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Contract Farming: The Survey on Different Issues

Pallavi Sharma[1], Dr. S.D. Vashishtha[2]

[1]MDU Rohtak (India)
blue_pallavi@gmail.com

[2]MDU, Rohtak (India)

Abstract

In India, 70-80% population of the country depends directly or indirectly to farming. So this field is very much important for research and the concept of contract farming is more important for farmers and other persons who are joined with this. There are so many models of contract farming and many of them are explained by authors in this paper. Many advantages and issues related to contract farming are also discussed by authors here.

Keywords: *Contract Farming, Contract Farming Models, Registration of Contracts, Types of Contract Farming.*

Introduction

There are so many definitions of contract farming and one of them is explained here by authors here. The concept of contract farming is agricultural production carried out according to an agreement between a buyer and farmers, which establishes conditions for the production and marketing of a farm product or products. Typically, the farmer agrees to provide established quantities of a specific agricultural product, meeting the quality standards and delivery schedule set by the purchaser. In turn, the buyer commits to purchase the product, often at a pre-determined price. In some cases the buyer also commits to support production through, for example, supplying farm inputs, land preparation, providing technical advice and arranging transport of produce to the buyer's premises. Another term often used to refer to contract farming operations is 'out-grower schemes", whereby farmers are linked with a large farm or processing plant which supports production planning, input supply, extension advice and transport. Contract farming is used for a wide variety of agricultural products. Contract farming is one of the different governance mechanisms for transactions in agri-food chains. The use of contracts (either formal or informal) has become attractive to many agricultural producers worldwide because of benefits such as the assured market and access to support services. It is also a system of interest to buyers who are looking for assured supplies of produce for sale or for processing. Processors are among the most important users of contracts, as they wish to assure full utilization of their plant processing capacity. A key feature of contract farming is that it facilitates backward and forward market linkages that are the cornerstone of market-led, commercial agriculture. Well-managed contract farming is considered as an effective approach to help solve many of the market linkage and access problems for small farmers.

Advantages of Contract Farming

The key benefits of contract farming for farmers can be summarized as:

1) Improved access to local markets;

2) Assured markets and prices (lower risks) especially for non-traditional crops;

3) Assured and often higher returns;

4) Enhanced farmer access to production inputs, mechanization and transport services, and extension advice

5) Assured quality and timeliness in delivery of farmers' products;

6) Improved local infrastructure, such as roads and irrigation facilities in sugar out grower areas, tea roads, dairy coolers/collection centers, etc.

7) Lower transport costs, as coordinated and larger loads are planned, an especially important feature in the case of more dispersed producers.

Shortcomings in the System

Under the present dispensation, there is no security of continuity of contract farming or tenure of land use for the sponsoring companies; as a result the companies are reluctant to go in for long term capital investment in the contracted land to enhance productivity and improve quality of product. The companies prefer large and medium farmers compared to the small farmers, presumably because of the problems of economies of scale, lack of access to capital, low literacy levels etc. inherent with the small/marginal farmers.

The problem of monophony, where a single buyer buys produce of hundreds and thousands of farmers, is observed in some cases of contract farming. This system has worked to the 4 disadvantage of those farmers who lack adequate information about the market resulting in asymmetry of information. A study of unsuccessful cases of contract farming points to the problem of enforceability of contracts. Both the parties – sponsoring company and the farmers tend to renege on the contracts, whenever the market conditions suit them. Pricing, under the present dispensation, is mostly as per convenience of the sponsoring company – contract price or open market price. There is often rejection of farmer's produce on the basis of flimsy or unjustified quality ground, especially when the market price is less than the contract price at the time of harvest. There is often delay in payment to farmers by the sponsoring company. In most of the existing models, the contracts protect company interests at the cost of the farmer and do not cover farmer's production risk, e.g. crop failure. The company retains the right to change price and generally offer prices which are based on the open market prices. Even organic produce buyers offer conventional produce market – price-based prices to the growers. This is a serious issue as sometimes a significant premium over market price may not help a farmer if open market prices go down significantly, which is not uncommon in India. The firms also manipulate provisions of the contracts in practice e.g. in case of broiler chickens in Tamil Nadu where they picked up birds before due date or delayed it depending on the demand which meant losses for contract growers. They also delayed payments up to 60 days. But, growers were locked into these contracts due to the firm specific fixed investments they had made. Thus, many Contract Farming projects also failed due to their poor design of the project or default by any of the contracting parties. In many of the states, the present APMR Acts still restrict the processors/manufacturers etc. from entering into direct contract with farmers as the produce is required to be canalized through regulated markets only. They have failed to incorporate a provision in the APMC Act recommended by the Model Act to specifically allow contract farming programs by processing or marketing firms. The produce covered by the agreement should be allowed to move freely from the farmer's field to any destination in the country or abroad without the necessity of going through the licensed traders or regulated markets.

Registration of Contracts

In the absence of the system of registration of contracts with any authorized agency of the state for the verification of the credentials/track record of the sponsoring companies, there are reported cases of farmers becoming victims of the fly-by-night operators. There is a very low level of awareness about contract farming amongst the different stakeholders. It is probably for this reason that vast areas of the country covering states such as Bihar, Jharkhand, Chhattisgarh, Orissa, West Bengal and the North-East and areas of Himachal Pradesh and Jammu and Kashmir have remained untouched by the major contract farming sponsoring companies.

The Model APMR Act, 2003 of the Government of India has recommended the compulsory registration of contract farming with Market Committee. Sponsor is commended to register himself with the Sub Divisional Officer or with an officer prescribed by law. The National Commission on Farmers, however, has given its recommendations not to involve the Market Committee as a party to contract farming. Accordingly, Market Committee would not be registration authority for Contract Farming and the Contract Farming Sponsor shall get the Contract Farming agreement recorded with the Sub-Divisional Magistrate, who, in turn shall ask for such documents as required to verify the credentials of the sponsoring company. Absence of a proper legal framework is a major impediment in popularizing contract farming system in the country. Under the present system, the Contract Act is the only law for contract farming, but the provisions of the Contract Act do not cater to the specific requirements of contract farming in a suitable manner. Besides the costs, procedure and the delay the distance from the Courts works as a disincentive to the farmer to invoke the Civil Courts jurisdiction when the need arises. The different types of possible disputes arising out of contract farming can be attributed to refusal to receive delivery of the commissioned goods, delay in payment beyond agreed period, discounting of payment, returning the commissioned goods without any good reason, forced price reduction, compulsory purchase by subcontractors of parent firm's products, and forcing subcontractors to pay in advance for materials supplied by the parent firm etc.

Types of Contract farming

These are a few of the models of contract farming that are accepted globally:

- Centralized model
- Nucleus Estate model
- Multipartite model
- Informal model
- Intermediary model

Centralized model

The contracting company provides support to the production of the crop by smallholder farmers, purchases the crop from the farmers, and then processes, packages and markets the product, thereby tightly controlling its quality. This can be used for crops such as tobacco, cotton, paprika, sugar cane, banana, coffee, tea, cocoa and rubber. This may involve tens of thousands of farmers. The level of involvement of the contracting company in supporting production may vary.

Nucleus Estate model

This is a variation of the centralized model. The promoter also owns and manages an estate plantation (usually close to a processing plant) and the estate is often fairly large in order to provide some guarantee of throughput for the plant. It is mainly used for tree crops, but can also be for, e.g., fresh vegetables and fruits for export.

Multipartite model

The multipartite model usually involves the government, statutory bodies and private companies jointly participating with the local farmers. The model may have separate organizations responsible for credit provision, production, management, processing and marketing of the produce.

Informal model

This model is basically run by individual entrepreneurs or small companies who make simple, informal production contracts with farmers on a seasonal basis. The crops usually require only a minimal amount of processing or packaging for resale to the retail trade or local markets, as with vegetables, watermelons, and fruits. Financial investment is usually minimal. This is perhaps the most speculative of all contract-farming models, with a risk of default by both promoter and farmer.

Intermediary model

This model has formal subcontracting by companies to intermediaries (collectors, farmer groups, NGOs) and the intermediaries have their own (informal) arrangements with farmers. The main disadvantage in this model is it disconnects the link between company and farmer.

Issues of Concern Related to Contract farming

As with any form of contractual relationship, there are potential disadvantages and risks associated with contract farming. If the terms of the contract are not respected by one of the contracting parties, then the affected party stands to lose. Common contractual problems include farmer sales to a buyer other than the one to whom the farmer is contracted (side selling or extra-contractual marketing), a company's refusal to buy products at the agreed prices, or the downgrading of produce quality by the buyer. Side selling by farmers to competing buyers is perhaps the greatest problem constraining the growth of contract farming. Contractors also may default by failing to pay agreed prices or by buying less than the pre-agreed quantities. Another concern about contract farming arrangements is the potential for buyers to take advantage of farmers. Buying firms, which are invariably more powerful than farmers, may use their bargaining clout to their financial advantage. Indeed, if farmers are not well organized or where there are few alternative buyers for the crop or it is not easy to change the crop, there is a danger that farmers may have an unfair deal. Tactics sometimes used are changing pre-agreed standards, downgrading crops on delivery so offering lower prices, or over-pricing for inputs and transport provided. Strengthening farmer organizations to better access appropriate services such as credit, extension services and market information and improving their contract negotiating skills can redress the potential for exploitation of farmers and poorly formulated contracts and their enforcement. Despite the typical problems listed above, contractual arrangements are gaining popularity as they are being used more frequently in agriculture worldwide.

Contract Farming in India (Tabular Form)

State	crops	Company/ Corporate
Haryana	Turmeric, Mentha, Sunflower, White Musli	HAFED
Punjab	Tomato and Chilly	Nijjer Agro Foods Ltd.
	Barley	United Breweries Ltd.
	Basmati, Maize	Satnam Overseas Sukhjit Starch (Mahindra Shubhlabh Services Ltd.)
	Basmati	Satnam Overseas, DD Intl. Incorp., Amira Foods India Ltd. (Escorts Ltd. and Grain tech)
	Basmati, Groundnut, Potato and Tomato	PepsiCo India Ltd.
	Green vegetables and exotic vegetables	Punjab Agro Foods Park Limited, a joint venture of Punjab Agro Export Corporation and IDMA, a corporate body.
Uttaranchal	Guar gum	M/s Mahindra Sulabh
Chhattisgarh	Safed Musli	Ms Larsen and Toubro
	Tomato	BEC Co.
Tamil Nadu	cotton	Super Spinning Mills, Appache Cotton Company
	Maize	Bhuvi Care Pvt. Ltd.
	Paddy	Bhuvi Care Pvt. Ltd.
	Gherkins	M/s Mahindra Sulabh
Maharashtra	Soybean	Tinna Oils and Chemicals
	Onions	Jain Irrigation Systems Ltd.
Gujarat	Processing of Medicinal Plants and Alovera	Reliance Group

Risk Management

Agricultural investments always involve risk. The most likely reasons for investment failure are poor crop management, natural calamities, pest epidemics, and market collapse and price fluctuations. The standard agribusiness approach to indemnify against quantity shortfalls is crop insurance. As the farming involved in a contract arrangement becomes technologically more advanced, the range of risks to which it is subject generally becomes more expensive. Where there are fixed price contracts, there is no apparent risk to farmers with regard to payment for their crops. If a market collapses, the sponsor should automatically shoulder the loss. Where contracts are on a flexible on spot-price basis the stability of farmers' incomes is always at risk. However a qualified risk analysis has to be made to determinate the economic advantages of insurance against the specific risks applicable to the particular crop. The sponsor of large volume of produce may, as part of the agreement, provide one or more the following services for coordination of production which includes identifying suitable production areas and forming farmers' groups; provision of extension advice on new cultivation/ harvesting practices, appropriate use of chemicals, and efficient farm management; transfer of technology leading to higher yield and / or improved quality; cropping schedules; and training and awareness programs for the success of the contract farming.

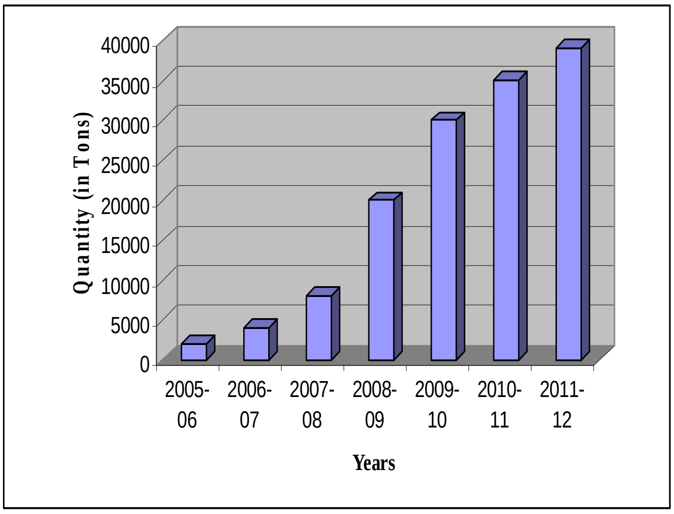
Linking Farmers to Sponsors

Intermediary bodies that link management/ sponsor and farmers for purposes of negotiation and interaction are necessary for all contracts. By creating farmer-management for a, sponsors can negotiate contracts with farmers either directly or through their representatives. The representatives should meet with management/ sponsor periodically, but at least three times in a season. The first meeting should be at the beginning of season in order to ratify the pricing structure and the season's crop schedules. A second meeting is advisable immediately before harvesting to discuss the crop progress and to confirm buying procedures. The final meeting to review performance at the end of harvest which may coincide with the final payment to farmers. The farmers' management for a include Farmers Associations, Farmers Cooperatives, Farmers Groups or any other organization of the farmer by whatever name called (to be named in the agreement). Each contract farming agreement must incorporate quality control and monitoring system suitable for its particular operation. Sponsor must prioritize monitoring procedures and decide how often they should be carried out, in what locations and who should be inspected and at what locations. Checking product quality can take place before, during and immediately after harvesting as well as at the time farmers grade their own production and when the produce reaches the company's processing or packaging facility.

Survey of Sunflowers Supplied in Haryana

Sr. No.	Year	No. of Villages	No. of Farmers	Quantity (in Tons)
1	2005-06	110	300	2000
2	2006-07	120	600	4000
3	2007-08	150	800	8000
4	2008-09	160	1200	20000
5	2009-10	200	1600	30000
6	2010-11	340	1800	35000
7	2011-12	400	2000	39000

The Graph Showing Contract Farming Survey



***Data provided by a survey by the authors on contact farming**

Conclusion

The contract farming, now a days is more advantages for big farmers meaning the farmers having more land and having political influence, they are having more contracts of farming. But the small farmers having small piece of land, are not having contracts of farming. The contract farming is very important for Indian farmers, but the government should take some right steps so that the companies will give right price for the product of farmers and it should be given to all categories of farmers. The Survey in this paper shows that the contract farming is increasing very fast in last decade, but in comparison of population this increase is not sufficient, so more impact of government should be on contract farming.

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