



Food and Agriculture Organization
of the United Nations



Planning and Setting Up Contract Farming Operations

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2022

Content



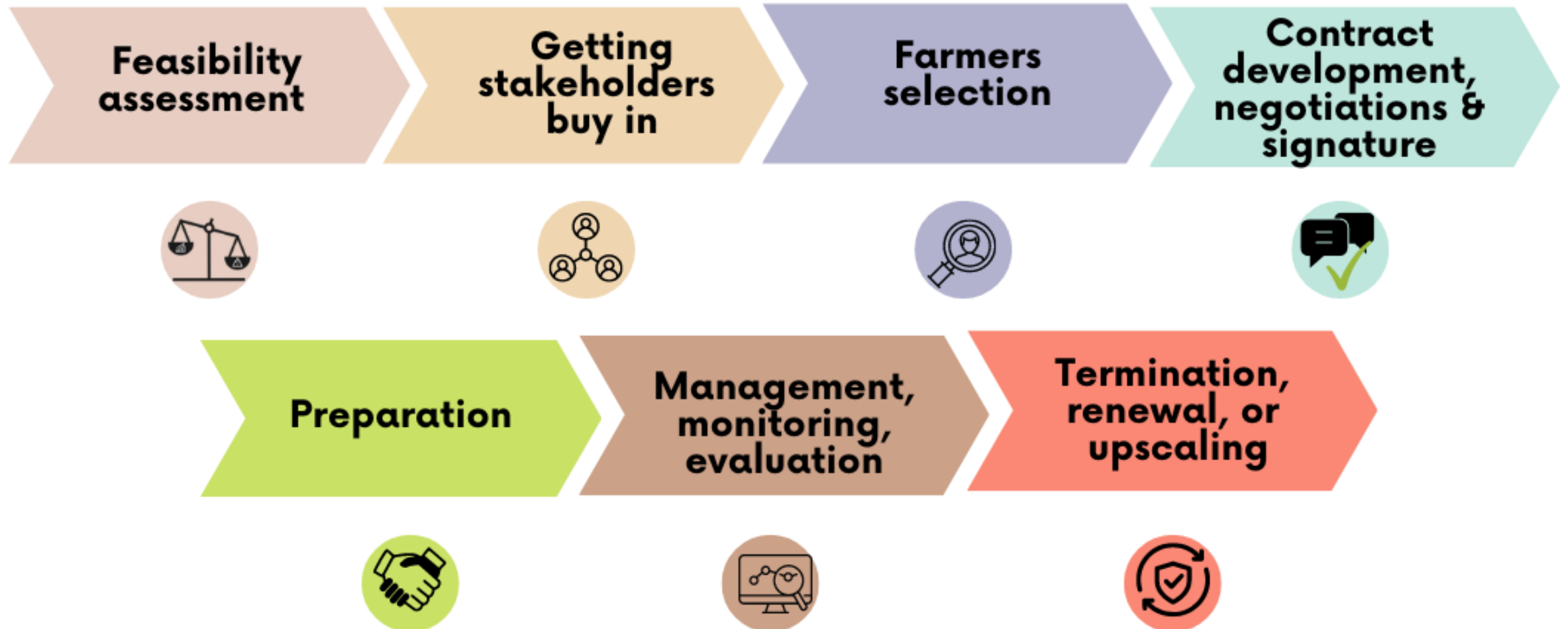
- What is CF?
- Overview of the process for pilot CF
- Roles of CF facilitators
- Conducting feasibility assessment
- Choosing a suitable CF model
- Getting stakeholders buy-in
- Selecting farmers
- Developing and negotiating a contract (*next presentations*)
- Preparing farmers
- Other recommendations for preparing CF pilot

What is contract farming?



- **Contract farming (CF)** is an agreement between **agricultural producers** and **buyers** in which both parties agree **in advance** on the terms and conditions for the **production** and/or **marketing** of agricultural products, usually, including the **price to be paid, quantity and quality** demanded and **delivery conditions**.
- The contract may also include information or terms on production methods, inputs such as seeds and fertilizers, financial assistance, technical advice, and other support services to be provided by the buyer and/or by another party.

Contract farming general process



Roles of CF facilitators



Roles of CF facilitators



- **Facilitators can facilitate, support and promote CF:**
 - government entities, extension services
 - producer organizations
 - nongovernmental organizations
 - development agencies
 - individuals (e.g. community leaders, lead farmers)

Roles of CF facilitators



- Create enabling environment for CF
- Promote linkages between buyers and producers
- Provide training and capacity development for CF
- Support value chain analysis and feasibility assessment
- Promote collaboration and engage stakeholders
- Provide support (legal and agribusiness) for contract development
- Facilitate negotiations to ensure fairness and transparency and overcome power imbalance
- Help farmers get organized and support producer organizations
- Provide extension services
- (Other recommendations in the next presentations)

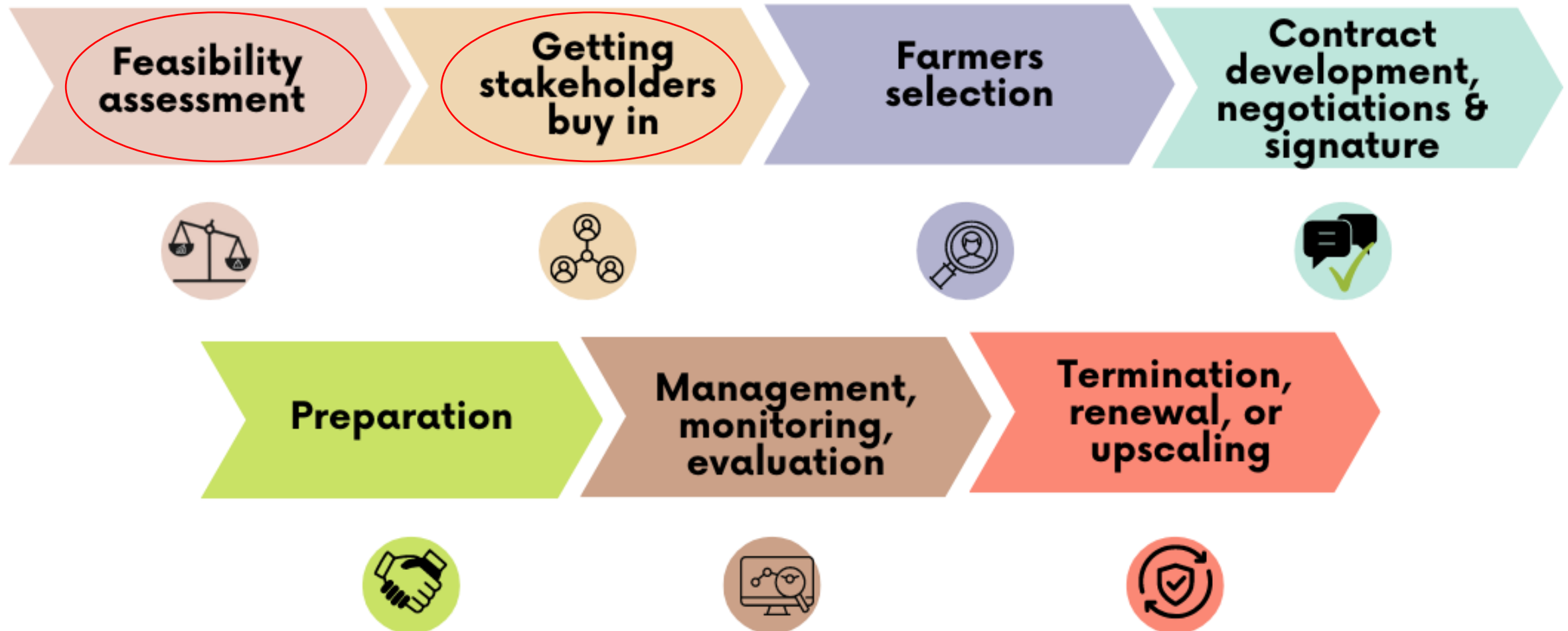
Roles of CF facilitators



- **Guiding principles for facilitators:**

- Empower and build capacities for stakeholders, esp. MSMEs, smallholder producers, producer organizations, extension services
- Set up collaborative arrangements with clear expectations and roles
- Facilitators shall not make decisions for the parties
- Adopt a participatory, bottom-up approach
- Prepare and communicate a clear exit strategy
- Respect experience and knowledge of parties and relevant stakeholders
- Support capacity development for stakeholders

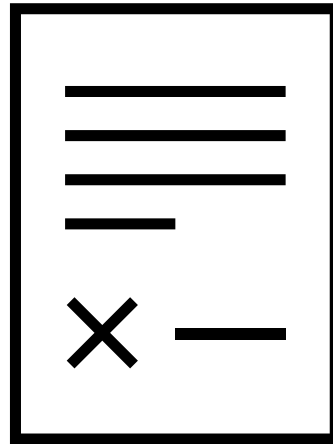
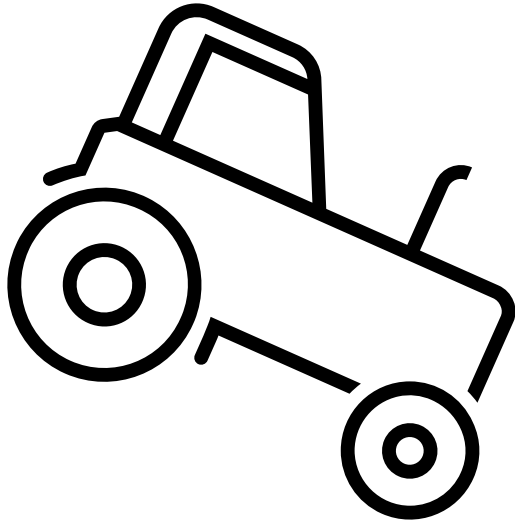
Contract farming general process



Feasibility assessment



When is CF needed?



Feasibility assessment



- **Incentives** for CF as business model:
- **Capacities** to implement CF

Is there a NET benefit?

- **Advantages** > disadvantages
- **Benefits** > costs



Feasibility assessment



- **Comprehensive value chain and feasibility assessment for CF**
 - **Value chain analysis for CF**
 - Market outlook
 - Value chain mapping
 - Analyses of core and extended value chain stakeholders
 - **Feasibility assessment for CF**
 - Enabling environment for CF
 - Advantages and disadvantages, benefits and costs for buyers and producers
 - Benefit-cost analysis, cashflow analysis
 - Capacities for buyers and producers
 - **Recommendations for CF**

Feasibility assessment



- **Enabling environment for CF**

- **Legal environment**

- General contract laws and contract enforcement mechanisms
 - Competition regulations
 - Regulations on associations
 - Commodity specific regulations

- **Agriculture and agri-food value chain development**

- Relevant agricultural and trade policies
 - Support policies (e.g. input subsidies), services (e.g. extension), and R&D
 - Functioning market mechanisms
 - Food safety and standardization (e.g. grades and standards)
 - Finance and risk mitigation mechanisms

- **Other relevant factors, policies and regulations**

Feasibility assessment



- **Advantages for buyer**

- More reliable, consistent and efficient supply of agricultural products
- Greater conformity to desirable quality, safety and other standards
- Reducing risks (supply, price and production risks) and improving planning
- Overcoming land-related constraints for commercial production
- Gains in efficiency and competitiveness and a more streamlined supply chain (vertical integration)
- Incorporation of social and environmental sustainability measures in production and marketing



Feasibility assessment



- **Advantages for producers**

- Access to buyers and markets
- More stable income
- Better production planning
- Improved access to technologies, training, inputs, credits, and other productive resources
- Capacity development through training, extension services and experiential learning
- Benefits from increased commercialization and value chain development

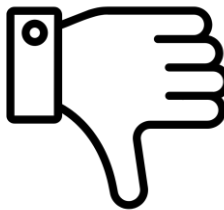


Feasibility assessment



- **Disadvantages for buyer**

- Risks of side-selling
- Farmers mis-using or side-selling of inputs supplied or not following production guidelines or delivery schedule
- High transaction costs esp. dealing with many individual farmers
- Management and support costs to be internalized
- Loss of flexibility to seek alternative supply sources
- Risk of undermining corporate reputation if things go wrong and not resolved well

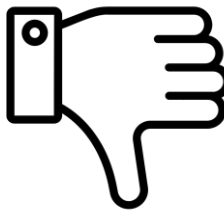


Feasibility assessment



- **Potential CF costs and investments for buyer**

- Staff costs (e.g. management, field agents)
- Commission fees for lead farmers
- Training costs
- Demonstration units
- Costs of CF financing (e.g. interest payments)
- Inputs to be supplied to farmers under CF
- Payments to farmers
- Processing
- Logistics (e.g. storage, transportation)
- Losses, defaults, and other risks
- Benefit-cost analysis, cash flow analysis



Feasibility assessment



- **Disadvantages for producers**

- Unequal bargaining power, power imbalance dynamics, potential manipulation of contract negotiation and implementation
- Possible delays in payments and input delivery
- Reduced selling options and potential loss of former market linkages
- Risk of indebtedness and increased dependency
- Risks of losing traditional farming practices, environmental risks of monocropping, loss of biodiversity, etc.
- Farmers may incur costs and investments for CF (e.g. required inputs, equipment, facilities)
- Farmers lacking capacities, land and other resources may be excluded (e.g. smaller farmers, women, youth, marginalized members)



Feasibility assessment



ADVANTAGES FOR BUYER

- Consistent supply and quality
- Increased efficiency
- Lower risks and better risk management
- Products complying with standards on quality, safety, social and environmental responsibility
- Overcome land constraint
- Incorporation of social and environmental sustainability

ADVANTAGES FOR PRODUCERS

- Access to markets, inputs, technologies, technical support, credit, services, etc.
- Better production planning
- Increased commercialization
- Capacity development (knowledge, skills, experience)
- Increased productivity
- More secure market and more stable income



- Risk of side selling
- Farmers mis-using or side-selling of inputs
- High transaction costs
- Management and support costs to be internalized
- Less alternative supply sources
- Risk of undermining corporate reputation if things go wrong and not resolved well

DISADVANTAGES FOR BUYER

- Reduced selling options
- Lack of bargaining power
- Possible delays in payment and input delivery
- Possible indebtedness
- Environmental risks of monocropping
- Exclusion of small farmers with fewer resources

DISADVANTAGES FOR PRODUCERS



Feasibility assessment



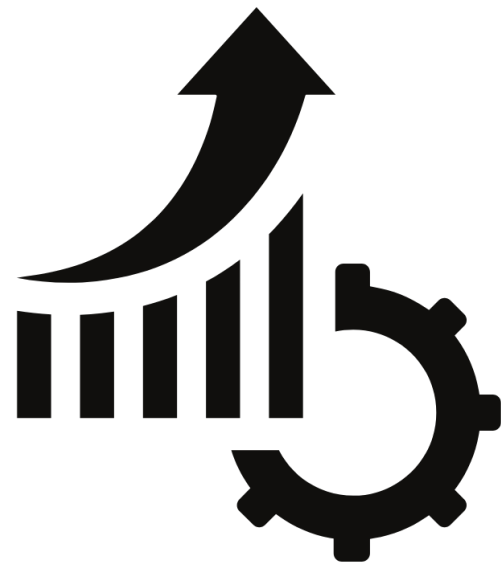
- **Is there a net benefit?**
 - Advantages > disadvantages, Benefits > costs
- Does CF promise sufficient advantages over the current business model for procurement?
- Alternatives:
 - spot market, direct purchase
 - imports
 - sourcing from large commercial farms
 - integrating production into own business



Feasibility assessment



- Capacities to implement CF



Feasibility assessment



- **Capacities for the buyer**

- Experience dealing contracts, capacities for business management and marketing
- Experience working with farmers and farmers' groups
- Production expertise esp. for production contract
- Capacities to cover costs and investments for CF (see the slide above)
 - Logistics, processing, production capacity
 - Infrastructure and facilities
 - Financial resources
 - Human resources

Feasibility assessment



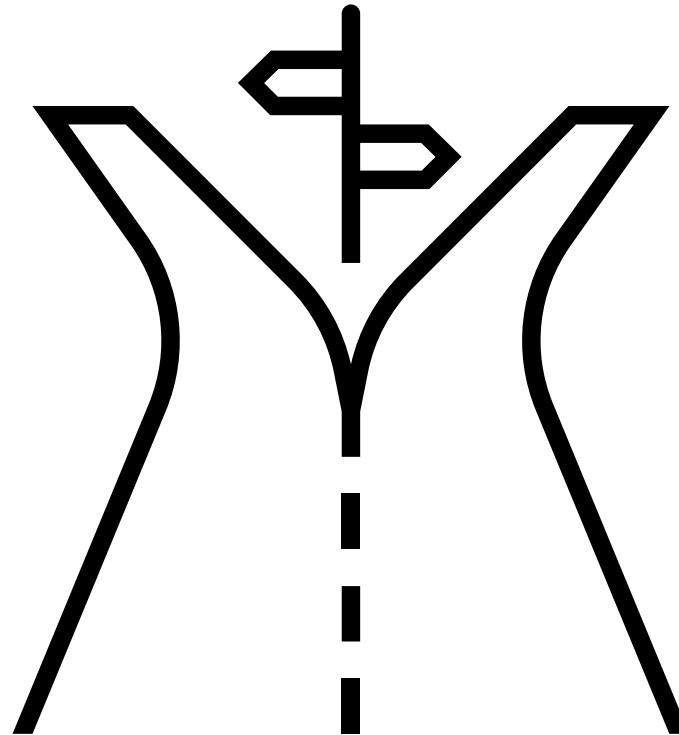
- **Capacities for the producers**

- Production knowledge and experience (e.g. productivity, quality, capacity to learn new skills and adopt new technologies)
- Experience in commercial production (e.g. supplying to processors or certain buyers)
- Farm management skills (e.g. record keeping, resource management)
- Experience working in groups and with producer organizations
- Capacities for post-harvest handling and primary processing
- Land, inputs, equipment, facilities, and other productive resources

Feasibility assessment



Decision point YES or NO!

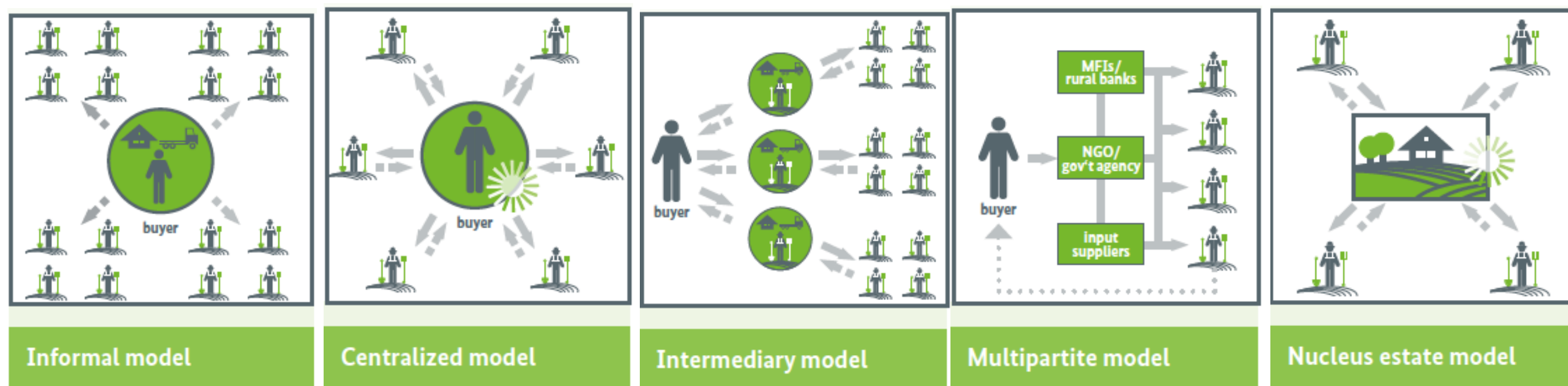


Choosing a suitable CF model



- **Different types of CF models**
 - **Marketing contract**
 - focus on the sales of the agricultural commodity
 - the buyer and the producer agree on the sales of the product before planting or even before harvest
 - **Production contract**
 - buyer is more involved in the production, has more process-related obligations compared with marketing contract
 - E.g. inputs to be supplied and used, production processes to be followed, financing options, training and technical assistance to be provided, etc.

Choosing a suitable CF model



(Source: GIZ, 2015)

Choosing a suitable CF model



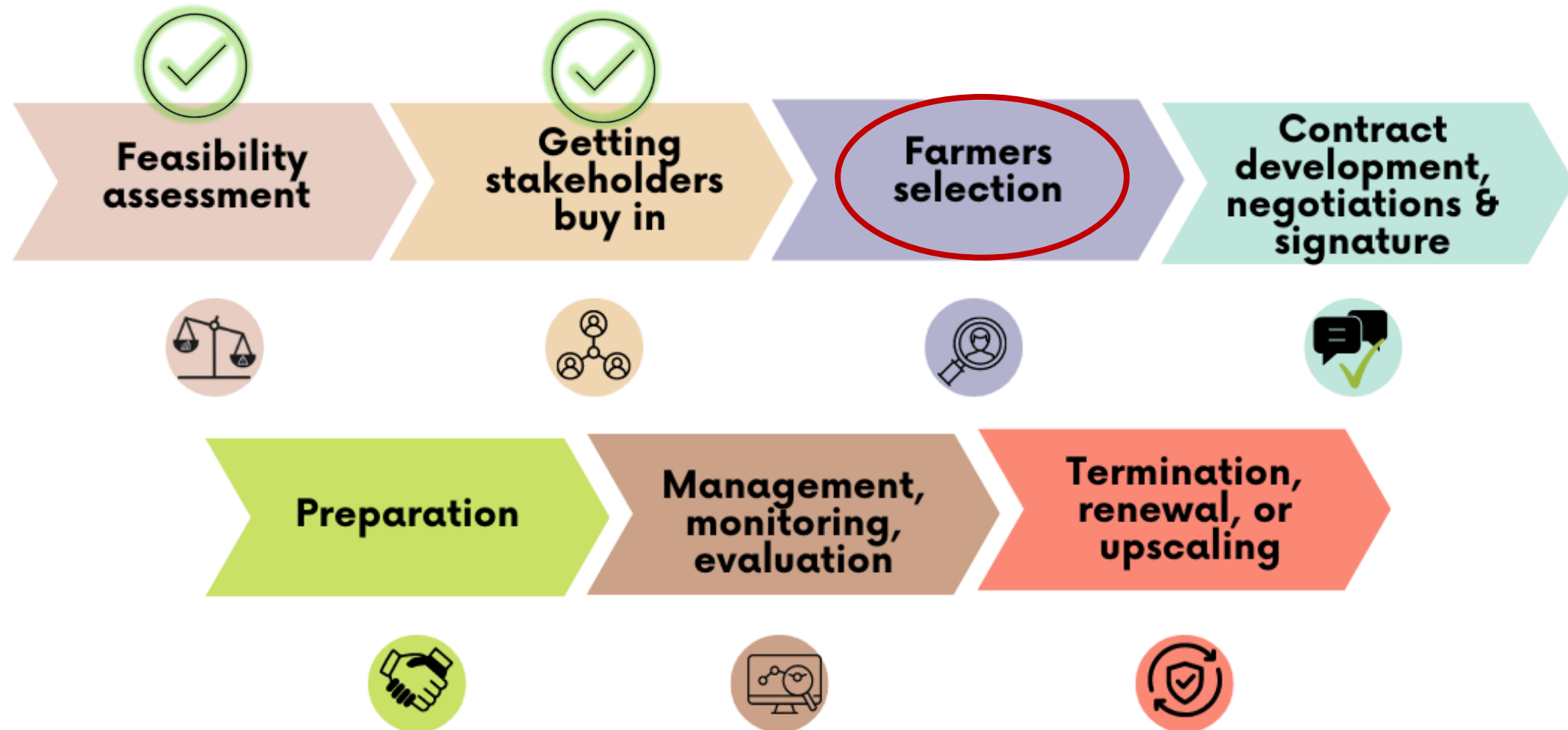
- **Which contract farming model to choose?**
 - Less complex CF models are suitable for piloting CF
 - e.g. the centralized CF model focusing on sales with a small number of producers, or the intermediate CF model with an effective producer organization
 - It is advisable to adopt a **gradual approach** when piloting CF; start with more straightforward CF **to build trust and capacity** for more advanced CF if suitable in the future.

Getting stakeholders buy-in



- **Identify 3rd party stakeholders that can support CF pilot**
 - Public sector, government entities, extension services, research institutions
 - Private sector (e.g. input providers, financial services, logistic services)
 - Development organizations, NGOs, civil societies
 - Producer groups and organizations
 - Buyers and consumers
- **Assess stakeholders' capacities for CF support**
- **Identify their roles and attain their support for CF**

Selection of farmers



Selection of farmers



- **Main criteria to consider when selecting farmers for CF:**

(Assumption: suitable conditions for production and business operation are met)

(The list is helpful esp. for buyers, e.g. MSMEs, have no experience or lack capacity for CF)

- Ownership or right to use under lease for the land for CF production.
- Adequate resources (e.g. land, labor, facilities) allocated to CF in the farmer's production mix.
- Capacities and willingness to meet requirements for equipment and infrastructure (e.g. storage, drying, cooling, packaging).
- Being pro-active and willing to invest in and implement new or improved technologies and practices.
- Being able to repay loans if any.

Selection of farmers



- **Main criteria to consider when selecting farmers for CF:**
 - Production knowledge, personally involved in production.
 - Being a good listener and willing to learn, cooperate, and follow suggestions/directives.
 - Being respectful and trustworthy for the agreement.
 - Being able and willing to keep records.
 - Having the land contiguous between producers is favorable for communication, management, equipment usage, etc.
 - Experience with working groups/producer organizations.

Selection of farmers



- **Other considerations for selection of farmers:**

- Facilitators (e.g. producer organizations, extension services, community leaders, business partners) can support selection of farmers.
- Buyers should clearly communicate expectations and criteria and the selection process should be transparent.
- If the buyer, esp. MSMEs has no experience in CF and/or has limited capacity, in order to ensure success of CF pilot, it is advisable to:
 - keep the number of contracted farmers small in the pilot phase;
 - start with farmers who have established supply relations or informal agreement with the buyer, and/or have capacities for CF pilot.

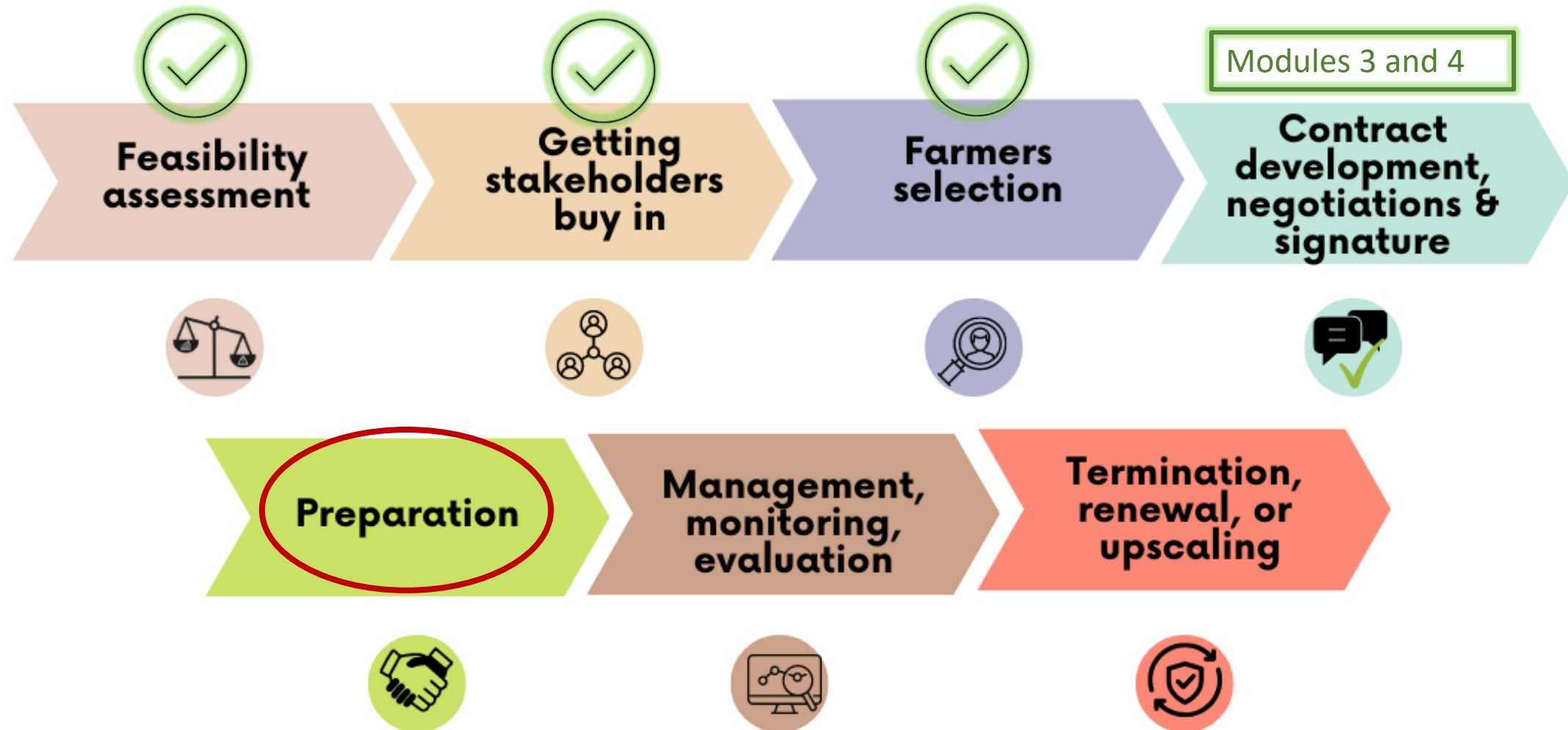
Selection of farmers



- **Recommendations for inclusive CF**

- CF has the potential to be inclusive of smallholder farmers, women, youth, and underserved communities.
- For buyers having capacities, it is recommended to be inclusive in the selection of farmers and all stages of CF.
- For buyers (e.g. MSMEs) lack capacities, it is possible farmers with certain capacities will be selected for pilot CF, but it is advisable for buyers to have a plan for inclusion beyond the pilot stage.
- It is important to find ways to improve equal access to training and learning, productive resources, markets, and participation in CF.
- It is advantageous to incorporate, besides quality standards, standards for social inclusion and decent labor conditions.

Preparing farmers



Preparing farmers



- **Ensure farmers clearly understand their responsibilities.**
- **Training and preparations for:**
 - Technologies, production process, etc.;
 - Demonstration plots, field days, tours, farmer field schools;
 - Production and business management (e.g. record keeping).
 - Make training and capacity development inclusive.
- **Organizing farmers**
 - Identify and work with lead farmers;
 - Establish working groups, and collaborate with producer organizations;
 - Identify the need to pool resources, share equipment, buy inputs in bulk, organize meetings for learning and experience sharing, coordinate communication and operation etc.; and plan accordingly.

Preparing farmers



- **Sound analysis, careful planning and adequate preparations** are critical to successful CF.
- **Feasibility assessment is essential.**
 - It is important to evaluate market outlook, enabling environment, incentives and capacities of both parties, etc.
 - Contractual relationships will only be sustainable if CF can provide mutual benefits for parties who also have the capacities to implement CF.
 - Concerns, issues and risks should be identified, assessed and discussed, and risk management and mitigation strategies are to be prepared.

Preparing farmers



- **Trust is fundamental** for CF arrangements to succeed and sustain.
- It is crucial to maintain **transparency, clear communication, and unbiased information sharing.**
- Ensuring farmers clearly understand terms, conditions and their responsibilities is important.
- It is advantageous to learn from existing CF examples for successes, lessons learned and best practices.

Preparing farmers



- **Facilitators can play an important role** in linking farmers to buyers, supporting CF feasibility analysis, initiating and preparing CF and other stages of CF operation.
- **Engage producers and relevant stakeholders** from the beginning and throughout the CF process. Successful CF requires multi-stakeholder engagement, commitment, cooperation and partnerships.
- It is advisable that the buyer has the **vision and plan for social inclusion in the next phase of CF and its upscaling**, whether the pilot CF is inclusive of smallholder farmers, women, youth, and underserved communities.



THANK YOU !

FAO Contract Farming Resource Center

Please visit CFRC for more information and resources on contract farming

www.fao.org/in-action/contract-farming
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