The new wave of contract farming in Ghana
The role of contract design in facilitating sustainable outgrower schemes

Many of the prevalent horticultural and tree crop outgrower schemes in Ghana have failed over time. There is, however, a new wave of contract farming in Ghana involving staple crops. This is due to agro-industrialization and increasing domestic demand for biomass-based raw materials. It is the objective of this brief to highlight the role of contract design in facilitating sustainable contract farming arrangements between small-scale farmers and agro-processing companies. Specific recommendations that can be employed by agro-processing companies in Ghana are also made to help promote the long-term sustainability of outgrower schemes, which are mutually beneficial for the small-scale farmers and companies.

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This brief is targeted at agro-processing companies in Ghana to help promote the use of contracts that have long-term viability for both parties involved in outgrower schemes. It examines the role of contract design in facilitating sustainable contract farming arrangements between small-scale farmers and agro-processing companies, particularly for staple crops. Accordingly, specific recommendations are made to these agro-processing companies. Contract farming in Ghana has thus far been dominated by a range of horticultural and tree crop outgrower schemes mainly for export. Many of these arrangements have failed over time. However, agro-industrialization and increasing domestic demand for biomass-based raw materials has led to a new wave of contract farming involving staple crops in Ghana. This has meant a transition towards modernized procurement systems for crops that have traditionally been dominated by spot market exchanges between small-scale farmers and traders. Crops like cassava and maize are typical examples of staple crops with increasing industrial applications. The reported findings draw from the research outcomes of the empirical study carried out by Poku et al. (2018).

Comparative case study approach

The study employed the use of in-depth interviews with the management personnel of seven agro-processing companies engaged in contract farming of staple crops in Ghana. Focus group discussions were also carried out with the companies’ outgrowers. This compa-
rative approach was used to elucidate the contractual design of the various outgrower schemes and juxtapose with their sustainability. Data was collected between July 2015 and January 2016.

The critical role of contract design

The study demonstrates that there are four contract design features that are key in assuring farmers of a marketing outlet and agro-processing companies of the supply of essential raw materials.

Pricing arrangement

An important, and yet often overlooked, aspect of pricing arrangements is the extent to which farmers find the actual price determination mechanism equitable. The empirical evidence revealed that most companies used a fixed pricing arrangement with their outgrowers. However, there was an important distinction between the arrangements in terms of the price determination mechanism. A few companies provided an objective and acceptable means of valuing farmers’ produce through the use of measuring or weighing equipment, leaving little margin for error. Conversely, other companies arbitrarily determined the amount of money to be paid based on the number of delivered tractor trailer loads. This biased valuation method often proved to be a source of contention between outgrowers and the companies.

Quality standards

Some of the companies set an internally verified minimum quality standard which was, however, not transparently communicated. Several outgrowers reported that their produce was rejected on account of not meeting the product quality specification. Yet the farmers had no means of independently verifying the quality standard. This uncertainty and the fear of complete rejection discouraged farmer participation in the outgrower schemes, as it largely eliminated the incentive of a guaranteed market. Other companies employed a transparent system of variable quality standards based on visual inspection, which reduced the risk of non-transparent rejection of farmers’ produce.

Transparently communicated quality standards give farmers more certainty about the marketability of their products and reduce their risk of complete rejection.
Input arrangement
Two of the companies did not have an input supply arrangement with their outgrowers. This was mainly attributed to the resource constraints of the companies and the large size of the outgrower schemes. The schemes also lacked technical assistance and a crop delivery arrangement. This was reported as a deterrent to farmers, and contributed to a very small number of years of participation in outgrower schemes. On the other hand, companies that provided outgrowers with planting material and herbicides on credit to ensure a high raw material output achieved higher participation. Outgrowers also benefitted from technical assistance and crop delivery services provided by the companies. These conditions effectively incentivized farmer participation and accounted for higher productivity of the participating farms.

Contract enforcement
Outgrowers of some of the companies confirmed that their arrangement with the company was based on verbal commitments with no written proof. As such, there was no means of conflict resolution for either party other than termination or non-renewal of the agreement. Conversely, outgrowers of other companies reported that they each had a generic signed written contract with the company which outlined the terms and conditions of the arrangement. Consequently, both parties had the additional option of sanctions such as legal redress for contract breach. These companies and their outgrowers reported that written contracts have been effective in enforcing the agreement and controlling side-selling.

Conclusions:
Sustainable contract conditions
Overall, the evidence shows that capital-intensive and formalized outgrower schemes are comparatively more sustainable based on the rate of outgrower retention and the volumes of outgrower output. Small-scale farmers participating in outgrower schemes were found to have benefitted from better access to inputs and new technology, which led to improved farm productivity. Therefore, equitable and transparent conditions as well as company investment in supporting farm production are crucial for the success of outgrower schemes.

References
Recommendations

Based on the empirical findings of the role of contract design in contract farming, four recommendations are given to agro-processing companies to help promote the long-term sustainability of outgrower schemes that are mutually beneficial.

- **Written contracts**
  Agro-processing companies should opt for written contracts with outgrowers rather than verbal agreements in order to ensure contract compliance. Written contracts provide both parties with superior enforcement possibilities and conflict resolution mechanisms.

- **Transparency in quality assurance**
  Agro-processing companies should endeavor to establish transparent quality assurance systems to maintain the trust and cooperation of outgrowers. This can take the form of a system involving third-party quality testing.

- **Investments in equipment**
  Agro-processing companies should invest in appropriate measuring and weighing equipment. This will prevent the use of contestable price determination mechanisms plagued with measurement errors or bias in produce valuation.

- **Incorporating support services**
  Agro-processing companies can effectively overcome the institutional constraints of contract farming, such as inaccessible seed markets, poor road networks and limited extension coverage, by incorporating support services such as input supply arrangements and technical assistance in outgrower schemes. Although this may be a more capital-intensive approach in the short run, it can lead to cost saving in the long run if properly managed, as a reliable supply of good quality raw materials is thus guaranteed.