

Contract Farming: Boon or Bane?

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OUTLINE:

1. INTRODUCTION - Definition and increasing appeal of contract farming, especially in transitional economies
2. BASIC CONSIDERATIONS – Advantages of Contract Farming as well as Potential Problems for Agribusiness firms and for farmers; Types of Contract Farming
3. KEY OBSERVATIONS & INSIGHTS – Myanmar Slant
4. WAY FORWARD
5. CONCLUSION



INTRODUCTION:

- ▶ *Purpose* : Two-fold
 - To provide an understanding of the relevance, challenges and opportunities surrounding **Contract Farming** especially within the context of **Myanmar's agricultural and rural development** efforts towards efficient, inclusive, and sustainable growth by drawing from largely ASEAN experience.
 - To **stimulate discussion** at this Forum, in so doing contribute to its expected outputs

Underlying theme: In addressing the **many challenges and potential pitfalls**, Myanmar need to focus on **getting the basics and balance right** with respect to **Contract Farming** within the context of **comprehensive supply chain management**, towards realizing her full potential – so much to be achieved... for appropriate investors and other stakeholders in the relevant supply chains as well.



INTRODUCTION: (Cont'd)

- Contract Farming (CF) **existed** for a **long time**, especially for perishable products delivered to **processing facilities** – milk for dairy industry and fruits and vegetables for preserves.
- **End of 20th Century** CF became **more important** in agri-food industry – liberalization, globalization, changing consumer demands, technology, government policies, **development of supply chains and trading networks**, especially rise of **supermarkets**.
- Spate of expansion of various forms of **CF in transition economies** – including **CLMV countries** – some contend that this is due to economic transformation from a socialist or central command system to a market-driven system (“**institutional failure**”) as well as endemic lack of market information on demand and prices, production technology, financing and low level of infra development (“**market failure**”). This is often **coupled with preferential market access** to developed countries.
- However, **empirical and anecdotal evidence** records successes as well as abject failures – **boon to some while bane to others**



CONTRACT FARMING: Definition

“agricultural production carried out according to an **agreement between farmers and a buyer** which places **conditions on the production and marketing** of the commodity”

– Eaton and Shepherd, 2001

“agreement established in advance of growing season for a **specific quantity, quality and date of delivery of an agricultural output at a price or price formula fixed in advance**”

– Binswanger et al, 1995

“contractual arrangement between farmers and other firms, whether **oral or written**, specifying one or more **conditions of production**, and one or more **conditions of marketing**, for an agricultural product which is **non-transferrable**”

– Rehber, 2007

And many, many more



ADVANTAGES OF CONTRACT FARMING:

a) for agribusiness firms

- **access to land** is facilitated (not 'land grabbing'), hence greater political acceptability
- **reduced risk** of loss from disease, pests or drought
- **labour costs** are reduced
- **some crops** considered **more suitable** for small-scale production, and hence contract farming
- **greater regularity** of agricultural product **supplies** to the firm:
 - enables it to meet its contractual and delivery obligations to its buyers (in supply chain)
 - guarantees factory throughput
 - ensures supplies are available at the right time, in the right quantity, of the right variety and necessary quality
 - ensures compliance with buyers' standards or other certification requirements



ADVANTAGES OF CONTRACT FARMING: (Cont'd)

b) for farmers

- **market access** is more secure, promoting a reliable revenue stream and income stabilization
- **credit access** is enhanced (in kind or via banks)
- **inputs supply** more easily obtained (less uncertainty regarding availability, timing, quality)
- **agro-services** and technological assistance can also be obtained (mechanization, transportation, extension)
- **production and management skills** of groups enhanced
- **risk reduction** production planned to only meet demand reduces losses as well as price fluctuation
- **higher value crops** introduction – higher income



Potential problems for agribusiness firms

- **transaction costs** of dealing with large numbers of farmers
- risk of **side selling**
- risk of misuse or **diversion of supplied inputs**
- failure of farmers to deliver crop or too much product may be supplied
- internalization of **support service costs**

Risks should contract breaks down

- risk of undermining the **corporate image**
 - ▶ in **breach of contract** with their buyers
 - ▶ **advances** to farmers **not repaid**
 - ▶ expensive **processing infrastructure idle or underutilised**
 - ▶ **investments** in land preparation and transport infrastructure **wasted**
 - ▶ **staff underemployed**



Disadvantages for farmers

- firms might **renege on contractual terms** (or exit business):
 - of particular concern for **long-term crops** (e.g. oil palm) or other products where there is “asset specificity”
- firms may fail to **deliver inputs on time**
- loss of **flexibility**
- inability to benefit from **high prices**
- traditional market linkages and **traditional farming practices lost**
- poor or non-existent income stream in first years for some crops
- risks associated with monoculture
 - possible impact on food availability
- risk of indebtedness grows



Enabling Environment for sustainable CF

- **contractual relationships** will only be sustainable if partners perceive that they are better off by engaging in them. There must be genuine economic benefits for both parties - **"win-win"** situation
- No successful contracting scheme can exist or remain sustainable where the **institutional and political setting** is not **conducive**. The enabling environment must be in place:
 - General contract laws
 - Land tenure laws
 - Contract enforcement mechanisms (even though rarely used)
 - Regulations on associations
 - A supportive banking environment
 - Infrastructure, communications, etc
 - **Strong political understanding of purpose and requirements of contract farming**



OTHER CONSIDERATIONS:

a) Choosing the farmers

- Farmers must have **capacity to exploit market potential** in terms of:
 - agronomic suitability, climate, pests and diseases
 - location, input supply and infrastructure
 - assets and access to finance (e.g. to pay labourers, other out-of-pocket costs)
 - capacity to meet market requirements
 - land area (too little land can lead to food crop neglect) and land tenure
 - social structure and education levels
 - a certain willingness to take risk



b) Developing mutual trust

- Contracts can break down because of disagreements
 - Parties are remote from each other
 - No social capital
 - Lack of understanding by farmers of long-term benefits of honouring agreements
 - Easy potential for side selling or input diversion
- Usually a need to work through farmer groups/associations to reduce transaction costs
 - Social cohesion within group necessary
 - Not all societies work well as groups
- There will always be unforeseen problems so some contract flexibility is necessary



b) Developing mutual trust (Cont'd)

- ▶ Companies need to ensure:
 - **Reliable** input supply
 - **Transparency** – maximizing communication, including reciprocal visits and “On-the-ground” presence of extension workers
 - Clear specifications and transparency in **grading and pricing and timely payments**
 - **Arbitration procedures**

- ▶ Some Recent Concerns
 - Exploitative effects of **monopsony control**
 - Bias towards **larger farms**
 - **Increased risk** – unfamiliarity of farmers with new crops, unanticipated pest outbreak – e.g. cashew nuts in Thailand
 - **Health and environmental** – mono-cropping with heavy reliance and potential **misuse of agro-chemicals, especially pesticides** (calendar spraying)



- Tendency for contract farming to be **seen as a development tool**
 - There is much emphasis on “inclusive business models” and “M4P” (markets for the poor).
 - Contracts **cannot be synonymous with social welfare**; commercial principles have to be applied
 - Farmers chosen have to be those **best able to do the job, not the poorest**



CONTRACT FARMING MODELS:

- 1) **Centralized Model** ~ classical CF model – huge processor/packer & large number of (small) farms – **sugarcane, tea, coffee, milk, poultry**
- 2) **Nucleus Estate Model** – variation of (1) with own production facility (estate/plantation) – base throughput for processing facility, R&D, breeding. Involve 'out-growers' – mainly **perennial crops**, some exceptions
- 3) **Multipartite Model** – JV between Statutory body with private company, contracts with farmers – China and many developing countries
- 4) **Informal Model** – individual entrepreneurs or small companies contracting informally with farmers on seasonal basis – **fresh fruits and vegetables** – success depends on availability of agri-support services provided by government
- 5) **Intermediary Model** – involving at least 3 parties (combination of (1) and (4)– processor/major trader contract with collector (middleman) who the informally contracts with a number of farmers.



SCAN OF INVOLVEMENT OF THE PRIVATE SECTOR – FDI, local –with various forms of CF

- **TNCs** active in the region – Nestle, Cargill, Tesco, Carrefour – regional chains, technology, export platforms; Also CSR and CSV ("**Creating Shared Value**") – increasing regional companies also involved
 - **Oil Palm** – FELDA, Sime Darby, KLK, SinarMas
 - **Livestock** – Charoen Pokphand Group (in Malaysia, Indonesia, Viet Nam, Cambodia, Myanmar – animal feed, layers, broilers, pigs, shrimp); Leong Hup Holdings (in Indonesia, Viet Nam – animal feed, layers and broilers); Betagro (in Lao PDR and Cambodia).
 - Initial step is to supply host country's market – subsequently integrate sourcing of inputs and marketing on regional basis
 - **Fruits and Vegetables** – bananas and pineapples (Philippines)
 - **Seeds** – contract seed growers – CP (maize) in CLMV countries
 - **Rice** – more sensitive – various modalities in Viet Nam, Cambodia, Lao PDR and Myanmar
 - comprehensive supply chain Vs 'land grab' (water grab?)



MYANMAR



MYANMAR BECKONS...



(4) Major Rivers (of which 3 originates within own border) and many rivers and creeks flow into or join the major rivers

- **Exceptional resources** (water, land, location, climate)
 - **Water**: 10 times as much per capita as China and India; 2 times as much as Vietnam, Thailand and Bangladesh
 - **Land**: 14 million acres virgin and fallow; 83 million acres of forest
 - **Strategic location**: near major regional markets
- **Diverse ecosystems** → diversification potential

Myanmar- potential to be water-energy-food secure, in short term, if not already so

LARGE POTENTIAL FOR DIVERSIFICATION

Production Growth Rate 1985 to 2010

Cereals

paddy, GOM	3%
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paddy, USDA	1%
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maize	6%
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Oilseeds	6%
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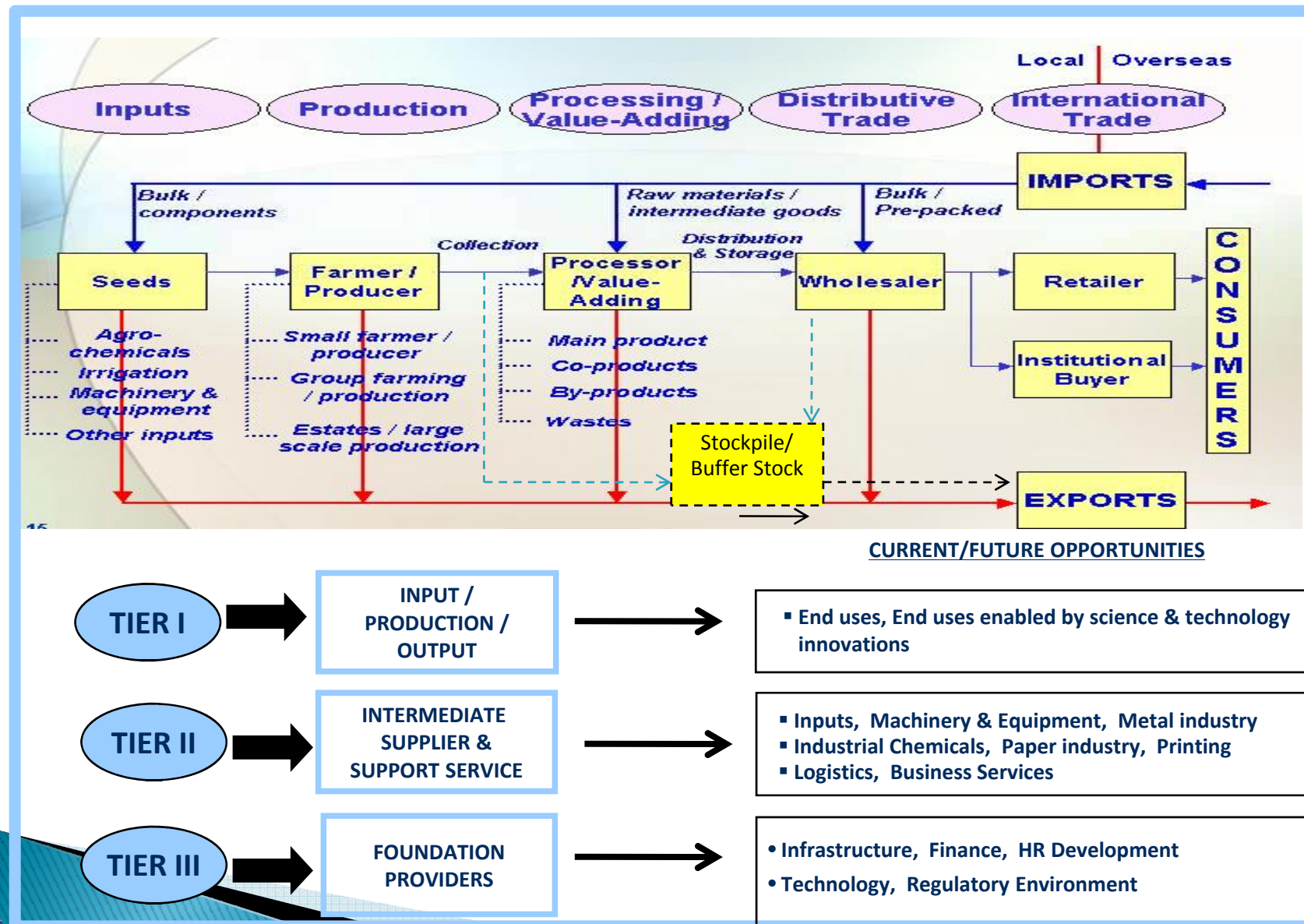
Pulses	9%
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Horticulture	7%
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Poultry	6%
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ASIDE: COMPREHENSIVE AGRI-FOOD SUPPLY CHAIN – Productivity increases and value adding along supply chain



Development of Emerging Comprehensive Supply Chains – under Specialization Concept



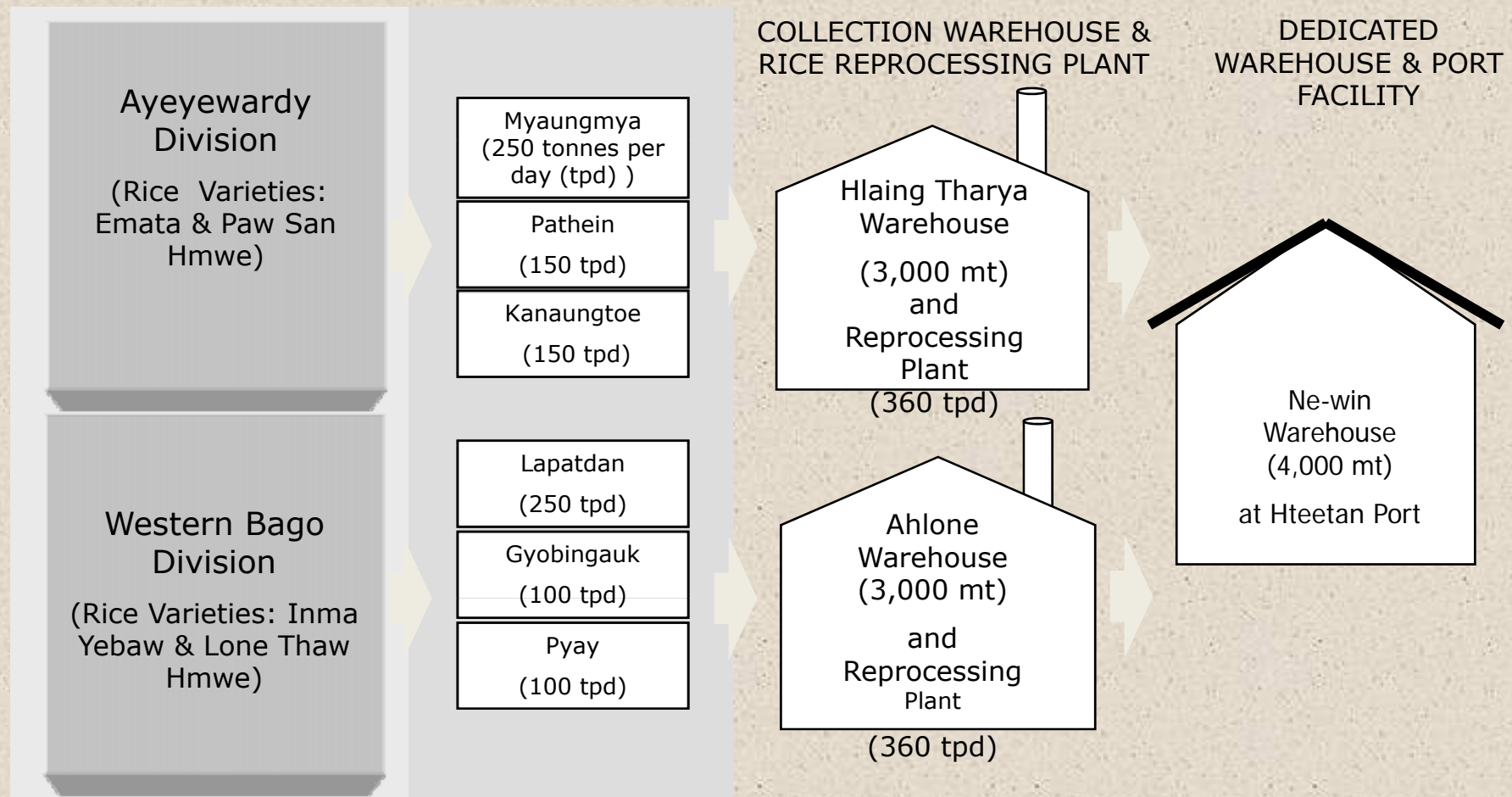
Specialization Concept-
From small scale to
commercial scale

1. Rice Specialization Companies
2. Bean/Pulses Specialization Co
3. Vegetables and Fruits Co
4. Onion Specialization Co
5. Oil bearing Crops Specialization Co
6. Horticulture & Floral Specialization Co
7. Livestock & Fishery Products Specialization Co



2000/01 RICE SUPPLY CHAIN IN MYANMAR

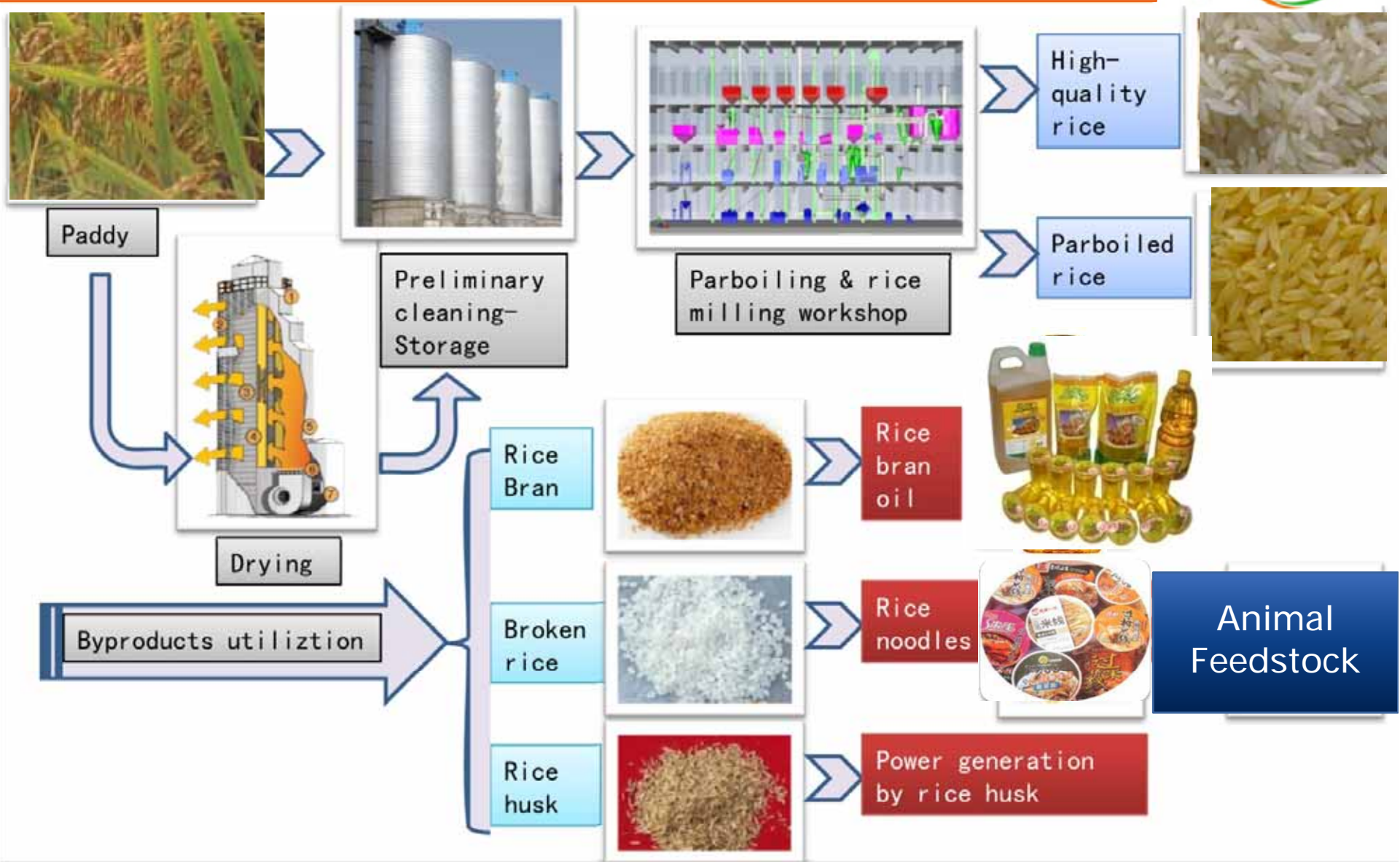
Developed by MAPT (in collaboration with BERNAS)



COMPREHENSIVE SUPPLY CHAIN DEVELOPMENT & MANAGEMENT



Transformation of Rice Supply Chain – Mid-stream segment - MAPCO-Mitsui JV



Transformation of downstream segment – packaging & branding



MOVING FORWARD:

- ▶ **Guardedly optimistic** of Myanmar's ability to arrive at innovative mutually beneficial forms CF, with the appropriate foreign and local investments. However, the increasing **need is to "get the basics and balance right"**. The **dynamic interplay** between the various drivers of CF within the overall development of supply chains and international trading networks, strategy for future food systems and evolving innovative developments/ideas can and should be harnessed to **generate wealth, income and stability**.
- ▶ A **key challenge** is continuously **address CF** within the overarching 'Fundamentals' of **population growth, poverty, the nutrition transition, energy, land, water, labour, and climate change** as well as emerging trends, new ideas and innovations.



CONCLUSION:

- o With increasing **interconnectivity/interdependence** between CF and other segments of supply chain as well as with Technology, Productivity, Regional Trade and Food Security – need to view more holistically as **food ecosystem**
- o Blindingly clear from above the will **Contract Farming promises much, but it is not a panacea** – so we must be **vigilant and strategic** in selecting the **relevant/innovative forms** of Contract Farming in relation to elected supply chains and trading networks to be engaged in and to **grow together and contribute towards Myanmar's concerted effort** at efficient, inclusive and sustainable growth.
- o Ultimately, and paraphrasing Victor Hugo, **markets open to trade and minds open to ideas will help drive Myanmar's efforts** in agricultural and rural development, **including CF**, ultimately targeted at **efficient, inclusive and sustainable growth**.



THANK YOU!

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