Making Rice Contract Farming Work for Smallholders and Agribusiness[1]

Introduction

Cambodia is a largely agrarian society. Agriculture is the main source of income and livelihood for 80 percent of the population, and the average landholding size for around two million farm households is one hectare or less (Mund 2011). The country was able to produce up to 8.78 million tonnes of paddy rice, leaving a potential exportable surplus of roughly 3.21 million tonnes in 2011 (FAO/WFP 2012: 2). However, the rice sector's significant progress has not translated into substantial benefits for smallholder farmers and limited post-harvest processing capacity continues to hinder further productivity improvement and export expansion. As a policy to ease constraints on the rice sector, rice contract farming has been organised by Angkor Kasekam Roongroeung Co., Ltd. (AKR), a Cambodian company established in 1999 (Cai *et al.* 2008). Yet there is little information available on contract farming schemes in Cambodia, specifically smallholder inclusion and poverty reduction, contractual arrangements, and benefits and challenges.

This article highlights the findings of a wider study that examines three aspects of rice contract farming and the agreement between contract farmers and AKR: smallholder inclusion and contractual arrangements, the benefits of contract farming for farmers, and the difficulties faced by farmers and agribusiness firms. AKR was selected for case study because it is the largest rice contract farming company in Cambodia. Analysis draws on qualitative interview data collected in Kampong Speu province in May 2012 and June 2013; respondents included 10 farmers, 4 village chiefs, 1 commune clerk, 2 AKR staff and 3 local NGO staff. Study findings will contribute to policy issues integral to the success of rice contract farming in Cambodia and help shape a developmental approach that makes contract farming work in smallholder agriculture.

Smallholder Inclusion and Contractual Arrangements

At the start of its contract farming operation, AKR considered several factors in deciding where to develop contract schemes. The most important of these was agronomic conditions. Pkar Malis variety is suitable for rain-fed lowland areas with low flood risk. Some communes, villages and farmers, despite being in the same province, were excluded from contract farming schemes due to unsuitable agronomic conditions. Another criterion was the spatial concentration of production. The requirement for a high level of varietal purity excluded villages where interested farmers had a dispersed landholding pattern. Size of land was not an initial condition for selecting farmers; however, as of 2000, only 5 percent of AKR's contract farmers had less than one hectare of land. Even so, the company soon realised that working with farmers owning very small plots of land was too difficult and introduced the one hectare rule. Poor living conditions often pushed smallholder farmers to break the contract and restrained the company from taking legal measures against them. The present policy of collective purchase enables farmers owning very small rice fields to sell rice to AKR, but the company has no record of the number of such farmers taking part in their scheme. The contract farming scheme, therefore, does not discriminate against the poor and the poorest.

To establish trust with farmers and to ensure efficient supply management, AKR established commune associations. The associations had various roles including helping AKR select contract farmers, evaluating farmers' agronomic suitability and commitment, monitoring contract farmers, and keeping AKR informed of production progress and challenges.

Contracts between AKR and farmers were not prepared in a participatory manner. The company drafted the contract and farmers simply signed it. Although the contract specified a number of necessary clauses, it lacked several important aspects. Signing a contract to supply rice to AKR gave farmers access to quality seeds (initially only Pkar Malis but recently Romdoul and Angkong Seuy varieties as well), extension services, a secure market and competitive prices. The contract did not specify a purchase price, but stated that farmers would be paid 60 riels per kg more than the market rate at the

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time of selling. For every hectare of contracted land, farmers were expected to supply between 1.5 to 2.5 tonnes of paddy, though this rule could be waived in case of crop failure. The contract also indicated the quantity of seed farmers could borrow, but not the leasing cycle. It described AKR's obligation to cover the cost of transporting paddy rice to the company and to pay commune association members for their services. It also included the conditions under which the company would buy paddy rice from farmers. The penalty clause specified the punishment for farmers in breach of contract, but stated nothing about punishment for the company. The contract failed to stipulate when farmers should return borrowed seeds, the duration of contract and how either party could end the contract.

Benefits of Contract Farming

Access to a competitive market was the main and most important reason for farmers to join the contract farming scheme. The price offered by AKR was competitive in two ways: it was much higher than the prices farmers could get for ordinary varieties, for example Chong Banlar and Krachok Chab, and it beat the prices paid by informal traders. However, AKR's higher price came with many production challenges (for example, strict requirements for varietal purity and moisture content), which deterred some farmers from joining the contract scheme. The presence of AKR and the Cambodian Center for Study and Development in Agriculture (CEDAC) created a more competitive market, preventing informal traders from setting unreasonably low prices. Realising these dynamics, some farmers considered maintaining their AKR or CEDAC membership, despite the production challenges, in order to keep the market price of Pkar Malis variety consistently high.

The second most important benefit was access to quality seeds. In the early phase of contract farming, when rice farming was for domestic market and household consumption, farmers cared less about

Table 1: Yield, Price and Revenue for Wet Season Rice by Farmer Type, 2012

	Unit	Former contract farmer	Contract farmer	Non-contract farmer
Land size	ha	1	1	1
Yield	kg/ha	2,500	2,000	2,000
Price	riels/kg	1,350	1,450	1,350
Total revenue	riels/ha	3,375,000	2,900,000	2,700,000
Revenue: contract farmer vs. non-contract farmer	riels/ha		200,000	0
	%		107	100
Revenue: former contract farmer vs. contract farmer	riels/ha	475,000	0	
	%	116	100	
Revenue: former contract farmer vs. non-contract farmer	riels/ha	675,000		0
	%	125		100

Source: Authors' calculations based on information from interviews

Table 2: Comparison of Profit by Farmer Type, 2012

	Unit	Former contract farmer	Contract farmer	Non-contract farmer
Total revenue	riels/ha	3,375,000	2,900,000	2,700,000
Total costs	riels/ha	1,230,000	986,000	1,000,000
Profit	riels/ha	2,145,000	1,914,000	1,700,000
Profit: contract farmer vs. non-contract farmer	riels/ha		214,000	0
	%		113	100
Profit: former contract farmer vs. contract farmer	riels/ha	231,000	0	
	%	112	100	
Profit: former contract farmer vs. non-contract farmer	riels/ha	445,000		
	%	126		100

Source: Authors' calculations based on information from interviews the varietal purity of harvested paddy rice. With the establishment of an export market, the availability of quality seeds became a primary reason for farmers joining AKR's contract scheme. AKR supplied seeds that produce high yield with excellent varietal purity, one of the conditions for export to high-end markets. CEDAC also bought Pkar Malis rice, but it did not have a policy of leasing quality seeds to farmers.

Access to quality extension services was the third benefit of contract farming with AKR. The company was not the sole provider, however. Some local NGOs also provided technical extension services to farmers. Other secondary benefits received from AKR were access to low interest credit, payment for services rendered to commune associations, payment for transporting rice to the company, and a fair and accurate system of weights and measures.

The benefits enabled contract farmers to increase their income from rice farming. Contract farmers' revenues and profits were higher than non-contract farmers' (never joined the scheme) but lower than those of former contract farmers (joined the scheme but later quitted) (Tables 1 and 2). The differences between contract and non-contract farmers' revenues and profits could be explained by the production knowledge and higher prices provided by AKR. On the other hand, former contract farmers had more control over production in terms of fertiliser use, varietal purity and moisture content because they sold rice to informal traders who put no conditions on purchase.

Challenges of Working under a Contract

High varietal purity and low moisture content are the two most important criteria used to determine quality rice suitable for export to high-end markets. Some former AKR contract farmers cited their failure to comply with these two requirements as their main reasons for quitting contract farming with AKR despite the higher price. Although informal traders paid a lower price, there were no conditions attached. AKR attributed some farmers' failure to produce rice with a high level of varietal purity to their low commitment and cancelled its contracts with them. However, the company is cognisant of its own failing in not having rice dryers that would enable it to buy wet rice from farmers. This limited capacity means AKR has been unable to meet export demand, especially from high-end markets, and has had to resort to buying dried paddy from informal traders.

Limited access to quality seeds is another challenge faced by farmers. The terms of contract obligated AKR to lease seeds to farmers at no interest, but the contract did not specify the leasing cycle. Drought and contract farmers' lack of commitment resulted in reduced yields and lower levels of varietal purity at great cost to AKR. Learning from this experience, the company now only leases seeds to a few communes where farmers are committed to meeting its stringent requirements. A local organisation also leased seeds to farmers but the scheme was not large enough to cover all farmers and the seeds were a different variety from what AKR purchased.

AKR's irregular payments for paddy rice delivered to it and for services rendered to the associations created hardship for contract farmers and commune association members. The contract stipulated that AKR would pay these costs but in practice the company did not always fulfil these contractual obligations, incurring financial losses to contract farmers. In addition, despite promising to pay each commune chief 30 riels and each village chief 40 riels for every kilogram of paddy supplied by their members, the company only occasionally upheld this commitment. Even though the contract was legally binding, farmers had no power to hold the company liable for its actions or to claim compensation for breach of contract. Conversely, AKR had to contend with farmers' breach of contract. Extra-contractual marketing – farmers supplying paddy, which is supposed to be sold to AKR, to other buyers – was the main long-standing problem reported by AKR. No contract members have been penalised for this malpractice, however. Another issue AKR raised is the misuse of membership cards. Farmers reportedly lend their card to relatives or friends or "rent" it to informal traders who can then take advantage of the higher price AKR pays its members.

Limited access to sufficient credit has imposed significant constraints on contract farmers and AKR. Credit-constrained farmers were under pressure to sell their paddy rice to informal traders straight after harvest in order to raise cash quickly, or were reluctant to supply rice to AKR on credit because of the company's tendency to delay payment which risks pushing them into hardship. Informal traders smoothed the transaction for farmers by not attaching conditions related to moisture content and varietal purity and by paying farmers immediately. By contrast, contract farmers used to be obligated to supply rice to AKR on credit, resulting in a large number of farmers quitting the scheme. The company has improved its financial arrangements and has been paying its members cash on delivery since 2010, but the extent to which it can sustain immediate payment is questionable. Credit constraints have also prevented AKR from investing in rice dryers, which would enable the company to relax its rule about moisture content and buy wet rice.

Natural disasters have had direct negative impacts on contract farmers' rice production and indirect negative consequences for AKR. Crop damage caused by drought hit farmers particularly hard: lower yields meant they failed to produce enough paddy rice to fulfil their contractual obligations. AKR staff reported that frequent losses due to drought had forced the company to terminate contracts with several drought-prone communes.

Conclusions and Policy Options

Overall, AKR's contract farming scheme has evolved by increasingly providing space for the poor and poorest farmers to participate, particularly since the implementation of the collective purchase policy. Access to important benefits has increased contract farmers' profits from rice farming. Flawed contractual arrangements and the requirements for producing high quality rice, however, pose considerable challenges that must be addressed if contract farming is to benefit both smallholder farmers and agribusiness firms. Well-directed contract farming can enhance the potential benefits for both parties and contribute to rice sector development and rural poverty reduction. Below are some policy options that the government could consider.

1. **Raise farmers' awareness of costs and benefits of contract farming:** Better business skills would help boost farmers' commitment to AKR; the Ministry of Agriculture, Forestry and Fisheries (MAFF) could deliver information and/or training on cost-benefit analysis through its extension services or the commune associations created by AKR.

2. **Remove technical constraints on paddy drying:** MAFF could collaborate with the International Rice Research Institute (IRRI) to provide training on drying techniques; government could encourage the private sector (for example, rice millers) to invest in drying technology and/or provide agricultural loans/credit to AKR to invest in high-capacity rice dryers.

3. **Improve farmers' access to quality seeds and irrigation:** Seed varieties currently distributed by the local authority, for example Sen Pidor and Chulsar, are more for household consumption. The government should coordinate with rice exporters, prioritise the varieties to be promoted, and distribute quality seeds in order to produce rice to meet export market demand. Policy to improve irrigation infrastructure and coverage is included in the rice policy. The government, therefore, can improve farmers' access to quality seeds and irrigation by accelerating implementation of the current rice policy (RGC 2010).

4. **Ease credit constraints on both farmers and agribusiness firms:** Improving farmers' access to credit would help reduce the problem of extra-contractual marketing. Enhancing agribusiness firms' access to agricultural credit and/or increasing subsidies would enable greater investment in rice mills and dryers and ease cash flow requirements for regular payments to farmers, which would improve farmers' cash flows as well. Again, this can be achieved by speeding up implementation of the current rice policy (RGC 2010).

5. **Establish a sub-national body to enforce and regulate contracts:** This would help ensure balanced bargaining power between smallholder farmers and agribusiness and reduce the incidence of loss arising from breach of contract by both parties. For efficient and effective operation, the sub-national committee should be accessible to farmers and consist of representatives from four groups: farmers, local authorities, agribusiness firms, and MAFF (as the relevant ministry).

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