RISK MITIGATION THROUGH CONTRACT FARMING: INSIGHTS FROM INDIA

G20 AGRICULTURE- WHAT'S NEXT?

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MINISTÈRE DE L'AGRICULTURE DE L'ALIMENTATION DE LA PÊCHE DE LA RURALITÉ ET DE L'AMÉNAGEMENT DU TERRITOIRE

Colloque
G20 agricole : quelles suites ?

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CREATIVE AGRI SOLUTIONS

NEW DELHI

TOPIC OF DISCUSSION

- **Implementation of risk management instruments: To what extent an improved coordination between the different actors of the agricultural sector could help to reduce excessive prices volatility and to create a conducive environment to increase agricultural production and productivity?**

- **What should be the role of public policies in this area?**

OUTLINE OF THE PRESENTATION

- **Risk management in agriculture: Perspectives from India**
- **Contract farming versus traditional farming**
- **Details of Case studies conducted to understand the various aspects of contractual arrangements**
- **Risk management in contract farming**
- **Policy Implications for risk management**
  - For contract farming
  - Broader context of agricultural risk management

AGRICULTURE RISK MANAGEMENT : PERSPECTIVES FROM INDIA

Types of Agriculture Risks

- Production Risk
- Price Risk
- Financial Risk
- Institutional Risk
- Technology Risk
- Personal Risk

Risk Management Strategies

- Crop Insurance
- Minimum Support Price
- Hedging in Futures market
- Contract Farming

AGRICULTURE RISK MANAGEMENT : PERSPECTIVES FROM INDIA

- Crop Insurance, Minimum Support Price are traditional mechanisms
- Weaknesses Crop Insurance: Coverage is less than 15% farmers, heavily subsidized
- Weaknesses of MSP: Only for a limited number of key crops, whereas high value horticulture, plantation crops are not covered
- Contract Farming, commodity markets are relatively new approaches
- Involvement in commodity markets is very negligible because of high level of illiteracy
- Several models of contract farming are emerging
- Emphasis of this presentation is on understanding risk mitigation through contract farming

CONTRACT FARMING VERSUS TRADITIONAL FARMING

Typical Traditional Value Chains

- **Lack of Information about quality of inputs, seed varieties, etc.**
- **Purchase of Inputs: purchased from trader on credit, often times linked to buyback where the price is lower than market price**
- **Crop Production: No technical information about new techniques, methods to enhance productivity**
- **Sale of Produce: Mandi (Market) taxes, inaccurate weighing, long hours of wait at market, transportation cost, other costs**
- **No one gives him information, about where his produce was sold, what is the specific demand in this market**
- **The produce is on a hot and long journey to other states, cities, leading to HUGE wastage because of lack of post harvest management**

CONTRACT FARMING VERSUS TRADITIONAL FARMING

General Aspects of Modern Value Chain; involvement of company/agency in:

- **Providing information about quality inputs**
- **Ensuring availability of quality inputs**
- **Team of agronomists working with farmers to provide production technology leading to high productivity**
- **Information about pests and diseases minimizing production risk**
- **Information regarding harvesting and post harvest management to minimize post harvest losses**
- **Lower price risk as purchase is on previously announced prices**
- **Some examples of linking farmers to insurance to minimize risks**

DETAILS OF CASE STUDIES

- **Five case studies conducted by FAO (2008) to understand various aspects of contract farming: focus on risk management**
- **Selection of case studies – inclusive value chains meeting the quality requirements of international markets:**
  - Pepsico: procurement of potatoes for chip making – ”Lays” brand
  - Jain Irrigation: procurement of white onion for sale as dehydrated onion in global market
  - Mahindra Shubh Labh: procurement of GLOBALGAP certified grapes for sale to supermarkets in Europe
  - UOCB: procurement of basmati for sale in global market
  - Nestle Milk Procurement

DETAILS OF CASE STUDIES

- **Companies/agencies involved in onion, potato and rice procurement working with about 2000 small farmers (1-2 ha) – investments are not significantly higher than traditional farming**
- **Grape growers are a medium size, resourceful farmers because investment for catering to export market is significantly higher**
- **Companies/agencies:**
  - Provide input support – quality, price and timely availability of inputs
  - Technical input: production, post harvest, packaging
  - Floor price is fixed; price on the higher side is linked to market price
  - Involved in processing and marketing of the produce

RISK MITIGATION – CONTRACT FARMING

Type of Risk	Level of risk	Value Chain farmers
Weather Related Risks	⇩	Company extension agents are in touch with the farmers.
Risk from short-term price fluctuation	⇩	Minimized as a minimum guaranteed price is fixed for the contract farmers.
Risk from Long term Price fluctuation	⇔	Not included in the contract
Asset Risks	⇔	Not included in the contract
Financial Risks (Loans and Credit)	⇩	Company can be involved in arranging the loans between the financing company and farmers.

RISK MITIGATION – CONTRACT FARMING

Exchange Rate Risks	⇔	Exporter bears the risk
Risks of poor or deficient information	⇩	Minimized as the company Extension agents are working closely with farmers
Biological risks	⇩	Minimized as the company extension agents are scouting the fields regularly
Legal and Governmental Risks	⇔	No regulations in the country; the risk from defaulting and legal implications are not very high.
Farm Management Risks	⇩	Company extension agents are also providing information about new technology.
Personal Risks	⇔	Not included in the contract

RISK MITIGATION – CONTRACT FARMING

Key findings:

- **With contract farming, the risks are either lower than traditional farming or reduced. In none of the cases, are the risks HIGHER than traditional farming**
- **Downside**
  - company/agency dishonors contract
  - rejects produce on flimsy grounds
  - Randomly deduct price on pretext of quality norms
- **There is no legal mechanism in place to enforce the contract, the social pressure is high- news media reports, continued business in the local area, ensure that companies comply**
- **Draft regulation is in process in many states**

POLICY IMPLICATIONS

Contract farming perspective

- **Recognition of contract farming as a risk management technique**
- **Policy changes required to support contract farming through changes in the APMC Act (which will enable private processors to procure directly from farmers)**
- **Policy focus on legal aspects of contract farming**
- **Educating farmers about the pros and cons of participating in contract farming**

POLICY IMPLICATIONS

Overall agriculture risk management perspective

- **While the farmers involved in value chains benefit from better access to quality inputs, enhanced production technology, minimum price guarantee, etc. which help to minimize production and price risk. These farmers comprise only a small niche group**
- **Large majority of famers involved in traditional markets face high price and production risk. While the costs of inputs are increasing the farmers investments, the prices risk is only increasing because of closer linkages with global market – What can be done to minimize risks for these farmers?**

RECENT INITIATIVES

- **Government projects, donor initiatives focusing on developing inclusive value chains are being initiated**
- **Example: IFAD, ADB, World Bank projects in Maharashtra**
- **The thrust of these activities is to invest in developing farmer groups and developing backward and forward linkages**
- **Such initiatives will help to encompass larger share of farmers under coordinated value chains – minimizing risk and stabilizing farm prices**

QUESTIONS/ COMMENTS?