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Knowledge and Action
Fostering Advances in Agriculture

Contract Farming in Jordan

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1. Introduction

Contract farming has been in existence for many years as a means of organizing the commercial agricultural production of both large-scale and small-scale farmers. Interest in this type of agricultural marketing continues to expand. Changes in consumption habits, such as the increasing number of fast-food outlets, the growing role played by supermarkets in many countries, and the continued expansion of world trade in fresh and processed products; have also provided the impetus for further development of this mode of production/marketing.

In an age of market liberalization, globalization and expanding agribusiness, there is a danger that small-scale farmers will find difficulty in fully participating in the market economy. In many countries such farmers could become marginalized as larger farms become increasingly necessary for a profitable operation. A consequence of this will be a continuation of the drift of populations to urban areas that is being witnessed almost everywhere.

Attempts by governments and development agencies to arrest this drift have tended to emphasize the identification of “income generation” activities for rural people. Unfortunately there is relatively little evidence that such attempts have borne fruit. This is largely because the necessary backward and forward market linkages are rarely in place, i.e. rural farmers and small-scale entrepreneurs lack both reliable and cost-efficient inputs such as extension advice, mechanization services, seeds, fertilizers and credit, and guaranteed and profitable markets for their output. Well-organized contract farming does, however, provide such linkages, and would appear to offer an important way in which smaller producers can farm in a commercial manner. Similarly, it also provides investors with the opportunity to guarantee a reliable source of supply, from the perspectives of both quantity and quality.

Contract farming can be defined as an agreement between farmers and processing and/or marketing firms for the production and supply of agricultural products under forward agreements, frequently at predetermined prices. The arrangement also invariably involves the purchaser in providing a degree of production support through, for example, the supply of inputs and the provision of technical advice. The basis of such arrangements is a commitment on the part of the farmer to provide a specific commodity in quantities and at quality standards determined by the purchaser and a commitment on the part of the company to support the farmer’s production and to purchase the commodity.

The intensity of the contractual arrangement varies according to the depth and complexity of the provisions in each of the following three areas:

- **Market provision:** The grower and buyer agree to terms and conditions for the future sale and purchase of a crop or livestock product;
- **Resource provision**: In conjunction with the marketing arrangements the buyer agrees to supply selected inputs, including on occasions land preparation and technical advice;
- **Management specifications:** The grower agrees to follow recommended production methods, inputs regimes, and cultivation and harvesting specifications.

The contract farming system should be seen as a partnership between agribusiness and farmers. To be successful it requires a long-term commitment from both parties. Exploitative arrangements by managers are likely to have only a limited duration and can jeopardize agribusiness investments. Similarly, farmers need to consider that honoring contractual arrangements is likely to be to their long-term benefit.

2. Advantages and Problems of Contract Farming

2.1 Advantages

First: Advantages for farmers

- *Inputs and production services are often supplied by the sponsor*
- *This is usually done on credit through advances from the sponsor*
- *Contract farming often introduces new technology and also*
- *Farmers' price risk is often reduced as many contracts specify*
- *Contract farming can open up new markets which would*
- *otherwise be unavailable to small farmers*

Second: Advantages for Sponsors

- *Contract farming with small farmers is more politically acceptable than, for example, production on estates*
- *Working with small farmers overcomes land constraints*
- *Production is more reliable than open-market purchases and the sponsoring company faces less risk by not being responsible for production*
- *More consistent quality can be obtained than if purchases were made on the open market*

2.2 Problems

First: Problems Faced by Farmers

- *Particularly when growing new crops, farmers face the risks of both market failure and production problems*
- *Inefficient management or marketing problems can mean that quotas are manipulated so that not all contracted production is purchased*
- *Sponsoring companies may be unreliable or exploit a monopoly position*
- *The staff of sponsoring organizations may be corrupt, particularly in the allocation of quotas*
- *Farmers may become indebted because of production problems and excessive advances*

Second: Problems Faced by Sponsors

- *Contracted farmers may face land constraints due to a lack of security of tenure, thus jeopardizing sustainable long-term operations*
- *Social and cultural constraints may affect farmers' ability to produce to managers' specifications*

- *Poor management and lack of consultation with farmers may lead to farmer discontent*
- *Farmers may sell outside the contract (extra-contractual marketing) thereby reducing processing factory throughput*
- *Farmers may divert inputs supplied on credit to other purposes thereby reducing yields*

3. Types of Contract Farming

Contract farming usually follows one of five broad models, depending on the product, the resources of the sponsor and the intensity of the relationship between farmer and sponsor that is necessary.

3.1 The Centralized Model

- Involves a centralized processor and/or packer buying from a large number of small farmers
- Is used for tree crops, annual crops, poultry, and dairy. Also products often require a high degree of processing, such as tea or vegetables for canning or freezing
- Is vertically coordinated, with quota allocation and tight quality control
- Sponsors' involvement in production varies from minimal input provision to the opposite extreme where the sponsor takes control of most production aspects

3.2 The Nucleus Estate Model

- Is a variation of the centralized model where the sponsor also manages a central estate or plantation
- The central estate is usually used to guarantee throughput for the processing plant but is sometimes used only for research or breeding purposes
- Is often used with resettlement or transmigration schemes
- Involves a significant provision of material and management inputs

3.3 The Multipartite Model

- May involve a variety of organizations, frequently including statutory bodies
- Can develop from the centralized or nucleus estate models, e.g. through the organization of farmers into cooperatives or the involvement of a financial institution

3.4 The Informal Model

- Is characterized by individual entrepreneurs or small companies
- Involves informal production contracts, usually on a seasonal basis
- Often requires government support services such as research and extension

4. Past Experience in Contract Farming in Jordan

It should be noticed that most of contacts with farmers are verbal, which make them un-binding for the two parties.

4.1 Contracts for Local Market

Since farmers need some kind of finance to cultivate their lands, they try to get this finance from two sources:

A. **Formal credit institutions:** Mainly from the Agricultural Credit Corporation (ACC), since all farmers who own land and have adequate collateral are eligible for getting loans from ACC. Very few large farmers can get loans from the commercial banks. These loans are seasonal or short term.
B. **Commission Agents and Traders:** The farmers can get loans, in kind or money, at the beginning of the cultivation season from commission agents or traders through a verbal contract conditioned that the farmer should send his produce to the contracted commission agents in the central markets. The latter group gets back the value of the loan and a commission of 5% of the value of the produce. Most of the farmers fulfill their obligations because they need to be refinanced in the next season unless the prices are low and do not cover the loan.

4.2 Contracts for Export Markets

4.2.1 The Jordan Agricultural Exports Project

The "Jordan Agricultural Exports Project" financed by the World Bank and the government of Jordan, suggested a type of exporter-farmer relationship called "Export Farm", sometimes called Satellite farm. A summary of this project is presented in this section.

A. The Approach

The proposed approach to the establishment of an export system of quality agricultural produce from Jordan is based on the establishment of two types of bodies, namely, business agencies and supporting systems. The business agencies will be private export-oriented farms which will engage in the production and marketing of quality agricultural produce. The support systems will supply those needs which are not expected to be met within the business framework, such as training of managerial staff, provision of marketing information, and logistical coordination.[1]

[1] For more detailed discussion kindly refer to the report titled "Jordan Agricultural Development Project" Prepared by the World Bank Mission.

In general, the intervention of the World Bank in the establishment and management of the support systems appears to be an essential requirement for generating the necessary confidence and co-operation between these systems and the export farmers.

Thus the strategy proposed in preference is based on the establishment of business agencies charged with the task of developing agricultural production systems, providing for the transfer of agricultural know-how (including plant protection), establishing the means and facilities for handling produce, and establishing a marketing system directed to quality markets. Assistance in the development of these systems would be provided by experienced professional staff.

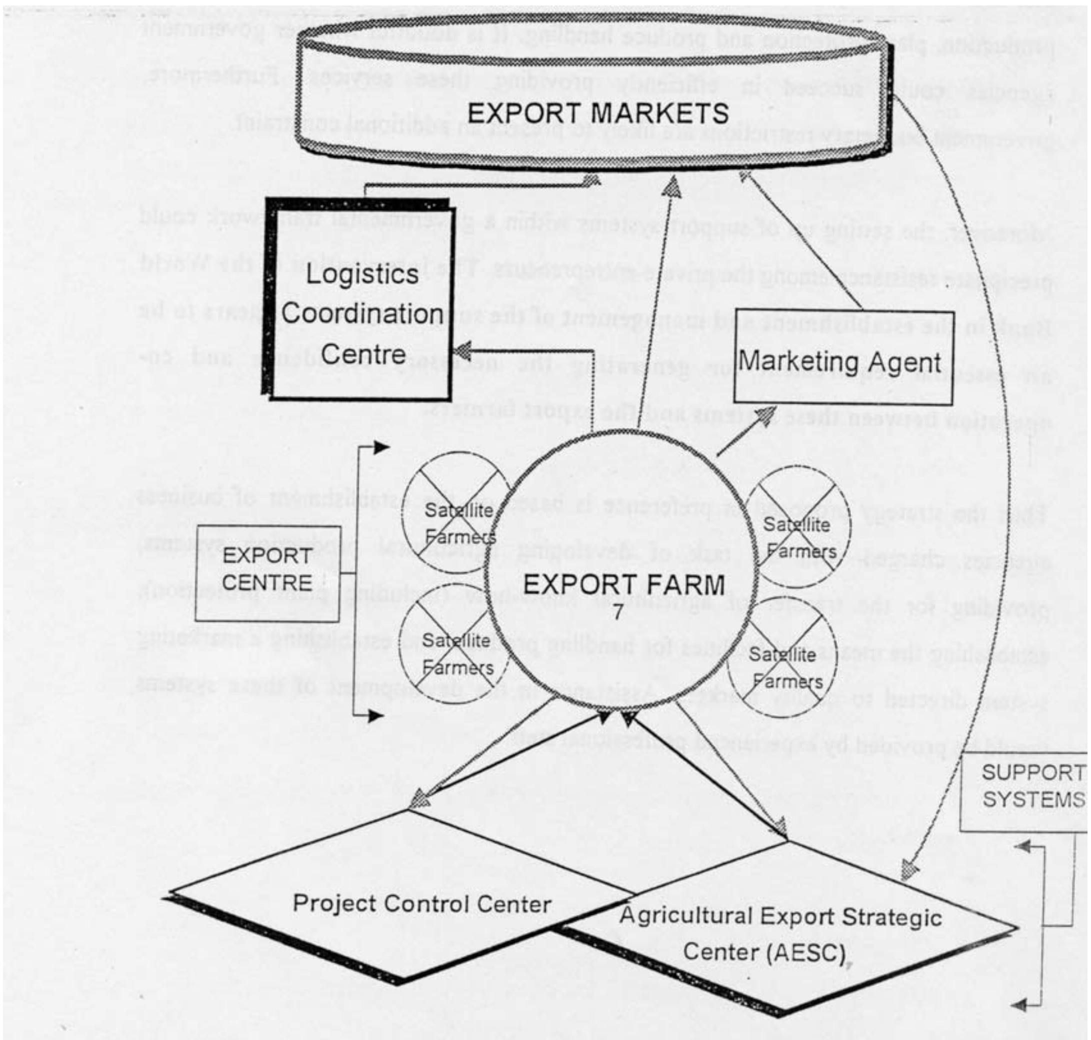

Fig. 1: The Proposed Conceptual Structure

C. Components of the Export Farm (Satellite Farming)

These are as follows:

- Production sources of a high quality and wide range of crops;
- A team specializing in the production technologies of quality produce, including plant protection;
- Post harvest systems for fruits and vegetables;
- A marketing and logistic system for export of the quality produce;
- A system of liaison with international marketing companies having a purchasing scope sufficient to ensure receipt of orders prior to the beginning of the season:
- A system of contacts with farmers in the area (hereinafter referred to as satellite farmers) aimed at increasing the amount and variety of produce available for export by purchasing their production;
- An extension system to provide the services needed by the satellite farmers so as to enable them to obtain the required produce quality;
- Secondary centers in different climatic regions which will enable lengthening of the marketing season and an increase in the quantities exported.

Each export farm will be large enough to enable independent operation and will be established by private entrepreneurs, where part of the capital required for farm establishment will be in the form of commercial loans from a special line of credit financed by a World Bank loan. This assistance will be designed to act as an incentive for the export farmers to purchase and market quality produce from the satellite farmers. In this manner, the spread of quality export crop production to a greater number of farmers will be made possible, with the advantage to these farmers of the higher profits entailed.

The export farms to be established will operate according to business considerations. For this reason there are fears that short-term considerations may influence their decision-making. In order to assist in internalizing long-term considerations, and to respond to potential market obstacles, for which the business system is not expected to provide optimal solutions, it is proposed that a number of support systems be established. These support systems will be centralized and will include a 'Project Control Center', an 'Agricultural Export Strategic Center' (AESC), and a 'Logistic Coordination Center'. Their functions are outlined below.

a. Project Control Center

The function of the Project Control Center will be to inspect and approve the plans of the entrepreneurs and the stages of project implementation supported by the sponsoring institution, ensuring they correspond to the proposed content and implementation principles of the project.

b. The Agricultural Export Strategic Center (AESC)

This center will deal with a study of the market, mainly through market surveys and collection of information from various sources. It will be part of the Strategic Center's responsibilities to gather and disseminate information on the best crop mix selections from year to year. It will also assist in guiding development of new products based on market requirements. The information collected and processed by the AESC will be made available to the export farms. This unit will also be responsible for follow-up of the implementation of the managerial training program.

c. The Logistic Coordination Center

This unit will deal with the technical co-ordination of the various logistical aspects, such as timing of deliveries and loading of produce at the different export ports, particularly Amman Airport.

D. The Business Agencies - The Export Farms

a. The Production System

The proposed export farms will have a minimum size and will be worked according to advanced crop growing technologies and according to the basket of crops to be selected. The farms will grow vegetables, flowers and orchard fruits. Vegetables and flowers will be grown in open fields and under covered structures, such as walk-in tunnels and high greenhouses, according to the selected crop mix. Orchard fruits will be grown in open fields.

The minimum size of the export farm will be determined on the basis of the economic feasibility threshold and will be dependent on the crop mix; the minimum size is 150 dunums. The growing methods and type of product strongly influence the scope of investments and the expected return per dunum of cultivated land. For this reason it is not possible to compare one dunum of high greenhouses to a dunum of orchards or vegetables grown in open fields.

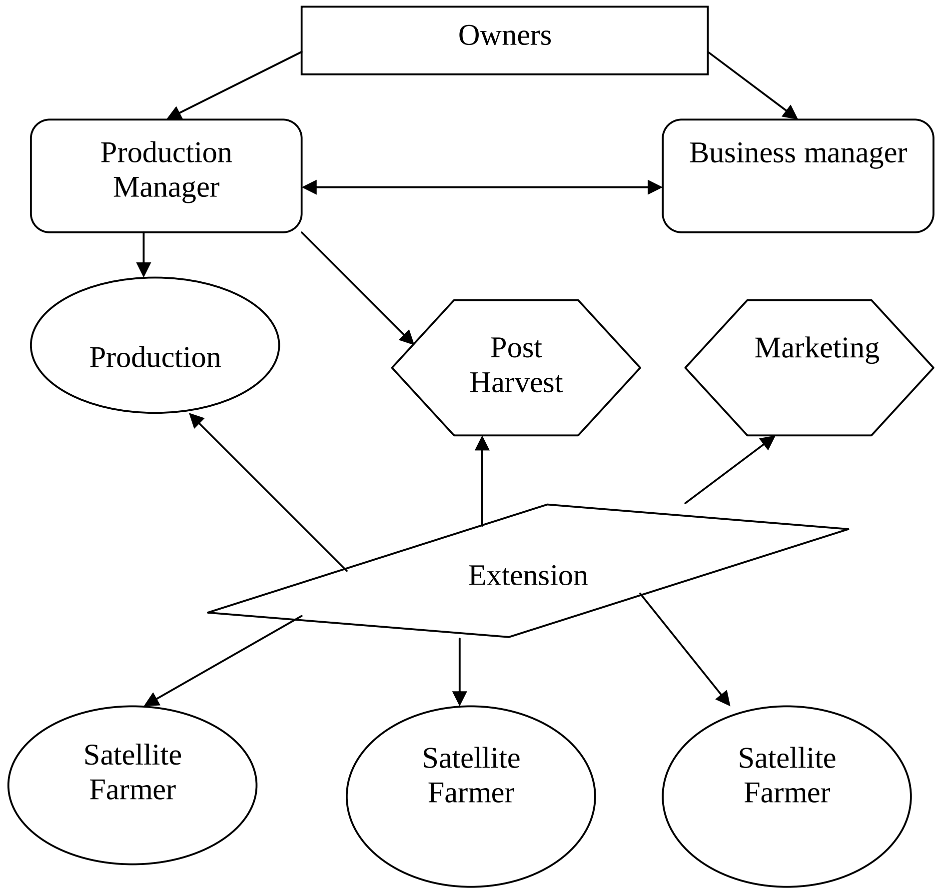

Figure 2. The Export Center

b. Market and Brand Development

Market development consists of identifying potential markets with a demand for the produce of the export farm, as well as delivery dates and prices which will enable profit attainment for all concerned. This aspect of the work-will be based on market research and on the presence of marketing personnel in the target markets. Considerable market information can be obtained from the Agricultural Export Strategic Center, but the processing of this information according to the needs of the specific export farm will be done by the Marketing Department.

In parallel, several additional areas must be developed by the department, namely:

- Marketing strategies;
- Establishment of liaisons with various marketing entities;
- Awareness-raising, among potential importers, of farms in Jordan producing quality produce, and of the basket of products proposed;
- Management of business negotiations;
- Sponsorship of sales promotion activities;
  penetration of new markets;
- Promotion.

The annual marketing plans from which the production programs will be derived will be processed by Marketing Department personnel. This will be done in co-operation with the growers, and in accordance with the development processes of the specific markets on the one hand, and with the development of the farms on the other.

On the other hand, special importance is attached to brand development in the marketing of agricultural produce since the consumer judges the quality of the produce mainly on the basis of its internal properties (taste, shelf-life, etc.) which only reveal themselves after actual purchase and consumption. The brand name affords the consumer the assurance that the produce purchased will always be of consistent quality.

Generation of a well-based, well-tested, highly-positioned brand name is essential for successful international marketing. Its establishment is a relatively costly process taking several years. The main costs are for market surveys, advertising and sales promotion.

In this respect, it should be noted that not every export farm need have its own specific brand name. Indeed there are considerable advantages in establishing a single uniform brand name for all Jordanian exporters within the project framework.

The Project Management Unit (PMU) started in July 2003 to implement the contract farming component, for this purpose it discussed the proposed contract farming procedures with selected exporters/producers, JEDCO, AMD, NCARTT, Plant Protection Department (PPD) in the Ministry of Agriculture, and they reached to the following structure (figure 3).

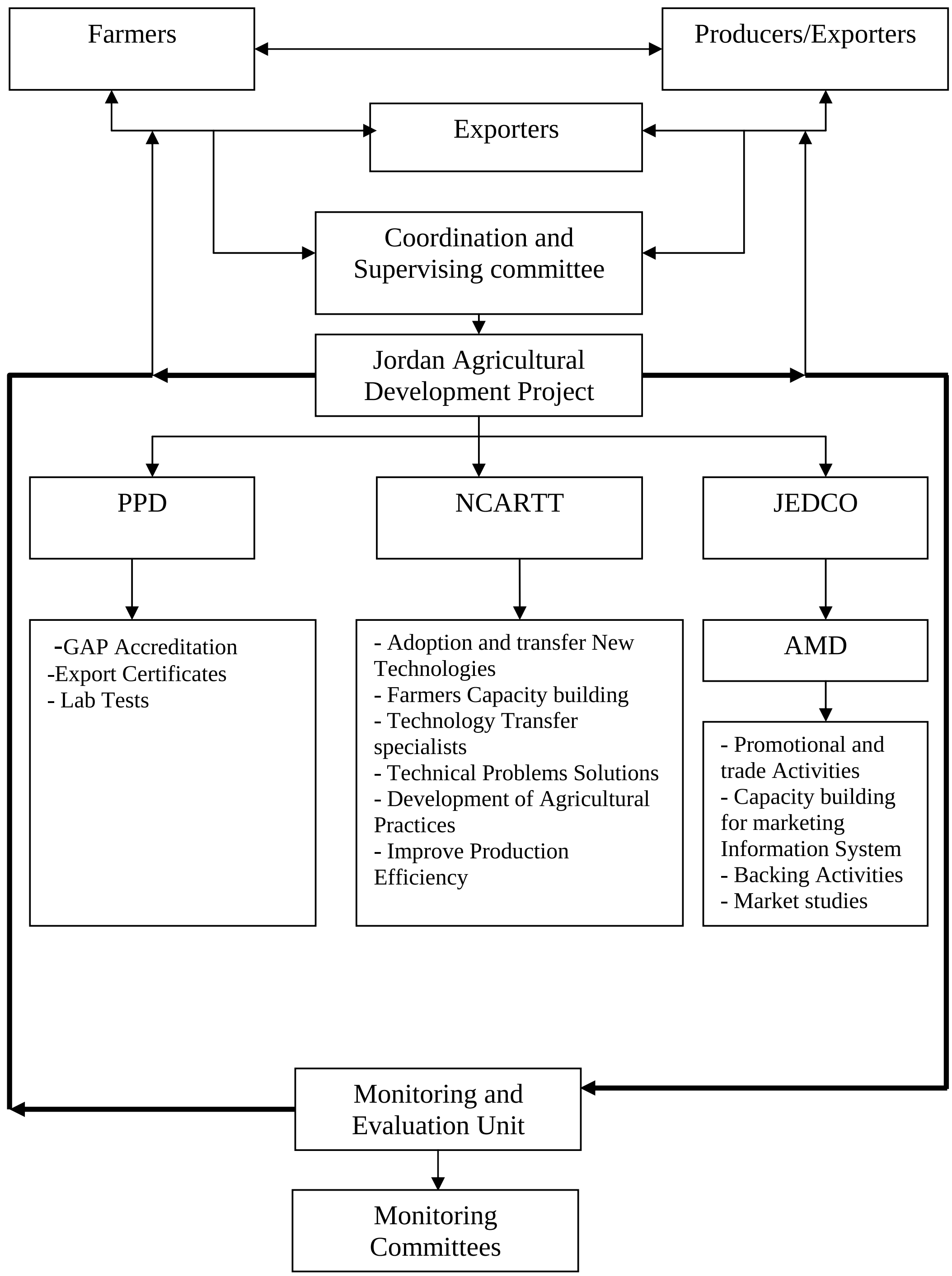

Figure 3. Flow chart of procedures

The next step was establishing seven exporters/ farmers groups, one of them was for cut flowers exports, two for fruits and the rest were for vegetables exports. At this stage two of these groups are still interested to work according of this procedure.

4.2.2 Past Experience

Many attempts for contract farming were tried in the past by public institutions and by private sector.

In late 1960's The Agricultural Marketing Organization (AMO)[2] signed contracts wit farmers to produce potatoes, A deficit product at that time, I t provided them with seeds. At the harvesting time, the prices in the central market were higher than those in the contract, and AMO was tough in sorting the produce, so large number of farmers did sold their produce in the central markets, and the trial was failed.

Some of the exporters in the private sector either signed written or verbal contracts. Last year one of these exporters did not respect his written contract and had problems with the farmers. On the other hand verbal contracts between exporters and farmers succeeded because confidence was built between the two groups. But the problem in this case is that small quantities with few farmers were dealt with in these contracts.

The main problem that face the exporters, which make them unable to fulfill there obligations, is air transportations. The exporter who did not fulfill his obligation mentioned that the cause of that was the three days strike in Heathrow Airport. More than one exporter said that The royal Jordanian may cancel the shipment if there is no enough space in the Airplane, although they were notified for the cargo in advance. In addition, the security inspection takes at least two hours on the open yards, which affects the quality of the produce, to solve this problem the exporters suggested that the inspection takes placed in the refrigerated storage in the airport; also the storage room should be divided into small compartments to make it more feasible to carry the small consignments.

Two approaches to contract farming in Jordan have shown initial success, and should be considered as models to be replicated to expand the reach to other small farmers.[3]

A. The Modern Valley Farms Model

Modern Valley Farms is the only EurepGAP certified exporter in Jordan and is exporting produce to the EU. The experience of Modern Valley Farms with contract growing arrangements illustrates the difficulties inherent in establishing such arrangements. Modern Valley started working with 22 satellite farmers 4 years ago. They now have formal supply arrangements with only 4. Part of the problem is attributable to Modern Valley Farms internal production systems, which have improved through their process of gaining EurepGAP certification. They found that most of the 22 original farmers were unable to adhere to EurepGAP standards. Mr. Heridin Shukry reports that now they are better prepared to expand from the current group of 4 satellite farmers.

[2] AMO is now attached with the Ministry of Agriculture as "Agricultural Marketing Department AMD.
[3] The examples mentioned here were derived from the report titled " Assessment of Jordanian Marketing System for Fresh Fruits and Vegetables" part of marketing assessment activities by KAFAA

B. Integrated Agricultural Project Model

The make-up of the Farm Owner's Model is different from the more commercial approach by Modern Valley Farms in that it involves initial subsidies. The first pilot farm is being implemented on 510 dunum with 8 farmers growing okra and sweet peas. The startup costs of JD 150,000 were provided by the Ministry of Water and Irrigation to pay for the farm manager, and structural changes and equipment required to bring the farms into EurepGAP compliance. Limited government funding is anticipated for the second year, and it is expected that the enterprise will be self-sustaining by the third year. The farmers, under the guidance of Mustafa Hamarneh, an agricultural consultant at the University of Jordan arranged a marketing contract with Modern Valley Farms who sold the okra.

5. Recommendations

The primary precondition for any investment in contract farming must be that it is likely to be profitable. Having identified a potentially profitable market the sponsor can then move on to assess whether that market can be profitably supplied by contracted farmers in a particular location of a particular country.

This involves an assessment of the social and physical environment of the proposed contract area as well as the potential support likely to be provided by the government. The following sections therefore consider preconditions under the headings of:

A. **A Profitable Market**;

The sponsor's decision to invest in a particular market must be based initially on the knowledge that, subject to certain conditions, it will be profitable. However, contract farming is then just one of a number of solutions to a commercial market opportunity. A market must have the capacity to remain profitable in the longer term. In the case of tree crops, for example, prices tend to be cyclical.

An analysis of economic viability carried out when prices are high would produce very different results than those obtained at the bottom of the price curve. A "sensitivity analysis" is thus required to ensure that production can be carried out profitably even when prices are low.

B. The Physical And Social Environments;

The main factors affecting the success of all agribusiness ventures are:

- The physical environment;
- Utilities and communications;
- Land availability and tenure;
- Input availability;
- Social considerations.

The success of any agricultural investment requires that two multidimensional preconditions be met; firstly, the general suitability of the topography, climate, soil fertility and water availability. Secondly, the suitability of the physical environment for the specific plant genotype or animal for which there is a market demands. The extent to which all these factors interact determines production yields, quality and profitability.

C. Government Support

Governments have to play an important role if contract farming is to be successful. A relevant legal framework and an efficient legal system are preconditions. Moreover, governments can do much to foster success by developing linkages between investors and farmers and can play an important role in protecting farmers by ensuring the financial and managerial reliability of potential sponsors. The role of national governments and their local agencies can be divided into:

- The enabling and regulatory role; and
- The developmental role.

5.1 Contracts

5.1.1 Introduction [4]

The contracts should have the following three components:

A. The legal framework

- *The contract should comply with the minimum legal requirements of the country*
- *Local practice must be taken into account*
- *Arrangements for arbitration must be addressed*

B. The formula of contracts can be based on:

- ***Market specifications,*** *where only quality standards are specified and input provision is often minimal*
- ***Resource specifications,*** *where details of production, e.g. varieties, are specified. Input provision is often limited and income guarantees are minimal*
- ***Management and income specifications,*** *which are the most intensive and may involve predetermined pricing structures, farm input advances, technical support and managerial control*
- ***Land ownership and land tenure specifications,*** *which are a variation of the management and income model with additional clauses relating to land tenure. This formula is usually used when the sponsor leases land to the farmers*

[4] For more details to this section refer to: Eaton, Charles and Andrew Shepherd "Contract Farming-Partnership for growth" FAO. Rome, 2001

C. The format

- ***Formal agreements*** *are legally endorsed contracts which closely detail obligations of each party*
- ***Simple registrations*** *are the most common format which the farmer signs to indicate that he/she has understood the terms of the agreement and wishes a contract to be reserved for him/her*
- ***Verbal agreements*** *are frequently used under the informal model and sometimes by corporate sponsors*

The specifications *may include:*

- *The duration of the contract*
- *The quality standards required by the buyer*
- *The farmer's production quota*
- *The cultivation practices required by the sponsor*
- *The arrangements for delivery of the crop*
- *The way in which the price is to be calculated using:*
    - *Prices fixed at the beginning of each season*
    - *Flexible prices based on world or local market prices*
    - *Spot-market prices*
    - *Consignment prices, when payment to the farmer is not known until the raw or processed product has been sold, or*
    - *Split pricing, when the farmer receives an agreed base price together with a final price when the sponsor has sold the product*
- *Procedures for paying farmers and reclaiming credit advances*
- *Arrangements covering insurance*

5.1.2 Guide to the Preparation of Smallholder Contracts[5]

A. Background

- Where smallholders grow a particular crop or crops on part of their own land and sell the product to a company, it is desirable to formulate an agreement between the producer and the purchaser. This constitutes the smallholder contract.

- It is important that such contracts specify clearly the rights and obligations of both smallholders and purchasers, and indicate the penalties that will be imposed on either party in case of non-fulfillment of agreed obligations. This note outlines the components which one would normally expect to find included in a smallholder contract, and presents a brief guide to the preparation of such an agreement.

[5] Ellman, Antony "Guidelines on Contracted Out grower Schemes and Nucleus Estates" Briefing Note for the Special Programme for Food Security, FAO

B. Form of Contract

- A smallholder who is contracted to grow a particular crop and sell it to a company is generally free to enter a scheme and free to leave it if it does not prove to be to his or her advantage. This gives the smallholder an automatic protection against the company and any other party who may have interests in the scheme. However, the effectiveness of this protection will depend on whether the smallholder has made a substantial investment in the holding (e.g. by planting long-term crops), and on whether there are satisfactory alternative uses for the land.

- The point of legal contact between smallholders and a company is normally a contract in which the smallholder agrees to use a specified area of land to produce the crop in question, and the company agrees to purchase the smallholder's produce and perhaps to provide finance, production inputs and technical advice.

C. Area of Land to Be Used

- The contract should specify the area of land on which the crop may be planted, defining it in terms of land type, slope, accessibility, distance from the purchasing or processing centre, and other relevant criteria.

- In some cases it may be appropriate to specify the maximum area that may be planted, in terms either of the labor available to the household, the management ability of the smallholder, or the need to ensure that a part of the holding is retained for subsistence food crops, firewood reserve, etc.

D. Duration of the Contract

- For annual crops a contract will normally be issued for a single season, with renewal to be negotiated at the appropriate time. For long-term crops a longer term contract will be needed.

- The duration of the agreement should be specified in the contract, along with the procedures for its renewal or renegotiation.

E. Charges

- The contract should specify the charges to be paid by the smallholder indicating whether they are calculated as payments for inputs supplied on credit, access on produce delivered, or a service charge related directly to the cost of services rendered by the company.

- If the charges are variable or subject to periodic increase, and if they include a proportion of the overhead costs of the company, it is particularly important that the contract explains clearly the basis of calculation of the charges.

F. Sale of Produce

- The smallholder contract should specify the following points relating to sale and purchase of farmers' produce:

    - Any restrictions on smallholders selling produce through alternative channels to those specified by the contracting company;
    - The quality requirements of smallholders' produce which the company guarantees to purchase;
    - The purchasing and payment procedures;
    - Any charges deductible at source.

- The method of calculating the price to be paid for the smallholders' crop should be clearly explained.

G. Obligations of Parties to the Contract

- The obligations of the crop purchaser should be specified in the contract These would normally include the following:

    - Supply of seeds or planting material, other production inputs and services;
    - Provision of technical advice, managerial support and training;
    - Agreement to purchase all production that meets agreed quality standards;
    - Maintenance of relevant infrastructure;
    - Maintenance of smallholder accounts in a form that is comprehensible to the smallholders.

- The obligations of the smallholders should also be specified. These would normally include the following:

    - Agreement to use the designated land area and inputs supplied for the purposes specified in the contract;
    - Agreement to follow any production regulations attached to the contract;
    - Agreement to sell the crop through the specified channels;
    - Agreement to repay the loans received from the purchaser;
    - Agreement to contribute to maintenance of common services where appropriate.

- Every effort should be made to ensure that a fair and mutually acceptable balance is achieved between the rights and obligations of both parties to the agreement

H. Sanctions for Failure to Fulfill Obligations

- The crop purchaser should be empowered to impose sanctions on the grower for failure to fulfill obligations covered in the contract. These sanctions would normally take the form of warnings, graded fines or similar penalties, and ultimate cancellation of the contract

- The contract should equally include provision for imposition of penalties on the crop purchaser in the event of failure to fulfill the obligations under the contract. These penalties would normally take the form of compensation payable to the growers for losses incurred as a result of the purchaser's shortcomings

- A procedure for arbitration in the event of disagreements or disputes between contractor and smallholder should be built into the contract document

I. Compensation and Succession

- In the event that a contract is compulsorily terminated by the company, provision should be made for payment of compensation to the smallholder for buildings erected, unexhausted improvements made and standing crops on the holding

- Provision should be made for the smallholder to nominate an heir to inherit the remaining period of the contract in the event of the smallholder's death

- If disposal of contracts is to be restricted this should be clearly stated, and the terms under which a transfer can take place should be made clear

K. Arbitration

- A procedure should be established for arbitration in the event of disputes between company and smallholder. This could take the form of an Arbitration Committee with representatives of smallholders and company and with an independent chairman. The Arbitration Committee should develop a system for resolving disputes and imposing sanctions, which should be specified in the contract or its attached regulations

- All disputes relating to the contract, other than those involving activities of an alleged criminal nature, should be referred to the Arbitration Committee in the first instance. Recourse to legal action outside the contract should be restricted until internal arbitration has been attempted

L. Style and Presentation of the Contract

- The contract document should be prepared in terms and in a language which is comprehensible to the smallholders. If necessary a summary should be prepared and translated into the local language. The contents of the contract document should be carefully explained to the farmers before they are asked to sign.

5.1.3 Sample Farmer to Company Contract for the Cultivation of (Vegetable crop VC)

A. General:

- Farmers of Village .... (the Farmers) wish to grow VC and Company .... (the Company) wishes to promote and buy their production and market it overseas.

- This contract specifies the terms and conditions under which the Farmers will grow VC and the Company will promote, purchase, process and market them.

B. The Company agrees:

- To measure and assess the suitability of the plot proposed by the Farmer for planting VC.
- To provide high-quality seed to the Farmer in good time for planting, in the quantity required for planting the accepted area of land.
- To supply on cash payment (or on credit once the Farmer has qualified as an established and reliable contract grower) the type and quantity of fertilizers and agro-chemicals required for the area of VC planted by the Farmer.
- To advise the Farmer on all technical aspects of growing VC.
- To buy all VC of acceptable quality grown by the Farmer, for a price announced at the start of each growing season. The quality requirements will be as described in Schedule 1.
- To pay the Farmer his/her dues as described in paragraph C below.

C. The Farmer Agrees:

- To use the part of his/her farm that has been surveyed and approved by the Company, for the purpose of growing VC for the duration of this agreement.
- To plant the VC seeds supplied by the Company on this land, on the dates and following the procedures advised by the Company,
- To follow all technical recommendations made by the Company with regard to planting, irrigating, weeding, fertilizing, controlling pests and diseases, picking, sorting and packing VC.
- To sell all VC of acceptable quality grown on the farm to the Company, for the price and following the procedure outlined in para D below.
- To become a member of ..... Farmers' Group, and to contribute to the maintenance of common facilities for irrigation, input distribution, sorting, packing etc as agreed by the group.

D. Payment for VC and Production Inputs shall be determined as follows:

- The base price at which each grade of VC will be bought will be announced by the Company at least one month before the start of each planting season.
- The prices at which fertilizers and agro-chemicals will be sold will be announced at the same time, but may fluctuate during the year in line with exchange rate fluctuations.
- Payment for VC delivered each month, less the cost of fertilizers and agro-chemicals taken on credit will be made before the 15th of the following month.

E. Penalties and Bonuses:

- If the Farmer delivers VC which do not meet the agreed quality standards, the Company will reject them. The Farmer may re-submit them after sorting, but the Company is under no obligation to accept beans which do not meet the agreed quality standards.
- If the Farmer fails to follow the procedures detailed in this agreement, he/she will be warned verbally and in writing. After three written warnings the Company has the right to terminate the agreement.
- If the Company fails to fulfill its commitments as detailed in B above, the Farmer has the right to claim compensation to the value of the services foregone or to the value of the crop lost, at rates agreed between the Company and the Farmers' Group.
- If the Farmer delivers VC which exceeds the required quality standards or the expected level of production, he/she shall be eligible for a bonus payment at a level agreed between the Company and the Farmers' Group.

F. Duration of the Agreement:

- This agreement will last for one growing season from the date of signing to the end of the economic harvest of the VC crop.
- If both parties are satisfied with the outcome of the agreement it may be renewed for a further season, but there is no obligation on either party to renew the agreement.

G. Dispute Settlement:

- Any dispute arising as result of this agreement will be settled wherever possible by discussion between the Company, the Farmers' Group and the Farmer.
- Any dispute which cannot be settled by this process will be referred to an independent arbiter acceptable to all the parties involved.

H. Signature:

I have read and understood the contents of this agreement and I sign it of my own free will.

1 …………………………………………………. (Farmer)
2………………………………………………….. (Company)
3…………………………………………………..(witness)
4………………………………………………….. (Date)

Schedule 1: Grades and Quality Requirements of VC

1. Grade specifications:
   - Grade 1 (should be specified)
   - Grade 2 (should be specified)
   - No other sizes will be accepted

2. Quality Requirements: acceptable beans must be:-

- free from pests, wounds, scars, bruises;
- free from mud, dust or other debris;
- not broken or damaged in any manner;
- fresh and not pre-wilted by sun-burn or other sources of heat;
- naturally green, not tainted by disease, smoke etc.
- Others (specific for the kind and variety)

5.1.4 Sample Price Formula for Smallholder (VC) Production

The price at which the contracting Company agrees to buy the Smallholder's (Farmer's) CROP is determined as follows:

- A minimum price per kg VC of acceptable quality is announced by the Company at least one month before the start of the coming planting season.
- This price is calculated as follows:

    - The average cost of production for cultivating 1 ha of (VC) in the area in question is determined by the Company in consultation with representatives of the Farmers' Group. The production costs are based on the recorded experience of contracted smallholders who grew VC in the previous season, and include:

        a) The cost of all materials used for cultivating 1 ha of beans (seed, fertilizer, agro-chemicals, fuel, depreciation on cultivation equipment, harvesting equipment and materials);
        b) The total value of the labor required through the season for all operations, charged at the opportunity cost of household labor in the area (usually equivalent approximately to the cost of hired labor in the local informal agricultural sector).

    - The total cost of production is divided by the average yield of VC from 1 ha achieved by contracted farmers in the previous season. The resulting figure is the absolute minimum price which the farmer must receive to cover the costs of production, without allowing for any profit margin or return on fixed investments (especially land).

- The base price (minimum price) is adjusted as follows:

    - A minimum profit margin equivalent to approximately 25% of the cost of production is added. This profit margin must be set at a level which attracts farmers to grow VC and sell them to the company, rather than apply their land and labor to alternative enterprises or sell their products in alternative markets. (If there are attractive alternative income-earning opportunities which farmers can take up, the minimum profit margin for VC may need to be set at a higher level. The open market prices for VC and for competing commodities - if such prices exist in the area – are useful pointers to the minimum profit margin which is required to attract and retain green bean growers).

    - A quality bonus of 10% of the adjusted base price is added for extra fine VC (linked to the 10% premium which such beans realize in the end market).
    - A levy of 2% of the base price may be retained by the company in a stabilization fund to allow for losses in storage or for losses or gains further up the marketing chain, but it must be made clear that this fund is held in trust for the smallholders.

- The adjusted base price is paid to farmers as follows:
    - The value of all VC delivered by each farmer in a particular calendar month is calculated by multiplying the kg of crop delivered by the adjusted base price;
    - The costs of any inputs or services supplied to the farmer by the company on credit are deducted; the resulting net revenue due to the farmer is paid no later than the 15th of the month following he calendar month in which the beans were delivered to the company.

- At the end of the company's financial year, when the audited accounts have been received:

    - The profit realized by the company through the export of VC is calculated;
    - A productivity bonus linked to company profits is calculated at an appropriate level for payment to contracted farmers;
    - The productivity bonus is paid to contracted farmers per kg of VC delivered in the previous financial year, as in incentive for future performance and as a trust-building exercise between farmers and company.

- Operation of a price formula based on the above model depends on:

    - A willingness on the part of the company to accept a significant degree of transparency in relation to its financial accounts;
    - Open consultation between the company and farmer representatives, usually with the help of a facilitating intermediary, throughout the process.

Few companies may yet be willing to enter into such an open dialogue, but the dividends for those that do, in terms of enhanced farmer commitment and loyalty and raised future productivity, are great. The model should be viewed as an ideal target to be achieved over a period of time.

5.2 Contract Sponsors or Guarantor

The guarantor could be individual, company, private entity, or NGO. Its task is to make sure that the commodity and financial transactions were fully completed as mentioned in the contracts. The guarantor should compensate the party who did not receive the value of the product. This entity should also charge fees or commissions for their work.

5.3 Legal Entity for Dispute Settlements

The method of dispute resolution provided for in a contract creates not just the mechanism for resolving disputes that can arise in the grow out relationship, but also determines the ability of producers to seek redress either from the courts or other authorities.

Any controversy or claim arising out of or relating to the agreement, or the breach thereof, shall be settled by arbitration administered by legal institution and judgment on the award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

Either party shall demand arbitration in writing within ninety (90) days after the alleged claim was known or reasonably should have been known. Such demand shall include the name and address of the arbitrator appointed by the party demanding arbitration.

Within thirty (30) days after such demand the other party shall name an arbitrator and notify the first party of the name and address of said arbitrator.

While arbitration may offer a viable process with certain advantages, it does have its limitations and is subject to criticism as being inherently biased toward institutions vis-à-vis individuals.