FACTORS AFFECTING THE VIABILITY OF SMALL SCALE SUGARCANE BUSINESSES – A CASE STUDY OF KDDP

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1 INTRODUCTION

Swaziland is amongst the poorest countries in the world. Not only that but it also has a very high unemployment rate. The majority of the over one million people living in the country, a large share live in poverty. Swaziland, like other countries, had poverty alleviation as one of their millennium development goals (MDGs). The Government of Swaziland’s strategy of poverty alleviation recognized the importance of smallholder agricultural development, using water as a catalyst and a major engine for stimulating rural development in the country hence the formation of SWADE to implement its strategy. This is to be achieved by creating the conditions for the transformation of subsistence level smallholder farmers into small-scale commercial farmers, using water as a vehicle for such development.

In 1999, the government of Swaziland initiated the Komati Downstream Development Project. The project was aimed at transforming the livelihoods of people through small-scale commercial farming on Swazi Nation Land, land held by the King of Swaziland in trust for the Swazi nation, covering 6000 hectares. The formation of the small-scale commercial farms on Swazi Nation Land involves a process of getting land rights from traditional authorities (TAs) and grouping individual farmers into associations for ease of development. The associations are then registered as companies or co-operatives. The KDDP has a total of 17 companies and 2 multi-purpose co-operatives making a total of 19 farmers associations (FAs).

2 OBJECTIVES OF THE PAPER

The objectives of the paper is to
- To identify the key factors affecting viability of small scale sugarcane business particularly in the KDDP.
- To assess the effect of such factors on the existing farmers in the KDDP
- To present the mitigation measures put in place and recommend further mitigation plans to improve the viability of the businesses.

3 METHODOLOGY

This is a desktop study based on project information and performance reports. Fifteen companies have been used to assess the factors affecting the viability of these companies.
4 DISCUSSION

4.1 Factors affecting viability

A viable business is one that is able to meet its operational and financial obligations and be able to sustain itself. There are a number of factors that affect the viability of small-scale sugarcane businesses. These are discussed below.

4.1.1 Investment cost

The cost of investment is a major factor in the viability of any business. It consists of the development cost and the cost of financing. The major development costs comprise of land preparation and irrigation installation. The KDDP farmers use a variety of irrigation systems which include dragline, semi-permanent and centre pivots. All these systems require high pressure water for efficiency. This means that the farmers invested in pumping equipment to drive the required pressure. The cost of development varied from one farm to the next depending on the landscape of the farm, the distance from the water abstraction source as well as the irrigation system used.

The cost of finance is another factor affecting the viability of small-scale commercial farmers. The businesses were 100% debt financed and the impact of finance charges is greatly felt by the farmers. The FAs sourced capital financing from three (3) Development Finance Institutions (DFIs), namely; Swazibank, FINCORP and SIDC. The interest rates charged by these DFIs were linked to prime, with some charging up to 3.5% premium above the prime rate. Prime-linked interest rates are not good for development financing since they greatly affect the viability of the business during harsh economic conditions that result in increase in interest rates.

4.1.2 Market

Market analysis is also an important factor in analysing the viability of a business. The sugarcane industry has a ready market. Despite the availability of a market there are other factors associated with the market that have an effect on the viability a business. These factors are (a) the distance from the miller, and (b) the sucrose price.

a. The distance of the market from the business location. KDDP farmers are within a radius of 50km from the mill. A distance of less than 60km is considered a viable distance and the mill subsidises the cost of hauling cane beyond this distance.

b. The sucrose price.

Unlike in other businesses where the seller fixes the price, the sugarcane producer depends on the buyer for price setting. Twelve (12) out of the fifteen (15) FAs considered for this viability analysis were developed before 2005. The price of sucrose at this stage was above the E 1,500.00 mark and the forecasts showed an
incremental trend from this price, hence the decision for financiers to finance the FAs, as they were viable.

4.1.3 Operational costs
The major operational costs in the production of sugarcane are harvesting and haulage, fertilizer, electricity, and labor. These costs have risen over the years from a about E12,000.00 per hectare in 2005 to E22,000 per hectare in 2009.

Harvesting and haulage is the major cost in the production of sugarcane at KDDP and contributes 35% to the total operational cost in small-scale sugarcane production.

Fertilizer is the second highest sugarcane production cost, taking 21% of the total operational cost. In the 2009 season, the average cost per hectare was E4,193.00 per hectare compare to E5,181.00 in 2008.

The KDDP farmers rely heavily on electricity for irrigation purposes. It accounts for about 17% of the total operational costs and is currently at an average of E3,229.00 per hectare, with the highest being E4,100.00 per hectare. The cost of electricity is expected to rise by 16% this year and 25% per annum in the next two years.

Sugarcane production is labour intensive and the cost of labour contributes 12% to the total operational cost. Labour laws have insisted on a number of provisions for agricultural labour like food rations, housing and workman’s compensation. Small-scale sugarcane producers are unable to meet all the labour law requirements and have resolved on outsourcing some of the services to cut down on labour cost especially harvesting.

If not well managed these costs affect the farms ability to meet its financial obligations.

4.1.4 Production levels
Production yields are an important element for the viability and sustainability of every business. Sugarcane production requires high yields in order for a business to cover all its costs. Most of the production costs are linked to area under production which are then considered as fixed costs. At project inception, a yield of 100 tons cane per hectare (TCH) and 13.5% sucrose was a good yield for a viable business. On average, the KDDP FAs were able to attain good yields, ranging from 98 to 104 TCH and 13.62% to 14.7% sucrose. Most FAs produced high yields competing with large scale industries. The only exception was in in 2005 and 2006 which was due to drought that was experienced then.

4.1.5 Area under production
Basic economics tells us that producing in high quantities leads to the benefits of economies of scale. The KDDP farmers’ production area ranges between 46 hectares to 352 hectares. Each FA has fixed costs that are non variable to area, e.g. administration and farm
management costs. Two (2) of the fifteen (15) FAs have an area below 100 hectares which makes them bear heavier fixed costs compared to the other FAs.

4.1.6 Management team capacity
The aim of the project was to empower the shareholders with business management skills and allow them to run and manage their businesses. Most of the farmers had no sugarcane husbandry skills, save for those who once worked for the Royal Swaziland Sugar Corporation. Better still, none of them had been involved in financial management. The farm supervisors had no sugarcane husbandry qualifications and had to be trained and mentored through the assistance of SWADE.

4.1.7 Social cohesion
The formation of the small-scale commercial businesses involved the grouping of individual farmers into associations that were then registered as legal entities. The FAs’ Board of Directors are from the membership and strong and healthy relationships are vital for the sustainability of the businesses. Individual farmers contributed their land to the companies to form one contiguous farm for economies of scale. If the business does not yield the expected returns, social tensions can emerge and social disputes can affect the performance of the business thus negatively influencing the viability of the businesses. Only two (2) out of the 19 FAs had social disputes, which affected the farm development.

4.1.8 Turnaround time
A number of the FAs at KDDP were developed in phases. Some had to delay planting which resulted in foregone revenues. This impacted negatively to the cashflows of the FAs thus negatively influencing their viability. FAs that developed the whole area were able to realize revenues in the following year and were able to meet their financial obligations. A delay in the receipt of projected revenues has a long-term effect on the viability of a business since it has to carry the finance costs of a non performing loan.

4.2 Impact of the factors to the viability of the businesses

There a number of indicators of a viable business, the basic ones being the capacity to meet its operational and financial obligations.

4.2.1 Financial impact
All fifteen FAs have been able to meet their operational costs over the years. Some of them had difficulties paying their yearly interest obligations, especially in 2005 and 2006 when the production levels were low. This led to DFIs rescheduling the loan repayment periods from seven to ten (10) years for some FAS. A prolonged repayment period means fewer returns to the shareholders since most of the returns go towards debt servicing.

The full debt financing means a debt ratio greater than 1 since both capital and operational costs were debt financed. This is not a good financial for a business. Another indicator is the Times Interest Earned ratio which measures the ability of a business to cover its interest
obligation. Most of the FAs ratios are less than 2, which is also not a good indicator of long term viability.

4.2.2 Social impact

Shareholders expect returns from the sugarcane businesses in form of dividends. Businesses with a poor viability forecast are unable to pay dividends to its shareholders. Most of the shareholders depend on the income received from the sugarcane businesses and when none is received, social disputes are prone to emerge thus disturbing the operations of the business. Most have now started paying dividends to their members. This will reduce the conflicts amongst members.

5 MITIGATION PLAN

A number of mitigation plans have been put in place to counter against the viability challenges faced by the small-scale sugarcane farmers. These include:
  a. Rebates paid by the Government of Swaziland to the existing FAs at KDDP. This has seen an improvement on the payback period of the FAs, with some cutting down payback time by 3 years.
  b. European Union grant funding of up to 70% of capital investment for new schemes to improve viability
  c. Bulk purchasing of farm inputs by farmers which resulted on a saving of up to E3 million in 2009.
  d. Collective bargaining for services by the farmers – haulage rates is being negotiated.
  e. Negotiations for interest rates and electricity tariffs are ongoing.
  f. Continued training and mentoring of farm management teams. This has resulted in an improvement on yields obtained by the farmers.
  g. Stakeholder collaboration is being intensified especially with DFIs.
  h. Technical support from SWADE and the mill.
  i. Compliance to fair trade requirements for revenue improvement

6 LESSONS LEARNT

  a. The increasing sugarcane production cost needs to be looked into and cost reduction measures should be intensified.
  b. Social cohesion is vital for sustainable rural development
  c. Traditional authorities need to be part of the development system to ensure peace and harmony among association members
  d. Development finance cost should be reviewed and should not be linked to prime
  e. New development needs more than 70% grant funding