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Contract Farming as Business Model for Sustainable Rural-Urban Supply Chains: Sincere Efforts or Just Profit?

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Abstract

In the recent years significant population growth increased food demand and the crisis stimulated commodity prices rise, thus putting the pressure on liberalised markets of developing countries whose efforts to escape indigence mainly remained unrealised. Agriculture is hugely important in Malawi and it is witnessing a relative change in farming practices, which underpins millions of livelihoods and contributes to the economy. However, much of the growth has emanated from the emergence of contract farming, an option that leads to increases in agricultural income for rural and urban farmers, which alleviates hunger and poverty, and thus provides a promising business platform for the development of value chains. Contracting represents the bridge that allows marginalised smallholder farmers access domestic and international markets. The paper examines contract farming as a business model that is intended to preserve and improve smallholder farmers' production and marketing activities and thus lead to socio-economic growth. It employs an exploration method to review, as well discusses the bias of contract compliance and its consequences for smallholders within a conceptual framework supporting contracting pathways for sustainable agricultural development. This study summarizes and analyses 25 scientific and expert papers on contract farming published since 2007 to date. This will be done with the aim to evaluate the impact of contract farming on smallholder producers in rural Malawi. Primary and secondary data on economic and social performance of contracts have been generated with a preliminary econometric analysis, whereas the research is part of broader practical PhD project. Conducted study shows evidence that contract farming leads to more expanded markets but limited in farmers' direct access to influence market governance due to terms and conditions under which contract farming production, processing and distribution are organised. It also identifies and compares key policy levers that favour and support smallholder farmers' interests to

be able to influence market governance and compete with commercial investors through co-operative producer organisations. Therefore, the future will depend on further persistent smallholders' linking and efficient collaboration with neighbouring business and political units.

Keywords: contract farming, value chain organisation, sustainable rural-urban relations

Introduction

Malawi is a low-income country with high levels of malnutrition, HIV infection and poverty. About 79% of the population live in rural area and earn their income by working in agriculture (78% of active population) (FAO, 2013). One of the problems militating against agricultural development for smallholder farmers is their inability to access market their produce efficiently. The reasons adduced includes poor productivity levels, lack of access to finance, increased cost of quality inputs such as fertilisers, agrochemicals, high costs of production and climate changes. Contract farming models have been advocated as one of the means to sustained smallholders agricultural development.

The core of contracting is an agreement between farmers and an agribusiness companies. Farmers are obliged to produce and deliver produce at determined quality, volume and time. On the one hand, company provides inputs on credit at the beginning of the season, offers extension services, secures market for farmer’s produce and pays at an agreed price (Prowse, 2012). This kind of relationship provides the basis for sustainable long-term business connection which awards both small farmers and companies. However, each contracting party at some point (buying/selling products) are subject to the risks associated with deviations from the agreed terms. Whether it is a practical breach of contract or unfounded suspicions in other’s sincere efforts, the end result has created mistrust that reduces efficiency and profitability of the contract farming model.

Methodology

The study was conducted using exploration method to review recent developments in contract farming. The study reviewed 25 scientific and expert papers published since 2007 with focus on contract farming performance in Malawi. Specific research and case studies were analysed and compared in order to analyse the main pillars and gaps that exist within the value chains which sustain contract farming business model. Data on observed behaviour were used to build theory framework and approach for practical future PhD research in Malawi.

Results

The results show that smallholder farmer controls 0.4 hectares of cultivable land. An average land holding in Malawi, has to set aside10% of farm income as input costs. Agribusiness companies controls 15,000 contracts with small farmers and allocate 40 euros to each farmer to be able to procure all inputs and services.

An average profit per season for small farmer amounts to between 75 and 90 euros, while companies have to invest minimum of 380,000 euros to put into action all the contracts. Apparently, analysis shows that farmers' incomes are lower, while company's investments are high. This reveals more complex and dependent relations hidden within contracting between farmers and investment companies.

Also, companies are usually accused of exploiting contract farmers. Research evidence shows different scenarios relating to contract violation with varied consequences both in short and long term period (Table 1).

Price fluctuation on the international market contributes to possible disruption in contract agreement, a reflection of poor payment usually not defined before any critical price shift. The rise in prices encourages small farmers to demand higher reimbursement, however regardless of market conditions which favour the farmers; the company is faced with extra expenses which directly affects the reduction in funds available for next season. Therefore, if small farmers get a higher price for their produce, company will find other ways, for example increasing input prices, to compensate for the loss. When produce prices fall, companies pays lower prices to the farmers, but in turn has to cope with low debt repayment rates since farmers earned less income. With this price regime, farmers can be worse-off when climate change or natural disasters occur – with the implication that less volume and quality of produce on the one hand will result in limited marketable goods, and eventually loss of incomes to both the farmers and the companies on the other.

Distrust and irresponsibility often lead to inappropriate behaviour manifested in side-selling or price and grading manipulation. Once small farmer decides to sell produce to anyone other than the company that provides the inputs for production, the market automatically crumbles. The initial positive expectation of increased income for the farmers quickly becomes a burden since most farmers must repay loans to the company, leading to termination of the contract with long-term consequences for farmers' livelihood. In this case, the companies are left with wasted inputs and no produce to market. Likewise, when it comes to grading produce and setting the proper price, buyer's practice of avoiding regulations and underrating farmers' outputs leads to less income and more debts for producers. This simultaneously decreases production base for the next years and triggers strong resistance towards further participation in similar contract farming models.

Investing in successful contract farming, requires working with 40 farmers' associations, 2 government institutions, 2 NGOs and 6 agribusiness companies currently involved and seeking working models of improving contract farming in Malawi. The effectiveness of the work of different groups is often a subject of debate, but the basic environment to be successful exists.

Table 1. Profits and losses in different scenarios

FARMER		COMPANY
more income	Higher price	more expenses
less income, more debts	Lower price	less expenses, low repayment rate
less volume,quality, income, more debts	Climate disaster	less income, market volume low repayment rate
more income, loans stay unpaid	Side-selling	wasted inputs, no product
lower income, more debts	Price and grading manipulation	more income, no trust, less production base

Source: authors' research

Conclusion and implication

Given that agriculture is the mainstay of Malawi's development, and that small farmer in Malawi face discrimination in terms of their impact on significant business flows, contract farming remains one of the ways through which livelihoods can be improved for poor farmers. Framers as a vulnerable group, most times do not understand or follow market rules, therefore, they are left with no support and protection. When farmers are contracted by companies driven by profit with huge investments, exploitation and limited bargaining power becomes the order of the day. However, government, associations, NGOs and other third parties should fill the missing link by connecting, empowering, and monitoring the relationship between farmers and contracting companies. This helps to improve relations, as well as assist in reducing the risk and responsibility balance within contract farming model. The Malawi government should regulate contract farming design, through national and local development policies and strategies, with a focus on risk management and transparent pricing systems. Finally, sincere efforts between the companies and farmers will secure sustainability for all parties with a unique vision for agricultural development.

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