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Strengthening value chains in Africa: conditions for sustainable contractual arrangements

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Africa continues to suffer from extreme poverty and malnutrition and the agri-food sector faces numerous challenges. Contract farming can boost value chain efficiency by enhancing coordination between stakeholders but a number of conditions must be met before it can drive sustainable development.

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Sub-Saharan countries face daunting challenges that include eradicating the extreme poverty in which 40% of its people still live, feeding a population that is set to double over the next 25 years as nearly a quarter of people continue to suffer from food insecurity and yields remain under constant threat from climate change, and finding jobs for the millions of young people arriving on the jobs market. Agri-business can play a decisive role in meeting these challenges and achieving the UN's Sustainable Development Goals (SDGs). Indeed, most of Africa's poorest people live in rural areas and depend either directly or indirectly on agriculture. There is massive potential for boosting agricultural productivity which is considerably below that observed in other parts of the world. Lastly, agri-food upstream and downstream industries and services constitute largely untapped sources of jobs.

Massive opportunities

Given this context, contract farming – which aims to enhance coordination between stakeholders in the sector – provides massive potential opportunities. It can boost value chain efficiency by reducing transaction costs, ensuring a better fit between supply and demand on agri-food markets (in terms of quantity, quality and flows of goods), reducing post-harvest losses and improving food safety management. The related arrangements are many and varied.

The diversity of contractual arrangements

Contractualisation is an intermediate solution for coordinating the market that lies somewhere between spot transactions and vertically integrating stakeholders in the sector. Based on Rehber’s 2007 definition, a contract is a contractual arrangement between farmers and other firms, whether oral or written, specifying one or more conditions of production, and one or more conditions of marketing, for an agricultural product, which is non-transferable. Based on this definition, a contract does not necessarily involve setting a price. Typically, we distinguish between marketing and production contracts. Marketing contracts cover quantity, quality, delivery date and possibly production price. Production contracts cover the supply by the buyer of inputs (seeds, fertiliser, etc.) and possibly services (technical assistance, insurance, etc.). Production belongs to the company and the farmer is paid a fixed fee plus a quality premium. In practice, contracts come in many different forms and can be hybrids of these two types.

Contracts give farmers better access to inputs (which are generally paid for in kind), mechanised processes and credit as well as better market access, thus alleviating the structural deficiencies of African economies. They also enable businesses to safeguard their supplies so that they can meet the burgeoning demand from cities more effectively. Therefore, because it also includes more effective arrangements for managing price risk , contractualisation helps to grow incomes, investment, competitiveness and jobs. Stakeholders become more inter-dependent and they are encouraged to leave the informal economy and open bank accounts. While these are all considerable advantages, we need to distinguish between theory and practice and the situation on the ground is a little more complex.

The limits of contracts

Despite all of its benefits, with the exception of traditional exports (i.e., cotton, coffee, coco, etc.), contractual farming is still not very widespread Africa. It has struggled to make inroads into the internal market (barely 10% of rice production in the Senegal River Valley) and this raises a number of issues. First, although economic research credits it with boosting farming incomes considerably, this is not always borne out in practice. A recent study in Ghana reveals that corn growers under contract are failing to offset the increase in production costs caused by greater use of external inputs. In brief, the advantages of contractual arrangements vary greatly depending on what is being produced and the different contexts . Also, contract farming is fraught with risk: smallholders may be excluded because of the extra transaction costs they generate for businesses. Indeed, businesses wield greater market power and are often able to force farmers to accept unfavourable purchase terms. Lastly, contractual arrangements may entrench unsustainable production methods if buyers insist on conditions that potentially impair soil fertility, human health or the environment, or if they fail to oversee adequate use of inputs by producers. Conversely, contract-based production may encourage farmers to improve their processes if businesses vaunt such practices when communicating with receptive consumers or if stricter standards force them to.

So we really need to ask what conditions are needed to make contract farming work properly. A recent report from the FARM Foundation stresses the need to build trust between farmers and businesses and this means proactive two-way communication between stakeholders. But this is not enough on its own and other avenues described below also need to be explored.

Enhancing contracts with services

Obviously, complying with the terms of the contract is an essential pre-condition: businesses vis-à-vis producers and vice-versa (i.e., supplying quality inputs – if such an arrangement exists – on a timely basis and prompt payment on the part of farmers). When market prices rise beyond the pre-agreed price, producers often decide to sell to another buyer. Businesses could choose to sue the producer but the court case would probably be long and costly and would not be an optimal solution. To foster loyalty among farmers, it is better to include payment of a bonus or access to a wide range of services (i.e., inputs, technical assistance, climate insurance, etc.) as part of the contract. For sure, these options come at a cost and are not accessible to all businesses.

Creating and sharing value

Certification (of quality, production methods, fair prices for producers, etc.) is one of the preferred ways of creating and sharing value within a given sector. It provides farmers with better pay and access to higher value markets, and consumers with a guarantee that more rigorous environmental and social standards are being complied with. Moreover, the involvement of competent producer organisations capable of wielding market power is likely to improve contractual terms in favour of farmers simply because organising producers into a single point of contact actually provides a service to businesses.

Giving priority to flexibility

Most farmers and businesses wish to keep some room for manoeuvre in their selling and supply strategies due in particular to the volatility of agricultural prices so they generally combine spot market transactions with contractual arrangements. Similarly, certain contracts deliberately exclude setting prices. For example, in Benin, Tolaro Global only requires cashew growers to make them a first offer. Contract flexibility also makes it possible to share value more effectively with farmers and to foster their loyalty by offering them price supplements when prices rise. In this as in many other areas, digital solutions such as the N’kalô service proposed by Nitidae prove to be very useful .

The role of public policy

Governments and financial backers have a crucial role to play in helping to deploy contractual arrangements and making them more effective and inclusive. First, farmers will be less dependent on the contracting companies to obtain their inputs and sell their production if governments can ensure market effectiveness and transparency (notably through a robust competition policy) and provide the goods and services (i.e., infrastructure, social security, etc.) not provided by these companies – or not provided to all producers.

Second, public intervention is needed, especially to create a regulatory framework suited to contractual arrangements and resolving litigation, guaranteeing farmers’ land rights and implementing the social, health and environmental standards needed to drive sustainable development. The major constraint of poor access to credit for farmers and SMEs needs to be alleviated by public guarantees and help with developing risk management solutions (i.e., futures markets, climate insurance, etc.). Emerging channels frequently require carefully targeted protection against cut price imports.

Finally, in the interests of economic efficiency and social inclusion, the professionnalisation of producer organisations needs to be encouraged through training and consultation bodies such as inter-branch organisations. As we can see, a lot of different actions need to be taken before contractual arrangements can realise their full potential.

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Footnotes:
1 The different types of contract handle price risk in different ways (see insert).
2 A detailed analysis of contract farming impact assessments shows that they lead to numerous distortions that frequently make it very hard to distinguish between correlation and causality. See Bellemare, M.F., and J.R. Bloem, 2018, Contract Farming: A Review, Working Paper, University of Minnesota.
3 Contractualiser avec les agriculteurs en Afrique, June 2018, available atwww.fondation-farm.org.
4 N’kalô, a service offered by the Nitidae association, provides subscribers with market information on several. different agricultural sectors. A complementary service called n’kalô Partage helps secure contracts in a fully transparent manner and adjust prices paid to producers based on changing prices. Basically, the producer uses a digital app to commit to selling part of their harvest to a given processing business on a given date. In exchange, after the end of the campaign, the buyer undertakes to pay over to the producer the difference between the price actually paid and the best price achieved during the campaign, for half of the quantities delivered.