Operational Mechanism of Contract Farming in Punjab

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ABSTRACT

Indian agricultural markets have been witnessing a transformation since independence. Traditional farming model and the role of state functionaries is slowly fading. There is an increasing role of private entities in the new regime of agribusiness. Among many new practices brought in the agriculture sector by agribusiness companies, contract farming is much talked about now a days (Naduvinamani, 2007) [1].

In India, the traces of contract farming can be traced back to colonial period. Later in 1989 PepsiCo. brought contract farming in complete way in India particularly in Punjab. Now It is being promoted in a vociferous way to help the agriculture sector to diversify (Shoja Rani, 2007) [2]. The fact is, India stands 2nd in world's production of fruits and vegetables; of which only 2% is processed unlike 83% in China, contract farming can help to bridge this gap between India and China. With time, many companies has come in the sphere of contract farming in India. These are private as well as govt. based. According to the literature, five models of contract farming were found in India; these are - Bi Party Model, Tri Party Model, Quad-Party Model, State led Model and Franchisee Model. Out of these five, Bi Part and a mix of Tri Party and State led Model were identified in Punjab (Singh, 2011) [3]. In this context the present study tries to find out and compare different contract farming models that exist in Punjab.

Keywords: Contract Farming; Contract; Bi-Party Model; Tri-Party Model; Middlemen ('Artihas')

1. INTRODUCTION

Indian agricultural markets have been witnessing a transformation since independence. Supply chain has noticed a gradual increase and value addition. Traditional farming model and the role of state functionaries is slowly fading. There is an increasing role of private entities in the new regime of agribusiness. Among many new practices brought in the agriculture sector by agribusiness companies, contract farming is much talked about now a days. Contract farming models at present are gaining importance in developing countries like India. It is considered an important tool for commercialization of agriculture. Contract farming by national and multinational companies (MNCs) is increasing day by day. Contract farming for agro processing is the most important force which is helping the development of super market chains and economy of India (Roopam Singh, 2009) [4]. The World Bank (1989) has identified that “contract farming” creates a dynamic partnership between private capital and small holders, which would lead to technology transfer, innovation and market growth. It provides for a vertical coordination between growers of an agricultural product and processors of the product.

Contract farming is an agreement between farmers and agribusiness firms for production and supply of agricultural products under pre-determined price. The recent developments in the processing and retailing sectors have resulted in new marketing and trading opportunities, but the challenge lies in linking farmers with these emerging markets in order to make the process inclusive, competitive, sustainable, and scalable. Farmers with small marketable surplus, very little price information and located far away from wholesale markets (mandis) find it difficult to market their produce. High value commodities are often perishable in nature and lack of coordinated supply chains can result in significant post harvest losses and low net returns to the farmers as well as the firms. Strengthening institutions like contract farming is an option to provide risk-mitigating services, and enable farmers to make transition from traditional grain crops to higher value commodities. In this prospect, it is necessary to move beyond traditional farming and link production agriculture with the complete agri-food system, including input markets, warehousing, logistics, processing, and retailing. Although, returns from higher value crops are subject to greater price and production risk as compared with grains. In recent year some economist and policy makers are emphasizing on contract farming system and saying that it is suitable for Indian agriculture and also share the risk of farmers.

1.1 Contract Farming

Contract farming is defined as a system for the production and supply of agricultural/horticultural produce under pre-signed contract between producers/suppliers and buyers. Contract farming refers to a distinct farming system in which a central processing/exporting unit purchases the harvests of independent farmers under a contract. This contract specify how much produce will be purchased by contractor and what will be the price of contracted crop. The contractor frequently provides credit inputs and technical advice to the growers as per contract. Contracting is fundamentally a way of allocating risk between producer and Contractor. Primarily there is a risk related to production and latter on the risk of marketing, both these risks are shared by contractor and the farmer in contract farming practice. (Pari Baumann, 2000) [5]. On the basis of the thoughts and definitions given by various authors related to contract farming, this can be concluded that contract farming is a system of agriculture production and marketing which has a contract. Both buyer and supplier remained abide by the conditions of contract. Buyer is abide to provide technical and financial input to the grower and the grower is bound to supply a contracted quantum of produce within the limits of pre decided quality standards and price. It has three benefiting components which are described as follows :

- Market Specification
- Availability of Resources
- Production Management

Under Marketing Specification, the quantity, timing and price of the commodity is being decided. Second one ensures the provision of technical and financial inputs and also the availability of agri-produce to the company. The third one assists in shaping and regulating the production of contracted crop. In addition to this, for availing benefits through the market it is essential that farmers should be educated enough.

2. DIFFERENT MODELS OF CONTRACT FARMING IN PUNJAB

During field investigations, two types of Contract Farming Models are found to be practiced in Punjab i.e. Bi- Party Model and Tri-Party Model. Four companies have been selected to study the different models of contract farming. These are as following:

To study the operational mechanism (contract farming) of these companies, two district of Punjab has been selected - Jalandhar and Bhatinda. The details of these models and the type of contracts of the companies with the farmers are as following:

- 2.1. Bi-Party Model
  PepsiCo India ltd.
  Markfed
  Field Fresh
- 2.2. Tri-Party Model
  UBL Group

2.1. Bi-Party Model

PepsiCo India ltd.

PepsiCo. started contract farming in Punjab for the crop of Potato (since 1995) and Basmati (2000 onwards). As PepsiCo. opted for Bi-party model which has 2 parties, Therefore they has direct relation with farmers. Company's field officers directly contact farmers to do contract with them. The prerequisite for farmers to get into the contract, is ownership of at least 4 acres of land. The farmers who have less than 4 acres can't contract with PepsiCo. in Punjab. This model does not involve any middlemen in whole operation of contract farming. PepsiCo. provides inputs in the form of seeds, fertilizers, pesticides, insecticides and technical advice to the farmers. They also provide incentives to the farmers for good cultivation practices. Base price for crop procurement, is decided by the company before signing contract with farmers. If crop market price goes up than base price, company procure the produce at market price. It is for the sake of securing their relationship with farmers and keeping farmer's trust and credibility alive in the company. In return farmers provide produce on agreed quality and quantity. The operational process of contract farming model of PepsiCo. is shown in Figure 1. Beside this, PepsiCo. is providing attractive incentives to the potato growing farmers for good farming practice such as:

- 15 Paisa/kg to the farmers who have taken crop insurance
- 25 Paisa/kg for maintaining quality of the crop
- 40 Paisa/kg for using safe chemical kit recommended by PepsiCo.
- 50 Paisa /kg to the farmers having sprinkler irrigation
- 1Rs./kg to the farmers having drip irrigation

These incentives of the company are a good approach to maintain quality of the crop and to promote water saving technologies. No incentives are being provided by the company under the contract farming operations of Basmati crop. But company make sure that Basmati growing farmers grow Basmati by direct seeding. Direct seeding is promoted by the company to save water which is one of the prim agenda of the company. As told by the PepsiCo. officials and the farmers having long back contract farming relationships with the company, PepsiCo. in its initial years, was also covering for crop failure and rejected crops under their contract agreement. But some farmers started doing fraud with the company, they supply less produce to the company in the name of crop failure and sell rest of their produce in the market. Therefore, due to farmer's deception company withdraw from this facility. The contract agreement remains in English. The copy of contract agreement is for Pepsi's record only, they don't provide it to farmers. It makes farmer's part weak, if company backs out from the conditions of contract, farmers don't have any thing in their hands to claim on the company.

Markfed

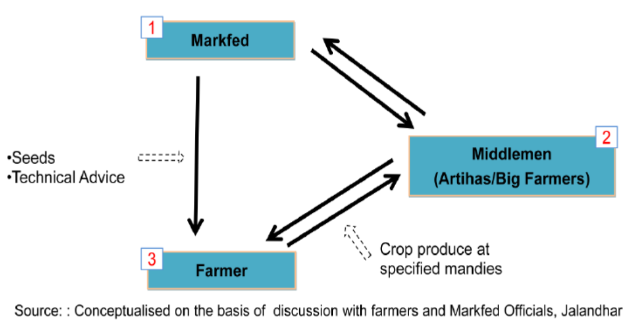

Fig1. Contract Farming Model (as per being practiced on ground) of Markfed in Jalandhar

Markfed has started contract farming in Punjab in 2002 and they introduced contract farming of Basmati in Jalandhar in 2007. Markfed contract-farming model involves two parties according to the agreement i.e. Markfed and farmers. Company is supposed to provide seeds, fertilizers, pesticides/insecticides and technical advice to the farmers. As per the contract, the place of procurement is decided by Markfed. And farmers have to provide the produce to Markfed at these places on pre-agreed quality and quantity. But the situation which is actually in practice in the district of Jalandhar was found very different from the above discussed bi-party model. It was found that they also includes Middlemen ("Artihyas" / Big farmers) as an active role player at the time of approaching to the farmers and procurement of produce (Figure 1.). But this middlemen is not part of their contract on papers. As per Markfed contract agreement the terms and condition of the contract are as given bellow:

- Markfed will issue identity and registration cards to the contracted farmers.
- Markfed will provide best quality seeds to the farmers, Pusa Basmati – 1, Pusa Basmati – 1121, Pusa Basmati – 386, HVC – 19, Sharbati Basmati and Super Basmati seeds will be provided.
- Markfed is also supposed to provide fertilizers, pesticides, weedicide to the farmers at appropriate prices.
- To provide technical support and recommendations about farming practices are also the responsibility of Markfed.
- It will also provide work calendar for crop cycle prepared by its technical team to the farmers.
- Markfed will also arrange training camps, exhibitions and model farm visits for the farmers.
- It will also provide work calendar to the farmers prepared by a technical team. Other farmers who have
- Markfed will purchase basmati on a pre-decided fixed rate under the agreement.
- The quality specification also remained given in the contract and Markfed takes the produce from the contracted farmers on the basis of following quality assessment criteria.

Table 1. Quality Assessment Criteria of Markfed

Sr. No.	Details	Grade I (%)	Grade II (%)
1	Moisture	16	17
2	Waste(without cleaning)	3	5
3	Green and Raw Seeds	2	4
4	Broken Seeds	1	2
5	Foreign Matter	0.5	1

- The price for Grade II crop will remains Rs. 50 less than the price for Grade I.
- The purchasing base price of Basmati provided by Markfed are as following:

The contract of Markfed is a written agreement which is in Punjabi language. It

Table 2. Purchasing Price (Base Rate) of Markfed

Sr. No.	Basmati Variety	Price (in Rs./quintal)
1	Basmati 386/ HBC 19	1400
2	Pusa basmati 1121	1200
3	Super basmati	1100
4	Pusa basmati 1	100
5	Sharbati basmati	750

- If the rate of the above varieties is more in market, Markfed will purchase it according to the existing market prices.
- Markfed will make payment to the farmers by a check or draft within five days of purchase.
- In case of any dispute between the Markfed and the farmers, the matter will be brought to the notice of the Managing Director of Markfed. And in this case contract gave the sole power of Arbitration to the M.D. of Markfed who can take final decision alone. But as per Indian law, one can not be the judge of his/her own activities. A fair and unbiased decision can only be taken if the arbitrator is impartial and don't belong to / in favour of any one of the contracting parties.
- In case of any legal proceeding the jurisdiction will be at Chandigarh court.

But as mentioned earlier, before describing the terms and conditions of the contract that farmers are not provided the copy of contract, so they take it as a verbal contract. Hence they don't have evidence on the basis of which they can register their plea. This makes the contract an unhealthy and biased contract which is more in favour of the contractor company.

Field Fresh

Bharti group started its contract farming operation in Punjab with the name of Field Fresh in 2006. Its model of contract farming is a direct contracting model like PepsiCo. It also has two parties the company itself and the farmers. They directly approach farmers and make them indulge in contract farming of Baby corn. This model is very similar to PepsiCo's model of contract farming. Company provide good quality seeds and the technical advice to farmers. They also demonstrate to farmers, cultivation process of Baby corn. And in return farmers supply the crop produce to the Field fresh at their Ludhiana centre in Punjab. Transportation is the responsibility of farmer. Company don't provide any incentive to the farmers like PepsiCo. Crop price remained fixed between 600 to 800 Rs./quintal according to the quality of produce. In 2012 company paid 50 Rs higher/quintal to the farmers (650-850Rs/quintal).

2.2 Tri-Party Model

United Breweries Ltd. (UBL)

United Breweries Ltd. started contract farming in Punjab in 2001 for the crop of Malting Barley. UBL is covering five districts of Malwa region in Punjab i.e. Bhatinda, Barnala, Mansa, Muktsar and Firozpur, under its contract farming program. The contract-farming model adopted by UBL is a tri-party model - UBL, Punjab Agro Food corporation (PAFC) and farmers. As per the contract, UBL is having relation with the farmers through PAFC. It contacts farmers with the help of PAFC 's field officers. This model does not involve any middlemen as per the contract agreement. PAFC is an important agency which was acting as a nodal agency for contract farming in Punjab till two years back. It was playing a role of facilitator for different companies when contract farming was operationalized in Punjab with the efforts of Punjab Govt. Currently PAFC is facilitating in the contract farming operations of UBL only for the crop of Malting Barley. According to the contract, UBL approach farmers through PAFC. PAFC is suppose to provide seeds and technical advice to the farmers on behalf of UBL. Farmers are suppose to provide Barley produce to the company directly according to their quality and quantity standards. But actual execution of this model in Bhatinda district is different from the model in contract. The actual model can be understood with the help of Figure 2.

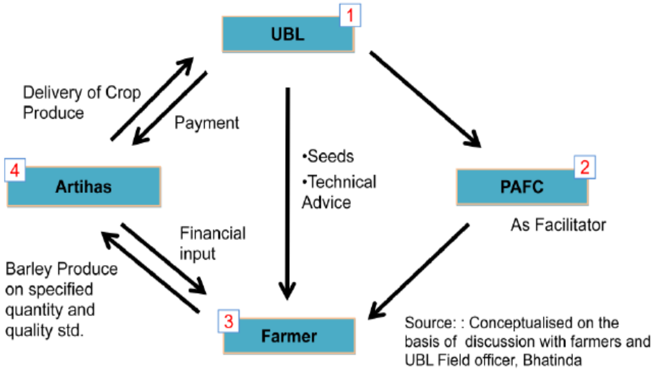

Figure 2. Contract Farming Model (being practiced on ground)

According Figure 2., this model has four parties involved in the whole operation of contract farming. "Artihyas" are also playing an important role in the whole process. In its initial years UBL used to approach the farmers through PAFC and PAFC provide facilities to the farmers on behalf of UBL. But now PAFC is just keeping the record of the farmers and taking their fee from UBL. UBL is directly involving the farmers under contract farming with the help of its own field officer in each of its operational area. Seeds and Technical services are provided by the company itself to the contracted farmers. The role of "Artihyas" are very crucial in this whole system as they are the finance provider to the farmers. Farmers are having long back borrowing accounts with "Artihyas" which keeps on running as farmers are not able to repay all borrowed money with its interest. Therefore they have to depend upon the "Artihyas" for getting credit for their agriculture and non agriculture purposes.

Therefore, farmers are not ready to give their produce direct to the company, though company is ready to take the produce directly. This is the main reason why "Artihyas" are so powerful link in the contract farming model of UBL. Hence the crop is procured by the company through "Artihyas" and the payment is also made to the "Artihyas". Then the "Artihyas" who have accounts of farmers don't give any amount in the hands of farmers. If farmers ask about his money they show them that it has been deducted in the name of repayment. When farmer needs money, he will have to again borrow from the "Artihyas". This is how the whole network of UBL contract farming works. The terms and condition of the contract under UBL contract farming model are as given bellow:

- Good quality seeds will be provided by the company to the contracted farmers on subsidized rates.
- UBL will maintain a close relationship with the farmer and it will deliver the package of practice for crop care to the contracted farmers.
- Quality specifications for crop procurement is also mentioned clearly in the contract, these are as following:
    - Moisture Content ≤ 12%
    - Weak and broken seeds ≤ 2%
    - Foreign matter ≤ 1%
- Farmer will supply quality produce at the place decided by PAFC/ UBL.
- Loading & transportation, quantity and quality of the produce will be the only responsibility of the farmer. If any loss will be due to this, farmer will be the only bearer of that loss.
- At the time of supply the produce will surely be free from any crop disease.
- The base price of Barley will remain 1050 Rs/quintal. If the market price will be higher then produce will be taken from the farmer on market price.
- PAFC/UBL will give the payment for the produce within three days of crop procurement.
- PAFC will be the mere arbitrator in case of any disobey of the contract conditions by any party. And its decision will be the final decision.
- In case of any dispute the case will be solved in Chandigarh court.

As compared to Markfed contract, UBL contract is better in terms of arbitration power. There, the main contractor company is keeping the sole power of arbitration in their own hands but in UBL case this power has been handed over to third party i.e. Punjab Agro Food Corporation. Though, farmers remain as one of the active party in every contract farming model but they have no role in deciding the terms and condition of the contract agreement. They don't even have stake in base price fixation, that also is decided by the contractor company itself.

3. CONCLUSION

By comparing different models of contract farming in Punjab, it can be concluded that, presently the contract farming mechanism of PepsiCo. is working efficiently. Reasons behind this, PepsiCo. is giving proper extension services to farmers and farmers also getting benefited from the exposure they provide in terms of new varieties of seeds, expert advice and technology. This can be attributed to the efficient field staff of PepsiCo. who monitor crop operation and production in entire area. After PepsiCo. Field Fresh model also shows good progress and it is becoming very popular among farmers as economic returns from baby corn are high in comparison of total investment. On the other hand, Markfed Model of involving a middleman is doing partial justice only, to the idea of promoting contract farming. Contract farmers who were associated with Markfed, admitted that they are not satisfied with the working style of Markfed. Moreover, they prefer doing contract with private companies than with govt. agency. Last but not the least, the tri-party model of UBL, PAFC and Farmers portray a picture of perfection but ground realities shows something else. The indirect involvement of middlemen is infecting this model. Due to middlemen, actual benefit of contract farming is not reaching in the hands of farmers. Farmers don't have enough resources to fulfil their agriculture and non agriculture needs, therefore they are not capable to get rid of the network of middlemen. This study reveals that the efficiency and commitment for work is more good in private companies than govt. agencies in the state.

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