



Problems and Prospects of Contract Farming In India

Dr. Bairagya Ramsundar¹ & Sarkar Shubhabrata²

¹Department of Economics, SambhuNath College, Labpur, Birbhum, West Bengal, India.

²Department of Commerce, Sundarban Mahavidyalaya, Kakdwip, South-24 Pargana, West Bengal, India.

Abstract

Contract farming is nothing new. During the British period there was indigo plantation through contract farming. But that was exploitative. But modern contract farming is mutually advantageous. Now-a-days the term 'contract farming' is frequently heard. Contract Farming is an institutional arrangements in which both producers and the processors/exporters enter into a contract to supply and purchase, respectively, a specified quantum of commodity, at a pre-determined price and for a specified period of time. In this context it would be useful to discuss such issues as: what is contract farming, what are the benefits of contract farming etc. Contract Farming has become relevant in view of the recent decision of the Govt. of India permitting entry of FDI in multi-brand retail sector. In the wake of liberalization, the concept of contract farming in which national or multinational companies enter into contracts for marketing and providing technologies and invest capital. The purpose of the present paper is to discuss these issues in the simplest manner.

Key words Bargadars, contract, inter-linkage, mechanization, technology

1. Introduction

Contract Farming was recommended in the McKinsey Report submitted to the Govt. of West Bengal during the tenure of the Left Front. Govt. of India's National Agricultural Policy (2000) states, "Private sector participation will be promoted through contract farming". The Government of India's National agricultural Policy (2000) states, "Private sector participation will be promoted through contract farming and land leasing arrangements to allow accelerated technology transfer, capital inflow and assured market for crop production, especially of oilseeds, cotton and horticultural crops." Contract Farming has become relevant in view of the recent decision of the Govt. of India permitting entry of FDI in multi-brand retail sector.

2. Historical Background

Contract farming is nothing new. During the British period there was indigo plantation through contract farming. But that was exploitative. Modern contract farming is mutually advantageous. For the first time it was introduced in Taiwan in 1895 by Japanese government. In India it was introduced by Pepsi company for the cultivation of vegetables particularly tomato and potato in Hosiarpur taluk of Rajasthan in 1927. In Karnataka contract farming was started with the cultivation of gherkin in 20th century. Contract Farming was recommended in the McKinsey Report submitted to the Govt. of West Bengal during the tenure of the Left Front. Govt. Following this recommendation the Govt. of West Bengal is considering the proposal seriously.

Contract farming is introduced in the case of peasant farming. There are two parties in the contract farming. One party is the landowner or peasant. The other party is a contracting company. According to the contract the farmer is required to plant the contractor's crop on his land and to harvest and deliver to the contractor a quantum of produce. This could be at a pre-agreed price. Towards these ends the contractor supplies the farmer with selected inputs, including the required technical advice. Thus under contract farming the contractor supplies all the inputs while the farmer supplies land and labour.

During the period of Green Revolution, like a contracting company, the Govt. supplied inputs like HYV seeds, new technology, water for irrigation, fertilizers, insecticides, pesticides, subsidized credit etc. Again the Govt. purchased agricultural crops from the farmers at predetermined prices. This new agricultural strategy was a resounding success but success came at a cost.

2.1 Why Contract Farming?

Farming is an old-age means of livelihood for millions of Indians. Farmers have on occasion had to throw their produce away for want of buyers. This is the one side of the coin. On the other side is the agro-based and food industry which requires timely and adequate inputs of good quality agricultural produce. This underlying paradox of the Indian agricultural scenario has given birth to the concept of contract farming which promises to provide a proper linkage between the farm and the industry. Farmers need assured market. Agro-based and food industry requires inputs of good quality agricultural produce. Contract farming can provide a linkage between the farm and the industry. Some other reasons for the introduction of contract farming: Financial burden of central and state governments will be reduced. Private investment in agriculture will increase. Contract farming is needed to bring about a market focus in terms of crop selection by Indian farmers. Contract farming will generate a steady source of income at the individual farmer level. Contract farming will provide a linkage between agriculture and processing industries. Contract farming will generate gainful employment in rural areas. Contract farming will reduce migration of labour from rural areas to urban areas.

The main objectives of contract farming are the followings: (i) To reduce the load on the central & state level procurement system. (ii) To increase private sector investment in agriculture. (iii) To bring about a market focus in terms of crop selection by Indian farmers. (iv) To generate a steady source of income at the individual farmer level. (v) To promote processing & value addition. (vi) To generate gainful employment in rural communities, particularly for landless agricultural labour. (vii) To flatten as far as possible, any seasonality associated with such employment. (viii) To reduce migration from rural to urban areas. (ix) To promote rural self-reliance in general by pooling locally available resources & expertise to meet new challenges.

3. Different Types of Farming

In the case of *Peasant Farming* the owner of land cultivates has land himself and the cultivation is done by the family members jointly. This type of farming is very common in India. The system of peasant farming based on small size of holdings and for this the surplus land and above the ceiling of holding was distributed among the rural landless agricultural labours. Vital decisions like what crops to be produced or how much amount of land to be used to produce any crop are taken by the members of the family.

Instead of cultivating his own land a land owner can lease out his land to others in lieu of rent payable in cash or kind and this type of farming is called *Tenant Farming* or share-cropping. Along with peasant farming the tenant is also present in West Bengal and India. Several laws have been enacted in India to protect the interests of the tenants who are commonly known as Bargadars. The Government of West Bengal has taken up a programme of Operation Barga to record the names of Bargadars so that the Bargadars cannot be evicted at will.

In case of peasant farming tenant farming the size of the holding is small so the economies of large scale production cannot be enjoyed. Good irrigation system, improved technology and farm mechanization cannot be adopted on small holding. Hence, to raise productivity the large farming is needed. Two models of large farming have been used in many countries. One model is *Capitalist Farming* which is present in advanced capitalist countries like the U.S.A., U.K. etc. Here one individual is the owner of a large farm. He engages hired laborers in lieu of wages. Capitalist's farms are, so to say, factories in the field.

On the other hand in Socialist *Collective Farming* the Collective farm society becomes the owner of land. Members work in the farm and get share of the produce in proportion to labor contributed by them. The land is cultivated jointly and the members get share of the produce in proportion to the labour contributed to them. After the disintegration of Soviet Union and fall of socialism in east European countries collective farms are also disintegrating. Socialist countries like China, Cuba and Vietnam are also introducing reforms in the agricultural sector to permit private ownership in land. Another way of getting the benefits of large scale production is the introduction of cooperative farming. In *Cooperative Farming* the Private ownership is retained but cultivators join voluntarily for joint cultivation. Lands of different cultivators are pooled together for the purpose of joint cultivation, though individual ownership is retained. Though attempts were made to introduce this type of cooperative farming in India, there was not much progress.

3.1 Nature of contract farming

After considering different types of contract farming let us now turn to contract farming. Contract farming is introduced in the case of peasant farming and there are two parties in this type of farming. One part is the landowner or peasant who cultivates his own land. The other party is the contracting company who purchases agricultural products from the landowners. The farming contracts may fall into three categories

Market specification contracts :- are pre harvest agreement that bind the processing firm and the grower to a particular set of conditions governing the sale of the crop. These conditions often specify price, quality and timing.

Resource –Providing Contracts: - obliges the processor to supply crop inputs, extension or credit, in exchange for a marketing agreement.

Production management contracts : – binds the farmer to follow a particular production method a input regimen, usually in exchange for a marketing agreement or resource provision.

4. Various Models of Contract Farming

Contract farming usually follows one of five broad models, depending on the product, the resources of the sponsor and the intensity of the relationship between farmer and sponsor that is necessary.

4.1 Centralized Model

This type of model involves a centralized processor and/or packer buying from a large number of small farmers and is used for tree crops, annual crops, and poultry, dairy. Products often require a high degree of processing, such as tea or vegetables for canning or freezing and dairy products. It is vertically coordinated, with quota allocation and tight quality control. Sponsors' involvement in production varies from minimal input provision to the opposite extreme where the sponsor takes control of most production aspects.

4.2 Nucleus Estate Model

This type of model is a variation of the centralized model where the sponsor also manages a central estate or plantation. The central estate is usually used to guarantee throughput for the processing plant but is sometimes used only for research or breeding purposes. It is often used with resettlement or transmigration schemes and involves a significant provision of material and management inputs

4.3 Multipartite Model

This type of model may involve a variety of organizations, frequently including statutory bodies which can develop from the centralized or nucleus estate models, e.g. through the organization of farmers into cooperatives or the involvement of a financial institution.

4.4 Informal Model

This type of model is characterized by individual entrepreneurs or small companies who involve informal production contracts, usually on a seasonal basis. It often requires government support services such as research and extension which involves greater risk of extra-contractual marketing.

4.5 Intermediary Model

This type of model involves sponsor in subcontracting linkages with farmers to intermediaries and there is a danger that the sponsor loses control of production and quality as well as prices received by farmers.

Apart from this there are several reasons for the introduction of contract farming in India. Some of the reasons are follows:

Financial burden of central and state governments will be reduced. Private investment in agriculture will increase. This is required in the context of liberalization and privatization.

It is needed to bring about a market focus in terms of crop selection by Indian farmers.

It will generate a steady source of income for the farmers.

It will provide a linkage between agriculture and processing industries.

It will generate gainful employment in rural areas, particularly for agricultural landless labour.

It will reduce migration of labour from rural areas to urban areas.

As a matter of fact contract farming will be mutually advantageous for both the farmers and the sponsoring companies.

5. Advantages to the Farmers

The farmers adopt contract farming will get the following advantages.

- (i) Inputs and production services are often supplied by the sponsor and is usually done on credit through advances from the sponsor.
- (ii) Contract farming often introduces new technology and also enables farmers to learn new skills.
- (iii) Farmers' price risk is often reduced as many contracts specify prices in advance.
- (iv) Contract farming can open up new markets which would otherwise be unavailable to small farmers.
- (v) The farmers will be exposed to world class mechanized agro-technology. This will increase productivity.
- (vi) The farmers obtain an assured price for their product.
- (vii) The farmers get healthy disease-free nursery, agricultural implements and improved technology from the contracting company.
- (viii) There will be crop monitoring on a regular basis, Technical advice will be provided free of cost at the doorstep of the farmer.

5.1 Advantages for Sponsors

The sponsors adopt contract farming will get the following advantages.

- (i) Contract farming with small farmers is more politically acceptable than, for example, production on estates.
- (ii) It overcomes land constraints when working with the small farmers.
- (iii) Production is more reliable than open-market purchases and the sponsoring company faces less risk by not being responsible for production.
- (iv) More consistent quality can be obtained than if purchases were made on the open market.
- (v) The company will get uninterrupted and regular flow of raw materials for its processing plant.
- (vi) The company will get protection from fluctuation in market pricing as the company enters into forward contract with the farmers.
- (vii) It will be possible for the company to formulate long term planning.
- (viii) If the move is successful for one crop it can be extended to other crops. As a result the company can diversify its product base and farmers can also produce several products.

The company gets a dedicated supplier base. The contract farming builds long term commitment between the company and the farmers. It also generates goodwill for the organization.

6. Problems Faced by Farmers

The farmers adopt contract farming will face the following problems:

- (i) Particularly when growing new crops, farmers face the risks of both market failure and production problems.
- (ii) Inefficient management or marketing problems can mean that quotas are manipulated so that not all contracted production is purchased.
- (iii) Sponsoring companies may be unreliable or exploit a monopoly position.
- (iv) The staff of sponsoring organizations may be corrupt, particularly in the allocation of quotas.
- (v) Farmers may become indebted because of production problems and excessive advances.

6.1 Problems Faced By Companies

The companies adopt contract farming will face the following problems:

- (i) Contracted farmers may face land constraints due to a lack of security of tenure, thus jeopardizing sustainable long-term operations.
- (ii) Social and cultural constraints may affect farmers' ability to produce to managers' specifications.
- (iii) Poor management and lack of consultation with farmers may lead to farmer discontent.
- (iv) Farmers may sell outside the contract (extra-contractual marketing) thereby reducing processing factory throughput.
- (v) Farmers may divert inputs supplied on credit to other purposes, thereby reducing yields.

7. Preconditions for Success

7.1 A Profitable Market

- (i) Sponsor must have identified a market for the planned production.
- (ii) Sponsor must be sure that such a market can be supplied profitably on a long-term basis.
- (iii) Farmer Must find potential returns more attractive than returns from alternative activities and must find the level of risk acceptable.
- (iv) Farmer must have potential returns demonstrated on the basis of realistic yield estimates.

7.2 Government Support- Regulatory Role

- (i) Suitable laws of contract and other laws are required as well as an efficient legal system
- (ii) Governments need to be aware of the possible unintended consequences of regulations and should avoid the tendency to over regulate
- (iii) Governments should provide services such as research and, sometimes extension.

7.3 Government Support- Developmental Role

- (i) Governments can take steps to bring together agribusiness and suitable farmers
- (ii) Provision of training and technological and managerial skills at all levels.
- (iii) Initiation and facilitation of research studies into the product under contract, in collaboration and consultation with the sponsors.
- (iv) State research institutes can particularly benefit small ventures, especially those managed by individual developers who cannot sustain their own plant breeding programme etc.
- (v) Provision of agricultural extension services to ventures that do not employ their own field staff.
- (vi) At the national level, it is a precondition that specialized services are available to provide institutional support to production, processing and marketing.

8. Legal Framework

- (i) The contract should comply with the minimum legal requirements of the country.
- (ii) Local practice must be taken into account.
- (iii) Arrangements for arbitration must be addressed.

8.1 Agreement Format

Formal agreements are legally endorsed contracts which closely detail obligations of each party.

Simple registrations are the most common format which the farmer signs to indicate that he/she has understood the terms of the agreement and wishes a contract to be reserved for him/her

Verbal agreements are frequently used under the informal model and sometimes by corporate sponsors

9. Successful imitations in India

Contract farming in wheat is being practiced in Madhya Pradesh by Hindustan Lever Ltd (HLL), Rallis and ICICI. Pepsi foods Ltd. in Punjab – Tomato puri, Tomato paste, Basmati rice, Chillies, oilseeds and vegetables crops like potato. The company has established strategic partnership with PAU and Punjab Agro Industries Corporation (PAIC).

Appachi's integrated cotton company model –Coimbatore, Tamil Nadu backed by a model called the Integrated Cotton Cultivation (ICC), which guarantees a market- supportive mechanism for selling the produce to growers.

Contract farming in 'Gherkin' in Karnataka Andhra Pradesh and Tamil Nadu. In Karnataka alone approximately 30,000 small and marginal farmers have taken up contract farming of gherkins. Karnataka exported 50,000 metric tons of gherkins valued at Rs. 143 crores during 2004-05.

9.1 The Success Stories of Some of the Private Companies Involved in Contract Farming

Key Elements of PepsiCo's Success

Strong focus for field preparation. Deep chiseling for the first time in Punjab. New imported & locally developed varieties and hybrids introduced. Crop management techniques disseminated to the farmers. Execution of technology transfer through well-trained extension personnel. Their extension services team was user friendly, informed and available at the farmers call.

9.2 Key Elements of Nestle India's Success

Nestle India's success was a result of developing effective backward and forward linkages.

Their prime aim was to win the confidence of the farmers. So they set up.

Transparent and economic milk collection system which because of low rate of production per family, had to reach thousands of farmers.

Large scale programme of technical inputs / advice to farmers aimed directly or indirectly at increasing their milk production at reduced cost.

Right from the day one Company embarked upon a development plan to help farmers improve farm production / productivity through systematic provision of various inputs.

The company provides free veterinary aid and extension, breeding services, fodder production techniques, etc. for quality production.

The company provides stable and remunerative market to the milk producers. Most of the milk comes from the small dairy producers.

357 tube wells were installed at exceptional speed, low cost to farmers as loans at favorable interest rates. This helped the farmers to meet the irrigation requirement of fodder and other crops thus improving their farm production substantially.

Company has also arranged loans firstly from its own resources and then from commercial banks for the farmers to buy milch animals. These loans were secured against Tripartite Agreements and installments were recovered from farmers milk payments and passed on to the banks.

To improve livestock quality, Company provides good quality bulls to farmers. These bulls are purchased from breeding farms and given free / 75% subsidy. Though availability of bulls is very low, yet 326 pedigree bulls have been supplied by 2002.

Company is also running 51 Artificial Insemination Centers. The persons working at these centers have been trained by Punjab Agricultural University, Ludhiana and then given all the required equipment / tools to work in villages. Semen is arranged from reliable source and made available at these centers. Farmers can get the service by paying just the labour cost to the inseminator.

In order to motivate farmers to improve livestock quality management, Milk Yield Competition and other such activities are organized on yearly basis. The outstanding performers at such programmes are honored with attractive prizes. Such incentives are really motivating the farmers to put in all out efforts to efficiently manage their milch animals.

In an effort to move towards mechanization of dairy farming, milking machines are made available to large farms. Farmers were given financial assistance to the tune of 80% to install latest farm equipment such as milking parlour and farm cooler to handle the milk hygienically and commercially.

Provision of chilling facility by the Company at village milk collection point has given a big boost to milk production. This Project has given dairy farming a commercial and professional look. 558 such cooling units have been installed by 2002. This Project is continuing and the Company will be spending nearly Rs. 45 - 50 crores on this Project. Company also supplies literature on regular basis to update farmer's knowledge on the dairy farming and related field. Company's quarterly Newsletter "SUNEHA" - about 30000 copies are reaching the farmers.

The assistance to farmers has resulted in a very good response from the farmers in taking up the dairy farming commercially and increasing the milk production in the area.

10. Problems of Contract Farming

In the first place there is no credible enforcement mechanism for contract farming in India.

Secondly, since the size of the holdings is small the company will have to enter into contract with a large number of farmers. This increases costs of the company.

Thirdly, there is a lack of comprehensive crop insurance scheme in India.

10.1 What Measures Can the Government Take?

In order to promote contract farming the government can take several measures. Some of the suggested measures can be stated.

In the first place state level legislation should be made for the regulation of contract farming. The contracts need to be more transparent and the farmers will have the better bargaining power and also to have legally protected.

Secondly, the government should allow contract farming organizations to take out realistic and deregulated crop insurance policies.

Thirdly, the government should give tax concessions or tax holidays to the companies engaged in contract farming.

Fourthly, the government should instruct the ICAR and the University system to provide region specific crop solutions and make them part of public information domain.

Fifthly, the government should facilitate import of new improved varieties of seeds/saplings/hybrids and technology for contract farmers/contracting companies.

Sixthly, even in the absence of any legal framework the Company can take certain measures to make the system effective.

Seventhly, the Company can maintain a proper database on farmers.

Eighthly, the Company can publicize the names of defaulters.

Ninthly, the Company can also introduce a system of incentives and rewards.

The farmers can be encouraged to set their own targets. They can also be permitted to sell their surplus output in the open market after meeting their contractual obligation to the Company.

11. Conclusion

Contract farming is nothing new. During the British period there was indigo plantation through contract farming. But that was exploitative. Modern contract farming is mutually advantageous. Since the company is financially stronger than individual farmers the terms of the contract may go against the farmers. Herein the Govt. will have to come forward. India, given the diverse agro climatic zones, can be a competitive producer of a large number of crops. There is a Need to convert our factor price advantage into sustainable competitive advantage. Contract farming offers one possible solution.

Acknowledgement

In preparation of this paper we deeply acknowledge our respected sir Prof. Jaydeb Sarkhel, Department of Commerce, Burdwan University, West Bengal, India, e-mail: jaydebsarkhel@gmail.com.

References

National Institute of Agricultural Extension Management (Manage): Contract Farming Ventures in India: A Few Successful Cases; Spice, Vol. 1, No. 4, March 2003, www.manage.gov.in.

Subramaniam, A : “Fieldday in Store for Farmers”; Rallis India, <http://www.rallies.co.in>.

TIDCO (2004): Contract/Corporate Sector Farming Policy:TamilNadu for the development of Fruits and vegetables.

Contracting Farming in India: Opportunities and issues, swapsushias.blogspot.com, Feb, 22 2014

Ashok Gulati, P.K. Joshi and Maurice Landes, “Contract Farming in India: An Introduction”, <http://www.ncap.res.in>

Shoja Rani B N, “Globalization and Contract Farming in India-Advantages and Problems”, <http://dspace.iimk.ac.in>