

Source/Strategies for Finance and Marketing

W4 L3: Contract Farming

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Hello friends, in this lecture, we are going to discuss about contract farming. One of the most promising strategy to improve the productivity and efficiency of agriculture in developing countries. As you all know, smallholder farmers in developing countries face several constraints in raising the productivity and efficiency of agriculture.

The reasons behind it re poor access to information on new farming methods, inputs and credit, biotic and abiotic stresses, unremunerative market, price uncertainty, and high transaction cost. Contact farming, in which an agribusiness firm contacts with farmers to receive goods at a pre decided price with the certainty of delivery of a specified quality and quantity at a specified time.

It has emerged as one of the most important instrument to facilitate the integration of the value chain activities. Now, for many of you, the contact farming seems a new concept and also an exploitative one. But contact farming in India is not a new concept. During the 1850s and 60s, cotton was grown by the Indian farmers under the contract signed with the East India Company.

Similarly, plantation of tea and coffee in northeast and the southern India and poppy and indigo plants in eastern India plain was grown by the Indian farmers under the contract with the Britishers. And yes, under these contracts, the farmers were exploited. So in independent India, the concept of the contract farming get recognition after FMCG company PepsiCo set up a tomato processing plant in Hoshiarpur, Punjab.

And for this purpose, they used to procure the tomato from farmers. Directly by setting up contracts with them. This led to an increase in the to oil from the 7.5 ton per acre to 20 ton per acre in that particular area of Punjab. So what? Contact farming. So contact farming and

agreement between the farmers and processing and oral marketing firms for production and supply of agricultural products under forward agreement frequently at predetermined prices.

So, what is forward agreement? It is a binding contract between two parties to buy or sell a product in a predetermined prices in some future date. Now in agriculture, a forward contract is merchandising contract that transfer physical possession and ownership of an agricultural commodity at a specific future time.

So, in this contract, what are covered? The firstly, under the contract the grower and the buyer agree to terms and condition for the future sale and purchase of a crop or livestock product. Secondly, in conjunction with the marketing arrangement, the buyer agrees to supply selected inputs.

It may include on occasion land preparation and technical advice and credit also. Thirdly, the grower agree to follow the recommended production methods, input regimes, and cultivation and harvesting specification, so that there is an security of the quality of the product. Now based on the things covered under this contract, the contract farming can take various form.

It may be an procurement contract under which only sale and purchase conditions are specified. It may be an partial contract, wherein only some of the inputs are supplied by the contracting firm and produce is brought at the pre agreed prices. And it may be a total contract, under which the contracting firm supplies and manages all the inputs on the farm and the farmer becomes just an supplier of the land and labour.

So, according to the farmer and agricultural organization. There are five basic model of the contact farming across the world. In India, there is no single type or set of contact farming is practiced. In the majority of the cases, it is the mixed of all type customized according to the need of the buyers and seller.

So, what are these five model? One model is the centralized model. In the centralized model, there will be one buyer, who is the only entity involved in the contract with the farmers. The

buyer procure from many small farmer rather than buying from the few large farmer. And the total contract is strictly monitored and managed by the buyer.

And all the services from technical guidance or advisory is provided by the buyer and no other stakeholder or entities are involved in this process. Now, this service may be providing good quality seed or to the extreme opposite by providing all the required services like land preparation, seedling, agrochemicals and even the harvesting services.

So, this is the most dominant model of the contact farming across the world. And in a country like India, where 86 percent of our farmer are small and marginal farmer, this particular model may prove beneficial if the contacting firm. Act ethically and in the legal way for the welfare of the farmers. The second model is the multi partier model.

So in this model, a number of different entities or number of different technical entities jointly take part in the contact with the farmers. So the services are provided by the farmers will come from the different organization. Based on their expertise, like there may be financial organization, there may be input organization, there may be organization who provide the firm machineries and all this.

And the buyers at the end, they buy at the quality product in the pre agreed prices. The third model is the informal model. So, as the name suggests, in this particular model, a single entrepreneur or a small company entered in formal contacts with the farmers. Mostly for a particular season and this contact or this model is generally followed for the prediscible product like fresh vegetable, fruits, milk, etcetera.

Generally, the buyer take help from the government or any organized body for regarding or providing services like extension service, technology transfer, technology know how as well as for the credit arrangement. The buyer can also form contact with farmers without giving any particular service to them.

only ensuring that produce will be bought by the buyers in the pre agreed prices. Mostly under this model, the contracts are not for the long term and this may range from the single season to

two seasons and the duration of such contracts depend upon the need and the resource arrangement by the entrepreneurs or the small companies.

The fourth model is the intermediary model, where the buyer company may not be directly involved in contact with the farmers. So, the agent and traders, they generally maintain the contact with the farmers. Now, these intermediaries are the sort of external representative of the final buyer company. So, the harvested produce will be taken by the agents and which will be eventually sell to the, the buyer company.

Now this model can have a severe disadvantages for firstly, for the vertical coordination and secondly, for providing incentive to the farmers and these disadvantages may be the buyers may lose control over the production process, quality assurance and regularity of the supply. Farmers may not benefit from the technology transfer and most importantly there is an also a risk of the price distortion and reduce farmers income due to exploitation by the agent and traders.

The last model is the nucleus estate model. In this model, buyer company owns and manages the farm, the land which they own, maybe their own or taken in lease from the farmers. So this model ensure close ecosystem, but the buyers has much control on the farm as well as the activities which are done by the farmers throughout the season.

In India, this model was in past used for the state-owned farms that reallocated land to the farm owners. The farmers are at times called satellite farmers and illustrating their link to the nucleus farm. And this way, this model became known as an outgrower models and mostly in India, this model was practiced for the perennial crop in the southern part of India. So, this model generally guarantee supplies to assure cost efficient utilization of the installed processing capacity of the buyers also, in some cases, the nucleus estate model is used for the research, breeding, piloting and demonstration purpose and or as an collection point by the buying companies. So, what are the famous example of the contact farming or successful example of contact farming in India? First one is the Indian tobacco companies contact with the tobacco guard in the Andhra It is one of the most successful model.

Also, we should not miss the PepsiCo's contact with the potato growers in Gujarat, Karnataka and West Bengal, mostly for the chips making purpose. Also PepsiCo had a successful contact farming establishment with the tomato growers in the Punjab. Also, ITC limited has arrangement with the vegetable growers in the Punjab like FMCG company Nestle India also have contact with the farmers with the of the Punjab for the supplying of the dairy products, mostly milk.

Now, if you want to look into the what is the impact of contract farming, so we can say that based on the research evidence, the impact of contract farming is varied in nature. It depends upon the different commodity. According to a Nash policy paper 2022, they represent the impact of contract farming based on the response ratio. So, response ratio is based on the, the different welfare indicator of the commodity. It is the mean welfare values in the experimental firm that is the contact farmers and non experimental firms that is our control, uh, group that is the non contact farmers. So, in the world level, the commodity like potato, sweet pepper, French bean and fruit like lychee, watermelon, those have an high response ratio indicating the positive impact of the contract farming.

So, if you try to compare this scenario with the Indian scenario, we will find out the broiler chicken followed by papaya, potato and milk ok they have the better response ratio indicating the positive impact. In case of the marigold, pomegranate, black pepper, the response ratio was very less or indicating negative contact so, the success of the contact farming depend on what type of crop the farmers or what type the contact is signed with what type of crop and many other consideration. So, what we learn from the Indian experiences in with the contact farming that effective, it is very effective in linking the small farm sector to the source of the extension advice.

Mechanization, seed, fertilizer, credit and also it guaranteed profitable market for the produce. In India, agriculture market is highly uncertain specially for the farmers. Secondly, private agribusiness usually offer technology more efficiently than the private So, in this case, it involves a direct economic interest for the farmer as well as for the buyer or contracting company.

It also reduces the price uncertainty to the farmers. Like as I said, most of the farmers are small and marginal. So, they may be affect much higher rate in case of price uncertainty. And lastly,

the companies can gain access to the crop production or quality crop production. But contract farming in Indian condition also number of risk for the different stakeholder, for the farmers, for the buyers there may be a number of, a wide sense of risk will be involved.

What are the risks? So for farmers, uncertainty involved in growing new or unfamiliar crop, which are mostly because contract farming is done mostly for the commercial crop, having high commercial risk. So, this unfamiliar crop growing of the unfamiliar crop or producing for the market might not always be live up to their expectation or their sponsor forecast.

Secondly, mostly in the contract farming, the large agro industry are involved. So, there is a chance for the loss of bargaining power when dealing with this larger agro industry who, have a monopolistic market power or who can actually exploit them. So, there is also chance for the manipulation of the quality standard by the sponsor.

So, if they intentionally want to reduce the quantity of the purchase. Also the farmer's care can fall into the debt trap because of the production problem, poor technical advice, significant change in the market condition or company's failure to honor the contracts. So, what are the risks for the sponsor or the buyer?

In contract farming, land ownership is not handed over to the buying company. So, there is an always an insecurity of the access of the land. Sometimes as agriculture is highly dependent on the local weather, ok, so farmers inability to meet the strict timetable and regulation because of the social obligation, religious practices or any a natural event may actually have affect the company's business or the buyer business.

Also, there is a chance for the extra contractual marketing. Means, farmer break the contract and sell their produce to the alternate market specially when there is an positive or there is an increase in the market price than the pre agreed price of that particular product. Also this extra contractual marketing sometimes encouraged by the rival companies which are involved in the contract farming.

So, what are needed to make this contract farming a success? The firstly, there is a need for the profitable market. So, the farmer must find the potential return attractive on the basis of realistic demonstrated yield and acceptable risk when they are involved or they are entering into the pre agreed So, there is a need for the positive or physical and social environment, like there is a need for the ready communication, there is a need for the land availability and secure tenure, there is a need for the ensure, there is a need for the good input availability, so that farmer can ensure the true quality product and also the social consideration because in India the agriculture is the part of our culture and society. So when the farmer is entering with the contact farming with any company who mostly do contact for the commercial product. The social need of the farmers also need to be ensured and in a country like India, where the, a huge number of small and marginal farmer dominate the farming scenario, there is always need for the government support. To regulate the buying companies or sponsoring companies as you alleged, to ensure the palm welfare in the hand of the, this large monopolistic FMCG companies.

So there is a need for the suitable laws of contact and efficient legal system. There is a need for the ensuring that buying companies or sponsor contracting companies, they provide the proper research based. Input and extension support and also the government need to ensure or need to take step to bring together agri business and suitable farmers.

So what are the policy support for the this entrepreneurship development or contract farming development? So, in 2020, you know, the government introduced a bill for ensuring the contract between the farmer and the contacting companies.

So under this bill, which are later withdrawn, the contact farming, and these are related with the contact farming and privatization of the extension services. Okay. Under this bill, the government widen the definition of the farm produce include agriculture, pig, dairy cattle, product and many other products.

So that ensure the formers right. Also, they, it become compulsory to have a written agreement between the two parties and the government try to establish an, establish an agreement or an mechanism so that the violation of the agreement can be settled readily. And also, under this law, the exemption from the State Act for Sale and Purchase of the Essential Commodity Act, 1955 was granted to support the different companies or different buying FMCG companies to

enter contact with the farmers. So, this was the first organized approach to ensure and to develop and structured contact farming situation in India, but due to different problem, the act was later withdrawn by the government.

So, this act was the Farmers Empowerment and Protection Agreement or the Price Acceleration Farm Service Ordinance 2020 also famously known as a Farm Bill. So, in today's class we discussed about what is contact farming, what are the different forms and model of contact farming, what is being provided to the farmers in the, under this contract, what are the problem under the contact farming both for the farmers as well as the consumers the sponsoring companies and what are the precondition or government intervention needed to ensure the contact farming become a success in India. And also about an firm bill which was introduced to structure the contact farming situation, to organize the contact farming situation in India and later withdrawn.

Thank you.