Module 2: Best practice on “farm to factory” handling of grains

How food processing companies can contribute to farmers income increase - How to engage in a win-win relationship with farmers?

INCLUSIVE BUSINESS SWEDEN

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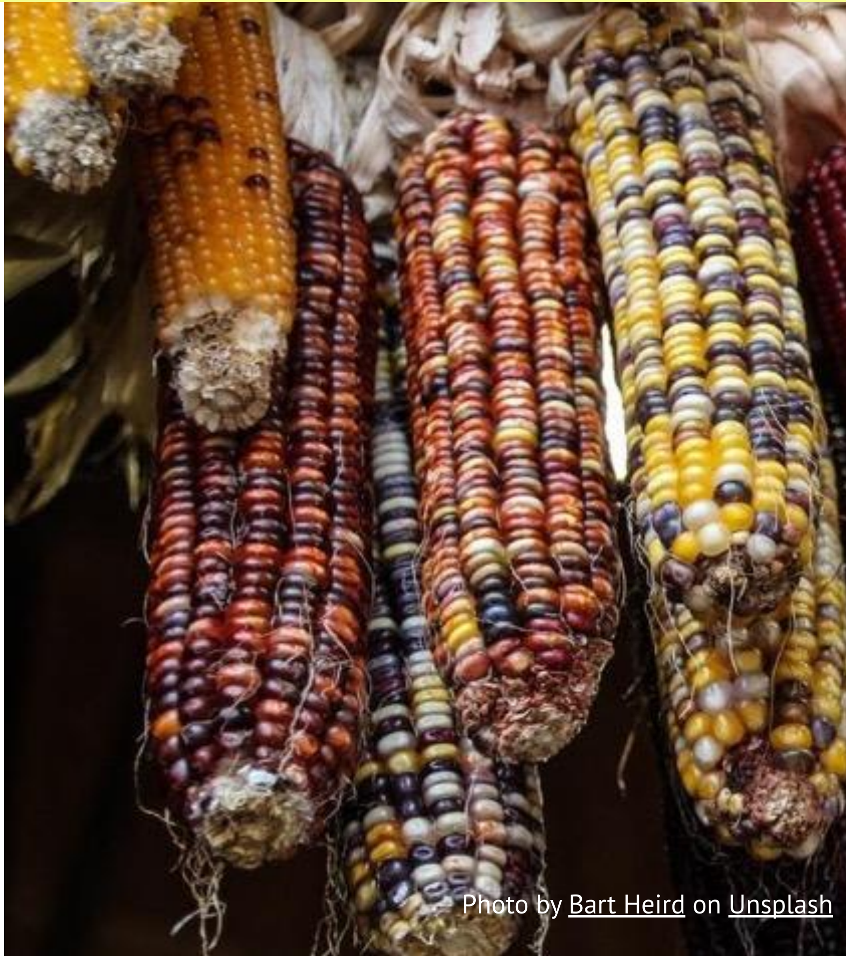
Engaging with farmers

In this presentation we will show some examples of how companies can engage with farmers for mutual benefit.

There are many ways on how this can be done. In this presentation we will focus on two proven methods that processing companies can readily implement:

- Contract farming or out-grower contracts
- Price arrangements



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Contract farming - Definition

Contract farming is defined as “an agreement between farmers and processing and/or marketing firms for the production and supply of agricultural products, frequently at predetermined prices”. Eaton and Shepherd (2001)

Contract farming links commercial and developmental objectives and is especially important when it comes to including smallholder farmers to market value chains. Globally, governments and development organizations support and encourage such arrangements as they increase both farmers’ income and the amount of agri produce and food products available in the market.

Contract farming - Roles

The role of the **processing company** is to buy the farmers usually under agreed conditions (agreed price, quantity, quality, etc.) and, to provide support during the production, in the form of:

- **Supply of quality inputs** such as seeds or organic fertilizers. This is usually done as a loan to farmers, by the processing company or a a third party.
- **Extension of service providers** such as access to Climate Smart equipment and practices.
- **Finance** to farmers either directly from the food company or through a third party for example a micro-finance institution.

Contract farming - Roles

The role of the **farmers or farmer's cooperative** is to:

- Ensure agreed **quantities**
- Ensure certain **quality** standards
- Provide products **on time**

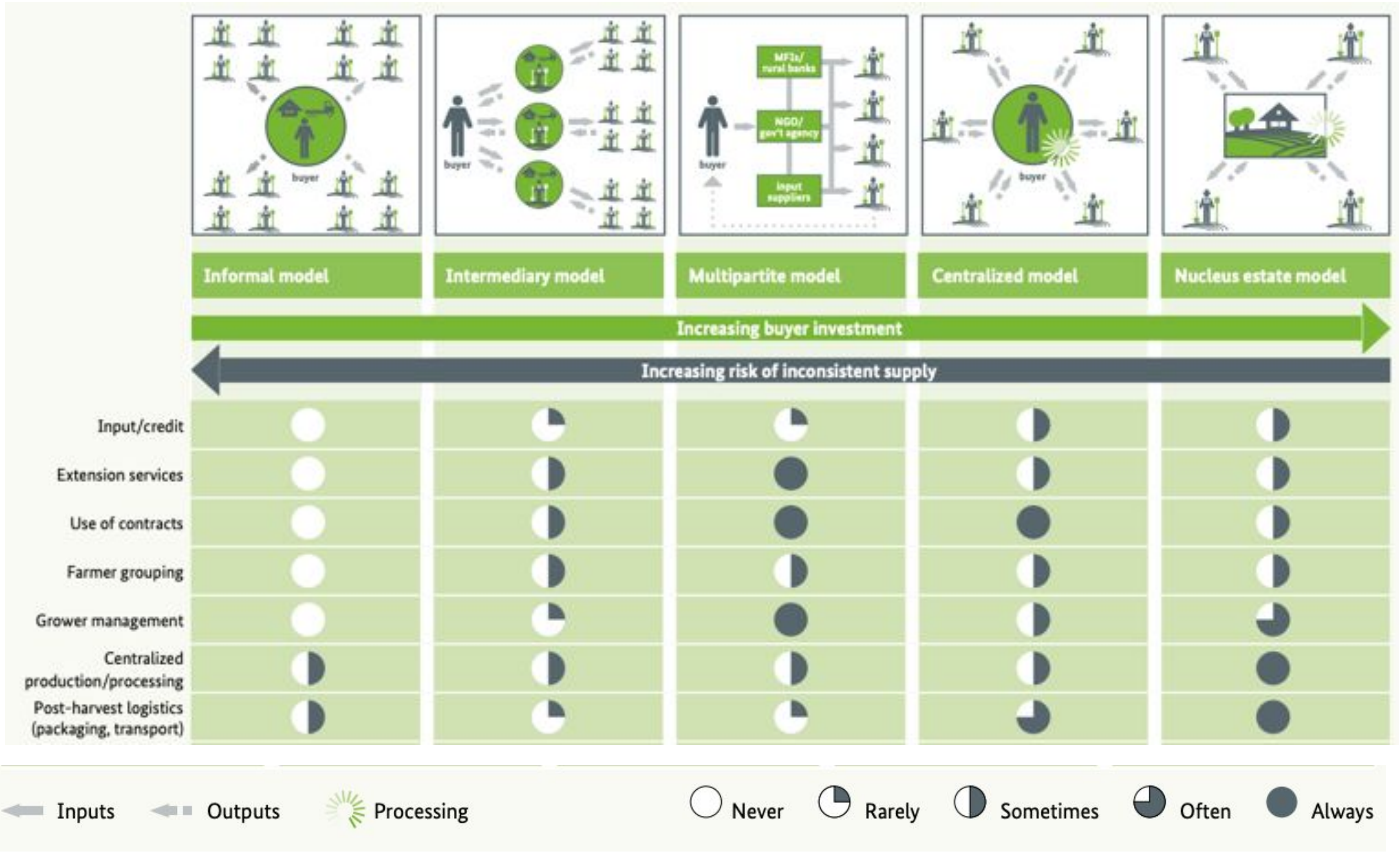
Read more: Eaton, C. and S. A. (2001). Contract farming: Partnership for Growth. http://www.fao.org/uploads/media/PSDA_CFKenyaSelectedVCs_Main Report_final.pdf

Photo on Unsplash

Contract farming - Models

- **The Nucleus Estate Model:** The food company provides all material and management inputs and also manages the estate or plantation. Company has its own field staff that manage smallholder farmer groups and purchases 100% yield.
- **The Centralised Model:** Similar to the nucleus estate model (company provides all material and management inputs) except the company does not manage the estate/plantation.
- **The Intermediary Model:** Involves a sponsor or middle man who provides linkage between farmer and company. – Contracts are generally established between company, intermediary (NGO, farmer groups, collectors) and farmers.
- **The Multipartite Model:** Involves a variety of partners, generally using a 3rd party organisation for credit provision, management, processing and marketing.
- **The Informal Model:** Contracts are informal and made on a seasonal basis. Material inputs are often restricted to the provision of seed and basic fertilizer.

Contract farming - Models

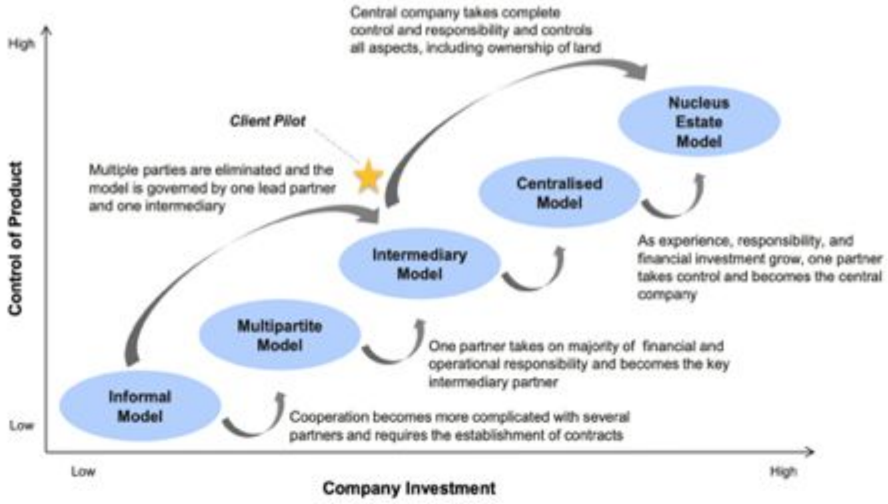


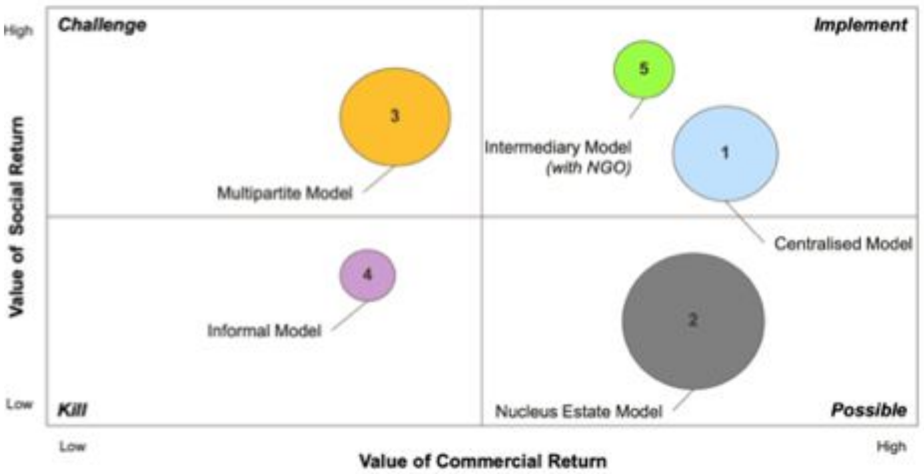
Source: Technoserve and IFAD, 2011, p.3 as cited in GIZ, n.d., page 19

Read more: GIZ. (n.d.). Contract farming handbook. https://europa.eu/capacity4dev/file/16814/download?token=3aWcRVTy

Contract farming - Models

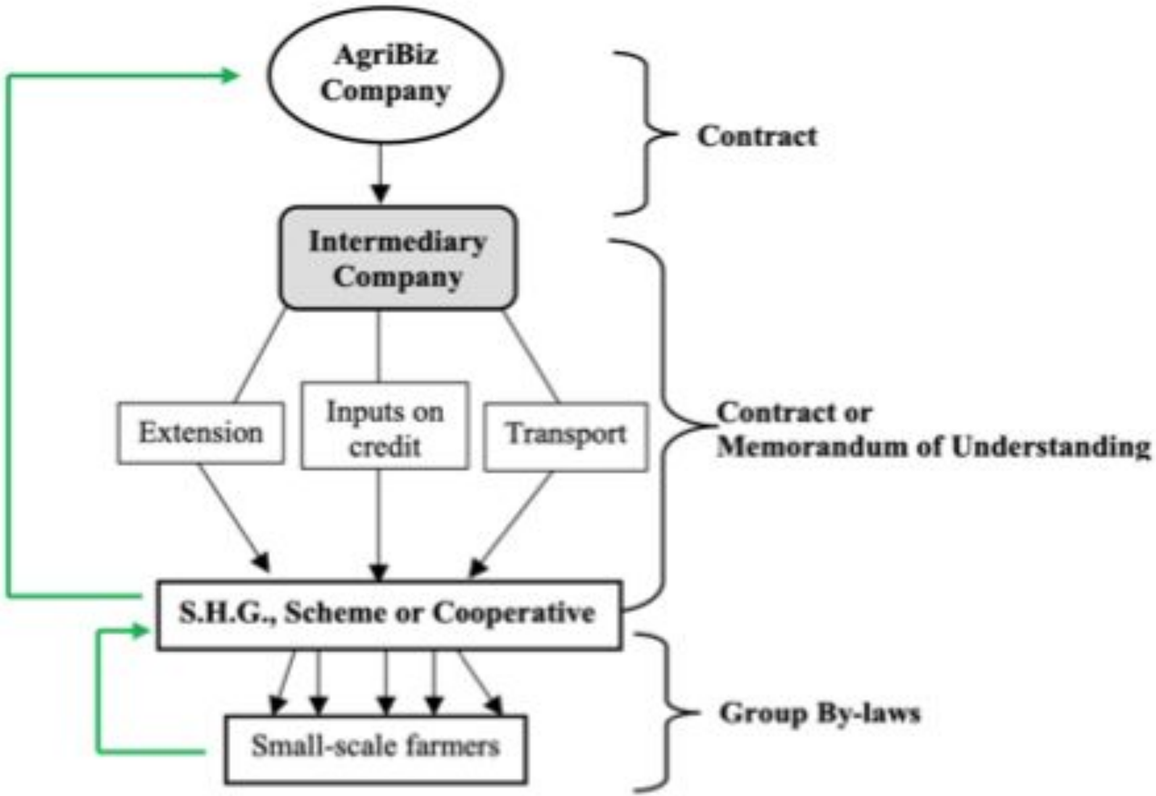
These two illustrations can help you to compare the different models and to find out which one would suit your company better





Source: Business Innovation Facility, 2012

Contract farming - Intermediary Model



Advantages:

- Company gains access to farmers and local inputs.
- Large opportunity for scalability.

Disadvantages:

- Model disconnects direct link between farmer and company.
- Model becomes overly reliant on the intermediary.

Source: FAO, 2006

Price arrangement - Definition

Pricing arrangements are often necessary to:

- Shield farmers from price volatility and stabilize farmers incomes.
- Ensure a fair distribution of margins along the value chain.
- Increase price levels for farmers and to provide a fair price for products.

“These arrangements can take a number of forms, but they generally involve a guaranteed minimum price that is either set by the government or negotiated by representatives of producers, as well as premiums for meeting quality and other standards.” (Farmer Income Lab, 2018)

Source: Farmer Income Lab, 2018

Photo on Unsplash

Price arrangement - Benefits

Pricing arrangements benefits are:

- Higher prices and less risk for farmers usually enables them to plan and invest in capital items and improved production technology.
- Higher investments in the farm result in improved production efficiency/yield and product quality.
- Higher net incomes leads to wealth accumulation, sustainable growth of farm businesses and improved livelihoods of smallholder farmers over time.

Source: Farmer Income Lab, 2018

Price arrangement - Benefits

“The combination of price setting, stabilization, supply chain transparency, and quality management system leads to high yields and high quality”

(Molenaar et al., 2017

Price arrangement - Mechanisms & Instruments

Price setting:

- Premium price - a higher than standard price for a good which is perceived to be of higher quality than standard.

- Floor or minimum price - the lowest price at which a product can be sold- with **supplementary payments -** payments that are additional to floor price.

- Price as a **share of the export price**.

- Price structure or formulas set by public interventions, public-private interventions or certification bodies.

Source: Farmer Income Lab, 2018

Read more: Molenaar, J. W., Vorley, B., & Blackmore, E. (2017). Reaching beyond the value chain: How sector governance can improve the performance of agricultural commodity sectors. Page 22-27

Price arrangement - Mechanisms & Instruments

Stabilization:

- **Price stabilization fund to compensate farmers** when, for example, the price is below the cost of production by more than an agreed percentage.
- **Price stabilization fund to compensate agro-processing companies** when, for example, companies paid a higher fixed price to farmers than the final market price.
- **Guaranteed purchase** means that farmers may sell their output at an established minimum price.

Source: Farmer Income Lab, 2018

Read more: Molenaar, J. W., Vorley, B., & Blackmore, E. (2017). Reaching beyond the value chain: How sector governance can improve the performance of agricultural commodity sectors. Page 22-27

Price arrangement - Recommendations

- **Calculate the price considering the economy of the smallholder farmer.** The price is not enough to ensure an increased income to farmers. A better indicator of increased incomes is the net income or profit of the farmer.
- **Increase negotiating power of farmers,** who can remain on disadvantage even when farmers are members of a price setting organization. It is essential for them to be able to benefit from price setting mechanisms.
- **Introduce a third party which is neutral.** While farmers seek to earn the highest price for their products, agribusiness companies would generally like to pay lower prices. Third party initiatives could take the role in distributing the margins in the sector.
- **Establish a direct and transparent trading relationshi**p that details the criteria for the price increases and the expectations of both buyer and supplier.
- **Time the announcement of the new prices**. As delays in price announcement have a negative impact on their income.

Source: Farmer Income Lab, 2018

In the following chapters of this module we will explore how food companies can integrate technical and managerial processes to produce affordable, tasty and nutritive food products.