The development potential of anchor enterprise models in Malawi

Todd Benson, Lara Cockx, and Joachim De Weerdt

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What is an anchor enterprise model?

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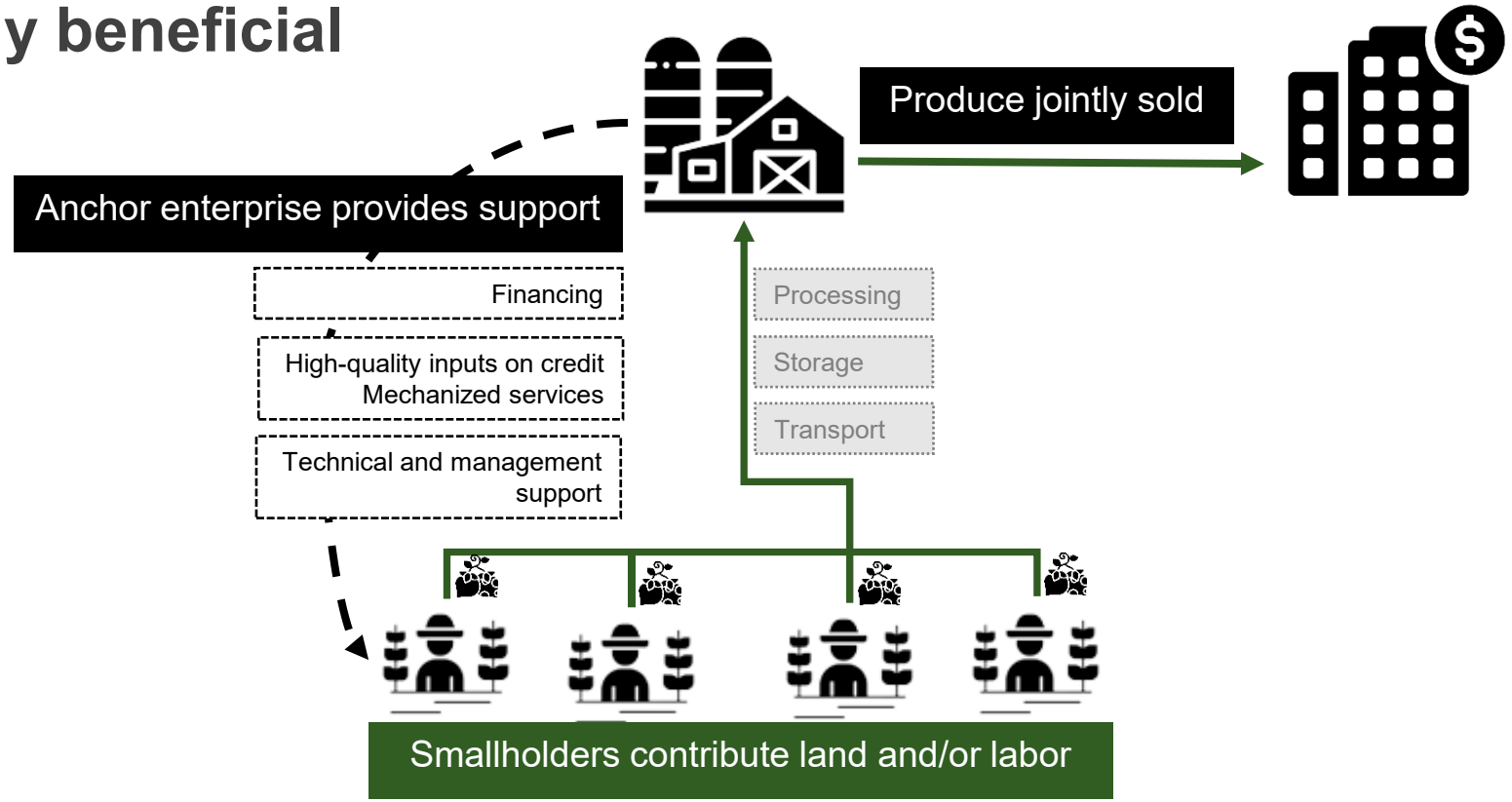
What is an anchor enterprise model?

Agricultural development approach built around a **larger-scale farm or agro-processor** commercially partnering with **smallholders**

→ **Commercially viable**

→ **Mutually beneficial**



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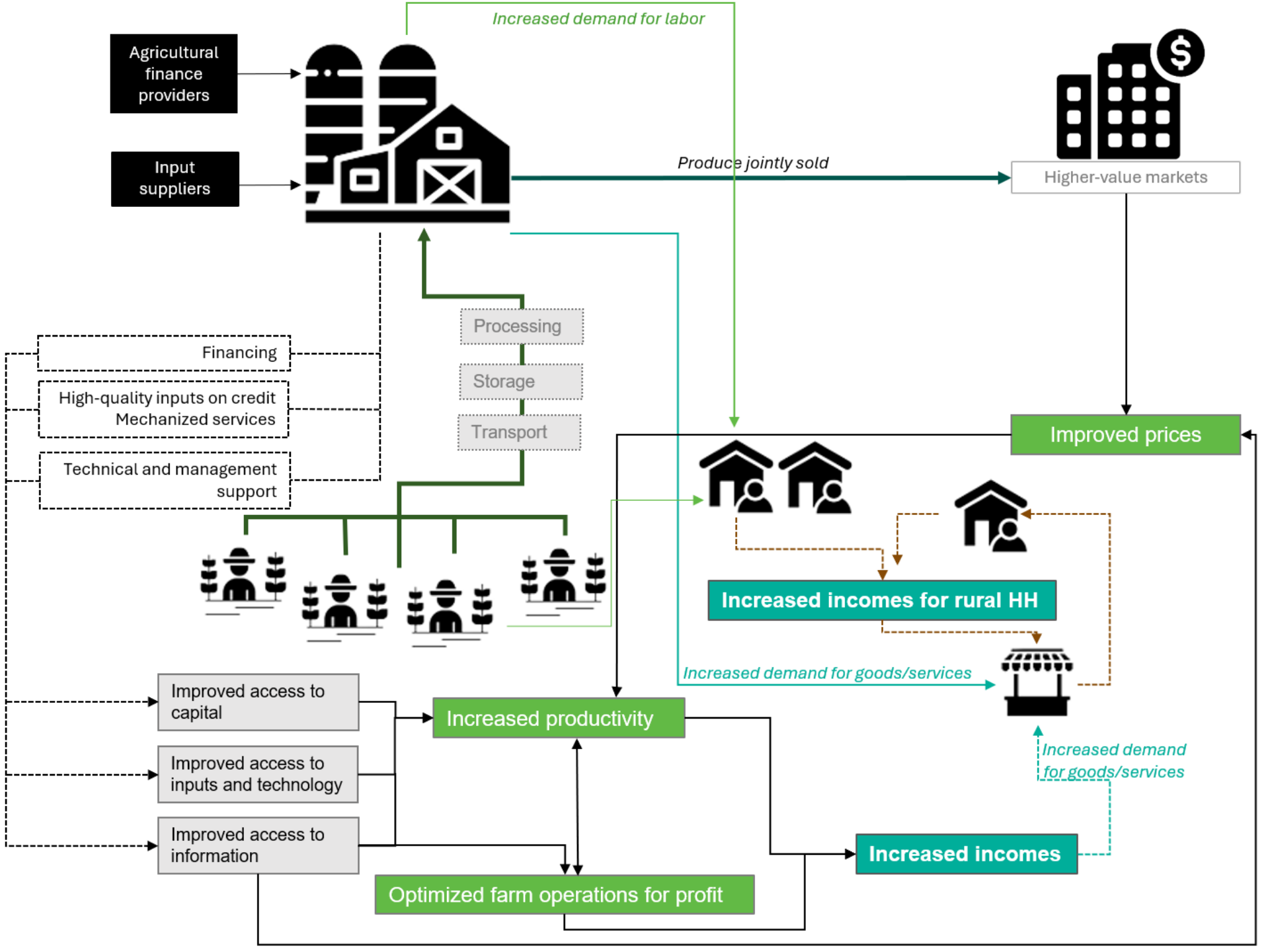
Assumptions

- The anchor enterprise is better endowed with productive assets, better connected to markets, and better able to acquire and effectively use improved technologies
- Partnership enables smallholders to improve productivity and farm operations
- Partnership enables anchor enterprise to increase production
- Combining operations enables economies of scale
- Broader spillovers into the rural economy will occur



When does the model make sense?

… when transaction costs can be reduced

If an enterprise wants to obtain (more) of a product, it has three options

1. Source from the open market
2. Organize or expand own production
3. Partnership with preferred suppliers

→ **Nature of the product** and **market conditions** largely determine transaction costs for each option

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**.

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When does the model make sense?

Type of product	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

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When does the model make sense?

… when transaction costs can be reduced

- For a **generic product** with a large number of suppliers and buyers, transactions costs from sourcing from the open market are limited
  - → **Sourcing from the market** is usually the lowest-cost option
  - → Partnerships are more costly and carry high risk
    - Farmers can easily find and sell to other buyers (side-selling)
    - Enterprises can easily find and buy from other suppliers (side-buying)

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When does the model make sense?

… when transaction costs can be reduced

- For **specialized products** sourcing from the open market can come with high costs
  - Identifying suppliers
  - Assessing quality or other attributes
  - Discovering prices
  - Negotiating agreements (on time)

  →Sourcing from the market is unlikely to be the lowest-cost option

  →Organize or expand **own production** or form **partnerships**?

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When does the model make sense?

… when transaction costs can be reduced

- Organize or expand **own production** of **specialized products**
  - Access to factors of production
    - →Malawi's land, labor, and capital markets are constrained
    - →Cost associated with obtaining the necessary factors of production are significant
    - →Cost associated with monitoring hired labor can be high
  - More control of the production process, but limited flexibility to scale up or down

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When does the model make sense?

… when transaction costs can be reduced

- **Partnerships** with preferred suppliers of **specialized products**
  - Setting up and managing partnerships involves significant costs
  - But…Eliminates transaction costs associated with
    - Finding and coordinating with suppliers
    - Obtaining factor of production when markets for land, labor, and capital are weak
  - Finding alternative suppliers or buyers or uses (on time) is difficult

    → Lower risk of side-selling or side-buying

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When does the model make sense?

… when transaction costs can be reduced

- From the farmer's perspective, partnering with an anchor enterprise can
  - Reduce transaction costs associated with
    - Finding and coordinating with buyers
    - Finding and procuring inputs or services

    →Enabling them to access and benefit from the elements that underpin the anchor enterprise's strong performance

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When does the model make sense?

… when economies of scale can be realized

- Fixed costs can be spread over a larger volume of output
  - Investments in mechanization or irrigation
  - Investments in transport, storage, or processing equipment
- Coordinating larger/bulk input purchases and output sales can result in better prices

- Attempts to achieve such economies of scale through farmer organizations in Malawi have had limited success

  → Established enterprises more likely to have the necessary management skills to realize these economies of scale

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When does the model make sense?

… when community relations matter

- Establishing and maintaining good community relations can help
  - Prevent or mediate issues of theft, property damage, and other crime of security incidents
  - Enhance the enterprise's image
  - Foster goodwill with government(s)

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For whom can the model work?

- Anchor enterprise engaging in agricultural **production** itself is likely better able to
  - Offer technical production and farm management support
  - Achieve economies of scale in production by partnering
  - Screen potential partners
  - Distinguish partners who made good faith efforts but failed from those acting in bad faith

- Anchor enterprise engaging in **processing** can have very strong incentive for partnering
  - Using processing equipment to full capacity requires a steady and reliable flow of primary agricultural produce

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For whom can the model work?

- **Smaller** anchor enterprises
  - More dependent on partnerships to achieve economies of scale
    → Stronger incentives for partnering
  - More accessible and socio-culturally similar to smallholders
    → Can make partnerships easier to establish and maintain

- **Larger** anchor enterprises
  - Greater capacity to manage large number of partnerships
  - More likely to have better access to capital, knowledge, technology, and information than smallholders
    → Greater potential to generate economies of scale and spillovers

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For whom can the model work?

- **Poorest and most vulnerable** smallholder farming households are less likely to participate
  - Partnership with anchor enterprise carries risk that relatively larger or richer smallholders can manage better
  - Anchor enterprises are (and should be) selective
  - Working with fewer, relatively larger smallholder farmers is less costly
  - Working with larger number of spatially dispersed smallholders can be part of a risk diversification strategy (i.e. different exposure to pests, diseases, weather shocks, etc.)
  - Costs and practical challenges of working with large number of smallholders can be mitigated if another organization acts as intermediary

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How can the model work?

A major challenge of the anchor enterprise model is the **risk of default**

- Default (anchor enterprise)
  - Fails to deliver inputs or other services (on time)
  - Arbitrarily raises quality or other requirements
  - Purchases from other suppliers (side-buying)

- Default (smallholder)
  - Diverts inputs provided by the enterprise
  - Fails to supply products due to production failure
  - Sells to other buyers (side-selling)

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How can the model work?

- Formal contract enforcement is difficult and costly
- Agreements can be **self-reinforcing** when both parties stand to lose by breaking the relationship
  - →Most likely for specialized product, with few alternative supplier, buyers, or uses

- Other approaches to reduce risk of conflicts and farmers defaulting
  - Access to (product-specific) services and technologies with high expected returns
  - Accurate screening, clear communication, and close monitoring (supported by sufficient field staff who regularly interact with farmers)

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How can the model work?

- Contracts should be written in accessible language and explained clearly to smallholder farmers
  - Poor understanding of the terms generates distrust and dissatisfaction
  - Limited information about the terms of loans raises risk of indebtedness and lock-in

- Independent quality verification has been shown to strengthen trust and even increase farmers' investments in production (Saenger, Torero, and Qaim, 2014)

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How can the model work?

- Effective farmer organizations can also help prevent and mediate conflict
  - Increase farmers' bargaining power
  - Facilitate communication
  - Provide a forum for grievances
  - Group-based loan repayment mechanisms can reduce the risk of default

  But… Many farmer organizations in Malawi 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 effectively

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Can the model contribute to inclusive rural development?

- Successful anchor enterprise operations can attract more traders and investments
- Knowledge or technology transfers to non-participating farmers

→ Poorer HH often less able to capture such spillovers

- Higher demand for local labor
- Higher demand for goods and services
  - Locally produced goods and services (that are labor-intensive and require limited capital)
    - → Income-earning opportunities for wider community (including the poorest and most vulnerable HH)
    - → Reduced prices for locally produced basic goods

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Conclusions

In **specific contexts** and for **specific products**, partnerships between larger-scale farms or agro-processors and smallholder farming households can be mutually beneficial and commercially successful as they help **reduce transaction costs**, **overcome market failures**, and realize **economies of scale**

- ✘ Grain or other generic staple crops
- ✓ More specialized, higher-value, less widely grown, more complex to produce or process, or highly perishable agricultural products

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Conclusions

- Anchor enterprise models **cannot** be **profitably** and **sustainably** employed for **many types** of commercial **agricultural production in Malawi**
  - Only a small portion of farming HH can participate (and poorest and most vulnerable are less likely to be included)
  - Indirect benefits to the broader rural community (incl. its poorer members), by stimulating local demand for labor, goods, and services

- Likely better suited for commercial agricultural development than inclusive rural development, but anchor enterprise models can be valuable for development in Malawi

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Conclusions

A model centered around commercial farms or agro-processors, however, requires an **enabling environment** for such enterprises to operate in

- Macroeconomic stability and favorable investment climate
- Supportive trade policy environment
- Improved rural infrastructure

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Conclusions

Anchor enterprise models should be grounded in a strong economic rationale, but there are options to **support** such partnerships without eroding their commercial foundations

- Provide assistance in managing relationships with smallholder partners
- Organize financial and business training for smallholder farmers
- Support organizations, such as cooperatives or NGOs, that can act as intermediaries
- Develop effective grades or standards and/or organize third-party certification of quality
- De-risk partnering with smallholder farmers

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Thank you

Lara Cockx
l.cockx@cgiar.org

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