



Guiding principles for responsible contract farming operations



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Photo credits

- ©FAO/Olivier Asselin A farmer woman using a magnifying glass to check rice reeds for insects [cover]
- ©FAO/Rodger Bosch Cotton is widely grown in Africa by smallholders working under contracts that can have specifications regarding the provision of inputs by the product buyer
- ©Antonello Proto The fruit processing industry often contracts farmers to grow their raw materials under specific quality requirements. These should be clearly expressed in the contractual instruments
- ©F. Mattioli Timeliness of delivery is a common pre-requisite in contract farming operations. Clauses that deal with assignment of responsibilities for harvesting and product delivery issues are advisable to be included in the contracts
- ©FAO/Bay Ismoyo Food processing enterprises can be an important outlet for smallholder agricultural production. Well-designed contracts can be a mechanism to promote fairness in the relationship between small farmers and agro-processors
- ©J. Koelen Through the provision of technical assistance, contracting firms can promote improvements in agricultural productivity and farmer's income

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BACKGROUND

Contract farming can be defined as an agricultural production system 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 commits to providing agreed quantities of a specific agricultural product. This should meet the quality standards of the buyer and be supplied at the time that the buyer determines. In turn, the buyer agrees to purchase the product at agreed pricing conditions and, in some cases, to support production through, for example, the supply of farm inputs, land preparation and the provision of technical advice.

If the conditions that are stipulated in a contract farming agreement are detrimental to the interests of either partner, be it for reasons of imbalances in market power, opportunistic behaviour or other unfair practices, the relationship between buyer and farmer will most likely deteriorate. Under such a scenario, contract farming operations will not be successful and opportunities for the mutual benefits that can ensue from a well coordinated buyer-seller relationship will be missed.

Contract farming continues to gain importance as a mechanism for governing transactions in agrifood supply chains and as a tool to promote the access of smallholder farmers to markets. It is therefore timely and opportune to consider the various approaches available for minimizing the likelihood of conflict in contractual relationships, with a view to enhancing the potential of benefits for both partners

and promoting the social and economic development impacts of contracting in the agrifood sector.

This document presents a set of guiding principles that are conducive to responsible contract farming operations. It is intended to serve as guidance for farmers and buyers engaged in contractual relationships, in order to promote good business practices and maintain an atmosphere of trust and respect that is essential if contract farming is to prove effective.

This brief is a complement to other publications available on FAO's **Contract Farming Resource Centre** (www.fao.org/ag/ags/contract-farming).

GUIDING PRINCIPLES

Common purpose

Farmers and buyers should have a common purpose when engaging in contract farming. The arrangements should be based on the principle that the contract will protect the parties from risks that may occur during the fulfilment of duties and facilitate the execution of contractual obligations. The aim is that the agreement should promote agricultural production and guarantee a secure market for the commodity, thereby allowing farmers to earn increased revenue and buyers to obtain a return on their investments (the so-called win-win situation).

Adherence to a legal framework

To regulate their agreements, farmers and buyers should agree to enter into a contract.

To be valid, contracts must comply with a number of essential requirements: parties

COTTON IS WIDELY GROWN IN AFRICA BY SMALLHOLDERS WORKING UNDER CONTRACTS THAT CAN HAVE SPECIFICATIONS REGARDING THE PROVISION OF INPUTS BY THE PRODUCT BUYER.



must have the legal capacity to contract and provide free and informed consent. In cases where a group/association enters into a contract, it must be made clear whether responsibility lies with the individual member or with the group. This will depend on the type of association chosen for the group and on the national legislation in force.

Contracts should be concluded by the acceptance of an offer that one party (e.g. the buyer) makes to the other (e.g. the farmer).

Contracts should clearly specify the parties' responsibilities. In addition, contracts must be based on an "object" (i.e. the good or service that constitutes the obligation of farmer and buyer) such as the sale of a designated crop by the farmer and the payment by the buyer. Finally, the contract must be based on the detailing of the farmer's and the buyer's duties and responsibilities (the so-called "cause" or "consideration" in legal terminology), which includes the price and the

method of payment. The “object” and the “cause/consideration” of the contract should be lawful, i.e. they should not be illegal, immoral or contrary to public policy.

Clear documentation

Preferably, a contract should be stated in writing, so as to document the terms that the parties have agreed to and the right to obtain enforcement of their obligations, as outlined in its terms. It is recommended that written agreements be drawn up to provide clear guidelines regarding agreed quality of products, conditions regarding prices, payment and product delivery and to prevent conflicts arising due to misunderstandings. In cases where the parties make a verbal agreement, this should ideally take place in the presence of one or more witnesses who have no interest in the economic relationship between the farmer and the buyer.

Readability of contracts

Contracts should be written in clear and coherent language, using a legible typeface and words that are understandable by a farmer of average education and experience. Confusion

and misunderstandings can easily arise if the terms of the agreement are not clearly explained and understood. It would be advantageous if contracts were drafted in the language with which both parties are mostly familiar. In cases where farmers are illiterate, the text of the contract should be read aloud by a third party.

Due attention and review

Buyers should grant farmers a sufficient period of time, depending on the case, to review the draft contract and seek legal or other advice before signing. Contracts should be concluded well in advance of the commencement of an agricultural season and farmers should not be pressured to agree to a contract without having first taken necessary advice. Buyers should also grant the right to cancel the contract within a designated period. Once the agreement is concluded, buyers should provide a copy of the signed contract to farmers.

Disclosure

Farmers and buyers should make full disclosure of all information necessary for the conclusion of the agreement

and be transparent in all their dealings. Contracts should clearly indicate the quantity of the commodity to be supplied by the farmer over a period of time, the quality standards required and the means of assessing these on delivery. Other conditions to be set out in the contract, if established by the buyer, may include the time when farmers should deliver or when buyers should collect the commodity, as well as the responsibility for transportation. Terms and conditions for the eventual supply of production inputs to farmers should be clearly outlined in the contract. Criteria for product price determination, and their means of verification, should also be specified unequivocally. Contracts should establish the contract duration and conditions for termination, i.e. a written notice of termination within a reasonable time period.

Transparency in price determination

Prices and payment constitute a key element of any contract, and these points need to be clearly understood and agreed upon by farmer and buyer. It is advisable that the parties negotiate in order to



THE FRUIT PROCESSING INDUSTRY OFTEN CONTRACTS FARMERS TO GROW THEIR RAW MATERIALS UNDER SPECIFIC QUALITY REQUIREMENTS. THESE SHOULD BE CLEARLY EXPRESSED IN THE CONTRACTUAL INSTRUMENTS.



agree a price that is mutually satisfactory, and that both sides strictly honour this agreement. The price and payment methods should be carefully determined in the contract, including all necessary information to ensure clarity in the performance of contractual clauses. It is also important to specify when and where payments to farmers will be made.

Contracts should ensure transparency in price determination and payment procedures. They should avoid complex formulas or measurements of quantity and quality unlikely to be fully understood by farmers. It is advisable that contracts should clearly disclose any charge or deduction that may affect the net amount paid to the farmer under the terms of the contract. Contracts should also provide transparency on information regarding the costs of any inputs and services to be supplied.

It is advisable that a contract should allow provision for prices to be renegotiated in the event of unforeseen circumstances, such as substantial changes in market conditions leading to large differences in price with respect to the contracted terms.

Transparency and fairness in clauses relating to quality

Contractors expect farmers to engage in production practices and procedures that are conducive to producing good quality products. Such practices include proper use of production inputs, which are recommended for the type of agricultural product to be grown or reared. Farmers are also expected to follow good management practices, which may include maintenance of hygienic conditions, use of



TIMELINESS OF DELIVERY IS A COMMON PRE-REQUISITE IN CONTRACT FARMING OPERATIONS. CLAUSES THAT DEAL WITH ASSIGNMENT OF RESPONSIBILITIES FOR HARVESTING AND PRODUCT DELIVERY ISSUES ARE ADVISABLE TO BE INCLUDED IN THE CONTRACTS.

clean containers and water and protection of produce from heat. Ideally, these expectations should be expressed in the form of clear contractual clauses.

It is advisable that contracts should indicate not just the type of production process recommended for farmers, but also the post-harvest handling materials to be used, specifying which party will supply them and their price. After harvest, farmers are expected to comply with the post-harvest handling specifications needed to prevent spoilage or other forms of product loss.

Buyers should strictly adhere to agreed commodity grades and should promote fair and transparent ways of assessing the quality of produce delivered. Farmers and their representatives should have the right to be present at the time of delivery and receive a full explanation in the event of any rejects or downgrading. Soon after delivery, farmers should receive a written report of quantities received and grades applied to their produce.

Transparency and fairness in clauses related to input supply and use

The contract should stipulate which party will be responsible for supplying and applying farming inputs. Where contracts envisage the supply of inputs (i.e. pesticides, fertilizer, seeds, fuel, veterinary inputs, feed, etc.), before the start of each season all inputs should be identified and ordered well in advance of farming operations such as sowing, transplanting or livestock breeding.

Where farmers require inputs for the crops under contract, the buyer could consider supplying these and deducting the cost upon delivery of the contracted product. If provided by buyers, inputs defined in the contract should meet necessary quality standards at prices that are no higher than prevailing commercial prices. They should be delivered on time so that farmers can use them to maximum effect. In cases where the buyer undertakes to provide farmers with inputs and other advances, farmers should not

use these for purposes other than those for which they were intended.

Farmers should also follow recommended practices in order to meet specifications and maximize returns from the use of the buyer-supplied inputs

Fairness in risk sharing: *force majeure* and contractual flexibility

Contracts should envisage the possibility of renegotiation. They should also specify the issue of sharing of production and market risks among parties.

In cases of controllable plant or animal disease risks that may impede production from reaching the contracted agreement, distribution of the resulting financial burden should be assigned in a way that is commensurate with each party's responsibility for the event. Problems caused, for example, by inadequate inputs or technical advice provided by buyers should not result in financial losses for farmers. Conversely, problems caused by mismanagement, inadequate use of inputs or failure to comply with the technical advice supplied by the buyer, should not penalize the buyer.

In cases where natural disasters (weather related, non controllable plagues or diseases)

or man-made disasters (war, civil conflict, strikes), which can be classified as *force majeure*, cause farmers or buyers to be unable to meet the conditions of the contract, neither party should be considered liable for the non-performance and, in these circumstances, the contract should have a provision for renegotiation. Renegotiation should be based on the principle of equal sharing of the costs, or benefits, arising from the event classified as *force majeure*.

The possibility of insurance programmes against crop or livestock losses should also be evaluated as a means of risk management.

Prevention of unfair practices in buyer-farmer relations

Contracts should not prohibit or discourage farmers from associating with other farmers to compare contractual clauses or to address concerns or problems. Moreover, they should not prohibit or discourage farmers from discussing contracts with business partners or seeking professional, legal, financial or agricultural production advice related to the contract's terms, obligations, and responsibilities.

Buyers should not engage in retaliatory or discriminatory practices against farmers who exercise their rights against them,

such as by filing a complaint against a buyer's perceived unlawful conduct. They should not misrepresent contract terms as an inducement to a farmer to sign the agreement.

Buyers should avoid situations that can lead to farmer dissatisfaction, such as discriminatory buying (unequal treatment of farmers), late payments, inefficient services, poor technical advice and unreliable transportation for commodities. They should not change pre-agreed production quotas in the event of changing market conditions in an attempt to avoid purchasing contracted production. Additionally, they should not refuse delivery of goods when farmers are ready to supply them. In order to maintain trust and respect, they should ensure transparency and fairness during the buying process.

Honouring contractual terms

Farmers and buyers should be loyal to each other. Mutual trust and respect are important factors for the success of contract farming operations.

In order to avoid disagreements, buyers should ensure that farmers have all necessary information to enable them to plant, grow, harvest and deliver the required commodity,



FOOD PROCESSING ENTERPRISES CAN BE AN IMPORTANT OUTLET FOR SMALLHOLDER AGRICULTURAL PRODUCTION. WELL-DESIGNED CONTRACTS CAN BE A MECHANISM TO PROMOTE FAIRNESS IN THE RELATIONSHIP BETWEEN SMALL FARMERS AND AGRO-PROCESSORS.



THROUGH THE PROVISION OF TECHNICAL ASSISTANCE, CONTRACTING FIRMS CAN PROMOTE IMPROVEMENTS IN AGRICULTURAL PRODUCTIVITY AND FARMER'S INCOME.

and buyers should guarantee that they will purchase the product from farmers as scheduled. In turn, farmers should supply the produce, meeting the quality standards specified in the contract.

Farmers should respect the commitment agreed in the contract to deliver items produced by using inputs and financing supplied by the buyer exclusively to that specific buyer, unless alternative arrangements are specified in the contract. They should not sell all or part of their production to a different buyer (“side-selling”) if the latter offers a higher price. For their part, buyers, in their turn, should not renege on contractual terms when market circumstances or government policy change.

It is advisable that farmers or their representatives be present when the product is collected from the farm or delivered to

the buyer's premises. In the event of product rejection, buyers should notify farmers of the reasons and offer them the chance to inspect the rejected consignment or have it inspected by a third party.

Open dialogue

Dialogue between farmers or their representatives and buyers is essential for the stability of contract farming operations. Lack of communication between them can lead to misunderstandings and conflict.

Dialogue between the parties should be promoted on matters such as contractual terms and requirements for land cultivation or livestock rearing, as well as to help rectify misunderstandings and resolve conflicts.

It is also advisable that farmers and buyers should meet at the beginning of each season so that buyers can explain their

management programme, clarify the duties of both parties as set out in the contract and address any emerging problems.

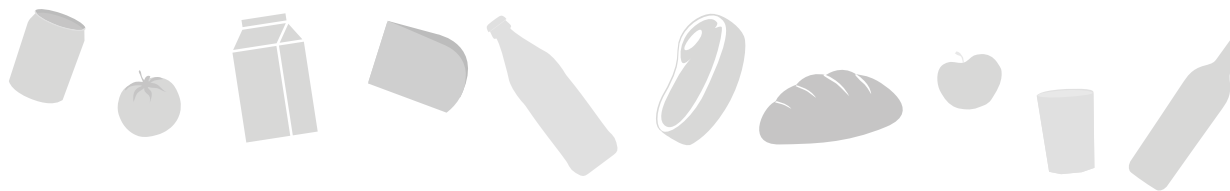
Clear mechanisms to settle disputes

Farmers and buyers should agree in the contract on a neutral third party to assist them in the event of disputes. When contractual disputes arise, both parties should endeavour to resolve them amicably. If these attempts fail, it is advisable that the parties seek mediation or arbitration before resorting to judicial proceedings.

If the buyer is the subsidiary of a parent company, this parent company should be liable to the farmer for any debts and claims against the buyer.

If the farmers and buyers are located in different countries, the contract should specify which country's law should apply in the event of a dispute.

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