



Food and Agriculture Organization
of the United Nations



Basic Concept

Lan Li, Ivana Radic, Kaiqi Zhao
Agrifood Economics Division
Food and Agriculture Organization of the United Nations
2022

Contents

1. Basic concepts of contract farming
 2. Why the growing interest in contract farming?
 3. Advantages and disadvantages for producers and buyers
 4. Contract farming models
 5. Maximizing impact for successful contract farming operations
-

Basic concepts of Contract Farming

What is contract farming (CF)?

At the heart of 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 marketing of agricultural products, usually including the price to be paid, quantity and quality demanded and delivery dates.

The contract may also include information or terms on how the production will be carried out or if any inputs such as seeds and fertilizers, financial assistance, technical advice, and other support services will be provided by the buyer and/or by another party.

CF Basic concepts

Who?

- Producers, producer organizations
- Processors, exporters, wholesalers, retailers
- Public institutions, NGO

How?

- Different CF models including formal and informal agreements → Different CF models
- Contract instrument establishes the terms and conditions for the commercial transaction agreed between farmers and buyers

Why?

- Why the growing interests in CF?
- Advantages of CF for producers and buyers

When?

- → When is CF suitable and feasible ?

Why the Growing interest in CF ?

Growing interest in CF

- **Contract farming (CF) is not a new concept**

- References to its use in the 19th century in Asia and Latin America
- **Commercial contracts are common for agricultural commodities in economies with commercialized agriculture sector**, especially in advanced economics (e.g. U.S. and EU countries).
 - USA: from 11% of agricultural production value in 1969 to 39% in 2008; Most common in livestock and cash crops: 90% of poultry, tobacco and sugar beet, 68% of hog production, also for fruits, vegetables and nuts.

- **Intensified interests and adoption in emerging and developing economies**

- Brazil: 75% of poultry production under contracts; a new law on contract farming passed in May 2016
- CF operations in Ghana, Morocco, Malawi, Mozambique, Kenya, Tanzania, Uganda, Zambia, Bangladesh, China, India, Thailand, Vietnam, Fiji, Turkey, Afghanistan, etc.; and policies to promote CF.
- Expanding literature and references on CF in emerging markets and developing countries.

Why the Growing interest in CF ?

- **The transformation of global agri-food systems**

- Globalization and rising dominance of global value chain (GVCs)
- Increasing demand, quality requirements and other standards for agricultural products
 - Consumers not only demand safe products, but also products of higher quality and greater variety and produced in ways that do not damage the environment or harm the workers.
- Driven by increasing competition, better response to market demand, increased integration and coordination of value chains in vertical and horizontal dimensions → Overall more efficient value chains
- The development of value addition activities, agribusiness, agro-industries and export capacities and commercialization of the agriculture sector in emerging and developing economies.

Why the Growing interest in CF ?

The challenges faced by smallholders for market participation in developing countries

- Long-standing constraints:
 - Lack of knowledge, skills and market orientation...
 - Lack of access to markets, productive resources (incl. inputs), technologies, information, finance, support services, organization and collective action...
 - Lack of infrastructure/facilities/actors in value chains, value addition activities, agribusiness and agro-industries...
 - → low productivity, high transaction costs and scant economic opportunities

- In addition, compounding and emerging challenges:
 - The recent transformation of agri-food systems and the resultant demand for higher standards and increased efficiency
 - Rapid technological advancements and growing technological divide
 - Accelerating impact of climate change and degradation of natural resources

Why the Growing interest in CF ?

- **CF has the potential to**

- Provide smallholder farmers access to **economic opportunities**, resources and technologies, and **build capacities for commercial production**

- Access to buyers, market information, access to inputs, technologies, credits, and/or technical support
- Sustainable development of value chains, agribusiness and agro-industries
- Improved food security and livelihoods, poverty reduction

- **Incorporate environmental and social measures in CF operations**

- Climate-smart and other sustainable production practices and processes
- Inclusion of small famers, women, youth, minority and decent work conditions

Pros and Cons of Contract Farming

Advantages for producers

Overcoming some barriers to market participation

- access to buyers and markets

Helping manage/reduce production and market risks

- secure more stable income and plan production better

Improving access to inputs (e.g. seeds, fertilizers) and (new) technologies, training and technical assistance, financing solutions (e.g. input on credit, loans or collateral for loans), support services (e.g. transportation, storage, quality control), etc.

Capacity development (knowledge, skills and experiential learning) for more resilient and sustained growth in productivity, competitiveness, livelihoods and wellbeing.

Increased commercialization, development of value chains:

- entrepreneurs, agribusinesses and agro-industries → increased economic opportunities and livelihoods for smallholders

Advantages for buyers

- More reliable, consistent and efficient supply of agricultural products
- Greater conformity to desirable quality, safety and other standards, easier to respond to market demand
- Reducing risks (supply, price and production risks) and improving planning
- Overcoming land-related constraints for commercial production
- Gains in efficiency and competitiveness through integrated provisions of inputs and support services and a more streamlined supply chain (vertical integration)
- Making it possible to incorporate social and environmental sustainability measures in production and marketing and to meet market demand

Disadvantages for producers

- Unequal bargaining power and 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 without land and less resources may be excluded (e.g. smaller farmers, women, youth, marginalized members)

Disadvantages for buyers

- High transaction costs of dealing with individual farmers especially large numbers of farmers
- Risks of farmers breaking contracts and side-selling
- Risks of farmers mis-using or side-selling inputs supplied or not following production guidelines or delivery schedule
- Internalizing support costs
- Loss of flexibility to seek alternative supply sources
- Risk of undermining corporate reputation if things go wrong and not resolved well

ADVANTAGES FOR FARMERS

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

DISADVANTAGES FOR FARMERS

- Reduced selling options
- Lack of bargaining power
- Possible delays in payments and input delivery
- Possible indebtedness
- Environmental risks of growing only one or certain crops
- Small farmers with fewer resources are excluded

ADVANTAGES FOR BUYERS

- 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

DISADVANTAGES FOR BUYERS

- Reduced supply options
- High transaction costs dealing with many small farmers
- Risks of farmers breaking contracts and side-selling
- Potential misuse of inputs, non-compliance of processes or standards
- Reputation risks if things go wrong

- Increase in CF indicate the positives outweigh the negatives.
- Creating enabling environment and engaging multi-stakeholder collaboration are needed for successful CF
- CF may not be suitable or feasible to organize a commercial relationship. A careful assessment of its applicability and alternatives is needed.

Contract Farming Models

Production v.s. marketing contract farming

- **Marketing contracts focus on the sales of the agricultural commodity:** the buyer and the producer agree on the price or pricing mechanism before harvest or before the commodity is ready to be marketed.
- **Production contracts also include specific terms on the production** of the commodity that both parties agree on: inputs to be supplied and used, production processes to be followed, financing options, training and technical assistance to be provided, etc.

The centralized model

- A company negotiates with farmers from small to large who supply the desired agricultural commodity
- Tight quality and standard control and vertical coordination
- The buyer's engagement can range from minimal input provision to predominant control of most production aspects.
 - Seeds, fertilizers and chemicals can be ordered in bulk and supplied to farmers on credits.
 - In advanced CF, machineries and farm infrastructure may be covered in the contract.
 - In-field training and technical support can be provided.
- Common with commodities with large volumes, such as tea, coffee, tobacco, coffee and poultry, which require processing

The nucleus estate (outgrower) model

- A variation of the centralized model, where companies
 - have their commercial production (cultivate crops or raise livestock); and also use CF to source supplies from farmers (e.g. rubber in Ghana);
 - have contracted commercial farms, which also serve to manage new or smaller farmers in their vicinity (e.g. a case of sorghum for beverage production in Ghana).
- Useful for demonstration and capacity development purpose when introducing new varieties/practices to farming communities, and/or expanding production capacity, leveraging productive resources

The multipartite model

- Jointly involve multiple actors, e.g. government entities, NGOs, financing institutions, private company/buyer, producer organizations, etc.
 - Each has clear responsibilities, such as finance, technical support, management, aggregating, processing, marketing.
 - Producers can be organized by cooperatives.
- In Mexico and a number of African countries, governments have encouraged CF schemes (via multipartite model) in harmony with private sector interests
- In China, multipartite CF ventures are made with village committees, cooperatives, country governments and private firms including overseas companies

The intermediary model

- The buyer subcontracts linkages of farmers to intermediaries.
- The buyer may have less control and quality and production might be comprised.
- Increased risks of price distortion and manipulation of contracts, and reduced incomes for farmers.

The informal model

- Usually involves individual entrepreneurs or small businesses acting on a seasonal basis and frequently requires governmental support services.
- Long-term trustful relationships can be mutually beneficial for SMEs and smallholder farmers
- Services provided are often basic and typical products can be fresh fruit, vegetables, staple crops or other produce that do not require much processing and packaging.

Maximizing impact for successful Contract Farming

Critical issues

Successful contract farming

- **Basic principles—CF can only be sustainable if**
 - Both parties perceive that they are better off by engaging in CF (Fair and Mutually Beneficial)
 - Parties develop mutual trust (central!) and reciprocal and healthy dependency (synergy and cooperation!)
- **The importance of enabling environment**
 - No successful contracting scheme can exist or remain sustainable where the institutional, regulatory and political setting is not conducive to it.
 - Need to countervail uneven balance of power (an element of enabling environment) such as through promoting farmers' associations, third-party mediation, and legal provisions.

Successful contract farming *other critical issues*

- Minimizing contract hold-ups
 - Farmers: enhance bargaining power through organization and collective actions
 - Buyers: improved communication, group lending, quality and scope of service provision, strict treatment of defaulters, extending contract and building trustful long-term relations.
- Reducing transaction costs, working with groups, increasing scale.
- Again! Thorough assessment of applicability of CF.
- Careful assessment of risks in designing contracts and resolution and mediation strategies
- Considerations for social inclusion and environmental responsibilities →

Maximizing impact

Drivers of CF to promote inclusion of small farmers

- **Producers:** lead farmers/entrepreneurs, farmers groups and organizations, cooperatives, women and youth
- **Private sector:** SMEs, social enterprises, traders/processors/exporters/wholesalers/retailers
- **Public sector:** institutional procurement (schools, food reserves, hospitals, food aid), financing support, enabling environment
- **Innovative PPPs:** public facilitation/support, aligned private interests

Multi-stakeholder engagement and collaboration:

- Successful CF is often a multi-stakeholder effort, involving incentivized private sector, organized producers, innovative models including PPPs, enabling environment and public support.

Maximizing impact

Sustainable Development Goals (SDGs) and the triple bottom line of sustainable agri-food value chain development



The potential of CF to promote economically, socially and environmentally sustainable growth.

Contract farming in summary

- CF is increasingly relevant in developing regions due to globalization and transformation of agri-food systems.
- CF offers essential benefits to both parties with pros and cons; and fairness, mutual benefits, trust and collaboration between parties are needed for sustainable and successful CF operations.
- CF has the potential to have sustainable impact and promote sustainable development in all three—economic, social and environmental—dimensions.
- Inclusion of smallholder farmers, women and youth and promotion of environmental responsibility are not automatic.
- It requires political will and enabling environment. It also requires multi-stakeholder engagement, commitment, cooperation and partnerships. It needs private-sector led mechanisms and innovations for impacts.
- CF is not a universal cure or sliver bullet, and maybe ill-advised under some circumstances. An enabling environment is key to successful CF. Thorough assessment, good planning, transparent and effective implementation, monitoring and evaluation are critical to successful CF → NEXT.

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