Editorial: The multi-faceted dimensions of contract farming

THIS SPECIAL ISSUE OF *Food Chain* focuses on contract farming (CF). Under this form of agrifood chain coordination mechanism, producers typically commit to the future delivery of farm products to a buyer under pre-set specifications that can include mutually agreed conditions on prices, production technologies, quality characteristics, and production delivery dates. Interest in such contracts has grown significantly in recent years, a fact attributed to the transformations taking place in agrifood systems globally that put greater emphasis on the demands of consumer markets and on the competitive environment. Food safety and quality standards are also becoming more stringent and can better be met in closely coordinated chains. This need to adapt leads to challenges for both farmers and those who depend on their output to meet their business needs. A fruit processing company, for example, needs raw materials that are ideally standardized with respect to quality characteristics and which are provided regularly around the year. Uniformity in fruit properties facilitates processing, favours the quality of the processed product, and reduces processing costs. Regularity in raw material supply ensures that the processing company can maximize throughput. Companies that use contracts can ensure that their procurement systems are perfectly tailored to meet these particular needs. They can also better predict their raw material costs, by agreeing on a final price to be paid to producers well in advance. From the point of view of farmers, they are usually provided with inputs and sometimes with land preparation, so avoiding the need to use their own funds or to obtain credit. Companies sometimes provide technical assistance, which is increasingly unavailable from other sources. Farmers have a guaranteed outlet for their products and avoid the transaction costs of seeking out markets.

There are also, of course, potential disadvantages for both partners. For farmers these often revolve around misunderstanding of contract terms, confusion about pricing arrangements, and disagreement about quality specifications. In extreme cases farmers may have made significant asset-specific investments, only for the company to go bankrupt. In the case of companies, such disagreements with farmers can have a negative effect on their corporate image. As well, there is a danger of extra-contractual marketing (side selling) by farmers, diversion of inputs supplied, and attempts by farmers to deliver products not produced under contractual terms, a particular problem when products must be certified.

As in any other commercial transaction, the two parties should ensure that the balance between risks and opportunities is favourable to them. A relationship of trust between farmer and buyer must be developed, leading to a so-called 'win–win'

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situation. Contracts must be defined so that they are clearly understood by all involved, facilitating legal protection in the event of contractual breaches by either party.

The constant need for better coordination in agrifood supply chains means that CF is likely to continue being increasingly adopted. To the extent that the risks of failure can be well assessed and properly managed, and to the extent that trust among farmers and their buyers can be developed, contracts can constitute an important driver of efficiency and competitiveness for food and agricultural systems. There have been many successful CF experiences in both developed and developing countries. There are also cases that have not been so successful. Examples of both are discussed in this special issue of *Food Chain*.

The need to maximize 'inclusion' by ensuring that poorer farmers play a significant role in value chains, including those involving CF, is a popular theme in development circles these days. This is discussed in a *Crossfire* debate between Professors Sukhpal Singh from India and Martin Prowse from Denmark. The debaters express opposing views on the issue, with Professor Singh making the case for the intrinsic exclusionary nature of CF schemes, arguing that contracting firms tend to exclude smallholders by virtue of factors such as location preference for better endowed regions, choice of crop, and technological conditions for participation that do not favour the resource poor, as well as unfavourable terms and conditions in the contracts themselves. While accepting part of the argumentation of his contender, Prowse calls for a more nuanced view of the issue of inclusion, having in mind the heterogeneity of aspects such as demand conditions, agrarian structures, crops, actors involved, conditions of the specific CF scheme, the characteristics of the contracts, and the overall enabling environment. Remarking that this is not a 'black and white' issue, he calls attention to the fact that context is a vital consideration in this debate. The exchange of viewpoints continues with a response from Singh that highlights the need for policy mechanisms that can leverage the benefits of CF for smallholders. In his rejoinder, Prowse observes that, disagreements notwithstanding, both contenders share a view that contract and policy design need to ensure that non-competitive practices do not undermine potential benefits of contracting schemes. The debaters also make reference to recent articles supporting their arguments, illustrating the fact that this debate is still very much open in professional and academic circles.

The papers presented in this special issue provide further evidence on the issue of smallholder inclusiveness, as well as on others that are of relevance to CF planning, implementation, and policy design. In a separate paper, Sukhpal Singh expands his *Crossfire* arguments, suggesting that policy reforms designed to promote greater market access for smallholders in India have facilitated the development of CF but that such contractual arrangements have tended to be exclusionary. He feels that there should be mechanisms to monitor and use contracts for development purposes. At the same time, he argues that the government should not attempt to intervene directly in CF, noting that such an experiment had failed in the Punjab. He believes that farmers are best served where there are many competing companies. For example, he notes that in Karnataka state there are multiple companies implementing contract farming arrangements for crops such as gherkins, so giving small farmers greater choice.

While the debate on inclusiveness has received a good deal of attention in the CF literature, an associated issue – the dynamics of farmers' entry and exit in contractual relationships – has been much less examined. Sudha Narayanan provides an insightful contribution to help fill this gap, by examining cases of attrition in CF schemes for five crops in India. Her article brings new knowledge on the reasons for exiting from such schemes, both those that stem from the farmer's own decisions and those that are initiated by the contracting firm. She also calls attention to another insufficiently covered issue, the episodic participation of farmers in CF arrangements, that is, the intermittent entry and exit, instead of continued participation. By analysing survey data from 822 farmers, she concludes that even though resource-constrained farmers appear to have a higher propensity to leave CF schemes involuntarily, it is also the case that often more attractive farming alternatives can lure them away from contracting. Episodic entry–exit, on the other hand, can be associated with market dynamics leading to the firm withdrawing or farmers opting out. Professor Narayanan concludes this interesting evidence-based analysis by suggesting that policies to promote successful smallholder participation in modern supply chains need to be well informed by the reasons behind attrition. Overlooking this issue, she argues, can lead to misguided policy design.

Despite the undoubted benefits of contract farming in many circumstances, Andrew Shepherd reminds us that problems can still be encountered. He discusses companies linking with farmers to obtain biofuel feedstock. These have usually had little or no prior experience of contract farming and seem to have made little effort to identify problems experienced with more mainstream contract farming in the past. Common difficulties have included: the use of unrealistic expectations about both potential yields of biofuel crops and the ability of farmers to produce economically viable yields; biofuel price fluctuations that result in changes in the price paid to farmers for the feedstock, leading to a breakdown of trust; poor input supply arrangements; and the lack of clarity with regard to government policies for the sector. Biofuels have been heavily subsidized and have also benefited from the mandated blending percentages of biofuel use established by some governments. Shepherd believes that this may have contributed to some of the difficulties faced in biofuel contract farming.

A danger with contract farming is that it can lead to something close to monocropping. Food production can suffer, as pointed out by Shepherd in the case of biofuels, and there are many risks attached to relying on just one significant income source. Farm incomes can be increased, with a consequent benefit for farmer–company relations, if the company can assist farmers to diversify, even if this is into crops in which the company has no particular interest. Andrew Cockburn and Charles Eaton discuss two diversification programmes established by tobacco companies: one in Lombok, Indonesia, and one in Fiji. Tobacco is a seasonal crop so farmers have both land and time available during the off-season. In Lombok, the company has provided both inputs for and training in a new planting system for rice to be grown in rotation with tobacco. It has also supported farmers wishing to become involved with chicken rearing and has promoted tree growing to provide fuel for tobacco curing. In Fiji, initial success in the 1980s in promoting diversification into maize and papaya eventually came to nothing after the company's management changed its policy. Nevertheless, Cockburn and Eaton consider that the farmer-support models promoted in both Lombok and Fiji could be applied in the context of other contract farming ventures. This will, however, require willingness of companies to support farmers in areas other than the core crop.

Both the *Crossfire* and the papers presented in this special issue certainly enrich the body of knowledge on CF operations and on the multi-faceted nature of contracting as a chain mechanism that can promote not only efficiency but also inclusiveness in agrifood systems. Although contract farming must always be an activity that is clearly based on commercial principles, there have also been a growing number of development initiatives that focus on contracting as an instrument to promote chain efficiencies and smallholder–market linkages. It is hoped that the issues discussed herein can help further improve CF-related policy design, implementation, and impact evaluation.

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