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Contract Farming and Market Development in India: A Review

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Abstract: ***This study tries to evaluate the progress of contract farming in India over the period of time. As the farmers are switching towards the contract farming which reveals that farmers are efficient adaptor of this farming. The tools for the growing associated industrial base, exports and a fair and equitable global system for the farming community needs an agricultural model unconventional workable, "Commitment-driven Contract Farming". The data reveals that several international and Indian companies have already started contract farming in India, while most of them have successfully started operations. However, their success depends on a viable market, physical and social environment and especially the active involvement of government entities that play a key role in contract farming. Overall, the future of Indian contract farming looks bright given the positive trends in the fast-growing middle-class organized retail sector and the food safety requirements of developed country export markets.***

Keywords: Contract farming, India, Positive trend, market

1. Introduction

Producing and selling on a contractual basis is a common arrangement in agriculture all around the world. Contract farming has existed for a long time, particularly for perishable agricultural products delivered to the processing industry, such milk for the dairy industry or fruits and vegetables for making preserves. At the end of the 20th century, contract farming has become more important in the agricultural and food industries of the developed and developing countries. Spurred by changes in (international) competition, consumer demands, technology, and governmental policies, agricultural systems are increasingly organized into tightly aligned chains and networks, where the coordination among production, processing and distribution activities is closely managed. Contracting between producers on the one hand and processing or marketing agribusinesses on the other hand is one of the methods to strengthen vertical coordination in the agrifood chain.

CF has been defined as an agreement between one or more farmer(s) and a contractor for the production and supply of agricultural products under forward agreements, frequently at predetermined prices (Eaton and Shepherd, 2001). The US Department of Agriculture defines contract farming as "the growing and marketing of farm products under such circumstances that selective terms of the market-quantity, grade, size, inspection, timing, or pricing are specified to both the grower and the processor or shipper before production is undertaken. The contractor can be a processing firm or a trading/marketing firm; it can be a private or a public entity. The agreement often includes the provision of production support by the contractor, such as inputs and technical assistance. The basis of a CF arrangement is a commitment on the part of the farmer to provide a specific commodity in quantities and at quality standards determined by the contractor and a commitment on the part of the contractor to support the farmer's production and to purchase the commodity.

Economic Rationale for Contract Farming

All markets require some form of vertical coordination—that is, matching of supply and demand between different participants in the marketing channel, such as farmers, processors, wholesalers, and retailers. Economic logic would suggest that well-informed farmers will not voluntarily enter into contracts with buyers unless they believe there will be benefits. However, the actual impact may be negative because of misperceptions or lack of information. If the contract-farming scheme involves tree crops or other transaction-specific investments, farmers may be locked into an arrangement that is not beneficial. Early reviews of the literature concluded that most studies suggest that farmers benefit from contract farming because it provides them with inputs on credit, technical assistance, and often a guaranteed price, allowing them to produce a higher-value commodity than would otherwise be possible (Glover 1984; Minot 1986). Little and Watts (1994) provide a more skeptical view of the benefits of contract farming based on a set of seven case studies of contract farming in Africa south of the Sahara. These studies focus on conflicts between farmers and the contracting firms, the imbalance of power between the two parties, intra household tensions over the division of labor and new revenue, and increasing rural inequality. Similarly, Porter and Phillips Howard (1997) conclude that contract farming generally raises farmer incomes, but may also cause social problems.

Table 1: State wise Contract Farming initiatives by private companies in India

State	Company	Crop
Karnataka	Himalaya Health Care Ltd.	Ashwagandha
	Mysore S N C oil Co.	Dhavana
	AVT Naturals Products Ltd.	Marigold and Caprica Chilli

	Natural Remedies Pvt. Ltd.	Coleus
	20 Pvt. Companies	Gherkins
	Rallis India	Cotton
Maharashtra	Tinna Oil and Chemicals	Soyabean
	Rallis India	Basmati, Wheat, Fruits, Vegetables
	ION Exchange Enviro Farms Ltd.	Several Fruits, Vegetables, Cereals and Pulses
Madhya Pradesh	Cargil India Ltd.	Wheat, Maize And Soybean
	Hindustan Lever Ltd	Wheat
	ION Exchange Enviro Farms Ltd.	Several Fruits, Vegetables, Cereals and Pulses
	ITC	Soyabean
Punjab	NIJJER Agro Food Ltd.	Tomato And Chilli
	United Breweries Ltd.	Barley
	Satnam Overseas, Sukhjit Starch	Basmati, Maize
	Satnam Overseas, Amira Indian Foods Ltd.	Basmati
	PepsiCo India Ltd.	Basmati, Groundnut, Potato and Chilli
Tamil Nadu	Super Spinning 570 mills	Cotton
	Bhuvi Care Pvt. Ltd.	Maize
	Appachi Company	Cotton

Conditions to benefit Small farmers

Dorward et al. (1998) have identified a number of conditions related to the structure of the market which have to be fulfilled before interlocking contracts (i.e., contracts with a focus on providing credit) can be beneficial for both contractor and (small) farmers:

- There must be strong demand for the crop output (i.e., a sellers' market), providing incentives to engage in CF to those traders who have access to capital. This will normally be associated with traders making investments in some form of specific assets in crop trading, an investment which needs to be serviced by a high turnover. Specific assets may include investments in plants (such as in processing) or in a special relationship (including reputation) with a large retailer or exporting company.
- There must be competition among traders, to prevent farmers being locked into unequal relationships with a particular trader.
- Farmers must face effective repayment incentives, which means that they incur a loss of earnings if they default on a loan. This requires that the crop provides them with better returns than other income earning opportunities. In a situation where traders are competing for farmers' business, there then needs to be either (a) effective exchange of information on farmer reputations, or (b) specific investments by farmers in establishing trust with a particular trader over a period of time.

Governments may play two important roles in ameliorating the negative effects of CF (Eaton and Shepherd, 2001; Simmons, 2002). First, the state may act to regulate the market ensuring that contractors do not abuse their market power. the state may facilitate contracting by encouraging agribusiness firms to initiate new contracts and providing support to smallholders to make them suitable for contract selection. Such facilitating activities may include the provision of training (for instance in negotiation), extension services providing information on pros and cons, and research on CF practices and their impact. But also providing more information on markets and prices may greatly support the position of smallholders when entering CF schemes. Finally, direct subsidies to smallholder may be helpful. Glover and Kusterer (1990) report that smallholders with contracts were subsidized in the early years of their participation to reduce yield risks. In South Africa, the Black Economic Empowerment in Agriculture (AgriBEE), with the goal of ensuring black people's improved access to productive resources and full participation in the agricultural sector, supports the establishment of contract between black smallholders and contractors (Sautier et al., 2006). Another condition relates to power distribution between producers and contractor. Given the large differences in resource endowments between smallholders and contractors, CF arrangement tend to be characterized by an unbalanced power relationship. This may easily lead to exploitation of the powerless by the powerful (Little and Wattts, 1994). Glover (1987), Porter and Phillips-Howard (1997), and Warning and Key (2002) provide a number of recommendations for preventing skewed power relations.

Some studies examining the impact of Contract farming on Incomes or revenues

Little and Watts (1994) concluded case-study analysis of several schemes in Africa. Concludes that incomes increased for a moderate to high proportion of farmers, but highlights range of problems including conflicts between farmers and the contracting firms, the imbalance of power, intrahousehold tensions, and rural inequality.

Singh (2002) reviewed various schemes in India and Focuses on problems of power imbalance between farmers and firms, violation of terms, and social differentiation, but also finds higher incomes and satisfaction with participation in contract farming schemes.

Birthal, Gulati, and Joshi (2005) found that most dairy and vegetable farmers would prefer to grow under contract, but most poultry farmers would not. Contract poultry

growers tend to be less experienced and leave scheme when they become more experienced.

Birthal et al. (2008) concluded that contract dairy production is more profitable than independent contract production, mainly because of the lower transaction costs associated with contract production. A treatment-effects model suggests that participation in contract production increases net revenue more than 80 percent compared to the average.

Narayanan (2014) found that participation in contract farming estimated to have increased profits of gherkin farmers by 21 percent, papaya farmers by 32 percent, poultry farmers by 150 percent. Contract farmers in marigold earned 49 percent lower profits than they would have outside the scheme.

Harish (2020) revealed that, about the level of major strength, it is seen that the majority (17.50%) of respondents said that fixed price is the major strength of contract farming. It is also evident that the majority (12.50%) of respondent's major weakness of contract farming is the rejection of crop, most (10.00%) of the respondents, major opportunities of contract farming, are job opportunities. A majority (14.06%) of respondents, major threats of contract farming, is no compensation for their crops, while any risk happened.

Paltasingh, K. R., et al. (2023) suggested that marginal and small farmers are involved under CF in a very negligible percentage (9.32%) as compared to medium (32.79%) and larger farmers (57.89%). From a long-term perspective in terms of agricultural market involvement, their exclusion from contracting technology cannot be overlooked as around 68% of total farmers' population in Haryana and around 80% of total farmers' population in India is belonged to this category. So, the study suggests that contracting firms should bring the marginal and small-scale farmers into the ambit of the contract to uplift their well-being. Institutional and structural barriers to CF adoption by these farmers should be eliminated on both the supply (farmers) and demand (contracting firms) sides. So, the study suggests that contracting firms should bring the marginal and small-scale farmers into the ambit of the contract to uplift their well-being.

Stages of Market Development and Contract Farming

Stage 1. Transformation from subsistence to commercial agriculture: the main function of contract farming is facilitating transformation from subsistence to commercial farming.

Stage 2. Development of agro-industry and crop diversification: contract farming is essential in the growth and development of the agro-processing industry.

Stage 3. Mass production and spot market transaction: the market functions well, and the importance of contract farming is relatively limited. Stage 4. Product differentiation and globalization: contract farming functions as an institution to address market failures associated with product attributes in the globalized market.

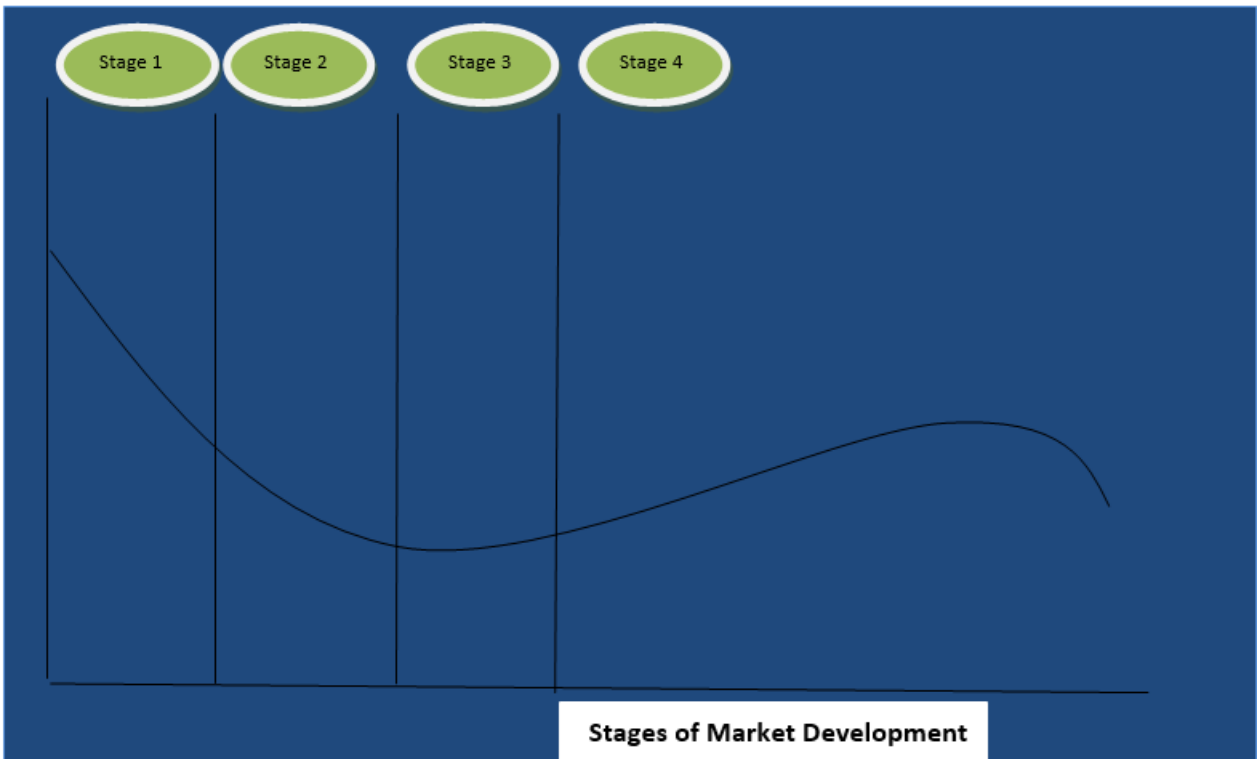

Figure 1: Stages of Market Development and Contract Farming

Concerns of Contract Farming:

Although there is a range of benefits in contract farming, like Cost efficiency, Quality management, consistency, reduced risk it is by no mean a panacea to agricultural commercialization and poverty reduction. Several concerns have been raised regarding the desirability of contract farming from a poverty and equity standpoint, foremost of which involves the opportunistic nature of such arrangements. The major concerns are discussed in this section.

A. Monopsony Control Contract farming as a development tool has been criticized for the exploitative effects of monopsony control, whereby farmers are tied to one purchaser (Grosh, 1994). The firms generally possess more information, resources, and organizational ability than small farms. Their strong bargaining position enables them to potentially extract significant rents from smallholders, leaving them only marginally better off. Many examples reveal farmer vulnerabilities whereby their bargaining power is reduced due to coercive contractor practices (Little and Watts, 1994). Once farmers invest in new crops and production to adhere to contractual requirements, financial and time constraints render them unable to easily switch to other types of crops (for example, tree crops take a long time to establish and grow). Lacking alternatives, farmers become dependent upon buyers, and firms are then able to elicit more self-serving contract terms. In addition, the transition from subsistence farming to cash crop production has the potential to render households vulnerable to food shortages and nutritional loss. Many contract farming arrangements are based on monocropping of a non-traditional crop, causing farmers to become reliant on income from the sole cash crop. If the firm does not live up to its the contractual obligations, farming households may thus be vulnerable, since they no longer grow a variety of edible crops and lack the funds to purchase food (Key and Runsten, 1999).

B. The Burden of Labor Management Although contract farming may reduce the cost of labor management for the agro-business firm, the burden of labor management is in fact transferred to the poor farm households. The act of purchasing directly from farmers rather than hiring wage workers shifts the burden of labor recruitment and control onto the producer (Baumann, 2000). In this respect, although agro-business firms may benefit from reductions in labor management and land cost, such practices may also lead to exploitation since family labor is inclusive of women and children. White's (1997) study of dairy contract farming ventures in West Java determined that in "family" run dairy farms women and children provided an estimated 60% of all labor inputs (White, 1997). However, contractual agreements are often signed and the proceeds controlled by the male head of the household. The burden of farming practices may be placed on the most vulnerable members of the household.

C. Contract Enforcement Many developing countries lack the laws and ensuing legal framework to support contractual agreements. Agreements themselves may not be easily enforceable or legally binding. Opportunism on the part of both parties can result. In most developing countries contract farming arrangements are operated in accordance to traditional values and norms rather than legal agreements (Glover and Gee, 1992). In the absence of legally binding contracts, firms can suffer from the effects of extracontractual sales of outputs (Eaton and Shepherd, 2001). Contract default by farmers often increases with a rise in the number of willing purchasers. When alternative markets develop and competing buyers offer competitive prices, farmers are given the incentive to break their contracts, often failing to repay input credit to the contractor (Coulter et al., 1999). The absence of an effective legal system and the lack of collateral held by small farms can result in considerable risks for agro-business firms. An issue involving input diversion occurs when farmers are tempted to use inputs supplied by the firm for non-intended purposes (Eaton and Shepherd, 2001; TDRI, 1996). Much can be done to mitigate the opportunistic behaviors of both contractual parties. At the local level, farmer organizations and NGOs can play a pivotal role in protecting farmer assets by establishing their own systems for quality management, input production (fertilizers), traceability, and, if possible, certification (IFAD, 2005). Local government bodies and NGOs can ensure a firm's capacity to offer profitable contracts to farmers prior to the establishment of agreements by checking a contracting firm's financial and managerial capacities.

D. Bias Toward Large Farms One criticism of private-led contract farming is that agro-business firms favor large-scale farmers (Key and Runsten, 1996). Agro-business firms may be motivated to seek contracts with larger farmers to reduce transaction costs and allow for the procurement of more uniform products (Baumann, 2000). In this respect, the cost of managing a large number of small farms may indeed influence a firm's decision to establish such relations. Nevertheless, in the context of developing countries, contract farming with small farms has proven successful in some instances. Agro-business firms prefer limited land size to ensure easier maintenance and greater quality control over a given crop as is the case with asparagus and cucumber farming in Thailand. Often smallholders can produce a high-quality, labor-intensive crop if given the appropriate technical supports. Nevertheless, although contract farming appears to involve small farms, such arrangements may exclude the poorest of the poor. Landless peasants and households possessing only limited marginal lands tend to be overlooked by firms.

2. Conclusion

Based on review of the literature, contract farming appears to be a promising institutional arrangement to facilitate farmers' access to an array of agricultural services from which they are typically excluded. Contract farming enhances the agricultural productivity and efficiency of poor farmers by introducing improved farming practices through the provision of inputs, transportation, extension services, and, most importantly, market access. It also brings investments and technical expertise to rural areas,

facilitates cross-border quality control, contributes to employment, and fosters sustainable cooperation within the region. Though this review focused primarily on GMS transition economies, the potential benefits of contract farming are relevant in the broader context of other developing countries. This review highlights the strong potential uses of contract farming in the following context:

1. As a development tool in facilitating the transition from subsistence production to commercial production.
2. In facilitating growth of the agro-processing industry to add value to primary products.
3. In facilitating crop diversification through transition from conventional, low-cash crops to high-value crops for niche market in domestic and export markets.
4. In fulfilling new stringent trade requirements for export market. Although it appears that contract farming can potentially lead to large-scale rural poverty reduction, there are several concerns that need to be addressed by the public sector. The concerns are perhaps best discussed in the general context and also in the context of different stages of development.

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