Global Restructuring and Development of Contract Farming Models of Contractual Agreements for Emergent Farmers

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Outline

• Introduction – Brief overview of the global restructuring of agrifood markets and definition of contract farming
• Field methodology – A geographical approach
• Empirical results – Contracts for small-scale farmers
• Discussion and conclusion
The global Restructuring of Agri-food Markets

- Trade liberalization, deregulation of agricultural markets
- Urbanization and growth in population density, increased disposable incomes, changes in consumer preferences

- Changes in procurement, processing, distribution and retail
  - consolidation of large retail chains (60% share of formal markets in South Africa) and agri-food processing companies

- Four pillars of restructuring:
  - Development of private standards
  - Establishment of centralized procurement
  - Shift from conventional to dedicated wholesalers/suppliers
  - Preferred supplier schemes (more vertical coordinated and integrated mechanisms which include both explicit and implicit contracts)
Focusing on contract farming

• Context:
  – Increasing attention on how improving market access for poorer farmers who face many constraints
  – Need to provide tools for public and private actors to generate concrete options to accommodate the poorer farmers in the commercial agribusiness sector

• Objectives of the study
  – To identify and to characterize contracts:
    • defined in its widest sense including marketing agreements, production contracts, as well as out grower schemes
  – To determine the conditions of the development of contracts
    • benefits and constraints from farmers’ perspective
  – To provide guidance to the key stakeholders of the agricultural sector and to assess whether or not contract farming is a viable tool to improve market access for SSF
Defining Contract Farming (1/2)

• What is Contract Farming?
  – means by which people seek, identify and negotiate opportunities from exchange
  – An institutional arrangement operating as an intermediary between spot market and vertical integration

• All contracts are incomplete (oral or written) and present enforcement issues
  – subversion or opportunistic behavior, manipulating scheme rules, side selling
Defining Contract Farming (2/2)

- CF = system where a central processing, distribution or exporting firm procure from farmers according to modalities negotiated in advance
  » Bauman 2000; Eaton and Shepherd 2001; Swinnen & Maertens 2007

- Contracts can be differentiated in 3 types according to the degree of delegation of the decisions:
  - Market specification contracts: future purchase agreements which determine quantity, timing and price of commodities to be sold
  - Production management contracts: specify the sorts of crops to be cultivated, some practices and the quality and standardisation through the provision of technical packages and credits
  - Resources providing contracts: directly shape and regulate the production and labour processes of the grower
    » Bauman 2000

- Applied in different ways on the ground
  - Need of a better understanding – how applied & who is engaged?
**Why contract farming?**

- Contract farming as a risk sharing strategy
- Imperfect markets
  - high transaction costs, information asymmetry
- Asset specificity

**Contract Farming and collective action**
- Reduced transaction costs
- Economies of scale is achieved
- Lower risks of contract default (peer pressure, joint collateral, etc.) from farmers
Methodology

• Study region: Tzaneen (Limpopo Province, South Africa)
  – Conducive agro-climatic conditions for vegetable, fruit and field crop production
  – Irrigation opportunities
  – An agricultural hub in the province
    • One of the major producing area for fruits and vegetables
  – Presence of commercial farming, by both large- and small-scale farmers (LSF/SSF) which create dynamic markets
  – Effective presence of Contract Farming in the area
  – Effective involvement of small-holders in contractual arrangements

• Geographic approach to capture the diversity of contracts (both formal and informal) with agribusiness and farmers as a focal point (i.e., no commodity specificity)
  – Identification of agri-businesses engaged in contracts with SSF
  – In-depth analysis of contracts and of the characteristics of farmers
Typology of Contracts (1/2)

- Five types of contracts were identified
- Contracts vary in their characteristics and modalities

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<th>Resource providing contracts (total integration)</th>
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<th>Market specification contracts</th>
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<td><strong>Type of Contract</strong></td>
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## Typology of Contracts (2/2)

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<th>Major characteristics</th>
<th>Organic vegetable (Certification) Contracts</th>
<th>Production Management and Export Market Specification Contracts</th>
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<td><strong>Market specification contracts</strong></td>
<td><strong>Combination of Production management and Market specification contracts</strong></td>
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Major Characteristics of Contracts (1/5)

(1) Resource Management for deep litter chicken Production Contracts

- Commodity: industrial chickens for domestic and local market
- Formal -written contract (5 years)-linked to funding from government
- Specifications:
  - Farmer contracted to produce ready-to-slaughter birds on a fixed producer price
  - Company (Bushvalley farms) provides day-old chicks and all required inputs (food, medicines, etc.)
  - Company manages the entire production cycle (growth of chickens per cycle)
    - Company experts manage the automated environmentally controlled chicken houses
    - Farmer monitors the growth of the chickens (reports any problems to the company)
- Marketing:
  - Company catches chickens, transports to abattoir for slaughtering and selling
  - Farmer paid subsequent to marketing
  - Costs of production and management deducted prior to payment (1 month)

Types of farmers:

- Redistribution land (private) – 40ha to 120ha
- Individual farmers
- Government funding (infrastructure)
- Contract established in public/private partnership
- Nine (32%) of contracted farmers engaged
Major Characteristics of Contracts (2/5)

(2) Production Management and Market Specification Contracts

• Commodities: Peppadew and tomato for domestic market (supermarket)
• Formal-written contract, renewable on a seasonal base
• Specifications:
  – Types of chemicals and the expected standards of the products
• Input provision and technical assistance:
  – The buyer (Peppadew International, APOL, Tiger brands) provides seedlings and technical assistance
• Marketing:
  – Prices fixed in advance
  – Farmer supplies peppadew/tomatoes and cost of seedlings deducted prior to payment (3 weeks)
  (only one – cooperative farm – got funding from contractor)

Type of farmers

• Larger-scale – 40+ha (70%-emerging farmers)
• Own irrigation system
• Individual-private or previous home government farms
• Contract based on own initiative of farmer
• Ten (36%) and 18% of contracted farmers engaged for peppadew & tomatoes, respectively
Major Characteristics of Contracts (3/5)

(3) Production Specification and Market Specification Contracts

- Commodities: Citrus (oranges & grapefruits)
  - export market
  - Domestic market (fruit juice factory, Fresh produce market, supermarkets)
- Formal-written contract, renewable on a seasonal base
- Specifications:
  - The buyer (Lona, Dole) stipulates types of chemicals to be used and technical itinerary (time of application of pesticides and fertilizers)
  - Fruit quality stipulated prior to planting
- Input provision and technical assistance:
  - Very little monitoring – just punctuality verification
  - Emergency finance provided on request
- Marketing:
  - Farmer delivers citrus and paid after 1-3 months
  - Export oriented – contractor exports fruits

Type of farmers:
- Individual private land & former homeland government plots
- Larger-scale (12 to 300 ha)
- Own irrigation system
- Own initiative (farmers) & public/private partnership
- Four (36%) of contracted farmers engaged
Major Characteristics of Contracts (4/5)

(4) Organic Certification Contracts

- Commodities: Organic vegetables (green beans, green pepper, lettuce, butternuts, beetroot, sweet corn) for domestic market
- Formal-written, renewable on an annual basis (Woolworths)
- Specifications:
  - Vegetable quality, norms and standards are stipulated prior to planting (organic certification)
- Marketing:
  - Prices fixed in advance
  - Farmers deliver vegetables according to buyer’s packaging requirements
  - Payment of the farmer one month after the delivery

Types of farmers:
- Contract between a buyer and a farmers’ association
- Farmers’ association was linked to buyer by a donor organization
- Both larger- and smaller- scale (emerging) farmers are involved
  - 10 to 50+ ha private land and communal land
- Own irrigation system
- Four (14%) of contracted farmers were engaged
Major Characteristics of Contracts (5/5)

(5) Production Management and Export Market Specification Contracts

- Commodities: kumquats (for exports)
- Formal-written seasonal contract
- Specifications:
  - The buyer (Capespan) stipulates types of chemicals and application standards
  - Fruit quality stipulated prior to planting (export standards)
  - Monitoring done sparingly to confer quality
- Payment 1-3 months after delivery (advance payments done)

Type of farmers:
- Individual private land
- Own irrigation system
- Larger-scale (12+ha)
- Own initiative (farmers) with the backing of other already contracted farmers
- One (4%) of contracted farmers engaged
Main Conclusions

• **Empirical evidence shows that the identified contracts are diverse**
  – Great variations of the terms of the contracts
  – Few commodity specific contracts
  => **Difficult to come up with tailor-made contract types**

• Few farmers (only 28!) are engaged in contracts with agribusinesses and supermarkets in the study region, while it is known as a dynamic agricultural production area
  – Concerns very low volume of production
  – Only the better-off farmers, characterized by specific trajectories and having benefited from case-specific support measures
  Is CF really helpful to better access markets?

• **Collective action has a catalytic effect on contract involvement for SSF**
  – Several SSF engaged in CF subscribe to associations
  – Co-op farms are engaged in CF (with funding support from contractors/State)
  – Need for sustainable funding (external) from a reliable source - Operators are not covering transaction costs (shift from collectively organized procurement to individual one)
  – If public support is not available to cover them, farmers will act individually (with the engagement in CF becoming limited)
  Efficiency of contracts – and thus CF - is anchored by external support