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?)
(4) Major Rivers (of which 3 originate 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

<table>
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<th>Cereals</th>
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<td>paddy, GOM</td>
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<tr>
<td>paddy, USDA</td>
<td>1%</td>
</tr>
<tr>
<td>maize</td>
<td>6%</td>
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</tbody>
</table>

| Oilseeds         | 6%       |
| Pulses           | 9%       |
| Horticulture     | 7%       |
| Poultry          | 6%       |
ASIDE: COMPREHENSIVE AGRI-FOOD SUPPLY CHAIN – Productivity increases and value adding along supply chain

CURRENT/FUTURE OPPORTUNITIES

- **INPUT / PRODUCTION / OUTPUT**
  - End uses, End uses enabled by science & technology innovations

- **INTERMEDIATE SUPPLIER & SUPPORT SERVICE**
  - Inputs, Machinery & Equipment, Metal industry
  - Industrial Chemicals, Paper industry, Printing
  - Logistics, Business Services

- **FOUNDATION PROVIDERS**
  - Infrastructure, Finance, HR Development
  - Technology, Regulatory Environment
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
Developed by MAPT (in collaboration with BERNAS)

### Ayeyewardy Division
(Rice Varieties: Emata & Paw San Hmwe)
- Myaungmya (250 tonnes per day (tpd))
- Pathein (150 tpd)
- Kanaungtoe (150 tpd)

### Western Bago Division
(Rice Varieties: Inma Yebaw & Lone Thaw Hmwe)
- Lapatdan (250 tpd)
- Gyobingauk (100 tpd)
- Pyay (100 tpd)

### COLLECTION WAREHOUSE & RICE REPROCESSING PLANT
- Hlaing Tharya Warehouse (3,000 mt) and Reprocessing Plant (360 tpd)

### DEDICATED WAREHOUSE & PORT FACILITY
- Ne-win Warehouse (4,000 mt) at Hteetan Port
COMPREHENSIVE SUPPLY CHAIN DEVELOPMENT & MANAGEMENT

MAPCO, Rice Specialization Companies

Certified Seed Production
- Mechanization
  - Commercial Farming
- Processing/Value Adding
  - Integrated Farm
    - Model Farm
      - Contract Farmers
    - Intercropping with other crop
      - Local Mills & Re-processing Plants @ Major Trading Towns

Distribution and Branding
- Food Safety, Traceability

Processing/Value Adding
- Domestic & International Trade
  - Regular Supplier-Buyer Model
    - Asia - Malaysia, Singapore, Indonesia, China, Philippines,
    - Africa, Middle East, EU, etc

Institutional Buyers
Retail Outlets
Exports
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:

- 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

- 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.

- 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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