



## **ANTI-CORRUPTION BUREAU**

### **INVESTIGATION REPORT**

**Subject: ALLEGATION OF CORRUPTION AND CONNIVANCE AMONG TOBACCO BUYERS, AUCTION HOLDINGS LIMITED AND OTHER STAKEHOLDERS IN THE TOBACCO INDUSTRY.**

**Classification: Secret**

**Ref: CR/LIL/412/2005**

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#### **1. INTRODUCTION**

- 1.1 On 25 August, 2005, the Anti-Corruption Bureau received a complaint alleging that there is corruption and connivance among tobacco buyers, Auction Holdings Limited and other stakeholders in the tobacco industry. They do this to the disadvantage of the tobacco growers.
- 1.2 On the same day, the Director authorised investigations into the matter in accordance with Section 11 (1) (a) of the Corrupt Practices Act.

#### **2. METHODOLOGY**

- 2.1 The following people assisted by providing information;
- Mr.F.Mkumba Executive Secretary,  
TAMA.
  - Mr.Harris Chanza Deputy Director,  
Agriculture Investment  
Programme, Ministry of  
Agriculture.
  - Dr.Evans Chipala Group Chief Executive,  
AHL

- Mr.Wilson Katumbi Chief Starter, Lilongwe Auction Floors.
- Mr.H.A.Kanjadza Manager, Mzuzu Floors.
- Mr.Bakali Agriculture Investment Programme, Ministry of Agriculture.
- Grant Bvumbwe Sales Leader, Africaleaf (Malawi) Ltd.
- Dr.Godfrey Chapola General Manager, TCC.
- Mr.Gary Taylor Group Operations Director Limbe Leaf Tobacco Co.Ltd.
- Mr.P.B.Chitokwe Manager, Limbe Floors.
- Mick Gange Harris Director, Africaleaf (Malawi) Ltd.
- Hetherwick Mbale General Manager, Tobacco Exporters Association of Malawi.
- Hugh Saunders Leaf Director, Alliance One Tobacco.
- Mr.Alastair D.Craik Managing Director, Alliance One Tobacco Co.
- Mr.S.Stephens Senior Starter, Limbe Floors.
- Mr.A.Chimbaya Chief Auctioneer, Limbe Floors.
- Mr.A.Chifungo Senior Leaf Buyer, Alliance One.
- Mr.Henry Mphamba Statistician, Alliance One.



Control of Tobacco Auction Floors Act establishes the Tobacco Control Commission hereinafter referred to as the "TCC". The mandate of TCC is to advise the government on the sale and export of tobacco, promote and expand the sale of tobacco, collate statistics relating to tobacco, distribute market studies and information relating to tobacco and control/regulate the sale of tobacco on the floors in Malawi<sup>1</sup>.

3.1.2 TCC is a statutory body with a board appointed by the Minister of Agriculture. The composition of the board is as follows;

- (a) a chairman appointed by the Minister
- (b) two members to represent the Agriculture Development and Marketing Corporation.
- (c) two members to represent the Tobacco Association
- (d) two members to represent the Tobacco Exporters Association
- (e) four members to represent tobacco farmers
- (f) two members to represent the Government

3.1.3 This composition of the board represents the whole tobacco industry. This means also that TCC is not independent. Buyers also sit on the Board of TCC and are likely to work against policies which are against their business interests<sup>2</sup>. Buyers may also influence dictate the changes they want in the industry<sup>3</sup>. The situation put TCC in a situation where it can not control the malpractices on the Auction floors<sup>4</sup>.

3.1.4 Until 1994, production of tobacco in Malawi was also controlled under the Special Crops Act. There were controls on who would produce the crop. Farmers were also given production quotas which would regulate the amount of tobacco to be produced in order to match with the demand.

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<sup>1</sup> Control of Auction Floors Act.

<sup>2</sup> Status and prospects of Malawi's Tobacco Industry: A value chain analysis.

<sup>3</sup> Statement of Felix Mkumba on 14 September, 2005.

<sup>4</sup> Statement of Henderson Kanjadza on 27 September, 2005.

After repeal of this Act, the number of farmers engaged in tobacco has increased.

3.1.5 In Malawi, Tobacco is only sold at Auction Floors. The Auction Floors are licensed under the Control of Tobacco Floors Act. Currently the only licensed seller of Tobacco in Malawi is Auction Holdings Limited hereinafter referred to as "AHL".

3.1.6 Auction Holdings Ltd sells the tobacco on behalf of Growers in the four Auction Floors in Malawi namely; Lilongwe, Limbe, Mzuzu and Chinkhoma in Kasungu. The tobacco is sold through auction, whereby the buyer who bids the highest buys the tobacco.

3.1.7 Persons or Companies who buy tobacco at the Auction Floors have to possess a license which is issued by the Minister. Persons or Companies granted buying licenses are supposed to comply with any conditions and provisions of the Tobacco and Control of Tobacco Auction Floors Act.

3.1.8 Currently the following companies buy tobacco on the Auction Floors in Malawi;

1. Africa Leaf
2. Limbe Leaf Tobacco Company
3. Alliance One
4. RWJ Wallace.

Alliance One is a merger of Dimon Tobacco Company and Stancom Tobacco Company. These two companies have just merged this year into one<sup>5</sup>.

### 3.2 **PROCEDURE OF AUCTIONING TOBACCO AT THE AUCTION FLOORS.**

3.2.1 On the line of selling tobacco, AHL has the following officers; Starter, Auctioneer, two Ticket Markers and the Checker Board. They face the buyers who also line themselves. The buyers are known by symbols. Africa Leaf uses symbol AF, Limbe Leaf Tobacco Company Limited uses symbol LL,

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<sup>5</sup> Statement of Dr.Evans.Chipala on 20 September, 2005.

Alliance One Tobacco uses two symbols of either M or O. Previously M was for Dimon Tobacco Company and O for Stancom Tobacco Company; RWJ Wallace uses symbol W. Sales of tobacco begin at 07:30 a.m every day Monday through Friday.

- 3.2.2 Buyers are required to bid using signs. Auctioneers are trained to look at the various signs from buyers and either increase or decrease the price of a particular bale. In the course of bidding, buyers are supposed to hide the signs from each other so that they do not know how the other is bidding. Shouting of bids (prices) by buyers is not allowed. Shouting of bids is only allowed where the buyer shouts a higher price than the one shouted by the Starter. For example where a Starter shouts the price of one dollar and twenty cents (\$1.20), a buyer can shout one dollar and forty cents (\$1.40). Shouting of prices downwards by the buyers is prohibited<sup>6</sup>.
- 3.2.3 The Starter is a person who is authorised to place an approximate value on tobacco offered for sale at the Auction Floor. The price is determined by looking at the quality of tobacco, value according to grade and the market trend of a particular time (day)<sup>7</sup>.
- 3.2.4 The Auctioneer is a person who picks bids from the buyers and chants the price either upwards or downwards. If no buyer comes in to bid, the Auctioneer chants the price downwards until one or two buyers comes in. If two or more buyers come in at the same time, the Auctioneer chants the price upwards until one buyer remains. When one buyer remains the Auctioneer knocks down the price and the bale to that buyer<sup>8</sup>.
- 3.2.5 The Ticket Marker is a person who marks the price on the ticket on every bale. After the Auctioneer has knocked down the price and the buyer, the Ticket Marker marks the knocked down price and the buyer on the Ticket which is on every bale. The buyer's name is marked on the ticket by using symbols mentioned in 3.2.1 above.

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<sup>6</sup> Statement of Mc. Andertone Chimbaya on 6 October, 2005.

<sup>7</sup> Statement of Grant Kadiwa on 27 September, 2005.

<sup>8</sup> Statement of Mc. Andertone Chimbaya on 6 October, 2005.

3.2.6 The Check Board is a person who records the price knocked down by the Auctioneer and the buyer in the course of selling the tobacco on a Check board. After every line of selling tobacco, the Check Board cross checks his information with the information on the ticket on every bale if it is the same. The aim is to ensure accuracy. The ticket marker may sometime miss the information from the Auctioneer since the sale is very fast. A tobacco bale is sold within seconds.

3.2.7 Growers Representatives are employees of AHL who represent Growers in terms of prices at the Auction Floors. They mainly represent Growers who do not come to witness the sale of their tobacco. They check the prices offered to see if it worthy the tobacco. They have the power to cancel the sale of tobacco bales which they feel the prices offered are not worthy the quality of tobacco and re-offer the bale<sup>9</sup>.

### **3.3 OBSERVATIONS ON THE CONDUCT OF SALES AT THE AUCTION FLOORS.**

3.3.1 Bureau officers in a covert operation witnessed and observed the sales of tobacco at Mzuzu Auction Floors on 26 September, 2005. The aim was to witness and observe what actually happens when tobacco is being sold at the floors. The observation was followed by interviews of key people involved in the sale of the tobacco.

3.3.2 It was generally observed that there are some practices which the buyers are involved in which have changed the process of auctioning. The practices have greatly reduced competition thereby reducing the price of tobacco. The following practices have been observed in all the Auction Floors:

#### **3.4 SHARING OUT SYSTEM AND BUYING OF TOBACCO ACCORDING TO AGREED PERCENTAGES.**

3.4.1 The Companies which buy tobacco on the Auction Floors behave like a cartel. *A cartel is a group of independent business firms which work together to increase profits by not competing with each other.* The buyers have shared out on the percentages that each buyer is supposed to buy on a

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<sup>9</sup> Statement of Dr.Evans Chapola on 20 September, 2005.

daily basis<sup>10</sup>. Each buyer has a fixed percentage which he is supposed to buy<sup>11</sup>. The buying companies come to the Auction Floors knowing how much each company is supposed to buy. The buyers ensure that each buyer is maintaining his percentage by employing statisticians<sup>12</sup>.

3.4.2 The buying companies especially Limbe Leaf Tobacco Company and Alliance One ensure that each buyer is buying within his percentage by employing Clerks or Statisticians. The Clerks count the number of bales bought by each company every four lines of tobacco bales bought. The number of bales each company has bought is calculated as a percentage. The clerks keep on consulting and sharing information with fellow clerks of other buying companies in the counting of bales throughout the sale. They consult in order to know how much each company has bought so far. The clerks constantly feed the information to their respective buyers through a small piece of paper called "counter" so that they do not exceed their buying percentages of that day<sup>13</sup>. Because of this system, the buyers do not compete against each other since they are assured of buying their required percentage whatever the case may be.

3.4.3 When the Buyers receive the information of how much they have bought so far from their respective clerks, buyers who have bought more than their percentage are cautioned by their fellow buyers<sup>14</sup>. Those who are cautioned respond by just walking on the line of buying pretending as if they are buying. They bid in such a way that they should leave the bales to those buyers who are low in terms of percentage so that they should catch up. This behaviour triggers a reduction in prices as competition is defeated<sup>15</sup>.

3.4.4 Buyers who are offering high prices are also cautioned by fellow buyers. This happens especially where the buyer offering high prices is a junior buyer. Senior buyers will give a report of the conduct of a junior buyer to his authorities. The next thing that happens is that the junior buyer is

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<sup>10</sup> Statement of Walli Bapu on 23 November, 2005.

<sup>11</sup> Statement of Samuel Kasambala on 27 September, 2005.

<sup>12</sup> Statement of Walli Bapu on 23 November, 2005.

<sup>13</sup> Statement of Mac.Bomen Chipeta on 27 September, 2005.

<sup>14</sup> Statement of Henderson Allison Kanjadza on 26 September, 2005 and Samuel Kasambala on 27 September, 2005.

<sup>15</sup> Statement of Mac.Andertone Chimbaya on 6 October, 2005.

withdrawn from the line of buying and prices consequently go down.

3.4.5 The share out system is also observed where buyers come across tobacco bales that are of the same quality. The Buyers deliberately bid in such a way that Limbe Leaf Tobacco Company gets at least two or more bales before Alliance One and Africa Leaf<sup>16</sup>.

### 3.5 SHOUTING OF PRICES.

3.5.1 In tobacco auction, Buyers are not allowed to shout out prices. Only the Starter shouts the price. However, some Senior Buyers shout prices. When the Senior buyer shouts the price, the rest of the buyers would listen. The aim is to set a price pattern of a particular quality of tobacco on that day of Auction. Most people interviewed at the Auction Floors indicated that in most cases, the first bale is bought by Limbe Leaf Tobacco Company. This also sets the bench mark price for that type of tobacco on that particular day.

3.5.2 TCC is supposed to act on the Buyers who shout when bidding at the Auction Floors by removing them from the buying line. Though TCC has acted on such buyers, the senior buyers continue to shout prices.

### 3.6 STATISTICIANS/BALE COUNTERS

3.6.1 Buying companies like Limbe Leaf Tobacco Company and Alliance One have employed Statisticians. The Statisticians count the number of bales purchased by each buying company every four lines after buying. The Statisticians act as checkers for buyers to make sure that every buyer is buying within his share of percentage.

3.6.2 The Statisticians have confirmed to the Bureau that they are told to take records of how many bales each company has bought after every four lines. They have said that they feed the information to their respective buyers so that they should know how much they are buying. This is done so that the buyers are buying within their required percentage. The Statisticians further confirmed normally Limbe Leaf Tobacco Company buys more, seconded by Alliance One and then

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<sup>16</sup> Statement of Mac Andertone Chimbaya on 6 October, 2005.

Africa Leaf. They also confirmed that this pattern is complied with on each day of buying<sup>17</sup>.

3.6.3 Alliance One has confirmed to the Bureau that they employ Statisticians to count the number of bales they have bought on every four lines of tobacco. The aim is to make sure that they remain within their requirement and also to make sure that they buy a consistent amount of tobacco so as to remain on the Auction the rest of the buying season<sup>18</sup>. The Buyers also said that they buy tobacco based on the orders from their customers most of which are cigarette manufacturers<sup>19</sup>. The Buying Companies accepted that their Statisticians share the information on the Auction Floors<sup>20</sup>. TCC said that currently there are no laws to check the malpractice<sup>21</sup>.

3.6.4 The buyers said that the price they offer on the floors is determined by first looking at what their customers are prepared to pay on a particular quality of tobacco. Then they determine what will be their profits. Thereafter they arrive at how much they are to have to offer on the auction floors<sup>22</sup>.

### **3.7 OTHER OBSERVATIONS**

3.7.1 In Malawi there are only four buyers of tobacco on the Auction Floors against a situation where other countries like Zimbabwe have about 16 buyers<sup>23</sup>. Out of these four buyers, two buyers buy less than ten percent of the tobacco. Limbe Leaf Tobacco Company Limited buys over fifty percent of the tobacco on the Auction Floors. Alliance One buys between thirty and forty percent of the Tobacco. Africa Leaf buys about eight percent and RWJ Wallace buys less than one percent<sup>24</sup>. In a situation like this one there is no competition since the tobacco is mainly bought by two companies. The Share out system is strengthened by the fact that the two largest companies dominate the process and co-ordinate with each other.<sup>25</sup> The fact that the practical outcome is a

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<sup>17</sup> Statement of Henry Mphamba on 4 October, 2005.

<sup>18</sup> Statement of Alastair D.Craik and High Saunders on 24 October, 2005.

<sup>19</sup> Statement of Garry Tailor on 25 October 2005.

<sup>20</sup> Statement of Gary Tailor on 25 October, 2005.

<sup>21</sup> Statement of Dr.Godfrey Chapola on 26 October, 2005.

<sup>22</sup> Statement of Garry Tailor on 25 October, 2005.

<sup>23</sup> Pathways to greater efficiency and growth in the Malawi Tobacco industry.

<sup>24</sup> Statement of Dr.Godfrey Chapola on 26 October, 2005.

<sup>25</sup> Statement of Samuel Kasambala on 27 September, 2005.

complete absence of competition is revealed by the fact that the market share do not change perceptibly from month to month or year to year or even day to day.

- 3.7.2. New buyers on the Auction Floors face the problem of processing their tobacco<sup>26</sup>. Tobacco is supposed to be processed before it is exported. Currently only Limbe Leaf Tobacco Company Limited and Alliance One have processing plants. Africa Leaf processes its tobacco at Limbe Leaf Tobacco Company Limited. Where a company has no processing plant<sup>27</sup>, it is restricted on how much it should buy. Companies which have processing plants charge high fees<sup>28</sup> and also attach tough conditions for processing of tobacco<sup>29</sup>.
- 3.7.3 Currently there is no control on production of tobacco. Previously production was controlled by production quotas under the Special Crops Act<sup>30</sup>. Loss of control on production has led to overproduction in some years and has also compromised the quality of the crop. In a scenario where there are few buyers and also the demand is not good coupled with high production of tobacco, the buyers tend to control the market<sup>31</sup>.

#### **4.0 FINDINGS**

- 4.1 The investigations have established that there is a cartel among the tobacco buyers in Malawi which has resulted in lowering of prices at the auction floors.
- 4.2 There are very few tobacco buyers in Malawi. This has resulted in buyers colluding thereby reducing competition and lowering of tobacco prices at the floors.
- 4.3 Limbe Leaf Tobacco Company and Alliance One have employed Clerks who assist the buyers on a daily basis so that they do not exceed their buying requirements (shares). The system reduces competition since the buyers are assured of buying their requirement.

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<sup>26</sup> Statement of Dr.Evans Chipala on 20 September, 2005.

<sup>27</sup> Statement of Dr.Godfrey Chapola on 26 October, 2005.

<sup>28</sup> Statement of Walli Bapu on 23 November, 2005.

<sup>29</sup> Statement of Dr.Evans Chipala on 20 September, 2005.

<sup>30</sup> Statement of Walli Bapu on 23 November, 2005.

<sup>31</sup> Statement of Dr. Godfrey Chapola on 26 October, 2005.

- 4.4. Some senior buyers influence the reduction of prices at the floors by shouting of lower prices contrary to the standing procedures.
- 4.5. The composition of the Board of TCC puts it in a situation where it can not suggest major reforms in the tobacco industry and implement them. The buyers and some other stakeholders who may be affected by the reforms sit on the board.
- 4.6. Fixing volumes on an auction floor must be regarded as an unlawful act, the conspiracy to commit an unlawful act is an offence under common law.

## **5.0 RECOMMENDATIONS**

- 5.1 TCC and AHL should ensure that the Clerks employed by the buyers should not be allowed on the floors during the sales.
- 5.2 TCC should impose stiffer penalties on any buyer who shouts prices in addition to being removed from the buying line.
- 5.3 The Government should attract more tobacco buyers to bring back competition on the auction floors.
- 5.4. The government should review the structure of the board of TCC in order to remove the conflict of interest of the current composition of the board.
- 5.5 The Anti-Corruption Bureau regards the habit of sharing out percentages as a crime in its scope but it feels that it is a matter that should be dealt with by the relevant ministry.
- 5.6 The report should be referred to Ministry of Agriculture so that corrective action is instituted under section 10 (4) of the Corrupt Practices Act.

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