Indian agriculture, as it exists today, has come a long way from its hitherto image of being non-commercial and traditional in its methods of farming. With the increasing demand for value added and high quality niche products, Indian agriculture has been forced to step up and adopt commercially, technically and economically viable agribusiness solutions. Business and investment opportunities in this sector have suddenly jumped manifold. However, so far only a few successful efforts have been made by corporates to enter into the sector through contract farming. There is a pressing need to develop a structured approach for increasing the number of bankable agribusiness projects through private sector participation for better quality, increased quantity as well as better price realization for different stakeholders.

**What is Contract Farming?**

Contract farming in its simplest of definition is ‘an arrangement for the production and supply of agricultural/allied produce under advance contracts, with a commitment to provide a commodity of a particular type, at a particular time and price, and in the quantity required by a known buyer.’

There are three basic agreements that are formed under contract farming. The first agreement is the ‘Market Provision’ wherein the grower and buyer agree to terms and condition for the future sale and purchase of a crop or livestock product. Under the second agreement called the ‘Resource Provision’ the buyer agrees to supply selected inputs, including land preparation and technical advice on certain occasions. The third agreement is the ‘Management Provision/Specification’ under which the grower agrees to follow recommended production methods, input regimes, cultivation and harvesting specifications. Thus we see that though under contract farming the three major aspects of inputs, production and sale of produce is provided for, the issue of financing is not addressed fully.

**The Growing Need for Contract Farming and its Benefits**

Contract farming is perhaps the need of the hour in the Indian agricultural scenario due to the whole gamut of benefits it provides not only to the immediate parties involved but also to society as a whole. Contract farming would reduce the load on the central & state level procurement system by increasing private sector investment in agriculture. It would bring about a market focus in terms of crop selection by Indian farmers and generate a steady source of income at the individual farmer level. Contract farming would generate gainful employment in rural communities, particularly for small holders and landless agricultural labor and promote rural self-reliance in general by pooling locally available resources & expertise to meet new challenges.
Benefits to Farmers

- Obtain an assured up front price & market outlet for his produce
- Exposure to world class mechanized agro technology
- Technical advice, free of cost at his doorstep
- No requirement to grade fruit, as mandatory for fresh market sale
- Remunerative returns
- Crop monitoring on a regular basis
- Technical advice, free of cost at his doorstep
- Builds long term commitment
- Dedicated supplier base
- Protection from fluctuation in market pricing
- Generates goodwill for the organization
- Supplies offers
  ✓ Healthy disease free nursery
  ✓ Agricultural implements
  ✓ Technical bulletins etc

Benefits to Private Sector/ Company

- Uninterrupted & regular flow of raw material
- Long term planning made possible
- No requirement to grade fruit, as mandatory for fresh market sale
- Dedicated supplier base
- Protection from fluctuation in market pricing
- Generates goodwill for the organization

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One of the important results of contract farming would be the enhancement of processing & value addition and the integration of the Food Value Chain. This integration has been depicted in the diagram below with contract farming as an option to integrate this Chain.

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**Contract Farming and Small Holders**

Contract farming in India has so far mostly been with large farmers but we need to realize the importance of involving small holders in this system. The driving force behind this school of thought is that the Indian agricultural scene is dominated by a large number of small farmers and a limited number of large farmers. Further, the small farmers are less rigid and therefore easy to manage. Direct dealing with small farmers builds a corporate image with social appeal to large groups and also meets their objective of social empowerment and farmers’ upliftment. Moreover, it is easier to spread the risk of default across a large number of small farmers rather than a few large farmers.
Major Issues in Contract Farming

Even though the system of contract farming has a whole plethora of benefits, there are a number of issues that are faced in the implementation of contract farming. The need to contract with a larger number of farmers leads to an increased risk and high transaction cost of dealing. The lack of a comprehensive crop insurance scheme to protect against natural calamities implies that the farmer production risk is not shared. There is no credible enforcement mechanism in place that checks default by the companies or the farmers. Sometimes, the farmers may not provide the level of quality agreed upon or may delay their deliveries as well as the company may not provide appropriate extension facilities or delay payments. Moreover, the open market prices need not match the contract price which would result in one of the parties wanting to default. Natural calamities may result in seed/crop failures which would harm both parties. Thus there are a number of factors that arise from contract farming that need to be studied and addressed fully before contract farming can take off successfully in India.

Indian Experience

In India there have been quite a few initiatives that have taken off on contract farming lines. There have been different models of contract farming that have been adopted across regions, agencies and crops. In some cases the government has played a direct role (for example through Safal, NDDB etc) whereas there are other instances where the government has not been so directly involved. A number of private companies like Reliance, Pepsi Co and Pantaloons among others have already started contract farming projects in the various parts of the country.

Existing Role of Financial Institutions

Currently, the financial institutions are playing an important role in contracting and agricultural financing in India. On the contracting front, financial institutions provide production credit to the farmers due to the RBI’s Priority Lending Sector norms. These institutions also act as payment channels for companies and provide crop insurance products to the farmers.

On the agricultural financing front, banks offer various banking products such as warehouse receipt financing and commodity based financing for their clients (farmers). They also assess and evaluate the project viability. However, even though the financial institutions in India have started providing these facilities, there are a number of lacunas in the system which needs to be identified and dealt with.

The first setback, which is perhaps the biggest one, is the conservative approach of financial institutions towards agriculture. The primary reason behind lending to farmers is in order to meet the PSL targets. Agricultural financing is not treated as equivalent to other financing avenues like the manufacturing industries or the services sector. Due to this approach, the financial institutions tend not to provide their services to farmers at the same level of commitment and zeal as they do to their other customers. This has inadvertently led to
farmers not really benefiting from their products like crop insurance etc. Thus there is need to realize the increasing importance of agriculture and in particular contract farming which provides a channel to link up the financial sector with the farmers.

**Miles to Go**

There is the need for a new thinking to boost Indian agriculture with special focus on building capabilities and promoting investment. Technology enhancement with the focus on adoption of hi-tech production practices is needed. Further, the government R&D system needs to link up with private sector initiatives for better dissemination of new technologies to farmers.

Therefore, the “public private partnership” approach between private sector contract farming initiatives & Govt. Research infrastructure is becoming very crucial. Further, efforts should be made to link up the extension services provided by the private sector to public sector efforts.

**Building Blocks for Sustainable Contract Farming**

R&D activities, technology transfer and commercialization of agriculture are the three important building blocks for sustainable contract farming. The main activities under these are listed below.

**R & D Activities**

- Evaluation of promising varieties and hybrids
- Multi-locational trials and short-listing - selection
- Blueprint for agricultural practices after adapting to local conditions, to suit intellectual & financial means of the farmer
- Evaluation of farmer economics model
- Demonstration farming

**Technology Transfer**

- The extension services team - selection and training
- Farmer education program
- Field trials at farmer fields- multi-locational & crop timing

**Commercialization**

- Land preparation & planting,
- Crop monitoring during growing period
- Harvesting & procurement, transportation logistics
- Prompt farmer payment system

In the traditional model the objective of farming is food security whereas the involvement of the private sector is more in the processing to distribution of the produce as illustrated below.
Today, the objective of farming has changed towards market demand and with the changing movement towards a Value Delivery system, the involvement of the private player has changed more towards defining the value, providing the value and then communicating the value to the final customers. Therefore, the involvement of the private player has increased across the entire food value chain as depicted below due to which various models of contract farming have evolved and are being practiced in the country.

**Changing Roles**

With the fast changing roles of different stakeholders, the role of banks has also changed in the context of agriculture. Now, banking is beyond the traditional definition of lending and borrowing. The role of banks has changed to that of knowledge providers through the evolution of the concept of knowledge banking beyond the normal production financing and insurance products offered by the banks. Thus, banks are evolving knowledge based products for their customers across all sectors and agriculture has been one of the important sectors given the importance of RBI compliance of priority sector lending.

As the agriculture sector is subject to infrastructure and knowledge deficit, the emerging banks have the backing of knowledge experts from various sectors who are well equipped to provide the expert advice to the client and thereby helping them in choosing the viable investment option. In addition, the knowledge banking approach has provided the banks to assist farmers and agri-entrepreneurs by developing suitable bankable agribusiness projects through adequate private sector participation. Further, the knowledge banks also assist in assessing and evaluating project viability, risk assessment and necessary guidelines for adequate land use planning for the farming community.

This is as a result of the changed financing approach of bankers towards the sector whereby agricultural financing is being treated as an equivalent to other financing avenues. The role of Government is also very crucial in the overall process of contract farming. Development of a proper Institutional Mechanism/framework is very important to safeguard the interests of both farmers as well as corporates. There is the need for suitable laws of
contract/and an efficient legal system to execute a transparent, participatory, comprehensive and flexible contract. There is also the need to create awareness of unintended consequences of regulation and avoid the tendency to over-regulate.

An institutional arrangement to record/register all contractual arrangements to promote confidence between the parties and also help in solving any dispute, arising out of the violation of the contract needs to be put in place. Further, dispute settlement machinery - a single tier regulatory authority for contract farming at the district level should be in place for resolving any dispute and for contract enforcement.

**Mechanism for Developing Bankable Projects**

A project based approach in the rural sector will not only allow the micro sector (farmers-small holders) to link to the SME (agro processing) and large scale segment (through product off takes) but enhance the commercial bank financing to this sector. So far, commercial banks have ventured into agrarian financing only under the blanket of covering their priority sector lending requirements. But by developing viable projects, extending agricultural credit can be perceived as a profitable venture on a standalone basis by commercial banks with priority sector coverage giving additional returns. Under this framework (as depicted below), the micro sector stakeholders are linked together through a project.

**Figure: Mechanism of Developing the Bankable Projects**

Developing a viable and bankable project is the key to the successful implementation of the above model. This requires technical and financial expertise which is not in the skill set of
micro-stakeholders. Developing an SPV also involves a special activity set. Specialized knowledge banks have an in-depth understanding of the Indian agri sector as well as demand side linkages to national and international corporate level and should be actively involved in this process.

**Improved Model for Contract Farming**

Given below is an improved model of the contract farming system where the banks play a very crucial role of being the knowledge and debt providers and thereby knitting various stakeholders together for attaining the commercial objective.

**Improved Model of Contract Farming**

In the above mentioned model, the hi-tech agribusiness farm will assist in providing the quality planting material, R&D support and technology transfer to the farmers along with the requisite technical assistance. The farm will be established and facilitated by the private players. The private players will also contract with the farmers for the production as well as the marketing of the desired product.

Thus this model provides the use of innovative high technology in production, technical assistance along with well structured and customized financial products to the farmers.

**Suggestions**

There is a need to develop a **vision and implementation framework** for the **public private partnership framework** in Indian agriculture across the food value chain especially in the production front. Therefore, the following steps become crucial for the overall development of the Indian Agriculture.
• Developing proper PPP institutional mechanisms for contract farming
• Defining the commodities and area under contracting to avoid any sustainability issues
• Assisting in creating an appropriate legal framework
• Database development (Farmers, Crops, Pricing, Land Mapping – w.r.t Contracts)

Therefore, the future vision strategy is very crucial to set up for developing the proper mechanism for integrating the production potential and capacities with the marketing system.

2 YES BANK has been the advisor to the Government of West Bengal and successfully completed the Vision-2011 for the development of the state agricultural marketing systems.