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The development potential of anchor enterprise models in Malawi

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Smallholder-centered agricultural development strategies have had limited success in Malawi over the past several decades. Policy makers are now increasingly looking for alternative ways to accelerate agricultural and rural development. One emerging approach involves larger farms or agri-business firms partnering with smallholder farming households, in what we will refer to as an anchor enterprise model.[1] Support for such partnerships is growing, but there is still little clarity on what they involve, what they aim to achieve and the conditions they need for success. Summarizing findings from a detailed report (Benson, Cockx, and De Weerdt), this policy note seeks to address these questions and provide guidance for future action. We structure our discussion around five questions: *what* the model is, *when* it can make sense, for *whom* it can work, h*ow* it can be implemented, and whether it can contribute to inclusive rural development

What is an anchor enterprise model?

Many terms are used interchangeably in policy discussions, making it hard to reach a common understanding. During our research we encountered terms such as *anchor farms, anchor firms, nucleus estates, productive alliances, outgrower schemes, contract farming, hub-and-spoke models, satellite farmers, sharecropping,* and so on. Everyone is free to use these terms as they see fit, since none are strictly defined. However, this lack of clarity does little to advance the debate. That is why we begin this note by offering a clear definition.

We define an **anchor enterprise model** as an agricultural development approach built around a larger-scale farm or agro-processor commercially partnering with smallholders. Under this model, smallholders contribute land and/or labor to produce crops or livestock products that serve as inputs for, or are marketed jointly with, the anchor enterprise. In return, the anchor enterprise provides support such as technical assistance, inputs (often on credit), transport, or storage. The type and scope of these supporting activities vary, but we exclude arrangements where the enterprise only buys crops or livestock products without offering additional support. This partnership is intended to be commercial and mutually beneficial.

[1] Anchor farms are singled out as one of the priority areas in the first implementation plan for Malawi 2063 (GoM, 2021). Support for anchor farms is also an element of the 2024 National Agricultural Policy (MoA, 2024). Moreover, as part of the Mega Farm Programme of the Ministry of Agriculture, mega farms are expected to serve as anchor farms (MoA, 2022). The Agricultural Commercialization Program (AGCOM 2.0) aims to facilitate productive alliances between producer organizations and larger scale agrifood processing and marketing firms. Similarly, development partner programs such as Commercializing Agriculture for Industrial Growth (CAFIG) and the Malawi Growth Poles Project aim to enable and support economic partnerships between enterprises and rural households.

When does an anchor enterprise model make sense?

The viability and sustainability of this model depend on two things: what advantages might lead a larger-scale enterprise to partner with smallholders, and what incentives motivate the smallholder farming households to join such a partnership.

… when transaction costs can be reduced

Transaction costs

Transaction costs are the costs involved in arranging and carrying out any exchange. This includes the costs of searching and screening suppliers or buyers, gathering price and product information, negotiating terms such as price, quality standards, or payment arrangements, and ensuring that they are adhered to. Some of these costs will be tangible, e.g., staff time, transportation, or communication costs, while others are intangible, such as uncertainty as to the risk of being cheated.

Consider the perspective of an enterprise that needs (more of) a primary agricultural product for processing or direct sale. Its first option is to buy the product on the open market. A second option is to produce it in-house. Sometimes a commercial partnership with preferred producers or suppliers is the lowest-cost option for obtaining a reliable supply. Whether this is the case depends largely on the nature of the product and the prevailing market conditions.

For generic, widely produced, nonperishable goods with limited or easily observable differences in quality or other attributes, sourcing from the open market is usually the lowest-cost option. The coordination of supply and demand can occur effectively through price adjustments, so transaction costs are low even when markets are thin or weak, as is often the case in Malawi (Benson, 2021). For such products, partnerships are more costly and carry high risk since farmers can easily find and sell to other buyers if market prices rise above the agreed price (*side-selling*). Similarly, if market prices drop below the agreed price, enterprises may buy elsewhere (*side-buying*).

Types of agricultural products

Type	Description	Examples
Generic	Homogenous, widely produced, nonperishable, and easily observable quality or other attributes	Maize, soybean
Specialized	Require specialized skills, knowledge, or inputs	Seed, poultry
	Require specialized processing	Sugarcane, tea
	Have hard-to-observe quality or other attributes	Aflatoxin-free groundnuts, deforestation-free coffee
	Are highly perishable	Horticultural products, dairy

In contrast, for more specialized products that are technically more difficult to produce, require specialized processing to realize their economic value, have hard-to-observe and economically important differences in quality or other attributes, or are highly perishable, transaction costs associated with sourcing those products from the open market rise sharply. Identifying buyers or suppliers, assessing the quality or other attributes of the products they offer, discovering prices, and negotiating agreements all take time and resources. In such cases, anonymous market transactions are unlikely to be the lowest-cost option. The enterprise faces two alternatives: organize or expand its own production or form partnerships. Let's consider the transaction costs involved with each.

In Malawi, starting or scaling up agricultural production can be problematic. The factors of production needed to do this – land, labor and capital – are all constrained. Access to land is predominantly organized through customary land tenure mechanisms tied to community membership rather than through markets. Intense seasonal demand for labor results in periods during which no labor is available for hire. In addition, while members of a farming household have strong incentives to work efficiently, hired workers require supervision, which can involve high costs for the enterprise (Binswanger and Rosenzweig, 1986). Finally, capital markets for agricultural production are severely limited in Malawi. As a result, the costs associated with obtaining and combining the right amount of land, labor, and capital to set up or expand one's own production are significant. Moreover, while organizing production in-house might offer more control of the production process for the enterprise, it also decreases its flexibility to scale up or down.

For an enterprise facing high transaction costs for sourcing from the open market because of the specialized nature of the product and high transaction costs for organizing internal production because of weak factor markets, commercial partnerships can be the most cost-effective option. Even though setting up and managing such partnerships involves substantial costs, the total transaction costs may still be lower than the alternatives. This is the sweet spot where investing in partnerships with smallholder farmers makes most sense as it eliminates transaction costs associated with finding and coordinating with suppliers and avoids inefficiencies associated with weak markets for land, labor and capital.[2]

While we have so far focused on transaction costs from the perspective of the enterprise, they affect farmers as well. Smallholders producing more specialized products usually face high transaction costs because they lack information on prices and buyers and can be far away from markets. Weak input markets in Malawi also make finding and procuring inputs costly for smallholders. Successful anchor enterprises are likely better connected to high-value markets and better able to acquire and effectively use improved technologies than their smallholder partners. They will also be better endowed with productive assets, such as storage facilities or machinery. A partnership can enable smallholder farmers to access and benefit from the elements that underpin the anchor enterprise's strong performance.

… when economies of scale can be realized

Anchor enterprise models make most sense when they can spread fixed costs over a larger volume of output, or secure better prices by coordinating larger input purchases and larger output sales. Although there are some potential economies of scale in crop production – especially when pooling adjoining farmland - deriving from increased mechanization or large-scale irrigation, economies of scale in anchor enterprise models in Malawi are likely primarily achieved in activities that are supportive of production, rather than directly in production itself. This includes spreading the costs deriving from investments in transport, storage, or processing equipment, and the coordination of bulk input and services procurement and output sales.

[2] While this logic also applies to partnerships between enterprises and large farms, in the context of Malawi, where smallholder farmers overwhelmingly dominate agriculture and larger-scale farms are rare, partnering with smallholders will often be a more viable option.

Attempts to achieve such economies of scale from jointly obtaining inputs and selling their agricultural outputs in large aggregate quantities through farmer organizations have had limited success. Farmer cooperatives in Malawi generally have not been able to build sustainable businesses, since doing so requires higher levels of business management capacity than can generally be found in rural farming communities (Davis, et al., 2023). The commercial success of some established enterprises in Malawi suggests they have the necessary management skills, making the anchor enterprise model a more viable pathway to realize these economies of scale.

… when community relations matter

Collaborating with smallholder farmers can also help anchor enterprises establish and maintain supportive community relations. This can hold economic value for the anchor enterprise by preventing or mediating issues of theft, property damage, and other crime or security incidents on the premises of the anchor enterprise. More broadly, partnering with smallholder farming households can help enhance the enterprise's image and foster goodwill with local and national governments.

For whom can the model work?

Originally this model was centered on larger-scale farms. This makes sense because anchor enterprises engaging in agricultural production themselves are well-positioned to provide technical and management support to smallholder farmers. Their own production experience can also improve their ability to screen potential partners and distinguish partners who made good faith efforts but failed from those acting in bad faith. However, the model can just as well apply to agro-processors, in particular those who need a steady and reliable flow of primary agricultural produce to use their processing equipment to full capacity.

The size of the anchor enterprise matters. Smaller ones may be more dependent on partnerships to achieve economies of scale and reduce transaction costs. They are often also more accessible and socio-culturally similar to smallholders, which can make agreements easier to establish and sustain. Larger enterprises, however, typically have greater capacity to manage a large number of partnerships, and have better access to capital, knowledge, technology, and information, giving them greater potential to generate economies of scale and spillover benefits for their smallholder partners (Minot and Sawyer, 2016).

While commercial partnerships between anchor enterprises and smallholders can work well, the poorest and most vulnerable smallholder farming households are less likely to participate. A partnership with a large enterprise carries risks that relatively larger or richer smallholders can manage better. To minimize the risk of default, enterprises are selective in whom they partner with, as they should be if the model is to be commercially sustainable. Pyxus, for example, requires prospective groundnut outgrowers to allocate at least 0.5 hectares to the crop and provide a deposit as collateral for input-loans. In addition to such explicit selection criteria, enterprises will look for more motivated, knowledgeable, and productive farmers. These considerations tend to result in the exclusion of the poorest and most vulnerable farming households from anchor enterprise partnerships.

For an enterprise, working with fewer, relatively larger smallholder farmers is also less costly. Doing so, for example, reduces the costs associated with negotiation, but also with the provision of technical assistance, distribution of inputs, or collection of the harvest. On the other hand, working with a larger number of smallholders can be part of a risk diversification strategy for an anchor enterprise as spatially dispersed smallholders will have different levels of exposure to pests, diseases, or even local weather shocks. While the practical challenges of working with a large number of smallholders are significant, these can possibly be mitigated when another organization, such as a farmer cooperative, serves as an intermediary.

How can the model work?

A major challenge of the anchor enterprise model is the risk of default. Enterprises may break contracts by failing to deliver inputs or other services on time, refusing to purchase the product after harvest, or arbitrarily raising quality requirements. Smallholders, in turn, can default due to production failure, by selling the inputs provided by the enterprise, or side-selling to take advantage of higher or faster payments, or to avoid repaying credit. The problem of side-selling is especially common.

Although Malawi has taken steps to develop a Contract Farming Strategy (MoAIWD, 2016), the legal foundation for anchor enterprise partnerships remains weak, and formal contract enforcement is difficult and costly. However, even in the absence of a strong legal framework, agreements can be self-reinforcing when both parties stand to lose by breaking the relationship. This is most likely when the product has few alternative suppliers, buyers, or uses. In such cases, the reduction in transaction costs provides strong incentives for maintaining a longer-term commercial relationship. Despite not having formal contracts with outgrowers, Malawi Mangoes, for example, has faced little problems with side-selling. The highly perishable nature of mangoes implies that farmers cannot easily find alternative buyers on time. In addition, Malawi Mangoes cannot easily source the specific varieties of mangoes they require from other farmers.

Continued access to valuable services and technologies creates incentives for smallholders to uphold agreements. When expected returns from technologies are high, or when technologies are specific to the relationship and the product, farmers are also less likely to divert inputs (Swinnen and Kuijpers, 2019). Accurate screening, clear communication, and close monitoring—supported by sufficient field staff who regularly interact with farmers—further reduce the risk of default.

Transparency is key to preventing conflict. Contracts should be written in accessible language and explained clearly to smallholder farmers. Poor understanding of the terms of the agreement can generate distrust and dissatisfaction that may culminate in default or drop-out. Limited information and transparency about the terms of loans specifically also raise the risk of indebtedness and smallholders becoming locked into a relationship that is no longer beneficial to them (Ruml and Qaim, 2020). Disputes related to the weighing or grading of products are also common. Independent quality verification has been shown to strengthen trust and even increase farmers' investments in production (Saenger, Torero, and Qaim, 2014).

Effective farmer organizations can also help prevent and mediate conflict. They can increase farmers' bargaining power, facilitate communication, and provide a forum for grievances. Group-based loan repayment mechanisms can also reduce the risk of default. In Malawi, however, many farmer organizations remain at an infant stage with limited management capacity and weak governance (Davis, et al. 2023), making it difficult for them to fulfill this role in an anchor enterprise model effectively. While Satemwa has, for example, partnered with farmer organizations in tea production, it maintains individual farmer contracts to ensure smooth implementation.

Can the model contribute to inclusive rural development?

When anchor enterprise models operate productively and profitably, they can generate wider benefits for the local economy. The operations of the anchor enterprise and its partners can, for example, attract more traders and investments in local infrastructure, improving market access for all farmers in the area. Non-participating farming households may also benefit from improved availability of inputs and services, or knowledge and technology spillovers. However, evidence suggests that poorer households are often less able to capture these spillovers (Chamberlin and Jayne, 2020).

Higher labor demand from both the anchor enterprise and its smallholder partners can also create more local employment opportunities. In addition, rising incomes of participating households can stimulate local economic growth. Their increased consumption, particularly of goods and services that are labor-intensive and require limited capital in their production, such as construction, carpentry, or transport, creates income-earning opportunities for the wider community, including for the poorest and most vulnerable households. Over time, the resulting expansion in local supply and reduced prices for locally produced basic goods can contribute to further welfare improvements.

Conclusions

Larger-scale farms or agro-processors act as anchor enterprises when engaging in commercial partnerships with smallholder farming households. In specific contexts and for specific products, such partnerships can be mutually beneficial and commercially successful as they help reduce transaction costs, overcome market failures, and realize economies of scale. The nature of the product at the center of the partnership is key. Anchor enterprise models are generally not suitable for grain or other generic staple crops. Rather, these partnerships are most likely to be economically justified for higher value, less widely grown, more specialized, more complex to produce or process, or highly perishable agricultural products. For these products, the risk of default is lower as the reduction in transaction costs provides both parties with strong incentives for maintaining a longer-term commercial relationship.

Anchor enterprise models cannot be profitably and sustainably employed for many types of commercial agricultural production in Malawi. Consequently, only a small portion of farming households can directly participate and generally the poorest and most vulnerable are less likely to be included. Nonetheless, where such models work well, they can deliver indirect benefits to the broader rural community, including its poorer members, by stimulating local demand for labor, goods, and services.

While likely better suited for commercial agricultural development than inclusive rural development, anchor enterprise models can be valuable for development in Malawi. A model centered around commercial farms or agro-processors, however, requires an **enabling environment** for such enterprises to operate in.

- This includes macroeconomic stability and an investment climate that facilitates private investment in agribusiness sectors.
- Anchor enterprise models are especially suited for export-oriented production. However, the current policy environment in Malawi for trade, including the exchange rate policy, is largely unfavorable for formal exports. When exchange rates better reflect market conditions and other export restrictions are removed, formal exporters can offer more competitive farm-gate prices. This reduces the risk of side-selling to informal traders and improves the viability of anchor enterprise models.
- The viability of partnerships with geographically dispersed smallholder farmers is severely constrained by poor rural infrastructure. Improved conditions on rural roads reduce the cost of distributing inputs, organizing extension services, and collecting harvests.

To be sustainable, anchor enterprise models should be grounded in a strong economic rationale for partnering. Government and development partners, however, have several options to **support** such partnerships without eroding their commercial foundations.

- *Provide assistance in managing relationships with smallholder partners*. Many enterprises are not well-equipped for or experienced in dealing with smallholder farmers. They typically en-

gage in relationships with less marked power imbalances where contracts are better enforceable. Managing relationships with smallholders may require a different skillset and dedicated systems. Assistance could range from the development of model contracts, or training in relationship management, to setting up data systems to track input deliveries, sales, and repayment.

- *Organize financial and business training for smallholder farmers*. This type of training could help ensure farmers understand the terms of the agreement, are able to assess the risks involved, and prevent indebtedness and other forms of lock-in.
- *Support organizations, such as cooperatives or NGOs, that can act as intermediaries.* These intermediaries can facilitate effective communication with smallholder farmers, help coordinate and enforce loan repayment and product delivery, manage grievances, and mediate conflicts. As they reduce the costs of dealing with many smallholders, effective intermediaries can allow for more inclusive anchor enterprise models.
- *Develop effective grades or standards and/or organize third-party certification of quality*. Quality control is often a contentious issue. The establishment of grades and standards that are easy to implement will facilitate communication and help avoid conflicts and mistrust. Alternatively, organizing a third party to assess and verify the quality independently can help prevent or resolve such disputes.
- *De-risk partnering with smallholder farmers*. Even when the business case is strong, risks are inherent to working with smallholder farmers relying on rainfed agriculture. Agricultural insurance or other insurance products may offer a solution to safeguard enterprises when smallholder farmers default because of production failure.

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