

## **Annexure 1**

### **Basics of Contract Farming**

Contract farming essentially means growing Agri produce as per a written agreement between producers (individual farmer or farmer groups) and an institutional buyer (corporates, aggregator supplier to corporates) with agreed terms and conditions for the production and marketing of the agri-produce. In such an arrangement, the producers agree to cultivate, and market-agreed quantities of the agri-produce within the agreed time frame, compliant with agreed quality standards as described by the buyer. The buyer agrees to purchase the agri-produce and support the production process by streamlining the package of practices including the supply of farm inputs, land preparation, and technical support to producers, enabling them to grow agri-produce compliant with the buyer's requirements.

Existing examples of contract farming in India include large scale seed production by farmers and farmer groups, facilitated by National Seed Corporation, State Seed Corporations, and private sector seed companies; private sector players working with farmers to produce niche varieties of crops like Potato, Tomato, etc. suitable to buyer's quality standards and requirements. The new ordinance opens the existing gamut to a wider variety of crops such as cereals, coarse grains, pulses, oilseeds, fruits, vegetables, nuts, spices, and livestock sector – poultry, piggery, goatery, fishery, and dairy.

### **Benefits of Contract Farming & Responsibilities of Producers**

Contract farming has the potential to become an important tool to bring significant value in production systems adopted by small and marginal farmers, helping them stabilize their farm income. Because of the existence of the contractual agreement, one of the important benefits for farmers is assured buyback of agri-produce at an agreed price, resulting in minimal exposure to price volatility. The institutional buyer usually undertakes to buy back all produce grown, within specified quality and quantity parameters. Contract farming can also benefit farmers to access a wide range of farm services including technical support, farm management advice, and niche extension services specific to their farm. Financial inclusion is another important dimension that small and marginal farmers can leverage upon contract farming, by exploring possibilities to use the contract agreement as collateral for exploring agri-credit availability with lenders within the formal financial system. Similarly, some of the key benefits that Indian farmers can avail from contract farming are:

- Access to quality farm inputs and production services – supported by contract buyer
- Access to suitable technology – tailored to India's farming system and land holdings driven by buyer
- Improved access to farm credit – backed by the comfort of contractual agreement
- Minimized susceptibility to price volatility – through mutually agreed price structures
- Access to stable marketing channels – through long term relationship with buyers
- Support by Union and State Governments– enabling environment through a new ordinance

Much like the responsibilities of sponsors (that more often are a stronger party in such agreements), the producers share equal responsibility to follow the agreement terms. It is suggested that the terms of the contract should ideally undertake the practical situation on the ground and ensure suitable steps of fair contracting. Such practices are aimed at providing the producers enough time to understand and review the contract terms, seek advice, and understand their obligations as well as responsibilities. In the Indian context, it is observed that the inability to properly understand the obligations becomes a common factor for non-compliance, therefore the suitability of the contract between both parties can help to protect the interests on both sides by ensuring that the terms of the deal are well understood. For example, while the responsibilities of the buyer include honouring

the contract by paying the farmers agreed on price irrespective of the market price of the commodity, the producers also need to trust the premium and bonus payment mechanism of the contract, rather than selling the produce in the open market even if the open market price of the commodity is higher than contractual price. By mutually supporting each other, both parties stand to gain in long term and can build a lasting symbiotic relationship.

The government's ordinance brings a lot of clarity about the contract framework, responsibilities of the engaging parties, and facilitating various means for dispute resolution. Another component that could be added to increase the effectiveness and suitability of contracts is a defined risk management strategy in case of force majeure (such as weather extremities). A long-term relationship between buyers and producers can be achieved by creating a transparent and commercially viable contract for farming suitable to both parties. From the Indian perspective, such contracts should ideally be flexible and focus on clarity on parameters like:

- **Quantity** – specifying the minimum volumes of agri-produce
- **Quality** – details on various standards the produce needs to meet
- **Price** – a minimum price for produce meeting quality standards with compensation/premium structure built around market price fluctuations

### **Role of FPOs for Small and Marginal Indian Farmers to Get Into Contract Farming**

Agriculture is the important occupation of the Indian economy, engaging more than half of the population. Historically, there has been a strong correlation between the performance of the agriculture sector and the economy of India. The productivity of the agricultural sector can be a strong trigger for a high GDP growth rate. However, Indian agriculture is dominated by small and marginal farmers, highlighting many constraints that accentuate the non-suitability of Indian farmers at the individual level to get into contract farming. It is observed that often the livelihood of small and marginal farmers is highly dependent on a combination of multiple economic activities with agricultural systems, and often irregular and volatile streams of cash flows become a hindrance for these farmer's future adaptability and quality of life; thus makes them more vulnerable to non-compliance of agreed terms of contract farming.

Thus, established aggregation mechanisms such as Farmer Producer Organizations (FPOs), Producer Groups, Farmer Cooperatives, etc. can act as one of the most suitable vehicles to meet the buyback requirements of institutional buyers, by playing an important role of aggregator of the marketable agri-produce by the small and marginal farmer that fits the required stringent quality and quantity parameters set by the buyer.

It has been observed that the financial risk-taking abilities of small and marginal farmers are quite low, because of their vulnerability to income fluctuation happening because of the adoption of new practices. Contract farming is no different, therefore, there needs to be an agricultural extension framework in place to prepare Indian farmers for the long-term changes that the government's new ordinance can bring. There is existing personnel available on field level from implementing institutions, that with appropriate training, can play a significant role in such extension framework. Such extension staff can be from various resources including NABARD POPs, NGOs, private sector corporates with strong ground presence having regular interactions with farmers in their existing form – such as commodity traders, processors, aggregators, farm input companies, etc. The extension services can focus on promoting the ordinance and its benefits to farmers to producer groups, farmer cooperative societies, FPOs, etc. to increase the outreach of the message to the largest possible number of farmers; thus making the ordinance very effective in the implementation and supporting the sector through multiple dimensions.

## **Ways to Encourage Farmers towards Contract Farming**

Well-managed contract farming has the potential to bring high farm productivity and profitability for producers in India. However, in current form, Indian producers lack the right set of information to understand the contract farming and its benefits. Effective communication and utilization of technology to disseminate the right information about the Government's new ordinance and benefits to the farmers could open huge opportunities for the Indian agri-sector. Below are a couple of mediums through which this information could be communicated effectively.

- Creation of infographics, pamphlets, brochures, etc. about the ordinance and its benefits to farmers
- Creation of IEC (Information, Education, and Communication) tools for farmers to understand the policy, regulation, and mechanisms for contract farming
- Development of multi-media such as short 1-2 minutes video clips of farmers answering basic doubts, while interacting in local language
- Duly trained extension services personnel for on-ground interaction with farmer groups, FPO management to bring home the message
- Preparation of Frequently Asked Questions to represent farmer's queries – can be used by
- Webinars in regional languages
- Organization of promotion-oriented events/Kisan melas at the district level
- Media coverage in local newspapers, television programs, etc.

Another area to explore for promotion of the ordinance could be through ecosystem players that operate across the entire value chain of the agri-produce. Such ecosystem players can bring the ability to articulate the stringent requirements of the institutional buyers to producers and help them understand and adapt their farming practices suitable to the market requirements in the best possible ways. In this way, these ecosystem players could increase the effectiveness of the implementation on the ground and help the administration's efforts to make this campaign a success.

The key message and content of various mediums described in the list above should be carefully chosen and should focus on the benefits to the farmers, and the government's support mechanism to make this initiative successful. A successful promotion campaign on this ordinance can create a win-win situation for institutional buyers and small and marginal producers alike, by creating a mutually beneficial long term relationships between producers and consumers, while also increasing the farm productivity and profitability.