Mr Weston Kusani	Head of Credit	01 875 910	wkusani@nbsmw.com
Banks	NedBank	Blantyre	Mr Joseph Saiti	Deputy Head of Credit	01 821218	jsaiti@nedbank.co.mw
Banks	Stanbic Bank, Corporate Banking	Blantyre	Mr Welkam Phiri	Account Executive	01 820144	wphiri@stanbic.com
Banks	Stanbic Bank, Vehicle & Asset Finance	Blantyre	Mr Hannock Ng'oma	Account Executive	01 821326	hng'oma@stanbic.com
Buyers	VanRees	Blantyre	Mr Maganga	Tea Manager		
Donors	EIB	Belgium SA?	Ms Isabel Costa Mr David White	Luxembourg office Head of regional office		costai@eib.org; white@eib.org
Donors	EU: Rural Dev't & Food Security (STABEX, APIP)	Lilongwe	Mr. Raniero Leto Ms. Tomaida Msiska	Programme Officer	01 773199	raniero.leto@ec.europa.eu; tomaida.msiska.eu.europa.ec
Donors	Food Security Joint Task Force Technical Secretariat	Lilongwe	Mr Andrea Pozza		01 789131	andrea@techsec.malawi.net
Donors	USAID Deepening Malawi's Microfinance Sector (DMS) Project	Lilongwe	Mr Victor Luboyeski Mr Ezikiel Phiri Ms Teresa Maru	Director	01 773863 01776127	vluboyeski@dmsproject.net ephiri@dmsproject.net tmaru@dmsproject.net
Dev't Finance	NORSAD	Blantyre	Mrs Agnes Valera		01 824301	ajv@presscorp.com
Inputs	Chemicals and Marketing	Blantyre	Mr Patrick Khembo	Managing Director	01 670600	pkhembo@chemicals.co.mw
Inputs	Farmers Organisation	Blantyre	Mr Robert Renshaw		01 673088	farmorg@africa-online.net
Inputs	Yara Malawi Ltd	Lilongwe	Mrs Victoria Keelan	Managing Director	01 710181	victoriakeelan@eomw.net

Category	Organisation	Location	Contact Person/s	Position	Office	E-mail
MFIs	Concern Universal Microfinance Operation (CUMO)	Blantyre	Mr Bola Garbadeen Mr Ken Nyirenda		01 223604	cumo@malawi.net
MFIs	Development of Malawi Enterprise Trust (DEMAT)	Blantyre	Mrs Chirwa Mr Charles Sambani		01 642982	demat@malawi.net
MFIs	Ecumenical Church Loan Fund (ECLOF)	Blantyre	Mr Andersen Kamwendo Mr Barnabas Tauzi	Operations Mgr	01 833053	eclofmw@globemw.net; eclofmw@africa-online.net
MFIs	Finance Trust for The Self Employed (FITSE)	Lilongwe Blantyre	Mr Albert Thindwa Mr Alfred Lungu	CEO Operations Officer	01 759471	albert_thindwa@wvi.org
MFIs	Foundation for International Community Assistance (FINCA)	Blantyre	Mr Dickson Mainjeni	Agricultural Advisor	01 822256	
MFIs	Malawi Rural Finance Company (MRFC)	Lilongwe	Mr S. Murotho Mr E Kanongola	General Mgr Assistant Operations Mgr	01 753133 01 821625	mrfc@mrfc.co.mw; eliaskanongola@yahoo.com
MFIs	Malawi Union of Savings and Credit Cooperatives (MUSCCO)	Lilongwe Blantyre	Mr S. Kadzola, Mr F. Nyangulu	CEO Acting Operations Mgr	01 756000 01 820917	skadzola@muscco.malawi.net; fumbanin@yahoo.com
MFIs	National Association of Business Women (NABW)	Blantyre	Ms M. Malunga Mrs C. Chikaonda		01 677812	
MFIs	Opportunity International Bank of Malawi (OIBM)	Lilongwe	Mr Rodger Voorhies Mr Luckwell Ng'ambi Mr Steve Mgwadira	Chief Operations Officer Head, Planning & Marketing Head, Banking Operations	01 758403 01 758888 01 758888	rvoorhies@oibm.mw lngambi@oibm.mw smgwadira@oibm.mw
MFIs	Pride Malawi	Blantyre	Mr Cornelius Majawa	Managing Director	01 833453	cmajawa@pridemalawi.com
MFIs	Project Hope	Blantyre	Mr Timothy Kachule	Country Representative	01 644991	projecthopemw@sdnp.org.mw
MFIs	Small Enterprises Development Organisation of Malawi (SEDOM)	Blantyre	Mr S. Kondowe Mrs Mang'anda	General Mgr Operations Mgr	01 824535	skondowe@sdnp.org.mw; tmanganda@sdnp.org.mw
MFIs	The Hunger Project	Blantyre	Mr Rowlands Kawotcha	Managing Director	01 644699	hungerproject@hungerproject.malawi.net

Annex 4: Questionnaire Templates

Demand for and Supply of Credit in Tea and Coffee Sectors in Malawi
QUESTIONNAIRE: Commercial Producer/Processor

NOTE: Any financial information provided shall be kept confidential. If disclosed, it is on agreement that information provided at an individual institutional level will not be shared publicly. However, information from individual institutions will be aggregated to draw conclusions on a sectoral level which will be made available to you and other interested stakeholders.

The main aim of this study is to increase the flow of sustainable financial services to farmers, processors and other industry players.
****

Part A: General Information

Name of firm:

Contact person (name & position):

Tel (office): Cell: Email:

What sectors does your firm work in? (√ all that apply) What % of your gross sales (or turnover) does each account for?

□ Tea ___% □ Coffee ___% □ Other (please list) ___%:

If both TEA and COFFEE, please disaggregate responses by sector to the extent possible.

Tea	2005/6 growing season
Estate: # of hectares under tea Estimated production (mt) Made Tea	
Smallholders/out-growers: # of farmers # of hectares under tea Estimated production (mt) Made Tea	
Estimated average price/kg Made Tea Approx 5 kgs Green Leaf = 1 kg Made Tea	

Coffee	2005/6 growing season
# of hectares under coffee # of bushes, if avail.	
Estimated production green beans (mt)	
Estimated average price bulk green beans sold/kg	

Company's Structure/Ownership: Describe if privately owned, local business or owned by parent company (if so who), # of years in business, etc.

Part B: Financing Sources, Needs and Gaps

1. How do you finance your business?
   a. Own capital and/or equity/loan from parent company? □ YES □ NO
      If YES, what percent of your financing comes from self financing? ___%
   b. Credit:
      i. Loans – overdraft, term loans, medium term, mortgages etc.
         □ YES □ NO

      If YES, please list each facility separately.
      Please specify the loan's purpose, amount (Kwacha, USD or USD fully convertible), term (# of months or years), from when to when, from which bank, interest rate, repayment schedule, etc.

ii. Leasing □ YES □ NO

If YES, please list each facility separately.

Please specify the loan's purpose, amount (Kwacha, USD or USD fully convertible), term (# of months or years), from when to when, from which bank, interest rate, repayment schedule, etc.

iii. Trade credit from suppliers □ YES □ NO

If YES, please describe terms normally received (e.g. Net 30 days, Net 90 days, interest rate charged), value of credit extended and primary purposes.

c. Other sources?

2. With which banks do you currently work?

3.

For the current financial year, what is your company's total:	Specify whether in Kwacha or USD
Turnover projected?	
Capital Expenditure budget?	
Development Expenditure budget (if separate from CapEx)?	
Working Capital budget?	

CAPITAL EXPENDITURE: Breakdown by major category, e.g. buildings-factory (new), buildings-other commercial, factory equipment, irrigation equipment, other equipment, social works (staff housing, schools, clinics, ambulances, etc.), tools/sprayers, vehicles, other infrastructure (such as boreholes, fencing, etc.), other-specify. **If an expenditure is solely for tea or for coffee, please indicate.**

Expenditure category	Amount	What is the source (self-financed, loan, other-specify)? If loan, specify which?	Is there a financing gap?* How much? For what?
TOTAL CAPEX			

*Details of financing gaps can be provided under question #4 below.

DEVELOPMENT EXPENDITURE (if any): **If an expenditure is solely for tea or for coffee, please indicate.**

Expenditure category	Amount	What is the source (self-financed, loan, other-specify)? If loan, specify which?	Is there a financing gap?* How much? For what?
TOTAL DEVEX			

*Details of financing gaps can be provided under question #4 below.

WORKING CAPITAL: Breakdown by major category, e.g. inputs, labour, transport, fuel, social works, smallholder development, other-specify. **If an expenditure is solely for tea or for coffee, please indicate.**

Expenditure category	Amount	What is the source (self-financed, loan, other-specify)? If loan, specify which type?	Is there a financing gap?* How much? For what?
TOTAL WORKING CAPITAL			

*Details of financing gaps can be provided under question #4 below.

4. Does your firm have financing needs/gaps, which are not currently being met? If YES, please describe □ YES □ NO
.
   a) Financing for what purpose:
   b) Type of financing (lending, e.g. overdraft, short/mid/long-term loan, lease, trade credit, etc.):
   c) Amount needed:
   d) Loan term needed (# of months/yrs):
   e) Other key terms needed (interest rate, repayment schedule, grace period, etc.):
   f) If for onlending/microloans to smallholders, # of borrowers:

Part C: Current Lending, i.e. to Smallholders
Is your firm a credit provider (lender: cash or by providing inputs), i.e. to smallholders? If NO, please skip this section. □ YES □ NO

Please provide the following information for each credit type/scheme:
Use additional paper, as needed, for each credit scheme.

Purpose of Finance (Type of Credit):
E.g. inputs (fertiliser/chemicals, plant material, etc.), working capital, CapEx (tools/equipment), other

1. Provide description of scheme:
2. Borrower/s (individuals or if association, please specify which):
3. Total # of borrowers:
4. Total (aggregate) amount of credit extended per season:
5. Credit methodology
   a. Smallholder identification process and qualification criteria (who can qualify?):
   b. Application and screening (who gets/who does not) process:
   c. Disbursement process (cash or in-kind):
   d. Collection process (how are repayments made):
   e. Default process:

6. Credit terms
   a. Term of loan (# of months, years):
   b. Typically from when to when (month x to month y):
   c. Loan size range (minimum to maximum):
   d. Average loan value:
   e. Allowable grace period
      Capital:
      Interest:
   f. What loan value includes in addition to inputs – (transport, admin charges etc.) Specify type and amounts:
   g. Interest rate (simple, fixed, compound) and period (per month, per year?):
   h. Is collateral required? □ YES □ NO
      If YES, what type?
   i. Is guarantee required? □ YES □ NO
      If YES by whom?
7. Geographical distribution of clients supported:
8. Repayment rates (on-time payments of interest and capital, portfolio quality if measured):
9. Defaults and write-offs/losses:
10. Is there additional unmet demand for this type of credit? □ YES □ NO
    If YES, what is wanted: larger size loans, more loans to additional borrowers not currently being serviced, different terms, etc.?
11. Or is this type of credit under-utilised? □ YES □ NO
    If YES, what are reasons, e.g. interest rate too high, amount of loan too small/too large, loan doesn't meet needed purpose?

Part D: Miscellaneous/Other Info

Who supplies your inputs for tea? For coffee?

On standard Trade Credit (Net 30 days) or enhanced terms, if so describe?

Demand for and Supply of Credit in Tea and Coffee Sectors in Malawi
QUESTIONNAIRE: Banks/MFIs

NOTE: Any financial information provided shall be kept confidential. If disclosed, it is on agreement that information provided at an individual institutional level will not be shared publicly. However, information from individual institutions will be aggregated to draw conclusions on a sectoral level which will be made available to you and other interested stakeholders.

The main aim of this study is to increase the flow of sustainable financial services to farmers, processors and other industry players.
****

Name of financial institution:
Contact person (name & position):
Tel (office): Cell: Email:

Does your institution provide financing to the tea sector? □ YES □ NO
Does your institution provide financing to the coffee sector? □ YES □ NO

If both TEA and COFFEE, please disaggregate responses by sector to the extent possible.

1) Type of clients (commercial grower/processor, smallholder assn, buyer/broker, etc)?

<u>Type of clients</u> <u># of clients in each category</u>

2) Below please list the TOTAL AGGREGATE VALUE of financing this agricultural season (2005/6) provided by facility type (e.g. overdrafts, seasonal loans, medium-long term loans, leasing, letters of credit, etc):

Type of Financing	**Tea**	**Coffee**
	(Please specify whether Kwacha or USD)	
Working Capital		
Overdrafts		
Seasonal loans		
Other (pls specify)		
Total Working Capital Lending		
Fixed Assets Term range (# of mos/yrs)? For what purpose (equipment, new factories, vehicles, etc.)?		
Medium-term		
Long-term		
Leasing		
Other (pls specify)		
Total Fixed Asset Lending		

3) Please describe the key terms (interest rate range, loan period, repayment terms, etc.) generally offered for loan facilities offered?

4) Does your institution see opportunities for increased financing in tea? In coffee? What, how, how much, to whom?

5) What is needed to realise these opportunities? Any plans?