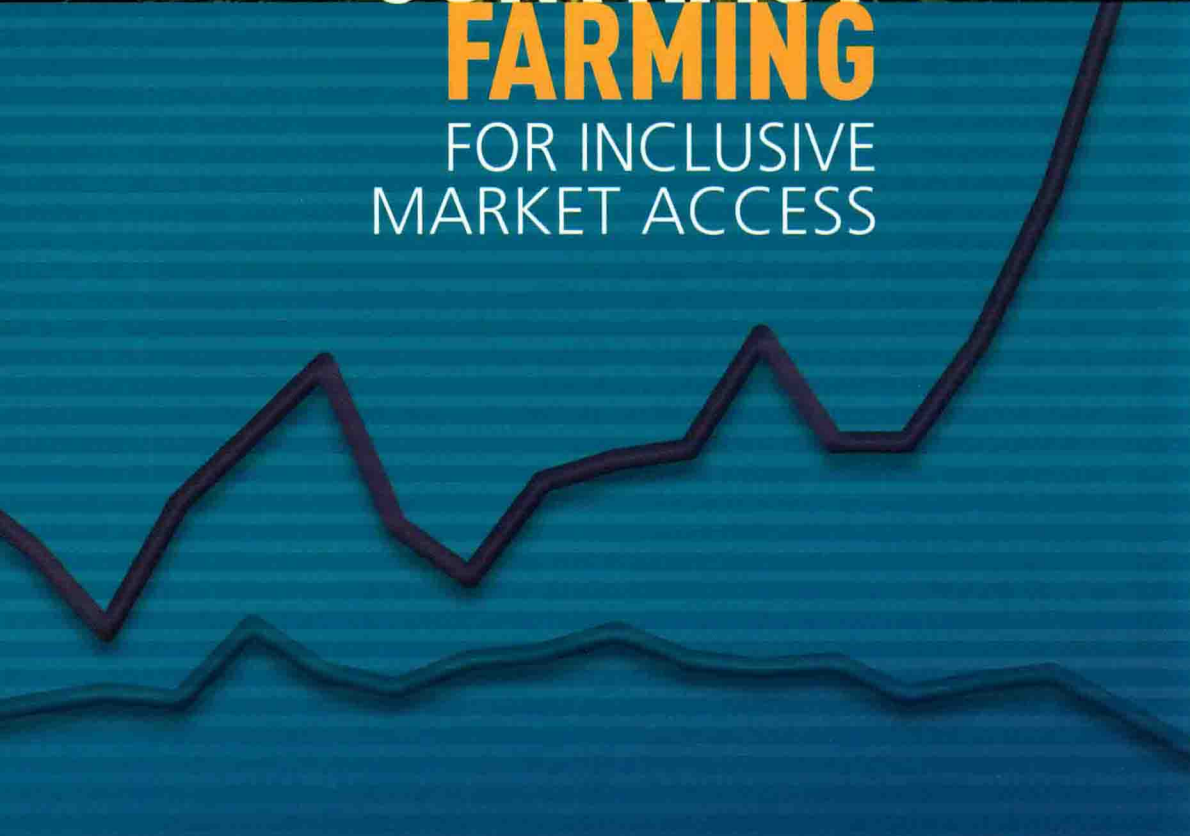




# CONTRACT FARMING

FOR INCLUSIVE  
MARKET ACCESS

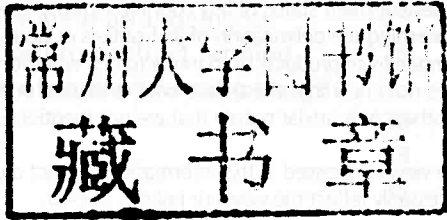


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## **CONTRACT FARMING** FOR INCLUSIVE MARKET ACCESS

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## Foreword

Food manufacturers, modern retailers, food exporters and the food service industry are under tremendous competitive pressures. Large- and medium-scale firms in these increasingly concentrated sectors are using market power and alliances to establish market entry requirements. These firms have also been introducing procurement and supply chain management practices in order to gain control over supply processes and improve efficiency along the supply chains.

These changes in industrial organization and procurement are creating costs and technical requirements that are making it difficult for small farmers to access modern market channels. Since a rapidly growing number of firms – at least in modern market channels – are increasingly relying on contract procurement, a relevant question for development professionals is whether contract farming can be an effective institutional mechanism to enhance prospects for the participation of small farmers in the modernizing agrifood systems.

Modern agrifood systems imply strong competitive pressure for all value chain participants. The need to respond to demands from consumers, processors, retailers and transportation firms imposes stricter and stricter requirements for suppliers, in terms of quality, timing, handling and other delivery arrangements. Smallholder producers, representing the major part of global agriculture, are now facing the growing challenge of complying with these requirements. The issue of inclusiveness of smallholders in agrifood systems is not only a matter of efficiency of the systems but is also one of the key questions for the income and welfare of rural populations in developing countries. It is specifically for these reasons that consideration of effective institutional mechanisms to enhance the participation of smallholders in modern markets is at the forefront of FAO's agenda.

Contract farming is one such mechanism that has been widely discussed in world literature over the last few decades. It involves several aspects worthy of consideration: economic, institutional, social, legal, etc. The potential benefits of contracting for helping small farmers will depend, *inter alia*, on the product category and the requirements of the end market. Differences in potential benefits will also depend on country and local circumstances, including such factors as sector policy and availability of services.

Against this backdrop, FAO's book on contract farming for inclusive market access is a welcome addition to the body of knowledge on farmer to market linkages and on the roles of contracts in this regard. The book presents a range of cases covering different commodities and country contexts, competitively commissioned from researchers and development professionals worldwide, all of which illustrate the multifaceted nature of contracting as an agrifood chain coordination mechanism to promote inclusiveness and efficiency in supply chains. It also contributes to the treatment of conceptual issues in this general discussion and to the achievement of FAO's Strategic Objective Four: *Enable inclusive and efficient agricultural and food systems*.

In addition, in the introductory chapter, the editors draw a number of significant key messages that bring new contributions to the professional debate on the role of contracting in agrifood system development.

Contract farming will certainly remain high on the agenda of development professionals in the years to come, as can be inferred from the growing number of developmental initiatives that focus on contracting as an instrument to promote chain efficiencies and smallholder market linkages. It is expected that the issues discussed in this book will further inform the related policy design, implementation and impact evaluation.

**Eugenia Serova**

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## 1.1 INTRODUCTION

Efforts to fight poverty and promote food security in developing countries need to include systems that revitalize rural areas, the main livelihood for large numbers of poor farmers and rural families worldwide. Smallholder agriculture is particularly the main source of the food consumed in many developing countries, supplying some 500 million farmers globally and providing an income source for an estimated one billion people (IFAD, 2011). While agricultural development interventions enhancing technical practices and improvements in productivity and contribute to farm output growth, extensive product integration from a sustainable source of farm income for this large contingent of producers means that attention also needs to be paid to the provision of market access. Yet the challenges of linking farmers to developing markets and agricultural systems that are integrating remarkable transformations globally should not be underestimated.

Indeed, changes in agro-ecological organization and in production practices followed by smaller producers, processors and other actors of agricultural products are creating technical, institutional and governance-related gaps that are making it increasingly difficult for small-scale farmers to access the local markets, potentially undermining market chains. As response to consumer requirements and needs prompted by rising incomes, increased urbanization and other socio-demographic transformations, higher demand drive and means that farmers could supply vegetables, adhere to stringent safety and quality standards, comply with logistical requirements and change their traditional trading practices. In many circumstances, these demands effectively work to divert resources from farmers from the main farm supply chains.

Approaches to link farmers to markets in inclusive ways have been the subject of growing attention by the Food and Agriculture Organization of the United Nations (FAO) and other development agencies for a number of years. Approaches can include arrangements and other forms of knowledge generation have been



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## Chapter 1

# Contract farming for inclusive market access: Synthesis and findings from selected international experiences

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### 1.1 INTRODUCTION

Efforts to fight poverty and promote food security in developing countries need to take into account that agriculture remains the major livelihood for large numbers of poor farmers and rural families worldwide. Smallholder agriculture in particular is the main source of the food consumed in many developing countries, engaging some 500 million farmers globally and providing an income source for an estimated two billion people (IFAD, 2011). While agricultural development interventions enhancing technology uptake can lead to improvements in productivity and contribute to farm output growth, converting product intensification into a sustainable source of farm income for this large contingent of producers means that attention also needs to be paid to the promotion of market access. Yet the challenges of linking farmers in developing regions to agrifood systems that are undergoing remarkable transformations globally should not be underestimated.

Indeed, changes in agro-industrial organization and in procurement models followed by traders, exporters, processors and other buyers of agricultural products are creating technical requirements and generating compliance costs that are making it increasingly difficult for resource-constrained farmers to access the more modern, potentially remunerative market channels. In response to consumer requirements and needs prompted by rising incomes, increased urbanization and other socio-demographic transformations, buyers demand more and more that farmers ensure supply regularity; adhere to stringent safety and quality standards; comply with logistical requirements; and change their traditional trading practices. In many circumstances, these demands effectively work as drivers to exclude poor farmers from the modernizing supply chains.

Approaches to link farmers to markets in inclusive ways have been the subject of growing attention by the Food and Agriculture Organization of the United Nations (FAO) and other development agencies for a number of years. Appraisals, case studies, consultations and other forms of knowledge generation have been

carried out, from which a number of lessons might be drawn (FAO, 2013a; GIZ, 2013a; Wiggins and Keats, 2013; FAO, 2007). Among these, the question of whether contract farming (CF) could be an effective institutional mechanism to enhance prospects for the inclusion of small farmers in modern market channels stands out as one of special relevance.

Recent years have seen a surge in publications on the CF topic, including journal articles, conference proceedings, books and other reports discussing theoretical concepts, case studies and research findings relating to technical, economic and social aspects.<sup>1</sup> Reviews of the vast literature that highlight the increasing prevalence of CF in developing countries have been presented recently by authors such as Prowse (2012), Bijman (2008) and Setboonsarng (2008), and previously by Singh (2002), Kirsten and Sartorius (2002), and FAO (2002), among others.

The present book adds to this growing literature. While several recent studies have considered the economic and social impact of CF on smallholder farmers (Smalley, 2013; Barrett *et al.*, 2012; Bellemare, 2012; Miyata *et al.*, 2009), this book's purpose is to characterize the extent to which CF is helping small farmers to access markets and meet increasingly stringent requirements – not only of “modern” food manufacturers, retailers, exporters and food service firms, but also in non-food sectors such as biofuels and forestry. These firms mostly produce differentiated, often branded and labelled products, in compliance with private and public sector quality and safety standards targeting global and regional markets. They may also provide import substitution for minimally differentiated and/or minimally transformed products for national or local markets, or produce goods requiring raw materials that, for processing efficiency reasons, must comply with special quality prerequisites.

In addition, the book seeks to clarify differences in the functionality of contracts depending on commodity, market, technology, public policies and country circumstances, by providing a series of nine diverse case study appraisals based on real world examples from developing regions. These case studies were competitively selected from scholars and development practitioners working in the field of CF by FAO, in collaboration with the International Association of Agricultural Economists (IAAE). Cases were selected from a range of commodities including livestock, food crops, bioenergy feedstock and forestry, in order to provide readers with an opportunity for cross-product comparisons of contract provisions and enabling environment factors. To achieve this objective, authors were requested to follow a predefined chapter outline covering the following salient points.

- Market conditions that lead to the need for contracting for the specific product category
- Background to the contract agreement between the parties involved
- Characteristics of the contract, including features associated with the flow of services and reciprocal obligations, price formulation and contingencies for contract failure
- Assessment of the effectiveness of contract arrangements in terms of how particular aspects of the contracts have helped smallholders to access more

<sup>1</sup> A sample of this literature is freely available from the FAO Contract Farming Resource Centre Web site: <http://www.fao.org/ag/ags/contract-farming/en>



remunerative, but also more demanding modern markets; the benefits for the contracting company; and risks involved for each party

- External factors that affect the likelihood of establishing and sustaining procurement contracts
- Recommendations on ways in which contracting could be improved for all parties
- Conclusions on the extent to which contracts have helped to enable small farmers to access markets by meeting the procurement requirements of modern supply chains

## 1.2 OVERVIEW OF BOOK CHAPTERS

The presentation of the nine cases in Chapters 3 to 11 of this book is preceded by an analytical chapter by Xiangping Jia and Jos Bijman. This provides both an explanation of the patterns and trends that are emerging in market organization and a synthesis of the theoretical arguments for the rise in CF. The authors propose a multidimensional framework for the analysis of CF that broadens the intellectual debate beyond the functional roles of contracts and the focus on CF as a transaction cost-reducing business model. They emphasize the need for a holistic perspective on CF that looks not only at the issue from the commodity perspective, but also includes consideration of the territorial and sectoral dimensions that give rise to imbalances in market power that may heavily influence the bargaining positions of partners involved in contracts. The social and political dimensions are also considered, to the extent to which they influence behavioural norms that have the potential to affect the sustainability of contractual arrangements.

The authors identify several additional themes requiring further elaboration in the CF literature. These include the employment effects of CF on- and off-farm; the distributional effects (i.e. equity and social dimension); and the interplay between agricultural production, market organizations and information and communication technology (ICT). They suggest that ICT has the potential to undermine the need for CF by reducing the importance of collective action and improving the services available to support spot and open market transactions. They conclude by noting that while the traditional reasons for CF (e.g. market failures for farm credit and inputs) continue to be important, the need to strengthen vertical coordination throughout the agrifood value chain has become the dominant explanation for the rise in CF in recent years. This argument has also been put forward by authors such as da Silva (2005). However, they caution practitioners to restrain expectations about the development potential of CF, by recognizing its locally embedded nature and the importance of adaptation of CF systems to address local contextual complexities.

Chapters 3 and 4 give examples of smallholder involvement in contracting in the livestock sector from Bangladesh (poultry) and China (pig meat). Both chapters claim strong benefits for smallholder farmers involved in contract arrangements when compared with non-contract farmers, not only in terms of net income but also in terms of increases in production efficiencies and the adoption of food safety and disease management practices. Similar market factors have given rise to the need for contracting, including increasing domestic demand, food safety scares resulting from disease outbreaks and the use of prohibited chemical inputs (e.g. “bird flu” and *clenbuterol* contamination) and supportive government poli-