# Role of Price in Managing Buyer-Seller Relationships in Contract Farming


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# Buyer-Seller Relationships in B-2-B Marketing

- Focus on managing b2b relationships has increased from 1980s (Anderson & Narus, 1984; Morgan & Hunt, 1994; Geyskens *et al*, 1999; Brown *et al*, 2000; Narayandas & Rangan, 2004)
- Performance of a firm depends on relationships (Hakansson & Snehota, 1995)
- Buyer-seller relationships is one of the priority areas at ISBM
- Factors affecting relationships are yet to be studied empirically and in a systematic way (Bowman 2012)
- Marketing practices and perspectives are at odds with the realities of emerging markets (Sheth, 2011)
- Ignoring the diversity of contexts will impede the progress of understanding of relationships (Frazier, Gill & Kale 1989)

- Relationships were studied using
  1. Relationship marketing – trust & commitment
  2. Dependence
  3. Transaction Cost Economics -TSI and opportunism
  4. Relational norms
     - Combination of perspectives used (Palmatier *et al*, 2007)

- Empirical research in developing and underdeveloped countries is needed (Frazier *et al*, 1989; Ruaud, 2005)
- Buyer-seller relationships in contract farming are unique - actors, product, infrastructure etc
- No study on buyer-seller relationships in contract farming

# Rationale for Contract Farming

- Food processing and seed production firms
  - Requirement

- Strategies for procurement of agricultural produce fall on a continuum (Key & Runsten, 1999)

| | | | | |
|---|---|---|---|---|
| **Spot Market** | | **Contract Farming** | | **Vertical Integration** |

# Contract Farming

- “Pre-negotiated agreement of production of agricultural produce between a producer and a buyer. The terms of agreement shall include commitment on the part of producer to deliver specified variety, quality and quantity of produce at specified time, place and price. In-return, buyer may provide inputs and influence production decisions”.

- Agricultural produce under contract farming:
  - Vegetables, fruits, aromatic crops, poultry, baby corn, safflower
- Firms involved in contract farming:
  - Pepsico, ITC, Nijjer, Marico, Safal, HUL,Global Green (Thapar’s), Rallies, Namdharis, Suguna

# Problems in Contract Farming

- Mixed experience with contract farming.
- Problems due to price, produce quality, cross-selling, non-procurement (Jaffee,1994; Watts, 1994; Singh, 2004; Asokan, 2007; Imbruce 2008 )

- **Main problem for firms:** Maintaining relationship
  - Continuity of relationship
    - Why to continue?
  - Opportunism (cross-selling)
    - Inward & outward

# Research Questions

1. What was the role of unit price in managing relationships of agribusiness firms with farmers in contract farming?

2. What was the role of overall profit received by farmers in managing contract farming relationships with firms?

# Literature on Contract Farming

## Advantages

- increase in farmers' income (Minot, 1986; Singh & Asokan, 2004; Tripati *et al*, 2005; Miyata, 2007)
- Insulate farmers from volatility of market risk
- Access to speciliazed inputs (Minot, 1986; Key & Runsten, 1999; Singh & Asokan, 2005; Begum, 2005)

## Criticism

- Indirectly secure effective control over farmers' land and labour leaving them with only formal title to both
- Impose technological, managerial and marketing direction on farmers (Clapp, 1994)

# Literature on Contract Farming

## Limited Studies on Contract Relationships

- Explored the role of transaction specific assets (TSA) and opportunism (Asokan, 2007)
- No studies have explored the role of other perspectives of relationship building

In-depth study was required to understand buyer-seller relationships in contract farming

# Methodology

- Case study research was used
  - Knowledge base on the topic is scarce (Easton, 2010; Bonoma, 1985)
  - In-depth understanding of complex phenomenon (Remenyi et al., 2002; Yin, 2009)
  - Mostly preferred to address ‘why’ and ‘how’ questions (Brown, 1998; Yin, 2009)
  - little or no control over the events and the focus is on contemporary phenomenon within a real-life context (Yin, 2009)

- Study Area
  - Karnataka – pioneer in contract farming, accessibility, convenience and language

- Multiple case design
  - Findings from multiple cases were considered as more compelling and the overall study regarded as robust (Herriott & Forestone, 1983; Yin 2009)
  - Short duration and high and low price fluctuating crops
  - Availability of alternate channels

1. Namdhari Farm Fresh (NFF): Baby corn
2. NFF: Tomato
3. ABC: Tomato
4. Namdhari Seeds (NS): Tomato seeds

- Data collection
  - Interviews with farmers and officials
  - Records
  - Observation
- Total villages : 24
- Farmers interviewed: 42; officials interviewed: 14

# Results

## Namdhari Seeds Pvt Ltd.

- One of the largest seed companies, started in 1985
- One of the largest contract seed producers
- Breeding, production and distribution of seeds

## Namdhari Farm Fresh Pvt Ltd.

- Started in 2000, near Bengaluru
- About 1500 contract farmers in Bidadi area alone

## ABC

- Subsidiary of the public sector board
- Started contract production of tomato in 2008 with about 350 farmers

| | NF Baby Corn | NF Tomato | NS Tomato | ABC Tomato |
|---|---|---|---|---|
| Geographical area | Bidabi and Ramanagaram (40-60 km from B' lore) | | Ranibennur and Byadagi Taluks (350 km from B'lore | Gauribidanur (70 km from B'lore) |
| Farmers relationship status | Good | | Good | Ok |
| Opportunities for alternate crops | Yes | | Yes | Yes |
| Competitors (other companies) | No | | Many | No |
| Alternate market | Available | | Available | Available |

# Reasons for Entering into Contract Farming

- NFF Baby corn: For guaranteed (fixed) price and reduce market risk
- NFF Tomato: Expectation of high profit. Lucky crop
- ABC Tomato: Dual purpose of receiving guaranteed returns and high profit
- NS Tomato seeds: To earn more profits

Proposition1: Farmers enter into contract farming mainly to earn more profit than they were previously earning by cultivating same or other crops or to get guaranteed fixed price and avoid market risks and costs.

# Unit Price

| | NF Baby Corn | NF Tomato | NS Tomato | ABC Tomato |
|---|---|---|---|---|
| Unit price | Fixed price / assured price | Market linked | Price range | Fixed but changed sometimes |
| Diversion | Very Low | Low | Very low/ nil | High |

- Proposition 2: Sellers do not divert the produce as long as the unit price offered by contract firm is at least equal to that offered by alternate buyers at farm gate.

- Proposition 3: Sellers will not divert the produce to open market as long as the differential profit that could be earned by selling in open market, rather than supplying to contract firm is less than marketing costs and risks.

- Proposition 4: Farmers continue cultivating contract crop as long as the overall profit obtained from contract crop is at least equal to the profit obtained by cultivating other crops with similar resources.

# Overall Profit

| | NF Baby Corn | NF Tomato | NS Tomato | ABC Tomato |
|---|---|---|---|---|
| Overall profit compared to other crops | High | High with risk | High | High |
| Overall profit compared to supplying to rival firms | No rival firms | No rival firms | High | No rival firms |
| Profitability by supplying to local markets | Low, risky | Low, risky | Low | Depends on market price |
| Remarks | Year round income | | | |

# Comparison Level of Alternatives ($CL_{alt}$)

- $CL_{alt}$ is the overall benefit (social and economic) available from the best possible alternative exchange relationship (Thibaut and Kelley, 1959; Lambe, Wittmann and Spekman 2001)

- Proposition 5: Farmers continue the relationship with contract firm as the outcome from the relationship exceeds comparison level of alternatives.
- Proposition 6: Farmers will continue with contract firm as long as the overall outcomes from existing contract relationship exceed $CL_{alt.}$
- Scope to refine the concept

# Comparative Level of Alternate Crops ($CL_{alt\text{-}crop}$)

- $CL_{alt\text{-}crop}$ helps to determine whether a farmer continues to grow the same crop under contract or change the crop.
- $CL_{alt\text{-}crop}$ is defined as the overall outcome available from cultivating best possible alternative crop.

- Proposition 6: Farmers will continue cultivating contract crop as long as the overall outcomes from contract crop exceed $CL_{alt\text{-}crop}$.

# Conclusion

- Both unit price and overall profit play important role
- $CL_{alt}$ determines farmer's continuation of relationship with the firm
- $CL_{alt\text{-}crop}$ helps in determining the continuation of contract crop by farmers

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# Discussion