Contractual governance in agro-industry institutions in Tanzania
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Chapter 7
Alliance One Tanzania Limited (AOTL)

7.1 Introduction

Alliance One Tanzania Limited (AOTL) is a company, which owns a tobacco factory facility in Morogoro. The main activity of the facility is to sort, grade and package tobacco leaves into different sizes of packs according to customers’ demand. The major buyers of tobacco from AOTL are the Tanzania Cigarette Company Limited (TCCL) and international companies such as Phillip Morris International.

In 1995, AOTL started as Dimon Company Limited (DCL) in the Tabora region. The company started the business activities during the second phase of leadership in Tanzania. The second president, Ali Hassan Mwinyi, who took over from President Nyerere in 1985, introduced liberal market policies. The second phase government, therefore, has the name of the ruksa period because the president promoted the Washington Consensus policies. Many governments owned enterprises were privatised including the tobacco government owned companies. The Tanzania Tobacco Board remained as a regulator of the industry instead of being involved in the production of tobacco. The Dimon Company Limited (DCL) changed its name in 2005 to Alliance One Tanzania Limited (AOTL).

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61 The first term president was President Julius Kambarage Nyerere who served as president for 40 years during the Ujamaa period. The second term leadership was for president Ali Hassan Mwinyi, who served for 2 periods, i.e. 10 years. The third term leadership was for Benjamin Mkapa, also serving for 2 terms. The current fourth term leadership is for president Jakaya Mrisho Kikwete.

62 The term “Washington Consensus” is used for the period between 1970s and 1990s when the term was coined to refer to the common denominator in the policy advice of the Washington-based institutions (e.g. IMF and World Bank). These policies include tax reforms, fiscal discipline, interest rate liberalisation, competitive exchange rate, trade liberalisation, liberalisation of inflow of foreign direct investments, privatisation, deregulation and secure property rights.
As described earlier, primary cooperative societies (PCSs) have been part of the social fabric of the Tanzanian farming community from colonial period until today. Hence, when Dimon started buying tobacco in Tabora in 1995, the cooperative societies were there. Therefore, DCL decided to contract SHFs through the existing primary cooperative society. Currently, the PCS is still the contractor of AOTL. In 2001, DCL and another tobacco company, the Tanzania Tobacco Leaves Company Limited (TLTCL), set up a joint venture known as the Association of Tobacco Traders of Tanzania Limited (ATTT), or also known as “A-triple T”, to facilitate extension services, to provide grading services and administrative and logistical services. AOTL and TLTCL buy tobacco from cooperative society members. AOTL transports tobacco through the central railway line to its Morogoro based factory. Although AOTL buys tobacco leaves from farmers in different regions of Tanzania, this case study confines itself to the contracting of tobacco farmers in the Tabora region.

7.2 Regulating the tobacco industry

The Tanzania Tobacco Board (TTB) regulates the tobacco industry. The TTB was established in 1972 to organise production, processing and marketing of tobacco products. Before the privatisation era, the TTB dealt with all aspects of the tobacco value chain in Tanzania. For example, TTB owned a factory in Morogoro and it was directly involved in selling processed tobacco leaves on internal and export markets. With the privatisation of the tobacco production, the TTB sold its factories to TLTCL. TTB was restructured into a regulatory agency. As a regulatory agency, the TTB set up the Tanzania Tobacco Council (TTC). The TTC comprises of growers (via the representatives of PCSs), traders (tobacco companies, i.e. AOTL and TLTCL) and other experts (Ministry of Agriculture). The council discusses issues pertaining to the industry. Within the TTC, the participants set up the contractual terms that are to be used to contract SHFs. This concerns prices, grading, fertiliser loans and extension services.

As discussed in chapter 2, the PCSs in Tanzania date back to colonial times and were much encouraged during the Ujamaa period (1961-1982). At that time, the government owned the factories and the major means of production. All farmers sold their crops through cooperative societies, which would then supply the crops to government owned

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factories. After the introduction of trade liberalisation policies from mid 1980s, the tobacco farmers, like many other Tanzanian farmers, remained members of the cooperative societies.

To become a member of the tobacco related cooperative society, a SHF needs to register with a PCS. The PCS then submits a list of the names to TTB. The list shows the acreage of land a farmer has at his disposal to grow tobacco and the corresponding inputs required by each SHF. Every applicant must make sure that he has at least 0.8 hectares of land, which is prepared for growing tobacco, a barn, a tobacco store, woodlots, and some financial capital. The farmer must complete an application form, attach a photograph, and submit these to his respective PCS.

The PCS collects all members’ applications and sends them to the TTB. Afterwards, the PCS, the AOTL, and TTB examine the application and if the applicant fulfills the conditions, the TTB issues an identification card to the tobacco farmer. The card displays the farmer’s photograph, name, location/village, society name, and the farmer’s identity number. On behalf of the members, the PCS leaders sign the contract regarding the cultivating and the selling of tobacco. The District Cooperative Officer (DCO) and TTB approve the contract between the PCS and AOTL or TLTCL to buy tobacco from SHFs in Tanzania.

### 7.3 Contracting the tobacco smallholder farmers

There are two companies which contract tobacco farmers in the Tabora Region. These companies are AOTL and TLTCL. In the period before the planting season, i.e. between May and August of each calendar year, SHFs need to contract with the tobacco factories. In the Tabora region, farmers need to form a group of ten in order to sign a contract with AOTL. Joining a group is necessary. A group of ten members gives each member the right to apply for a loan. However, the farmers need to stand surety for each other for the loans these farmers receive to buy fertiliser. The PCS officials record the loan information of each group and the members. After registration, the group of 10 receives the farm inputs such as fertilisers from AOTL. Although every individual farmer owns a tobacco farm separately, he receives farm inputs only through the group. When one member defaults, the group is responsible to repay the loan or trace the defaulter to force him to
repay the loan. It is thus important for a farmer to join a group with members he can trust.

The tobacco contract specifies crop production estimates per hectare, crop volume, and corresponding input requirements. AOTL is obliged to report monthly to several offices, namely: the district agricultural officer, the regional agriculture officer and the TTC with regard to the tonnage of crops purchased, the average price offered and the inputs distributed to growers within the existing farming contract. The buyers are also supposed to offer extension services to the contracted SHFs. The TTB has the powers to inspect and verify the quality of the extension services rendered by the buyers. The deduction of the value of the inputs provided on credit from tobacco sales by SHFs is regulated in the Tobacco Industry Act (2001).

The farming contract specifies the prices and payment procedures, which were already agreed upon in the TTC. A standard contract between AOTL and a tobacco farmer will show that AOTL will deduct 5% of the sales price from a farmer’s revenues for the district council as a district cess (a form of agricultural product tax), society levy 5%, unions levy 2.2%, apex cooperative society levy 1% and TTB 0.1%. In addition to this, AOTL will deduct the amount of money the farmer owes due to the borrowed farm inputs.

For the next season, AOTL needs to make sure that the SHFs have repaid all their loans before they can sign a new contract (URT(d), 2001). If this is not the case, AOTL may not provide that farmer with a loan for the farm inputs.

### 7.4 Influence of Ujamaa legacy to the SHFs

During the Ujamaa period (1961-1982), the SHFs received many services including subsidised fertilisers from the government agencies for what seemed to be a free service through the PCS. The government, through the respective crop boards, bargained and contracted with different domestic and international dealers on behalf of the members of the PCS. The government marketed and sold the tobacco the farmer harvested.

The crop boards based the payment to farmers on anticipated world prices after deducting the boards’ expenses. The SHF received the remaining income, which he perceived as his the total income from the sale of the crops. If there were arrears, the farmers were paid the
difference. The farmers were not well informed about the details of the system and they interpreted all services as free from the PCS. After all, during the Ujamaa period, all PCSs, including the crop boards, were under the government control and were involved in all stages of the crops value chain.

**History of defaulting**

Defaulting on loans started in the *ruksa* era after the privatisation of the tobacco factories. The farmers registered their names with more than one tobacco company, and each of these companies offered the SHFs a loan for farm inputs, as the law required this. Figure 15 shows the impact of the defaulting behavior on the production of tobacco.

*Figure 15 Tobacco total sales in tons per year in Tanzania*

As usual, the PCSs were supposed to take care of all transactions as before privatisation. Figure 15 shows the drop in production between 1997 and 2001, as many of the SHFs defaulted on the repayment of farm input loans. As farmers saw it, the loans were free handouts from the government, but now administered by the tobacco companies. Due
to that experience, the SHFs, especially in rural areas, did not understand that the loans were connected to the delivery of formerly free services. All this resulted in a fall in the production of tobacco.\(^{64}\) In order to mitigate this problem DCL and TLTCL established ATTT in 2001 to control the offering of services to farmers, streamline tobacco leaves procurement, and the promotion of tobacco leaf production among farmers.

### 7.5 Introducing A-triple T

A-tripleT, or ATTT, is owned by AOTL and TLTCL, each having a share of 50\%. The major reason to establish A-triple T was to control the SHFs who contracted with DCL (the company that changed into AOTL) and TLTCL. The SHF entered into contract with AOTL and TLTCL at the same time. Some SHFs could easily default on farm inputs because of the competition between the two buyers.

With ATTT, it has been easy to sort out the farmers who contracted with both of the two companies, but still there is a long way to go. The objectives of setting up the ATTT were, and still are, to offer extension services, distribute farm inputs, assisting in buying tobacco, following up logistics and repayment of the loan from the faithful farmers and the defaulters. ATTT conducts all activities on behalf of the two companies. However, despite the presence of ATTT, some of the SHFs in Tabora region are still facing many unsettled disputes in the primary court because of defaulting repayment of loans received as farm inputs on credit.

### 7.6 Grading at the “gulio” and the “PCS”

Apart from growing tobacco, the SHFs harvest, cure, dry, bale, grade, weigh, and take the cured tobacco bales to the market centres (gulio) on specific days. At the gulio the TTB classifier assigns a grade to each bale, which the farmers call “a government grade.” After the TTB classifier, the ATTT classifier also grades the tobacco and attaches a sticker with his grade to the tobacco bale. Thereafter, the PCS classifier also grades the tobacco and records this on a separate sticker on the bale, or sometimes records it in a separate notebook. Grading is done by the way of smelling, touching, feeling, visual inspecting, and tasting.

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\(^{64}\) The Economic Survey, 2007 and the interviews among the officials at AOTL – Morogoro office.
The contracted transporters then take the bales from the *gulio* and bring them to the PCS store. An ATTT official and the contracted transporter assign a PCN,\(^{65}\) which contains the information about the bale including the owner’s particulars and the grades. At the PCS’s office, all three classifiers (TTB, ATTT and PCS agent) agree on a single grade of that bale of tobacco, in the absence of the SHF. This grade is recorded on a sticker on the bale. The ATTT and the PCS official feed the particulars of the tobacco bale into the computer and send an e-mail to the factory officials in Morogoro. From the PCS store, the baled tobacco with the final grade is to be transported to Morogoro by railway to the factory. A last round of grading takes place in the factory in Morogoro in order to arrive at the final grade, which is the basis of the price for the tobacco leaves. Through the PCS, AOTL then pays the farmers based on this grading system.

### 7.7 Transportation of tobacco

The shipping officers at the railway station receive the tobacco bales.\(^{66}\) The officers pick about 10% of the bales at random and reweigh them to confirm whether the bales weigh as the information provided indicates. If there is any difference(s) in the weight this is recorded at the railway station. The bales are then grouped for a specific wagon. For such a group of bales, an officer attaches a dispatch that contains information such as wagon/truck number, date, name of the ATTT classifier, and transport cost to the bale and records the information in a computer system. The system produces a consignment note for the tobacco company and automatically sends an e-mail to the factory with a copy to the railway station officer of Morogoro.

From the railway station of Morogoro, the tobacco is transported to the AOTL or TLTCL factories. The railway line passes under the roof of the factories. The computer system reads the coded information on the bales.

### 7.8 Grading at the factory

The inspector at the factory inspects the quality of the bales and decides on a final grade. The final grading, thus, takes place in the absence of the SHF and the three other classifiers. The inspector at the

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\(^{65}\) PCN is a number which is placed on the bale for identification purposes.

\(^{66}\) Shipping officers are the railway station employees contracted by AOTL to send tobacco to the Morogoro factory.
factory may degrade or upgrade the tobacco bales. In the case that the inspector at the factory assigns a bale with the lowest three grades out of more than the 100 grades, then the inspector has the right to discard the tobacco as unsuitable. The grade assigned determines the price of the tobacco and thus the amount paid out to farmers.

After the final grading, the factory sends the information back to the PCS who transmits the information to their members. The information includes the name of the PCS member whose tobacco has been discarded, upgraded, or degraded and the resulting amount of payment per person per grade. The same information is sent to ATTTT officials. The ATTT accountant pays the SHFs through their PCS.

### 7.9 Farmers’ perceptions of grading

SHFs complained of this grading system. In the group discussion, the participants revealed their suspicions that grades were swapped. They said that the stickers on the bales could be easily detached from the bales, or swapped by some malicious persons during classification, transportation, or at the factory. When a sticker on a bale with a good grade is swapped with a sticker on a bale with a bad grade, the first one might end up discarded at the factory, while the latter may get payment for a low graded bale.

Discarding unsuitable tobacco has raised many questions to the SHFs. The participants still question why the tobacco has to go through all the classifying stages when it is later to be discarded at the factory. Such a grading system is difficult for the farmers to grasp and the system has created mistrust. The SHFs believe that those who receive high grades pay bribes. For example, farmers knew some cases where a few farmers, known for not practicing good farming techniques, ended up with better tobacco grades than those who know good farming practices. The same applies to a farmer who claimed to have used good farming practices, but at the end, received information that his tobacco was graded “unsuitable for smoking” and therefore discarded.

The Tobacco Industry Act, 2001 (URT (u), 2001), provides for three classifiers, one from the PCS, the TTB, and ATTT each, in order to ensure that each individual is awarded the correct grade for his tobacco. These classifiers are supposed to grade the tobacco at different times and meet later to compare the grades they have awarded. During this joint grading session, they are supposed to check and to make sure that there are no huge discrepancies between the
grades awarded by each classifier. The possibility of reaching an agreement on joint grade before feeding it in the computer, or the bale being transported to Morogoro seems to be a solution to the farmers' complaint. However, joint grading has even raised more suspicions. The group discussion participants claimed that the three classifiers collude to give high grades to classifiers’ relatives. The participants claimed that the classifiers sometimes swap the stickers to favour their relatives or those who give bribes.

Another complaint of the farmers was about the long period between selling and receiving payment. It takes more than two months for a farmer to receive the payment. This made it difficult for farmers to meet their financial obligations. Farmers may thus wait for a long time and then may end up with a lower grade than expected, or receive information that their tobacco has been discarded in Morogoro. Meanwhile, during the waiting period farmers get in debt in order to pay school fees for their children or to take care of their family. The farmers, who participated in the discussion, explained that many farmers are outraged due to the fraudulent practices and sometimes a farmer revenges by defaulting.

Although grade swapping and opportunistic re-grading may happen in the Tabora region, it is hard to prove. Factory officials state that farmers sometimes claim higher grades than actually awarded to cover their agronomic ineptitude. As the grading system is also very complicated (encompassing more than 150 different grades), it makes it difficult for farmers to grade their own produce correctly. Complexity coupled with a lack of transparency in grading makes it difficult to encourage and build trust among the SHFs.

7.10 Defaulting behaviour in Ibiri

Many farmer groups borrow farm inputs, but find it difficult to repay the loan later. Farmers think that farm inputs are too expensive to recoup the cost. They believe that the prices of farm inputs have increased because AOTL would rather increase its profits than offer a fair price. During the group discussion, farmers in Ibiri explained what happened in 2007. The participants said that a group of 10 members failed to repay the loan, because three members did not harvest enough tobacco leaves.

The participants revealed that there were two reasons behind this defaulting. Reason one was that some farmers did not use the fertiliser
for the intended tobacco crop. They did not grow tobacco at all. Instead, they used the fertiliser on other crops such as maize and groundnuts. Alternatively, some farmers apportioned the fertiliser to both tobacco and groundnuts. Since groundnuts fetch better prices on the local market, these farmers planted a smaller acreage of tobacco than was expected from them. When they harvested the tobacco, they received a low grade due to a shortage of fertiliser. These farmers remained with an outstanding loan to repay in the following season. Therefore, the group in question was unable to settle their contractual obligation in relation to the AOTL contract.

The second reason was to be found in the fact that tobacco is more labour intensive compared to other crops. Therefore, farmers who committed themselves to growing good quality tobacco leaves could not undertake other income generating activities during the period before harvesting because of the care the tobacco needs. While waiting for payment from AOTL, these farmers needed to borrow some money from their neighbours and friends promising to repay the borrowed money as soon as they received the tobacco sales income. The financial situation worsened when the tobacco grades were too low to fulfill the loan obligations, or when they received the message that their tobacco was discarded.

In the new tobacco season, those whose tobacco was discarded in the previous season, applied for farm inputs from a PCS under another name. A farmer might join another PCS, or might even change his registered name in his home village PCS. After changing PCS or his name, the farmer might apply for farm inputs again and start another tobacco farm. In Ibiri, when farmers received these inputs, they sold them directly on the spot market to independent farmers, or used them on other crops instead. Such farmers became so-called “run away”-farmers.\(^67\) The “run away”-farmer is the term used to describe the farmers who hide from the ATTT officials. The villagers (neighbours) being aware that their neighbour was a defaulter, when they saw the ATTT officials coming to visit the defaulter’s farm, informed the defaulter to run away and hide. This meant that villagers conspired to hide the “run away”-farmer. ATTT officials who visit villages were easily recognisable as they drove ATTT cars. Also all extension officers in Tabora were provided with red motorcycles, which they use to visit the farms. The “run away”-farmer grew tobacco and in many cases sold that to an “influential” person, whom - the participants claim – was able to manipulate the grades.

\(^67\) The Swahili term is *Jifiche* for these farmers.
The remaining members of the group of the “run away”-farmer in his original home village did not repay the whole loan. It was not easy for them to say where their fellow defaulting group members went, because such a culprit is still their colleague or close relative. The cultural norm and values do not allow group members to betray the defaulter. Furthermore, the farmers believed that these incidents occur randomly and any farmer might default at some point in time. The members were not yet ready to cooperate with ATTT because they had lost trust, especially with respect to the pricing and measurements of their tobacco leaves.

ATTT started to file lawsuits to claim damages. It had to collaborate with the local government officials such as Ward Executive Officer (WEO) and Village Executive Officer (VEO) in the process of dealing with such civil cases. However, due to a shortage of magistrates and a long distance to the nearby courthouse such cases took, and still take, a long period to settle. In a number of cases when claims were awarded, the values of the properties of the convicted were not enough to recoup the loans. Such a “run away”-farmer then needed to live in a mud house and farm land which had a lower value than their original plot. One of the participants in Ibiri was able to show the houses of the “run away”-farmers. The houses were worthless. No villager would take it even if it would have been given for free. The participants said that the court system could not resolve the disputes, as the value of the properties of the poor person was often lower than the value of the farm inputs received. For example, during the data collection period, a piece of land with a mud house was being auctioned, but nobody showed up to buy. The participants said that unless AOTL would decide to buy the properties of the defaulters, nobody would be interested in buying the mud hut together with the exhausted land, while the farmers knew that they could go to a neighbouring village and could start farming there. One might even better move somewhere else in the pori. In addition, he might better start planting tobacco in virgin fertile soil than buying the auctioned land of a neighbour. Furthermore, the cultural values in Ibiri are such that the buying of auctioned land and houses of neighbours is not seen as socially acceptable behaviour. The values are to assist or help a neighbour when he has problems, especially when in the perceptions of the villagers the discarding of tobacco happens randomly.

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68 Pori means the virgin forest. If one clears the forest and plants crops, then the plants are fertilised by the organic fertiliser from the humus of the forest.
7.11 New bargaining system

The problems of the farmers who receive farm inputs from ATTT and fail to pay the loan obligations have created a new bargaining system. Some SHFs who understand the importance of good farming practices (via the training provided by PCS and ATTT) have decided to contract individually instead of contracting through the cooperative societies. These farmers buy fertilisers in cash on the markets to grow crops. Such farmers have realised the importance of growing tobacco. Other farmers have acquired agricultural knowledge and they have financial capital. These farmers have initial capital to start their tobacco farming activities without needing credit. Participants reported that these SHFs exacerbate the defaulting behaviour as they entice the poor SHFs to receive subsidised fertilisers and sell it to them. As the number of independent farmers increases, the demand for subsidised fertilisers increases too, and at the same time the number of defaulters increases.

7.12 Summary

The chapter presents the case study on Alliance One Tanzania Limited (AOTL). Even though the AOTL operates in the whole country, the case has confined itself to explain the contracting of tobacco farming in Tabora region. It shows that AOTL is not alone in the tobacco industry. The second company in the industry is Tanzania Leaf Tobacco Company Limited (TLTCL). Both companies have factory facilities in Morogoro. They contract farmers in Tabora, transport tobacco by rail to Morogoro. The SHFs grow tobacco on their own land and sell their tobacco through the PCS, or independently to AOTL and TLTCL. Both companies set up a joint venture, ATTT that is owned by AOTL (50%) and TLTCL (50%).

ATTT distributes farm inputs on behalf of the two companies. In addition, ATTT facilitates the provision of tobacco extension services and participates in the grading of tobacco. This sharing of technical capabilities in the value chain has enabled AOTL and TLTCL to enforce the contracts through ATTT privately. However, some SHFs still default on the loans. The chapter also details the Ibiri ward case where SHFs receive a loan for various farm inputs from ATTT and use the inputs to different purposes. These farmers may sell the inputs on the spot market, use it on other crops, apportion some of the inputs to other uses, or use all inputs on the tobacco crop. The chapter also shows that different strategies have been employed to change the
behaviour of the farmers. The major strategy has been to keep training the SHFs and there is some evidence that SHFs are changing from being defaulters to independent operating farmers. An independent farmer does not need to borrow the farm inputs, but buys his own inputs and sells the harvested tobacco leaves directly to the factory. However, as the number of independent SHFs increases, the demand for fertilisers also increases. The increased demand for fertiliser makes the independent farmers to entice the poor farmers to join a PCS in order to receive subsidised fertilisers in the group and then sell it to them. The consequence of this is to create another series of farmer defaults in the system.