COST BENEFIT ANALYSIS OF CONTRACT FARMING AND NON-CONTRACT FARMING IN KARNATAKA

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Abstract:

Well-managed contract farming is an effective way to coordinate and promote production and marketing in agriculture. Nevertheless, it is essentially an agreement between unequal parties: companies, government bodies or individual entrepreneurs on the one hand and economically weaker farmers on the other. The advantages, disadvantages and problems arising from contract farming will vary according to the physical, social and market environments. Non-contract farming is more suitable if the area of the holdings or land tracts are big. Non-contract farming suffers from several limitations, one of which is lack of appropriate methods and techniques for cost reduction and control. In this regard, a study has been taken up to know the cost-benefit analysis of contract farming on practicing farmers. This study is purely based on Secondary Sources of data.

Keywords: Cost-Benefit Analysis, Contract Farming

INTRODUCTION:

The scenario of agriculture in India is changing. Farmers are keen on transforming from a traditional approach of farming to a market-led approach. Farmers are now looking for the means and ways to shift from subsistence agriculture to market-oriented production. In this context, contract farming provides a unique opportunity to diversify their production. With minimum risk, it motivates the farmers to take up a new venture. There is an unprecedented interest shown by all the stake holders of contract farming. After opening up the Indian economy and entry of many domestic and multinational players into the agribusiness sector, contract farming, which was restricted now, became the dominant and growing node of raw material production and procurement coordination among the processors and fresh produce marketers and exporters.

Well-managed contract farming is an effective way to coordinate and promote production and marketing in agriculture. Nevertheless, it is essentially an agreement between unequal parties: companies, government bodies or individual entrepreneurs on the one hand and economically weaker farmers on the other. It is, however, an approach that can contribute to both increased income for farmers and higher profitability for sponsors. When efficiently organized and managed, contract farming reduces risk and uncertainty for both parties as compared to buying and selling crops on the open market. Critics of contract farming tend to emphasize the inequality of the relationship and the stronger position of sponsors with respect to that of growers. Contract farming is viewed as essentially benefiting sponsors by enabling them to obtain cheap labour and to transfer risks to growers. However, this view contrasts with the increasing attention that contract farming is receiving in many countries, as evidence indicates that it represents a way of reducing uncertainty for both parties. Furthermore, it will inevitably prove difficult to maintain a relationship where benefits are unfairly distributed between sponsors and growers. The advantages, disadvantages and problems arising from contract farming will vary according to the physical, social and market environments. More specifically, the distribution of risks will depend on such factors as the nature of the markets for both the raw material and the processed product, the availability of alternative earning opportunities for farmers, and the extent to which relevant technical information is provided to the contracted farmers.5 These factors are likely to change over time, as will the distribution of risks.

OBJECTIVE OF THE STUDY:

1. To know the cost-benefit analysis of Contract Farming and non-contract farming.

CLASSIFICATION OF CONTRACTING FARMING

Contract farming involves mere buying certain quantity of agricultural output at a pre-determined price to purchasing the entire lot and having complete control over production right from supplying the agricultural inputs to harvesting the output. However, there are five pre dominant styles of Contract Farming which is observed in the country. They are:

1. **Centralized model:** The contracting company provides support to the production of the crop by smallholder farmers, purchases the crop from the farmers and then processes, packages and markets the product, thereby tightly controlling its quality. This can be used for crops such as tobacco, cotton, barley, sugarcane, banana, coffee, tea and rubber. The level of involvement of the contracting company insupporting production may vary.
2. **Intermediary model:** This model has formal subcontracting by companies to intermediaries (collectors, farmer groups, NGOs) and the intermediaries have their own (informal) arrangements with farmers. The main disadvantage in this model is it disconnects the link between company and farmer.
3. **Multipartite model:** The multipartite model usually involves the government, statutory bodies and private companies jointly participating with the local farmers. The model may have separate organizations responsible for credit provision, production, processing, marketing and management of the agricultural produce.
4. **Nucleus Estate model:** In this system, the promoter owns and manages an estate plantation (usually close to a processing plant) and the estate is often fairly large in order to provide some guarantee for the plant. It is mainly used for tree crops, but can also be used for fresh vegetables and fruits for export trade.

BENEFITS OF CONTRACT FARMING FOR FARMERS

The prime advantage of a contractual agreement for farmers is that the sponsor will normally undertake to purchase all produce grown, within specified quality and quantity parameters. Contracts can also provide farmers with access to a wide range of managerial, technical and extension services that otherwise may be unobtainable. Farmers can use the contract agreement as collateral to arrange credit with a commercial bank in order to fund inputs. Thus, the main potential advantages for farmers are:

- **Provision of inputs and production services**

Many contractual arrangements involve considerable production support in addition to the supply of basic inputs such as seed and fertilizer. Sponsors may also provide land preparation, field cultivation and harvesting as well as free training and extension. This is primarily to ensure that proper crop husbandry practices are followed in order to achieve projected yields and required qualities. There is, however, a danger that such arrangements may lead to the farmer being little more than a labourer on his or her own land. It is often difficult for small-scale farmers outside the contract-farming context to gain access to inputs. Fertilizer distribution arrangements have been disrupted by structural adjustment measures, with the private sector having yet to fill adequately the void created by the closure of parastatal agencies. In many countries a vicious circle has developed whereby the low demand for inputs provides no incentive for the development of commercial distribution networks and this, in turn, further adversely affects input availability and use. Contract farming can help to overcome many of these problems through bulk ordering by management.

- **Access to credit**

The majority of smallholder producers experience difficulties in obtaining credit for production inputs. With the collapse or restructuring of many agricultural development banks and the closure of many export crop marketing boards which in the past supplied farmers with inputs on credit, difficulties have increased rather than decreased. Contract farming usually allows farmers access to some form of credit to finance production inputs. In most cases it is the sponsors who advance credit through their managers. However, arrangements can be made with commercial banks or government agencies through crop liens that are guaranteed by the sponsor, i.e. the contract serves as collateral. When substantial investments are required of farmers, such as packing or grading sheds, tobacco barns or heavy machinery, banks will not normally advance credit without guarantees from the sponsor.

- **Introduction of appropriate technology**

New techniques are often required to upgrade agricultural commodities for markets that demand high quality standards. New production techniques are often necessary to increase productivity as well as to ensure that the commodity meets market demands. However, small-scale farmers are frequently reluctant to adopt new technologies because of the possible risks and costs involved. They are more likely to accept new practices when they can rely on external resources for material and technological inputs. Nevertheless, the introduction of new technology will not be successful unless it is initiated within a well-managed and structured farming operation. Private agribusiness will usually offer technology more diligently than government agricultural extension services because it has a direct economic interest in improving farmers' production.6 Most of the larger sponsors prefer to provide their own extension rather than rely on government services.

- **Skill transfer**

The skills the farmer learns through contract farming may include record keeping, the efficient use of farm resources, improved methods of applying chemicals and fertilizers, a knowledge of the importance of quality and the characteristics and demands of export markets. Farmers can gain experience in carrying out field activities following a strict timetable imposed by the extension service. In addition, spillover effects from contract farming activities could lead to investment in market infrastructure and human capital, thus improving the productivity of other farm activities. Farmers often apply techniques introduced by management (ridging, fertilizing, transplanting, pest control, etc.) to other cash and subsistence crops.

- **Guaranteed and fixed pricing structures**

The returns farmers receive for their crops on the open market depend on the prevailing market prices as well as on their ability to negotiate with buyers. This can create considerable uncertainty which, to a certain extent, contract farming can overcome. Frequently, sponsors indicate in advance the price(s) to be paid and these are specified in the agreement. On the other hand, some contracts are not based on fixed prices but are related to the market prices at the time of delivery. In these instances, the contracted farmer is clearly dependent on market volatility.

- **Access to reliable markets**

Small-scale farmers are often constrained in what they can produce by limited marketing opportunities, which often makes diversification into new crops very difficult. Farmers will not cultivate unless they know they can sell their crop, and traders or processors will not invest in ventures unless they are assured that the required commodities can be consistently produced. Contract farming offers a potential solution to this situation by providing market guarantees to the farmers and assuring supply to the purchasers. Even where there are existing outlets for the same crops, contract farming can offer significant advantages to farmers. They do not have to search for and negotiate with local and international buyers, and project sponsors usually organize transport for their crops, normally from the farm gate.

PROBLEMS FACED BY FARMERS

For farmers, the potential problems associated with contract farming include:

➢ Increased risk

Farmers entering new contract farming ventures should be prepared to balance the prospect of higher returns with the possibility of greater risk. Such risk is more likely when the agribusiness venture is introducing a new crop to the area. There may be production risks, particularly where prior field tests are inadequate, resulting in lower-than-expected yields for the farmers. Market risks may occur when the company's forecasts of market size or price levels are not accurate. Considerable problems can result if farmers perceive that the company is unwilling to share any of the risk, even if partly responsible for the losses.

✓ Unsuitable technology and crop incompatibility

The introduction of a new crop to be grown under conditions rigorously controlled by the sponsor can cause disruption to the existing farming system. For example, the managers may identify land traditionally reserved for food crops as the most suitable for the contracted crop. Harvesting of the contracted crop may fall at the same time as the harvesting of food crops, thus causing competition for scarce labour resources. Particular problems may be experienced when contract farming is related to resettlement programmes. In Papua New Guinea, for example, people from the Highlands were resettled in coastal areas to grow oil palm and rubber. This required the farmers, who were traditionally sweet potato eaters, to learn cultivation techniques for new food crops and to adapt their dietary practices accordingly.

Two factors should be considered before innovations are introduced to any agricultural environment.

- ✓ The first is the possible adverse effect on the social life of the community. When tobacco growers in Fiji were encouraged to cure tobacco themselves rather than sell it in the fresh green form, it was found that they were unable to handle the highly technical curing operation with any degree of continuity. This was attributed to intermittent social commitments and customary obligations that overrode contractual responsibilities and eventually resulted in the cancellation of their contracts.
- ✓ The second factor is the practicality of introducing innovations or adaptations. The introduction of sophisticated machines (e.g. for transplanting) may result in a loss of local employment and overcapitalization of the contracted farmer. Furthermore, in field activities such as transplanting and weed control, mechanical methods often produce less effective results than do traditional cultivation methods. Field extension services must always ensure that the contracted crop fits in with the farmer's total cropping regime, particularly in the areas of pest control and field rotation practices.

- **Manipulation of quotas and quality specifications**

Inefficient management can lead to production exceeding original targets. For example, failures of field staff to measure fields following transplanting can result in gross overplanting. Sponsors may have unrealistic expectations of the market for their product or the market may collapse unexpectedly owing to transport problems, civil unrest, change in government policy or the arrival of a competitor. Such occurrences can lead managers to reduce farmers' quotas. Few contracts specify penalties in such circumstances. In some situations management may be tempted to manipulate quality standards in order to reduce purchases while appearing to honour the contract. Such practices will cause sponsor-farmer confrontation, especially if farmers have no method to dispute grading irregularities. All contract farming ventures should have forums where farmers can raise concerns and grievances relating to such issues.

- **Corruption**

Problems occur when staffs responsible for issuing contracts and buying crops exploit their position. Such practices result in a collapse of trust and communication between the contracted parties and soon undermine any contract. Management needs to ensure that corruption in any form does not occur. On a larger scale, the sponsors can themselves be dishonest or corrupt. Governments have sometimes fallen victim to dubious or "fly-by-night" companies who have seen the opportunity for a quick profit. Techniques could include charging excessive fees to manage a government-owned venture or persuading the government and other investors to set up a new contract farming company and then sell that company overpriced and poor quality processing equipment. In such cases farmers who make investments in production and primary processing facilities run the risk of losing everything.

- **Domination by monopolies**

The monopoly of a single crop by a sponsor can have a negative effect. Allowing only one purchaser encourages monopolistic tendencies, particularly where farmers are locked into a fairly sizeable investment, such as with tree crops, and cannot easily change to other crops. On the other hand, large-scale investments, such as for nucleus estates, often require a monopoly in order to be viable. In order to protect farmers when there is only a single buyer for one commodity, the government should have some role in determining the prices paid.

- **Indebtedness and overreliance on advances**

One of the major attractions of contract farming for farmers is the availability of credit provided either directly by the company or through a third party. However, farmers can face considerable indebtedness if they are confronted with production problems, if the company provides poor technical advice, if there are significant changes in market conditions, or if the company fails to honour the contract. This is of particular concern with long-term investments, either for tree crops or for on-farm processing facilities. If advances are uncontrolled, the indebtedness of farmers can increase to uneconomic levels. In one venture "compassionate" advances for school fees, weddings and even alimony resulted in many farmers receiving no payments at the end of the season. Dropout rates for farmers in that particular project were high, as they thought contract farming did not pay.

BENEFITS OF NON-CONTRACT FARMING:

Non-contract farming is more suitable if the area of the holdings or land tracts are big. Non contract farming helps small and marginal farmers in diversifying farming and also undertakes other allied farming activities such as animal husbandry, horticulture, sericulture etc. Non contract farming is more suitable than contract farming when it comes to organic farming and use of traditional methods and seeds and techniques.

LIMITATIONS OF NON-CONTRACT FARMING

Non-contract farming suffers from several limitations, one of which is lack of appropriate methods and techniques for cost reduction and control. Since, there is no transfer of risk, the owners of the land holdings are exposed to all kinds of risks. There is no scope for expansion, modernization due to lack of finance, expertise. Gestation periods are longer in terms of non-contract farming and the owners are not capable of absorbing the escalated costs. There is no usage of intensive farming methods such as rotation of crops etc.

CONCLUSION

For successful implementation of contract farming, having co-ordination and collaboration consciousness and acting in an organized manner are advisable for both sides. The impact of the contract farming on the farmers was improved. The profit of famers almost increased after joining contract farming. Savings and investment practice is improved by the farmers. Contract Farming is not a panacea to solve all related problems of agricultural production and marketing systems. But contract farming could be evaluated as a way of providing earlier access to credit, input, information and technology and product markets for the small scale farming structure. Contract farming might also be seen as a way or as a part of rural development and promoted to improve agricultural performance. Besides farming to both sides, there are some problems. Finally the research concludes that contract farmers are satisfied by the contract farming practice and the standard of living and income of the farmers was improved after joining contract farming.

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