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Contract farming in transitional economies: A stakeholder theory perspective

REVIEW

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Abstract

In transitional economies, contract farming is widely recognized as a means for addressing numerous market failures affecting small farmers. Reviewing the scholarship on contract farming, we show that its traditional understandings have been framed by the narratives of transaction cost economics and power dynamics. We critically evaluate these narratives and demonstrate how stakeholder theory, with its relational understanding of business, offers a more comprehensive understanding of contract farming. We argue that a stakeholder theory perspective underscores the trust-based and collaborative nature of successful contract farming arrangements. It highlights the importance of informal and moral stakeholder relationships that compensate for the limitations of weak enforcement mechanisms and inadequate legal frameworks in transitional economies. This way, a stakeholder theory perspective on contract farming highlights its strategic management and business ethics dimensions, offering valuable guidance for cultivating successful stakeholder relationships.

Keywords: contract farming, power, stakeholder theory, transaction cost economics
JEL codes: D2, M1, M2, P2, Q1

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1. Introduction

In many transitional economies, the agricultural sector faces numerous failures in the markets of insurance, information, and credit that limit the productivity of small farmers (Grosh, 1994; Katchova and Miranda, 2004; Key and Runsten, 1999). Contract farming helps to address many of these failures by improving economic linkages between farmers and agribusiness companies (cf. Kumar *et al*., 2023; Pham *et al*., 2021). According to a prevalent transaction cost economics understanding, contract farming embodies a form of vertical coordination that blends the benefits of both vertical integration and spot market transactions. It ensures rigorous quality control and robust coordination akin to vertical integration, while maintaining the flexibility characteristic of spot market transactions. Firms involved in contract farming commonly provide guidance and support to farmers throughout the production and marketing processes (Ba *et al*., 2019; FAO, 2013; Meemken and Bellemare, 2020). The positive economic effects of contract farming have been acknowledged by a number of authors. According to Goldsmith (1985), contract farming leads to higher incomes for small farmers, increased productivity, and the modernization of the agricultural sector (cf. also Bellemare, 2012; Key and Runsten, 1999; Maertens and Swinnen, 2009; Miyata *et al*., 2009).

While the scholarly literature on contract farming has been quite extensive, it is framed by two dominant narratives. One of these is the transaction cost economics narrative which envisions contract farming as an economic institution that has "the main purpose and effect of economizing on transaction costs" (Williamson, 1996, p. 46). This narrative brings to foreground the important observation that agri-food value chains in transitional countries indeed operate in a high transaction cost-environment which often makes "arm's length" transactions unfeasible (Hanf and Gagalyuk, 2018; Swinnen, 2005). Many of these transactions, despite their value creation potential, fail to materialize in view of weakness of public enforcement mechanisms (cf. Gagalyuk and Kovalova, 2024; Gorton *et al*., 2003). If contract farming succeeds in replacing the unreliable spot market contracting by vertically coordinated governance, it indeed economizes on transaction cost and enables value creation (cf. Boukharta *et al*., 2024).

Another narrative dominating the literature on contract farming is how contract farming is shaped by the power dynamics unfolding between farmers and intermediaries. On the positive side, these dynamics involve the use of power for coordination of business-to-business relationships within the agri-food value chains. Used in this way, power takes these relationships out of the realm of chance and gives them purpose, order, and direction (Dwyer *et al*., 1987; Xhoxhi *et al*., 2022a,b). For example, a coordinating chain agent, such as a processor or exporter, may control the decision variables of the other agents so as to promote harmonious relationships within the chain and enhance its overall performance (Belaya and Hanf, 2016), by enabling high product quality, improving market positioning, and enhancing added value.

On the negative side, contract farming scholarship has raised concerns about exploitation, especially in developing and transitional economies, where small farmers are often at a disadvantage and may be exposed to the power of intermediaries (Murray, 1997; Musa *et al*., 2014; Pokhrel and Thapa, 2007; Shrestha and Shrestha, 2000; Xhoxhi *et al*., 2014). Powerful intermediaries can shift excessive risks and unexpected costs onto farmers, compromising innovation, modernization, and restructuring (Doney and Cannon, 1997). Moreover, this exploitation can lead farmers to engage in unsustainable land use practices, such as overusing pesticides, which can have negative environmental consequences.

We argue that both of these narratives carry significant insights into the nature of contract farming in transitional economies, but fail to capture some of its crucial aspects. Transaction cost economics is known to subscribe to methodological individualism which ultimately reduces explanations of social reality to the calculus of rational utility-maximizing individuals (cf. Pratten, 1997). While methodological individualism may bring analytical rigor, it obscures the way the evolution of governance structures is shaped by thick institutional contexts and the associated systemic problems. It is noteworthy that Williamson (1996, p. 117) predicted that in institutional environments marked by substantial contractual disturbances, hybrid contracting modes will be less stable than pure types of market and hierarchical governance. But the institutional environments of developing and transitional countries, where substantial contractual disturbances are widespread, in fact prioritize hybrid governance featuring informal and trustful relationships between business partners (cf. Dorward, 2005). The prominence of informality and trust is not a good fit with the emphasis of transaction cost economics on how formal governance is used to suppress opportunistic (i.e., distrustful) relationships. The power narrative likewise remains cycled on the debate whether the power dynamics within contract farming is ultimately beneficial for farmers. Until this debate is finally settled, the effects of power must be considered to be ambivalent, indeed too ambivalent for firmly establishing a positive case for contract farming. Whereas the transaction cost economics narrative faces challenges in addressing the informal and trust-based aspects of contract farming, the power narrative vacillates between viewing it as exploitative or collaborative.

To address the limitations of these dominant narratives, we will advance a new conceptual framework of contract farming as stakeholder collaboration. As suggested by the term, this framework is grounded in the extensive literature on stakeholder theory, which understands business "a set of value-creating relationships" among stakeholders (Phillips *et al*., 2019, p. 3), and focuses analysis on stakeholder relationships rather than on individual transactions between them (Freeman *et al*., 2020, p. 225). Stakeholder theory faces no limitations in acknowledging the informal, trustful, collaborative, and indeed moral nature of those business relationships that may be considered to be successful examples of contract farming (cf. Shin *et al*., 2024). We will argue that viewing contract farming as stakeholder collaboration will not only advance the understanding of its institutional economics foundations but also link it to the strategic management and business ethics perspectives which have not been emphasized by the two dominant narratives.

In methodological terms, this paper undertakes a review of existing empirical scholarship on contract farming in transitional economies. Based on this review, we develop a new conceptual framework that offers a stakeholder-theoretic interpretation of this phenomenon. Maxwell (2013, p. 49) defines a conceptual framework as "the system of concepts, assumptions, expectations, beliefs, and theories that supports and informs … research". Such frameworks help "to bridge existing theories in interesting ways, link work across disciplines, provide multi-level insights, and broaden the scope of our thinking" (Gilson and Goldberg, 2015, p. 128; cf. Maxwell, 2013, p. 50), without necessarily generating new testable hypotheses or propositions (Gilson and Goldberg, 2015, p. 129). Accordingly, in the present paper we do not present original empirical research, but develop a conceptual framework that lays the foundation for future empirical studies. In line with the requirements noted by Gilson and Goldberg (2015, p. 128), our conceptual framework bridges contract farming and stakeholder theory literatures by elucidating how contract farming arrangements present a variety of stakeholder collaborations. It contributes to a better linkage of the disciplines of agribusiness management and stakeholder theory whose relationship has been relatively underexplored. It provides multi-level insights into how firm-level contract farming arrangements are embedded in the particularly turbulent institutional environment of transitional countries. As a result, the proposed framework broadens our thinking about the ongoing structural transformation within the transitional agrifood value chains.

2. Vertical coordination and contract farming in the transitional agrifood value chains: setting the stage

In many East European and Central Asian countries, the transition from socialist to market-based economies has precipitated significant disruptions within agrifood value chains. Early agricultural economics studies of the transition process have underscored the emergence of "private vertical coordination" as a predominant response to these disruptions, noting its pronounced prevalence and complexity relative to Western contexts (World Bank, 2005; Swinnen and Maertens, 2007). Vertical coordination has been observed across various sectors, including dairy, sugar, grains, fresh produce, and cotton (World Bank, 2005), with contract farming serving as its pivotal institutional mechanism (Swinnen, 2005). Subsequent research has further explored the role of contract farming in facilitating the integration of small-scale farmers into value chains across several countries, including Serbia, Ukraine, Kyrgyzstan, Azerbaijan and Turkey (Hanf and Gagalyuk, 2018; Xhoxhi *et al*., 2014). Some of the noteworthy studies highlighted the wine production industries in Armenia and China (Bitsch *et al*., 2020; Li *et al*., 2021), as well as the dairy sector in Albania (Imami *et al*., 2021).

Much of the current scholarship on contract farming within transitional economies centers on the persistent challenge posed by the inadequate capacity of public institutions to establish and enforce stringent food safety standards (cf. Imami *et al*., 2021). This deficiency presents a formidable obstacle to the smooth operation of agri-food value chains, as public bodies responsible for food safety oversight are unable to ensure the requisite levels of quality control. Consequently, the predominant strategy within the transitional agri-food sector today revolves around the adoption of vertically coordinated supply chains as a means to address sectoral changes, including concerns related to food safety, shifting consumer preferences, ethical considerations, and heightened awareness of the environmental impacts of food production (Carillo *et al*., 2017; Ménard, 2004). This strategy is pursued by the diverse array of firms along the food chain, ranging from small to medium-sized farms to large-scale manufacturers and food retailers (Saitone and Sexton, 2017), propelled by the imperative for product differentiation to cater to evolving customer demands (Carillo *et al*., 2017; Ménard, 2004).

Today, the suggested significance of contract farming is particularly pronounced in sectors with strong focus on quality such as the wine production. Previous research has highlighted that leading wine producers in transitional economies like Albania and Kosovo, especially those emphasizing quality, frequently own their vineyards (AGT-DSA, 2021a; FAO, 2016; Xhoxhi *et al*., 2022a,b). Despite this ownership, the wineries in question heavily rely on small-scale farmers for grape supplies. The substantial number of grape suppliers per winery, coupled with the modest size of most farms — typically less than one hectare — underscores the critical role of coordination within the value chain. The wine industry in the region exhibits considerable diversity, with some wineries specializing in large-scale production of lower-priced wines and others concentrating on premium, high-priced varieties. This trend is accentuated by the rising consumer preference for high-quality wines, driven by increasing ethnocentrism and improvements in household incomes and lifestyles across Albania and Kosovo (Zhllima *et al*., 2020; FAO, 2016; Miftari *et al*., 2021). For winemakers aiming to produce top-tier, premium wines, the acquisition of high-quality grapes is paramount. This objective can only be realized through vertically integrated contract farming arrangements that offer support to supplying farmers (Xhoxhi *et al*., 2022a,b). Wineries with a focus on quality provide guidance to their suppliers on various aspects of wine grape cultivation, including pruning, irrigation, and plant protection, often establishing grape yield targets. Moreover, in some cases, wineries or buyers extend assistance to farmers by supplying seedlings and aiding in vineyard construction (AGT-DSA, 2021a).

Likewise, Xhoxhi and Szucs's (2024) recent investigation into small ruminant value chains in Western Balkan countries sheds light on the critical role of coordination within the dairy sector in Albania. The dairy industry in the region is grappling with challenges related to milk supply shortages and issues of quality and safety. In response to these challenges, novel forms of collaboration between milk processors and farmers have emerged. A specialized small-scale milk processor situated in Malesi e Madhe, located in northern Albania, stands out as a prime example. This processor not only offers support to farmers but also actively advocates for training opportunities and financial assistance from donors, recognizing these efforts as integral to the success of his business model. Furthermore, the processor ensures that farmers receive competitive prices for their milk, surpassing those offered by other processors in the region, based on the quality of the milk supplied. The assurance of milk quality is paramount to the production of high-quality cheeses, which are targeted towards restaurants and the high-end retail market. The creation of premium-quality cheeses results in significant value addition, commanding higher prices in the market. This not only enables the processor to secure substantial profits but also allows for the sharing of this added value with farmers as incentives to maintain and enhance the quantity and quality of milk supplied (ibid).

Xhoxhi and Szucs (2024), AGT-DSA (2021b) and Imami *et al*. (2021) present the cases of two leading milk processing companies in Albania. Both companies company have undergone a comprehensive restructuring of its supply chain over the past years. Previously reliant on milk collectors for their milk supplies, they have transitioned to sourcing most of the milk directly from farmers, in order to ensure milk quality and safety standards and traceability . This strategic shift necessitated a reimagining of the approach to supply chain management and led to the implementation of initiatives aimed at enhancing milk quality and quantity. The companies offer technical assistance and financial support to their farm suppliers, recognizing the crucial role they play in the company's operations. As part of its efforts to improve milk quality and farm productivity, one of these companies deploys veterinarians to provide guidance on feeding regimens, animal health, and milk quality standards. Additionally, the company incentivizes farmers by installing cooling tanks on farms that supply larger quantities of milk or in the case of farmer groups/cooperative. In instances where farmers encounter challenges related to milk quality, processor personnel conduct thorough investigations and collaborate with farmers to address issues promptly. Furthermore, there are cases when the buyer extends financial assistance to farmers seeking to expand their herds, offering interest-free credit with repayment structured around milk deliveries. Farmers are only required to repay the principal amount, which is deducted from their milk sales, facilitating sustainable growth within the farming community (ibid).

3. Two narratives of contract farming

3.1 The transaction cost economics narrative

From a transaction cost economics perspective, vertically coordinated contract farming practices appear to be a formal governance mechanism that economizes on transaction cost by dampening the opportunistic impulses of farmers and intermediaries. However, upon closer examination, this interpretation reveals several limitations. For a start, transaction cost economics explores the attributes of alternative governance mechanisms against the background of the spot market contracting practiced within market governance. Williamson (1996, e.g., p. 105), however, makes fully clear that market governance relies on the use of the legal system for enforcing the contracts, including the possibility of litigation. But a key characteristic of the transitional institutional environment is that the legal system does not operate reliably. Particularly for small farmers, the legal system is costly and often inaccessible. If some economic actors, such as small farmers, do not seriously consider the possibility of relying on the legal system as a background institution, they are not engaged in that type of rational transaction cost-economizing calculus that was envisioned by Williamson.

Second, transaction cost economics is concerned with formal governance instruments. While acknowledging that informal human relationships may serve transaction cost-economizing purposes, Williamson sees such relationships to reflect the parameters of formal instruments, such as contractual safeguards, which "include penalties, information disclosure and verification procedures, specialized dispute resolution (such as arbitration)" (Williamson, 2002, p. 183). According to Williamson (1983), a variety of such contractual safeguards could be "hostages", i.e. investments that would be forfeited if the party posting the hostage acts opportunistically. Xhoxhi *et al*. (2014) suggest that advance payments offered by intermediaries to farmers could play the role of such a hostage. Xhoxhi *et al*.'s (2014) study of farmers in Adana, Turkey, reveals that farmers, facing significant uncertainty regarding the demand for oranges and watermelons, are hesitant to enter trading relationships with intermediaries unless the latter provide advance payments as a form of hostage (Xhoxhi *et al*., 2014). Meanwhile, it is clear that the use of formal governance instruments must be ultimately backed by the background institutions of the legal system, which often does not work reliably in the transitional context. While it may be true that informal relationships may reflect the realities of formal governance, it cannot be excluded that these relationships may play a primary role and set the context within which formal governance may unfold. The latter scenario does not seem particularly far-fetched in the transitional context. If formal institutions are not well-developed, then the possibility of vertically coordinated contract farming may more critically depend on the existence of trust, effective reciprocity, and informal common understandings than on the possibility to take legal redress. In that sense, it may be informal relationships that determine how far formal governance may go rather than the other way around.

Third, Williamson (1996, p. 6) explains that transaction costs result from a unique combination of the behavioral assumptions of bounded rationality and opportunism. This may not be a comprehensive enough explanation in a thick institutional context of transitional countries. Rather than being solely determined by inherent human traits, transaction costs can be significantly influenced by the nature of the institutional environment. As Hart (1990) argued, even in the context of Western economies, one of the underappreciated consequences of bounded rationality is the limited ability of the courts to resolve contractual issues. As the transitional context implies additional limitations of the functionality of the legal system as well as food safety control institutions, the transaction costs of conducting business in this context will tend to be higher. Furthermore, the weakness of public institutions can make value creation heavily reliant on the coordinated efforts of individual economic agents. For example, this can be seen in the case of Kosovo, where the production of high-quality wine requires effective coordination within agri-food value chains. While transaction cost economics views contract farming as a solution to manage contractual hazards within these chains, it deemphasizes these chains' systemic characteristics that influence not only transaction costs but also the very potential for value creation.

3.2 The power narrative

The concept of power has been instrumental in explaining how contract farming and vertical coordination lead to positive outcomes, such as increased farmer income and improved performance of agrifood chains. The power narrative asserts that the failure of public institutions creates a power vacuum, making it difficult to coordinate actions on a larger scale. To compensate for this lack of public power, private business power can be leveraged within contract farming arrangements. Of course, a key implication of this narrative that it is not the farmers who exercise this power, but the intermediaries who have significant influence over the farmers' economic and social well-being. Previous research shows clearly that intermediaries do not always use their power for the benefit of farmers, often generating negative effects, such as environmental harm and reduced farmers' welfare (Glover and Kusterer, 1990; Goldsmith, 1985; Key and Rusten, 1999; Little and Watts, 1994; Opondo, 2000; Porter and Howard, 1997; Simmons *et al*., 2005). Smallholders carry particularly high risks of being exploited by the intermediaries.

While the debate on the effects of power on contract farming outcomes has been ongoing, it has been usefully illuminated by Xhoxhi *et al*.'s (2018, 2020, 2022a,b) distinction between two types of power: "power over quality" (POQ) and "power over margin" (POM). POQ refers to the power intermediaries have to ensure product quality and compliance with food safety standards, which benefits both farmers and intermediaries. POM, on the other hand, refers to the power intermediaries use to exploit farmers, leading to reduced trust, reduced investments, and short-term thinking (Xhoxhi *et al*., 2018, 2020, 2022a,b). Xhoxhi *et al*. (2018, 2020, 23022a,b) have shown that reorienting power from POM to POQ can improve farmer-intermediary relationships and promote high-value crops, reduce conflict, and encourage organic production, thereby making agrifood value chains more sustainable in economic, social, and environmental respects (cf. also Bellemare, 2012; Birthal *et al*., 2007; Cai *et al*., 2008; Michelson, 2013; Miyata *et al*., 2009; Ramaswami *et al*., 2006; Singh, 2002; Wainaina *et al*., 2014; Warning and Key, 2002).

The distinction between POQ and POM has been extremely useful in clarifying the discussions around power in contract farming. However, it cannot solve the ambiguity that surrounds the concept of power itself. On the one hand, power is seen as a fundamental aspect of business-to-business relationships (Cox, 2001) and corporate organizations (Barnard, 1938). It acts as a key behavioral factor that impacts performance (Reve and Stern, 1979; Xhoxhi *et al*., 2018) and coordination between supplier firms and distributors (Wilkinson, 1973). Some authors assert that power is necessary for giving purpose, order, and direction to business relationships and removing them from the realm of chance (Dwyer *et al*., 1987; Xhoxhi *et al*., 2022a,b). However, critical scholars have been warning for decades that excessive business power can be dangerous and lead to political power games for the pursuit of privilege (Atkinson *et al*., 2019; Brady, 1943; Dugger, 1989; Galbraith, 1967; Veblen, 1975/1904). This abuse of power can compromise the very principles of a liberal society (Friedman, 1970). This leads to the conclusion that it is not possible to predict if the power exercised in contract farming will generally be of the POQ or POM type. Hence, the power narrative cannot be considered a sufficiently comprehensive explanation of how contract farming functions in transitional agrifood value chains. What this narrative lacks is a more solid account of the institutional context within which power is exercised.

4. A stakeholder theory approach to contract farming

4.1 Stakeholder theory background

Stakeholder theory has established itself as a significant area of inquiry at the intersection of business ethics and strategic management. Having received its decisive development impulse from Freeman (1984), the theory draws on the core idea that capitalistic business is constituted by stakeholders, that is, individuals and groups with a vested interest in its success. Thus stakeholder scholars see business as "a set of value-creating relationships" (Phillips *et al*., 2019, p. 3) among its stakeholders. Freeman *et al*. (2010, p. xv) describe stakeholder theory as "an abrupt departure" from the traditional perspective of business, which encourages managers to consider the interests of a wider community in society and adopt a more comprehensive approach to understanding the role of business in society. Stakeholder theory highlights the crucial role of moral norms in establishing cooperative human relationships within business, and accordingly takes a relationship to be a more useful unit of analysis than an economic transaction (Freeman *et al*., 2020, p. 225).

The focus on relationships creates space for a consideration of human complexity encompassing emotions, creativity, personal fulfillment, and trust (San Jose *et al*., 2017). Crucially, stakeholder relationships are explicitly recognized to require trust, fairness, and mutual loyalty (e.g., Bosse *et al*., 2009; Harrison *et al*., 2010). In that sense, businesses are seen not simply as economic units, but firstly and fundamentally as "human institutions populated by real live complex human beings" (Freeman *et al*., 2010, p. 29; cf. Jones and Wicks, 1999). While all this may sound intuitive, a remarkable insight of stakeholder theory is that the institutions of the mainstream shareholder capitalism do not any longer provide a sufficient outlet for the creative energy of the capitalist enterprise. According to Freeman *et al*. (2007, p. 52), "capitalism … is primarily a cooperative system of innovation, value creation, and exchange" (Freeman *et al*., p. 6). Yet, the full realization of the cooperative nature of capitalism requires the flourishing and nurturing of human relationships rather than maximizing shareholder wealth. Therefore, considering stakeholder interests to be fundamentally joint (Freeman *et al*., 2010, p. 27), stakeholder theory sees human relationships as the main locus of the value creation process.

A core interest of stakeholder theory pertains to the question how corporations respond to the demands of society in the midst of the challenges presented by globalization, liberalization, and increasing societal expectations towards businesses (Freeman *et al*., 2010, p. 3 *et seq*.). This complex landscape results in a particularly turbulent business environment (Freeman *et al*., 2010, p. 3 *et seq*.). In that sense, stakeholder theory's focus on fostering stakeholder relationships is a response to the growing recognition among managers that the traditional focus on profit and shareholder wealth maximization, which was once effective "when there was much less concern with turbulence," is no longer sufficient in today's business world (Freeman *et al*., 2010, p. 3). Stakeholder theory posits that turbulence can be addressed through the prioritization of stakeholder relationships in the formulation of new understandings of the problems of today's capitalism, such as those of value creation and trade, of capitalism's ethics, and of managerial mindsets (Freeman *et al*., 2010, p. 4; Freeman *et al*., 2020b, p. 216).

4.2 Revisiting contract farming

The turbulence in the business environment is particularly relevant in the context of agrifood value chains which require significant coordination among participants. Obviously, turbulence heightens the difficulty of coordination. Jones *et al*. (2018, p. 381) characterize turbulence in terms of environmental dynamism, high knowledge intensity of specific business activities, and significant task and outcome interdependence. Bridoux and Stoelhorst (2022) add that the joint value creation process may be subject to collective action problems, which raise the problems of opportunism similar to those considered by transaction cost economics. Obviously, ensuring coordination within agrifood chains requires managing turbulence. To achieve that effect, stakeholder theory would advise chain participants to "craft relationships in which all … stakeholders win over time, or what might be called 'win–win–win–win–win' relationships" (Freeman *et al*., 2018, p. 3). There is room to argue that successful cases of vertical coordination and contract farming in transitional economies can be described in terms of the precisely these types of relationships.

One reason supporting this interpretation is that agrifood value chains in transitional economies exhibit a peculiar kind of turbulence that arises out of the weaknesses of the extant public institutions. These weaknesses, be it in the legal system or in quality control, limit the effectiveness of formal governance in facilitating value creation. However, the key point of stakeholder theory is that value creation can also occur within informal relationships that are rooted in human complexity which includes emotions, creativity (San Jose *et al*., 2017), and perhaps even more importantly, trust, fairness, justice, and mutual loyalty (Bosse *et al*., 2009; Harrison *et al*., 2010). We argue that these moral characteristics of stakeholder relationships serve as elements of informal governance that compensate for the deficits of the formal governance. Furthermore, the overall performance of transitional agrifood value chains depends on the quality of intra-chain coordination, and as such, constitutes an example of the jointness of stakeholder interests as described by stakeholder theorists (Freeman *et al*., 2010, p. 27). Just as stakeholder theory recommends the nurturing of moral stakeholder relationships as a way of overcoming the dysfunctional consequences of shareholder wealth maximization in today's globalized capitalism, it would recommend essentially the same solution for improving the performance of transitional value chains. There is room to argue that forging and maintaining moral stakeholder relationships can address these chains' problems, such as exploitation, conflict, and opportunism.

Concurrently, the moral dimensions of stakeholder relationships within agricultural value chains may stem from the social connections prevalent in rural areas. These areas often feature intricate social networks formed through family bonds, community ties, friendships, and the leadership dynamics within rural communities. These networks, if they foster a culture of trust, become valuable assets that can be strategically leveraged by leaders within the value chain. This trust network may align with patriotic sentiments, reflecting a strong loyalty to specific locales and their inhabitants (Cafaro, 2010), or with the active involvement of certain individuals in the civic affairs of their communities. For example, in the context of Western Balkans, prominent figures in the agricultural sector often have deep connections to their local communities, stemming from their involvement in political governance or grassroots activism. These successful agricultural entrepreneurs may often have strong religious beliefs, as well as occupy prominent roles and be actively involved in religious activities or local structures, such as the village mosque. Such attributes, indicative of strong community integration, contribute to their perceived trustworthiness. The significance of religious beliefs in this context is well-recognized; for instance, Islamic principles play a crucial role in ensuring the quality control and certification of products intended for Muslim consumers (Bonne and Verbeke, 2008). There is room to argue that it is ultimately the credibility of stakeholders, rooted in their adherence to these principles, that drives trust and ensures food safety. Similarly, in twentieth-century Italy, the activism of Catholic believers led to the establishment of cooperatives that wielded influence within local agricultural networks (Fonte and Cucco, 2017). The use of religious principles to facilitate coordination within value chains through trust thus emerges as a plausible strategic approach.

Also, in emerging economies like Kosovo and Albania, where government support for agricultural sectors and rural development is limited, a notable challenge arises with people leaving rural areas and abandoning farming. This trend is exacerbated by the appeal of migration opportunities to the European Union. This scenario contrasts with that observed in African nations, where farmers often face various constraints that limit their mobility. In the regional or national contexts where the risk of widespread farmer disengagement from the sector increases, processors come to recognize the importance of preventing farmers from leaving, rather than solely pursuing immediate profits. Toward that end, processors come to prioritize the sustainability of agricultural production and the ensuring of the continuous operation of farms. To achieve this, it becomes imperative for processors to establish mutually beneficial and ultimately moral relationships with farmers, even if it means operating with minimal or zero profit margins. This sacrifice is justified by the fact that a narrow focus on short-term profits poses risks of long-term inefficiencies and financial losses for processors. For instance, if processors fail to secure sufficient raw materials for processing, it not only impacts their profitability but also leads to additional expenses such as fixed costs and loan repayments, thus jeopardizing their long-term viability.

All in all, from a stakeholder theory perspective, contract farming can be seen as a form of collaboration between stakeholders that addresses the systemic issues present in transitional agrifood value chains. These issues stem from the limitations in the value-creation potential of the chain, caused by the weakness of formal public institutions. This perspective builds upon the strengths of previous narratives on contract farming, while addressing their shortcomings. For instance, the transaction cost economics' emphasis on asset specificity is augmented by the understanding that assets become specific based on the overall value-creation potential of the value chain and the failures of formal public institutions. Furthermore, the stakeholder theory approach to contract farming highlights the role of informal human relationships in compensating for the limitations of formal institutions. In terms of the power narrative, these relationships shape the context in which intermediaries wield their power, either to the benefit or disadvantage of farmers. When these relationships are characterized by trust, fairness, justice, and loyalty, the power exercised by intermediaries is more likely to be of the POQ (power over quality) rather than POM (power over margin) type (cf. Xhoxhi *et al*., 2022a,b).

5. Contributions to the argument

5.1 Improving the understanding of contract farming

Until now, the conventional understanding of contract farming, based on the transaction cost economics narrative, has viewed it as a formal institution that helps to reduce the potential for opportunism. However, we argue that the key elements of contract farming are informal in nature and that reducing opportunistic behavior is achieved not through formal contractual safeguards, but by fostering moral attitudes. Thus, we view the moral elements of contract farming as an essential aspect of informal governance, which is necessary when formal governance is inadequate. While we acknowledge the unique context of contract farming in transition, we do not view its informal nature as a weakness. Instead, we highlight the stakeholder theory argument that turbulence in even well-developed Western economies requires managers to shift away from a singular focus on maximizing shareholder wealth and instead cultivate informal, human, and moral relationships with stakeholders.

Recent research on stakeholder theory in fact emphasizes the importance of informal relationships in shaping moral interactions among stakeholders. Valentinov and Roth (2024) argue that while transaction cost economics sees informal relationships as influenced by formal governance structures, stakeholder theory recognizes that some informal relationships can be inherently moral and not solely dependent on formal governance or contractual arrangements. In transitional contract farming, the limitations of formal governance become apparent especially in the production of goods with high export potential (e.g., greenhouse vegetables) or those subject to stringent food safety standards (e.g., dairy and livestock production). In various industries, such as meat processing in Albania (Imami *et al*., 2011; Zhllima *et al*., 2015), as well as wine production in both Albania (Imami *et al*., 2013) and Kosovo (Zhllima *et al*., 2020), formal governance structures play a crucial role in contract farming arrangements. However, challenges arise in sectors like the dairy industry, particularly when large processors do not own dairy farms, leading to ineffective formal guarantees for contract execution (cf. Imami *et al*., 2021). In the absence of formal mechanisms, processors often resort to informal methods, such as cultivating positive moral relationships with farmers. Empirical evidence supports the significance of informal elements in contract farming, indicating that trust within these informal arrangements surpasses reliance solely on formal governance. For instance, Imami *et al*. (2013) suggest that in Albanian orchard farming, informal contracts are deemed more enforceable than formal ones, driven by widespread distrust in the legal system. Similarly, studies on consumer preferences for fresh meat in Albania reveal that consumers place greater trust in their relationship with the butcher than in the official veterinarian stamp on meat carcasses (Imami *et al*., 2011; Zhllima *et al*., 2015).

Based on the above understanding of contract farming, we encourage contract farming scholarship to adopt a stakeholder theory perspective, exploring three areas in accordance with the descriptive, instrumental, and normative dimensions of stakeholder theory (Donaldson and Preston, 1995). Descriptively, a stakeholder theory approach to contract farming would examine the characteristics and mechanisms of the stakeholder relationships that form the core of its functioning. Instrumentally, this approach would focus on the effect of stakeholder relationships on the performance of individual chain actors and the chains as a whole. Normatively, it would identify and elaborate on the moral principles that could provide a compelling reason for intermediaries to consider the interests of farmers. Finally, following Donaldson and Preston's (1995) typology, we believe that a stakeholder theory approach to contract farming should also be managerial in nature, providing practical guidance for chain participants seeking to establish successful stakeholder relationships.

5.2 Informing managerial practice within transitional agrifood value chains

Stakeholder scholars have traditionally framed their research within the context of enhancing firm-level success and competitive advantage (cf. Jones *et al*., 2018). We propose that in the realm of contract farming within transitional countries, stakeholder theory takes on novel managerial significance related to specific motivations prompting managers at all levels of agrifood value chains to turn to stakeholder theory for guidance. One such motivation arises from the formidable task of navigating weak institutional environments. As outlined earlier, transitional countries often grapple with inadequate or ineffective formal institutions, spanning legal systems, regulatory frameworks, and enforcement mechanisms. In such settings, contract farming arrangements may lack the requisite legal safeguards and enforcement mechanisms essential for ensuring fair and equitable outcomes for all stakeholders involved. Leveraging stakeholder theory enables managers to address these institutional shortcomings by tapping into informal mechanisms like trust, reciprocity, and adherence to social norms to govern contractual relationships and mitigate instances of opportunistic behavior. These mechanisms not only facilitate adaptation to shifting circumstances but also aid in anticipating risks and capitalizing on opportunities arising from the dynamic business landscape.

Secondly, managers may find motivation to apply stakeholder theory due to its emphasis on fostering trust in the absence of formal guarantees. In environments where robust formal governance structures are lacking, trust becomes indispensable for the successful operation of contract farming arrangements. Stakeholder theory underscores the significance of cultivating trust-based relationships with various stakeholders, such as farmers, processors, and intermediaries. By adhering to principles of transparency, fairness, and integrity in their dealings, stakeholder theory provides managers with a framework to cultivate trust and instill confidence among stakeholders. This approach not only enhances the effectiveness of contract farming initiatives but also promotes their long-term sustainability.

Thirdly, stakeholder theory can assist managers in comprehending and leveraging the social and cultural dynamics inherent in agrifood value chains. Transitional countries often feature distinct social and cultural elements that impact the dynamics of contract farming. These may encompass traditional social networks, cultural norms, and historical legacies that influence stakeholders' attitudes, actions, and anticipations. By applying stakeholder theory, managers can effectively understand and navigate these social and cultural dynamics. By recognizing and respecting local customs, traditions, and values, managers can cultivate stronger relationships with stakeholders and foster increased acceptance and adoption of contract farming practices.

This approach facilitates smoother integration into local contexts and enhances the overall effectiveness of contract farming initiatives.

Fourthly, stakeholder theory can offer valuable assistance to managers committed to fostering inclusive and equitable agricultural development. Contract farming has long been scrutinized for its potential to perpetuate socio-economic exclusion and exploitation (cf. Vicol *et al*., 2022). We posit that stakeholder theory can serve as a guiding framework for managers seeking to leverage contract farming as a means to promote inclusive and equitable development. This entails facilitating smallholder farmers' access to markets, technology, and capital. In transitional countries, disparities in power, resources, and information among stakeholders are often pronounced. By leveraging stakeholder theory, managers can identify and rectify these disparities, ensuring that contract farming initiatives yield benefits for all stakeholders, especially smallholder farmers and marginalized communities. This approach aligns with broader efforts to foster sustainable and inclusive agricultural practices in transitional economies (cf. Hajdu *et al*., 2021).

In practical terms, stakeholder theory enlightens managers about the efficacy of informal governance mechanisms, such as trust, fairness, and mutual loyalty, which can offset the deficiencies of formal governance structures. Understanding these governance mechanisms holds particular significance in transitional economies where the legal system and quality control mechanisms may lack robustness. By embracing stakeholder theory, managers gain insight into how ethical stakeholder relationships can mitigate challenges like opportunism, exploitation, and conflict, thereby enhancing coordination and performance within the value chain. Moreover, stakeholder theory advises managers to harness social networks as a vital asset for successful vertical coordination. These networks serve to align business practices with local sentiments, such as patriotism or religious beliefs, thereby bolstering stakeholder credibility and trustworthiness. This strategic alignment fosters stronger relationships and greater collaboration, ultimately contributing to the success and sustainability of contract farming initiatives in transitional economies.

5.3 Informing stakeholder theory

Stakeholder theory has long struggled with the issue of how managing for stakeholders fits within the larger system of capitalistic institutions. Contemporary stakeholder scholars still see areas for improvement in this regard. Johnson-Cramer *et al*. (2022, p. 1112) highlight the existence of "the stakeholder-system divide" and the need for a "system-level stakeholder theory," as pointed out by Wood (1994). Wood (1994) argued that a system-level stakeholder theory should take into account the "societal, organizational, and legal constraints" that impact the fairness of corporate operations and the balance between corporate power and autonomy for corporate managers. Despite Wood's (ibid) early call, the prevalent firm-level focus of stakeholder theory has resulted in a persistent disconnection between the firm-level and system-level perspectives, as noted by Johnson-Cramer *et al*. (2022, p. 1112). As a result, the application of stakeholder theory to the institutional context of transitional economies has been quite limited. The proposed stakeholder view of contract farming offers a novel contribution to stakeholder theory by proposing that stakeholder relationships reflect the constraints imposed by dominant institutions. In developed market economies, these institutions are linked to shareholder capitalism, while in the context of transitional economies, they are related to the legal system and public food quality system. We argue that the need for moral stakeholder relationships arises from a desire to address the shortcomings of these dominant institutions.

Furthermore, the examination of contract farming may trigger discussions among stakeholder theorists who examine the ways in which managing stakeholders involves the exertion of power. Stakeholder theory recognizes the presence of power but has typically linked it with privilege (Colvin *et al*., 2020) that could make some stakeholders more salient than others (Mitchell *et al*., 1997). For instance, the conventional hub-and-spoke model of firm-stakeholder relationships implies that managers have a type of central control over their stakeholders (Bridoux and Stoelhorst, 2022, p. 220). The potential forms of power in stakeholder relationships have elicited critical evaluations about the dangers of overly firm-centered interpretations of stakeholder theory (Bevan *et al*., 2019, p. 132; Calton and Payne, 2003; Fassin, 2008; Rowley, 1997; Stormer, 2003), since the use of power may weaken the collaborative character of stakeholder relationships. Although we do not refute these concerns, we demonstrate that the exertion of power may foster those stakeholder collaborations that play a crucial role in filling the gaps of formal institutions. In fact, we aim to apply to stakeholder collaborations the same constitutive understanding of power that Chester Barnard (1938) applied to formal organizations. If Godfrey and Mahoney (2014) are correct in viewing Barnard as a precursor to contemporary stakeholder theory, then discerning a constructive use of power at the heart of stakeholder relationships will offer fresh perspectives on both the hub-and-spoke model and managing for stakeholders more broadly.

6. Conclusion

We present a novel perspective on contract farming in transitional economies that departs from traditional perspectives based on transaction cost economics and power dynamics. We propose a stakeholder theory approach to contract farming, focusing on the informal and moral dimensions of stakeholder relationships. We see stakeholder collaboration as a way to address the limitations of formal governance and the inadequate legal systems by drawing upon the informal and moral dimensions of relationships between stakeholders. This perspective builds upon the strengths of the dominant two narratives on contract farming, while addressing their shortcomings. The transaction cost economics' emphasis on asset specificity is augmented by the understanding that assets become specific based on the overall value-creation potential of the value chain and the failures of formal public institutions. Furthermore, the stakeholder theory approach to contract farming highlights the role of informal human relationships in compensating for the limitations of formal institutions. In terms of the power narrative, these relationships shape the context in which intermediaries wield their power, either to the benefit or disadvantage of farmers.

The proposed stakeholder-theoretic understanding of contract farming opens up exciting avenues for future research centered on testing the hypothesis that informal and moral relationships between stakeholders are more effective than formal contractual safeguards in mitigating opportunistic behavior and fostering cooperation within contract farming dynamics. This hypothesis may be investigated by employing a mixed-methods approach that combines quantitative data on contract performance indicators, such as yield, quality, price, income, and satisfaction, with qualitative insights into stakeholder perceptions, attitudes, and behaviors, including trust, commitment, reciprocity, and fairness. By comparing different types of contract farming arrangements — such as formal versus informal, short-term versus long-term, and simple versus complex — scholars can gain deeper insights into how these arrangements influence the informal and moral dimensions of stakeholder relationships.

Another rich area of exploration could be a longitudinal and comparative examination of the factors influencing the formation, maintenance, and evolution of informal and moral relationships between contract farming stakeholders. By tracking these relationships over time and across diverse contexts — such as regions, sectors, and products — scholars can identify the variables that shape the development and quality of stakeholder relationships, including stakeholder characteristics, institutional environment, market conditions, technological innovation, and social norms. Moreover, investigating the feedback effects of stakeholder relationships on these variables will shed light on the dynamic interplay between stakeholders and their environment, informing opportunities and challenges for contract farming.

Furthermore, we see a considerable potential in the analysis of how informal and moral relationships between stakeholders impact value creation and distribution in contract farming. Adopting a value chain approach, scholars can map the flow of value from production to consumption and assess the contribution and capture of value by different stakeholders. This approach will enable us to evaluate the economic, social, and environmental outcomes of contract farming and examine how they are influenced by the power dynamics within the relationships between farmers and intermediaries. Moreover, exploring the trade-offs and synergies between different types of value and how they are balanced and integrated by stakeholder collaboration will provide valuable insights into the dynamics of value creation and distribution in contract farming contexts.

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