

Contract Farming

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

- 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; and
 - **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.

- 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

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

- **The physical and social environments**
 - ❖ 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