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Contract Farming: Driving Agricultural Development and Market Integration in India

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INTRODUCTION

Contract farming is gaining considerable traction as a strategic approach to agricultural development, especially in India. The recommendation for contract farming was highlighted in the McKinsey report submitted to the government of West Bengal during the Left Front's tenure, highlighting its potential benefits for enhancing agricultural productivity and market access. Moreover, the National Agricultural Policy of 2000 of the Government of India emphasizes the promotion of private sector involvement through contract farming and land leasing arrangements. These initiatives aim to facilitate accelerated technology transfer, capital inflow, and guarantee a guaranteed market for crop production, with a particular emphasis on oilseeds, cotton, and horticultural crops. The recent decision of the Indian government to allow Foreign Direct Investment (FDI) in the multi-brand retail sector further underscores the relevance of contract farming. This initiative presents prospects for enhanced collaboration between farmers and retail establishments, thereby facilitating enhanced market connections and investment avenues in the agricultural sector. As India continues to navigate its agricultural landscape, contract farming emerges as a pivotal instrument to propel development, promote sustainable practices, and enhance the overall agro-economic ecosystem.

Historical Background:

Contract farming has a long history that dates back to the British colonial era, particularly evident in exploitative practices such as indigo plantations. Modern contract farming, on the other hand, is fundamentally different, with the goal of bringing about mutual benefits. The origin of this organization can be traced back to Taiwan in 1895 under Japanese rule, thereby marking a departure from exploitative practices. In India, the concept gained traction when PepsiCo began contract farming for tomato and potato cultivation in the Hoshiarpur taluk of Rajasthan in 1927.

Karnataka subsequently implemented contract farming for the cultivation of gherkin in the 20th century. The recommendation for contract farming in West Bengal, as elucidated in the McKinsey Report during the tenure of the Left Front, demonstrates its increasing significance. The government of West Bengal is currently seriously considering this proposal.

In contract farming, two parties are involved: the landowner or farmer and the contracting company. The farmer agrees to grow the contractor's crops on their land and will give them a certain amount of produce at a certain price. In return, the contractor furnishes essential inputs, including technical guidance, while the farmer furnishes land and labor.

During the Green Revolution, the government assumed a role similar to that of a contracting company. The inputs provided by the organization comprised of high-yielding variety seeds, novel technologies, irrigation water, fertilizers, pesticides, subsidized credit, and the acquisition of agricultural crops from farmers at predetermined prices. Despite the significant success of this agricultural approach, it was also accompanied by associated expenses.

Why Contract Farming?

The concept of contract farming has emerged as a crucial solution to address the persistent challenges faced by Indian farmers. Farmers have often had to deal with the problem of surplus produce going to waste because there were not enough buyers; while on the other hand, the agro-based and food industries constantly look for high-quality agricultural goods. Contract farming acts as a bridge between farm production and industrial demand, ensuring a seamless connection between farm production and industrial demand. This system not only provides farmers with a guaranteed market, but also provides the agricultural industry with reliable access to quality produce. Moreover, contract farming offers numerous additional advantages, including the alleviation of financial burden on both central and state governments, the encouragement of private investment in agriculture, and the promotion of a market-oriented approach to crop selection. Furthermore, it provides a stable income source for individual farmers, strengthens the links between agriculture and processing industries, and creates employment opportunities in rural areas. Ultimately, contract farming plays a pivotal role in halting the migration of rural individuals to urban areas by providing sustainable livelihoods within local agricultural communities.

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.

(viii) To promote rural self-reliance in general by pooling locally available resources & expertise to meet new challenges.

Different Types of Farming

In the realm of peasant agriculture, landowners typically cultivate their land alongside family members, a common practice in India. This system is distinguished by the existence of small landholdings, with surplus land distributed among rural landless agricultural laborers. The crucial decisions pertaining to crop selection and land utilization are made collectively within the family unit. Alternatively, landowners may opt for tenant farming, which involves leasing out their land in exchange for rent. This practice is known as sharecropping. Tenant farming, which is prevalent in West Bengal and across India, is protected by various laws to protect the interests of tenants. Initiatives such as Operation Barga in West Bengal aim to legitimize tenant rights, thereby preventing arbitrary evictions.

Nonetheless, both peasant and tenant farming encounter limitations owing to the modest size of their holdings, thereby impeding the implementation of sophisticated production techniques such as advanced irrigation systems, technology, and mechanization. In order to increase productivity, large-scale farming becomes essential. Different models have been implemented. Different models have been implemented worldwide, including Capitalist Farming, where individual ownership prevails and hired labor is employed on large farms similar to factories. Socialist collective farming, on the contrary, involves collective ownership of land, with members receiving a share of the produce based on their labor contributions. Despite its decline post-Soviet Union dissolution, socialist countries such as China, Cuba, and Vietnam are introducing agricultural reforms to allow private land ownership.

Another way to achieve the benefits of large-scale production is through cooperative farming. In this model, private ownership persists, but cultivators are willing to join forces for joint cultivation. Despite the efforts made to introduce cooperative farming in India, there has been a limited amount of progress. Nevertheless, these diverse farming models highlight the need for innovative approaches to maximize agricultural productivity and address the challenges inherent in small-scale farming systems.

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:

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

Resource –Providing Contracts:

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

Production management contracts:

Production management contracts bind the farmer to fallow a particular production method an input regimen, usually in exchange for a marketing agreement or resource provision.

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.

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.

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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.

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.

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.

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.

Advantages to the Farmers:

The farmers adopt contract farming will get the following advantages:

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

Advantages for Sponsors:

The sponsors adopt contract farming will get the following advantages:

1. Contract farming with small farmers is more politically acceptable than, for example, production on estates.
2. It overcomes land constraints when working with the small farmers.
3. Production is more reliable than open-market purchases and the sponsoring

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company faces less risk by not being responsible for production.

4. More consistent quality can be obtained than if purchases were made on the open market.
5. The company will get uninterrupted and regular flow of raw materials for its processing plant.
6. The company will get protection from fluctuation in market pricing as the company enters into forward contract with the farmers.
7. It will be possible for the company to formulate long term planning.
8. 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.
9. 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.

Problems Faced by Farmers:

The farmers adopt contract farming will face the following problems:

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

Problems Faced By Companies:

The companies adopt contract farming will face the following problems:

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

Preconditions for Success:

A Profitable Market:

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

Government Support- Regulatory Role:

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

Government Support- Developmental Role:

a) Governments can take steps to bring together agribusiness and suitable farmers
b) Provision of training and technological and managerial skills at all levels.
c) Initiation and facilitation of research studies into the product under contract, in collaboration and consultation with the sponsors.

d) State research institutes can particularly benefit small ventures, especially those managed by individual developers who cannot sustain their own plant breeding programme etc.
e) Provision of agricultural extension services to ventures that do not employ their own field staff.
f) At the national level, it is a precondition that specialized services are available to provide institutional support to production, processing and marketing.

Legal Framework:

a) The contract should comply with the minimum legal requirements of the country.
b) Local practice must be taken into account.
c) Arrangements for arbitration must be addressed.

Agreement Format:

a) Formal agreements are legally endorsed contracts which closely detail obligations of each party.
b) Simple registrations are the most common format which the farmer signs to indicate that he/she has understood the terms of the agreement and wish a contract to be reserved for him/her.
c) Verbal agreements are frequently used under the informal model and sometimes by corporate sponsor.

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 a Rs. 143 crores during 2004-05.

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

Key Elements of Pepsi Co's Success:

Strong focus for field preparation. Deep chiselling 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.

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 favourable 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 instalments were recovered from farmer's 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 our 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.

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.

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.

CONCLUSION

Although contract farming has historical roots, contemporary practices are considered mutually advantageous arrangements. However, caution is needed, as the financial leverage of companies may lead to contracts favouring them over individual farmers. Government intervention is essential in order to ensure fairness. India's diverse agroclimatic zones offer tremendous potential for competitive crop production. It is essential to convert our factor price advantage into a sustainable competitive advantage. Contract farming emerges as a viable option in this endeavour, providing a means to enhance agricultural productivity, market integration, and overall sustainable development.