MOOCS on Entrepreneurship Development

Contract Farming

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Introduction

- Smallholder farmers in developing countries face several constraints in raising the productivity and efficiency of agriculture.
- Poor access to information on new farming methods, inputs and credit, biotic and abiotic stresses, un-remunerative markets, price uncertainty and high transaction costs are the main reasons for it.
- Contract farming in which agribusiness firms contract with farmers to receive goods at a predecided price with the certainty of delivery of a specified quality and quantity at a specified time, has emerged as one of the most important instruments to facilitate the integration of the value chain activities.

- Contract farming is an old concept in India. During the 1850s-60s, cotton was grown by Indian farmers under the contract signed with East India company.
- Plantation of tea and coffee in North east and South India and poppy and indigo in the Eastern India was grown by Indian farmers under the contract with Britishers. Yes, under these contracts the farmers were exploited.
- FMCG company PepsiCo set up a tomato processing plant in Hoshiarpur, Punjab for which they procured the tomatoes from farmers directly by setting up contracts with them.
- This led to an increase in tomato yield from 7.5 tons per acre to 20 tons per acre.

Definition

- “An Agreement between farmers and processing and/or marketing firms for the production and supply of agricultural products under forward agreements, frequently at predetermined prices.”

-FAO; Contract Farming: Partnerships for Growth; 2001

- In agriculture, a forward contract is a merchandising contract that transfers physical possession and ownership of an agricultural commodity at a specified future time.

Areas Covered by Contract Farming

- **Market provision:** The grower and buyer agree to terms and condition for the future sale and purchase of a crop or livestock product.

- **Resource provision:** In conjunction with the marketing arrangements, the buyer agrees to supply selected inputs, including on occasions land preparation and technical advice.

- **Management specifications:** The grower agrees to follow recommended production methods, inputs regimes, and cultivation and harvesting specifications.

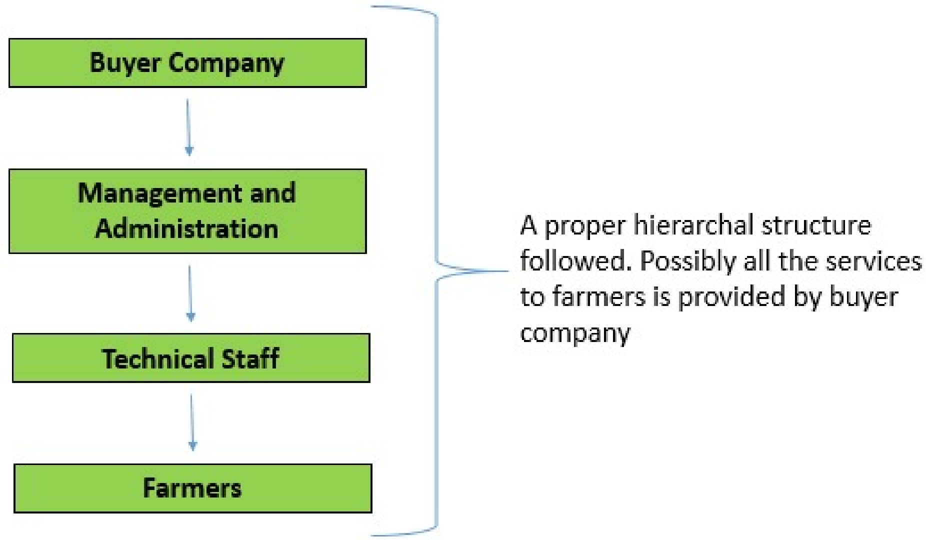
- Contract farming can take various forms:

- **Procurement contracts** under which only sale and purchase conditions are specified.
- **Partial contracts** wherein only some of the inputs are supplied by the contracting firm and produce is bought at pre-agreed prices.
- **Total contracts** under which the contracting firm supplies and manages all the inputs on the farm and the farmer becomes just a supplier of land and labour.

Contract Farming Models

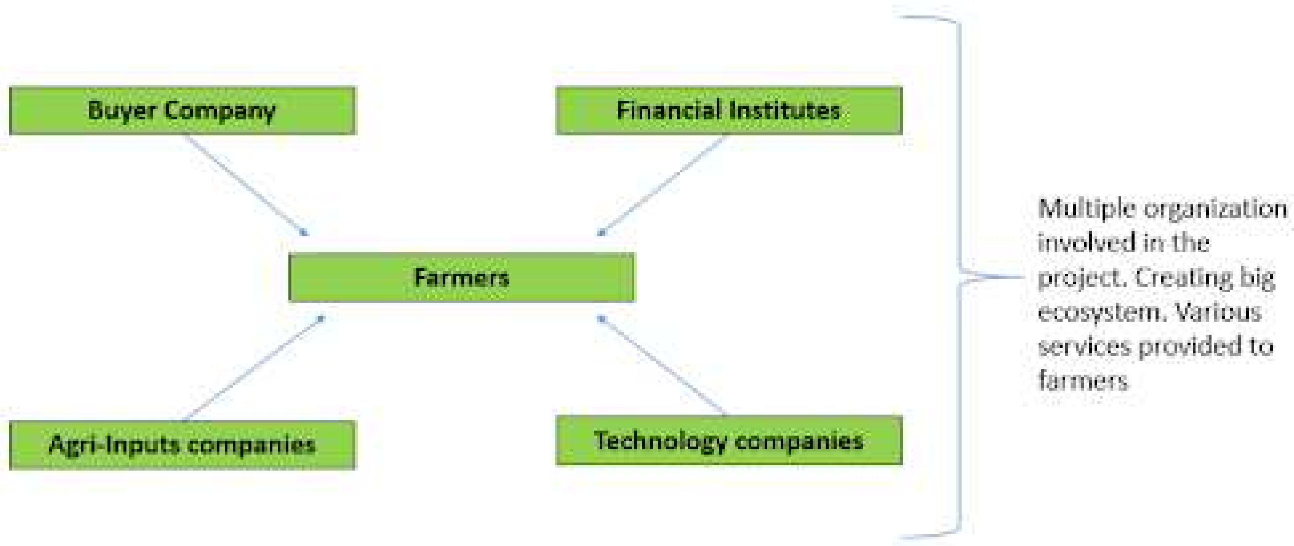
- Food and Agriculture Organization (FAO) specified five basic types of contract farming model.
- In India there is no single type or set of contract farming is practiced. In the majority of cases it is mixed of all types customized according to the need of buyer and seller.

The Centralized Model:



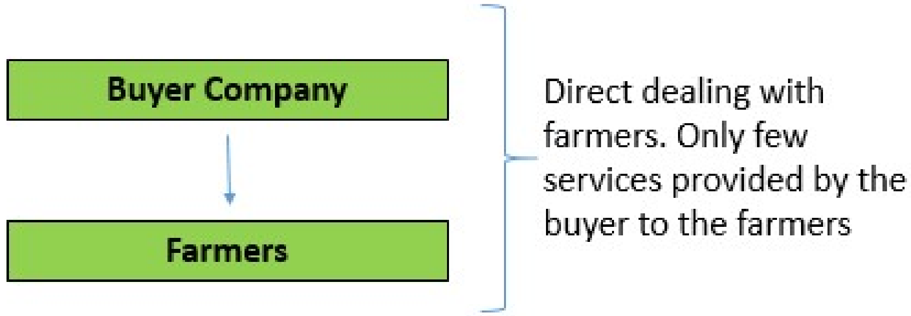
- One centralized processor or buyer who is the only entity involved in the contract with farmers.
- The buyer procures from many small farmers rather than buying from a few large farmers.
- Centrally monitored and managed by the buyer.
- All the services (technical guidance or advisory) is provided by buyer and no other stakeholder or entity is involved.
- The services may range from providing just good quality seeds or the extreme opposite by providing all the required services like land preparation, seedlings, Agro-chemicals and even harvesting services.

The Multipartite Model:



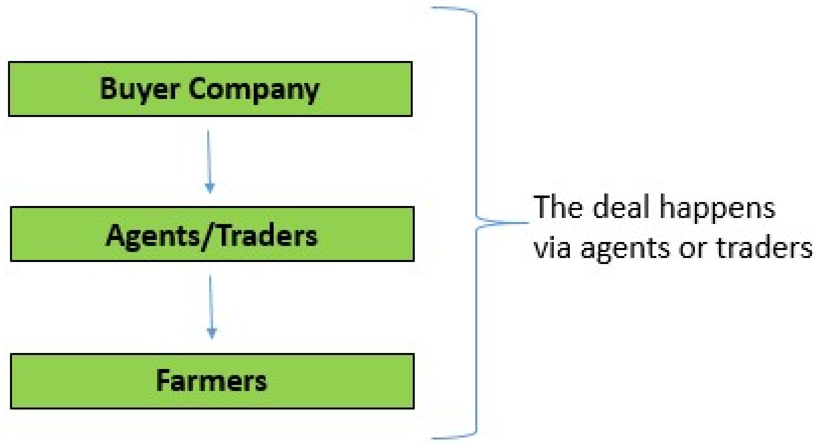
- Different entities and companies jointly take part with the farmers.
- The services provided by the farmer will come from different organizations according to their expertise.

The Informal Model:



- It is followed by single entrepreneurs or small companies who enter informal contracts with the farmers for a particular season.
- This is majorly done for fresh vegetables and fruits.
- Generally, the buyer take help from the government regarding the supporting services like extension service, technology transfer, technical know-how as well as credit arrangement.
- The buyer can also form contracts with farmers without giving services to them while ensuring their produce will be bought by the buyer.
- Contract is not for long term. It could be for a single season or two.
- The duration of such a contract depends upon the need and resource arrangement by the entrepreneurs or small companies.

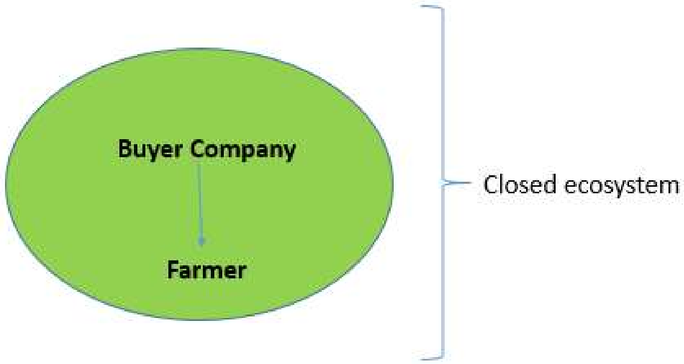
The Intermediary Model:



- The buyer company may not be directly in contact with the farmers.
- Agents/traders are in direct contact with the farmers. These intermediaries are sort of external representatives of the final buyer company.
- The harvested produce will be taken by the agents which will eventually be given to the buyer company.
- This model can bear disadvantages for vertical coordination and for providing incentives to farmers.

(buyers may lose control of production processes, quality assurance and regularity of supplies; farmers may not benefit from technology transfer; there is also a risk of price distortion and reduced incomes for farmers).

The Nucleus Estate Model:



- The buyer company owns and manages the farm. The land which they own may be their own or taken on lease from the farmers.
- It ensures a closed ecosystem where the buyer has much control on the farm as well as all the activities done throughout the season.
- This model was in the past often used for state-owned farms that reallocated land to former workers. The farmers are at times called 'satellite farmers' illustrating their link to the nucleus farm. This model is often referred to as the "Outgrower Model".
- Typical products: perennials
- Usually guarantees supplies to assure cost-efficient utilization of installed processing capacities.
- In some cases, the nucleus estate is used for research, breeding or piloting and demonstration purposes and/ or as collection point.

Examples:

- ITC Limited' and tobacco growers in Andhra Pradesh.
- Nestle India and dairy farmers in Punjab.
- Pepsico India and potato growers in Gujarat, Karnataka and West Bengal.
- Pepsico India's experiment with tomato growers in Punjab.
- ITC Limited's arrangement with vegetable growers in Punjab.

Impact of Contract Farming

Figure 1: Global impact of contract farming: response ratio for various commodities considering different outcome indicators

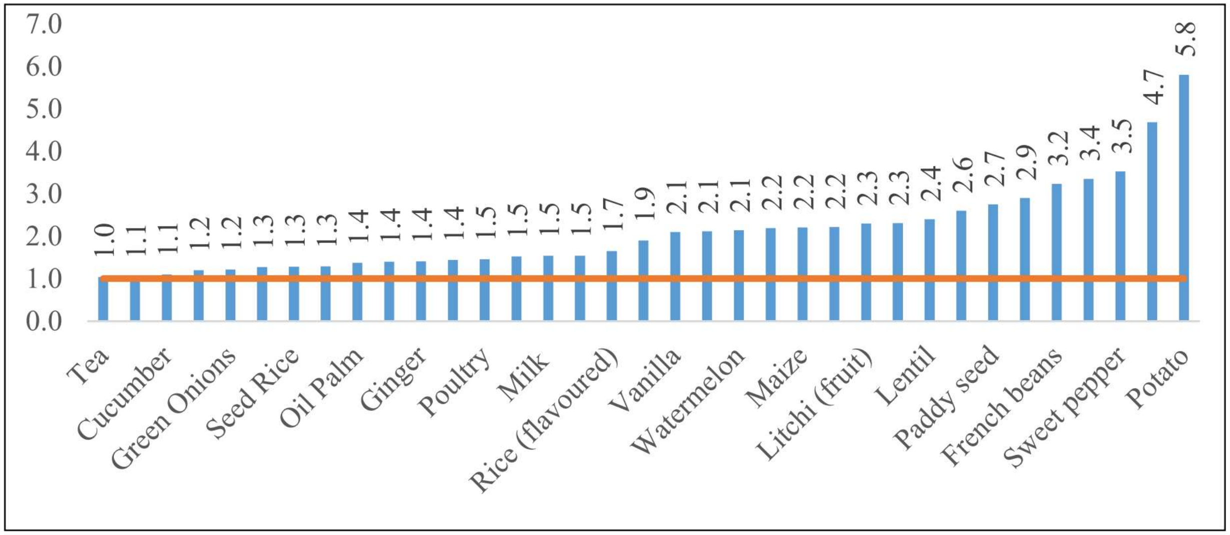
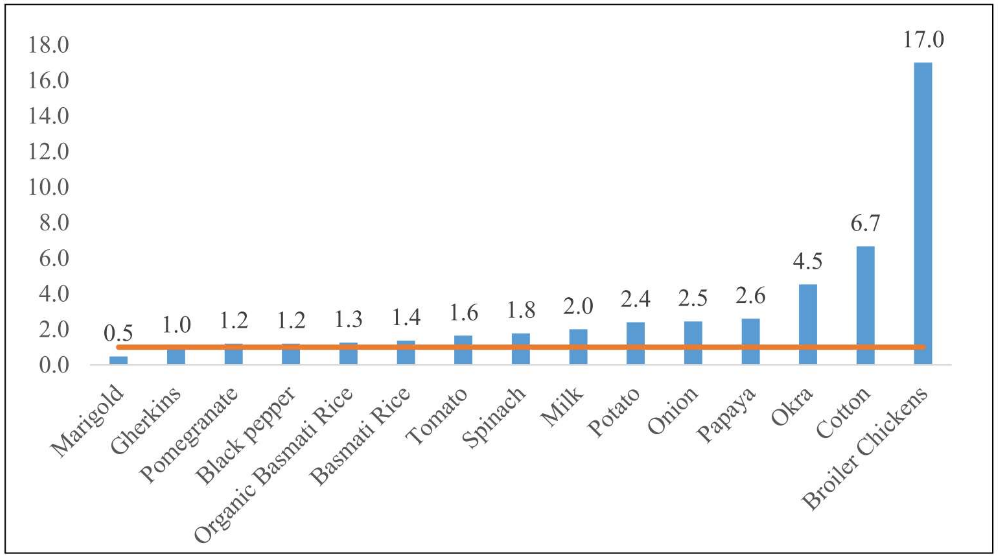


Figure 5: Impact of contract farming in India: response ratio for various commodities covering different outcome indicators



Source: NAAS (2022). Policy Paper 113

Positive Lessons

- Effective in linking the small farm sector to sources of extension advice, mechanization, seeds, fertilizer and credit, and to guaranteed and profitable markets for produce.
- Private agribusiness usually offer technology more effectively than government agricultural extension services, because it has a direct economic interest in improving farmers' production.
- Reduce price uncertainty to farmers.
- Companies gain access to crop production.

Risks For Farmers

- Uncertainty involved in growing new, unfamiliar crops and producing for markets that might not always live up to their expectations - or their sponsors' forecasts.
- Loss of bargaining power vis-à-vis a large agro-industry, monopsonistic market power and exploitative terms.
- Manipulation of quality standards by the sponsor in order to reduce purchases
- Debt caused by production problems, poor technical advice, significant changes in market conditions, or a company's failure to honor contracts.

Risks For Sponsors

- Insecurity of the access to land.
- Farmers' inability to meet strict timetables and regulations because of social obligations or religious practices.
- "Extra-contractual marketing" - farmers breaking the contract and selling their produce on alternative markets – sometimes encouraged by rival sponsors.

Key Preconditions For Success

- **A profitable market**
  - ❖ For the sponsor an identified market for the planned production that such market can be supplied profitably on a long-term basis.
  - ❖ The farmer must find the potential returns attractive on the basis of realistic, demonstrated yield and acceptable risks.

Key Preconditions For Success

- **<u>The physical and social environments</u>**
  - ❖ The physical environment
  - ❖ Utilities and communications
  - ❖ Land availability and tenure
  - ❖ Inputs availability
  - ❖ Social considerations

Key Preconditions For Success

- **Government Support**

❖Suitable laws of contract and an efficient legal system

❖Awareness of unintended consequences of regulation and avoid tendency to over-regulate

❖Provision of research and extension

❖Take steps to bring together agribusiness and suitable farmers

Policy support for Entrepreneurship Development

THE FARMERS (EMPOWERMENT AND PROTECTION) AGREEMENT ON PRICE ASSURANCE AND FARM SERVICES ORDINANCE, 2020

No. 11 OF 2020

Promulgated by the President in the Seventy-first Year of the Republic of India.

- Contract Farming and Privatization of Extension Services
- Widened the definition of farm produce – includes agriculture, piggery, poultry, dairy, cattle fodder, oilcake, raw cotton, cotton seed, raw jute
- Compulsory written agreement between two parties
- Violation of agreement leads to dispute settlement mechanism
- Registration authority, Conciliation board for dispute settlement
- Exemption from State Acts for sale and purchase and Essential Commodities Act 1955


Thank
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