

# Understanding the Concept of Contract Farming and Its Positive and Negative Impacts

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**Abstract – The foundation of an agriculture economy that guarantees sustenance and healthful security for a populace of over a billion, crude material for an extending modern base, surpluses for exports, and a reasonable and impartial reward framework for the cultivating network requires responsibility driven contract cultivating which unmistakably is a suitable elective cultivating model. Previous literature reveals that several Indian and multinational companies have already begun contract farming initiatives in India and have been broadly successful. It is found that their success is dependent on a profitable market, the physical and social environment, and government support. However, effort is needed to reduce negative impacts which arise from contract farming via the active involvement of institutions governing the contract farming business. The overall future of contract farming in India is quite promising due to increasing trend for organised retailing amongst the burgeoning middle class population and the food safety requirements of the export market in developed countries.**

**Keywords: Positive and Negative Impacts, Agribusiness Firms, Contract Farming in India**

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## I. INTRODUCTION

India appears to be the agriculture economy from the time human settled on subcontinent. Though the efforts of development past few years have layered India's industrial standards, agriculture still remains the most important part of economy adding up to 14% GDP and reflects a total of 11% of national reports. Earlier PTO regime's privatization, liberalization and globalization have laid down significant strategies for the market. Also, the agriculture sector similar to others needs to emerge out as a mechanism that will help face additional realities. This necessitate reforms in marketing of agriculture to evolve needed changes and further push the sector to rise from the existing 2-3% to a higher 4-5% [1]. Huge support for farming of contract under the SAP along with liberalization policies and corresponding promotion through agencies as World Bank, IFC, USAID and CDC supports contract farming development in the country that help revolutionize variant practices of farming.

Contract farming's first evidence as known loops back to the time of British Colonization owned by East India Company and made arrangements of farming in terms of tea and coffee. True that the idea of farming is known to Indians yet there exists few reforms for contractual arrangements that were the part before independence. The area totally covered by contract farming is not more than 2% of the total

land available for cultivation. But if you take in consideration the corporate contracts along with farmers and their corresponding contracts, then the above number would not be more than 0.005%. Indian contract farming is seen to change through this model of contract as seen in multiple companies alike Pepsi, Cadbury, Unilever, Cargill, ITC Ltd., and Frito Lay. In the same way domestic corporations as Ballarpur Industries Limited(BILT), Green Agro Pack (GAP) Ltd., JK Paper, and Wimco, VST Natural Products, Intergarden India, Global Green, Kemps City Agro Exports and the Sterling Agro, Nijjer Agro, United Breweries (UB) , Tarai Foods, McCain India, A I M Todd, are indulging into Indian contract farming [3-5].

Considering the current scenario, the paper lays focus on the contract farming importance along with its impact on agriculture of India incorporating the famijg literature of available contract. Five sections constitute the remaining part of the paper:

- Contract Farming Concept
- Indian Contract Models
- Corporate Farming incentive to both farmers and the corporation

- Contract farming impact both positive and negative
- Contract farming future prospects

## II. THE CONCEPT OF CONTRACT FARMING

Contract farming is basically a transaction that involves farms and agribusiness vertically. Baumann (2000) [6] defines contract farming in terms of a system where the exporting unit or the central processing is seen to purchase independent farmers harvest along with aligning contracts in advance. It further involves range of institute's as the financial institutions, processing firms, companies providing input along with the farmers.

Contractual argument detail depends on the complexity and provision depth in all areas. Further one can classify contracts as:

- Market provision,
- Resource provision
- Management specification

On a whole, contract farming pledges to:

- Draft a link between the market and the farm
- Enhance the degree of competition both at market and supply ends
- Reduce intermediaries to promote farmer's income.

### Contract Models in India and Preconditions for their Success

Eaton and Shepherd (2001) have defined five different models where you can find contractual models occurring between the farmers and the markets [8]. A sponsor has decided to go with a model that depends on the requirements of market, processing and production requirements along with social and economic viability.

Buys of small farmers from large farmers. Quantity that would be brought is determined at the time of sowing while monitoring the quality standards. Inputs as provided by the firms are pesticides, fertilizers, seeds, machines and credits. The above model has been used for crops that need extremely high extent of processing. Also the contracts of central model concerns products where the markets need changes in the technology of farm with an intensive level of sponsors support. Involvement of sponsors largely vary depending on the provision for input to extremities where the entire control of the product is given to the sponsors like the one of tomato

processing done in Punjab by Pepsi Co. This is similar to the contract farming type 1 with respect to the classification as provided by National Institute of Agricultural Marketing [5].

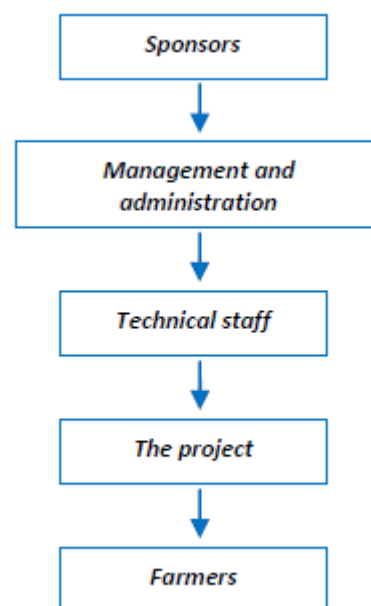


Figure 1: Centralized model

**Nucleus Estate Model:** The Nucleus estate model appears to be the centralized models variation where plantation is also managed by central estate. This is used to mainly affirm processing plants throughput however at times the same has been used for research purposes. A desirable amount of material has been provided by the sponsors and also helps the management by inputs. The above model has been found to be significant for the crops as the tea, coffee, cocoa, rubber, oil palm and the sugar crops and of these farmers has less experience.

They also necessitate considerable investment for long term and seek processing post harvesting. Few firms procure through farmers across the estate.

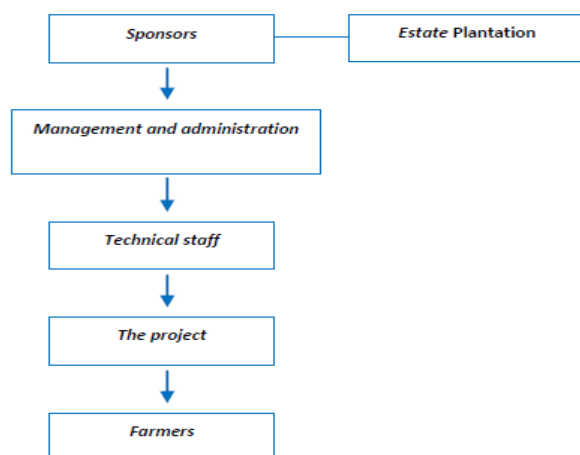


Figure 2: Nucleus estate model

**Multi-partite Model:** this model comprises varied organization, and has statutory bodies as well. All entities are responsible for giving the provision of plethora of services and products as credit, machineries, inputs, equipment's, processing, transport, and marketing options [Fig-3]. Above is a kind of varied multivariate contract as one of the leading Dabar firm that has acquired land arrangements for leasing from government and then enters into a contract along with the tribal communities to aid growth of medicinal plants. Similar example is the Rallis firm that organizes production on a contractual basis and characteristics that appear are in the type 4 farming contract by NIAM.

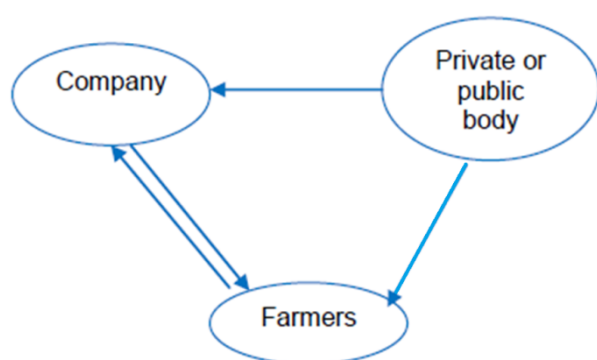


Figure 3: Multipartite model

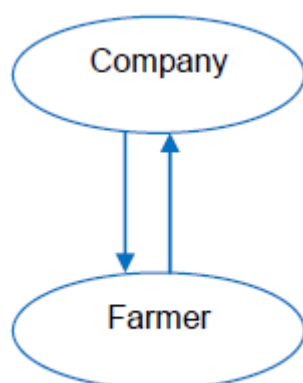


Figure 4: Informal model

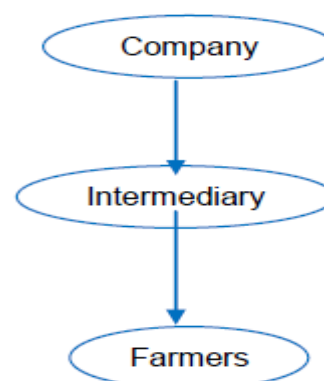


Figure 5: Intermediary model

**Intermediary Model:** This model consists of sponsors appealing in farmer's linkage of subcontractors with the intermediates. Under this model, there is a risk of losing the quality along with the received prices by farmers. In case they prioritize quantity over quality this model works. Whether to appoint or not the intermediary relies on the cost trade off and firm quality. For instance, Rallies - The Hindustan Lever Limited appoints the above method for the wheat and candy procurement in Uttar Pradesh and Madhya Pradesh. Type 3 along with Type 4 model of NIAM - 2004 has classified the contract farming on the basis of characteristics same as the ones mentioned above.

**Informal Model:** this is basically the SMEs and the individual entrepreneurs. This includes contracts of informal production based on seasons. It necessitates the need of support of government in externsion and research method. Also, the above is seen in crops that does not require informal processing. Before they are set to market, they have been graded as well as sorted and found mostly in cases of vegetables and fruits. Also, the involvement of the firm in procurement and actual production is less. Chains of supermarket take up the above model.

Though there are plethoras of contracts in India yet there is need of inducing condition for promoting success. Precondition that prevails are assured market, social and physical environment, profitability, adequate communication system, irrigation, land, input availability, rural community's social consideration and trust amidst the farmer and the experience practices for successful contract farming

### III. INCENTIVES FACING AGRIBUSINESS FIRMS AND FARMERS TO ENTER CONTRACT FARMING

Corporation as well farmers have significant motivation while joining agreement for contract farming. Such motivations are basically antagonistic and contract farming incentives are such that they would benefit both the farmers as

well firm. Here, we give description for the incentives to be part of contract farming.

#### A. Agribusiness Firms

An attempt to help the firms of agribusiness expand their operational scale and better their profitability and risk management via diversification of products is contract farming. Companies expected duties are giving the provision of support of product to the farmers for inputs and advices technical.

Also, it gives reasons why firms look out for the farmers and avoid buying the same from existing self-plantation policy or markets. The concept of Transaction Cost Theory has been put by Simmons and state that in absence of any contract the firms look up for products from the open market and mostly in case of HVF products and are faced by uncertain supply, price and quality. Also, if the firms choose to get into self-plantation then issues of transaction cost of supervision high cost, uncertainty crop yield, any technical constraints, cost of land acquisition along with skill acquisition cost is more than the predictable supply benefits. So, firms adopt the contract farming schemes.

#### IV. FARMERS

Farmers that are part of the scheme hold the responsibility to give quantities in desirable commodity and at company standards. Entering into such a scheme provides given benefits:

**Market Access:** Agribusinesses have been considered as something that is specialized more than the farmers with respect to market knowledge, legal expertise, information links, size economies in processing, transport, potential of finance & international market relationship. Such advantages are costly if farmers do it by themselves.

**Credit Access:** Several farmers having credit constraint are supported through financial assistance by the firms of agribusiness. Repayment here is through the cash settlement that is post-harvest.

**Risk Management:** Opportunities that reduce risks via contracting comprise of Farming diversification, subsidies and firms extension services.

**Information Provision:** Farmers contracted receive advantageous data as information that is crop specific, chemical restrictions pertaining to requirements of food safety, planting timing and harvest that meet market needs, product quality management and technical data.

If the above benefits are more than what farmers usually own they would definitely be a part of above schemes.

#### V. POSITIVE AND NEGATIVE IMPACTS OF CONTRACT FARMING

As seen in table 1, contract farming proponent's debate that contract farming would enhance employment and income increase in all regions of agriculture and further estimate productivity levels and along with production instability. Also, contract farming benefits put the economy in place of development and growth. With growing Indian economy, there occurs an increase in number of people with high income and better health seeking specifications of food standard.

Next, the developed countries suggest standards for export quality of both processed foods and commodity of agriculture from developing nations. Sanitary and Phytosanitary (SPS) agreement by WTO have both food and quality standard mapping with that of Codex Alimentarius Commission (CAC). CAC guidelines important aspect is applying system of food safety namely Hazard Analysis and Critical Control Points (HACCP). Above needs to be undertaken in the systems of food quality of all units of food processing; else the SPS agreement appears to be exports non-tariff barrier. Contract farming helps firms own production control of agricultural commodities at varied growth stages hence, turning it efficient in meeting food safety standards [11].

**Table 1: Positive and negative Impacts of contract farming**

Positive Impacts	Negative Impacts
Contract farming increases the income of participating farmers due to improved access to market, better use of resources and better management of technology.	Simmons (2003) agribusinesses corporations mostly prefer to deal the contracts with large farmer groups because they have lower average costs and are more reliable suppliers in terms of quality and quantity.
Contract farming benefits rural employment by providing additional employment opportunities through processing.	Most contract farming schemes occur only in the regions where, commercial agriculture is already established and offering reliable infrastructure and access to markets.
Contract farming helps in improving farmer's production through the provision of appropriate technology and through the creation of structured, efficient farming operations.	Due to unequal power in terms of bargaining, negotiating, or contract enforcement contracts between agribusiness firms and farmers tend to be unfair and lead to exploitation.
Agribusiness firms enable the farmers to reduce their price risk through predetermined prices, production risk through provision of technology, extension services and diversification of farm activities.	Some times contract farming may act as catalyst for gender conflict within the household due to the condition that the agreement is usually through man though women do the bulk of the farm work.

Contract production is seen to shift the production of farm that favours cash crops and export-oriented basic food crops for poor. Such a move cost higher food commodities prices and of products also, mainly for the non-contract farmers along with the household labors that has no benefit owing to contract farming higher incomes. Also regional differentiation will increase since firms look for better areas to implement schemes of contract farming [15, 16].

#### VI. CONCLUSION

Undoubtedly contract farming is an excellent alternative that gives to users reliable inputs along with the required produce to the firms. MNCs in India have started this kind of business.



Cases of contract farming success gives a blueprint for future growth of contract farming to improve the agricultural produce quality and increase rural farm community's income. Further, it is to see how contract farming successes rely on markets profitable, the social and physical environment along with the government support. Further, contracting firms should take into consideration the physical infrastructure, land availability, telecommunications infrastructure, input availability, tenure and the social considerations.

Pre-existing literature implications state that contract farming owns positive as well as negative aspects yet the benefits outlay the negative and has been addressed via Institutions involvement relating to contract farming governance. But, in the current context, it is seen that contract farming has a win - win context both for farmers and companies. Contract farming future in India appears to be promising with increasing consciousness related to safety or quality of food in the middle class people along with export markets quality demands in all developed countries.

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