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Research Problem

The main objective of the contract farming study was to exploit the potential of contract farming as an institution that can assist linking small-scale farmers to commercial supply chains. The specific focus was to establish possible channels of exploiting the potential of the private sector - agribusiness - to develop and promote smallholder contract farming. The aim of the study was, not to do just another research study in the field of contract farming but was, specifically, to develop policies and action plans that can be used to expand the use of contract farming in the SADC region, especially in South Africa, Malawi and Zambia.

The need to examine the potential of contract farming (CF) in the region derives from two main scenarios: firstly, the development of market linkages for small-scale farmers is seen as a top priority for agricultural development in the sub-region. Although contract farming should be considered only as one institutional option among others, the potential of contract farming to link smallholders to agribusiness is widely regarded as significant. The industrialization of agriculture in many developed countries has resulted in the tighter alignment of supply chains and promoted the emergence of fewer larger farms. It has been suggested that this trend could exclude small-scale farmers in developing countries from profitable niche markets. In this respect, it is also argued that smaller operations, not linked with agribusiness, will have increasing difficulty in gaining the economies of size and the access to technology that is required in order to be competitive. It is against this background that governments and aid agencies have now recognized contract farming as a policy and planning priority, and hence the need to provide guidance to the key economic players in agriculture to exploit the potential of this institution.

Secondly, despite commitments expressed by the private business sector to develop such mechanisms, in reality they seem to be reluctant to do so, particularly regarding the small-scale farming sector. Given this reluctance - perhaps due to the high transaction costs and limited trust between business and small-scale farmers - there is a strong need to determine ways and means to make it possible for contract farming to be used more to link farmers to markets in a non-exploitative but empowering way. The key question is, therefore, to determine whether there is a role for government through appropriate policy interventions, in the context of contract farming, to improve the commercial future of small-scale farmers.

The Research Study

The study involved three countries: South Africa, Malawi and Zambia. The research task was to review of the status of contract farming in each of the study countries. This included summarizing history/background of contract farming, a summary of major examples of contract farming and a review of the issues confronting the expansion of contract farming. The second research task was to develop a vision for contract farming for each study country, as well as, a list of practical steps to promote this vision. The third task required the research teams in each country taking practical steps to actively promoting and implementing national level contract farming...
projects. The study was led by University of Pretoria, in South Africa.

The study Results

The historical legacies of the three countries are very different, yet in some ways certain common problems emerged. Smallholder exclusion was specifically problematic in all three countries. In general, although the increased procurement of raw commodities from small-scale and emerging farmers forms part of the national priorities of South Africa, Malawi and Zambia, there is no specific vision or policy to promote contract farming linkages that include this category of farmers in the country’s agro-processing supply chains. There, also, appears to be a general reluctance, on the part of agribusiness, to include this category of farmers in their supply chains. Two primary reasons explain this reluctance: firstly, in many developed countries modern agricultural supply chains increasingly insist on higher levels of managed coordination - so fewer larger farms are preferred as suppliers of raw commodities; secondly, the local and international experience suggests that small-scale farmers generate higher levels of transaction costs for their agribusiness partners.

A wide range of crops is procured from smallholder producers in South Africa, Malawi and Zambia by some “sort” of contracting. In South Africa documented examples of smallholder contracting are found in the tea, fruit, sugar, flower, cotton, vegetable, timber, tobacco, mariculture and beverage industries. In Zambia and Malawi - tobacco, sugarcane, paprika, cotton, coffee and tea are the principal traditional crops that were produced through smallholder contracting. Smallholder farmers in Malawi and Zambia were also supplying fresh fruits, vegetables, honey, milk and pork. In this regard, however, the total percentage supply of raw commodities by smallholder farmers was found to be very low - less than 10% in South Africa.

The results from the three countries indicated that the agribusiness sector has the potential to significantly expand the smallholder supply of raw commodities and that contract farming was the institution best suited to attaining these objectives. In many instances plans and projects are underway and the surveys indicated that initiatives were being developed in 24 out of 31 raw commodity supply chains. As an example of the potential of agribusiness to expand smallholder supply, it was estimated that if the smallholder supply of fruit and vegetables was increased to 10%, an additional 11 000 new farmers could be created in South Africa alone. In general, however, smallholder supply is constrained by a number of issues relative to their commercial farmer counterparts. These issues include: historical legacies in each of the countries; the general and specific barriers of entry to various raw commodities; problems with contract enforcement; the legal environment; land tenure; lack of power-representation of smallholders versus their agribusiness partners; agribusiness reluctance; and a wide range of other miscellaneous issues.

Finally, it was suggested that smallholder supply groups need to be equipped to operate in a much wider range of supply structures in the future that include: agents, cooperatives and intermediaries, as well as, be able to contract both formally and informally using trust as a basis to reduce transaction costs.

The Way Forward

On the basis of the current status that exists with respect to the relationship between agribusiness and smallholder farmers, a number of steps are required in order to expand the contract farming institution in South Africa, Malawi and Zambia:

• The identification of the key players - these include agribusiness (specifically the agro-processing sector), the government, input suppliers, farmer associations and research institutions. In this regard, associations representing emerging smallholder farmers must be developed/upgraded if they do not exist or, alternatively, are inappropriately structured.

• A synthesis report - FANRPAN should present a combined synthesis report to the governments of the study countries - that clearly demonstrates the feasibility of expanding smallholder contract farming. This report should clearly highlight how agribusiness can contribute towards key government transformation objectives, as well as, create a ‘win-win’ situation for agribusiness, government and the input players. From a government perspective, therefore, the report should clearly show how the limited government resources can be optimally leveraged by putting the onus on individual agribusiness companies to invest in smallholder farmers.
• **Contract farming policy dialogue workshops** - a series of policy meetings and workshops should be convened amongst all the players in order to establish a joint structure and vision for expanding the institution of smallholder contract farming. In addition, the roles of each of the players should be clearly articulated.

• **The role of agribusiness** - more specifically, the role of agribusiness must include the social responsibility of expanding contract farming opportunities for smallholder farmers in their supply chains. Although widespread evidence exists that numerous smallholder farmer projects are in progress, there is a need to ensure that these projects result in long term contractual arrangements. Agribusiness should be the first line initiators of contract farming projects that require the provision of a wide range of inputs. In addition, the individual agribusiness companies should act as facilitators for finance and land.

• **The role of government** - governments must undertake to promote the institution of contract farming by developing the necessary legislation, as well as facilitating inputs like finance, land and infrastructure. If agribusiness is going to incur additional start-up and running costs as a result of contracting with smallholders, it is important that some incentive/relief is accorded to this sector. This relief could be in the form of a tax break or subsidy if certain volumes or numbers are achieved with respect to smallholder supply chains. Government should also ensure that legislation enables the necessary level of contract enforcement. Policy also needs to be enacted to ensure female farmers operate as freely as their male counterparts, as well as restructuring the regulation with respect to the minimum wage legislation in the farm sector.

• **Win-Win contracts** - the development of suitable contractual arrangements should ensure that agribusiness companies do not use this legislation to entrench commercial farming power. Smallholder farmers and new emerging farmers should be adequately represented in the establishment of the contract and, in this respect; the use of powerful farmers’ associations could ensure that farmers are not exploited. At present most contract farming arrangements involve a production contract that stipulates the volume of supply, the quality, price and delivery date. The establishment of a production contract needs to be tailored to the type of raw commodity supplied and the period of duration of these contracts can range between 3-4 months and many years. Shorter-term contracts are typically classical type contracts where a majority of the terms and conditions are specified. Longer term contracts are more relational by nature and place far higher levels of reliance on ex post conditions.

• **Involvement of Input suppliers** - input suppliers including seeds, services, fertilizer, power, finance and transport should also undertake to support the development of smallholder contracting farming by customizing small-scale farmer input packages.

• **Role of smallholder farmer associations** - Smallholder farmer associations should sell this opportunity to their members, as well as, act as a conduit for developing the necessary structures and to facilitate training and other inputs. The development of representative farmers associations, in this regard, could mobilize smallholder farmers, increase economies of scale, reduce transaction costs and ensure the representation of this sector. Other forms of securing the horizontal coordination of farmers can also be examined to ensure the coordination of production, processing and marketing, as well as, land, labour, water and equipment.

• **Role of research organizations** - research organizations should investigate optimal ways to create linkages between agribusiness and small farmers, to investigate the suitability of various raw commodities for contract farming projects and to develop small-scale technologies. Research is also required with respect to the role of farmer associations, as well as,
investigating the suitability of different types of contracting arrangements. Various other ways in which farmers can be horizontally integrated, similar to the collaborative clustering that is precipitated by common interests and historical experience, should be investigated.

- A project-by-project approach - after a joint vision has been developed a project-by-project approach should be adopted as a specific agribusiness company decides to initiate a contract-farming project.

Policy Recommendations

There were four principle policy recommendations from the study:
1) Firstly, policy is required to convince agribusiness to undertake large-scale investment in smallholder contract farming projects. Some form of policy incentive is therefore urgently required.
2) Secondly, it was suggested that some form of policy is required to ensure the representation of smallholders in a contract farming relationship. This policy was twofold - on the one hand - policy is required to promote the existence and efficiency of farmers associations whilst - on the other hand - if farmers’ association are not developed, policy is required to protect smallholders in the unequal power relationships inherent in contract farming.
3) Thirdly, it was suggested that some form of policy be developed, where possible, with respect to the price structure of raw commodities in a similar fashion to determining the price paid for sugarcane or maize.
4) Fourthly, regulation is urgently required to ensure that legal systems were capable/prepared to guarantee contract enforcement, facilitate land tenure problems and traditional authority structures.

Conclusion

Despite, the different background of contracting farming in the three study countries, a number of common denominators exist. Firstly, none of the three countries have developed policy to specifically promote contract farming. Secondly, the agribusiness sector in all three countries appeared to have serious reservations about contracting with large numbers of small-scale farmers. Despite this, the agribusiness sector has enormous potential to expand the institution of smallholder contracting. A number of issues, however, need to be addressed in order for agribusiness to promote smallholder contract farming. These issues include the general high level of transaction costs, the influence of country specific legacies, the absence of regulation, issues surrounding trust and contract conflict and the weakness of legal systems. Finally, as a way forward, a common vision on contract farming amongst the key players in the agricultural sectors of the countries should be developed. Contract farming in the three countries has the potential to include large numbers of small-scale producers but only if the necessary conditions are present and suitable policy is developed.