

MARRYING FARMER COOPERATION AND CONTRACT FARMING FOR SERVICE PROVISION IN A LIBERALISING SUB-SAHARAN AFRICA

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The marriage of contract farming and farmer cooperation has the potential for increasing access to new market opportunities and services required to support smallholder intensification. Cooperation often works best where farmer groups are contractually linked to input and output markets. However, there are some constraints to the development of contract farming schemes, not least the risk that farmers will default, and the high costs of supervision. This paper explores ways of improving the performance of cooperation and contract farming, as well as the scope for linkages between them. It also discusses initiatives supporting the further development of the contract farming and cooperation approaches, and other means of providing improved services.

Policy conclusions

- Cooperation and contract farming can be effective ways of delivering agricultural services to smallholder farmers, enabling an intensification of production and diversification into more profitable cash crops.
- Contract farming is made difficult by default on credits provided for inputs and services. Poorer farmers may be excluded due to scale and quality considerations. However, agri-business is gradually developing innovations to meet these challenges for a range of different crops, and a number of 'best practice' principles are emerging. Governments can encourage initiatives by providing an enabling environment for private sector activities, including the provision of rural infrastructure. Donors have a role in collecting and disseminating experiences, and developing best practice guidelines.
- Cooperation tends to be most successful with small, cohesive, 'linkage-dependent' groups liaising with agri-business, for instance through improved access to services and increased negotiating strength. There is considerable scope for improving promotional strategies. Support for such groups (for example through training) is often more beneficial than that for 'linkage-independent groups'.
- Contract farming and cooperation often work best in tandem, with strong farmer groups linking to agri-business. Public policy and developmental initiatives to encourage linkages between farmers and agri-business include both direct and indirect support to smallholder market linkages and more general support to the smallholder sector. Direct support measures include the promotion of grassroots cooperation and facilitation by a specialised non-governmental organisation (NGO) increasing the business and technical skills of groups and developing good working relationships between groups and agri-business.

Introduction

One of Africa's main development challenges is the delivery of agricultural services (marketing, input supply, financing and other support) to smallholder farmers. Economic liberalisation and institutional reform have reduced and redefined the role of the state in service provision and the onus is now on the emerging private sector to provide production and marketing services. Better services are needed to increase production or arrest declining production of traditional smallholder crops and, where appropriate, to enable diversification into more profitable, high-value cash crops.

Over the last five years, the Natural Resources Institute (NRI) has carried out research in eight African countries to assess the viability of two approaches to improving agricultural service provision:

- Contract farming, otherwise known as outgrower schemes.
- Cooperation through formal cooperatives, farmer associations or groups, which are henceforth referred to collectively as Farmer-Controlled Enterprises (FCEs).

Contract farming refers to a range of initiatives taken by private agri-business companies to secure access to smallholder produce. Companies provide services to farmers and in return receive access to some or all of the farmers' produce. Schemes typically involve the provision of inputs (seed, fertilisers, and pesticides) on credit, often with extension advice, but may also include a range of other services such as ploughing and crop spraying. Costs are recouped when the produce is sold.

FCEs must be distinguished from the state-controlled cooperatives of the past. These failed to respond adequately to their members, performed poorly and were widely discredited, but now they are gradually being disbanded or

transformed into independent, member-run institutions. FCEs can reap benefits for members by achieving economies of scale for a range of activities, for instance by bulking up in output marketing or storage.

Contract farming and farmer cooperation are not mutually exclusive. When dealing with agri-business, the negotiating strength of a FCE is greater than that of individuals. Agri-business may also favour working with FCEs, since group liability for credit enables it to reduce lending risks while the scale economies involved may reduce transaction costs.

Contract farming

Research into contract farming included a desk review and fieldwork in Zambia, Zimbabwe and Uganda (Gordon and Goodland, forthcoming), covering a range of commodity sectors, particularly cotton, tobacco and high value horticulture for export. The potential of contract farming is threatened by two main problem areas: contract default and the scale of farmer operations.

Contract default

A company may break a contract with farmers, for example by failing to deliver inputs and services at the correct time, refusing to receive produce or arbitrarily raising quality standards. However the development of competitive output markets has shifted the balance of risk toward agri-business, and the latter now has a strong incentive to maintain good relations with smallholders, since this helps to secure future access to their produce. A key challenge for agri-business is how to overcome the threat of farmers defaulting on contracts.

Default can occur because of production failure or simply because farmers have sold the produce to competing buyers,

partly to avoid repaying the credits. The absence of strong legal systems, the lack of collateral held by smallholders, and weak insurance services, create considerable risk for companies entering into contracts. The problem of deliberate or 'strategic' default (Poulton et al., 1998) has been exacerbated where failure to recover earlier credit has created a lax atmosphere. The probability of default is greater with staple commodities and other crops for which there are many buyers.

However, agri-business is now actively innovating to reduce farmer default, and has developed a number of mechanisms for this purpose (Box 1), applied so far to relatively high value cash crops. There is a growing body of evidence that food crop productivity can be increased as a spin-off of well-conceived cash crop development (see Govereh et al., 1999).

Scale of farmer operations

Potentially high transaction costs in, for example, service delivery and monitoring tend to result in the exclusion of small farmers from contract farming. In Zimbabwe, it was estimated that in order to break even, a horticultural exporter might have to pay its smallholder suppliers less than 30% of the price paid to commercial farmers who delivered directly to a packing plant.

The production risks of smallholder cultivation may also be higher, especially on rain-fed marginal lands. Larger farmers may have better crop management skills and greater access

Box 1 Reducing farmer default

Lending through groups has several advantages. Peer pressure within the group screens out potential defaulters and can reduce the risk of default, particularly where the group has to put up some sort of joint collateral. This was the main rationale behind the use of groups by agribusiness in the Zimbabwe cotton sector. In addition, economies of scale can be realised in the delivery of services, thereby reducing costs. Farmers may also benefit by having a stronger hand in negotiations with companies.

Good communication and close monitoring of farmers – The need for good communication is a key lesson, since communication between agri-business and farmers is often weak. Group members can monitor each other, a particularly critical issue for export horticulture involving European markets, where there is a need to ensure quality and traceability of produce, and to prove due diligence throughout the chain. More generally, good communications help to foster good company-farmer relations and a sense of trust, which has a positive knock-on effect by reducing strategic default.

The range and quality of services offered – The better and broader the range of services offered, the closer the relationship between farmer and business, and the more the farmer stands to lose by breaking the relationship. Delivering timely services which respond to farmers' needs creates incentives for farmers to honour contracts. For example, input credit tends to be provided in kind to prevent credit being diverted to other expenditures. However, good performance in repaying in-kind loans can lead to cash loans being offered, as has happened in the Zimbabwe cotton sector, and in some of the stronger Kenyan dairy cooperatives

Incentives for repayment, and strict treatment of defaulters – Repayment rates in the cotton sector of Zimbabwe rose when incentives were applied together with asset seizure and group exclusion in the case of default. The case of tobacco in Uganda shows that legislation can be developed and enforced which, in theory, protects both parties in the contract and reduces the temptation for companies to take enforcement into their own hands.

Cooperation between buyers – This is not common, but potentially provides mutual benefits, either through agreement not to purchase from farmers under contract with other buyers, or, as in the Ugandan cotton sector, through joint operation of the scheme. Sharing information on defaulters is a further activity which would ultimately benefit all companies involved in contract farming, both within and across sectors.

to extension services, reducing the risk of crop failure. The Cottco scheme in Zimbabwe requires applicants to demonstrate that they can achieve a specified minimum yield before being accepted onto the scheme. This will tend to exclude weaker, smaller farmers.

Despite enjoying quality advantages (because of their intensive labour input) in the production of many horticultural products in recent years, there has been a tendency to exclude smallholders from outgrower schemes in export horticulture, due partly to difficulty in ensuring quality and traceability and partly to the difficulty of auditing and monitoring many dispersed farmers.

However, smallholders have been involved in contract farming in large numbers. In Zimbabwe over 50,000 now participate in the cotton sector alone, and a notable export horticultural scheme involves some 3000 farmers producing baby-corn on hand-watered micro-plots (initially 600 m² per farmer). Importantly, smallholders may be more willing to participate as they stand to benefit greatly, and therefore have a greater incentive to honour contracts and maintain contact with the company. Unfortunately farmers may also use the opportunity for strategic default. The onus is on the provider to anticipate situations in which this might arise (for instance, where a crop can be consumed on-farm or marketed locally), to put the necessary mechanisms in place to avoid it.

Farmer cooperation

Research into farmer cooperation focused on FCEs at the primary, grassroots level encompassing formal cooperatives registered under specific cooperative legislation and self-help groups (SHGs), which may or may not be registered and which are often formed under the auspices of a NGO or a development project. The research included:

- a desk review
- field studies in Ghana, Uganda, Zimbabwe, Mali and Burkina Faso, including case-studies of 18 FCEs reported to have performed successfully (Stringfellow et al., 1996)
- an investigation into the performance of pre-existing cooperatives and newly formed SHGs in the Kenyan dairy sector, under recent liberalisation (Morton et al., 1999)

This research identified key areas that affect the success of FCEs (Box 2). Cooperation was found to be generally most successful with small, cohesive groups involved in simple activities in liaison with agri-business and lenders.

Two types of successful FCEs were identified:

- The 'linkage-independent' group, which can stand alone in the market, and provide smallholders with sufficient market presence to seek out independent relationships with other market intermediaries.
- The 'linkage-dependent' group, having a long-term commitment to a particular service provider.

Linkage-independent FCEs are able to negotiate on behalf of their members to get the most competitive deal and are quite independent of any one buyer or supplier. The advantages of this type of FCE are independence and autonomy. The alternative of linkage-dependency has the advantage that the commercial partner has a strong vested interest in the FCE's survival and may provide assistance and support to the group to this end. In both cases, where the FCE is unskilled in business relationships the greater benefits may accrue to the processor or trader than the group.

The study identified some very serious efforts to promote sustainable FCEs as well as some weak initiatives that were likely to increase farmers' scepticism about the cooperative approach. Notable among the former were the efforts of cotton parastatals in Francophone countries in devolving input supply and procurement functions to Village Associations

which operated on a linkage-dependent basis, and the efforts of some NGOs seeking to build strong grassroots organisations. The negative findings related mainly to cases where FCEs were being formed on a large scale as part of development projects. Farmers were typically required to join a group in order to receive inputs that were donated or highly subsidised, thus attracting to the group those primarily interested in the subsidy.

Many programmes have promoted linkage-independent FCEs, whereas better results might often have been obtained by supporting linkage-dependent groups working in outgrower relationships with traders or processors. The advantage of the outgrower relationship is that it can enhance the FCE's sustainability and give it a strong business rationale.

Lessons from contract farming and cooperation

The private sector, both in the form of FCEs and conventional companies, may play a role in providing a range of services from input supply to crop assembly and marketing. Our research suggests that contract farming and farmer cooperation approaches often work best together, with strong grassroots linkage-dependent FCEs contracting with agri-businesses which supply them with a range of services, within a linkage-dependent outgrower framework. In contrast conventional cooperative systems involve the creation of vertically-integrated national organisations based on District Unions, Regional Unions and Apex bodies. Clearly there is no universal formula, but in many if not most cases, the division of functions presented here may provide the best overall mix in terms of equity, efficiency and dynamism.

When trying to involve smallholders in contract farming schemes, companies face several obstacles and public assistance may be called for to reduce associated risks and initial costs (for example through training in literacy or book-keeping or specific infrastructural investments). However, it is important to minimise any long-term dependency on subsidies.

Box 2 Features of successful FCEs

(1) The range of agricultural activities undertaken

- a close match between the activity and services and the group's experience and financial capacity
- generally involved in relatively simple marketing, input supply and credit operations involving liaison with market intermediaries higher up the marketing chain
- tend to begin with a single activity
- more complex operations, for example involving the operation of jointly owned fixed assets or processing often fail (with some significant exceptions in the case of women's groups)
- tend to concentrate on relatively high value produce (e.g. seed-maize, dried fruit, oil palm and cotton) rather than low-value staples

(2) Internal features

FCE structure

- generally built upon pre-existing organisations, where members already share considerable trust and familiarity
- tend to have a small membership, between ten and thirty members, of relatively homogeneous characteristics

Member control and participation

- a clear member-driven agenda, which tends to occur more in groups of small size
- strong democratic processes
- written constitutions and rules, and record keeping, assist in clarifying roles and enhancing transparency

Relationship to external agents

- absence of political patronage
- high degree of self-financing; successful cases were not associated with interest rate subsidies, but with viable business objectives which made subsidies unnecessary
- external training inputs, particularly when aimed at integrating the group into the wider economy through the development of links with financial and market intermediaries

The Kenyan dairy and Zimbabwean horticulture case studies suggested that there is a strong case for contracting NGOs to foster linkages between farmers and agri-business. But the NGO may be a less efficient provider than an agri-business that already has staff in the field and can cover its overheads. On the other hand NGOs may focus on longer-term capacity-building issues, such as training farmers:

- to bargain more effectively and exercise some choice over the business with whom they contract
- about the cyclical nature of product lifecycles, and the need this generates for savings and back-stop strategies
- to improve crop management skills, enhance the prospects of obtaining contracts from agri-business

However, the line between development and commercial objectives and outcomes is becoming hazy, given the increased profile of corporate social responsibility, particularly where public-private partnerships are involved. This may motivate business to address some wider social issues.

Bringing better services to smallholders

We now explore some initiatives supporting the further development of the contract farming and cooperation approaches, and other means of providing improved services.

a) Direct support to smallholder-market linkages

Promoting grassroots cooperation to access services

In the outgrower schemes promoted by the Fresh Produce Exporters' Association of Kenya (FPEAK), farmers are organised into small groups of 15 to 20 to obtain information, inputs, and technical and quality assistance. The groups are trained in integrated crop management systems, hygiene, pesticide use and record keeping, which are key concerns of the UK market. Such primary level organisations can moreover help farmers to respond to industry changes, and obtain access to finance and alternative market outlets.

A contrasting example is the NGO program, the Smallholder Agricultural Development Programme (SADP) in Malawi. SADP has followed the traditional cooperative route in promoting vertically integrated FCEs, without linkage to private sector buyers. However unlike the normal cooperative model, the primary group or club has been kept small at 10 to 30 members, along the lines research suggests to be optimal. These clubs are then federated upwards into local, regional and national associations. In this way the movement seeks to gain maximum economies of scale in hiring transport, in dealing at the tobacco auction and in other areas. It is possible that the small primary level groups will give the movement sufficient coherence to ensure long-term survival. On the other hand the speed with which the associations have been created could render them dependent on continued donor support. The effectiveness of the approach needs to be monitored over the long term.

Facilitation by a specialised NGO

In order to communicate effectively with small farmers and be credible to companies, NGOs need to be quite specialised in facilitating linkages, and have an understanding of business as well as skills in participatory development. In that way they can do much to motivate farmers, and help FCEs to develop the organisation, marketing and business skills they will need to link up with service providers.

The Cooperative League of the United States (CLUSA) and FAIDA, a Tanzanian NGO, are two noteworthy exponents of this approach. CLUSA has about 15 years' experience in Africa, supporting the development of a large number of FCEs in Niger, Mali, Cape Verde, Mozambique and Zambia. Using a bottom-up approach, it encourages farmers to develop

businesses of their choice, through associations and women's groups. Extensive training support is provided, particularly in functional literacy and basic business skills. Associations generally federate to gain negotiating power, and are assisted in linking with local agri-business and banks to access services.

FAIDA helps to facilitate negotiations and mediate in disputes between smallholders and agri-business and provides training in business and marketing to farmers, facilitating group formation and helping to ensure that farmers repay.

Lessons from such NGOs are not well disseminated, and there is a case for detailed study of their approaches.

b) General support to the smallholder sector

Infrastructure

In many places smallholder participation in private sector linkages is constrained by poor infrastructure, such as rural roads and telecommunications. For example, supermarkets' concerns about hygiene have served to exclude many smallholders and so public investment in hygienic water supplies, toilets and irrigation may help them to access profitable markets.

Sub-sectoral collaboration

Through coordinated efforts stakeholders can mobilise attention and resources to address critical bottlenecks and opportunities. A sub-sectoral industry forum for collaboration has been recommended for the Kenyan dairy sector including key stakeholders such as milk processing companies, farmers' organisations, relevant government departments, research organisations, donors and NGOs.

c) Indirect support

Development of periodic rural assembly markets

In many cases the simplest way to develop market linkages may be to encourage the development of these markets, bringing the service providers closer to the farmers on a given 'market' day. Costs are likely to be minimal. An interesting example is where a rural community in Angonia District in Mozambique, promoted by World Vision, announced a market day. The market was well attended, with large numbers of traders arriving from Malawi, and became a regular feature.

The main limitation of this approach is that transactions are usually on a cash basis, so it does not (at least in the short term) give rise to the interlocking of input supply and marketing services.

Supporting small-scale local service providers

An example of support for local service providers is the CARE Zimbabwe AGENT Programme that assists local level input retailers to increase the availability of affordable inputs at the local level. Credit is targeted at nominated local input suppliers, typically small-scale village level retailers who are then trained in input handling, marketing, finance and bookkeeping. The trained retailers order inputs from CARE, which negotiates prices and terms with regional suppliers. Current performance of the programme is encouraging. In its first year (1996/97) about Z\$4 million worth of inputs were sold to farmers, and 95% of payments were made on time (Mahove, 1999). The hope is that after two years of good performance, agents will be able to graduate and deal directly with the suppliers, but this remains to be proved.

Some private distributors have recognised the particular needs of smallholders. For example, Agricura in Zimbabwe produces and distributes agro-chemicals, primarily pesticides, and has tailored its operations to cater to their needs. Twenty-three depots are located around the country, and at each are

based a number of Agricura representatives. Each manages a number of coordinators responsible for mobilising smallholders into groups, having recognised that dealing directly with individual smallholders is too costly, considering the small quantities of agro-chemicals demanded. These take orders and then organise group field days for input delivery and advice. This is a relatively new programme, but it demonstrates how private initiative will sometimes address smallholder needs unaided.

Legislation on contracts

The development of legislation to cover contracts between smallholders and service providers may help to protect small farmers and minimise the risks incurred by businesses. An example of this is in the tobacco sector in Uganda where an amendment to the Tobacco Law has been made to protect both tobacco companies and growers. To take advantage of this, farmers must have good access to the legal system. Even where they do not, political realities and corporate image will often protect farmers to some extent.

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