

Contract Farming and Strategies to link with Farmer Producer Organizations (FPOs)

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Abstract

Agriculture's share in GDP has been dropping in several countries, however, the sector continues to play a major role in many developing country economies. Due to a strong reliance on subsistence farming, with limited technology and inadequate market access, most agricultural production in developing nations is associated with low productivity and low profitability. Contract farming is thought to increase productivity and income through facilitating coordination between farmers and other actors in terms of production, processing and marketing of agricultural products. Contract farming is defined as a company financing "inputs" such as seed, fertiliser, credit, or extension to a farmer in exchange for exclusive purchasing rights over a specific crop. It is a type of vertical integration used in agricultural commodity chains to provide the company more control over the manufacturing process and the end product. Contract farming is receiving a lot of interest from academics and policymakers and is frequently linked to an increase in household income for participants. FPO is a generic term for farmer-producer organizations that are incorporated or registered under the Companies Act, Part IXA, or the Cooperative Societies Act of the respective state. Linking contract farming with FPO can help farmers to increase their income and life style.

Keywords: Contract Farming, Farmer Producer Organization, Farmer.

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Introduction

In an era of globalization and expanding agribusiness, there is a danger that small-scale farmers will find it difficult to fully participate in the market economy. In many countries such farmers could become marginalized as larger farms become increasingly necessary for a profitable operation. A consequence of this will be a continuation of the drift of population to urban areas that is being witnessed almost everywhere. This is largely because the necessary backward and forward market linkages are rarely in place, i.e. rural farmers and small-scale entrepreneurs lack both reliable and cost-efficient inputs such as extension advice, mechanization services, seeds, fertilizers and credit, and guaranteed and profitable markets for their output. Well-organized contract farming does, however, provide such linkages, and would appear to offer an important way in which smaller producers can farm in a commercial manner.

Recently, the Rajya Sabha approved the Farmer (Empowerment and Protection) Agreement of Price Assurance and Farm Services Bill, 2020 or to put it simply the Contract Farming Bill. It allows farmers to enter into a contract with agri-business firms, processors, wholesalers, exporters or large retailers for sale of future farming produce at a pre-agreed price. It enables marginal and small farmers, with land less than five hectares to gain via aggregation and contract. This is significant as marginal and small farmers account for 86% of total farmers in India. The bill transfers the risk of market unpredictability from farmers to sponsors. It boosts farmer's income as it brings down the cost of marketing. (Simmons, 2002). It grants them the chance to engage in direct marketing by eliminating intermediaries and get a better price realization. However, the bill has been at the center of criticism because of concerns that it may weaken the bargaining power of the farmers. Contract farming creates more welfare and higher income to farmers, at least in the short run (Little & Watts, 1994; Sriboonchitta & Wiboonpoongse, 2008; Man & Navi, 2010; Miyata et al., 2009; Saigenji & Zeller, 2009; and Tuan, 2012).

Contract Farming is defined by Eaton and Shepherd (2001) as "an agreement between one or more farmer(s) and a contractor for the production and supply of agricultural products under forward agreements, often at predetermined pricing." The arrangement also invariably involves the purchaser in providing a degree of production support through, for example, the supply of inputs and the provision of technical advice. The basis of such arrangements is a commitment on the part of the farmer to provide a specific commodity in quantities and at quality standards determined by the purchaser and a commitment on the part of the company to support the farmer's production and to purchase the commodity. The contract farming system should be seen as a partnership between agribusiness and farmers. To be successful it requires a long-term commitment from both parties. Exploitative arrangements by managers are likely to have only a limited duration and can jeopardize agribusiness investments. Similarly, farmers need to consider that contractual arrangements are likely to be to their long-term benefit.

Historical Background

Contract farming isn't a new concept. Contract farming was used to plant indigo during the British period. That, however, was unethical. Modern contract farming is beneficial to both parties. It was first brought to Taiwan by the Japanese government in 1895. Pepsi was the first to launch it in India in the Hoshiarpur taluk of Rajasthan, to cultivate vegetables, mainly tomato and potato in 1927. In the twentieth century, contract farming in Karnataka began with the cultivation of gherkin.

• Contract farming: what attracts smallholders?

- ◆ Assured prices and procurement
- ◆ Higher profit
- ◆ Access to better technology and lower transaction costs
- ◆ More gains to smallholders than the large farmers

- ♦ Risk sharing
- **Contract farming has significant benefits for both the farmers and sponsors**

Advantages for farmers

- ♦ Inputs and production services are often supplied by the sponsor
- ♦ This is usually done on credit through advances from the sponsor
- ♦ Contract farming often introduces new technology
- ♦ Farmers' price risk is often reduced as many contracts specify prices in advance
- ♦ Contract farming can open up new markets
- **Problems faced by farmers**
 - ♦ Particularly when growing new crops, farmers face the risks of both market failure and production problems
 - ♦ Inefficient management
 - ♦ Sponsoring companies may be unreliable or exploit a monopoly position
 - ♦ The staff of sponsoring organizations may be corrupt
 - ♦ Farmers may become indebted because of production problems and excessive advances
- **Advantages for sponsors**
 - ♦ Contract farming with small farmers is more politically acceptable than, for example, production on estates
 - ♦ Working with small farmers overcomes land constraints
 - ♦ Production is more reliable than open-market purchases and the sponsoring company faces less risk by not being responsible for production

- ♦ More consistent quality can be obtained than if purchases were made on the open market

- **Problems faced by sponsors**

- ♦ Social and cultural constraints may affect farmers' ability to produce to managers' specifications
- ♦ Poor management and lack of consultation with farmers may lead to farmer discontent
- ♦ Farmers may divert inputs supplied on credit to other purposes, thereby reducing yields

- **Preconditions in contract farming**

No contract farming venture should be initiated unless some basic preconditions are met. The primary precondition for any investment in contract farming must be that it is likely to be profitable. This involves an assessment of the social and physical environment of the proposed contract area as well as the potential support likely to be provided by the government. The preconditions in contract farming are as follows:

1. Profitable market
2. Physical and social environments
3. Government support

1. Profitable market

- ♦ Sponsor must have identified a market for the planned production
- ♦ Sponsor must be sure that such a market can be supplied profitably on a long-term basis
- ♦ Farmer must have potential returns demonstrated on the basis of realistic yield estimates

2. Physical and social environments

- ♦ Physical environment must be suitable in general, and in particular for the product to be produced
- ♦ Utilities and communication must be suitable for farming, e.g. feeder roads, and for agro-processing, e.g. water and electricity
- ♦ Land availability and tenure - contracted farmers require unrestricted access to the land they farm
- ♦ Input availability - sources of inputs need to be assured

3. Government support

a. Enabling and regulatory role

- ♦ Suitable laws of contract and other laws are required as well as an efficient legal system
- ♦ Government should provide services such as research and, sometimes, extension

b. Developmental role

- ♦ Governments can take steps to bring together agribusiness and suitable farmers

Crops Suitable for Contract Farming

In general, companies use contracting for crops that are:

Perishable: cannot be stored for long periods of time and must be sold immediately

Bulky: more expensive to transport

Plantation crops: The plantation crops invariably require processing and are locked into an agreement with the processor

Processible: require processing-based crops

Variations in quality: where crops vary in quality and quality is important for processing

Unfamiliar: medicinal plants like safed musli, ashwagandha.

Model of Contract Farming

The centralised model, the nucleus estate model, the multipartite model, the informal model, and the intermediary model are the five contract farming models in the country. Depending on the commodity, the sponsor's resources, and the intensity of the farmer-sponsor connection that is required, contract farming usually follows one of the five basic types.

Centralized Model

This strategy is utilised for tree crops, annual crops, poultry, and dairy, and involves a centralised processor and/or packer purchasing from a large number of small farmers. Tea and vegetables for canning or freezing are examples of items that require a lot of processing. It is vertically coordinated, with strict quality control and quota allocation. Sponsorship engagement in production can range from providing minor inputs to taking control of the majority of production components.

Nucleus Estate Model

This is a variant of the centralised model in which the sponsor is also in charge of a central estate or plantation. The central estate is typically utilised to ensure processing plant throughput, but it is also occasionally used for research or breeding. It is frequently utilised in conjunction with resettlement or transmigration plans, and it necessitates a large amount of material and management inputs.

Multipartite Model

This type of model can involve a range of organisations, including statutory agencies, and can emerge from centralised or nucleus estate structures, for example, through the formation of farmer cooperatives or the participation of a financial institution.

The Informal Model

Individual entrepreneurs or small businesses are the hallmarks of this strategy. It entails ad hoc production contracts, which are frequently seasonal. It frequently necessitates government assistance, such as research and extension.

Intermediary Model

This model involves the sponsor subcontracting linkages with farmers to intermediaries, and there is a risk that the sponsor will lose control over production and quality, as well as the prices paid to farmers.

Examples of Contract Farming Companies in India and their Headquarters

S. No.	Contract Farming Company	Headquarters
1	Big India Farms	New Delhi
2	Dabur Contract Farming	New Delhi
3	Goodricke Group Ltd	Kolkata
4	Tata Coffee Ltd	Bangalore
5	Rallis India Ltd	Mumbai
6	Pacific Herbs Agro Farms Pvt Ltd	Nagpur
7	Patanjali Contract Farming	Haridwar
8	Anand Agro Group	Nashik
9	Baramati Agro Ltd	Pune

Potential advantages and challenges of Contract Farming and Producer Organizations

Particulars	Contract Farming		Producer organization	
	Pros	Cons	Pros	Cons
Farmers' risks	- Division of risk between the grower (production) and the contractor (marketing) - Price guarantees - Access to new markets	- Patterns of specialization and the introduction of new crops - Manipulation (of the agreed quotas and rejection of the crop)	- Internal risk management systems - External support and risk coverage	- External support causes dependency
Farmers' income	- Income rise through quality improvements, agri-processing and access to high-value markets	- Indebtedness because of easy access to credit	- Increase of bargaining power with buyers and suppliers	
Production efficiency	- Provision of capacity building measures - Provision of inputs and financial services	- Inputs and production techniques endanger sustainable land use	- Improved access to capacity building measures, inputs and financial services	- Lack of financial resources and expertise limits the PO functions
Value chain efficiency	- Aggregation of production - Provision of infrastructure (e.g. storage and cooling facilities) - Value adding and marketing activities		- Aggregation of production - Joint investments in infrastructure (e.g. storage and cooling facilities) - Joint investments in value adding and marketing	- Lack of financial resources and expertise limits the PO functions

(Source- Inka Gersch, 2018)

Farmer Producer Organization/Company

A producer company is a legal entity that is registered under the Companies Act of 1956 as a Producer Company (As amended in 2002). Production, harvesting, processing, procurement, grading, pooling, handling, marketing, selling, export of primary produce of members, or import of goods or services for their benefit are among its key activities. Promotion of mutual help, welfare measures, financial services, and producer or primary produce insurance are also included.

There are currently roughly 5000 FPOs (including FPCs) in the country. Over the last 8-10 years, these have emerged as a result of numerous initiatives by the Indian government (including SFAC), state governments, NABARD, and other organisations. The majority of these FPOs are still in their infancy and are in the early stages of their life cycle (2019 MANAGE Report).

Strategies to Link Contract farming with Farmer Producer's Organization

Realizing scale in primary production

In the Philippines, selected irrigation schemes with well-established water user groups, as well as Agrarian Reform Communities backed by the Department of Agrarian Reform, may be the most suitable sites to explore clustering.

Supporting market-oriented producer organizations

Cooperatives and producer organisations should be encouraged to grow. Japan, South Korea, and Taiwan have all had a lot of experience supporting farmer organisations or cooperatives in East Asia.

Introduction of appropriate technology

In order to improve agricultural commodities for markets that demand high quality requirements, new processes are frequently required. In order to

boost productivity and ensure that the commodity satisfies market expectations, new manufacturing procedures are frequently required. Small-scale farmers, on the other hand, are often hesitant to accept new technologies due to the potential hazards and expenses. When they can rely on external resources for material and technological inputs, they are more likely to accept new techniques.

Skill transfer

Record keeping, efficient use of agricultural resources, improved methods of applying chemicals and fertilisers, understanding the importance of quality, and the features and needs of export markets are some of the skills that a farmer acquires through contract farming.

Access to reliable markets

Farmers will not farm unless they are confident in their ability to sell their product, and traders and processors will not invest in initiatives unless they are confident in the ability to continuously produce the essential commodities. Contract farming, by offering market assurances to farmers and ensuring supply to consumers, could be a viable solution to this problem.

Need for incubation and handholding support to FPOs

FPOs need to be supported so that they will work in growth of farming and provide benefits to the members

Policy level challenges

FPOs are now unable to reap the benefits of contract farming due to lack of information and awareness about contract farming and companies which are into procurement of agri commodities directly from farmers. Hence, there is a need for changes in policy. FPOs need to be promoted and Government should make the policy for contract farming and FPOs.

FPOs will require infrastructure and technical facilities such as a packing house, warehouse, sorting and grading, packaging, material handling, transportation, and custom hiring equipment and machines, among other things.

Conclusion

The majority of the studies on the effects of contract farming on farmer productivity and income have been undertaken over a short period of time, and consequently, conclusions are drawn for the short term. Contract farming's long-term influence on producer productivity and revenue, however, is still unknown. Contract farming issues include late deliveries or payments, decrease in quality, a lack of bargaining leverage, and production and marketing concerns. Farmer producer organization can improve contract farming and can help the farmer through many strategies like policy changes, skill transfer etc.

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