Competition and Coordination in the Zimbabwe Cotton Sector

2001 – 2004

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Critical Issues

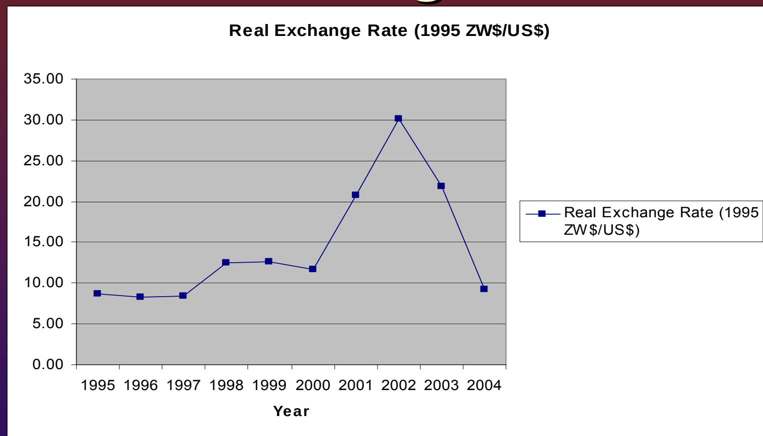
- Impact of economic crisis on the cotton sector
  - ⇨ Response of existing players to new conditions
- Impact of new players on sector performance
  - ⇨ Credit provision
  - ⇨ Quality control
  - ⇨ Pricing
- Need for a new regulatory framework
- Future prospects

Impacts of Economic Crisis on Company Operations

- Foreign exchange shortages
  - ⇨ Shortages of inputs
- Fuel shortages
  - ⇨ Companies – transport provision + reimbursement
- Cash shortages in 2003
  - ⇨ Bearer cheques (Cargill) + b. material & equip (FSI)
- Legal grey areas around foreign exchange retention
- Pricing uncertainty under hyper-inflation
  - ⇨ Interest rates
  - ⇨ Seed cotton pricing

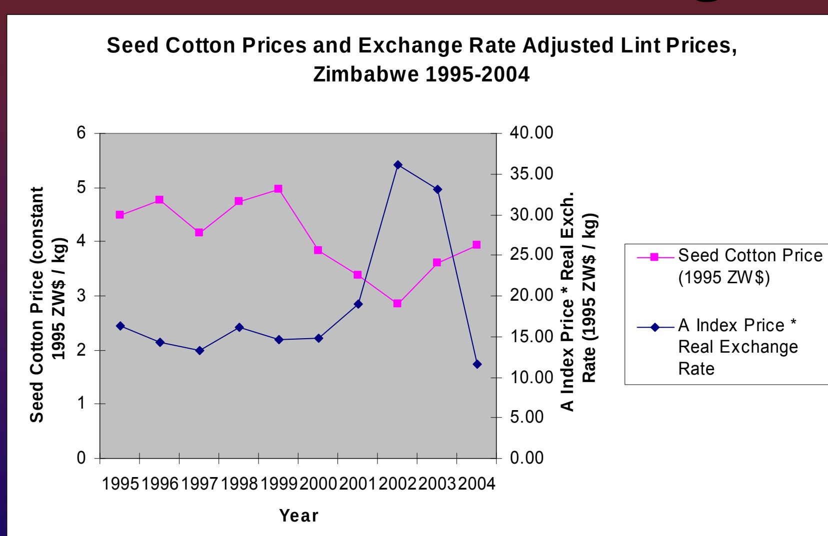
- Challenges for Agro-Chemical Companies
  - ⇨ Borrow money at higher interest rates
  - ⇨ Seek foreign currency on the parallel market (auction system)
  - ⇨ Distribute inputs based on controlled prices (monitored system)
- "Opportunities"
  - ⇨ Creation of 000s of new "larger smallholders"
  - ⇨ Attraction of cotton sector as source of forex
- Cotton sector has survived, but change (forever?)
  - ⇨ New challenges from new industry structure

Macro-Economic Instability: the Real Exchange Rate



	2000	2001	2002	2003	2004
Effective Exchange Rate (ZW$/US$)	55	172	600	2412	4210
Inflation Rate (year-on-year, August)	56%	77%	140%	456%	314%

Seed Cotton Pricing



Number of companies: 2000/01 = 4 → 2002/03 = 12

Climatic Impact

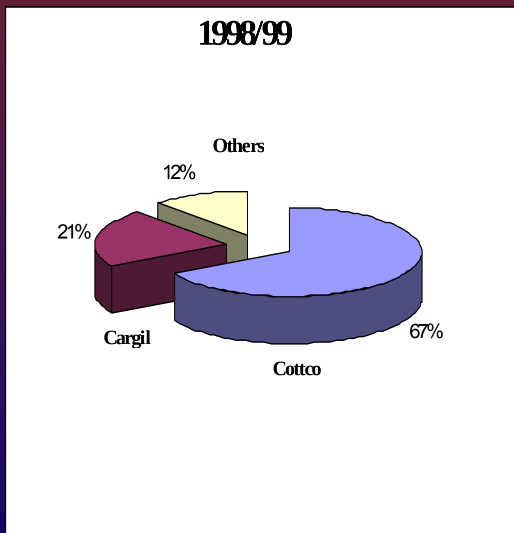
- 2001/02 drought
- 2002/03 also poor season

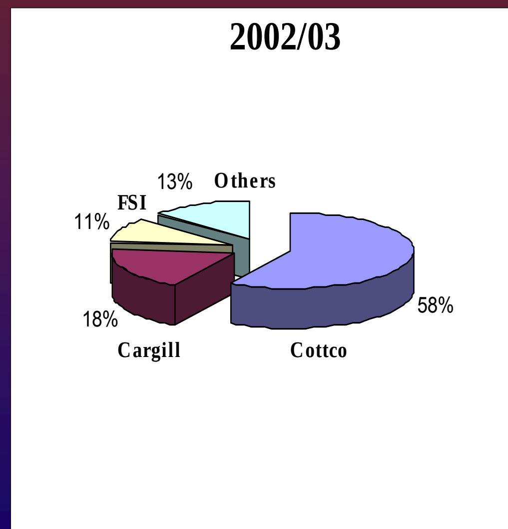
⇨ Low production exacerbated “scramble” for available seed cotton

How Far Has Competition Increased?

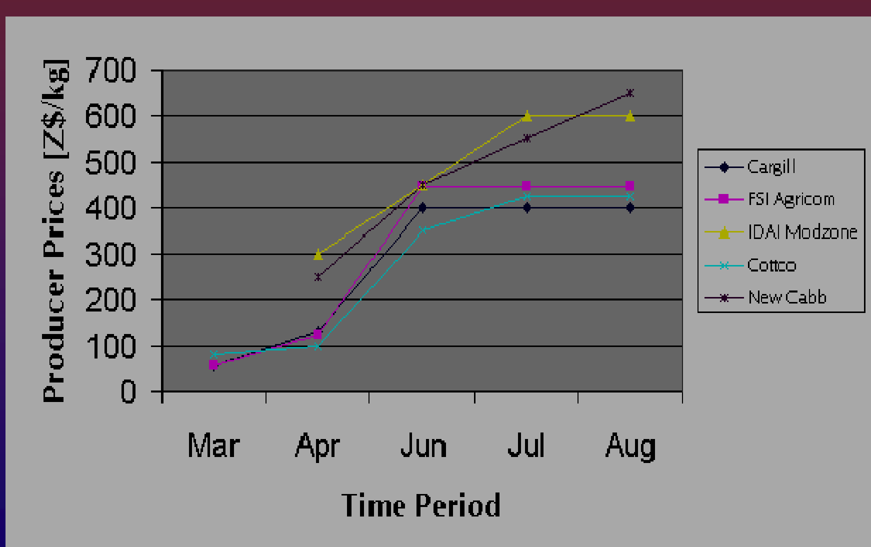
- Many new entrants, but have they challenged dominance of established companies?
- Cottco market share:- 79% (1999/2000) → 70% (2001/02) → 58% (2002/03) → 58% (2003/04)
- 2002/03: Cottco, Cargill and FSI Agricom compete amongst themselves; others remain “fringe”
  - ⇨ Big players not obliged to follow their pricing
- 2003/04: FSI Agricom fall back; other small companies capture 20%
- Market structure now similar to Ghana in the 1990s
  - ⇨ Can sustain an intensive production system …
  - ⇨… but only if you get the coordination mechanisms right!

Trends in market share proportions





Seed cotton pricing in Gokwe South District 2003



Credit Provision

Heightened competition has:-

- Increased access to credit
  - ⇨ New companies offering credit to challenge Cottco
  - ⇨ Cargill has increased credit scheme
  - ⇨ Of surveyed households, 107/279 (38%) received credit from companies in 2003/04, c/w 97/265 (37%) in 2001/02
- Increased problem of side-marketing
  - ⇨ Poor repayment 2001/02, but poor season
  - ⇨ Good repayment rates 2002/03, but deceptive
  - ⇨ Threats of pull-out by Cottco, FSI Agricom 2003
  - ⇨ More intensive monitoring by Cottco staff (more emphasis on loans, less on extension?)
- However, culture of credit repayment still intact

Quality Control

- Mounting fears – quality compromised (reduced output + increased competition)
- Abandonment of grading at primary marketing
  - ⇨ Driven by new entrants (mobile buying + no grading)
  - ⇨ Established – spot price system (dual grading system)
- Price differentials – disappeared
- Result – more poor quality seed cotton purchased
- Not (yet?) reflected in feedback from international buyers
  - ⇨ One exception: explicitly linked lower premium to relaxed grading since entry of new players

Seed Cotton Pricing

VARIABLE	2001/02	2002/03	2003/04
Exchange rate	742	2 412	5 601
Seed cotton price (ZW$/kg)	**56**	**600**	**1 900**
Lint equivalent price (ZW$/kg)	140	1 500	4 750
Lint equivalent price (US$/kg)	0.19	0.62	0.85
"A" Index price (US$/kg)	1.05	1.52	1.06
Including 10% premium (US$/kg)	1.15	1.59	1.17
f.o.b. export price (US$/kg)	0.95	1.39	1.09
Producer price as share of f.o.b.	**25%**	**45%**	**78%**

Modelling the Poverty Impact of Alternative Seed Cotton Prices

- Micro-economic models of seven smallholder cotton household types
  - ⇨ Calibrated on 2001/02 survey data from Muz + GSDs
- Base case (with actual 2002 prices)
  - ⇨ 56% of households below nationally-defined Total Poverty Line (TPL)
- Scenario 2: seed cotton raised to ZW$80 (to give farmers 35% of f.o.b. export value)
  - ⇨ 38% of households below nationally-defined Total Poverty Line (TPL)

Household Type	Credit?	Area Increase
1	**No**	**578%**
2	Yes	32%
3	Yes	36%
4	**No**	**78%**
5	Yes	0%
6	Yes	5%
7	Yes	44%

Households **without access** to credit show much more variable seed cotton production as prices change

The Need for a New Regulatory Framework

- Loose/informal coordination (NCC) - ineffective
- Established companies – through NCC – proposed new cotton regulations
  - ⇨ NCC as main regulatory authority
  - ⇨ Emphasis (Legislation + regulation)
- However, progress has stalled
- Could be overtaken by re-establishment of AMA

Prospects for the Future

Input Credit:-

- Side-marketing threatens existing schemes
- New entrants + competition (new schemes)

Quality Control:-

- Est. companies – quality – not giving Fs incentives
- New entrants – sending diff message (quality not important)
- Quality standards – not yet fully collapsed (time)

Thank You !!!