



Making Markets Work Better for the Poor

## 30 cases of contract farming AN ANALYTICAL OVERVIEW



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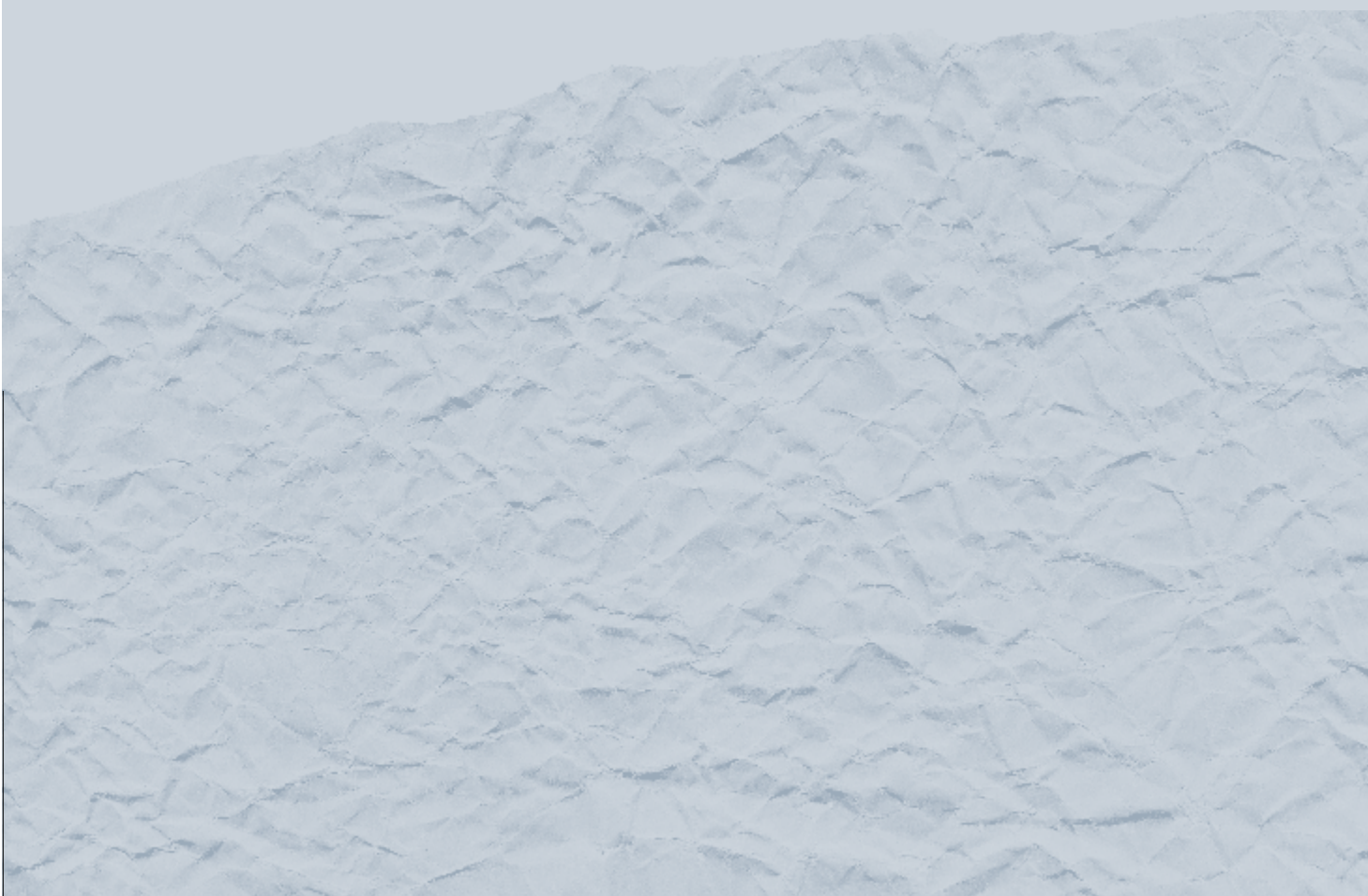
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# **30 CASES OF CONTRACT FARMING: AN ANALYTICAL OVERVIEW**



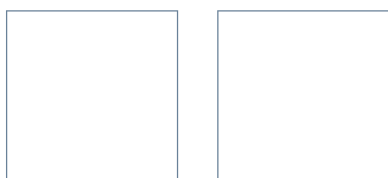


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# 30 CASES OF CONTRACT FARMING: AN ANALYTICAL OVERVIEW



Contract farming has the potential to improve the welfare of smallholders, however it is not a sufficient condition for such improvement. Smallholders can be excluded from contracts because of selection bias by agribusinesses awarding contracts to large-scale farmers. The direct negative impacts of contract farming is that farmers can be controlled and exploited by large-scale agribusinesses and lose their bargaining power. Furthermore, farmers may be adversely affected by the second-round effects of contracts on incomes and prices and suffer from narrowing of markets that lie outside of contracts. Annex 3 summarizes the advantages and problems of contract farming for both farmers and processors.

## I. Background

Along with globalization, market liberalization and technology innovation, the value chains have become increasingly important for all economic agents. For the program on *Making Markets Work Better for the Poor*, the global trend and experiences in other developing countries suggest 3 important lessons: (i) be part of value chains; (ii) learn how to create value chains; and (iii) learn how to include the poor in value chains<sup>1</sup>.

It is agreed that poverty reduction needs not only economic growth but also institutional mechanism to integrate poor farmers into the value chains (both nationally and globally), in order to help them benefits from market development. Development of contract farming is regarded as the potential institutional mechanism to integrate the poor farmers into the value chains.

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"*<sup>2</sup> (Eaton and Shepherd, 2001: 2). Contracts are often initiated by large-scale agribusiness firms, which undertake backward integration by forming alliances with groups of smallholders and, through written orverbal contracts, providing farm inputs such as credit and extension in return for guaranteed delivery of produce of specific quality often at predetermined prices.

Originally, contract farming emerged from the break up of many plantations in colonial countries after independence when foreign businesses were subject to nationalist pressures, threats of expropriation and new conditions of profitability with a changing international division of labor. This tendency has been promoted by international donors, which regard outgrower

schemes under state and/or private auspices as a way of creating dynamic partnership between agribusinesses and smallholders for technology transfer, innovation and market growth. Furthermore, market liberalization and globalization has been associated with more interaction between agribusinesses and smallholders in developing countries to meet demand of consumers in developed countries for high quality products with more technical specification and branding.

The major theoretical backup for contract farming is "transaction cost" theory<sup>3</sup>, which considers 3 factors for the emergence and evolution of contract farming, i.e.: bounded rationality, opportunism and asset specificity<sup>4</sup> (Williamson, 1989; Simmons, 2004). In the absence of these factors for market transaction, contract farming would not occur since agribusiness firms could buy all their produce in spot markets which would be instantly and perfectly responsive to their demand. Another procurement option for agribusiness firms is to operate their own plantations. Yet, with this option they may face other transaction costs such as supervision costs, crop risk, costs of land and skill acquisition. Therefore, contract farming may occur only if it generates lower transaction costs compared to the other alternatives of market arrangement.

Contract farming can be categorized either by the intensity of contractual arrangement or the schemes of organizational structures (Eaton and Shepherd, 2001). The intensity of contractual arrangement varies according to the depth and complexity of the provisions in 3 areas of market provision, resource provision and management specification. The schemes of contract organizational structures depend on the nature of product, resources of the processors and the intensity of the relationship between farmers and

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<sup>1</sup> Goletti (2004: 9-10).

<sup>2</sup> From now on, following Eaton and Shepherd (2001), we will use the terms of parties participating into the contract interchangeably, unless otherwise clearly indicated, as follows: (i) sponsor as processing and/or marketing firms, agribusiness firms, investor, processors, and contractor; (ii) farmer as producer and contractee.

<sup>3</sup> Annex 1 shows details of more recent theories by Gereffi, Humphrey and Sturgeon (2003) on market governance.

<sup>4</sup> Bounded rationality describes differences in information between contracting parties. Opportunism may occur when there are opportunities for taking advantages of situation to the detriment of the other party in an agreement. Asset specificity reflects risks associated with protecting 'sunk costs' in processing plants, logistical systems, and market development or, for smallholders, costs of protecting investment in specialized machinery and knowledge.



processors. Those categorizations are described in Annex 2.

Contract farming has the potential to improve the welfare of smallholders, however it is not a sufficient condition for such improvement. Smallholders can be excluded from contracts because of selection bias by agribusinesses awarding contracts to large-scale farmers. The direct negative impacts of contract farming is that farmers can be controlled and exploited by large-scale agribusinesses and lose their bargaining power. Furthermore, farmers may be adversely affected by the second-round effects of contracts on incomes and prices and suffer from narrowing of markets that lie outside of contracts. Annex 3 summarizes the advantages and problems of contract farming for both farmers and processors.

The viability of contract farming depends on both contracting environment and management practices. The contracting environment includes the strength of markets for contracted output, government macro policies, technical sophistication in production and attenuation of land ownership while important management elements are quality of management and actions taken by management such as farm groups, selection of participants for contracts, managing contract default and conflict resolution.

Decision 80, promulgated in 2002 by the Vietnamese Government, aims to promote agricultural transformation from a subsistence to a commercialized and export-oriented agriculture. This decision, often known as "four-party" contract, has attempted to increase the use of contracts to improve procurement and efficiency, and to promote technology innovation in the rural economy.

A number of reports from the Ministry of Agriculture and Rural Development (Dang Kim Son, Nguyen Minh Tien et al. 2005) and other studies (M4P/ADB, 2005; Pham Quang Dieu et al., 2004; Tran Cong Thang, Pham Quang Dieu et al., 2005; Nguyen Do Anh Tuan, Tran Cong Thang

et al., 2005) shows 4 major issues for implementing Decision 80 in Vietnam:

- The proportion of contract sale is quite low, often less than 30 percent of total output. Only for some agricultural products with high processing requirement like sugarcane, cotton, milk, cigarette, tea and rubber, the proportion of contract sale may reach 30 percent (Kim Son, Nguyen Minh Tien et al. 2005: 9).
- Reneging on contracts is quite common, including reneging by processors and farmers refusing to deliver product for repaying the advances on inputs and credit provided by processors.
- Direct contracts between farmers and processors are often transformed into a disguised form, in which contracts are often made between processors and traders (who are the representatives for farmer groups) with limited coordination with farmers.
- Contract farming is more likely to favor only large-scale farmers in highly commercialized regions like the Southeast and the Mekong Delta.

***It is agreed that contracts to date under Decision 80 have largely been unsuccessful. Furthermore, it is worth noting that even successful contract farming systems may hurt, rather than help, poor farmers.***

This raises the need of empirical investigation of mechanism to integrate the poor and improve their well-being through contract farming. However, studies done so far on contract farming still have a number of limitations<sup>5</sup>:

- Most of the studies just focus on the management aspects of contract farming rather than contracting environment, which may raise important implications for policy intervention.
- Lessons learnt are not specified for various organizational schemes of contract farming though it has been already recognized that

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<sup>5</sup> For more details, see M4P/ADB (2005).

"one size fits all" approach of contract system may not work for all kinds of agricultural products and locations.

- Studies often focus on pricing structure of contract farming, while other important dimensions of contract system (such as contract formula, format and specification) often overlooked.
- There is no systematic and coherent study on the impacts of contract farming on the poor.

## II. Objectives

The study has investigated 30 cases of contract farming linking small-scale farmers to processors. The case studies of contract farming are expected to:

1. Figure out the practices of contract farming in Vietnam, so international donors and domestic stakeholders may recognize the current situation and problems of contract farming, and appropriate measures to improve the performance of contract farming for the benefit of the poor.
2. Contribute important lessons for policy intervention and for the advocacy works of local managers and developers in the fields of contract development and poverty reduction.
3. Prepare background of contract farming cases for implementing pilot projects on contract development

Under those objectives, the study has focused on the following research questions:

1. What is the typology of contract farming in Vietnam?
2. What are the major characteristics of various schemes of contract farming in Vietnam?
3. What are the factors affecting the success or failure of various schemes of contract farming?
4. How to integrate and make the poor benefit from various schemes of contract farming?
5. What are the lessons for contract development and poverty reduction in Vietnam?

## III. Approach and Methodology

### 1. Case Selection

The study takes into account 3 dimensions for case selection:

- (i) level of success;
- (ii) organizational schemes;
- (iii) location.

Two-thirds of cases have been pre-determined as successes of contract farming, and the rest are somehow failures. For the categorization of contract farming cases, the study has selected the organizational schemes, rather than levels of contract farming intensity because it helps pre-determine stakeholders and organizational structures involved in contract farming more easily. Furthermore, it has been proposed that cases are evenly distributed through out various locations in Vietnam, both in the North, the Center and the South.

Success of contracts might be measures by whether they persist over time, indicating both parties are satisfied with the arrangement. Because Decision 80 was enacted in 2002, the time of 3-5 years are considered the "cross-point" for success or failure of contract. In addition, this timeframe combines other criteria such as: (i) growth of farmer and land coverage under contract; (ii) growth of output and sale under contract; (iii) number of contracts reneged upon; (iv) number of delayed repayment of advances on inputs and credit provided by processors; and (v) growth of processors' market outlay and revenue.

Among organizational schemes, the study focuses on the multipartite model since the this "two-contract modality" through cooperatives or farm groups is quite common in Vietnam under Decision 80. Yet, the study still takes into consideration other schemes, in order to give a flavor of current situation of contract farming in Vietnam. The study combines the intermediary and informal models into one category because empirical evidence suggests that those 2 models are often overlapped in Vietnam. The last scheme of contract farming is expected to give a comprehensive picture of contract farming and

become a benchmark for comparing the impacts of various contract schemes on the poor.

In each region, the study focuses on products with strong competitiveness and high growth potential in the future. In the North, cases are selected on the basis of industrial crops in the Northern Uplands, fruit and vegetables and livestock in the Red River Delta. In the Center, the study focuses on industrial crops, and fruit and vegetables crops. In the South, the focus is placed on food crops, fruit and vegetables, and auxiliary agricultural activities.

## **2. Case Guide**

For each case, the study describes major characteristics of contract farming case as follows: (i) general background; (ii) evolution; (iii) terms of contract; (iv) reasons for success/failure; and (v) lessons learnt and recommendations. For the first three items, the study focuses on information such as contact address, size of business, products, market outlets, and contract formula, format and specification.

For each case, the study considers two major groups of factors affecting the viability of contract farming: (i) economic, technical and social environment; (ii) and management practice. For the former, focus is put on strength of markets for contracted output, government macro institutional policies, technical sophistication in production, and attenuation of land ownership. For the latter, the study investigates the quality of contract management (such as the opportunistic behavior of staff of agribusinesses, social contact, knowledge of cultural values, and role of leadership) and actions taken by management (such as methods of setting up farm groups, selection of participants for contracts, enforcement of contract default and management of conflict resolution).

With its limited scope and timeframe, the study focuses only on the issues of exclusion/integration and direct effects of contract farming on the poor farmers. The issues of second-round effects and regional impacts of contract farming will need other studies with greater scope.

## **3. Data Collection Methods**

Firstly, the research team conducted desk studies and interviews in Hanoi to identify suitable case studies. Research team members have interviewed governmental officials, NGOs, the media, representatives of donor agencies and other researchers. The researchers obtained a list of 50-60 contract farming cases, from which the 30 most suitable cases were selected according to the above criteria.

At the research sites, key informant interviews were conducted with local leaders (at both provincial, district and commune levels, or leader of cooperatives or farm groups if they involve in contract farming) in the first instance to acquire background information about the localities. Then in-depth interviews were used in the meeting with contractors. The in-depth interviews strictly followed the case guide mentioned in the approach of the study, and they built up the major basis for the story of contract farming in each case.

A number of focus group discussions were undertaken with contract farmers (around 10-20 farmers: half poor and half non-poor) in some provinces. These discussions provided historical background of the contract farming case and other market arrangement for products under contract in the research sites. Ranking and scoring exercises were used in the focus group discussions to look for factors affecting success or failure of contract farming (and determinants of contract engagement and impacts of contract participation on the well-being of farmers, if necessary).

With the above approach for case studies being utilized, this analytical overview is concerned with the following issues: (i) typology of contract farming; (ii) characteristics of various contract farming schemes; (iii) success factors of various contract farming schemes; (iv) lessons learnt for contract development and poverty reduction.

## **IV. Major Characteristics of Contract Farming in Vietnam**

Following the analytical categorization of contract farming, the research team has investigated all types of contract farming in Vietnam. The research team has conducted fieldwork in 11 provinces

scattered all over Vietnam: Lao Cai (in the Northern Upland), Hanoi, Nam Dinh and Ha Tay (in the Red River Delta), Quang Nam (in the Central Coastal Area), Lam Dong (in the Central Highland), Ho Chi Minh City (in the Southeast), Vinh Long and Tien Giang (in the Mekong River Delta).

Table 1 shows the names of 30 cases of contract farming, in which 20 cases are regarded as success, and 10 cases as failure of contract farming<sup>6</sup>. The multipartite model accounts for almost half of cases, while the number of cases is 10, 2 and 3 for centralized, nucleus estates, intermediary and informal models respectively. Nine cases have been studied in the North, 9 in

**Table 1. Cases Selected**

Location Type of Contract		The North	The Center	The South	Total
<b>Success</b>	<i>Multipartite</i>	- Luveco Co. - Nam Dinh (vegetable) - Handicraft Jointstock Co. - Nam Dinh (vegetable)	- Xuan Huong Cooperative - Lam Dong (vegetable) - Hiep Nguyen Cooperative - Lam Dong (vegetable) - Cotton and fibre Jointstock Co in the Center - Quang Nam	- Tan Phu Trung Cooperative - HCMC (safety vegetable) - Thanh Loi Cooperative - Vinh Long (safety vegetable) - Phuoc Hau Cooperative - Vinh Long (safety vegetable)	8
	<i>Centralized</i>	- CP Group - Ha Tay (Pig) - Le Minh Cigarette Co. - Lao Cai - Sustainable Agricultural Product Co. - Hanoi (organic vegetable)	- Hai Yih Tea Co. - Lam Dong	- Sao Viet Center - HCMC (safety vegetable) - Thanh Nam Thang Co - HCMC (bee's honey) - Hoang Gia Co. - Vinh Long (grapefruit)	7
	<i>Nucleus estates</i>	- Thanh Binh Tea Plantation - Lao Cai	- Cau Dat Tea Co. - Lam Dong		2
	<i>Intermediary and informal</i>	- Rose Cooperative - Lao Cai		- Trung Tin Co. - HCMC (rice paper) - Tien Giang Vegetable Co. (pineapple)	3
<b>Failure</b>	<i>Multipartite</i>	- Vietnam Agro-Forestry Jointstock Co - Hanoi (safety vegetable)	- Thai Hoa Co. - Lam Dong (coffee) - Da Hoai Co.-Lam Dong (cashewnut)	- Loi Thuan Cooperative - Tien Giang (paddy) - My Luong Cooperative - Tien Giang (fruit) - Cholimex -HCMC (chilly) - Tan My Chanh Cooperative - Tien Giang (vegetable)	7
	<i>Centralized</i>	- Nestle - Ha Tay (milk)	- Agro-Processing Co. - Quang Nam (pineapple) - Bao Loc Silworm Co. - Lam Dong		3
<b>Total</b>		<b>9</b>	<b>9</b>	<b>12</b>	<b>30</b>

<sup>6</sup> Detailed list of cases are shown in Annex 4.

the Center and 12 in the South of Vietnam. In each region, the research team has selected cases with products representing the competitiveness and growth potential of each region. For instance, cases of industrial and ornamental crops are selected in the Northern Upland, vegetables and livestock in the Red River Delta, annual industrial crops in the Central Coastal Area, vegetable and perennial industrial crops in the Central Highland, vegetables and fruits, paddy and other auxiliary agricultural crops in Ho Chi Minh City and Mekong River Delta. It is worth noting that one-third of cases involves with vegetable crops, particularly safety vegetables in the peri-urban areas, since this crop has been booming to serve the increasing demand of high-income urban consumers for high-quality and safety vegetables. On the other hands, only one case of food crop is selected because cases of paddy contract have been already mentioned quite often in other studies.

This section will review the major characteristics of each type of contract farming, including: (i) contract participants; (ii) evolution of contract farming; (iii) terms of contract; and (iv) major constraints on contract operation.

### ***1. Multipartite Model***

In this model, contract farming is often operated through cooperatives and farmer groups, though the processors sometimes implement the contract through their affiliated procurement agents. There are various types of processors participating in this contract, including both processing enterprises (SOEs, shareholding companies, foreign joint-ventures, private companies), supermarkets, wholesale and retail agencies. The multipartite model also cover a range of various agricultural products from annual crops (paddy, vegetables, cotton) to perennial crops (fruit, cashew-nut, and coffee). Yet, this model is likely to be appropriate for small farmers, who cultivate crops with high risk and requirement of labeling and special marketing channels (like safety vegetables). Outlet for farmers in this model is strongly driven by the buyers, therefore scope and size of the contract depends strongly on the market outlets and production capacity of processors.

Interestingly, contract farming in multipartite

model occurred both before and after the issue of Decision 80 in 2002. For cases of pre-2002, contract farming was based on long-term establishment of input-supply zone for agro-processing enterprises and close relationship between enterprises and the cooperatives, with strong support of local governments. Yet, it is recognized that Decision 80 has provided incentives to trigger the participation of farmers and enterprises into the contract as well as the establishment of cooperatives and farmer group for contract farming. It is worth noting that SOEs is quite interested in implementing Decision 80, given the incentives of the decision such as credit and marketing support. In addition, the provincial Departments of Agriculture and Rural Development (DARD) have played a very active role in implementing Decision 80, by supporting the establishment of cooperatives and contract farming for small farmers. Major supports of DARDs include information dissemination of contract farming, raising awareness of contract farming among small farmers, introduction of market outlets and partners for contract, and technical support through agricultural extension system.

Contract farming is often initiated in areas with availability of agricultural intermediate inputs for further processing and/or in the area where enterprises are willing to set up stable supplies of intermediate inputs. In the initial stage, contract farming really motivates the interests of contract partners, but success of contract farming is accompanied when enterprises have well prepared land use planning, selected appropriate contract farmers and found out good market outlets. In case of contract failure, some enterprises change to outsource the procurement stage to other agents or pay attention only to sales of inputs for agricultural production to farmers.

In the multipartite model, particularly for perennial crops, processors often provide inputs on credit to farmers through the cooperatives and farmer groups. For annual crops, either processors or the cooperatives themselves may provide inputs on credit to farmers. Contract price is set in various methods. For perennial crops with high requirement of investment, processors often set up floor price for procurement, and the actual purchasing price is fixed for each year. For annual

crops, contract price is often higher than the spot-market price, in order to create incentives for farmers' sale as well as to motivate the cooperative management board. In the multipartite model, processors collaborate closely with the cooperatives to monitor and supervise production process of farmers. Furthermore, SOEs often provide fund for crop insurance for contract farmers.

The most important constraint in the multipartite model is the small-scale of farmers' production, which in turn prevent them from keeping the technical standard for product and production process. In addition, it is worth noting that it takes time to raise awareness of, and convince small farmers to strictly follow technical advices provided by either the processors' technicians and/or extension workers. Furthermore, cooperatives are limited by the availability of working capital, therefore it makes it difficult for the cooperatives to facilitate the procurement for on-time deliveries and technical monitoring over farmers' production.

On the other hand, major constraint for the processors is the uncertainty of market outlets, which sometimes force the processors to delay the procurement or payment for farmers. It has negative impact on the reputation of processors and on the relationship between processors and farmers. In addition, price instability, particularly for crops like vegetable, and purchasing competition from various stakeholders make it difficult for processors or even the cooperatives to control delivery of contract output from farmers. Furthermore, for product that needs labeling like safety vegetable, there is no effective certificate system hence the processors themselves have to cover all the costs of quality warranty. Meanwhile, the real safety vegetables often face price competition from the fake goods in the free markets.

The research team has found out very few cases, where processors receive credit support from the government, even for cases of SOEs. The lack of credit restraint the processors to open new contract or to expand the contract areas. Besides, processors complain that they do not get any support from local government in case of contract default. Therefore, it depresses processors'

incentive to sustain contract farming in those default areas.

## **2. Centralized Model**

In the centralized model, processors have direct contract with farmers. Therefore, processors are not interested in the contract with small farmers since it may generate high transaction costs. For small farmers, enterprises often encourage them to establish cooperatives/farmer groups to participate in contract farming. Processors in the centralized model are often large-scale enterprises, particularly foreign and joint-venture companies. Contract farmers in this model often need to make high basic investment in the infrastructure for production. Usually, this model is appropriate for perennial crops or other agriculture products with high requirement of basic investment.

Contract farming in this model is often initiated by enterprises to set up stable supplies of intermediate inputs after they have made big investment in processing factories in certain locations. In this model, contract farming also occurred both before and after the issue of Decision 80 in 2002. The implementation of Decision 80 is only undertaken if DARDs actively promote the linkages between enterprises and farmers. In this model, enterprises appraise the input-supply zone very carefully before they make investment decision and participate in direct contract with farmers. Success of contract farming is accompanied when enterprises operate efficiently, establish long-term commitment with contract farmers, and make good preparation for investment.

In the centralized model, processors often provide credit in cash to farmers to make basic investment. In addition, processors also collaborate with the local banks to lend credit for working capital of contract farmers. Furthermore, contract farmers also receive inputs on credit from the processors. In this model, processors have specialized technical teams strictly monitor and supervise production process of contract farmers. Processors set up floor price for procurement, and the actual purchasing price is stabilized and negotiable. Often, the actual purchasing price is higher than the spot-market price. Processors also provide fund for crop insurance for contract farmers in this model.



The most important constraint in the centralized model is the lack of consensus between farmers and processors on the terms of contract, particularly on technical standards of product deliveries. While the multipartite model may have the cooperatives and/or farmers' group mobilize farmers' support to follow the technical standards established by the processors, it is not easy for processors in the centralized model to deal with farmers individually to follow technical standards in production process. As usual, it also takes time to raise awareness of, and convince farmers to strictly follow technical advices provided by the processors' technicians. It is reported that processors in the centralized model often face higher transaction costs in doing business with individual farmers, and processors are willing to have cooperatives represent farmers in the contract.

However, farmers in the centralized model also complain that technical standards established by the processors are not clear and transparent, therefore it creates risk for farmers in the case that processors have difficulties of market outlets and are not willing to procure further contract output from farmers. Particularly, processors with monopsony power may use technical standards as a solution to reduce price paid for farmers. Furthermore, small farmers also claim that sophisticated procedures of payment by processors discourage farmers to sustain their incentives to respect terms of contract.

Similar to the multipartite model, price instability and purchasing competition from various stakeholders make it difficult for processors to control delivery of contract output from individual farmers. Meanwhile, it is reported that there is no effective legal mechanism for the processors to sanction contract-default farmers, particularly in the case that the processors have made investment and provided inputs on credit to contract farmers. Furthermore, local governments often support only farmers in case of contract default, and processors, particularly foreign and joint-venture companies, have to suffer all the risk of contract default. It is also worth noting that Decision 80 only provides credit support to SOEs in contract farming, therefore non-state enterprises are restrained from

access to financial support to initiate and expand contract farming.

### ***3. Nucleus Estate Model***

In this model, processors also have direct contract with farmers, but processors also own or control land used by farmers. Processors in the nucleus estate model often used to be state owned farms, which have been equitized and reallocated land for farmers' management recently. Contract farmers are the previous worker farmers in the state owned farms or farmers adjacent to the processors' land. Due to historical factors of state owned farms, which are often located in the hilly and mountainous areas, this contract is often used for perennial crops.

The nucleus estate model started when the state owned farms reallocated land to worker farmers and persuaded adjacent farmers to participate in contract farming. Scale of the previous state owned farms are quite large, so that they do not need support from the implementation of Decision 80. However, management inefficiency, particularly in procurement management, has forced the processors to establish contract farming through outsourced procurement agents.

In this model, contract farmers take the advantages of reallocated land for cultivation with good basic investment, which has been made under the central planning system. In addition, contract farmers also receive inputs on credit and certain amount of loans in cash. Furthermore, processors provide funds for crop insurance for contract farmers. Yet, contract farmers have to make commitment in the contract to deliver all produce to the processors. Otherwise, processors may take back land if farmers renege on the contract. Specialized technicians work for the processors to provide technical support and strictly monitor and supervise the production process of contract farmers. Processors often set up floor price for procurement, and fix the actual purchasing price annually.

The most important constraint in the nucleus estate model is the high transportation cost because contract land is often located in the remote and mountainous areas, where the

distance is far from farm gate to the processing factories and the mountainous typology makes the transportation conditions difficult. Though enterprises take the advantages of farmers' awareness in terms of technical knowledge (since most of worker farmers have been accustomed to technical process in the previous state owned farms), there are still cases of renegeing on contracts by farmers when market prices are higher than the contract prices.

However, farmers in the nucleus estate model complain that contract prices are often set unfairly by the processors, and lower than the spot-market prices. This lower price reflect difficulties of equitization process of state owned farms, which are assimilating themselves with the market system, finding new way of doing business with financial autonomy and seeking new market outlets. In addition, still registered as the state owned farms, the processors have to take political and social responsibility, hence it adds up relatively higher costs of production for the processors and eventually force them to set low purchasing price for farmers.

#### **4. Intermediary and Informal Model**

This model is based on oral contract or trust among various types of contract partners. There are various types of processors participating in this contract, including both processing enterprises, wholesale and retail agencies. Farmers may participate into contract in this model individually or through farmer groups. Contract transaction is often operated through intermediary traders or procurement agents. This type of contract provides market access for farmers supplying normal agricultural products, which are often characterized by unstable market outlets and price.

This type of contract arose from the need of business expansion for small-scale enterprises, which have been established for a long time in certain locations. Yet, it is difficult to increase the scale and scope of contract farming in this scheme because informal contract cannot create regular communication for strict control of product quality and standards. Yet, it is expected that the development of ICT technologies and better

technologies to codify transaction will encourage partners in this scheme to participate in formal contract.

In the intermediary and informal model, terms of contract are established very loosely. This is often the oral contract, which set up principle for contract price and delivery in the pre-harvest period. There are no inputs on credit and very few technical support and supervision. Contracts are mostly based on the trust and relationship among contract partners.

The most important constraint in the intermediary and informal model is the lack of coordination among the processors, intermediaries and farmers. Market relationship among contract partners is mostly based on trust and price signal, therefore it restrains effort for technical upgrading of production process. Particularly, farmers are not strictly attached to contract conditions in terms of technical standards and quantity, quality and timing of contract deliveries because they do not receive significant technical and financial support from the processors. As a result, contract farmers in this model still face high risk of unstable market outlets and prices, while there is no mechanism for insurance of crops under the informal contract.

### **V. Success Factors**

Following the analytical framework, we will review success factors for contract farming by economic, technical and social environment (including strength of markets for contracted output, government macro institutional policies, technical sophistication in production, and attenuation of land ownership) and management practice (including the opportunistic behavior of staff of agribusinesses, social contact, knowledge of cultural values, and role of leadership, methods of setting up farm groups, selection of participants for contracts, enforcement of contract default and management of conflict resolution). Those factors will be considered for each model of contract farming. Furthermore, the investigation on both success and failure cases of contract farming helps to see the extend to which those factors may affect the success/failure of each model of contract farming. Particularly, the success cases are expected to show how contract partners may



overcome the existing macro and institutional constraints on contract development.

### **1. Multipartite Model**

Since the multipartite model is often initiated by the processors that have established long-term business in certain locations and with certain cooperatives and farmer groups, success of contract farming in this model is strongly dependent on the appropriateness of land use planning for the input-supply zone.

Of course, the success of this model is also strongly affected by market outlets of the processors. The contract relationship operates smoothly and sustainably only if processors find out stable market outlets and maintain high competitiveness, particularly in the case of export products. It is observed that production differentiation is a major factor ensuring access to market for processors and farmers both in the foreign and domestic markets. This is also a factor encouraging processors and farmers to maintain cooperation and contract relationship, which generate mutual benefits and require certain level of asset specificity for product differentiation.

DARDs and local governments play an important role in facilitating the contract between enterprises and small farmers. It is recognized that DARDs may support the establishment of cooperatives and promote market linkages between enterprises and cooperatives/farmer groups. Furthermore, enterprises are more willing to initiate contract farming in the areas where DARDs and local governments provide active support in terms of contract information dissemination and extension services.

In terms of institutional structure, dynamic leadership of the cooperatives/farmer groups is always very important not only for the sustainability of the cooperation among farmers but also for the success of the contract. The management boards of the cooperative may support the processors in terms of monitoring technical standards of production process, coordinating the harvesting schedule and delivery of contract output, and getting consensus among farmers on the terms of contract. Therefore, processors need to take into account management

fees for those activities when implementing contract relationship with farmers.

Working with small farmers, the contract format should be kept as simple as possible. The success of contract farming in this model shows that farmers prefer monitorable and measurable indicators for technical standards of contract produce, and therefore enterprises should not set up too many kinds of contract output at various price levels. Beside the support of the cooperatives/farmer groups, consensus among farmers on terms of contract often come through open and participatory discussion between processors, cooperative leaders and farmers. This process takes time but this is the only way to make farmers aware of the contract benefits, hence to sustain the implementation of contract farming. Furthermore, crop insurance, floor price and flexible price setting, which ensure some premium (higher than the spot-market price) for contract farmers especially in case of differentiated product, are crucial for the success of contract farming.

### **2. Centralized Model**

In the centralized model, contract farmers in this model often need to make high basic investment in the infrastructure for production, therefore the most important factor for contract success is long-term commitment of the processors. Obviously, long-term investment also requires enterprises to make good preparation of land use planning for the input-supply zone and selection of appropriate farmers. Similar to the multipartite model, contract success depends strongly on the ability of processors in terms of market outlet and operation efficiency. Often, the most successful cases in the centralized model are going with enterprise having their own brand name in marketing channels.

In the centralized model, product specification plays crucial role for profitability of both large-scale processors and farmers. Therefore, processors need to have very professional technicians to provide technical support and to monitor strictly production process. In addition, enterprises with good management over the procurement staff face less complains from farmers, hence maintaining farmers' incentives to

keep contract relationship and technical standards. Often, leaders and staff of enterprises keep very regular contact with farmers to support them and to find out possible mistake in the implementation of contract farming. Furthermore, without much support of local governments, successful processors should be very patient in the negotiation with farmers in case of contract default.

Similar to the multipartite model, terms of contract in the centralized model should be kept as simple as possible, along with crop insurance and open and participatory discussion between processors and farmers on the terms of contract. Yet, compared to the multipartite model, farmers in the centralized model prefer longer-term contract since this type of contract requires high investment in perennial crops.

### **3. Nucleus Estate Model**

In the nucleus estate model, processors take advantages of previous basic investment on infrastructure, good human resources and technical capacity of contract farmers, and monopsony power in the remote and mountainous areas. Therefore, the success of contracts often increases when the enterprises undertake successful equitization and find new market outlets. Control of land use by processors is also an important factor to prevent farmers from reneging on contracts due to the threat of withdrawal of land by the processors. Yet, in terms of contract management practices, processors in the nucleus estate model should look for mutual benefits of both the processors themselves and farmers. Otherwise, unrealistically low contract prices with unrealistically sophisticated technical standards will force farmers to sell outside the contract system. This has already happened and certainly will happen in the future.

### **4. Intermediary and Informal Model**

The success of this model is mostly based on long-term trust, flexibility in marketing channels and price setting for products with high competitiveness. Success of this model is not easy to replicate. Therefore, it is not advisable to follow

this model, especially because of its constraints on technical upgrading of contract partners.

## **VI. Conclusions and Implications**

Review of 30 cases of contract farming reconfirms the proposition of "one size cannot fit all", in which each type of contract models is only appropriate for certain products, certain locations and/or certain types of farmers. It is shown that the multipartite model is likely to be the most appropriate for small and poor farmers, who otherwise could not cultivate higher value crops with high risk and requirement of labeling and special marketing channels (like safety vegetables).

The centralized model often engages large-scale enterprises, particularly foreign and joint-venture companies, and better-off farmers because contract farmers in this model often need to make high basic investment in the infrastructure for production. Usually, the centralized model is appropriate for perennial crops or other agriculture products with high requirement of basic investment.

The nucleus estate model has a special history in Vietnam, in which processors often used to be the state owned farms and they have been equitized and reallocated land for farmers' management recently. Contract farmers in the nucleus estate model are the previous worker farmers in the state owned farms or farmers adjacent to the processors' land. Also due to historical factor of state owned farms, which are often located in the hilly and mountainous areas, this contract is often used for perennial crops.

The intermediary and informal model is based on oral contract or trust among various types of contract partners. This type of contract often provides market access for farmers supplying normal agricultural products, which are often characterized by unstable market outlets and price. The existence of intermediary and informal model reflects the fact that formal contract farming is not always necessary for all types of agricultural products, locations and farmers.

Through 30 cases of contract farming, the research

team has found out that Decision 80 plays important role to initiate and promote contract farming and collective mode of agricultural production and sale. Particularly, DARDs and local governments have provided significant support for the establishment of contract farming. However, government intervention should be limited only to the provision of certain incentives, information and technical support for contract farming.

Success and sustainability of contract farming often depends strongly on the governance of contract relationship between contract partners rather than the sole government intervention. Otherwise, too much government intervention may create market distortion and disguise incentives for efficient and effective operation of contract farming. Lessons from 30 cases show that success of contract farming (particularly for processors) depends on the following factors:

- Growing market outlets and product competitiveness
- Support of local authorities
- Efficiency of processors
- Long-term commitment and investment of processors
- Well-prepared land use planning and selection of contract farmers
- Open and participatory discussion with farmers on terms of contract
- Simple contract format
- Consider seasonal characteristics of products and markets to set up contract price
- Good management of technical and procurement staff

Last, but not least, **empirical evidence through 30 cases shows that multipartite is the contract farming modality with most potential scheme to engage and benefit the poor.** In the centralized model, it is difficult to engage the poor due to high requirement of investment and high risk of production and market uncertainties.

In the nucleus estate model, due to historical factor of the previous state owned farms, the possibility to engage new contract farmers is quite limited, particularly for the poor lacking access to education and technical information. Furthermore, the new contracted farmers in the nucleus estate model also need to make high basic investment, and this is beyond ability of the poor. Even for the existing worker farmers, their income level strongly depends on the profitability of processors, and the final result is unclear along with the equitization process of the state owned farms.

In the intermediary and informal model, profit is mostly generated on the basis of resource endowment and availability of business relationship, which often serve the demand of processors. Participation in this contract scheme is quite common for farmers, but it is too risky for the poor.

The major advantages of the multipartite model locate in its facilitation for agricultural structural change, particularly for small farmers. Therefore, it creates a very good chance to engage and benefit the poor through this contract scheme. Yet, with the existing lack of access to technical information, finance and markets, the poor need strong support from the government in terms of extension services, inputs and credit provision. Otherwise, the poor is often refused to participate in the collective sale and production as well as contract farming in the multipartite model.

## ANNEX 1. Types of Market Governance

Governance type	Outcome	Characteristics
<i>Market</i>	<ul style="list-style-type: none"> <li>- Easy to switch to new partners</li> <li>- Spot market transaction without advanced capital and input support</li> </ul>	<ul style="list-style-type: none"> <li>- Easy codification of transactions</li> <li>- Simple product specification</li> <li>- No need for input support for suppliers</li> <li>- Buyers respond to specification and prices set by sellers</li> <li>- Little explicit coordination</li> </ul>
<i>Modular</i>	<ul style="list-style-type: none"> <li>- Suppliers make products to a customers' specification</li> <li>- Suppliers take full responsibility for production process without strict control of customers</li> <li>- Suppliers make capital outlays on behalf of customers</li> </ul>	<ul style="list-style-type: none"> <li>- Complex products</li> <li>- Yet, it is easy to unify product and process specification</li> <li>- Suppliers have the competence to supply full package</li> <li>- Linkages based on codified knowledge rather than price</li> <li>- Low degree of explicit coordination and low switching cost</li> </ul>
<i>Relational</i>	<ul style="list-style-type: none"> <li>- Complex interaction between buyers and sellers</li> <li>- High levels of asset specificity</li> <li>- High trust</li> </ul>	<ul style="list-style-type: none"> <li>- Complex products</li> <li>- Product specification cannot be codified</li> <li>- High competency of suppliers and no need for input support from buyers</li> <li>- Based on reputation, social and spatial proximity, family and ethnic ties</li> <li>- High degree of explicit coordination and high switching cost</li> </ul>
<i>Captive</i>	<ul style="list-style-type: none"> <li>- Small suppliers depends on much larger buyers</li> <li>- High degree of monitoring by buyers</li> <li>- Buyers control critical technology</li> </ul>	<ul style="list-style-type: none"> <li>- Complex products</li> <li>- High ability to codify transaction</li> <li>- Low competency of suppliers and need for input support from buyers</li> <li>- High degree of explicit coordination and high switching cost</li> </ul>
<i>Hierarchy</i>	<ul style="list-style-type: none"> <li>- Vertical integration</li> </ul>	<ul style="list-style-type: none"> <li>- Complex products</li> <li>- Product specification cannot be codified</li> <li>- Low competency of suppliers and need for input support from buyers</li> <li>- Total integration of production and marketing activities</li> </ul>

**Note:** Gereffi, Humphrey and Sturgeon (2003) build a theoretical framework to explain governance patterns in global value chains, basing on three streams of literature - transaction costs economics, production networks, and technological capability and firm-level learning - to identify three variables that play a large role in determining how global value chains are governed and change. These are: (1) the complexity of transactions, (2) the ability to codify transactions, and (3) the capabilities in the supply-base.

The complexity of transactions refer to the complexity of information and knowledge transfer required to sustain a particular transaction, particularly with respect to product and process specifications. The ability to codify transactions refers to the extent to which this information and knowledge can be codified and, therefore, transmitted efficiently and without transaction-specific investment between the parties to the transaction. The capabilities in the supply-base refer to the capabilities of actual and potential suppliers in relation to the requirements of the transaction.

The theory of market governance generates five types of global value chain governance - hierarchy, captive, relational, modular, and market - which range from high to low levels of explicit coordination and power asymmetry.

Source: Extracted from Gereffi, Humphrey and Sturgeon (2003)

## ANNEX 2. Categorization of Contract Farming

Intensity of contractual arrangement		Schemes of organizational structures	
<i>Market provision</i>	The grower and buyers agree to terms of conditions for future sale and purchase of a crop or livestock product	<i>Intermediary (tripartite)</i>	Involves processors in subcontracting linkages with farmers to intermediaries. There is a danger that the sponsor loses control of production and quality as well as prices received by farmers
<i>Resource provision</i>	In conjunction with the marketing arrangements the buyer agrees to supply selected inputs, including on occasions land preparation and technical advice	<i>Informal</i>	Often oral contracts between parties to meet demands of seasonal production of produce with low processing requirement. This model involves greater risk of extra-contractual marketing.
		<i>Multipartite</i>	Involves multiple actors such as governments and companies that are coordinated in relationship between processors and farmers. This model can develop from a centralized or nucleus estate models, e.g. through the organization of farmers into cooperatives or the involvement of a financial institutions.
<i>Management specification</i>	The grower agrees to follow recommended production methods, inputs regime and cultivation and harvesting specification	<i>Nucleus estate</i>	Similar to centralized model below, but processors also own land used by farmers. Often used for resettlement or transmigration schemes.
		<i>Centralized</i>	Vertical coordination with quota allocation and tight quality control between a centralized processors and large number of smallholders. Processors' involvement in production varies minimum input provision to the opposite extreme where processors takes control of most production aspects. Appropriate for products requiring high degree of processing

Source: Adopted from Eaton and Shepherd (2001: 44-45)

## ANNEX 3. ADVANTAGES AND PROBLEMS OF CONTRACT FARMING

	Advantages	Problems
<i>Farmers</i>	<ul style="list-style-type: none"> <li>- Provision of inputs and production services</li> <li>- Access to credit</li> <li>- Introduction of appropriate technology</li> <li>- Skill transfer</li> <li>- Guaranteed and fixed pricing structure</li> <li>- Access to reliable market</li> </ul>	<ul style="list-style-type: none"> <li>- Increased risk</li> <li>- Unsuitable technology and crop incompatibility</li> <li>- Manipulation of quotas and quality specification</li> <li>- Corruption</li> <li>- Domination by monopolies</li> <li>- Indebtedness and overreliance on advances</li> </ul>
<i>Processors</i>	<ul style="list-style-type: none"> <li>- Political acceptability</li> <li>- Overcoming land constraints</li> <li>- Production reliability and shared risk</li> <li>- Quality consistency</li> <li>- Promotion of farm inputs</li> </ul>	<ul style="list-style-type: none"> <li>- Land availability constraints</li> <li>- Social and cultural constraints</li> <li>- Farmer discontent</li> <li>- Extra-contractual marketing</li> <li>- Input diversion</li> </ul>

Source: Adopted from Eaton and Shepherd (2001: 8-9)

## ANNEX 4. List of Cases

### *The North*

1. Name: Luveco Fruits and Vegetables Joint-Stock Company

Address: Number 8, Thanh Binh street, Nam Dinh city, Nam Dinh province.

2. Name: Handicraft Import - Export Joint-Stock Company

Address: 45 A Giai Phong street - Nam Dinh city, Nam Dinh province.

3. Name: Nestlé

Address: Tan Linh commune, Ba Vi district, Ha Tay province.

4. Name: Charoen Pokphand Company Ltd.

Address: Xuan Mai town, Chuong My district, Ha Tay province.

5. Name: Rose Cooperative

Address: Ô Quy Ho commune, Sapa district, Lao Cai province.

6. Name: Thanh Binh Tea Plantation

Address: Thanh Binh commune, Muong Khuong District, Lao Cai province.

7. Name: Le Minh Company Ltd

Address: 40B, Hoang Dieu street, Pho Moi district, Lao Cai city, Lao Cai province.

8. Name: Vietnam Agriculture - Forestry Technology Joint-Stock Company

Address: 69B Group 5 - Thon Tien, Dich Vong Ward, Cau Giay District, Hanoi.

9. Name: Sapro Sustainable Agricultural Product Company Ltd.

Address: 6 Ly Dao Thanh - Hoan Kiem District, Hanoi.

### *The Center*

1. Name: Central Cotton Joint-stock company

Address: 139 Trung Nu Vuong street, Tam Ki town, Quang Nam province.

2. Name: Agriculture Import-Export and Food Processing Company

Address: Tra Cai Industrial Park, Tam Ky District, Quang Nam province.

3. Name : Cau Dat Tea company

Address: Xuan Truong commune, Cau Dat District, Lam Dong province.

4. Name: Hai Yih Tea company

Address: Xuan Truong commune, Cau Dat District, Lam Dong province.

5. Name: Bao Loc Cassava Silk-worm Joint-stock company

Address: 35 Dinh Tien Hoang - Bao Loc District, Lam Dong province.

6. Name: Thai Hoa - Lam Dong Coffee Company Ltd

Address: Tan Lam village - Da Don commune - Lam Ha district, Lam Dong province.

7. Name: Da Huoi cashew export and processing factory

Address: 2 Street, Madaguoi town, Da Huoi District, Lam Dong province.

8. Name: Hiep Nguyen Cooperative

Address: 71 Ngo Quyen - Da Lat city, Lam Dong province.

9. Name: Xuan Huong Clean Vegetables Cooperative

Address: 46 A Ho Xuan Huong street, 9 Ward - Da Lat city, Lam Dong province

### *The South*

1. Name: Thanh Nam Thang Honey-bee Production and Trade Company Ltd.

Address: 34/10 Yen The street, Tan Binh district, Ho Chi Minh city.

2. Name: Trung Tin Rice-sheet production factory

Address: Phu hoa village, Phu Hoa Dong commune, Cu Chi district, Ho Chi Minh city.

3. Name: Tan Phu Trung Cooperative, Cu Chi District, Ho Chi Minh city

Address: Dinh village, Tan Phu Trung Commune, Cu Chi District, Ho Chi Minh city.

4. Name: Sao Viet Center

Address: Number 6/19, Street 3, Lu Gia, Ward 5, District 11, Ho Chi Minh city.

5. Name: Thanh Loi Clean Vegetables Cooperative  
Address: Thanh Nhan Village, Thanh Loi commune, Binh Minh district, Vinh Long province.
6. Name: Tien Giang Fruits and Vegetables Joint-Stock Company  
Address: Long Dinh Commune, Chau Thanh district, Tien Giang province.
7. Name: Loi Thuan Agricultural Service Cooperative  
Address: My Loi B Commune, Cai Be District, Tien Giang province.
8. Name: Phuoc Hau Clean Vegetables Production and Consumption Cooperative  
Address: Phuoc Thanh A - Phuoc Hau commune - Long Ho District - Vinh Long province
9. Name: Cholimex Food export and Seafood Processing Factory  
Address: Block C40-43/I and 51-55/II, Road no. 7, Vinh Loc Industrial Park, Binh Chanh District, Ho Chi minh City.
10. Name: Hoang Gia Company  
Address: 2A/1, Group 1- Ward 2, Cai Von Town- Binh Minh District - Vinh Long province.
11. Name: My Luong Cooperative  
Address: Luong Le Village - My Luong commune - Cai Be District - Tien Giang province.
12. Name: Tan My Chanh cooperative  
Address: Tan Tinh village - Tan My Chanh commune - My Tho city - Tien Giang province.

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Address: 40B, Hoang Dieu Street, Pho  
Moi district, Lao Cai city, Lao Cai  
province.

Product: Tobacco

Contract Scheme: Centralized



# LE MINH COMPANY LTD

**L**e Minh Company Ltd is a private company, was established in 2000. Before, the company traded in import-export tobacco from China to Vietnam, to other countries. The company has 11 branches of purchase everywhere in Vietnam. However, in 2002, when the State started to manage tobacco industry and set quota, limit import, the company decided to business the other domestic goods. There were only 2 branches: in Lao Cai and in Tay Ninh. The company decided to open raw materials area in Tay Ninh in 2002 and in 2005, it started to invest 5.5 billion VND to open raw materials area in Lao Cai, in order to satisfy the more needs of export tobacco. The partner of company in China prepares to invest 1.4 billion VND to the potentiality raw materials area in Lao Cai.

## 1. Introduction

The advantage of Lao Cai is an area which has soil suitable for tobacco, but the terrain is obstacles, in addition the intellectual standards of the people is low, it makes more difficult for the company. Before Le Minh Company Ltd, there was 2 the tobacco companies tried to build raw materials area, but they failed, it made farmers to have not confidence in them. However, with a careful step at first, Le Minh Company Ltd has success such as from 7ha in the first harvest to 30ha in the third harvest. To estimate the difficulties, the company has chose Simacai commune where has the most difficulty has been the model commune and now 5 communes have been multiplied.

To open the raw materials area, the company has contracted to buy all products from the farmers to guarantees input's safety. This is the success contract farming.

In order to expand the material area, the company has signed contracts with farmer to see to the supply of materials for outputs. Regarding to the increase of contract volume, it can be concluded that this case is the successful contracts.

## 2. Emergence and Evolution of Contract

Due to the economic barriers if importing material from China, Le Minh Ltd. Company has decided to invest in material area for export. The export markets of company are big, such as England, the US, etc however, they are now lack of material. Meanwhile, the tobacco material has planted scattered to purchase. Therefore, signing contracts with farmer, encouraging tobacco plant, buying material are the indispensable.

Furthermore, since establishing, the tobacco price is grown up then the motive force to invest in tobacco is higher. Other while, since Vietnam joint AFTA, tobacco is not in the list of jointing then the company does not faced with the high competition when produce directly.

To create favorable conditions for farmers to shift to plant tobacco, Le Minh Company has free supply seed and oogonium for farmer basing on the square that they registered. Furthermore, in

each commune, there are two technicians to carry out the undercover activities such as training and guiding for farmers if they are in demanding. Though, the company headquarter office is in Lao Cai city but the farmers are supported for production timely and promptly.

The economic effect of tobacco is 4 or 5 times higher than the other previous plant such as maize and soybean. Furthermore, tobacco can adapt the harsh condition weather. Recently, Simacai is face with the drought, without irrigation system then the plant is depend on the weather but the tobacco live stronger than the other plants, the output is about 50-60%

However, the tobacco plant requires higher effort thus only household that have enough labour can shifting to plant. The other point causes farmers hesitate is that the two previous enterprises were encouraging farmer to plant tobacco but they refuse to buy tobacco when they are bankrupt. Due to the unbelief of farmer in tobacco enterprises then not only base on the economic interest of tobacco but also the effort to persuade farmers. Specifically, company need the support from the district to propaganda on the advantages of tobacco and to mobilize communist people to take part in the first crop.

Otherwise, the company has the insurance mechanism to compensate for farmer equal to soybean planting if the tobacco planting is inefficient. On the other hand, if there is natural calamity, the district will compensate equal to soybean plant. Therefore, in term of economic, the farmers have little reason to refuse the contract. The most important point is the prestige of company to do what they promise rather than previous enterprises since they let the farmers down.

## 3. Terms of Contract

Beside the above favorables, Le Minh Company also provides on account materials as coal, fertilizer, pesticide, etc. These materials are imported from China at lower prices. The company is also committing that in the case of natural calamity, these materials are free.

Le Minh company also support for farmer to build

tobacco drying kiln by providing 70% value, each farmer pay only 2 million dong. Each 4000m<sup>2</sup> of tobacco need 1 drying kiln thus farmers usually corporate to built. The commune people's committee also built some drying kiln to reduce the investment cost of farmers.

The price of tobacco is given by Le Minh Company but it is approval by district people's committee. Therefore, the district people's committee works as the representative for farmer's interest and raising their ability to bargaining. Currently, the price of tobacco is 20,000 dong per kg including three kinds: drying yellow leaves, Berley leaves and Oriental leaves but in this area the farmer only produce drying yellow leaves. Each kind of leaves is divided into 4 levels, depending on where it located in tobacco plant and how much Nicotin it provides. The other quality targets smell level, yellow color and the thick level.

On the farmer side, they are responsibility to use the on account material as guided. If they do not follow the technical instructions they have to compensate for the company initial investment, they have to pay a penalty of 5 times bigger than the initial investment if they use material for other purposes.

The commune people's committee also signs in the contract and they work as arbitrator in the case of dispute.

#### 4. Contract Implementation

Due to the complex processing and remote area of tobacco then the company is not faced with the competition of private company. Recently, the material is selling only for Le Minh Company. Beside that, the commune people's committee plays an important role to ensure the interest of two sides: the company and farmers. For example, in the second crop in Tung Trung Pho commune, when the company bought tobacco but they lack of money (because the productivity is higher than they predicted), the commune people's committee require them to pay all before gathering the tobacco. This intervention is necessary to setting up the belief of farmers; especially there were two bankrupt enterprises previously.

Although company can buy all the tobacco but they are facing with the long-term difficulty when this area is low intellectual standards of people. The guide for tobacco plant is very difficult but the guide for high standard tobacco plant is more difficult. In general, the tobacco cannot export due to the low quality but company has to buy all because they want to encourage farmer to plant, widening the material area.

Practically, tobacco is divided into 42 kinds, is not 4 kinds as listed in the contract because company afraid of the detail list is not familiar to farmers. Furthermore, company does not require the tight quality control process thus almost tobacco is first category even the quality is lower.

Even that the company gives many favorable conditions for farmers but it is not easy to convince them to plant tobacco. They have their own traditional habits and it is not easy to shifting and familiar with market mechanism and profit-driven production. Almost farmers familiar with self supply and demand, plant maize and rice with tobacco for food security. This leads to the unprofessional of tobacco plant and they cannot invest in one kind of crop.

On the hand of farmers, they are satisfied with tobacco. Sometimes, there were the conflict of tobacco quality but they are not forced. In case of Mr. Vang Khay Min, a farmer, he plants about 1400 m<sup>2</sup> tobacco, the output is 300 kg and the profit is 4.5 million for the first harvest in 2006. He also plant maize and soybean and he will continue to plant all because maize and soybean are the food for his family and livestock.

The low intellectual standards of people, difficulty to convince shifting to plant tobacco then the widening material area process is slow. Currently, in all Lao Cai produce 200 tons of tobacco while the company demand for export is 10,000 tons. Therefore, most of material is imported from China and purchased from other enterprises. The advantages of company are having export market thus they can pay high price for material. The export price is 150,000dong per kilo while domestic price is 30,000dong. Unfortunately most of Lao Cai tobacco is selling in domestic market; it is not the material area that brings profit for company.

## 5. Success Factors

Although the above difficulty, Le Minh company can be seen as the successful company in signing contract, opening the material area in Lao Cai, especially in compare with previous fail companies. Le Minh company has not received support from the government and they are now active in asking for grant, borrowing capital, widening the material area and they have positive feedback from the local government. Currently, the company plan to have 250 ha in 2007 and hopefully it is 3500 ha in 2010.

The reasons for success as follows:

- The tobacco is unique product thus company cannot buy retail in the market, farmers cannot sell for dealer. Other while, tobacco is easy to plant with high profit thus it attracts many farmers invest in.
- Thanks to the good survey of material area hence the difficulties is recognized and the progress is adjusted. This also helps to avoid the fail that caused to other enterprises before.
- The local government plays an important role in dealing with conflict between company and farmers and representing for unknowledgeable people.
- The company has committed to long-term investment and good finance source to widening the material areas thus creating good conditions for farmers shift to plant tobacco.
- The terms and conditions of contract is simple, especially the quality control process. This is very important for low intellectual standards areas.

## 6. Lessons

The learning experience of tobacco contract of Le Minh Company as follows:

- The agricultural contracts can be successful in even in less developed commodity economy area and lower intellectual standard of people. Due to the differences of farming habits of ethnic people in comparison with the Kinh, thus it is necessary to find out about the local people before planning to develop that region. The investment in the ethnic area require the huge capital but the progress is slow thus enterprise should be patient and careful.
- The determine factor of the success is the big output market thus enterprise can commit for long-term and big investment.
- The active participation of local government is very important, especially in low intellectual standard of people; the capability of bargaining is weak.
- The contract should be simple, easy to understand and quick form of payment

Address: O Quy Ho Commune,  
Sapa District, Lao Cai Province  
Product: Roses  
Contract Scheme: Intermediary  
and Informal



# ROSE COOPERATIVE

**R**ose Cooperative, is placed in O Quy Ho commune, Sapa District, Lao Cao Province, is established in 2004. It acts under the structure of cooperative; however, basically, this is joint-stock company to be directed by Ms. Le Thi Hoa. Her family has cultivated flowers since 2002. She decided to set up Hoa hong Cooperative and mobilize investment in 2004. At present, cooperative includes 10 members. These do not have land so they can not cultivate by themselves. These members contribute to Cooperative by their labor force and money. They will be shared the benefits. The cooperative capital is over VND 1 billion, in which, 70 percent is owned by Ms. Hoa, the remains are owned by members of cooperative. The Cooperative lets the farmers cultivating in Cooperative's land.



## 1. Introduction

Rose Cooperative, is placed in O Quy Ho commune, Sapa District, Lao Cao Province, is established in 2004. It acts under the structure of cooperative; however, basically, this is joint-stock company to be directed by Ms. Le Thi Hoa. Her family has cultivated flowers since 2002. She decided to set up Hoa hong Cooperative and mobilize investment in 2004. At present, cooperative includes 10 members. These do not have land so they can not cultivate by themselves. These members contribute to Cooperative by their labor force and money. They will be shared the benefits. The cooperative capital is over VND 1 billion, in which, 70 percent is owned by Ms. Hoa, the remains are owned by members of cooperative. The Cooperative lets the farmers cultivating in Cooperative's land.

The area of roses is rented from project 661 on greening of bare hill, about 0.43 hectares. The cooperative planted 30 thousands rose trees that are equivalent to 100 thousands flowers. Because the weather of Sapa is good so the roses are developed healthy. The life of rose is about 7 years. Rose is grown in Mar or Apr and the farmers can harvest in Aut or Sep. In a few of starting years, a rose had only 2 flowers, but now it gives 3 flowers. Recently, the cooperative has cultivated Lys flower to increase the economic effects.

The Cooperative has planned to grow more types of flowers and increase the flower quality in order to export or consume in supermarkets but, up to now, the cooperative have not had any formal contracts yet due to the low skilled labors. However, the operation of cooperative has provided the effectiveness, thus the Ministry of Science and Technology together with People Committee of Sapa District invested VND 800 millions to cooperative. The Cooperative has used this money to build 500m<sup>2</sup> of greening house for models of industrial flower cultivation. These models do not depend much on the weather. The Cooperative added VND 400 millions to complete the building.

The clients of cooperative are traders in the lowlands, who are Ms. Hoa's clients previously or she met when buying seedling. The contracts are most informal and oral contracts.

## 2. Emergence and Evolution of contract farming

The current mode of business of Rose Cooperative is only appropriate for informal and oral contract by three causes: firstly, the price of rose is fluctuated, thus it is very difficult to identify the prices for a long time; secondly, the rose market is dispersed, thus it is very easy to trade rose in the free market and the contract is not necessary. In other words, if the quality of roses is the same, the traders do care only about who sell the roses with lowest price; thirdly, it is impossible to contract with given number of roses while the traders do not have stable outputs. Hence, when the cooperative enlarges to grow flower in the greening house in order to qualify the flowers, it can contract to big companies which are having brand name and firmly outputs in the market.

On the other hand, the cooperative also could not sign the written form contract because it does not have surely outputs for its products. The cooperative will lose all crops if it can not find the regular purchasers from the early flower crops because flower is very hard to remain freshly. Private traders need contracts because they purchase flower with big quantity and they need the constant suppliers from the early crops. The traders and Rose Cooperative negotiate about flower prices and quantity right before harvesting and whenever they could break down the oral contract. Currently, the cooperative has 4 or 5 major clients per crop. As mentioned above, these clients are previous purchasers or the people who Ms. Hoa met when buying seedling, thus some have created reputation whereas the others have not. The clients negotiate prices on the phone based on their demands. Normally, clients and cooperative discuss about the prices and quantity every three days. If the consensus is done, the cooperative sells flowers; otherwise, the contract will be broken down. Both cooperative and traders can make the flexible business plan with such kind of contracts.

## 3. Terms of Contract

Presently, price of rose is VND 8 hundreds per flower but it is fluctuated depending on each time.



For example, the price increases to VND 2.5 thousands on the occasions of holiday or festival. In order to have sufficient flower supply for these events, the traders usually contracted in advance to buy certain quantity of flowers. Ms. Hoa therefore will be responsible for provide the flowers at the contracted prices. The correlation here is based on the prestige and the potential to work together for long time. If any side breaks down the oral contract, the business work will be stopped and very difficult to resume the former one. Finding new partner is waste of time and increasing the transaction costs.

Usually, every three days, the cooperative delivers flower to clients by rented truck. The delivering cost is 70 per flower. There are 4 or 5 trucks per day and Ms. Hoa can choose whatever on condition that it will arrive to lowland at night. The clients pay money back via the drivers, who is living in Sapa and familiar with Ms. Hoa.

Frequently, the clients help Ms. Hoa to buy fertilizers, materials and Ms. Hoa subtracts regularly on the flower buying money. The clients pay money to Ms. Hoa every 10 days, if not, the contract will be ended. In case of differed payment, clients contact to Ms. Hoa. She will consider their prestige and reasons to decide whether to continue the contract. Some clients do not pay money but a few. In these cases, it is very difficult to find out the clients, who are not legal entity, not to mention to treat legally.

The flowers are not classified in terms of quality in the field. They are wholesale instead and have only one fixed price. Traders classify their flowers when receiving them. The traders can also terminate the contract if the flowers' quality is low.

#### 4. Contract Implementation

It is very difficult to say about the result of contract is good or bad because the oral contract is not based on any regulations. In general, there are a few cases of broken down contract due to the regular business connections. In addition, it is not easy to refuse to pay a big debt to Ms. Hoa with the above money payment procedure in a short time. However, the terms of contract are not fixed

that conflicts are happened usually in terms of both price and quality of flowers

Out of special days, the traders usually force the cooperative to decrease the flower prices. Hence, the cooperative has faced to many difficulties. For example, in May 2006, the price of rose is only VND 3 hundreds per unit. In order to limit the price forced situation, the rose farms in Sapa link together to negotiate the price with traders although they also compete critically.

The traders usually have stopped the contract due to the low quality of flowers. The flower cultivation depends much on the natural condition. Ms. Hoa estimated that about 10 percent of products are decayed per crop because of raining, insects etc. In these cases, both sides have to discuss together and no intervention of local government.

Although has faced to many challenges, Ms. Hoa's cooperative has achieved significant successes. The annual average turnover of cooperative is VND 200 millions per crop and the benefit is VND 100 millions per crops after balancing the costs and expenditures. The oral contract helps somewhat the cooperative to plan its clients at the early crop. On the trader side, the oral contract helps them to ensure the inputs and estimate the general quality. On the other hand, the oral contract is not fixed to allow the both sides to stop the contract if they are not pleased.

Now, the Rose Cooperative is investing to develop high technology. It wants to increase the product quality to remain the stable outputs. It is towards to export or contract with supermarkets. The contract potential of high technical flower is higher much more than normal flower. The high quality flower is grown in the greening house that is not easy to invest. These kinds of flower are more beautiful than the flowers on the large scale and could not be sold freely in the market. Ms Hoa hopes that she can cultivate technical flowers right after completing the greening house building.

#### 5. Success/Failure factors

The contract of Rose Cooperative is presented typically to the fluctuated price product which is hard to obtain the stable inputs and outputs. The

reasons are defined for the mix of successes and failures are:

- The clients are familiar to Ms. Hoa. They have the long time business relation to Ms. Hoa. Thus the contract is negotiated easily based on prestige.
- The diverse consume channel needs kind of unfixed contract. Hence, it is very to avoid the contract conflict.
- Rose is not so special products and it is very easy to find the suppliers in the market. Hence, it is difficult for sides, traders and cooperative, to fix the prices. The roses could be specialized when they are grown in the greening house.

## 6. Lessons

The contract farming model of the Rose Cooperative provides the following lessons:

- This is a kind of normal contract that is suitable to the no special products. This product depends much on the given natural condition.
- Business prestige and relation have an important role that has contributed to the successes of contract.
- However, it is necessary to promote the brand name and written contract to enlarge high quality production.

Address: Thanh Binh Commune,  
Muong Khuong District,  
Lao Cai Province  
Product: Tea  
Contract Scheme: Nucleus Estates



# THANH BINH

**T**hanh Binh Tea Plantation is a state-owned enterprise, which was established in 1967. Before, this plantation had a great size, and employed 1600 workers. In 1979, the Border war between Vietnam and China ruined the farm and interrupted the work. In 1993, the plantation was reopened at this location, Muong Khuong District, Lao Cai Province, with 100% of capital owned by the state. In 2000, after having many problems with management, the farm decided to change the structure of operation by selling land for farmers with amortization price, so that the farmers could have full control over the land. At that time, tea plantation was assigned to the locality to manage.

## 1. Introduction

Thanh Binh Tea Plantation is a state-owned enterprise, which was established in 1967. Before, this plantation had a great size, and employed 1600 worker. In 1979, the Border war between Vietnam and China ruined the farm and interrupted the work. In 1993, the plantation was reopened at this location, Muong Khuong District, Lao Cai Province, with 100% of capital owned by the state. In 2000, after having many problems with management, the farm decided to change the structure of operation by selling land for farmers with amortization price, so that the farmers could have full control over the land. At that time, tea plantation was assigned to the locality to manage.

Thanh Binh Tea Plantation exports products to the Middle East, namely: Pakistan, Afganistan, etc., and has the intention of expanding to many countries. However, their problem was not in the output market, but in input, as the need for tea rises while the cultivation area is limited. The plantation is building tea's raw materials by signing contracts with tea farmers, though the process is taking place slowly. The total area of this plantation is 1196.5 ha, which is assigned to 300 families. However, the area of planning tea is 102.5 ha, because the land of this plantation is not only for the workers staying but not also for the farmers and the others. The families did not sell the land but they still live there and can not force them to plant tea. To expand the cultivation area, the company has mobilized 4 communes planting tea, raising total of planting tea area to 450 ha. According to the director of the plantation, opening its area has impetus, so the plantation do not need to campaign farmer planting tea, now they change themselves to plant tea. It is the success of Thanh Binh's Tea Plantation.

## 2. Emergence and Evolution of Contract

Before 2000, the plantation operated by the mechanism of paying worker by products and they were paid at a fixed rate. After that, when having change to the mechanism of management, the plantation decided to sell land for farmer, so they had self-control their tea hill, at the same time the plantation signed a contract to commit the farmer

have to plant tea on their land and sell all products for the plantation. Signing the contract guarantees a stable source of input, especially tea is a product which is not easy to find in the market.

The farmers who buy the plantation's land have not any reason to refuse signing the contract because they do not nearly invest more in that. According a farmer which we have interviewed, price of the plantation's land in 2000 was 5 million VND/0,3 ha, the price in market was 25 million VND. Besides, the tea was existed on land, so the farmer did not invest to variety. The plantation supplied plant protection substance on account, although it was difficult to find pestilent insect spreading on wide hill as Muong Khuong District. The farmer did not have force to change to the other plants because the land on the hill plant only the short-day crops and effect

The plantation provided farmers with pesticides in advance even though pest does not spread easily over the wide mountainous area where Muong Khuong district locates. The farmers also had little motivation to switch to another crop since besides tea, the hilly soil was only suitable for cassava and beans, which are significantly less profitable. Therefore, all the land that is suitable for tea cultivation has been utilized specifically for tea.

To expand tea production region, the plantation has encouraged other communes to switch to tea by providing breeds and veterinary, as aforementioned. The plantation also sends a number of staff to provide training to the farmers, supervise them, and purchase outputs at the commune. These activities have reduced the initial investment cost and provides significant enabling environment for poor farmers in Lao Cai.

After switching to tea, most households sign contract with the plantation since it is the biggest and most generous assembler in the region. The contract ensures a stable output market for the household.

## 3. Terms of Contract

The current terms of contract are quite favorable for farmers since the plantation is still trying to expand the cultivation area and needs to convince farmers to switch crop. The plantation provides

tea farmers with fertilizers, plant protection substance, and other inputs if the farmers are observed to follow the contract. Payment for these inputs will be deducted afterwards from the final payment from the company to the farmers. The price of tea is adjusted to the market price, but must stay above the floor price of 1,800 VND/kg. Currently, the price of tea is 2,400 VND/kg and is valid for all regions.

To make sure that farmers are not exploited by private assemblers, the plantation purchases tea directly from farmers rather than through private assemblers. This means that the plantation must have procurement officers who stay in the communes so that farmers do not need to travel over 3 km to the collection station. Farmers' transportation costs, therefore, is minimized.

Thanh Binh Plantation has 3 classes of quality: Class A is the tea buds, Class B is the stem, and Class C is close to the root. Currently, class A costs 2,600 VND/kg, class B, 2,400 VND/kg, and class C, 2,100 VND/kg.

Payments for the tea are paid every 15 or 30 days, or, under special circumstances, can be paid immediately. The household could receive cash or vouchers for later total payments.

The plantation also has a bonus system for households who fare well in the contract, such as those with higher-than-expected yields, those who sell 100% of their products to the plantation, those with tea of exceptional quality, etc. The plantation spares 45 million VND for this bonus system in an attempt to expand production and encourage contract abidance.

## 4. Contract Implementation

The implementation of the contract varies by time and location. Overall, the farmers who reside inside the plantation land abide with the contract fairly tightly since contacting the plantation and selling tea could be done easily. Admittedly, there are some private assemblers in the area who buy tea and dry it manually at home, though they cannot offer a higher price than the contract. Contract violation, therefore, rarely takes place. The households that live within the plantation also

receive careful instruction and supervision on tea cultivation and contract abidance.

In remote communes, the situation is immensely more challenging. Before, contract violation did not happen often as the plantation had a thick network of procurement staff so that farmers did not have to travel over 3 km when selling tea. Nevertheless, as the cost of transportation increases, the plantation decided to close several procurement stations and consequently creates obstacles for the farmers. Meanwhile, some private assemblers in those remote communes decided to buy tea right at the field and at the same price as the plantation. This convenient arrangement obviously attracts many farmers and causes contract violation to augment.

Another reason for households' preference to sell to private assemblers is that they do not like the plantation's product differentiation. During procurement, conflicts happen quite often as the aforementioned class of the tea greatly depends on the ability of the leaf picker to distinguish the buds with the middle stem, and the middle stem with the bottom stem. Buds that are too long and should belong to the stem will be classified as Class B. This creates considerable confusion among the farmers, especially the less well-educated ones. Even better-educated ones sometimes deem the quality control as too subjective. Meanwhile, private assemblers are willing to buy all kinds of tea at the same price, as they sell retail, rather export tea like Thanh Binh plantation.

Retail sale to private assemblers has just happened recently and has not pervaded the region; therefore, the contract has only encountered moderate difficulties. In order to overcome these difficulties caused largely by the geography, the plantation needs to strengthen its financial resources. It needs to increase the size of staff at the communes to tighten supervision, create favorable conditions for procurement, foster contact with farmers, and thereby, compete with private assemblers.

Besides remote areas, contract implementation fares well since the contracted price is high enough to encourage farmers to expand their cultivation area or to switch their current crops to tea. Even when the plantation makes losses, it



does not run the risk of reducing the price of tea for fear of losing tea farmers. Besides, the number of private assemblers is still small, thus, the competition has not been harsh.

The number of farmers switching to tea is increasing, and as a result, the tea cultivation area of the plantation has boosted. It is expected that by 2010, the plantation will have over 700 ha of tea. It is also beginning to switch to other tea varieties with higher profitability, though the effort is meeting considerable difficulties for unskillful farmers and infertile soil. The plantation is also actively searching for new tea importers and has created its own website to market the products. The website is considered progressive for a state-owned company which locates in a remote region, like Muong Khuong district.

## 5. Success Factors

The case of Thanh Binh tea plantation holds notable characteristics of contracts in remote areas. Even though the plantation has not made substantial profit as it is investing in expanding the cultivation area and searching for better output markets, it has overcome the biggest initial difficulties and accelerated its area.

Below are the success factors of the case:

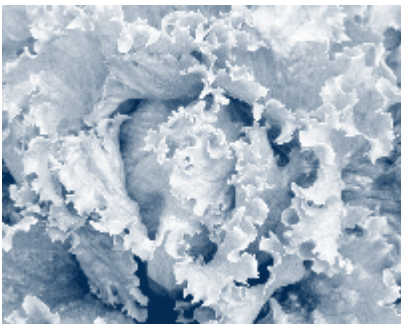
- The plantation has an export market whose generated profit enables it to open a cultivation area and pose a competitive contracted price. Besides, the floor price also makes the contract more attractive than the spot market.
- The enterprise inherits the remaining land of the old plantation and thus, does not need to make large initial investment.

- As the plantation is located in a sparsely populated region, the competition for inputs is small and contract violation only happens in a modest scale.

## 6. Lessons

The success of this tea contract has raised the following lessons:

- The plantation's labor arrangement has high applicability in remote areas. Here, enterprises not only need to pay attention to training farmers but also tighten management, and thereby, increases the enterprise's presence.
- Creating a specialized production region in remote areas requires tremendous effort and initial financial resources, as the enterprise need to make great investment it encourage farmers to switch crop. The low education in these regions also creates significant obstacles in training farmers to cultivate the contracted product as well as to abide with the contract.
- This contract model benefits the poor in remote areas. When participating in the contract, the poor obtain new cultivation skills and receives support to sell their products most conveniently. Their income after the contract has vastly increased.
- However, the model might not be applicable for the delta area as the enterprise might encounter ruthless competition for inputs.
- Quality control is still too complicated for farmers and has caused conflict. Therefore, discussing and explaining the criteria to farmers carefully are critical.



# **SUSTAINABLE AGRICULTURAL PRODUCTS COMPANY LTD.**

**Address: No. 6 Ly Dao Thanh - Hoan  
Kiem - Hanoi**

**Product: Organic vegetables**

**Contract Scheme: Multipartite**



## 1. Introduction

SAPRO is one of pioneer companies specialized in studying, producing and transferring agriculture-cultivating techniques in Vietnam. The advisory division of the Company composes of professors, doctors and experts at Vietnamese Biology and Agronomy. SAPRO has been working in the collaboration and kind support from some research institutes, universities and national and international NGOs. The Company has achieved international certification issued by IFOAM for their agriculture-cultivating techniques (ACT) in April 2004. Its business lines include production and trade in micro-organic fertilizers and agri-products; research and consulting on ACT transfer; consulting and construction of landscape architecture ect....

The Company has signed contracts with some localities to scale up the ACT model. However, by then most of these projects have been failed (vegetables production in Lien Mac cooperatives, Tu Liem district, Hanoi or in Quyet Tien hamlet Tien Phuong commune, Chuong My district, Ha Tay) or fragmented in some cases (black tea production in Phu Tho and Thai Nguyen provinces).

## 2. Emergence and Evolution of Contract

In the context when chemical fertilizers and pesticides are uncontrolledly used for farming cultivation, having adverse impacts on health conditions of producers and consumers, many case studies, programs or/and projects have been implemented aiming to change farming methods and change to use another less harmful fertilizers. Being aware of demands and market direction for such clean food, the Company has applied their research findings and absorbed aids from foreign-funded programs in order to make investment in developing ACT production areas, from which vegetables production is initiated in Hanoi outskirts

In 2002, under the financial support from CIDSE (the Netherlands), the Company has conducted research and make zoning for organic vegetables production in Lien Mac cooperatives and Quyet Tien hamlets with the total area of more than 2 ha.

Aiming to encourage farmer households with land located within the zoned areas changing their farming method, the Company shall ensure to procure outputs via contracts on investment and vegetables consumption deals

The Company only adopted a pilot model and signed contract with 2 farmer households with the total area of more than 1,000m<sup>2</sup> in Lien Mac cooperative. In Quyet Tien hamlet, the Company signed contracts with 31 households on the total area of nearly 2 hectares

Selected households are those whose land areas are located nearby the area surveyed and zoned by the Company. The cooperative leadership together with company employees shall organize a meeting to disseminate production techniques and basic contract terms and conditions and to encourage local people to make cooperation with the Company. Households whose land area is stationed within the zoning area but do not want to take participation, they are encouraged to exchange their land for another owned by the other households. The contracts shall be directly signed by the Cooperative rather than individual households. Such contracts shall be valid for 1 year.

## 3. Terms of Contract

The products ordered by the Company are very diversified, including more than 40 different categories, for instance morning glory, cabbage, kohlrabi, pumpkin, colocynth, tomato etc... Each product has various growth cycles and different profitability. Thereby, the Company shall has to elaborate a relatively strict contract in order to ensure the balance between supply and demands, and at the same time maintain the equality of.

The Company shall organize training courses in farming techniques applicable to organic vegetables production for households. In addition, the Company shall also second a technician to work at the local level in an attempt to promptly to elaborate to elaborate production plans, support and monitor production techniques of households. Each household is enabled to grow various crops in order to be able to always harvest their own products and create income equality. The Company shall ensure to procure all outputs as



planned and as required by organic production standards.

The contract shall specify a fixed unit price for each product item. This fixed price shall be discussed by the Company at the meeting with the participation of member households. The Company shall inform of the determined price before signing contracts. Under the contracts, the unit price can be adjusted after 6 months later.

However, the contract shall not clarify the volume of procurement. The Company shall inform of the estimated volume to be procure in case of specific vegetables categories at the beginning of every harvest crops. In case where outputs exceed demands for anticipated procurement, local people shall have to sell out their supplies in free markets by themselves. After the harvest, outputs shall be collected at the cooperative Director's yard and then transported to towns by the Company. The payment is made directly for individual households by monthly installments rather than via the Cooperatives by the Company.

The Company shall formulate investment policies, for instance advance supply fertilizers (micro-organic fertilizer produced by the Company) for households and get returns back with output after the crop harvest. In case of risks occurring because of natural disaster, the Company shall cover local people a certain amount of costs for seedlings and fertilizer (about 30%). In addition, local people living in Quyet Tien hamlet failed to be given priorities and other support from provincial agencies or local authorities.

#### 4. Contract Implementation

Organic vegetables production models and the Company's procurement were highly appreciated by farmer households at the outset. However, after 1 year implementation, such activity shown unsustainability, leading to an absolute failure in some areas. In Lien Mac cooperative, the number of households involved in contracting is 2, and then the figure is 9 households in 2003. However, since organic production requires so many efforts. Moreover, it does not bring in a high economic efficiency. it is also competed against other crops. Therefore, these 9 households refused to sign contracts with the Company. The same situation

happened in Quyet Tien hamlet where the number of households who signed contracts with the Company decreased from 31 on the total area of nearly 2 ha in 2005 down to 16 households in late 2005 on the area of nearly 1 ha. And in mid 2006, the entire area was converted into paddy cultivation or other crop farming. As estimated by the Cooperative Director, in case where organic vegetables are procured under the contract undersigned by the Company, high profits shall be generated. On average, the revenue from 360m<sup>2</sup> vegetables production is 6-7 million VND every year while it is 3-4 million VND/year and 800,000VND/year, and even breakeven from normal vegetables production and paddy cultivation respectively. However, local people still insist on shifting into paddy or crop cultivation since their undersigned contract with the Company is discontinued and cancelled.

Under the contract, the procurement unit price shall be adjusted after 6 months, agreed upon after the discussion with households. However, in fact the Company failed to re-sign contracts and adjust procurement price even if market price greatly fluctuates. This made local people discouraged to produce as scheduled. In addition, in some cases, the Company did not procure the entire volume of products as planned. In such cases, the Company had so many excuses, for example unconsumability or adverse weather conditions etc...The Company already promised to compensate for producers. However, local people have not yet received any compensation. The output which is not procured shall find itself difficult to be consumed since consumers here do not get used to such products (colocynth, tomato etc...) or since ACT produces are so not good in design as normal production (insects, red leaves...). Local people shall suffer from profit losses and discontinue growing such vegetables in the coming crops.

In addition, inconsistent technical specifications and requirements for the Company's product standards have brought in more or less risks to farmer households. In 2004, the Company instructed farmer households to grow pumpkin with the unit price of 8,000VND/kg. However, this rate is applied to the 300-400g weighted fruits which are harvested. Technicians failed to provide specific instruction and guidance.

Therefore, local people would usually harvest 1-2kg weighted fruits and sold them out at 1,500VND/kg only. The Company did not compensate for the damage for local people. Therefore, the relation between the Company and local people became very tensed.

In June 2006, the Company reduced the volume of procurement and stopped procuring output in hamlets. It requested farmer households to transport vegetables to the Company's agents in Hanoi for sale. At the same time, the Company failed to second their technical down to the grass-roots level and enabled local people to freely produce. The categories and unit price were daily informed whilst contracts started to be cancelled. Local people do not feel encouraging to enforce the undersigned contract. Only some households managed to transport their vegetables to sell out in the Company by means of motorbike, the rest promptly cancelled vegetables production in order to shift into other crop farming.

The Company also introduced farmer households with some organic vegetables consumers such as schools and agencies. However, the sale process is very difficult and unstable. The Cooperative failed to sign a selling contract with such agencies in a long term

In addition to difficulties local people were facing in contract enforcement, the Company also faced up obstacles to maintain the contract enforcement. According to the Company Director, the Company has made investment in kind, supplying a quite great volume of fertilizer valued 400-500 million VND for all project areas. In fact, some households failed to produce their products as regulated. Their produces do not meet quality standards as required. Therefore, the Company failed to procure. Therefore, households failed to reimburse their investment. At that time, the outstanding investment capital reached up to 200 million VND. The Company reduced their investment and felt reluctant to continue such contracts since they shall suffer from so many risks and fail to receive support from relevant agencies and local authorities CIDSE-funded project finished in 2003

The contract for organic vegetables production and consumption is signed via the Cooperative. However, the Cooperative were not allowed to get benefits from this contract and it also does

not play any role in monitoring the contract liquidation.

## 5. Success/Failure Factors

The failure of SAPRO Company Ltd is to be blame for the following major causes:

- Sustainable and sufficient consumption markets have not yet established in order to expand production and liquidate contracts. Although, the social living standards and consumers' awareness have been raised over recent years, majority of consumers failed to get used to buying organic vegetables with not good looking and high price.
- the contract fails to clarify specific quality standards strictly, causing losses for local people involved in production and sale.
- Their products are competed against other crops since requirements for tending are too complicated, requiring greatest efforts and finding it difficult to be sold out in markets in case the Company failed to procure or procure only a partial of output.
- Due attention has not yet paid by local authorities and relevant agencies even though here is the 1 st model of multi-purpose conversion, resulting in many common social benefits.

## 6. Lessons

Based on the SAPRO's failures, the following lessons learnt and experiences have been drawn out:

- Procurement contracts can not be liquidated if the Company's market share is not stable
- For unfamiliar products, the State support is needed in order to liquidate the agri-product consumption contracts. The support is not only financial support but also land availability and information communication, helping producers and consumers to make awareness of products benefits. In addition, it is necessary to support to trade promotion and certification for special products aiming to expand markets
- However, financial aids need to be strictly controlled and invested in a sustainable manner. Contracts and linkages are easily broken down when financial aids and preferential funds are unavailable

## VIETNAM AGRICULTURE - FORESTRY TECHNOLOGY JOINT-STOCK COMPANY



Address: 69B Group 5 - Thon Tien,  
Dich Vong Ward, Cau Giay District,  
Hanoi.

Product: Bao Ha safe vegetables  
Contact Scheme: Multipartite model

## 1. Introduction

Vietnam agriculture - forestry technology joint-stock company was established in 7/2005. Its registered business fields cover from input supply services for agriculture production, agri-forestry machinery to output services for agri-forestry products, etc...but the company now is focusing on the consumption service of safe vegetables for communes in the peri-urban.

Company signed contract farming for safe vegetables products with cooperatives and consigned those products in vegetables shops in Hanoi market under Bao Ha safe vegetables brand. However, company have not yet found stable market for those products and, so far, been continuously losing in its business. The director also admitted that he started frustrated due to the hard working and unstable business. This seems to be a failure case of contract farming signing due to the unstable output market. The number of cooperatives to sign contracts with the company decreased from four communes in two districts in the early days to only one, Dia village, Nam Dong commune, Dong Anh district for now.

## 2. Emergence and Evolution of Contract

From the observation of the increasing in living standard in the urban area, with a higher demand of safe and nutritious foods, the director, Mr Nguyen Quoc Tuan, put his idea into practise by establishing Vietnam agriculture- forestry technology joint-stock company. In the beginning, the company focused on investment and consumption of safe vegetables in Hanoi.

At the same time, Hanoi plant protection agency is implementing its project on building brand of safe vegetables in order to develop some safe vegetables areas in Hanoi peri-urban areas. Since 2000, farmers of some communes in Dong Anh and Soc Son districts have been trained about IPM program including excavation earthworking, cultivation, micro fertilizer and biology pesticide, limiting usage of chemical pesticide for growing vegetables.

Hanoi plant protection agency has been working as a bridge connecting Vietnam

agriculture - forestry technology joint-stock company with cooperatives and vegetables growers. Therefore, contracts farming were quickly signed between the company and the cooperatives in 10/2005. The cooperatives invited their members to have a meeting, then announced the company's requirements and signed contracts with those who commit to follow the right production process as specified. The contracts were made only with farmers who have investment ability and available land in the planned areas for growing safe vegetables.

At the very beginning, Hanoi plant protection agency supported and helped the company a part of business operation costs included barcode printers, nylon bags, paking cords. In addition, on behalf of the company, Hanoi plant protection agency negotiated and signed contracts with the cooperatives. In order to guarantee inputs for the company, Hanoi plant protection agency organized promotion activities, encouraged farmers to change their habits of production, from regular cultivation to safe and healthy vegetables which benefits both producers and consumers. The name of safe vegetables is Bao Ha that its full meaning is Hanoi Plant Protection.

Products under contract divert from water morning glory, sweet cabbage, cabbage, korhrabi to cucurbit and salad. In the beginning, the company purchased product via the plant protection agency, then directly signed contracts with the cooperatives (10/2005).

## 3. Terms of Contract

In the first contract, company signed a contract with cooperatives based upon the vegetables production seasons with unchanged price during the whole season. Nevertheless, this form had been quickly shown to be unreasonable and ineffective, so the company discussed with cooperatives to change it into annual contracts but price changes in monthly base, and then finally weekly base and possibly be adjusted in case of any big market change. These prices are usually higher than normal price in the market from 10 to 20 percent and farmers will be completely paid in one week.

The main terms of the contracts do not specify any



constant buying volume, but commitments of quality, time of delivery and places. The quality standards of product basically follow common safe vegetables requirements of Hanoi plant protection agency and delivery time is every 6PM at the cooperatives warehouse. The commission for cooperatives is 200 VND/kg and they are responsible for the quality of the products. Under the contract, the company does not have any investment in form of farm input or technical assistance for the cooperatives.

The cooperatives signed contracts with farmers based on the one signed with the company. This contract does not include buying price and volume, but requirements of product quality. The quality standards are signed with farmers as indicated in the contract with the Company, for instance: chemical pesticides are not allowed after isolation periods (7-14 days before harvesting, depend on which pesticide being used), uncrushable, unwetted and clean vegetables. Products from cooperative members are marked with barcode, so they have to be directly responsible for product quality.

Cooperatives informed households under contract with production and market orientation, as well as supervise their production process. The farmers who signed contracts did not receive any other support or investment from cooperatives and the company. (water irrigation, electricity system and fertilizer are supplied for the whole cooperative, not favored to any member). However, via Hanoi Plant protection agency, they received the subsidy from Hanoi City Government in form of seed and price for some first contracts in 2005, with about 300-500 VND/kg depended on different kinds of vegetables. For some excellent and prestigious households, cover nets for production are provided.

In the contract, there is no term of buying and selling commitment. This is actually one of the factors lead to the failure of this contract farming, as explained here below.

#### 4. Contract Implementation

Everyday, one staff of the company and one from cooperative (paid by the company) check the quality, samples of vegetables at the warehouse of

the cooperative before purchasing and packaging. The checking process is conducted by common observation and mainly focuses on the sampling standard. These products are immediately packed at the warehouse of the cooperative.

Also, the staff from cooperative has responsibility to regularly check and supervise the production process of cooperative members under contract and inform them about the prices that the company is going to buy for different products (informed at the beginning of every week).

The director said that the purchase is more and more difficult, so the number of contract farming signed is decreasing from 4 communes in the early days to only one, Dia village (Nam Dong commune) and a small volume in Dao Duc commune at present. He also revealed that "he intends to purchase more from other cooperatives to diversify the products category but farmers do not want to sign contract farming with the Company even they tried to persuade". This shows that there is no benefit for farmers in following the contract. In the meantime, the cooperative and farmers in Dia village complained that the purchasing volume was too small (10-15%) in compare to in the whole production. To explain this reason, the director said that the products in Dia village are poor in categories, so company could only sell a limited volume in Hanoi market.

Nevertheless, the most difficult work the company facing is seeking for a stable market. In the beginning, market seeking was also very difficult even the demand for safe vegetables is huge and potential. At that time, the company signed the contract with a fixed volume, therefore, in case safe vegetables shops could not sell them out, the company had to sell the rest in a night market as normal vegetables and bore losses. At present, company have not yet found any stable market and just been consigning with safe vegetables shops. Since vegetables are easily spoiled and faded, the unsold products are regularly considered as waste. The proportion of product being returned to the Company is still very high, about 5-10%. After much effort to expand the market, company increased the daily purchase from 150-170 kg/day in the beginning days to 400kg/day for now, which only accounts for 10-15% of the total output from cooperative members

under contract farming. The company got into the situation of continuous losses due to low sale quantity but high cost of delivery and operation. Hanoi city government (through Hanoi plant protection agency) supported 90 millions VND in the first year and 74 million VND in the second year, however, even 200 millions VND of company's initial investment is not guaranteed. The director grieved "hopefully we could keep the brand and distribution system" even though this brand is severely competing by other safe vegetables brands such as Dao Duc, Van Noi... with more diversified products.

Consequently, the company's consumption process got into a vicious circle. With a limited volume of product being purchased, the number of households under contract quickly decreased, leading to a decline in product category. Due to undiversified products, company had difficulty to expand the market and strengthen its brand, so the consumption is slowly increased. Therefore, company could only meet a small production ability of the growers.

In addition, due to unclear regulations about each side's responsibility in terms of supply and purchase, most Dia village's farmers tend to sell at high price and at convenience, instead of paying attention to the contract with the cooperative. At the time of unfavourable weather, flood or heavy raining, vegetables become scarce and their price increases, the farmers sell their products to other businessmen. In this case, if company does not soon adjust the proper price, it is very difficult to purchase enough volume because small dealers always do it in a faster way and with less demanding requirement on quality of the product. Thus, even once in a while, it harmed the company's prestige to the safe vegetables shops and loyal customers. Since there was no specific terms on responsibility in breaking contract specified, company could not apply any punishment with the cooperative. The same situation happens between the farmers and the cooperative. The cooperative almost could not do anything in this situation.

Besides, there is no organization or institution to supervise the production process, so both company and the cooperative can not guarantee the quality or level of safety of the product. The

director also worried about this issue and even though the company did a great effort, suffered losses to build up its brand, but in reality, there were still some farmers underhandedly put chemical fertilizer and do not follow the safe production process. Certainly, according to the contract, these farmers have responsibility for that product with the end-user. Nevertheless, if the case happens, the company suffers much more than the farmer since it will harm the product prestige and brand.

For growers, since the volume of product being sold for the company is too small, all the rest have to be sold in the normal market with low price (grown in safe production process, so the appearance of safe vegetables is not as beautiful and fresh as the normal production way). Farmers could not depend on the Company for the output of their product, so they shifted the orientation of cultivation or tried themselves to find outputs.

Besides, farmers in Dia village are frustrated about the unfair in the market. In many places, vegetables cultivated in regular way are marked as safe/clean product, which harms the reputation of safe vegetable production companies. Also, the habit of customers have a considerable impact on the market and many of them are not ready to pay higher price for safe vegetables even production costs for this kind of product is higher than the regular ones. This discouraged both farmers and the company to sign the contract contract farming for safe vegetables.

## 5. Success/Failure Factors

The Company director, chairman of the cooperative as well as farmers indicated that safe vegetables production is more profitable than regular vegetables cultivation and much higher than growing food crops. Dia village is a traditional vegetables cultivating area, and its turnover from production accounts for about 50% of total income. According to Mr Le Xuan Tien, a cooperative member who signed a contract with the company, total turnover from safe vegetables per 360m<sup>2</sup>/year is about 11-12 millions VND, in compare with only 7-8 millions VND for normal/popular vegetables and from several hundreds to 1 millions VND for rice. However, the contract farming between the company and

cooperatives failed due to following reasons:

- Company has not found stable market to match with the production ability of cooperatives. This issue comes from the weakness of company's development strategy and a poor distribution system. In the other hand, most customers's habit has not been changed and they have not believed in safe vegetables quality, so they are not ready to pay higher prices.
- Poor understanding of the market demand from the farmers side, which lead to an undiversify product category.
- The contract does not specify clear and detail regulations for two sides, which is not practical. Farmers are willing to sell their products to small dealers when the price suddenly grows up, so the company can not purchase this product.
- Cooperatives is weak in supervising the production process, quality controlling as well as guaranteeing two sides in implementing the contracts.
- The relationship among growers, company, authorities and science institutions is still weak. There is no scientific institution to supervise and examine the product quality, then create prestige and good reputation in the market. In addition, there is no authority to guarantee fair competition for safe vegetables producers, restrict the case in which regular vegetables growers sell their product under safe vegetables brand.

## 6. Lessons

Eventhough the company just started working with contract farming in the beginning of 2005, by examining the difficulties facing the company, we can withdraw some lessons to develop and improve contract farming:

- The stable market for the output is a basic factor to guarantee the contract implementation and success. Therefore, it is necessary to have an appropriate strategy from the company and support from authorities to control and ensure a fair competition.
- The contract should include a flexible price system, adjustable if there is any big market change, especially for agricultural commodities with short production seasons, low value and fluctuating price such as fruit and vegetable.
- It is necessary for the contract to specify clear and detail responsibilities of the in implementing the contract farming.
- It is necessary to support companies to sign the contract farming but government institution need to pay more attention to promote, create market outputs for these products. In fact, Vietnam agriculture-forestry technology joint-stock company shown that, due to lacking market development, the consumption contract is quickly failed when Hanoi plant protection agency fund stopped.





# NESTLÉ

Address: Nestle factory - Ba Vi District,  
Ha Tay Province  
Product: Milk  
Contract Scheme: Centralized

**Nestle** with its headquarter in Switzerland, is the one of the world's biggest food and beverage companies. It has branches in almost all countries in the world, including two in Vietnam. The branch in Dong Nai, Vietnam, produces coffee while the one in Ha Tay specializes in dairy products and lemon ice tea. Currently, the Ha Tay branch gathers 80% of its revenue from yoghurt and 20% from lemon ice tea. It has 43 tenured staff members and 24 contracted ones.

## 1. Introduction

This case examines the situation in Ha Tay, where the contract for milk is considered a failure despite its continuation until today. Since the contract first started in 1998, the number of farmers involved in the contract has dropped from 40 to 13 in Tien Phong village, Ba Vi district, Ha Tay province. The quantity of milk, similarly, plummeted. As of June 2005, the company collected 5 tons of milk a day, while the number has reduced to 1.5 ton this year, 2006. The remaining farmers are seeking an alternative source of livelihood while according to Nestle's business director, the company is making losses.

## 2. Emergence of the contract

Since milk is a differentiated product, which cannot be purchased at ease in spot markets, Nestle realized the need to form a contract system as soon as it first entered the region. To minimize the risk associated with milk quantity, quality, and price fluctuations, Nestle made effort to develop a milk specialized region in 5 districts of Ha Tay province in 1995. The districts chosen were the ones with fertile and large meadows where milch cow raising would be profitable. The company, then, cooperated with the District People's Committee to encourage farmers to convert from rice growing to cow raising. Even though the revenue potential from milk was much higher than that from rice, only a number of farmers with enough land could start the new business. The selection of farmers into the contract, therefore, was a self-selection process where poorer farmers were usually left out.

To facilitate the process of changing from rice to milk production, Nestle and the District People's Committee created a favorable economic, social, and technical environment. Technology transfer promptly took place when the company opened training courses for the farmers to breed their yellow cows into milch cows. Nestle also supported the farmers by providing them with bicycles and motorbikes for transportation, semen and semen containers, and other technology, to minimize the cost of starting a new business. Credit could easily be obtained from the District Bank, the District's Fund 120 of employment

generation, or from the company itself. A farmer at Tien Phong village, Ha Tay province, reports that he borrowed 6 million VND from Fund 120, 5 million VND from Nestle, and used 5 million VND from his own fund to try raising the first cow. With the careful training, technology subsidies, and inexpensive credit, many farmers changed to raising milch cows and started signing annual contracts with Nestle in 1998.

## 3. Terms of contract

Under the contract, Nestle consumes all the milk supplied by the group; in return, the group is obliged to sell back all their milk. Nestle also built milk collection terminals which cost them around 100 million VND, depending on the size of the refrigerator for milk storage and other complementary equipments. Cleaning chemicals are also provided by the company. The farmers, on the other hand, are responsible for building their own farms and buying other inputs, such as feeds, electricity, water, and labor. The construction of a complete farm could cost from tens to hundreds of million VND, though this fund could gradually be afforded from both credit and returns from the cows.

Each day, the company sends a person down to each village to collect milk and assess milk quality. Payments are made every 15 days.

Prices, which are determined solely by Nestle, barely reflect the market price. Since the demand for milk fluctuates by season, the price also fluctuates. Nevertheless, Nestle does not want to boost their price up in the summer and push it down in the winter since they might be accused by the farmers of pressuring the price down. Nestle wishes to ensure a stable price throughout the year under the contract.

Across the years, however, prices have gone through harsh fluctuations. Farmers report that the milk business is currently at their lowest time. The price of milk used to be 2,700VND/kg back in 1998 when a contract household earned up to 7 to 8 million VND a month. Farmers could then take good care of their cows so that they provided more and better milk. Now, in 2006, the price is 3,200 VND/kg, which is higher than in 1998, but is barely profitable, considering to the rate of input

cost rise since. Each month, a farm household has to pay 500,000VND for electricity alone; additional costs are fertilizers for the meadow, labor, water, and others. With only 4 cows remaining, an interviewed household earns only 400,000VND/month these days, after subtracting all the costs.

As low as the price already is, it is only the basic price listed in the contract and is usually not the case in reality. Nestle has a bonus and fine system to discriminate milk of different qualities. Farmers report that an additional 200VND will be added to milk with an exceptional kind of ferment, or with a high fat percentage, or some other qualities. The highest price possible, therefore, is 3,800VND/kg. In reality, not only has few received the bonus, but the price paid for most milk has also been deducted due to low quality. This story is contradictory to that told by the Nestle representative who insisted that the average price paid to the farmers was 3,400 to 3,500 VND since most milk were added bonuses. Nevertheless, when we examined the payment sheet for all the farmers of Tien Phong village on March 2006, the average price was indeed deducted more often than added. The amount usually received by the farmers of this village is, accordingly, between 2,700 VND to 2,800 VND. Of course, this number might vary by village and by month.

In order to specify the fines and bonuses for each batch of milk, Nestle has developed a tight quality control under which they take a random sample of milk from each village every month to test. Among all the qualities, Nestle is most careful about the proportion of anti-biotic, which is only allowed to be less than one billionth. In order to achieve such a small proportion, Nestle had trained the farmers and provided a gradual scale of qualifications to adapt to. Specifically, during the initial three months of training, Nestle still bought all the milk from the farmers, regardless of the level of anti-biotic. After that period, the allowed proportion was one millionth, which was still much higher than the current one. With the time given to adapt to the final qualifications, the farmers have made significant skill improvements. According to the Nestle representative, by June 1<sup>st</sup>, 2005, when Nestle first started anti-biotic testing, the ratio of

households whose anti-biotic in milk was higher than the allowed level was 6 to 7%. Now the ratio is only 1%.

There is not a clear negotiation process where the farmers could voice their opinions. In Tien Phong village, a farmer group emerged based on a pre-existing informal savings group. The group meet once in a while but has not managed to make significant changes in the contracted terms. Due to the lack of incentives to sell milk to Nestle, a subtle way of negotiation was developed: the farmers could instead sell to private assemblers who offer higher prices rather than to Nestle. It is hoped that competition with private assemblers will force Nestle to reconsider its price.

## 4. Contract performance

Due to plummeting prices, many households started to withdraw from the business. They have coped with the crisis by either slaughtering the cows that are not providing enough milk or changing to other businesses. "Many households go back to growing rice or raising chickens, though the income from that is also small", reported Mr. Chien, head of farmer group in Tien Phong village, Ha Tay province. If the price doesn't pick up soon, Mr. Chien might also have to leave the milk business. Thus, the price of milk has reached a level that makes cow raising worse than other alternatives for some farmers.

Nestle's quality control is another a source of dissatisfaction among the farmers. Despite the skill improvement across time, the farmers still complain about the low level of allowed anti-biotic. As Mr. Chien mentioned, the farmers could sell their milk to private assemblers who do not require such tight quality control. Besides, sometimes it is not clear where the anti-biotic that Nestle claims to find comes from and the farmers start to question the company's integrity. Once, the company insisted that the cows of 10 out of 13 households in Tien Phong village had anti-biotic in their milk, even though, according to Mr. Chien, that could not be the case. All the cows were healthy and he could not detect any anti-biotic. Regardless, Nestle decided not to buy the milk for the days when they could find the substance. After 5 days of wasted milk, Mr. Chien

decided to sell the milk to other assemblers at a much higher price of 3,300VND. On Nestle's side, the representative explained that anti-biotic could easily come from personal medicine into the milk. Thus, if one person in the house takes medicine and is not careful in handling the milk, the anti-biotic proportion could increase over the allowed level.

The anti-biotic incident indicates a gap between Nestle's expectations and the farmers' actual capacity. Since the milk business has not been industrialized, achieving a homogenous quality for all the milk is extremely challenging for the farmers. Besides, such tight quality control, combined with the bonus and fine system, causes the contracted price to be even more fickle than the market price within a given season. This fickleness, worsened by the farmers' lack of professional understanding, leads to their distrust towards the company.

The anti-biotic case is one out of several incidents after which, the farmers lost trust in Nestle. Another time, after being pressured by the households, Nestle promised to raise their price to 3,300 VND/kg to encourage them to sell back all their milk rather than to other assemblers. The actual price that the farmers eventually got, however, was 2,700 VND/kg. Another case which cost Nestle some trust was when it provided feed to the cows under the contract of one of the years. The quality of feed was good the first few times, but got worse after that. The farmers had no way of maintaining the expected milk quality if feeding the cows this provided feed. Thus, the company itself needs to be more transparent and responsible on their part of the contract.

The low price resulted in not only a lower quality but also a lower quantity of milk. While the company received enough milk before, now only 300 households from five districts remain and are divided into 9 clusters. Thus, there are now fewer households providing milk and the milk provided by each is also reduced. Even as of one cow, the amount of milk produced by each is only 10 to 12kg per day, compared to 18 to 20kg last year. Deep in the milk price crisis, the farmers are trapped in a vicious cycle where small income from milk provides insufficient nutrition for the

cows. The cows, in return, provide low milk quality and quantity, which earns even less money.

The reason for such a low supply of milk is not only because the cows can now provide less, but also because farmers are now selling their milk to private assemblers more, especially during the summer, when the market demand for milk is high. In addition to their looser quality control, these private assemblers offer a price of 4000 to 4,500 VND, which is substantially higher than that offered by Nestle. Due to this difference, the rate of contract violation, estimated by the company's business director, is approximately 50%, though the real rate could be much higher. This rate varies by season, however. During the winter, when the milk market is not as active and the price offered by private assemblers is lower, the farmers sell most of their milk to Nestle.

Another reason that pushes some farmers to sell their milk to private assemblers is the lack of trust in Nestle and its quality control, as mentioned above. In fact, one household terminated the contract with Nestle and signed one with another milk assembler in the area at the contracted price of 3,500VND/kg. Nestle, in return, offered 3,600VND, and then 3,800VND/kg, but the household refused to come back since the final price after bonuses and fines were unpredictable. Currently, in the group of farmers that are still under the Nestle contract, Mr. Chien permits 2 households to sell half of their milk to others. He told us this story with a sense of pride, "Nestle knows about the situation. The secretary called me up and begged me not to sell milk elsewhere". Clearly, Mr. Chien considers selling milk to Nestle not only an obligation, but also a leverage towards the company to increase its price.

On the part of Nestle, it has no solution to deal with contract violation. There is no legal system that the company could rely on nor could it bind the farmers economically. Furthermore, there is little threat of the company's refusal to renew the contract, since the company lacks milk and needs to gather as many milk farmers as possible. The company now has to resort on powdered milk as an alternative input to produce yoghurt.

As an attempt to target the problem of reduced

milk quantity, the company decided to buy milk by clusters. Each cluster had a head who was voted by the members and was then trained by the company. The cluster head must make sure the farmers supplied the contracted amount of milk and must distribute the company's payment to everyone. As an attempt to strengthen the contract system, Nestle offered this person a fixed salary and payment for his electricity bill. As more farmers started to break contract, the company decided to award the cluster head 200 VND for each kilogram of milk collected to increase his/her incentive. Buying milk by cluster also helps Nestle control the quality of the milk better, since the milk of many households is now stored in one container. Therefore, if one household has anti-biotic in the milk, it will affect others economically and lead to social costs. The households will, hence, supervise one another to ensure mutual benefit.

Unfortunately, having the cluster head as the mediator has caused occasional conflicts within each cluster. Even though s/he was voted by the farmers, the head is sometimes non-transparent in distributing the payment. One example is that s/he would receive the payment from the company but delay the distribution. The company has yet to find out a way to tackle this conflict.

As for the farmers, when asked why some households are still keeping Nestle's contract if the benefit elsewhere was better, Mr. Chien stated that the farmers needed Nestle's refrigerator to continue their milk business. Besides, the farmers needed to pay for transportation costs, which deduct from the profit, when selling to others. The farmers' initial investment in building the farm also acts as a bonding cost to secure its commitment to the contract.

## 5. Reasons for failure

If the usual reasons for two parties to enter a contract are to increase profit and reduce risk,

then the current contract between Nestle and the remaining farmers in Ha Tay is barely secured. The price has plummeted to such a level that makes milk production equally bad, if not worse, than other sources of livelihood. The quantity of milk provided by the farmers is also no longer stable, under the competition from private assemblers. Considering the number of farmers exiting the business, the Nestle contract case could be classified as a failure.

The reasons for this failure are as follows:

- The company fails to adjust the contracted price to the market price and thus, loses to private assemblers.
- Contract supervision and management are weak.
- There is no legal regulation for contract violation.
- Quality control is too tight for farmers' capacity. Besides, the standards were not well explained to farmers, leading to the loss of trust.
- There is no mediator organization to represent farmers and increase their negotiation power.
- There is a lack of commitment on the company's side since it could use powdered milk or imported milk to replace fresh milk produced inside Vietnam.

## 6. Lessons

The case of Nestle offered the following lessons:

- There is little potential for contracts in the milk industry if the enterprise's main source of profit does not come from milk and if the enterprise lacks long-term commitment.
- Contract management and supervision are crucial in preventing contract violation.



Address: Xuan Mai Town,  
Chuong My District, Ha Tay province  
Products: Pigs and chickens  
Contract Scheme: Centralized

## CHAROEN POKPHAND CORPORATION

**C**haroen Pokphand (CP) is an international livestock corporation whose head quarter locates in Bangkok, Thailand. It has branches in over 20 countries, with a variety of products, such as breeds, animal feed, fertilizers, seeds, aquaculture, land, telecommunication, banking, etc. CP first entered Vietnam in 1992 and invested 5 million USD to open the first two branches in Dong Nai. In 1996, the corporation expanded to the North, with an investment of 30 million USD to build animal feed factories, breeding chicken farms, egg-hatching factories, and livestock tool manufacturing factories.

## 1. Introduction

Charoen Pokphand company Ltd. Vietnam, which belongs to the CP Corporation, was founded and built in Xuan Mai town, Chuong My district, Ha Tay province, with an area of 25.5ha. The animal feed factory has a capacity of 216,000 tons/year; the breeding chicken farm can hold 120,000 chickens whose eggs are transferred to the egg-hatch factory to produce 12 million meat chickens and egg chickens annually. The company has now expanded to raise breeding pigs and baby pigs. 7 additional branches were opened in Hanoi, Hai Phong, Quang Ninh, Thanh Hoa, Nghe An, Thai Nguyen, and Ha Nam. The company has 488 workers and sells all of its products inside Vietnam. In 2004, its total revenue was 1000 billion VND.

CP company Ltd is an absolute success case in contract farming. The company started the contract in 1997, before Decision 80, and now has 500 contracted households for pigs and chickens. No household has terminated the contract with CP, except for rare cases of family crisis.

## 2. Emergence of the contract

As a large company, CP needed to find a stable source of input. It looked for areas with a suitable policy environment for livestock and with some previous commitment with the livestock industry. After identifying the area, commune officials helped the company find diligent, honest, and patient households, with experience in pig or chicken raising.

The contract with CP has not only ensured a stable output market for farmers but also expanded their scale of production and increased their income consequently. To encourage farmers to join the contract, the company agrees to provide the breeds, animal feed, and veterinary medicine. Farmers, on the other hand, are responsible for renting land for the farm and providing labor. The investment for the farm is vast. According to Mr. Tran Van Chien, a pig farmer, his family invested 3.5 billion VND to rent land, build the farm, and raised 1,600 pigs. To secure this capital, Mr. Chien borrowed from the district's bank quite easily using the contract with CP as insurance.

With the high income from the contract, Mr. Chien has paid back the loan within 5 years. Besides, from a small farmer, he now has a large house and a car.

On the farmers' side the large investment into the farm also acts as a commitment to the contract since terminating the contract would mean the farm is wasted. Similarly, on CP's side, the investment into breeds and other inputs acts as a commitment since not buying the farmers' output would mean all their invested inputs are wasted. Currently, an average household raises 6000 chickens or 600 pigs, depending on their ability.

## 3. Terms of the contract

We examine the case of the pig contract as the chicken contract is similar in terms of arrangements and management and only different in terms of price and quality. In general, all of CP's livestock contracts are written in details which indicate clearly the responsibilities of both sides and the fine and bonus system for pig quality, feed consumption, farm management, and farm condition. The farms are usually located on the farmers' land but have to be constructed according to CP's standards. These are meticulous standards to ensure epidemics cannot be spread and the livestock is raised in the best condition.

The contract lasts for 5 years and is divided into 2 kinds: breeding pigs and baby pigs. We examine the case of the baby pig contract, in which the company provide the farmers with baby pigs and the farmers will return these pigs after raising them for 5 or 6 months or when the pigs reach 90 to 120 kg. During the contract, CP assigns a technical officer to stay right at the farm to instruct and supervise pig raising. The officer not only ensures that the pigs are taken care of according to CP's standard but also score the farmers' management ability to take into account in the bonus and fine system. With the aforementioned share of investment, CP would invest approximately 300 million VND and the farmer, 200 million VND for each pig farrow.

An average baby pig weighs about 4 kg and age from 14 to 21 days when entering the farm. When the pigs are returned to the company, each kg gained would pay 500 VND. Additionally, a death



rate below 4% would pay at most 200 VND/kg. Feed consumption higher than standard would fine 155 VND/kg while feed consumption lower than standard would provide a bonus of 300 VND/kg. The company has other bonuses and fines for farm management as well as electricity costs and other above-standard farm maintenance. This has motivated many farmers to improve their farms. Some even have closed farms with a cooling system and therefore, industrialized pig raising.

During natural disasters or inevitable epidemics, CP will bear the entire cost since all variable inputs, such as breeds, feed, veterinary medicine, etc. are provided by the company. As a result, the farmers cannot ask for compensation. The company even holds the right to change the farm arrangement and raising method, stop pig importing, or slaughter the pigs to prevent the epidemic from spreading. The farmers have the responsibility to comply with the proposition.

#### 4. Contract performance

Due to the company's comprehensive investment and the technical officers' tight supervision, contract violation almost never happens. The few cases that did break the contract happened when there were family crises, such as a divorce, internal conflict, etc., and not because of the market. In these cases, the company would not sue the farmers due to the large leniency in the Vietnamese law. Besides, these families are usually at their worst time and cannot provide compensation in any case. Nevertheless, since contract violation rarely happens, the company does not make too many losses.

Thus, the success of the contract could be measured by the rate of households wishing to continue the contract. Since the company first introduced the contract, no household has wished to terminate it or not sign the following contract. The simple reason is that CP's contract not only ensures a stable output market and income, but also teaches the farmers to raise pigs and chickens in a large farm scale. These elements are especially important for households who are not yet wealthy and still depend on the company for capital.

The contract becomes more tortuous when the farmers become richer and can be financially independent. We examine the case of Mr. Tran Van Chien, a wealthy farmer who started off with a small pig business. Having learned to manage a large pig farm, Mr. Chien has now opened his own pig farm beyond the contract with CP. While the number of pigs he raises for CP is 1,600, the number of pigs of his own farm also reaches as high as 1,500 pigs. The breed, the feed, and other inputs are all bought from CP, thus the quality of his pigs are just as good as CP's. Mr. Chien sells these pigs to private assemblers at the profit of 4000 to 5000 VND/kg, much higher than CP's profit. According to CP's contract, he only makes a profit of 1,200 VND after adding bonuses and fines.

Mr. Chien is not content with CP's quality control and thinks the company uses it to depress the price: "The breed comes from the company, the feed and techniques all come from the company. How come it is the farmer's fault when the pigs do not meet their standard?". The company, in response, explains that there are many other factors determined by the farmer's capability, such as farm maintenance, equipment renewal, labor usage, and water supply. Conflict, therefore, happens once in a while since quality criteria are determined and measured entirely by the company without consultation with the farmers.

In order to increase their negotiation power, a group of farmers have gathered to form an association. However, the company still refuses to negotiate and does not feel threatened by this association since according to the company representative, the fact that they are still in the contract means that it is better than other alternatives, while those who do not benefit from the contract can terminate it at anytime.

Should nothing changes, Mr. Chien plans to discontinue signing further contract with CP since he now has enough capital to buy his own pigs and make use of the vacant farm. Hence, he will not waste the investment in the farm and the commitment with CP, as a result, will end.

Thus, contract performance could be split into 2 phases: when the farmer has not obtained sufficient capital to open his/her own farm and

when s/he has. During the first phase, the farmer is tied by his large investment into the farm and the company's contract has brought much better income than before. During the second phase, when the farmer has learned to manage his/her own farm and the investment tie begins to fade, s/he is more likely to terminate the contract since the market price is higher. However, this does not worry the company since they can always switch to other poorer and more willing households.

## 5. Reasons for success

CP's contract is a tremendous success for its tight tie and the boost in farmers' income. Farmers have learned to manage a large-scale livestock farm and this learning is perhaps the most valuable asset gained from the contract with CP. When the farmer can stand on his/her own, CP can find other households poor enough to find the contract attractive but rich enough to invest in a farm.

CP's contract has achieved the above success for the following reasons:

- Interestingly, the contract is a success despite the fact that chickens and pigs are not differentiated products. In other words, the farmers can easily sell them to private assemblers who are willing to buy such high quality products. However, the company has managed to overcome this obstacle by providing comprehensive investment and supervision for each farm.
- Since the company holds a solid position on

the market and a large financial potential, comprehensive investment for each farm is possible. Small companies might find the contract for these specific products more challenging

- The preparation for the contract was done carefully. It examined the region's investment climate and chose economically suitable and skillful farmers.
- The time for the contract is long enough for farmers to be willing to invest.
- Farmers received easy credit from the district bank under CP's contract.

## 6. Lessons

CP's contract has brought about the following lessons:

- A successful contract requires long-term commitment from the company.
- Contracts can help transforming the agricultural structure and identify differentiated products in highly competitive industries.
- The preparation process (choosing contracted regions and households) is crucial.
- Supervision and technical instruction need to be done thoroughly to make sure the farmers' capability meets the company's demand.
- If well organized, the contract could be successful without Decision 80's intervention.

# HANDICRAFT EXPORT AND IMPORT JOINTSTOCK COMPANY

Address: No 45A Giai Phong Street - Nam Dinh City

Product: Fruit and vegetable for export

Contract Scheme: Multipartite

**N**am Dinh Handicraft Export and Import Joint Stock Company was established since the centralized economy, belonging to Ha Nam Ninh Commercial Department (today is Nam Dinh). In the past, the Company's main task was to support handicraft cooperatives, instruct handy technique for cooperatives. It created close relationships with cooperatives and agricultural activities.

## 1. Introduction

In the open time with developed economic cooperation, the fruit and vegetable company moved to associate with China and it stopped purchasing fruit and vegetable from farmers in the province. Meanwhile, Nam Dinh has large area and tradition for fruit and vegetable production in the Red River Delta, arising up a necessary issue to have special company purchasing fruit and vegetable product, ensuring stable lives for farmers in the province. For this reason, province's leaders assigned this important responsibility to the Company along with maintaining handicraft production.

At the beginning, the Company still belonged to the Commercial Department, using the state budget. Then it transferred to form of accounting by itself. Products of the Company are diversified, including traditional handy products such as wool, woollens, rattan and bamboo..., agricultural products (fruit and vegetable) and imported steel. Particularly for fruit and vegetable, the Company only focused on export markets with two main products: semi-processed material (selling to Japan) and canned product (selling to European countries and Russia).

The Company's capital is 1.5 billion dongs, but it could borrow up to 20 - 30 billions dong from Banks in business season. Annual revenue of the Company is about 40 - 50 billion dongs, in which revenue from agricultural products accounts for 15%. According to the Company director, market for exporting fruit and vegetable always change, revenue from these products largely depends on agricultural production situation in China. If Chinese fruit and vegetable is in bad harvest, then Vietnamese products can find position in the regional and international market, revenue increases sharply. This is also reason for loose linkage and restrains to the Company in contract farming with people.

For business surface, the Company has 4 agricultural processing zone, 01 is located in the Company and 03 are located near fruit and vegetable producing zone with area of 4000 m<sup>2</sup> per station. At present, the Company has 15 staffs specialized for fruit and vegetable business of total 100 staffs. However, in the peak season, the

Company have to select 100 labors with average wage at 20,000 - 25,000 dongs per day.

Given specific feature of product and loose management mechanism, contract farming between the Company and households did not performed closely, breaking contract still happened frequently although both side get profit from this. For recent years, total area with contract farming of the Company has remained 70 - 100 ha. In the next years, the Company plans to expand area for contract farming with cooperatives in Thai Binh and Ha Nam.

## 2. Emergence and Evolution of Contract

Market of the Company is foreign buyers with strict requirement of deliver quantity and time as well as high product standard and quality, rather than purchasing in the domestic market, the Company need stable and high quality material source. Hence, since early years of business, based on good relationship with cooperatives, the Company signed contract with fruit and vegetable planters through cooperatives. In addition, the Company have to sign contract to perform social task by the Province to buy products of farmers that contributed to transfer plant structure, improve income and lives for people in the province.

Process of signing contract between two sides is relative close. In some cooperatives, the Company combines with leader board of cooperatives to plant performing model to make plant transference. Factory trains technique and quality standard for purchasing and suggest purchasing price. Based on performance model, people registers planting area, output and seedlings. Cooperatives will be on behalf of cooperative member to sign contract with the Company. Households who are selected to sign contract have good planting area, enough water for irrigation. For this, people have right to sign contract coincident with their land and producing ability. However, not all cooperatives in the province are able to sign contract with the Company. Director of the Company said that only cooperatives have active management board are suitable to sign contract. This ensures payment for the enterprise's

investment capital and prestige in the long-term. There are some 10 cooperatives in the province that never sign contract with the Company. Selecting commune to sign contract relies on individual decision of management board based on traditional relationship with cooperatives.

### 3. Terms of Contract

The enterprise pays in advance seedlings and provides technical process for planting (price of seedlings is import price not included transferring and importing cost). The enterprise will get back this advance payment when pay farmers money for selling product. For some new seedling, people with contract are subsidized seedlings by DARD and Extension Center. The enterprise is responsible of buying whole products which are well produced and timely in contracted area of households. Buying price is set by the enterprise, people have not right to discuss or agree. This fix price is calculated based on export price of product which is agreed with importer and it could not be changed by the market price. Presently, the enterprise uses one price for one product regardless product quality. Standard of purchased product is informed since technical transferring stage. However, contract do not mention details of quality standard such as size and color of fruit, leading to difficulty for people to implement contract.

The enterprise do not sign contract with each household, but through cooperatives and it sign contract with each head of small village or directly with cooperative member household. The enterprise will supply seedlings and technique to cooperatives and instruct each household to purchasing product stage. Near harvest period, the enterprise send collecting staffs to each hamlet, small village, establish buying station in each hamlet to buy products timely. In emergency case, cooperatives have to implement sanction means to force cooperative members to buy whole products signed in the contract.

The enterprise sends collecting staffs to field to check harvest activities and quantity, quality of product to catch harvest time and estimate output of each household for enough amount of purchased products. This mean is to prevent selling products

to market by cooperative members. If people have good harvest, the Company commits to buy all products and share parts of them to other enterprise to process.

Though, this is a kind of loose contract and not clear about quantity and quality of product as well as reward and punish measures between two sides which is reason for breaking contract.

### 4. Contract Implementation

Fruit and vegetable production is close and familiar job for Nam Dinh people, it is also suitable to soil and abundant labor force of this province. Exporting fruit and vegetable is high competitive industry in the Red River Delta and it is given support by the State and local authorities. Nevertheless, there are many difficulties in implementing contract and breaking contract still happened due to reasons from both side.

From the enterprise view, the biggest issue is quantity and price of product which agreed by the enterprise and importer before season, while the enterprise can not set fix buying price for planters. Although compulsory term in contract force cooperative member to sell products to the enterprise, market price increased suddenly or higher price given by other enterprise that encourage planters to sell products to market. Without material, workers do not have job while the company still pays their assurance. Moreover, the company has to break contract with importer losing faith (up to now, there is no case that the company has to compensate but persuading importer). The enterprise and cooperative has not found effective solution for this. The enterprise has failed to asked the local authorities to solve this problem.

In case of bad harvest (often due to natural disaster), planters can not refund advance payment and have no security for seedlings. The enterprise face many difficulties due to investment capital for export fruit and vegetable is small.

The company develops many solutions to enhance tight relationship and prestige between two sides. In the early stage of planting Japanese cabbage (2000), the enterprise signed contract with cooperatives but cooperative members had weak

technique leading to bug-infected products can not export. The company still bought whole products to sell in Vinh for domestic consumption. In the initial stage of planting cucumber, the company supported stick to make frame for planters, however this is reason for failed contract because planters did not care much, difficulty belonged to the enterprise.

Today, there are some legal ties in the contract but enterprise has not ever sued farmers of cooperatives for breaking contract in order to maintain relationship with cooperatives and farmer households to ensure supply for long-term production. Agricultural products only accounts for 15% total revenue, but the company continued to signed contract with farmer households to process because they invest much money in facilities and in fact, this product is low competitive and it has potential to develop in the future. The company plans to sign more contracts with more suppliers in the province and others to expand to nationwide market.

However, opinions of cooperatives and farmer households are different from the enterprise's opinion. Most of asked farmers said that quality standard for purchasing by the company is not unified and too tight. In the bad harvest, when market lack of supply, the company willing to buy whole products, included over size of fruit. However, for the good harvest, selling products became strict. In that cases, collecting staffs manage to reduce quantity of purchased product or give high standard for buying. When the company refuses to buy, products sold to market suffer from high pressure and bring low profit. In some cases, planters harvested products for 3-4 days but the company did not come to buy products, so farmers had to leave out all products because fruit and vegetable could not preserved in normal condition. Planters in Minh Tam cooperative said that they perform contract well and sell all products if the company has flexible purchasing and price mechanism despite of the price is lower than in the market.

Farmer households said that good relationship with collecting staffs will be better (less strict standard and products are bought right after harvesting). Collecting staffs of the company still inflexible and not able to persuade households

implementing contract well, even bring about difficulties to planters. Wage of 700,000 - 1,000,000 dongs per month for collecting staffs can not create motivation to encourage them working.

Contract farming for fruit and vegetable of Handicraft export and import company receives a lot of support by local industries such as about seedlings, technique for planter, land, facilities and soft loan for enterprises. Local authorities willing to create condition to households to transfer land. In addition, each household receives 800,000 dongs per ha from the province's budget for planting structure transference. However, ties in implementation of contract are not well managed. Contracts are signed with confirmation of Cooperative or the People Committee but breaking contracts has not solved yet.

In conclusion, planting fruit and vegetable crops through contract farming with company help planters have high profit than planting rice, people's lives with contract has improved considerably in recent years. However, loose contract in technical standard and purchasing condition may lead to producers sometimes suffering from high pressure and risk not less than producing without contract.

## 5. Success/Failure Factors

Given two main targets for signing contract are ensuring stable material supply for enterprise and preventing risk for farmer households, contract farming of the Handicraft export and import company has not implemented absolutely. Though, contract farming will be continued and developed because the company and planters get profit from this model of linkage. For planters, producing by contract brings higher profit and more stable than producing rice or plant other crops. Beside creating output for agricultural products, the company rent more about 100 labors (30 labors for each collecting station) with average wage of 20,000 - 50,000 dongs per day, this create more jobs for local people. For the company, although revenue from fruit and vegetable only accounts for 10% total revenue, this source is rather stable, low competitive and stagnant in capital. The company could not leave

this business form due to big investment in facilities. To maintain fruit and vegetable export, the most suitable form is contract farming with producers. Contract farming succeeded in term of creating mutual relationship between producers and the company, but it failed to keep and ensure right contract as signed.

Reasons for success:

- Nam Dinh People Committee and related industries (DARD, Extension Center) supported and encouraged the company and farmer households to sign contract in soft loan, extension subsidizing, supporting plant transference...
- Cooperatives played an active role as middle unit between people and the company in signing contract, receive advance payment and investment, supervising collecting products. Enthusiasm of cooperative members is important factor that help the company make decision to sign contract and ensure success of linkage.
- People could get bigger economic profit from planting fruit and vegetable by contract than planting rice. This encouraged people become fond of contract and the company, especially for special product as Japanese cabbage.

However, implementing contract still faced many difficulties, leading to failure in implementation such as:

- Instable market for output, so the company could perform contract well
- Price was set for each contract and inflexible, the company has not identify price for each product with different quality which discouraged households to implement contract, improve product quality, particular when supply limited in the domestic market.
- Production land was still tattered, while the company did not have good management to encourage collecting staffs.
- Contract did not received timely support by the commune's People Committee in locals that have people signed contract.

#### 6. Lessons

- The Decision 80 was not reason for this success. Leaders of the company, cooperative members and people get no information about the Decision 80.
- Agricultural consuming contract by this model could help farmers transfer crop season, which benefit the poors considerably.
- Preparation played an important role in success of contract.
- Tattered land may be restrain of sustainability of contract. Product will compete opportunity cost with other products and labor.



# LUVECO FRUITS AND VEGETABLES JOINT-STOCK COMPANY

Address: Number 8, Thanh Binh street,  
Nam Dinh city, Nam Dinh province  
Product: Canned fruits and vegetables  
Contract Scheme: Multipartite

**L**uveco, which belongs to the Northern Food Corporation, is a joint-stock company, with 55% of its capital belonging to its Chinese partner and 45% belonging to the state. The company's head-quarter locates in Nam Dinh city and its production regions are scattered in the nearby areas. Luveco exports its products to a dozen of countries, among which, Russia is the biggest consumer, consuming 70% of the company's products. Other important importers are Bulgaria, Mongolia, Hungary, France, and Switzerland. Only 20% of the company's products are consumed domestically.

## 1. Introduction

The company's main products are canned fruits and vegetables, namely baby cucumbers, baby tomatoes, sweet corn, and lychees. Among these products, baby cucumbers are the most important, with a contracted production area of over 110 ha in 3 provinces: Nam Dinh, Ha Nam, and Ninh Binh. This variety of cucumber and its cultivation method were imported from the Netherlands 10 years ago. Other products are baby tomatoes, with a cultivation area of 70 ha and sweet corn, 30 ha. The company's current demand for fruits and vegetables is soaring due to its expanding export market; nevertheless, building specialized production regions is meeting substantial difficulties.

To obtain a stable input supply, Luveco started contracts with farmers in 1986. The contracts are usually signed through cooperatives with farmers, so there are actually 2 contracts: one between the company and the cooperative, and the other between the cooperative and the farmers. After 20 years of contract, Luveco has increased the number of cooperatives to 20, among which, even the smallest cooperative can supply 20 to 30 tons of fruits and vegetables each season and the largest one could supply up to 400 to 500 tons. The number of farmers wishing to join the contract has also increased substantially. The fact that the contract is maintained after 20 years and the contracted area has boosted indicates the success of this contract.

## 2. Emergence of the contract

Baby cucumbers, baby tomatoes, and sweet corn are imported varieties; therefore, the establishment of a special production region is essential. In order to do this, the company identified the region, improved the soil quality, and encouraged the farmers to switch to the contracted products by providing seeds, fertilizers, and technical training in advance.

Before entering the contract, most farmers were rice farmers with low income. Therefore, when Luveco introduced its contract, they willingly switched crop if their land was located in the dedicated region. Income generated from the contract was higher and more stable than from

rice. Besides, farmers received careful training from the cooperative staff and took little time to familiarize with the new skills.

Only non-farm households or farm households who earn more income than that from the contract do not wish to enter the contract. For example, some households grow off-season cucumbers and tomatoes, whose prices are high while the competition is low. The contract with Luveco is, thus, not attractive for them. However, within a commune, the number of households not entering the contract is low since the company usually chooses rice growing regions.

## 3. Terms of contract

As aforementioned, the company provides the cooperative with seeds, fertilizers and other inputs in advance so that they could then be distributed to farmers. Payments for the inputs will be deducted from payments for the outputs when harvest seasons come. The cooperative acts as a mediator who provides training to the farmers and supervise their contract commitment. We now examine the case of the baby cucumber contract in Nghia Hong cooperative, Nghia Hong commune, Nam Dinh province.

All contracts were signed and agreed upon price and harvested quantity at the beginning of the season. For the season from January to June 2006, the price of 1kg of baby cucumbers was 2,800 VND, within which, 200 VND was the service fee for the cooperative. The farmers received the remaining 2,600 VND. This price is an 100 VND increase compared to last year's price. This indicates that it has been adjusted to the market. However, for each new season, the price is fixed at the beginning of the season and is not adjusted during the course.

This arrangement ensures equal risk sharing whether the market price increases or decreases. In the case when the price plummets to too low, the cooperative provides a crop insurance which equates income generated from rice (600,000 VND/360m<sup>2</sup>). Besides, in the case of disasters, households' payments for the company's input investment are partially waived.

Luveco has several detailed criteria for quality.

Cucumbers must be naturally green, pest-free, normally shaped, and firm; otherwise, they will be returned. Another important criterion is the size. A true baby cucumber must be from 40 mm to 50 mm long, with a diameter from 13 to 15 mm. Larger ones will be classified as medium cucumbers or 6-9 cm cucumbers, which have lower prices. As simple as it sounds, the size requirement is actually one challenging to fulfill since cucumbers grow by hours. Farmers would come to the field when they are not large enough only to come back the next morning to find them oversized. Meeting these quality criteria, therefore, could be difficult.

During harvest seasons, farmers bring their products to the cooperative where Luveco sends a person down to weigh and classify the products. Transportation costs, therefore, are paid by the company.

The contract is signed by the commune people's committee, who will supposedly be responsible for dealing with contract violation.

## 4. Contract performance

Since the contract is essential for both sides, it is usually complied. Interestingly, the contract was better complied before 1986 even though the investment climate was worse back then. The reason for this puzzle is that during central planning, households were obliged to sell all their products to this state-owned company as private assemblers were not given the right to compete. As the market economy develops, however, both private assemblers and farmers pursue profit rather follow any kind of planning. The contract, then, meets more obstacles.

Farmers usually follow the contract tightly during the first and second contracted seasons since this is the period when both the company and the farmers try to please the other for future business. After that, the company would start tightening quality control while farmers start to better understand the costs and benefits of the contract as well as alternatives to it. Contract violations would then happen more often.

Contract violation roots from the fact that prices are fixed at the beginning of the season. When the

harvest season comes and prices differ, private assemblers compete with the company for the outputs and, as a result, steal the company's input investment. This kind of violation happens most easily when the market price surpasses the contracted price.

Farmers also complain that Luveco's quality control is too tight and that their products are thrown away too often. This is not surprising given the fact that Vietnam's agriculture has not been industrialized and homogenous and high-quality production is hard for farmers to achieve. Besides, cultivating baby cucumbers and baby tomatoes requires intensive labor and attention to details, making it hard for small households with insufficient labor to meet the contracted quality. Meanwhile, private assemblers do not expect as high and homogenous quality as the company. Currently, there are about 10 private assemblers and companies competing with Luveco for farmers' outputs.

Luveco attempted to solve contract violation by subtracting 30% from the payment; however, this solution is not practical in Vietnam where the culture asks for not only rules but also leniency. The company would meet serious objection if it applies the fines. Besides, households can also ask the commune people's committee to issue verification for natural disasters as the cause for a drop in yield. The commune people's committee, in this case, plays a limited role in solving contract violation in a fair manner.

According to the company, the rate of contract violation is approximately 10%, though the real rate might be a lot higher due to the generous profit offered by private assemblers. On the other hand, this rate is still lower than that of a regular vegetable contract if we take into account product processing. In other words, since baby cucumbers require canning, which private assemblers cannot afford, the competition for the product is not as high as that for regular vegetables.

## 5. Reasons for success

Regardless of the above limitations, this case is a success, considering the sustainability of the contract. The contracted area increases steadily while the number of households wishing the leave

the contract is minimal. The reasons for this success are as follows:

- The contract brings more stable and higher income than other alternatives, especially rice.
- Luveco has an export market, which ensures large financial potential and the ability to offer farmers a competitive price. The company also has crop insurance, which has encouraged many farmers to switch to the contracted crop.
- Nghia Hong cooperative has a good management team with the ability to organize farmers and negotiate with the company on behalf of them.
- The company has made good preparation for building the specialized production region and for training farmers.

## 6. Lessons

Luveco's contract has brought about the following lessons:

- The contract has helped farmers to switch to a more profitable crop and has, thus, benefited the poor tremendously.
- Crop insurance plays an important role in increasing as well as maintaining farmers' motivation to commit to the contracted crop. However, this can only be applied to company with sufficient economic potential.
- An effective solution to contract violations is yet to be found
- Decision 80 does not play a role in this contract.

# CENTRAL COTTON JOINT-STOCK COMPANY

**C**entral Cotton Joint-stock company was found since 2003 by 5 members, 4 among which were state-owned companies (accounted for 93% of the company's share): Vietnam Cotton Company, Ninh Thuan Seed Company, Hue Textile and Garment Company, Gia Tho Textile and Garment Company and Huynh Lam private company (mostly specialized on purchasing seeds). The Company purchases cotton raw material from the three provinces: Quang Ngai, Quang Nam and Hue. In the crop year 2003/2004, the land used for input-supply under contract of the Company was 2700 ha with the total production of 4100 tons. In the crop year 2004/2005, due to the decline in the cotton price, the Company reduced the input-supply zone and farmers also shifted to cultivate some other crops.

Address: 139 Trung Nu Vuong street, Tam ki town, Quang Nam province.

Product: Cotton

Contract Scheme: Multipartite

## 1. Introduction

Central Cotton Joint-stock company was found since 2003 by 5 members, 4 among which were state-owned companies (accounted for 93% of the company's share): Vietnam Cotton Company, Ninh Thuan Seed Company, Hue Textile and Garment Company, Gia Tho Textile and Garment Company and Huynh Lam private company (mostly specialized on purchasing seeds). The Company purchases cotton raw material from the three provinces: Quang Ngai, Quang Nam and Hue. In the crop year 2003/2004, the land used for input-supply under contract of the Company was 2700 ha with the total production of 4100 tons. In the crop year 2004/2005, due to the decline in the cotton price, the Company reduced the input-supply zone and farmers also shifted to cultivate some other crops. The cultivated area of cotton then decreased to 1100 ha with the total output of 2200 tons. In the crop year 2005/2006, the total cultivated area increased up to 1200 ha with the total output of about 2600 tons. The major product of the Company is cotton fibre, which is distributed for textile and garment companies all over the country, mostly in the Central and the South. The by-product of the process, the cotton seed, is then used for oil-processing. The by-product of the oil-processing is also used for feeding dairy. Nowadays, the Company has in total 27 employees; both technical and administrative (the Company has 4 technical stations with 5-7 workers/station). In addition, during seasonal time (from the beginning of June to the end of September), the company hires 40 more seasonal workers.

Central Cotton Joint-stock company is one of the successful cases which have been following pretty right the Decision 80 of the Government. Even though the total area of the input-supply zone had decreased in the second crop year, the total number of farmers under contract farming did not decline (369 households), with almost no case of breaking contract. Contract farming for growing cotton seems to be successful, the cotton step by step shows its competitiveness in compare with other crops, and the cultivated area tends to expand in the future. Moreover, this is also one in very few cases of successfully established the "four-party" linkage.

## 2. Emergence and Evolution of Contract Farming

Since the very beginning, following the guidance of the Vietnam Cotton Company and the Quang Nam Department of Agriculture and Rural Development about implementing the Decision 80/2002/QĐ-TTg and transforming the crop structure, expanding and sustainably developing the input-supply zone, the Company started signing contract with farmers. Take into consideration that cotton could not be distributed via the retail channel, signing contract farming is critical for both sides, the company and the farmer.

In order to limit the risk for both sides, the Company had carefully investigated all the potential areas for growing cotton. The Company intended to expand the cultivation of cotton in all the favored area but under a plan. Cotton is a quite easy-grown crop, which requires only enough water supply, without flooding. In addition, cotton can be grown in a small area, garden for instance, therefore, suitable for any household. Transforming to grow cotton is also supported by all the related institutions such as Department of Agriculture and Rural Development, Department of Science and Technology, Agricultural Extension, and so on...in the form of providing seed or technical guidance. Thanks to that, since the very first year, the Company had signed contract farming with 369 smallholders, with the total area of 4,100ha of land coverage under contract. The areas in which cotton is grown extensively were established in Duy Xuyen, Dia Ban, Dai Loc, Thang Binh of Quang Nam province.

Contract farming is already familiar with the farmers in Quang Nam province, the case of contract farming with tobacco company for instance. However, contract farming for tobacco shows inefficiency due to unsuitable soil characteristics and shortage of technical assistance (without technical support in weekend days). Realizing that growing cotton is easier and more efficient, the farmers in Quang Nam shift to sign contract to grow cotton.

The Company signs contract mainly through the system of collaborators (group leaders of farmers



under contract). Group leaders are local people who participate in growing cotton, mostly are leader of the community, leader of the cooperative or having reputation among farmers. Group leaders serve as the information channel between the farmers and the Company. Group leaders have the responsibility to select and encourage local smallholders who are interested in growing cotton, having good skill and the ability to apply technology, to sign the contract with the Company.

### 3. Terms of Contract.

The terms of contract do not follow the form promulgated by The Ministry of Agriculture and Rural Development, however, is thought to be reasonable, practical and reflecting the spirit of the Decision 80/2002/Q?-TTg, in detail:

- In case the farmer needs, the Company can provide farmers with all the necessary inputs for growing cotton (hybrid cotton seed, pesticide, fertilizer). The farmers will be informed about the price of these inputs before delivery time, and they have the responsibility to completely repay for the Company by the time of selling the cotton. The Company is willing to provide in advance for the farmer the household expenses in case the farmer is in need and having the ability to repay (this case, however, very rarely happened). Besides, the company commits to provide technical support and to answer immediately any question related to growing extensively of cotton, at anytime (the technical assistant will show up at the cotton field at anytime the farmers have question). Besides, the Company also provides some other kind of technical assistance such as field training for the farmers or handout of technical guidance.
- The Company commits to collect all the cotton for the farmers, immediately and favorably. The cotton will be gathered to one specific point (mostly the house of the collaborator) and the Company will send a truck to collect the product. The purchasing price will be announced in May, one month before the time of harvesting, and never be lower than the floor price of 6,000 VND/kg. The price is the same

for both the first class cotton (white cotton) and the second class cotton (the blond cotton). The technical criteria is also cited in detail in the contract: the Company will not purchase cotton without drying, cotton mix up of the first and second class, spoiled cotton, cotton mix up with rubbish. At this floor price, the farmers have higher profit than growing paddy rice. Though the profit is not as high as growing melon or tobacco, the farmers still prefer cotton for a better secure of the output.

- The Company will pay the farmer within 1 or 2 days after purchasing (this term is not specified in the contract, however, is a commitment between the two sides). For all the activities include investment in advance, technical assistance, purchasing cotton and payment, the Company conducts via local collaborators. The Company pays for each collaborator 60,000 VND/ton of cotton. It encourages the group leader to work more efficient.
- For the farmers, they have to sell all the cotton for the Company, but not any other third side. The Company applies specific method for investigating the output with the assistance of the purchaser, technical assistant and group leader. Besides, the farmer have to commit for using in the right purpose all the provided input, as well as following all the instruction for growing and harvesting cotton provided by the Company.

The contract is confirmed by the People Commune Committee. The contract does not specify the punishment in case one side breaks the contract, and also does not mention the risk of force majeure. However, in reality, there exist such kind of arrangement among the Company, the group leaders and the farmers. In case of bad harvest (but not totally loss) or single poor harvest (only in the field of a specific household), the farmer has to take the loss by his own. In case of a lean harvest, or popular loss, the farmer will be subsidised for the total expense of seedling (possibly the Company will pay 100%, or possibly the Company 50%, the Department of Agriculture and Rural Development 50%).

When be asked about the terms of the contract, a

group leader in Ha Lam town, Thang Binh district said that all the terms of the contract have been read, discussed carefully and adjusted before signing. Both farmers and group leaders agreed that "the contract is reasonable". However, they expect the purchasing price of the cotton would increase a little bit, so that the life of the farmers could become better. This is also the common expectation of the farmer all over the country.

#### 4. Contract Implementation

Cotton can not be easily distributed via the retail channel. After the first two crop years, there was no case of breaking the contract. The farmers seem to satisfy with all the support of the Company, as well as the payment term. Also, after the two crop years, most of the farmers have master the technique of growing cotton, the technical assistant of the company only have to supervise the overall situation of the cotton cultivation. About payment term, in the first crop year, there was a case of a purchaser delayed the payment. The person was fired after that. Nowadays, all the farmers and group leaders agreed that the payment of the company is fast and convenient.

In the crop year 2004/2005, eventhough the price of cotton fibre has decreased to 18,500 VND/kg, the Company still got the benefit of over 1 billion VND while keeping the purchase price of 6,000 VND/kg. According to the the general accountant of the company, this benefit mostly came from the by-product which is the cotton seed. If take into account only the main product which is the cotton fibre, the Company almost had no profit. The company gained 700kg of cotton seed/ton of raw cotton with the price of cotton seed at 1,800,000 VND/ton. In the near future, the company has the plan of expanding the cotton cultivation to Kon Tum, Quang Ngai and Binh Dinh provinces. Meanwhile, the Vietnam Cotton Company have transferred the technique of compresse the cotton fibre for the Central Cotton Joint-stock company, which helps to save the processing time, as a result, speed up the purchasing period.

Cotton is said to be an easy-grown crop, which brings stable income for the farmers. Mr. Pho, a cotton grower in Ha Lam town said: "In compare

with paddy rice, cotton is easier to grow and bring higher profit". In 2004, this smallholder grew 720m<sup>2</sup> of cotton. He decided to increase the area for cultivating cotton up to 1440m<sup>2</sup>. As his estimation, in a normal condition, with the floor price of 6,000 VND/kg, he could make a profit of 800,000 - 1,000,000 VND/360m<sup>2</sup>. In addition, cotton harvesting is labor intensive, but not a hard work, and the harvesting period does not overlap with the agriculture rough time. Therefore, haverting cotton could take advantage of the labor force of young or elder people. In compare with tobacco, cotton is easier to grow. Cotton can be harvested within 90 days, therefore, it is possible to intercrop cotton with tobacco and peanut. Besides, cotton is not fertilizer and pesticide demanding. All the farmers indicated that they would continue sign contract farming for cotton plantation with the Company.

According to the Company, in the near future, there exist several difficulties that the Company has to deal with. First, the low purchasing price limits the competitiveness of cotton in compare with other crops (This is the main reason for the decline of the total cultivated area of cotton in the crop year 2004/2005 in compare with crop year 2003/2004). Thanks to the advantage of output security, the total land used for growing cotton may increase, however, still lower than the level of the first crop year.

Up to now, the Company has to be in charge of purchasing seed to provide for the farmers. The National Seed Fund supported the Company with a few tons of V20 seedlings. However, after a testing period in Quang Nam province, those seeds did not bring any output, therefore, were then stored in a warehouse.

In addition, the Company did not receive any credit from the Development Support Fund for the reason that the Company does not own any cultivating land. The Company does not receive any support as specified in the Decision 80. Besides, the Company has to bear an unreasonable VAT (without deducting tax for the input as raw material).

#### 5. Success Factors

While facing with many difficulties including the

low world price for cotton, the tax and credit policy, the contract farming of the Central Joint-Stock Cotton Company is however, successful for reasons as stated below:

- The Central Joint-Stock Company is a fully equitized company, which helps the Company to be more active and efficient in building and implementing business orientation and plans.
- The local authorities and all the Department, Insitutions of the Province have created a favorable socio-economic environment for the implementation of contract farming. Besides the extension in form of field training for the farmer, the Department of Agriculture and Rural Development gives 50% subsidy for the seed in several beginning years. Furthermore, the Department is willing to give 50% subsidy for the seed in case of bad havest.
- In addition, the four joint-stock members of the Company which are the Vietnam Cotton Company, Ninh Thuan Seed Company, Hue Textile and Garment Company, Gia Tho Textile and Garment Company, are all expert in processing cotton. On the other hand, that somehow guarantees the output for the Company. Besides, as joint-stock members are located in many different provinces, the Company has advantage in investigating for the suitable the plantation areas, which is a critical point for success.
- A compact administration system, mostly are competent employees (graduated from the Hue College of Agriculture) who benefit from a stable and decent level of income (about 30 millions VND/year), work efficiently and closely with the farmers.
- One of the factors which encourage the farmer

to grow cotton is the characteristics and economical benefit of cotton. Cotton can be cultivated in a poor land without complicated extensive care, with low rate of lean harvest. Growing cotton is less profitable than some other crops (except paddy rice), nevertheless, the output is guaranteed better and the purchasing process is more simple (other crops require more complicated selection before being purchased). Furthermore, cotton can be stored in the house in a normal condition for long time without being spoiled.

- Moreover, as cotton is a particular product which can not be easily distributed via the retail channel, the relationship between the two sides of the contract farming for cotton is therefore tightly guaranteed.

## 6. Lessons

The success of Central Joint-Stock Cotton Company could bring out some lessons:

- The Decision 80 is effective in cases of particular crop such as cotton
- The successful implementation of the Decision strongly depends on the cooperation and collaboration between the processor and the authorities.
- A reasonable predetermined price, along with a simple purchasing process could add in the advantage of the crop while comparing with the other crops.
- Investigating the cultivating area and selecting collaborators play an important role in the success of the contract farming.



Address: Tra Cai industrial zone, Tam Ky commune, Quang Nam.  
Product: Pineapple  
Contract Scheme: Centralized

## QUANG NAM PROCESSING FACTORY OF FRUITS AND VEGETABLES

**T**he Quang Nam processor of fruits and vegetables for export under the Da Nang Agricultural Product Im-Export and Processing Company was established on the base of the Soviet Union APK factory, which is specialized in producing fruits and vegetables for export to Soviet Union. After the collapse of Soviet Union, factories were shifted to other units for other purposes like rubber cultivation, and sapling cultivation. In 2000, the Ministry of Agriculture and Rural Development cooperating with the Provincial People's Committee implemented the target of developing pineapple production, thus invested in factories with new Danish equipment for exporting pineapples and planning material regions. At present, the factory is granted with certificates of ISO, HACCP, KOSKER which prove the ability of exporting products to the markets of the US and EU countries. The Department of Agriculture and Rural Development reported the material region covers 3000 ha and the planed region of pineapple trees is 4,700 ha. These are the bases for the development of the factory.

## 1. Introduction

The Quang Nam processor of fruits and vegetables for export under the Da Nang Agricultural Product Im-Export and Processing Company was established on the base of the Soviet Union APK factory, which is specialized in producing fruits and vegetables for export to Soviet Union. After the collapse of Soviet Union, factories were shifted to other units for other purposes like rubber cultivation, and sapling cultivation. In 2000, the Ministry of Agriculture and Rural Development cooperating with the Provincial People's Committee implemented the target of developing pineapple production, thus invested in factories with new Danish equipment for exporting pineapples and planning material regions. At present, the factory is granted with certificates of ISO, HACCP, KOSKER which prove the ability of exporting products to the markets of the US and EU countries. The Department of Agriculture and Rural Development reported the material region covers 3000 ha and the planed region of pineapple trees is 4,700 ha. These are the bases for the development of the factory.

The processor is the state-own unit with the operation capital coming from the credit source. As a unit with its own account, the processor has its own seal, but its production scale and technology have to follow the leadership of the Danang Agriculture Product Im-Exporting and Processing Company. In every crop, based on the common price and the approval of the company, the factory gives out the predicted price and then buys pineapples at this price for procession. In the early years, the main products of the factory are condensed pineapple juice and fresh pineapple juice. But in 2006, the factory focused on processing condensed pineapple juice. All the products are transferred to the Danang Agricultural Product Im-Exporting and Processing Company for consumption. The number of workers in the factory is 61.

Although receiving support from Danang Agricultural Product Im-Exporting and Processing Company; the central and local offices, the factory operates ineffectively, with more bad debts from the bank. Until June 15th 2006, the total debt of the factory is 99 billion VND and the interest is 18.3 billion VND. There are many reasons to the

failure of the factory but the most important one seems to be shortage of materials and broken contract farming. So far, the debt of the factory has been over 6 billion VND in which 5 billion VND is for varieties in the program of encouraging 100 ha for converting plants. The number of broken contracts and farmers in bad debt accounts for 40 percent of total signed contracts (equaling to over 400 contracts). This is seen as a failure in signing contract farming and buying agricultural products from farmers.

## 1. Emergence and Evolution of Contract

Pineapple is a traditional product of the APK factory and it is a popular tree in some regions of Quang Ninh province. Reports on agriculture reveal land in such regions as Nui Thanh, Dai Loc, and Que Son and even in highland regions like Tra My, and Hiep Duc are very suitable to developing pineapple trees. This is a reason why the Ministry of Agriculture and Rural Development and other related offices decide to invest in material region and processing factory in Quang Nam province. So far, the Quang Nam fruit and vegetable-processing factory is the only one in the Central Region. The link with farmers in material regions is the first priority.

In 2002, under the Decision No.80 and the leadership of the province, localities in the material region coordinated with the factory to mobilize farmers to convert plants and sign contracts with the factory. At first, the model was supported by both sides. In fact, with advanced technology, the factory needs a large amount of inputs for machine operation, thus it is necessary to set up a big and stable material region by signing contracts with growers. Farmers here are close to pineapple cultivation, every year they have to suffer from price pressure and risks. Information on province's support in varieties, fertilizer encourages farming households to sign contracts with the factory. At present, the factory has signed more than 1000 contracts with farming households on 700 ha of cultivation land.

## 3. Terms of Contract

There are two contracting models of producing



pineapples: (i) the model based on farm land of factory in which the factory invests (including breeds and agricultural materials), farmers (workers) grow, take care and harvest. They are paid by working-day assessment with yield norm. However, in practice, the model is not efficient and gives the low yield accounting for only 1/3 of the usual one. Thus, the factory has to face losses. The manager of factory said that the main reason is that every thing is invested by the factory so farmers do not aware of keeping, maintaining and managing. (ii) The second model is based on farmers' land (about 1 ha), in which the factory pays for breeds and fertilizer according to requirements of farmers. At the end of the harvest crop, farmers return the breeds and sell products to the factory. And the fund of the advanced agricultural materials is subtracted from the product selling money received at the harvesting time. The model is quite effective and is less risky for Business. Normally, the model yield is 2-3 times as high as the previous model, accounting for more than 16 tons/ha. Under the calculation of the factory, the point of 900VND/kg, equaling to the yield of 16 tons/ha is the breakeven point. In fact, farmers growing pineapples following the second model can gain about 14 millions VND/ha/harvest time (within 20 months)

Only farming households with sufficient labors, economic skills, and large land near the farm are allowed to sign contracts with the factory. These agreements are approved and monitored by the Commune People's Committee. However, in the agreements there are not any rules in case of farmer not selling their products to the factory.

The factory buys products at a floating price in markets and varying from 900-1600 VND/kg (the floor price of the province is 800 VND/kg). The collected products are divided into 2 categories with 2 different price levels. The first category is of more than 400 grammes, and the second category is the rest. Staffs will buy directly in growing areas. A group of 2-3 staffs will buy products for one district. Besides, the factory has the system of cultivation technical staffs (with at least 1 year training in Da Nang province) and quality monitoring and material developing staffs.

The matter of sharing the risks and losses in manufacturing pineapples is not mentioned in the

contracts. In the opinion of the factory manager, a person with twenty-year experiences in growing pineapples almost faces no risks, insects and labor power in taking care pineapples.

## 4. Contract Implementation

Its capacity is 50-ton of pineapple material with 8 hour working machine. Each time to kick-start a squeezer needs at least 7 tons of pineapple, therefore, the factory only purchases if having more 7 tons materials. However, in recent years, the factory usually faces supply storage. Since 2003 (beginning its performance), the highest its capacity only reached 27% designed capacity and the lowest was 7% and expected under 10% designed capacity in 2006. On the other hand, the factory has to achieve 47% designed capacity to reach break-even and above 50% to gain profits. It means that the factory need process more 15 tons materials a year. No good linkage between the factory and farmers and frequent lawsuits and breach of contract farming partly caused by both two sides - the factory and growers.

There are two kinds of breaking contract farming: (i) growers did not invest in seedlings and inputs in advance, not sell their products to the factory; and (ii) the factory did not purchase their products and not timely pay sellers.

At the beginning of raw material planning, technical staff specified suitable land for growing pineapple. However, complex terrain, disadvantage traffic (only three-crane car running) create more difficulties in pineapple delivery. In addition, pineapple is a fruit that need to be quickly bought and processed, therefore, factory leaders often confirmed that the factory always faces raw material storage and it can not seen lack pineapple buyers. But, in fact, many growers met difficulties and risks for their products because of not finding out buyers.

According to households, it is common that the factory did not purchase pineapple. If they want to sell their products, they will force to find private traders and suffered from compelled prices situation. But they have no choice as they cannot keep longer their pineapple. Answering this problem, the leader of factory explained that they agreed with pineapple growers on selling to



outside factory because quantities are not reach least purchasing level to kick-start machine.

Pineapple is long-day crop and requires large investment (about VND17-20 million per hectare) therefore it has to suffer from other crops like gum tree. Quang Nam province gives many preferential policies on crop conversion. A household who reclaims receives VND7 million per hectare, and, pineapple growers also funded fertilizer valued VND1 million per pineapple ha. In fact, however, many households received supports from the province and grew both pineapple and gum tree. When pineapple crop ended, the gum trees grown up, they chopped down all pineapples to maintain gum trees.

Furthermore, there is fierce competition between pineapple buyers for purchasing pineapple. The factory informed pineapple growers on buying prices at least 15 days before harvesting crop, therefore, it is base to help private trader to pay more. Moreover, assessing price process is very prolix (need approved by agriculture import and export company and the Da Nang processing food company) so buying prices are not flexible according to market prices. In this case, farmers are willing to sell their products to private traders at higher prices if the factory purchasers do not persuade and buy timely.

Sometimes, the factory did not pay timely or harass farmers during investment or purchasing their products... that led to lawsuits or build-up unaware for implementing contract farming. In some pineapple areas, the factory lost public confidence therefore it is unavoidable breach of contract.

For contract breakers, the enterprise is almost unsolved. Although the contract farming was confirmed by the people committee, role of local government does not bring into play their effect. In addition, during supporting the factory selecting contract farmers or changing crops, some local staff gave their relatives to contract list and then these households broken contracts, they are usually screened by authorities therefore it is difficult to deal with. Yet the factory's leaders find out measures to take back their investment, they said: "Contract means fair buying and selling but this is contract with farmer, farmer broken their

contracts, the enterprise or province leaders also suffer a loss".

To value success or failure of contract farming, we should consider satisfied level of all sides involving contract, increasing and decreasing numbers of contract, contract areas and production. Indices of repayment and development of the company are also important factors. Obviously, with these factors, the contract farming between Quang Nam export fruits and vegetables processing factory and pineapple growers was unsuccessful.

## 5. Success/Failure Factors

There are two main reason groups to the success or failure of contract farming: (i) the factors of economy, technology, and social environment; (ii) and the factor of management environment. In this case, the factor of cultivation and processing technology seems to be good. The variety of cayen planted in this region is of high-quality and productivity. The production process is the most modern in the Central Region. With the correct technology of cultivation and good protection, it is sure that pineapples are more comparative than other varieties in the region. Following the comparison table made by the factory, the income of a cayen pineapple-grower is more than 13 million VND per ha for each process of pineapple cultivation of about 20-24 months, meanwhile the income of a person planting forest is 6 million VND per ha in a year. The habit of working and good land conditions are the advantages of pineapple cultivation in the province. However, the management environment reveals a lot of weakness.

Because the factory is totally funded by the state and under the direct control of Danang imp-Export Company, the mechanism of management is very complex and ineffective. Every decision on investment, purchase prices are made by the Company, they are not flexible under the market changes. In addition, this mechanism does not encourage the activeness and responsibility of factory staffs. The company has no management method for investment capital thus the situation of bad debts and broken contacts is unavoidable.

Some factory staffs that are irresponsible for working and sometimes bother farmers even let growers to sell pineapples to other private traders. The payment by working day of more than 700,000 VND per month for staffs does not encourage them to pay attention to their job of purchasing inputs. Although leaders of the factory said that they would dismiss staffs who pay no attention to purchasing pineapples from farmers, in fact many farmers want to sell products to the factory but they are not allowed. This leads to shortage of materials and in turns to the impossibility of taking advantages of advance technology.

Although the processing capacity of the factory is great, material regions are located in many places. This results in the low production of the factory. In this case, the enterprise is impossible to purchase inputs despite scare materials. Meanwhile many growers may face risks and loss in finding their outputs. Besides, the infrastructures of the material regions are very poor, making up limitation of purchasing and transporting. The prestige of the

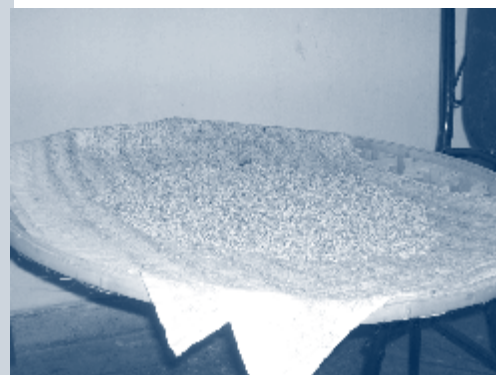
factory is worse and worse, the relationship between the factory and farming households are widened.

## 6. Lessons

The lessons withdrawn from the failure of signing contracts by the Quang Nam processor of fruits and vegetables for export are following:

- This is a kind of contract just for the state policy, thus it is difficult to be successful. The targets of beneficiaries are mainly to search for great investment from the state without strain management, thus in turns leading to loss, waste and ineffectiveness of the state investment.
- If the enterprises operate ineffectively, it is possible for contracts with farmers to be broken.
- Contracts set up just following the movement are wasteful for the state investment

## BAO LOC SILKWORM JOIN-STOCK COMPANY



Address: 35 Tỉnh Tín Hồng St.,  
B?o L?c city, Lm ??ng province  
Products: Casava silk and mudberry silk  
Contract Scheme: Centralized

**T**he Bao Loc silkworm join stock company, formerly was Bao Loc silk factory of the State owned General silkworm company, was established in 1989. Beside the main function of producing silk from raising silkworm, the company has spreaded its hands to the trade of agricultural products and tea, and providing supplies and services to rural areas. Recently, there are 7 branches of the company locating all over the country.

## 1. Introduction

Due to the historically low prices of silk when the company was under the umbrella of the state owned silk company, there have not been significant achievements. During 1989-1994, the company had 600 workers and 4 silkworm factories. Because of the ineffective working mechanism, the number of workers of the company in 2006, before the equitization, was only 42 and there was not even one silkworm factory. The State removed the debts for the company at the time it was also equitized-will be fully responsible for its own activities and finance. Warehouses, machines and land left at that time helped avoiding a huge investment on infrastructures. At the moment, 100 percent of the stocks come from state money-workers, since the equitization has been taken less than one month, cannot afford the shares.

In the past, the company had its own farm for raw materials. In addition, those materials were gathered from households on contract basis. However, the company could not compete with other private producers to buy raw materials from the households. Those contracts thus failed. In 1996, the company started to switch from raising mudberry silkworm to cassava silkworm. The cassava silkworm, first found in 1950 in India and Indonesia, was originally a wild silkworm species that eats cassava leaves. Its silk is not a continuous thread but has higher quality and more durable compared to the silk of the mudberry silkworm. Due to its higher quality, the silk is more preferred in Asian markets. Since the worm lives in the cassava plant, the company has to only find the areas where cassava has already been grown rather than establishing a material zone as for the other silkworm. Despite the fact that the price of mudberry silk is higher than the cassava silk, the company still decides to increase its production of the later due to its low investments and high development potential. Besides, the company has attracted foreign investments such as the ADB's project on supporting the cassava silk during 2006-2009.

The company has signed contracts with households in the provinces of Tay Ninh, Binh Phuoc, Dak Nong, Gia Lai, Kon Tum, and Thanh Hoa. In the past when the company collected raw

materials for mudberry silk production, they selected areas with similar characteristics-living areas of ethnic minorities, remote and mountainous areas, etc. Those characteristics also created typically different contracts between the company and the local people.

Contract signing can be divided into two periods: mudberry silkworm contract and cassava silkworm contract.

## 2. Mudberry silkworm contract situations

Mudberry silkworm contract was firstly issued in 1999. It is hard to say when it was finished and whether it could be considered existed due to its loose conditions. The company signed the contract because of high prices of incoming materials while gathering them from small scale producers was not secured. Since silk making processes require a long and complicated chain of connections from mudberry planting, silkworm raising, cocoon preserving, silk extracting, silk weaving, and garmenting to make complete products, stable inputs is therefore a vital needs.

From the farmers' side, contracted households usually have mudberry fields so they do not have to plant new crops. Nonetheless, as they are not well aware of the terms of references in the contracts, instead they consider them as short-term requests that they whether or not providing their materials.

According to the terms of reference in the contract, the company invests seedlings and some loans to the households to plant the mudberry. On average, the company releases 350kg of seedlings and VND 100 million each year, which is a tiny investment compared to that of the individuals within the areas. What is more, the private enterprises are usually located close to the communities thus being given more priorities when buying materials. In many cases, even when the price paid by the company is as high as that of the private enterprises, sellers still prefer to sell their goods to the individuals since they are physically closer and have simpler purchasing procedures.

Fixing prices is also a weakness of the contract

since the price is fixed before the silkworm's roes are given to the households, which is 21 days before the households sell back to cocoons to the company. At the contract signing time, households are usually satisfied with the price of the cocoons. However, 21 days is long enough for the price to fluctuate, especially with silk. When the price is low, households terminate the contracts and sell cocoons to ones who pay higher prices, creating a loss for the company for their primary investments. Fortunately, the investments are not much so that the company does not lose much. In addition, when the price is low, the company also limits their purchases from local households therefore the contract only has a loose correlation between the two sides.

In fact, the company has its own farm for mudberry plantation, but the benefits from the farm is not better than dealing with private enterprises since the company has already leased the land to households. Land and the mudberry belong to the company while seedlings belong to the households. Thus, those households frequently sell produces to private enterprises—they are afraid that the company will subtract the benefits.

Silk is a fluctuated price product. This is also a competitive commodity with many traders in the market. The State owned enterprise form does not allow actively changing the prices or linkage forms to compete against private enterprises. In addition, the company does not have a mechanism to deal with contract violation because the contracts are not certified by the Commune People Committee. Even they are approved by CPC, it is very difficult to solve because of the mass contract violations. The farmers do not understand the obligation of contract. The company's initial investment is not enough to even its performance, not including the farmers. Thus, the failure of contract is undoubtable.

### 3. Casava silkworm contract situations

The company started to do business casava silkworm in 1996 and the small scaled contract was also firstly issued in the same year. The official and larger scaled contracts were just established in July 2006 after the equitization. The

casava silkworm trade is simple and bringing much benefits for both households and enterprise. In company's side, the reasons of casava silkworm contract are the same with the mudberry silkworm one: they want to find the stable input resources for complex commodity channel. They discovered the material areas and convinced farmers to sign the contracts. The farmer households breed silkworm and supply cocoon to company. In farmers' side, when they breed casava silkworm, they had not to invest anything because they have casava gardens already. They only had to buy the silkworm eggs from company. This kind of business is quite effective because households can take full advantages of silkworm such as bulb of casava could be eaten or sold and leaves of casava, which were thrown away before, could be used as the food for silkworm.

Based on lessons learnt from previous contracts, the company now signs contracts with collecting dealers instead of individual households. At the moment, the company has contracts with 87 dealers each is responsible for collecting materials from 20-30 households. The company sells roe and advances some money (VND 1.5 million per kg) to the households through the dealers. Each 20gr box of roe costs VND 20,000. The dealers sell it again to the households at slightly higher price. On average, each household buys 3 boxes of roe each yield. In the dry season the cassava does not have leaves thus the households can only raise the worms 9 months per year, and three yields each month. Consequently each household spends VND 1.6 million for the roes.

That the Company determined to make comprehensive investment rather than fragmented as before make the Company itself more involved in the implementation and monitoring the contract liquidation. Since the Company shall go bankrupt in case where this contract is failed. The Company also selected relatively well-being households to act as procurement agents since the Company is worried about of their flying from their creditors. The selection of households who take over silkworm production is appointed to agents.

The Company's contracts are not certified by local authorities. However, their acknowledgement of debts shall be certified by local authorities.

The Company shall sign procurement contracts for the entire volume of cassava silkworm. As mentioned above, the Company shall make investment by means of supplying eggs in advance and pay an advance for households for households via agents and then reimburse such amount of money by the end of the year. In case households failed to refund the entire amount or deliver an adequate supply of silkworm as contracted after 3 months, they shall have to pay interest rate of 1.5%. This interest rate shall be 1.5 times as high as it after 3 successive months. Therefore, the Company has formulated a quite clear regulation to deal with contract violation cases, avoiding the cases of the illegal sale of silkworm to the private or debt fly. However, the contract shall clearly stipulate that households shall inform the Company in advance in order to find out proper solution in case they are unable to refund the amount of money or make adequate delivery of silkworm as stipulated. Since the contracts have been just signed, the Company's test settlement of such cases have not yet made

The fixed unit price for silkworm eggs to be delivered to agents is 60,000VND/kg, and 55,000 VND/kg silkworms to be delivered to households. However, this contract clearly states that the unit prices shall be adjusted according to market price fluctuation. In case where the price dramatically increases, the company shall make proper adjustment. In contrary, in case where the price goes down dramatically, the Company wants to stop procuring silkworm eggs, they shall have to inform agents in advance so that the later shall stop producing and procure all produced outputs. With the amount of 55,000VND/kg silkworm, each household shall enjoy 825,000VND/brood, equivalent to about 22 million/year. This amount is quite large in mountainous areas

The Company also elaborated some quality standards for silkworm, however they are not complicated. The silkworm cocoon enables 13% of H2O and 1% of residues for instance pupa, silkworm, tree trashes and strange residues. In general, under experience in cassava silkworm procurement in previous years, both the Company and local people do not meet any obstacles or disputes over the quality control

Since the contract just take effects 3 weeks before

we arrive the Company. Therefore the contract effectiveness has not yet been experimented. However, this contract is different from the previous one, making the contract more successful. Firstly, the Company signs contracts with agents nearby and more familiar with local people. Therefore, the capacity of management and monitoring of the Company. Employing agents to procure silkworm helps partially overcome people's poor awareness. People have not yet made awareness of the binding elements as stated in the contract, since such bidding elements shall act as a both economic and cultural bridge between the Company and households. Secondly, very few private companies make competition since they haven't good cassava silkworm varieties. The binding terms of the Contract shall be higher thanks to investment. Thirdly, the Company has been equitized. The price of the Company has been adjusted conditional on market price fluctuated. The Company is competitive against the private sector even the later can find cassava silkworm to be invested in. This competitiveness is strengthened by the important fourth element, i.e export markets. The Company is the biggest exporter to Japan. China also makes order for cassava silkworms. However the Company has not stock available for sale. Therefore, the Company's output is very stable. The high export price makes the cost of material input more competitive

However, the Company's success shall much depend on the management qualifications well as financial source. The Company has just been equitized the Company almost start from the scratch. There are many future challenges which determine business results as well as the contract liquidation of the Company.

## 4. Success/Failure Factors

Since the contract for cassava silkworm has just been newly introduced herein, only elements are considered causing losses of the silkworm contracts:

- The Company has been subsidized by the State, causing inefficient business performance, causing a lack of serious investment in people's business



- The people's qualification remains poor. Therefore, they have not yet been aware of the binding terms of the contract.
- The price is fluctuated and the output is not sustainable, leading to the failure of the contract liquidation

## 5. Lessons

The contract of the Bao Loc Cassava Company has brought in the following experiences:

- The Contract take effects in case the company's business goes smoothly. The

Company need to expand markets and improve business knowledge and economic management skills with aims to ensure people's investment

- Even though the Company is managing land areas, they do not make investment or arrange proper contracts, they shall find it difficult to collect products from local people
- The contract can create benefits for the poor because of being easy to implement. However, the employment of procurement agents can lead to the labour exploitation.



## THAI HOA - LAM DONG COFFEE COMPANY LTD

Address: Tan Lam village - Da Don commune - Lam Ha district, Lam Dong province.

Product: Coffee

Contract Scheme: Multipartite

**T**hai Hoa - Lam dong Coffee Company Ltd. was found in April 2005, is branch of Thai Hoa Coffee Company. In 1996, the Company was only a purchasing station. In 2000, the station transformed into a branch of Thai Hoa company. From 2005 up to now, the Company is functioning as a subsidiary of the parent - Thai Hoa company (which the head office locates in D21 Phuong Mai, Hanoi). This is a reputed company in the field of processing and exporting coffee in Vietnam. Registered capital of the Company was 4,5 billions VND, however, the total initial investment of the company was 29 billions VND, in which 24 billions was fixed assets such as machines, factories, warehouse, etc...

## 1. Introduction

Thai Hoa - Lam dong Coffee Company Ltd. was found in April 2005, is branch of Thai Hoa Coffee Company. In 1996, the Company was only a purchasing station. In 2000, the station transformed into a branch of Thai Hoa company. From 2005 up to now, the Company is functioning as a subsidiary of the parent - Thai Hoa company (which the head office locates in D21 Phuong Mai, Hanoi). This is a reputed company in the field of processing and exporting coffee in Vietnam. Registered capital of the Company was 4,5 billions VND, however, the total initial investment of the company was 29 billions VND, in which 24 billions was fixed assets such as machines, factories, warehouse, etc... Nowadays, the total land used of the Company is 3 ha. Another 7.1 ha for instant coffee processing was already approved. The Company has around 200 employees, among which 80% is seasonal labors, mostly local people. Though conducting business in a large area, the Company has only 6 purchasers distributed for 6 specific cultivating areas, along with 3 technical assistants. The Company purchase raw material via several channels: outlet, cooperative, afforestation yards, dealer or directly from the farmers.

In recent years, the coffee industry has been facing with many challenges, the fluctuation of the coffee price for instance. Though, the Company has been successfully developed and exported their coffee, especially the high quality Arabica. The Company purchased all the raw coffee of the province, without differentiate product under contract farming with product from the market. Despite the fact that the company is developing smoothly, the number of contract farming signed with the Company tends to decrease. Among nearly 1,000 contract farmings signed in 2002, only few contracts signed with purchase outlet are maintained. The total investment debt of the farmers during the period 2003-2006 was nearly 5 billions VND. The debt was basically collected just recently.

## 2. Emergence and Evolution of Contract

The Company started signing contract farming

with coffee growers even before the implementation of the Decision 80/2002/Q?-TTg. By the end of 2002, following the guidance of the Decision 80/2002/Q?-TTg, the Company adjusted the term of the contract, basically added in the confirmation of the authorities. The contract is either signed directly with the farmer or via dealer, cooperative, afforestation yards... Contract is signed yearly, mostly right before the harvest time with adjustment on the expected quantity, delivery time, payment term, quality requirement, price and responsibilities of each side.

Before signing contract, with the assistance of purchaser or dealer, the Company investigated the coffee plantation and the investment on coffee of each farmer to decide which one to sign contract with. Also, Cooperative, People Commune Committee, afforestation yards, purchasing outlet... help to inform and explain with the farmers about terms of the contract. The contract is sent to the farmer via purchasing outlet or purchaser. After returning to the Company, one copy of the sealed contract will be given back to the farmers. There also cases in which the farmers work directly with the Company and sign the contract at the Company.

## 3. Terms of Contract

The contract farming of Thai Hoa - Lam Dong Company Ltd follows the form made by the mother company, Thai Hoa Processing and Trade Company. The contract specifies all the terms include quality requirement and support policy i.e. price support, risk support, interest and credit support, farm input support and plantation expanding support, as well as delivery and payment terms. There were three options of payment term for the farmers: spot, consignment and investment. (i) spot: the seller and the buyer exchange product and cash right at the same time, the payment based upon the price of the market at the delivery time. As being suitable and practical with farmers, especially farmers in remote areas, this is the most common choice of the farmers. (ii) the seller consigns their product at the warehouse of the Company, then decide a day of reference (after the day the product is consigned) to determine the price based upon the market price of the chosen day. The storage fee is not taken

into account. At the time of consignment, the seller is pre-paid an amount equal to 70% of the total value of the product, the reference price is the market price of the consigned day. The prepaid amount is not charged with interest for one month. After one month, if the reference price is not determined, the prepaid amount will be charged interest at the rate of the Agribank. The maximum time for the seller to decide the reference price is 2 months. This term of payment is favorable for farmers who have experience and have the ability to expect the development of the market. (iii) investment: the Company invests farm input such as fertilizer, credit, technical assistance. The farmer commits to sell the farm output for the Company and pay back all the investment. After harvesting, the farmer has the right to choose one of the two above mentioned terms to sell their product for the Company.

Based upon the contract, the grower has the responsibility to sell all of his products as specified in the contract for the Company and the Company, in turn, commits to buy all of those products. The Company invests farm input in form of fertilizer or in form of cash for farmers under contract. The cash or the equal amount in form of fertilizer will be charged an interest at the rate of Agribank. After harvesting, the farmer has the responsibility to pay back for the Company in form of farm output, at the price of the delivery time or a predetermined price. However, as following the contract form of the crop year 2004/2005, the farmer has to mortgage by the ownership certificate, or savings book. This term restrict the farmers from receiving the investment of the Company. In fact, the investment of the Company is insufficient. The farmers still have to ask for loan from small lender and face many difficulties in paying back the loan.

With farmers under contract who intend to expand the plantation, the Company will provide seedlings with the price of 20% lower than the market price. Only households with available land for expansion are provided with this favorable investment.

The predetermined price of the fresh coffee bean as specified in the contract is 2,500 VND/kg. Based upon expert calculation, the farmer is able

to make a profit from the price of 1,800 VND/kg. This price can be adjusted based upon the market price when the price of the market tends to increase.

In addition, with farmers follow contract tightly and have the minimum output of 18,000 kg/ha, the Company has a risk support policy of 600 VND/coffee plant in case of bad harvest (over 60% loss) and 3 millions VND/ ha in case of lean harvest (100% loss).

## 4. Contract Implementation

In the first year implementing the Decision, the Company signed nearly 1,000 of contract farming, with 3,000ha of land coverage under contract. However, since breaking up contract often happened, investment was inefficient and hard to collect, the number of contract farming strongly decreased last year. According to the Director of the Company, the form of contract farming following Decision 80 (the Company invests farm input and purchases all the farm output of the farmer) is not applicable in this area. The contract farming implement through the system of purchasing outlet works more efficient.

Eventhough the contract is clear and complete, with considerable favored terms for the farmers, it shows to be inefficient in reality. According to the Director, the farmer did not respect the contract and the confidence between the two sides. The Company has limited the number of direct contract with the farmers. Nowadays, serious investigation and selection is done before any contract is signed.

The most common kind of breaking contract is when the Company invested farm input for the farmer, however, the farmer sold their product to the market instead of selling for the Company, escaping from paying back the loan. In this case, the Company has to recover the debt in form of cash, which most of the time very difficult. In some case, the Company had to buy the product with a considerable higher price in order to collect back the debt in the form of farm output. Up to 2006, almost all the investment of the Company has been collected back. Also, instead of using the new seedlings provided by the Company to

expand the plantation, some farmers sold those seedlings to the market to gain some profit, despite all the effort to control the situation of the Company.

As many others contract farmings, the contract farming for growing coffee of Thai Hoa Company also specifies the term of arranging dispute with help of Economic Court of Justice. In fact, many cases of breaking contract happened without interfering of the law. According to the Company, arranging based upon law is complicated and time consuming. Also, the Company prefers to bargain to recover the debt.

All the contracts are confirmed by the authorities. Nevertheless, in case of violating the contract, the authorities encourage the farmers only, instead of any sanction forcing the farmer to pay back the loan. The role of the authorities is unefficient in this case.

Facing with that situation, the Company shifted to sign contract via outlet, in order to share the risk in case of contract breaking. The Company invests farm input through the outlet system. The farmers receive all the farm input at the outlet. After harvesting, the farmer sell the output to the outlet. The Company does not control the distribution of the farm input, as well as the quantity of farm output being collected. Most of the time, the company does not provide enough farm input, the outlet may invest for the farmer. In addition, many outlets (mostly also functions as a groceries or shop of consumer goods) are willing to provide loan in form of consumer goods or cash for daily expenses. Nevertheless, all the loans are charged with interest and at harvesting time, the farmers have to sell product for the outlet with the price lower than the market price. As having a clear understanding about the production of each household in the areas, the outlets have their own method to manage and recover the investment.

The outlet is not forced to sell product for the Company, but has the right to choose the company with the higher purchasing price. One outlet is allowed to signed contract with two or more company. Thai Hoa Company has the policy to give favor for the outlet rather than farmers with or without contract farming. For instance: in season time, when the supply is higher than the

processing capacity, the Company prefers to buy product from the outlet. In the end of each season, the Company gives commission for each outlet based upon the quantity of product sold for the Company. Moreover, the outlets could benefit from a looser quality control and higher collecting price.

## 5. Success/Failure Factors

The Company is expanding their market. In the near future, Thai Hoa Lam Dong intends to invest on processing instant coffee for both domestic and international market. In order to reach the sustainable development, a secure input-supply zone is critical. At present, the input-supply zone is insufficient for the full capacity of the factory. Therefore, there exists a need for larger quantity of raw material. Nevertheless, the contract farming shows inefficiency. The reason for failure could be as follow:

- First of all, the fluctuation of the coffee price in the world in recent years causes a lot of difficulties for the farmers, especially when coffee is the only source of income for the farmers. They have to pay for daily expenses even if the price of coffee decline, therefore, having difficulty in return the loan for the company is understandable.
- Coffee is a perennial plant, which needs decent amount of investment. Since the investment of the company is insufficient, the farmers depend on the credit of the small dealers, in turn, are forced to sell their product to dealers instead of the Company.
- The management of the input-supply zone is weak with a shortage in technical assistant and purchaser. Only 6 purchasers for 6 input-supply zones are extremely insufficient.
- The support from the authorities is poor, especially in providing favored credit or encouragement to follow the contract.
- In addition, a strick selection for farmers to be under contract farming restrict the farmers to join in the process, especially poor farmer who would benefit the most from contract farming. The floor price did not take into account the seasonal characteristic of the product,

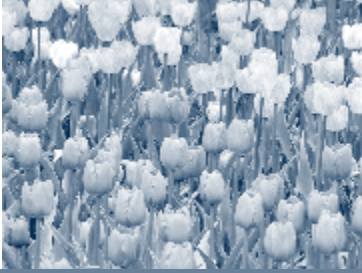
therefore, discourage the farmer from selling their product for the company.

## 6. Lessons

From the failure case of Thai Hoa - Lam Dong Co. Ltd, we can withdraw some lessons as follow:

- The Decision 80 favors state-owned company and farmers rather than private company. The Company receives no support from the authorities when the contract is broken.
- There should be special support to maintain contract farming for perennial industrial plant, especially the favored credit. Regulations on credit in the Decision 80 are too general, therefore, not practical. In fact the Company did not receive any support on credit.
- There should be a risk support fund for product with fluctuating market price such as coffee. This helps both the company and the farmers to follow tightly the contract farming.
- There should be support in order to help poor farmers to benefit from contract farming for crop which requires big investment as coffee.





Address: 46A Ho Xuan Huong,  
Precinct 9, Da Lat City, Lam Dong Province  
Product: Safety flowers and vegetables  
Contract Scheme: Multipartite

## XUAN HUONG COOPERATIVE



**C**ooperative Xuan Huong was established in April 2003, originated from the requirement of finding the market for Dalat's flower and vegetable. After a long period of trying to find a contract for product's outlet, till now the cooperative has gained significant success. The cooperative has associated with some large, and permanent trading partners in Hochiminh city and Danang which can ensure the outlet for greenhouse fruit and vegetable, contributed to raise income for cooperative's members. Through trade fairs inside and outside province, the cooperative has gradually showed its prestigious, as well as been granted certificate for safety vegetable production, and built trade mark Xuan Huong flower and vegetable. At the moment, cooperative's asset is invested by members is over 1 billion VND.

## 1. Introduction

Cooperative Xuan Huong was established in April 2003, originated from the requirement of finding the market for Dalat's flower and vegetable. After a long period of try finding contract for product's outlet, till now the cooperative has gained significant success. The cooperative has associated with some large, and permanent trading partners in Hochiminh city and Danang which can ensure the outlet for greenhouse fruit and vegetable, contributed to raise income for cooperative's members. Through trade fairs inside and outside province, the cooperative has gradually showed its prestigious, as well as been granted certificate for safety vegetable production, and built trade mark Xuan Huong flower and vegetable. At the moment, cooperative's asset is invested by members is over 1 billion VND.

In the very first days, the cooperative had 21 households with 34 labors and 5.5 ha of land, specialized in high technical and safety vegetable production. During the hard time of market finding, some households withdrawn from the cooperative. Up to now, cooperative has 15 households, 25 labors, and 4.5 ha land. Even though, the number of member decreased, model of outlet finding of the cooperative is considered as rather successful case.

## 2. Emergence and Evolution of Contract Farming

Dalat is a large plantation of flower and vegetable of the whole country, supplying vegetable, fruit and flower for both domestic and international markets. The temperate climate with average of 17C degree is suitable for vegetable and flower planting and harvesting whole year. But that is also difficulty for sell the products. Small farmers often meet difficult in directly connecting with final market outlets, therefore they have to sell their products to procurement middleman with low and unstable price.

Facing with urgent need of small households, a cadre of precinct's Farmer Association mobilized farmers to establish cooperative in order to find the outlet for vegetable, flower and fruit. At the very first days, a lot of farmers were very highly

enthusiastic in to be member. However, only household have land, capital, labor, knowledge and ability of technological renovation application, and especially have good relationship, as well as guarantee to the head of the cooperative could take part. The poor household had not much chance from the beginning.

In the first year after the establishment, the cooperative mainly contacted for the new contracts, products still sold to middleman in the market with unstable price. There were some enterprises attempted to contact with the cooperative but they couldn't sign contract because characteristics of risky and unstable price of fruit and vegetable products. Without contract, the outlet of product was uncertain. That is reason why some households were dispirited and withdrawn from the cooperative.

In year 2004, contracts with 5 agents in Hochiminh city, Vung Tau and Binh Thuan were signed, and the scopes of contracts were still in limitation. The management board of the cooperative on behalf of its members signed with the companies with prerequisite requirement is stable procurement price. In that year, cooperative produced 314.6 tons of vegetable and 210,000 flowers with the total value of 1,113,600 VND. In which, 110.6 tons vegetable sold under the contracts, counted 663,600 VND and 57.1 percent in total products. The rest had to sell to market with the market price.

Indicator for signing contract with the cooperative is a fix price in advance offered by the company. For the first years, the cooperative attempted in connecting with Metro in Hochiminh city, however, it didn't come up to good result. Because since Metro is the biggest super market in the city, it only could pay product's price base on the daily market price. Till June 2005, Metro officially signed contract with the cooperative. In years 2005 and 2006, the cooperative has gradually found out a stable market, signed with 4 other agents in Hochiminh city and 1 supper market in Da Nang. Apart from that, the cooperative also deliver its products to another export companies. The contracts are directly signed between the cooperative and its partners without any confirmation of local government.

### 3. Terms of Contract

In the contract, price is fixed in advance, averagely from 7,000 to 10,000 VND per kg, depend on product type. This price is often higher than market price. Companies often propose a planned output, however, it is not fixed for each day. Each company has its requirement for harvesting and packing. Nevertheless, almost these requirements are not so difficult for implementation.

The procedure of each partner is also different. Daily afternoon, companies often inform their need of quantity for next day. The cooperative's members harvest, pack, and deliver to trading partners. Among those companies, only Metro has procurement place in Dalat that is 20km far from the cooperative place. This supermarket has a very complicated procurement procedure with some divisions: a division informing procurement quantity, a division checking product quality, a division purchasing, a division making out invoice and paying. Procurement staffs check very carefully, in case product don't meet requirement, it will be returned back. For other trading partners, the cooperative only need to pack, and deliver without paying transportation fee. Requirements for product and paying price of those companies are nearly the same.

The cooperative sign contract with supermarkets but don't sign contract with each household. Based on the sell contract, management board allocate fairly cultivation land to households one after the other. The rotate of vegetable production is often short, sometimes is only one week, so the cooperative will have schedule about time and cultivation area for each member to make sure that each of them will have chance to plant good benefit vegetable, a part from the lower benefit one, at the same time ensure to have enough supply source for trading partners, not surplus. Apart from the schedule of plantation, the cooperative also has schedule of harvest and procurement of household. Therefore, if product's quality don't meet requirement of the partner and be return back, the cooperative can find easily which household the product is belong to and that household need to have its responsibility about product. This rule makes household trust in and conforms to direction of the cooperative.

Operation cost of the cooperative is based on financial source from contribution of household. At the beginning, each member contributed 1 million VND. This amount of money was to cover for fee of management board for finding new contracts. For the first period of time, the cooperative kept 200 VND per each 1kg product selling under the contract. In only year 2004, with 110 tons product, the cooperative kept 22 million VND. However, this amount of money was too small to maintain cooperative's operation. Therefore, since 30 June 2005, the cooperative decided keeping 5 percent over the total value selling through contract. The cooperative only helps in finding outlet for product, but doesn't support any else service. The household doesn't receive any support and investment from any organization.

However, only greenhouse's products are purchased by companies, outside greenhouse's product still have not stable outlet. The household have to sell those products to the market and take a risk of price and season.

### 4. Contract Implementation

It is necessary to confirm that with contract farming, Xuan Huong cooperative has solved partly problem of product outlet, contributed to making stable and raise living of the farmers. Even though it is a new form, the organization has shown its effectiveness and successes. 1,500 VND per 1 kg of product selling through the contract is kept for fee for pack, transportation and operation cost of the cooperative. According to members of the cooperative, after deduct all kind of production costs, benefit on 1 sao is about 4 to 5 million VND. Each year, farmer can rotate 7 crops in the same land area. All interviewees are trust in management board and contract farming.

Up to now, finding outlet for vegetable, flower, and fruit of Xuan Huong cooperative have been done rather well. For some period of time, the cooperative have not enough products to supply, because requirement of companies always change and fluctuate about 20 percent in comparison with estimated volume in the contract. The member of the cooperative also made acquaintance with the requirement of procurement, pack of the companies, therefore they do not feel so difficult in

supplying. Since contract was signed, only one time the product was returned back because it didn't meet requirement.

The demand of safety vegetable is increasing. The potential market is still very big. In addition, the whether is favorable, risky is low, are good conditions to develop the contract further. However, implementing is still having its problem, some households break the contract. In some case, even though companies committed buying a certain volume, but in the dry season, when the supply in the market is abundance with the lower price, they don't often buy all committed volume. In opposition, in the rainy season, when the supply is shorted, the companies often ask for much more product than in the contract, and sometimes that is over supply capacity of the cooperative. This puts the cooperative in the hard situation for selling and controlling production. Facing with that, the cooperative often to suffer lost to keep the permanent trading partners and need to find the way to adjust its planning by their experiences.

Some cadres of purchase division sometimes make procurement procedure of the cooperative become harder. In the dry season, when yield of vegetable outside the greenhouse is high, the price decreases, cadres only buy from cooperative a small volume, and buy the rest from market outside, and then cheating to put under the name of the cooperative. In some other cases, they ask cooperative decrease price. For example, in the lunar New Year celebration year 2006, Metro only bought about 100kg per day. Meanwhile the daily consumption is often about 500kg. The cadres asked for decreased price, due to low market price level. The cooperative agreed with the price level of 5,500 VND per kg, meanwhile the original price in the contract is 7,000 VND. However, the cadres continuously forced for much lower price. In that situation, the cooperative with the agreement of member decided don't make price dumping anymore and thrown away a big volume of output. Even the contract is signed the risky is still there for household.

In such situation of contract violation, the cooperative is hard to find the solution, they also can not sue, as well as cut the contract with the companies. In the case of contract with Metro, the

head of cooperative signed contract and sent to Metro for signature, however, the contract with fully signature never come again, even the contract stipulates the number of copies that is kept by each party. Therefore when Metro violates the contract, the cooperative has not any foundation to discuss.

Even though, it is a model, but cooperative has not received any support from the local government and province. Apart from the amount of 10 million supporting for brand name construction and vegetable sample analysis, and 100 million investing for 1000 square meter greenhouse to build an experimental performance place, the cooperative has not receive any support in extension, technology transfer, or credit for crop transferring. At the moment, the cooperative only can sign contract for area in the greenhouse, meanwhile the capacity to expand cultivation area and then expand market are very large. With the requirement investment for greenhouse is about 40 to 60 million per sao, cooperative and the member have not ability to build by themselves. All land used right certificates have been used as collateral for borrowing cash for investment from the bank. The cooperative hopes to borrow from the trust fund to expand its production. In fact, even with the confirmation of the province about the capacity and its good operation, cooperative still can not borrow from bank. In addition, no one certify in the contract between cooperative and trading partners. Therefore in case of contract's failure, there isn't any insurance from local government, and the cooperative finds hard to force trading partners to implement contract's clauses.

## 5. Success Factors

Due to overcoming difficulties and having right direction, Xuan Huong cooperative is developing day by day. Vegetable, flower of Dalat have high competitiveness and are special products. The cooperative promotes advantages of geography conditions as well as grasps demand of the society. With the increasing of living standard, demand for safety vegetable and fruit also increasing, especially in the big cities, where the dweller have higher expenditure.

The role of head of the cooperative is also a very important, an enthusiastic and competence leader in management is importantly contributed to successes of the cooperative. Members applied technology in producing safety vegetable

The cooperative has established a good position in both domestic and export markets. Even though, have not directly exported to abroad yet, but at the moment the cooperative has been exported through export companies.

The cooperative invested in building greenhouse to ensure quality and season for harvesting, meet requirement of partners. Even it is only in the small scale, but the first objective of finding outlet for its product has been done. For the next period, the cooperative will try to expand greenhouse to increase output, and market.

In general, Xuan Huong has combined economic, technological, environmental and social factors

with management skills to achieve its success.

## 6. Lessons

From the fact of signing and implementing contract at Xuan Huong cooperative, some learning experiences can be drawn as follows:

- Decision 80 can not be applied in a rigid method for vegetable and fruit areas, since no enterprise would like to invest into due to its risky, unstable price, and have a lot of supply resource
- The contract farming can success without support government if the market demand is big enough
- However, without support of government, poor households will be hard to take part since they don't have land, capital and technology.





# HIEP NGUYEN COOPERATIVE

Address: 71 Ngo Quyen Street, Dalat, Lam Dong

Products: Fruit and vegetable exports

Contract Scheme: Multipartite

**H**iep Nguyen Cooperative was established in September, 2003 with a large business scale of producing and processing fruits and vegetables for export; making business of glass aluminum and building materials. The main income of the cooperative comes from making shares, jointly making business with Mai Nguyen joint-stock company (invested by an oversea Vietnamese resident) on semi-processing fruits and vegetables for exports. Products from Hiep Nguyen and Mai Nguyen companies are shipped to many countries in the world, including South Korea, Singapore, Thailand, and Taiwan. In the future, the cooperative intend to explore the new market of the US.



## 1. Introduction

Before the liberalization, the name of Hiep Nguyen used to be the trademark of a business household. The son in the household, now being the head of the cooperative used to be in charged of producing fruits and vegetables for exports in Cong Thanh Company in Da lat city. After the collapse of the company, he was trusted by many people and appointed to set up the cooperative of Hiep Nguyen. Because the main customers of the cooperative used to be those of Cong Thanh Company (now is Mai Nguyen Company), thus the output of the cooperative are rather stable. At first, there were only 15 members working in the cooperative, but now about 38 households attend in business activities of the cooperative. Although the cooperative head has no idea about the Decision No.80, contracts farming between member households and the cooperatives have been effective. The total cultivation areas of the member households reach 110 ha with the contribution of 700 million VND to the company of Mai Nguyen

## 2. Emergence and Evolution of Contract

Before the establishment of the Hiep Nguyen cooperative, the Cong Thanh Company used to sign contracts with farmers in the regions for exports. When the Lam Dong authorities were encouraging to establish cooperatives in the province, the company of Cong Thanh was collapsed. Thus, facing the situation, Mr. Hung (the current head of the cooperative) with some members set up the Hiep Nguyen Cooperative. One of the conditions to be a participant of the cooperative is contributed capital of 1 million VND. The head of the cooperative said, many households were still hesitant to attend the model of cooperative because they still had impressive cooperative operations under the subsidy of the state in their mind. Therefore, they did not dare to take part in the new cooperative or if possible their contributed capital was not much. After some years of operation, the cooperative has won believes of many member households, and the amount of capital has increased and number of participants also climbed.

Since the establishment of the cooperative, to let

members feel secure on work and stabilize the output, the head of the cooperative signed contracts with member households. The input collected from members are processed and then exported by the cooperative and Mai Nguyen Company. Customers of Mai Nguyen Company are also those of Hiep Nguyen cooperative and workers of Hiep Nguyen cooperative used to work for Cong Thanh Company. Although growers do not totally depend on the cooperative, they believe on the cooperative's ability to stabilize outputs, thus the number of contracts have increased in the recent years.

## 3. Terms of Contract

At first, relying on the contracts signed with foreign customers and business experiences, the head of the cooperative signed contracts to buy products from member households at a fixed price. Then due the price changes day by day, the contracts have been changed to meet the flexibility of the market prices. And in fact, Hiep Nguyen cooperative buy products from member households at free market prices. The only advantage of member households rather than other farming households is to master information on products by orders and to have priority in selling products in case of supply exceeding demand

According to orders and information from the cooperative, farming households come to register to sell products to the cooperative before crop seasons. One week before harvest time, member households would inform the cooperative about the volume of products, and then the cooperative in turns would give out the predicted prices. However, in delivery the prices could be adjusted following the market price. Due to lack of capital, the cooperative would not invest in households' cultivation before.

However, the cooperative helps to contact with fertilizer companies and asks them to sell fertilizer on account to farmers. In turns, the fertilizer companies would receive money back in the next harvest season (usually the circle of harvest in vegetable cultivation is very short). In some cases, some member households can not pay the money of fertilizer in this harvest time but they are allowed to pay in the next season. So far, there

has never occurred bad debt or the case of farmers not making the payment.

In addition, thanks to the prestige of the cooperative, the member households find it easy to access to loans of banks. The cooperative is willing to support member households in making loans, and the households do not have to pay any fee to the cooperative management board.

In addition to agricultural product trading activities, the contributions of members help their member closed to the cooperative. The contributions by members are converted to shares in Mai Nguyen Company and the members are of course allowed to have benefit and loss under the rate of contribution.

No office is responsible for supervising contract activities between the cooperative and members. And until the time of survey, members have not received any preferential treatment or information related to the Decision No.80 by the Prime Minister.

#### **4. Contract Implementation**

Dalat is a traditional area of planting high-yield vegetables and flowers. Farmers here have a lot of experiences in cultivating and taking care of fruits and vegetables. The quality, quantity and variety of Dalat vegetables are highly appropriate for exports. However, the only co-operative, Hiep Nguyen could see the finding. This result is partly derived from business experiences, production and customers of Cong Thanh Company, which used to operate quite successfully in producing flowers and vegetables for exports, and now it is using storages of Mai Nguyen Company for production. So far, Hiep Nguyen co-operative have found many stables contracts and set up close relationships with 20 foreign companies, and expects to further develop in future. In 2005, Hiep Nguyen exported 3000 tons of cabbage and Chinese cabbage of all kinds at an average price of 250-350 USD/kg

Contracts with members of co-operative are signed and implemented flexibly by the head of the co-operative. Fluctuated prices encourage farmers to implement the agreements better and make them willing to sell products to the co-operative even in case of high price and input

scarcity.

Collecting and buying activities absolutely depend on export market of the co-operative and Mai Nguyen Company. In the peak period of delivery (in the second half of a year), products of the co-operative's member can contribute 75% of total materials of the co-operative and the company. As usual, in the peak time, their support is about 40-45% of the company requirement. The rest of the requirement is purchased from households outside. At that time, collecting and buying policies applying to both members and non-members are the same.

However, at the first half of the year, the export markets mainly include Singapore and Korea so that products of members are redundant. At that time, products of members are used for purchasing firstly. The prices of inputs depend fully on the market changes. Although price is low and varies, farmers can recover their capital and find it impossible to face the fact that their products can not be sold. In these days, the co-operative often informs its purchase power early to the members and in turns decreases the reserved amount of products. This can help members make production plans, master market information, decline risks and then not to suffer from pressure of prices by traders. In fact, the members still produce as usual and the remaining amount would be sold out to market.

Besides, the co-operative also received cares and encouragements of government, local authorities in creating producing and developing markets. Since established, co-operative received investment of post harvest processing technology with 150 millions VND of non-return fund to building cold houses storing vegetable. At the current time, export products of co-operative are duty-free. This helps co-operative increase purchase ability, competition ability with other processing and purchasing units to ensure implementation of agreements. Moreover, with brand-name, co-operative has advantages in trading with foreign companies. Head of co-operative reveals that foreign companies prefer co-operatives to other private companies because they are organized by government and controlled by the city people's committee and then contracts can be executed better. Currently, Hiep Nguyen has registered logo and brand name for itself and is asserting them in the regional market.

However, there are difficulties in implementing contracts. For foreign markets, trading is very complex. For instance, for some foreign companies, the first delivery seemed to be very good but in the second times, they tried to decline the price or make the late payment. The co-operative could not sue them for that because of high fee for an international lawsuit and the low knowledge of management. For domestic collecting and purchasing activities, there are some breaches of contract due to unexpected increase of prices. As the result, members can break contracts by selling products to private traders even having already agreed to sell to the co-operative. (The co-operative did not adjust price immediately or could not purchase at higher prices when compared to the agreed price). In some cases, the co-operative buy products at lower prices from outside, its members are able to face risks of surplus products or suffer from price pressure of private traders.

As for contribution share of co-operative, because the cooperative can not win the belief of all members so the capital contributed from them is only 38 millions VND (while the head of the co-operative himself contributed 400 million VND). When asked about interest and the contribution, members consider this just based on their belief and have no idea about the profits and contributions of the cooperative.

## 5. Success Factors

The most decisive factor of the success is the management role of the Hiep Nguyen cooperative. The head of the cooperative has many experiences in production and exporting of fruits and vegetables. In addition to this, he has good strategy in business, and knows how to bring into play the regional advantages and preferential policies by the government for development.

Furthermore, the cooperative are able to inherit the relations made by the Cong Thanh and Mai Nguyen companies, thus the foreign customers of the cooperative are stable. This reveals the stable outputs of the cooperative and is a basic factor to success of contract farming between the cooperative and its members.

By organizing to mobilize contributions of

members, the cooperative makes its member to be closer to the cooperative operation and to attract more capital for business development of the cooperative.

One of the most important factors is that the cooperative can export like other enterprises but it does not have to pay tax. This helps its business more profitable and more comparative, thus leading to export contracts and input contracts more possible.

## 6. Lessons

- From the success of the Hiep Nguyen Cooperative, the Decision No.80 seems to focus only on state-owned units. It has not popularized even in regions specialized in agriculture production for domestic and international markets. The head of the cooperative that has many experiences in making business of agriculture products and member households have no information on the Decision. And the Decision has no influences on production and consumption activities of the cooperative.
- For the common markets not requiring high-quality products, the cooperative can make profits and develop, (even the cooperative does not have to produce in large scale, in green house, and no need to pay much attention to varieties and planting)
- For products with unstable prices like fruits and vegetables, it is impossible to fix the prices for the producers. Thus, the government is required to set up a fund to support farmers who are easy to be at risks.
- It is known that poor households do not receive any benefits from the models of cooperatives. Because the poor households do not have land and capital to make contribution to the operation of the cooperative which is the first condition to take part in the cooperative. In addition, the cooperative can not pour investment on account into production.
- The government should launch programs improving business capacity, popularizing business experiences, supporting to set up international trademarks, stabilizing outputs of agricultural products, which is considered as the success to contract implementation.



# CAU DAT TEA COMPANY

Address: Xuan Truong Commune, Cau Dat District, Lam Dong Province

Products: Green tea, black tea

Contract Scheme: Nucleus Estates

**C**au Dat Tea Company was established on Cau Dat Tea Factory under Lam Dong Tea Company in 1927. It was the State-owned company and newly equitized in early December, 2005, only 7 months up to the survey time. At present, 51% of the capital in form of building and land is state-owned, the rest belongs to the staff. The company has plan to double its registered capital to build processing factory. In the initial equitization period, the company has many plans for construction, development and transition. Therefore, it is difficult to forecast its coming business situation.

## 1. Introduction

Cau Dat Tea Company was established on Cau Dat Tea Factory under Lam Dong Tea Company in 1927. It was the State-owned company and newly equitized in early December, 2005, only 7 months up to the survey time. At present, 51% of the capital in form of building and land is state-owned, the rest belongs to the staff. The company has plan to double its registered capital to build processing factory. In the initial equitization period, the company has many plans for construction, development and transition. Therefore, it is difficult to forecast its coming business situation.

The company has 230 ha of tea and 150 agricultural and processing workers. It produces Vietnam black tea and green tea and Thailand Tea. It is on the way to improve soil to produce new tea varieties with higher value such as O long tea. It mainly exports black tea to former East Europe, Iraq, Taiwan, Singapore, and the Czech republics but still through intermediary import-export companies. Thus, the price is often squeezed and the profit is little higher than national trade. Cau Dat Tea Company is trying its utmost to look for independent export market in order to raise profit but still faces with many difficulties.

Cau Dat Tea Company was once a state farm employing only planting workers without land allocation to farmers like it does at present. The company firstly signed the land allocation contract in 1975. The contract is renewed every 5 years. Both company's workers and farmers of Xuan Truong Commune can sign the contract. Up to now, 235 households have taken part in this business. In general, the contract has been carried out successfully in term of guaranteed stable input and output for both sides but risks have not been shared reasonably, which in turn has generated little profit for the company. The main cause is state ownership in which social benefit dominates the economic one. The company is often willing to bear loss to keep purchase price above the floor level. This situation happened regularly in subsidization period but it is expected to go down in the coming time as the company is equitized and self managed.

## 2. Emergence and Evolution of Contract

Cau Dat Tea company changed its mechanism from state-farm management to land allocation to farmers under the instruction of Lam Dong Tea Company according to the State policy with the purpose of transferring ownership to farmers. This is the top down reform not resulting from direct economic demand of the company. People signing contract are mainly former workers. Then some who have private land transfer the contract to other people to grow higher valued commodity according to their land characteristics.

At present, most of allocated households come from other localities and do not have production land. Signing contract with the company, they can earn enough money for living and saving to buy their own land. Some other households still sign contract with the company although they have their own land such as the case of Mr. Nguyen Huu Phuoc interviewed by us. His family is allocated 1.8 ha and own 6 ha of private land of which 2 ha is for tea, the rest for coffee. Tea produced on this 2 ha is also sold to the company at purchase price because the company is the only one who purchases black tea that can be grown on his land. Coffee brings him rather big profit but he does not invest all in coffee due to its fluctuated price.

## 3. Terms of Contract

The company signs contracts allocating tea field to farmers and purchase all harvested tea. Under this contract, the company allocates land, supplies tea plants and all input materials; the farmers only take responsibility for labor and harvest. This linkage form is different from state farm linkage. The farmers are paid according to their working effectiveness, not fixed salary as workers before.

Tea price namely floor price is fixed by the company at the beginning of the year and adjusted for increase during the year. This term transfers all risks of market price to the company. At present, the average price of black tea is 1.800 VND/kg increasing by 200 VND against last year while market price still remains. Similarly, the average price of green tea in 2006 still remains 2000 VND/kg, the same as last year while the



price of materials go up. The price does not go with market price bringing little profit to the company. But the company cannot adjust the price because behind a state-owned company is a stagnating system operating not only for economic benefits of enterprises but mainly for the people's benefits.

The company has some tea classification and quality control standards. At present, black tea is divided into 4 types: A, B, C, D by tea plant part. The good part dried to be the best tea is called type A sold at highest price. The price goes down from the top to the stump part correspondingly.

Difference in output investment leads to difference in profit share between the company and farmers. For 4-5 tons of tea/ha produced on the allocated land, the company enjoys 70% while farmers 30%. This is the quantity lump sum per 1 ha more than which the households can get all profit for the difference. Such share is reasonable and not claimed by farmers because they only contribute their labor. Besides, it also creates motivations for farmers to be more industrious to produce the excessive quantity. On the contrary, if the households cannot produce sufficient quantity, they have to compensate 35% of the shortage value. In fact, the average output reaches 6 ton/ha/household. For household owning private land, the price is the same as lump sum but they can enjoy all profit as they have to bear all expenditure.

Production monitoring is rather simple thanks to collective process of fertilizing and pesticide spraying. All households go to the field at the same time to take care the plants every time the fertilizer and pesticide truck comes. The director and other leaders of the company directly monitor this process and easily check whether the distributed fertilizer and pesticide are used up or not. Fertilizer and pesticide sacks must be returned to the company for checking.

Due to the characteristics of this linkage contract, the company has to bear all loss in case of natural disaster when all materials are lost. The farmers suffer less than the company in financial term because they only contribute their labor.

#### 4. Contract Implementation

It is not difficult to perform contract in Cau Dat

company thanks to simple linkage form with clear responsibility. The contract carried out for 30 years helps stipulate solid regulations and forecast potential difficulties during performance process. The key point is that Cau Dat is a state-owned tea company. Although it does not have strong financial potential, it still can guarantee a stable living standard for farmers. The price and quality classification and control are considered reasonable by farmers.

Besides, tea is also a typical product requiring complicated processing line. Not many private enterprises compete to purchase materials without investment such as the case of vegetables, milk v.v. Of course, in the past, some private enterprises took part in the competition but the commune police helped to suppress thanks to the close cooperation between the company and the local. The company only gives warnings without penalty to households breaking the contract selling tea to private enterprises or submits the case to the Commune's People committee, although the contract is certified by the local authority. Besides, the price offered by the company is the highest so the farmers have no reason to sell elsewhere.

The advantage of linkage contract is clear. There is little violation from both sides. However, the contract is not sustainable as the terms bring little profit to the company. "The company signs contracts with farmers mainly for its duties, not for profit", said the Director of Cau Dat Company. Every year, the company spends about 2.4 billion VND on 1,200 tons of materials. In addition, the company has to bear insurance and labor fee of workers and farmers. The company usually earns about 3 billion as price is squeezed by import-export companies. Almost no profit is generated. The company was equitized but in the coming time, it still has to depend much on the state. As the result, it is expected that profit from tea will not increase. At present, this situation benefits the farmers but in the long term when the state gradually withdraws its support, the existence of the contract depends on the way the company modifies the terms and conditions to share risks and profits equally between both sides.

Due to financial weakness, the company still cannot quickly overcome its difficulties. The



irrigation system is still weak so production still depends on rainy and sunny weather. The company is trying to improve its tea fields to produce higher valued tea varieties, such as O Long tea. However, up to now, only 70ha out of 230ha is improved. Besides, the company has intention to plant a grape area for vintage wine production. In that case, the company will sign purchase contract with farmers but the terms will be specified more strictly to ensure the benefit of the company. However, the company will meet difficulties in investing in wine production due to its lack of capital.

For farmers, growing tea helps generate stable income, escape hunger but cannot help make a fortune. If the company is able to improve tea fields, look for direct export market, the income of farmers will be much increased.

Thus, here is the case in which the farmers earn much more than the company. The company fixes the floor price, invests for farmers and bears all risks of natural disaster v.v., but the economic benefit is not high. As the result, in the long run, it is difficult for both the company and farmers to further develop

## 5. Success Factors

Cau Dat' tea contract has been carried out seriously with little break of both sides. The reasons for this success are as follows:

- The company does not have to compete to buy materials because of complicated processing line. Besides, the price offered is higher or equal to market price so the farmers have no

reasons to sell elsewhere.

- The company has an effective way of management ensuring that all materials supplied are used for tea production by farmers.

However, in the competition of the market economy, the sustainability of the contract is not high, especially in case of reduced State support. This disadvantage results from the following reasons:

- The Company is still State-owned and subsidized for socio-politic issues.
- The company does not have strong financial potential, has not found direct export market. Therefore, its tea field and living standard of farmers have not been improved.

## 6. Lessons

The case of Cau Dat Tea company brings the following experience:

- State-owned companies without fully transition to new mechanism have difficulties in getting sustainable contracts.
- Farm-based management and lumpsum payment is an effective way to minimize breach of contract and encourage farmers to improve their production.
- Exportation through intermediary affect the beneficiaries of the contract due to squeezed price and low profit.



## DA HUOAI CASHEW EXPORTS AND PROCESSING FACTORY

Address: Road 2, Madaguoi Town, Da Huoai District, Lam Dong province

Product: Cashew-nut

Contract Scheme: Multipartite

**T**he Da Huoai cashew factory belongs to the Lam Dong Food joint-stock Company funding 51% by the State. The factory was established by the end 1994 based Da Huoai - the centre of raw cashew areas in Lam Dong province. At the beginning time, its capacity was annual 1000 tonnes of raw cashew and up till now, the factory opened more a processing unit in Da lay, Da Teh district with its capacity above 6000 tonnes raw material a year.

## 1. Introduction

The Da Huoai cashew factory belongs to the Lam Dong Food joint-stock Company funding 51% by the State. The factory was established by the end 1994 based Da Huoai - the centre of raw cashew areas in Lam Dong province. At the beginning time, its capacity was annual 1000 tonnes of raw cashew and up till now, the factory opened more a processing unit in Da lay, Da T?h district with its capacity above 6000 tonnes raw material a year. The factory purchases raw material from various resources such as: contract farming signed directly with farmers or via Farmer Group, buying from agents and detail sellers. However, it still runs at 60% its capacity as raw materials shortage. Most processing products are exported and a small amount of low quality products (about 5%) launched to domestic markets. In recent years, the Company has consolidated its position and expanded its business performance. Its kernel products was sold out even not enough to meet all requirements (in 2004). Huge kernel demand forces the Company to develop its raw material region, increase purchasing raw cashew not only in local but also in other neighbour provinces. The contrary of this developing trend is less and less amount of contract farming between the factory and cashew producers. The factory's representatives also confirmed that signing contract farming under the Decision 80 is inefficient.

## 2. Emergence and Evolution of Contract

In order to stable raw material resources for full capacity, the Leaders of the company and the factory considered signing contract farming with cashew producers since 1999. The factory invested part of inputs and encouraged farmers in collecting and selling raw cashew to the company. At first this model was fairly good, then the factory really faced more difficulties because of a breach of contract farming. Besides, the factory signed contract farming via farmer's union branch and cooperative. And this model seems better and more efficient unless there is not in debt.

Under the Decision 80, the factory also signed

contracts with more suppliers but be more careful to select who engaged contract. Though the farmer's union branch, local government, only householdes who have prestige in doing business and good producing organization involved contract farming. As results, the factory only signed contract farming with cashew growers within 3 villages instead of 6 villages in 2002. In addition, the factory expanded contract areas in Cat Tien District. However, most contracts are inefficient. In the past, the factory provided advance inputs and gave zero interest rate for all contract farmers. Since 2005, it has only invested advance inputs for contract farming with Farmer Group and cooperatives. There was one contract farming with one household but the factory did not provide advance inputs for them. Up till now, there are still many contracts farming not withdraw advance money.

## 3. Terms of Contract

Contract farming is signed annually before beginning new cashew crop (main harvesting crop started early March and finished end May, however, some quantities harvested earlier or later than main crop). For contract farming under the Decision 80, the factory only purchases raw cashew. Each contract farming filled estimated trading quantity but has not give detailed prices. Price is usually fixed by market prices at delivery goods. It is common that quality of contract farming is lower than real harvesting products, about 2/3 or under total real outputs.

Contract farming of the factory has specific and close regulations in term of quality and qualifications (for example, cashew of main crop, not processed, not mixed green or wormy beans, not mixed soaked cashew...). To accompany, there are regulations in term of a fine for breaking contract. The contract farming comes to most farmer's knowledge except from some cases used breach of contract on their purpose (soaking cashew to make heavier...).

For contract farming signed with farmer group, the factory gave advance money and took back by products at harvesting crop. In 2005 crop, total advance money reached VND 110 million. Only Dam Loa village, the factory provide advance

VND 50 million and purchased 3,028 kg raw cashew valued at VND 42,936,000. The rest was withdrawn by cash. The farmer's union branch signing with the factory received VND100 per kg for management activities. Purchasing price at agents is usually higher VND 100/kg than directly buying price from farmers. The factory explained that to encourage agents in purchasing and selling raw cashew to them because the factory did not invest in the agents while these agents had to give advance money to farmers.

At present, there are 3 processing cashew units, therefore, it is fierce competitive within the district that require the factory to plan suitable policies to keep closed cooperation with business agents. The factory also implemented to invest new cashew varieties in contract farmers. With each new planting cashew hectare, the factory invested 100 - 150 cashew seedlings (valued VND 6000 per seedling without freight).

#### 4. Contract Implementation

Cashew is easily planting industrial crop. It is able to develop in sloping and bad soil therefore it is suitable for factory located. In addition, investing modern processing equipment and well planning long-day crops of growers created favorable conditions to help two parts to engage closely by contract farming. It is affirmed that signing contract farming brought more benefits into farmers for selling their products. Before no contracts, farmers usually sold all products to private traders and had to be constrained in term of price. Thanks to contract farming and be informed daily prices, they have not be suffered from private traders.

In fact, however, the contract farming seems not useful. According to reports of linkage between the factory and farmer in term of investment and purchase cashew from 2003 to 2005, the factory signed 10 contracts farming with individual and union branches with total advance VND 251,000,000. During the period, the factory bought 42,363 kg of raw cashew with valued VND 438,106,000. Most of the amount was purchased without contract farming. Only 2005, purchasing rate via contract farming of total purchase was too low, about 5-6 tonnes of 7000

tonnes. The factory only withdrew ½ total investment by products, the rest had to back by cash with non-interest rate.

Withdrawing by cash was very difficult and the capital of the factory is still debt in farmers, for example debts of Ha Lam village. In 1999, the factory invested in Ha Lam farmer' union branch, it had receive commission like agent to perform as middleman in distributing investment and purchasing products. However, by the end of harvest crop, the factory could not withdraw by products or cash. This case was submitted to district court but delayed in dealing with to waste time and cost. Therefore, the factory had decided to forgive Ha Lam debt.

The breach of contract farming originated from farmer's habits and their production scale. For a long time, cashew growers often sell their harvested crop to private traders who are their neighbour or have closed relationship. Besides, some growers received advance money to produce and expenditure from agents so they had to give back by their products.

Small scale of cashew region led to be difficult in trading and conducting contract. At the main crop, in key raw material region (one village or some hamlets), the factory set up drying ground, warehouse and arranged purchasing raw cashew to help growers to be able deliver their products and to prevent from reducing quality products.

However, in the early or late main crops, the factory did not purchase at ex-farm because of small harvested cashew, therefore, growers forced to sell their products to private traders or other company. This led to ease the linkage between cashew growers and the factory. In addition, as small scale and scattered place, many households had to bring their products to sell at the company while the private traders could buy at their home. At the beginning of two years, the company still support their freight

And then cashew growers had to delivery themselves. As results, growers would sell their products at favorable buyers to reduce their costs and labor.

It is common that the cashew producers signed contract farming with incorrect real harvesting



crops even lower quality sold to the factory. It caused by a lean harvest and growers sold to private traders and other companies. At present, however, there has not yet lawsuits or dealing with by law although can see breach of contract farming.

In spite of signing contract farming farmer council, cashew growers still sell their products to whom paid higher prices. Farmers need more money for their outputs and expenditure. A cashew producer in Dap Loa village said that if purchasing prices of the factory and of private traders or other processors are same, cashew producers will sell their products to the factory because of stabilization and long-term.

Prices paid by traders and other companies are usually higher than by the factory although in term of prices in the contract farming, the factory agreed paid prices according to market prices. Told the problem, the factory believed that agents have many cheats in doing business such as soaking to increase weight ... therefore they paid higher prices. In addition, the factory has to face fierce competition from private traders and purchasing cashew companies in Binh Thuan province. Cashew in Binh Thuan has better quality and high price so purchasing companies here usually buy raw cashew from Lam Dong and mixed Binh Thuan origin to get higher prices.

The contract farming has been confirmed by local government but they only persuade farmers rather than force them to conduct contract strictly. Furthermore, contract farmer did not received any support from local state departments. Representative of the factory said that in the near future, the factory will continuously sign contract farming because it is joint-stock company with 51% capital funded by the State. It mean that they need to obey by national and provincial guidance. The factory considers contract farming as political and social task to remain in spite of inefficiency. And Mr. Chien, a cashew producer in Damri town, believed that he still signs contract farming with the factory as he will receive new variety seedlings and stable purchasing resource.

## 5. Success/Failure Factors

- Firstly, failing contract farming caused by low fund and investment, mainly borrowed. Cashew is perennial crop that need long-term investment therefore the factory is in the red even fall into bankruptcy. This is the major reason led to reduce their investment, in specially to poor farmers. As result, linkage between the factory and cashew producers becomes looser and looser.
- Current planning nationwide cashew areas is not enough to meet processing demand so it can be seen unfair competition between traders and purchasing cashew companies. That led to many difficulties in implementing contract farming according to quality standards
- Purchasing raw cashew was not well carried out and managed that did not encourage cashew producers sell to the factory. In addition, scattered purchasing station, far delivery road and small quantity led to high cost and inefficient.
- The factory did not receive any preferential technical and credit from the State or local government. There is not any authority to guarantee as well any sanctions to treat contract breakers.

## 6. Lessons

Although cashew market is huge and business performance of the factory has continuously developed for recent years, contract farming still fell into failing. This considers as an experience lesson for who want to success contract farming.

- Need to large raw material region enough and centralized to ensure purchasing activity and implementing contract. The Decision 80 is not suitable for small scale and scattered production.
- When market resources are large and supply storage, growers will break the contract farming if the company has no encourage policy.

- Need huge investment for poor producers to develop perennial crops like cashew. If having no investment in production, farmers can not carried out correctly as well as not receive any benefit from contract farming signed.
- Via agents or local organizations the contract farming bring more efficient results than signed directly to the company and by this approach, it is easier to manage and withdraw investment fund.





Address: Xuan Truong Commune,  
Cau Dat District, Lam Dong Province  
Product: High-quality tea  
Contract Scheme: Centralized

## HAI YIH TEA COMPANY

**H**ai Yih Tea Company is one hundred percent owned by Taiwan Company. The company is placed in Xuan Truong Commune, Da Lat City, Lam Dong province. It was established in 1995 as a branch of Fusheng Tea Company, however, in 2002, it divided to independent company. The Company has many branches in Taiwan to consume 99.8% high - quality tea products such as "Kim Tuyen Tea", "Tu Quy Tea" and "O Long Tea". The invested capital of company has increased approximately five times since establishing, it is about USD 5 millions.

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The company is possessing presently 30 hectares under the farm structure, in which, 15 hectares is under cultivation, and the rest is on the capital construction process. Furthermore, the Provincial People Committee is approving to allocate 35 hectares to Hai Yih Company for its enlargement of processing ground. With high benefit and sustainable output, the company could pay competitive treatment for workers. The salaries are fluctuated from 1 to VND 3.5 millions , not to mention the workers rent the company accommodation with water and electricity are used free of charge. Besides, the workers is received VND 8 thousands per day for food expenses.

Hai Yih Company has started to contract with farmers since 2003, just one - year of separation from Fusheng Mother Company. After three - year of performance, the company has succeeded considerably to achieve stable inputs and bring high income to farmers. Now, Hai Yih is collecting 266 farmer households with the total harvested areas by contracts is 137 hectares. All contracts are 20 - year long term commitment due to the period of tea for good production is about 25 years. Therefore, in order to create motivation for farmer households moving to plant tea, the company has to ensure a steady output within the tea period.

## 2. Emergence and Evolution of Contract Farming

Before 2003, most households which are contracting with Hai Yih cultivated vegetable or

coffee. The vegetable cultivation could bring benefits much more than the tea growth but the vegetable price is fluctuated and unpredictable. Moreover, the vegetable is very easy to be injured by insects as well as affected by natural disaster. Therefore, to come after the mobilization of company and the other household movement, farmer households have shifted to tea cultivation step by step.

In order to encourage household cultivate tea, the company printed the leaflets that comprised the information about tea cultivation and its benefits. The company connected to the People Committee of Xuan Truong commune to mobilize farmers to shift from vegetable to tea development. Moreover, the company created the favorable conditions for farmers on initial investment. To be subsidized 50 percents seedling by government, thus Hai Yih supported the remaining 50 percents to farmers. Besides, the company also paid in advance fertilizers, pesticide and harvesting labor costs within 2 years until the farmer households could get stable income from tea, then the company would collect money from production. Thus, the farmers only had to invest a little on the crops. According to Mr. Huynh Ngoc Sang, Kim Tuyen commune, Lam Dong province, he only spent initially VND 30 millions to buy automatic watering machine for two "sao" of tea. At that time, he borrowed VND10 millions from Agribank and returned after 2 years. According to Mr. Hoang Do Tam, who is living in the same commune with Mr. Sang, he did not need to borrow money for crop shifting due to the same cultivated technique. He had already the automatic watering machine; the other materials are supported by the company. In addition, farmers were trained carefully before they grow tea.

Because of favorable conditions, many households want to sign contract with company. In order to select the most potential households, the company goes to each household to check households' land. The quality of land is considered as the only criteria to select the households to sign contract. This criterion brings to company production with highest quality and yield.

### 3. Terms of Contract

Hai Yih commits to buy all contracted products from the farmers. Not only does the company pay 50 percents of the seedling, it also gives many encouraging conditions to the farmers for their tea crops. In addition to the favorable market-based prices for fertilizer, pesticides and other materials, the farmers only have to pay 50 percent of the total costs at the time of buying. The rest will be paid off in the next harvest. Investment on account like that can be seen as a kind of insurance. The company insures to buy all contracted products that does not depend on company's demands. The company will pay to farmers by Hai Yih - based prices of one year crop for compensation if it does not buy products. The company also pays crop labor costs for the first two year and will deduct gradually in the following years. Now, the crop labor cost is VND 2 thousands per kilogram.

Besides, contract includes several terms to guarantee the company's interests and share risks for both sides. For example, the farmers have to pay to company twice as much as stable one year crop if they do not sell the products.

The company buys fresh tea buds as floor price is VND10 thousands per kilo within the first ten years of contract. In applying this term, the company increased to VND 13 thousands per kilo in the second year. At this moment, the price is VND 16 thousands per kilo. After deducting the crop labor costs, the farmers receive VND 14 thousands per kilo. This price is higher than prices of other companies in the market that ensures firmly households' income.

On the farmer side, they have to guarantee the quality of tea such as no diseases. The price of tea depends on its quality: VND 16 thousands for category A, VND 13 thousands for category B.

Annually, the company holds the meetings with farmers to exchange experiences and explain difficulties. These can be seen as the exchange floor for 4 - house linkage that to create the stableness of contract farming: farmers, enterprises, researchers and state.

Contract farming is certified by the Commune People Committee to ensure the validity of contract.

### 4. Contract Implementation

Up to now, the number of households who want to contract to Hai Yih is increasing. The existing contracted households also want to widen the current area. Mr. Sang, who we mentioned above, have now 2 "sao" of tea and 1 "mau" coffee. He plans to enlarge 5 "sao" of tea more due to high benefits from tea. In addition, the Hai Yih tea price is higher by far in compare to others. Therefore, the households sell products to Hai Yih only.

The quality of tea is ensured due to the detail technical guiding. However, there are a small number of households, who have to pay transportation costs by themselves, to carry much tea in one container that lead to tea quality decreasing and have to be subtracted money. For some other cases, the farmers pour water to tea in order to gain weigh. The company discovered these cases and subtracted about 5 to 6 percent the total money. In general, the number of households, who have to be subtracted money by the lower tea quality, is not many. Most households are willingly and believe in the company. Besides, the company does not check strictly the quality. Hence, almost all tea is bought at price of VND 16 thousands per kilo.

The key point of Hai Yih's success is its export capability. Therefore, it can buy tea with high price and have sound competitive ability in market. The tea export price is USD 25 to 250 on average while the price of fresh tea is very low, and the processing cost is about VND 60 thousands per kilo. Thus, the profit is very high after taken into account all input costs and export taxes as well. With insured inputs, the company's economic capacity is strong enough to behave kindly towards farmers in terms of price and quality. This is not only to make company's prestige but also farmers' responsibilities to fulfill correctly the contract.

Cultivated shifting households have remained and gained their incomes. They harvest tea 6 times per year. Hence, households have annually VND 21 millions per "sao". After taking into account the costs for fertilizer and pesticides, farmer households' profit is VND 13 millions per "sao".

Furthermore, the certification of Commune People

Committee has contributed to increase the validity of contracts. Formerly, several of farmers transferred land to other household and hand out the contract farming to other company. In these cases, the commune people committee intervened to force the households returning contracts to Hai Yih Company.

## 5. Success Factors

Hai Yih Company has done successfully in contract farming by the following factors:

- The Company not only has surely the inputs but also high profits thus can provide the contract with competitive prices.
- The Company has traded the high quality tea such as "O Long Tea", "Tu Quy Tea". These kinds of tea require technical processing line that the smaller traders could not have. Thus, there is no competition between private small traders.
- The company comprises professional monitoring staffs work everyday at tea gardens and is ready to help farmers in all technical issues.
- The Company has built the good relationship with farmers to promote the pesticide. It does

not obstruct farmers in term of quality checking and breach of contract. It can be done due to the company economic potentially.

- The Company is subsidized by Government to reduce the input costs.
- The contract farming is supported legally by local government to treat the contract breach.
- The Company has provides risk insurances and encouraged farmers broadening tea land.

## 6. Lessons

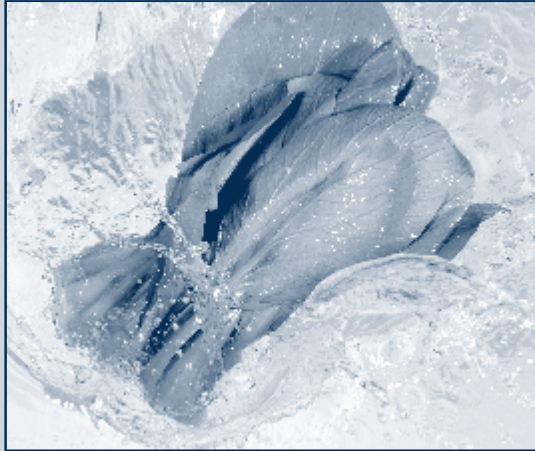
Hai Yih Company has offered the following experiences and lesson learns:

- This is a winning case in term of 4 house linkages to bring benefits to both enterprise and farmers. This kind of contract has done successfully for the last 4 years and will be able to remain in many coming years.
- The success of contract based on to promote the professional management and competitive advantages.
- The financial potential and stable outputs are very important to make the victory of contract.



Address: Thanh Nhan hamlet,  
Thanh Loi commune,  
Binh Minh district, Vinh Long province  
Product: Safety Vegetable  
Contract Scheme: Multipartite

## THANH LOI COOPERATIVE



**T**hanh Loi safety vegetable cooperative is located in One district, Ho Chi Minh city. It was established on 30th September 2005, belonging to the linkage chain between safety vegetable farmers and Central Coast economic development company (COFIDEC). The cooperative is the bridge between farmers and the enterprises through economic contract of the cooperative and the company. The cooperative consists of one head, one vice head, one technical staff, one accountant, one fund keeper and two groups of farmers.

## 1. Introduction

Major products of the cooperative are okras and eggplant. In forthcoming time, the cooperative make a plan to add more crops in production such as mushroom or lime. The cooperative chose vegetable for its business because local land condition is suitable for production and farmers have lots of experiences in vegetable cultivation.

This is a successful case in the linkage model of production and consumption through contract farming in Vinh Long province. The cooperative started this contract model with only 47 members but now the number of its members increased to 240 with total area for okras of 150 ha. The contract on cultivating okras and eggplant (mostly okras) between the cooperative and COFIDEC company helps to create jobs and increase income for the cooperative's members. The company gets benefit through stable raw materials for their production as well.

The success in contract farming of Thanh Loi cooperative and COFIDEC company is a good evidence of the dynamic roles of the cooperative and the company in creating the linkage and reasonable conditions of contract for farmers.

## 2. Emergence and Evolution of Contract Farming

Safety vegetables (okras and eggplant) are special products which COFIDEC company could not purchase retail in the market. Moreover, the company needs to be supplied a certain amount with ensured quality. Therefore, COFIDEC company recognizes the importance of having contract in providing materials with Thanh Loi cooperative. Thanh Loi was established on the basis of the linkage of local vegetable households (mostly vegetable households in Thanh Loi commune) to become the representative (the head of the cooperative) for signing the contract with the company (because the company could not sign contract directly with individual households). The farmers who are members of the cooperative change their old vegetable production pattern (utilizing fertilizer and pesticide with no direction) to new one with careful direction of the company. The formulation of the contract and the participation of farmers in the cooperative to

produce safety vegetable for the company are based on the acceptance and agreement between the cooperative and the company. The criteria for selection of the households to participate in the cooperative is not so severe. Selected households are the ones who have land, labour and are willing to join in this kind of production through the contract with conditions.

The company and the cooperative have introduced and guided the farmers about the market demand on safety vegetable as well as organizing production, utilizing fertilizer and plant protection chemical substance to assure safety vegetable quality. To produce safety vegetable, farmers do not have to invest much on input cost, especially okras is provided free of charge. However, it is important to pay attention on the awareness of farmers in using fertilizers and pesticide pursuant to the direction correctly.

The price of the company is often higher than the price in the market while the requirement on size of the product is not so strict. To be aware of the effectiveness as well as the benefit of contract farming, many farmers have registered to become members of the cooperative to produce and sell vegetable to the company. The contract of COFIDEC company and the cooperative was first implemented at the end of 2005.

## 3. Terms of Contract

The contract farming between COFIDEC company and the cooperative points out major terms and conditions as follows: the company will purchase safety vegetable from the cooperative and the cooperative has the responsibility to produce vegetables which meet the requirement on places, seeding time and quality with negotiated price.

The company provides vegetable seeds for cooperative's members free of charge and gives the direction on production pattern. The qualified products will be consumed by the company.

Thanh Loi cooperative is responsible to organize all production steps on land preparation, fertilizer, harvesting, quality control, conservation, package and transport of the product. In production process, the cooperative has to use agro-chemistry following the direction of the company and make



a weekly report on agro-chemistry and fertilizer utilization. If any disaster happens, the company will keep the debt, and the cooperative has to continue the production to deliver the products in the next season.

All terms and conditions in the contract are discussed by the cooperative and farmers so that all can grasp and implement the contract unanimously. The cooperative monitors production activities and support farming technique for its members. A staff of the company is assigned to come to the cooperative to take the products every day. A technical staff of the cooperative will check out the product quality right at the deliver place (at the office of the cooperative) through normal observation. The company checks up the quality once again at their place with modern checking equipments. Actually, there are a few cases which do not meet the requirement.

The company purchases the products of the cooperative with the price of 10 % higher than market price (in the first six months of 2006, the price of okras in the contract is 3000 VND/kg) and it is stable during six months. Both the company and farmers want to have stable price for planning their production and business. Stable price is the core factor which makes members of the cooperative feel secure to invest in production.

To encourage the staff of the cooperative to work effectively, the cooperative has the policy regulated that the staff will receive 100VND for every one kg qualified product from the budget of the company as a merit. According to the management board of the cooperative, this payment is reasonable and helps the activities of the cooperative run smoothly.

Sometimes, the market price changes higher or lower than the price in the contract but almost farmers do not sell vegetable to market. The company also does not change the price even when the market price goes down. Well management of the cooperative and well compliance of farmers contribute positively to the success of the contract.

## 4. Contract Implementation

Having the contract with COFIDEC company, the cooperative can receive better quality of vegetable seeds which are provided for farmers free of charge. In the past, farmers have to sell their products to private traders with unstable price and amount. At present, the contract farming helps farmers get stable price for their products. Moreover, thanks to the contract, farmers can learn new techniques and change the traditional custom in utilization of chemical fertilizers and plant protection chemical substance (which raises production cost and makes vegetable become unsafe).

As for the company, signing contract help them to have stable material sources in terms of amount, price and quality for processing safety vegetable for export. Owing to the contract, income of farmers and the cooperative increase considerably; the production scale of the cooperative is expanded as well. Up to now, there is no case which breaks up the contract.

At present, major difficulty of the cooperative is the capital to invest for the members who are still not able to borrow money from the bank. The company does not lend the money to farmers as well. In addition, the cooperative wants to borrow money with preferential interest rate to buy inputs, fertilizer, and pesticide and provide production services for its members. Through selling fertilizer or pesticide to farmers, the cooperative can manage the fertilizer and pesticide utilization of the farmers to ensure product quality before delivering to the company.

## 5. Success Factors

Thanh Loi has traditionally specialised in vegetable production, especially for okras and eggplant. Contract farming for safety vegetable is a determined strategy to transform crop structure in accordance with the trend of modernization and industrialization as well as helps to improve income for farmers significantly. This contract is just implemented since 2005 but it shows the effectiveness which might be applied to other

localities. The success of this case is due to following factors:

- All parties are able to grasp the demand of the market and they set up a stable output market as well as facilitate the expansion of production for local farmers.
- Terms and conditions in the contract are understandable with moderate requirement on product quality which is suitable with the capacity of farmers.
- The assessment of the price is reasonable. The harmonization of the benefit of COFIDEC company, the cooperative and farmers is the decisive factor to maintain the contract.
- The participation of all parties: the company, the cooperative and farmers in discussion.
- The cooperative plays an important role in monitoring technical issues in production
- In implementation process, the cooperative organizes meetings regularly. Through the meetings, its members have chances to report the implementation progress as well as difficulties arising in their production so that

the cooperative and the company can discuss to solve the problem. This is one of the reasons which make this contract stable and successful.

## 6. Lessons

There are some good lessons learnt from the success of Thanh Loi cooperative to develop the model of contract farming:

- Contract farming may be successful even when all parties do not receive any preferential treatment in Decision no 80. This successful case proves the dynamic roles of the company and the cooperative.
- Contract farming can make a success even for products which have different consumption channel if the price is reasonable and flexible.
- The terms and conditions of the contract are understandable and farmers can take part in the discussion on related issues
- This contract helps farmers to transform their crop structure, especially poor farmers can get some certain benefits.



## HOANG GIA C O M P A N Y

Address: Company office - 2A/1. To 1 -  
Khom 2, Thi tran Cai von,  
Huyen Binh Minh - Vinh Long province  
Factory: Ap Long Hoa II, xa Long Thanh,  
Huyen Binh Minh, Vinh Long  
Product: Nam Roi grapefruit  
Contract Scheme: Centralized

**T**he full name of the company is Hoang Gia private company of fruit processing and exporting, established in 2002. Although the company's objective is to trade multifruits, Hoang Gia company has just focused on NAM ROI grapefruit since establishment.

## 1. Introduction

Initiative of Hoang Gia firm foundation came from a family, who have lived long time on the land which had a special grapefruit commonly known all over the country "Nam Roi grapefruit". There is 4.000ha annually for planting grapefruit in district Binh Minh - the original of this grapefruit, of which 2.900ha usually bears fruits and is fast increasing annually due to the acknowledgment of the available output market for grapefruit. Therefore, the company has advantage of being located in the large source of raw materials. In addition, with the experience of over 20 years working on sector of agricultural management and the acknowledgment of Nam Roi grapefruit as being one of the few highly competitive fruits on market, the leadership of company has determined to invest on trading this potential good both on international and domestic markets.

There are 37 staffs, 17 out of which have signed the long labour contract with the company while the rest have worked as seasonal labour. Apart from collective purchasing unit and transaction of trade and exporting unit, the company's staffs almost are agricultural engineers and business management bachelors, company also built an achieving store for stock, classification and preservation of grapefruit with the use of modern preserving technology from America. This store is about one ha and located just right in the middle of the grapefruit plantation area, hence farmers can deliver the grapefruits to the store straight away in a short time, which cut down the cost of delivery and decomposition after the big harvestment.

Currently, the company is upgrading a factory for grapefruit juice processing, which is qualified enough for exporting, therefore, this company can buy all grapefruit of 3rd and 4th categories which are not qualified for fresh exporting. This is also an important aspect which attracts farmers planting the grapefruits because one of the challenges that farmers had to face before was that, they can not sell the grapefruits with poor quality and too small weight which were not accepted in the market of fresh grapefruits.

Further investment has been put on production in order to have products with productivity, good

quality and uniform which stabilize the output to be secure about signing big contracts with foreign partners. For example, the company has invested in a breeding garden for the first generation of grapefruits with the use of advanced technology and support of heading scientists about citrus. This investment has enabled the company in supplying the first generation of Nam Roi grapefruits with good quality for export for farming households in Binh Minh.

Currently, beside big contracts with the famous distributors inland such as Sai Gon CoopMark, Metro...Hoang Gia company has exported Nam Roi grapefruit to many countries in Europe, Asia and in particular America and the exported output has also significantly increased. Before 2005, company only exported approximately 10-20 containers (size of 40 fits) and sells 2000 tons of grapefruit for domestic market as it mainly focused on production. Since 2006, the company has exported 2-3 containers per week at the average and the exported price was also as five to ten-folds as the domestic price. Therefore, it attracts the majority of round year grapefruit of the area and the company be able to consume all products of 2000ha grapefruit planting in Binh Minh district.

The contracts of agricultural products revealed that the need of business and grapefruit planting farmers may give rise to the contracts without the support or capital preference from government. Moreover, the sustainability is only made to the enterprises which have capacity of organization, strong potential of economics and when contracts made bring benefits to both parties.

## 2. Emergence and Evolution of Contract Farming

Before 2003 backward, although area and output of grapefruits increased significantly, the consumption of Nam Roi grapefruits in Binh Minh was mainly controlled by traders. They usually bought on-site a small number of grapefruits directly from farmers, each dealer only bought 500-1000 fruits on-spot of about 40.000 fruit per litter. Therefore, they usually selected the best fruits and left out the small grapefruits, worse quality and farmers themselves had to transport those fruits to other places for consumption. This

was a really difficult since the first and second categories of grapefruit were always the most welcome.

Meanwhile, Hoang Gia company with having idea and capital, since establishment, has professionally carried out the deploy of market development plan such as brand registration "Nam Roi grapefruit", and setting up the website [www.buoi5roi.com](http://www.buoi5roi.com) for marketing and trading through website. The director in person and business executive advertised and market the product to the distributors with the commitment of quantity and species according to the tight demands. Therefore, the contracts for exporting were smoothly as there was a high demand of right quality of grapefruits at that time.

On the other hand, Hoang Gia company cooperated with the Department of Agriculture and Rural Development of Vinh Long province to train farmers on production technology and use of technology after harvestmen. The enterprise committed to sponsor fund and technical, to buy grapefruits at higher price than the dealers do and consume all the output. All these criteria were composed by the company and disseminated as well as clarified to all households which made households excitingly participated. Moreover, at the final round of asking households to sign the contract, both company and households had to sit together for negotiation, eventually enterprise had to repeatedly explain in detail about the advantages and disadvantages of each clause to the farmers (as the low education level and the limited acknowledgement of law of the farmers). In addition to that, the company's selection of households' capacity has motivated more than 30% of households who grew Nam Roi grapefruits in Binh Minh district signing the contract of supplying grapefruits to the firm.

### 3. Terms of Contract

Right after the establishment in 2002, the enterprise and households had immediately signed contract with important terms like the firm would buy all grapefruit categories of the farms, firm would purchase at the higher price than the market price about 300-500 d/kg, eventually 1000 d/kg for the best category. According to this

agreement, farmers would be consulted by technical staffs about caring grapefruits as soon as they signed in the agreement. In particular, farmers had to use the specific fertilizer for their Nam Roi grapefruits (eg. Using organic fertilizer would increase the quality, longer preservation and less damage for grapefruits) and use specific chemical substances for preventing pesticide which enabled the grapefruits having good quality meeting export standard as well as following the hygiene standard designed by Department of Agriculture and Rural Development. Depend on the ability of household's labour source; the delivery of grapefruits from households' farm to the store could be done either by enterprise or households themselves. The firm is usually in charge of the categorization of the grapefruits, households normally sell whole tree to the firm. Other transaction is also in charged by firm so it cuts down the cost of the households while the output is always greater due to the application of advanced production procedure.

Since early 2005, Hoang Gia and farmers have completely trusted each other so there was no further contract signed, they worked together through loyalty (this is a typical characteristic of people living in Mekong river area, it is said that verbal agreement is always loyal while written agreement means not being friends). The firm completely believes in households so it follows verbal agreements and be confident in business bearing the "heartedness" to the farmers without being put in disadvantage.

### 4. Contract Implementation

The cooperative model for consuming 5 roi grapefruits of Hoang Gia company has been very helpful to majority of farmers who plant grapefruits in Binh Minh district in improving their livelihood. All three households participating in the interview agreed that, although the area of their grapefruits was not increasing, cooperation between their family and Hoang Gia company has worked out the math of output and so their incomes were significantly increasing. For example, Chinh's family has 3.000m<sup>2</sup> of grapefruits; he said that it used to be very hard to sell all the grapefruits because of many transactions and annual income from grapefruits was only 6-7

millions. However, his family received 20 millions and 34 millions respectively in 2004 and 2005 from selling grapefruits to Hoang Gia firm. Another family, Dung' household having 3000 m<sup>2</sup> of land planting grapefruits, has increased the income three-folds since selling grapefruits to Hoang Gia (output of 4-5 tons instead of 1-1.5 tons). All the interviews had been agreed that selling grapefruits to Hoang Gia company was the most benefit, high price, good technical support, stable output and do not need to find the consuming markets although there is no written agreement between the firm and farmers. Both parties feel satisfied as both get benefits. Hoang Gia company has great benefit of having stable raw materials and uniform quality. The factual investment of the company is investing for themselves on the land of farmers.

The basic advantage of Hoang Gia enterprise is having good inherent potential. Firstly, the owner of enterprise had a bachelor background of agronomy and business management. Secondly, his relative was having senior experience working for district's agriculture, so he was good at technical of producing 5 roi grapefruits as well as good understanding about the past market of this fruit, about the procurement of local dealers. Then, the enterprise has found out the strength and weakness of the product to overcome the problems.

Currently, agribusiness itself really wants to have legally written contract with farmers to stabilize the product outlet as the enterprise is having a strong consuming market with good representative after four years of transaction, possesses a famous brand and has a serious investment. Yet, the farmers haven't been ready to sign the written contract. Therefore, the enterprise still needs the help from government in encouraging and enhancing the consciousness and knowledge of the farmers about the market so that their production and transaction will be more expertized and farmers should recognize that the signing written agreement is a beneficial condition helping them in stable consuming their output.

The enterprise is going to establish the scheme of becoming a joint-stock enterprise and will sell the stock to farmers, so that they will have close

relationship with the company in term of their rights and responsibility as well as improve their incomes. Only the linkage contract of production and consumption of agro-products will be feasible and sustainable suited for micro-scale of farming production.

Although the enterprise was considered as having potential of capital, the agribusiness still needs to have financial support from the government because of the high risk of investment in agro-business. The mobilize capital of any agro-firm is insufficient, in particular the enterprise at the initial stage.

Another difficulty is the monthly significant expenditure by enterprise for renting labour in helping farmers harvesting, categorizing and packing up the grapefruits in site. Therefore, the local authority should support households forming the co-operative group in order to reduce the pressure for the firm. Enterprise only wants to sign the agreement with a co-operative group to cut down the cost and acquire the complaints or solve the conflict at one clue only.

## 5. Success Factors

Yet, there was no official agreement in typology of signing contract between enterprise and households, it contains all the terms which follows the standard of the farming contract. The enterprise closely supervises the scheme and the technical of production through the encouraging agro-activity which is supported by the firm - this is an important criterion of the linkage agreement. Furthermore, the business environment of the company was very stable and government has made the good condition for the good business activities (eg. Tax policy was zero for grapefruit).

The success of Hoang Gia enterprise is highly sustainable due to their expertized business, strong capital, strong market, maro vision and good investment in the key processes of production which were hardly done by other agri-business. For example, the enterprise did not loan in cash to the associated households but instead the firm supported the poor households in the hard time with no interest and under the typology of supporting agricultural technique and seeding. Furthermore, the enterprise itself spent money on



building a model garden of grapefruits to demonstrate the technical and advanced cultivation for helping farmers to learn.

In the process of harvesting and preservation, the enterprise paid the agricultural technicians to instruct the farmers and often check the grapefruit farms about the pest and decide the best time for harvesting. In addition, the firm has supplied bags for fruits to avoid the damage. Therefore, both parties have got their own benefits, farmers have products with good quality and higher output while the enterprise has procured enough goods with qualified standard in time for the business contracts with its partners. Definitely, the enterprise's representative was increasing in the market.

The enterprise always procures the grapefruits from households at the higher price than the spot-market about an addition of 300-1000 d/kg, it created the increasing attractiveness of the linkage between Hoang Gia firm and households although there is no official binding by written contract between them.

## 6. Lessons

Case of farming contract of the Hoang Gia company revealed the following lessons:

- The contract helps increase the significant income and alleviate poverty
- The agreement could be appeared due to the needs of enterprise and residents without financial support or preference of the government. Owner of Hoang Gia firm said that the Decision 80 of the government was very good but it only bears the theory. Only the farmers and businessman have binding based on legislation, there is no binding for other parties but only encouraging, therefore, there is no sustainable linkage formula.
- The application of sustainable linkage between business and farmers can not be implemented anywhere. Only the agribusiness with organisation capacity and strong economic potential can form the linkage with farmers and the agreement needed to be satisfied by both parties and co-benefited which can bring the success of farming contract.

# PHUOC HAU COOPERATIVE

Address: Phuoc Thanh A, Phuoc Hau commune, Long Ho district, Vinh Long province.

Product: Safety vegetable (RAT)

Contract Scheme: Multipartite

**P**huoc Hau cooperative was established at the end of 2003 and it is an unobligatory farmer organization. The cooperative has long traditional farming activities on vegetable including of green vegetable, fennel, roots and fruits. There are two hundred households who cultivate in total area of 100 ha horticulture land in the commune. Average cultivated land per household is about 4-5 "cong" (4,000-5,000m<sup>2</sup>). Currently, there are 85 ha vegetable land of the commune belong to members of Phuoc Hau cooperative. On average, farmers get around 50-70 million VND per ha safety vegetable land compared to 20-50 million VND when they cultivate vegetable following old traditional method.

## 1. Introduction

Phuoc Hau cooperative was established at the end of 2003 and it is an unobligatory farmer organization. The cooperative has long traditional farming activities on vegetable including of green vegetable, fennel, roots and fruits. There are two hundred households who cultivate in total area of 100 ha horticulture land in the commune. Average cultivated land per household is about 4-5 "cong" (4,000-5,000m<sup>2</sup>). Currently, there are 85 ha vegetable land of the commune belong to members of Phuoc Hau cooperative. On average, farmers get around 50-70 million VND per ha safety vegetable land compared to 20-50 million VND when they cultivate vegetable following old traditional method. The reason of higher income of new method is the lower input cost (fertilizer, pesticide, seed...) but greater output and quality which help to meet the demand of the market. Each member of the cooperative supplies for the market approximately 1.5-2 tons per year, 30% higher than before. On the other hand, Phuoc Hau cooperative provides 2-3 tons safety vegetable per day for enterprises which have signed contracts.

The success of the contract farming in Phuoc Hau cooperative is the strong evidence for the dynamic support of the DARD (Department of Agriculture and Rural Development) in making an effort to connect farmers and sellers. At the same time, this case also points out a good lesson learnt in organizing the cooperative with the aim at supporting farmers to transform the crop structure through contract farming.

## 2. Emergence and Evolution of Contract Farming

According to farmers in Phuoc Hau commune, prior to 2003, they never know about the linkage of vegetable production and consumption. They never take part in any organization to make a financial contribution on production as well. Indeed, even when the DARD and local authority encourage them to join in, they are still in doubt because they are afraid of being loss due to the tied conditions of the contract. Representative of the farmers notes that before joining in the cooperative, they can sell vegetable by themselves despite of unstable price which is suggested as a

normal thing for vegetable farmers. Farmers do not have the orientation on vegetable cultivation, whenever a kind of vegetable price is down, they change to another kind. All of them are poor or medium households since a long time but they do not think they should change the strategies in production to make their lives better.

Every morning, before delivering to Phuoc Hau cooperative, farmers bring their vegetable to some vegetable stalls in local markets to sell (they have their own trading partners there). If the vegetables are accepted by vegetable stall owners, farmers will sell all otherwise they will sell by themselves in the markets. On the other hand, if they can not sell all vegetables, they bring back home and sell to other households in order to use as animal feeds. Sometimes, private traders come to collect vegetables but not regularly. Hence, their income from vegetable is not stable. Moreover, farmers do not pay attention on cultivation techniques as well as completely do not know how the market demand on quality is. Vegetable production relies totally on economic capability of each household. Some better-off households can buy fertilizers or pesticides for their production while some poorer ones do not have enough money to buy.

By 2002, in Vinh Long and Can Tho cities, some enterprises, supermarkets, enterprises providing ration foods and other service activities in industrial zones came to Phuoc Hau to propose a plan to collect a large amount of safety vegetable. Therefore, local authority started to think about the establishment of a cooperative to have legal right in trading for vegetable farmers of the commune.

Thus, Phuoc Hau cooperative was established on 2th October 2003. From the start, the cooperative was actively supported by Vinh Long DARD. To be aware of the important role of reorganization of agricultural production system, the DARD determined to design and implement a pilot model on production and consumption of agricultural products. More specifically, before the establishment of the cooperative, Vinh Long DARD and local authority had tried to inform and explain about contract farming as well as the benefit that farmers may get if they follow this kind of production. After all farmers are aware of the issue, the DARD and local authority officially established the cooperative.

When the cooperative was established, it had total of 20 members without signed contract but with a verbal commitment with the management board of the cooperative in providing safety vegetables for the cooperative by type of shared financial contribution. (This kind of commitment has been still implemented until now). Initially, each member contributes a total amount of 200 thousand VND, mostly to build cooperative office (on the borrowed land of the commune committee) and other administrative cost. Actually, in the first days, the cooperative was not trust by the members who just wanted to try whether their production and income become better or not.

In such circumstance, although Vinh Long DARD is not a participant in the contract linkage: farmers-the cooperative-enterprises, it plays an important role in the formulation as well as implementation of the cooperative. For example, the DARD distributed a budget of nearly 100 million VND of Safety vegetable project of the province to support the training on seeds, providing land protective cover. All members of the cooperative are also supported in training IPM technique; hence, their vegetable output and quality become better than before.

In addition, the DARD ask vegetable provision companies to give seeds to farmers for free (it is considered to be a kind of marketing and promotion of their companies).

Mr. Tran Van Sau, the head of the cooperative, is an experienced vegetable farmer. According to other farmers, he is a responsible, capable, prestigious and disinterested person. The management board of the cooperative initially has three people who work without salary.

With the orientation on safety vegetable production, the cooperative activities run smoothly in looking for product market. At every lately afternoon, after reviewing all customer orders, the management board of the cooperative calls or goes to the households to place the orders with specific amount and types of vegetables for the next day.

Previously, the cooperative just focused on production organization step, and then waited for the enterprises to come for negotiation and signing

contract. The enterprises were introduced to the cooperative through the DARD. Since early of 2006, the cooperative has been starting to look for more market for the products. At present, there are several enterprises which have signed contracts with the cooperative in vegetable consumption. The linkage of the cooperative and the enterprise is established by official contract farming. During three year contract with the enterprises, many requirements have been set but no break up in contract is found.

### 3. Terms of Contract

The cooperative has clear terms and conditions in the contract with total of 36 customers including both small retail stores and large enterprises. The cooperative commits to have the responsibility on vegetable origins, quality strictly following the State standards. Also the cooperative has to deliver the products following the signed agreements on amount, time and places.

In term of price, the cooperative give the comparative price with preferential conditions for example deferred payment after the delivery of the products. If the cooperative's price set in the contract is higher compared to the market price without reasonable explanation, the enterprises have the right to deduct the next trading turn. Moreover, the cooperative has to inform the price to the enterprises seven days before the delivery, if it is accepted, the cooperative starts to deliver.

Normally, the cooperative brings the products to enterprises to make an offer, and then wait for the acceptance and business code regulated by the enterprises before the delivery. At the same time, the cooperative is assigned by the enterprises to select knowledgeable and responsible farmers in safety vegetable production to take part in.

Although the linkage between the cooperative and farmers is not by signed contract but through financial contribution but this kind of linkage is relatively sustainable owing to the advocacy of the farmers to the principles set by the cooperative. These principles are discussed freely by the farmers and cooperatives to assure the benefits of the both. Here, the cooperative is considered as the representative for farmers to protect them unconditionally.

The accountability of the cooperative in the contract is to provide the products and take the responsibility for farmers in case of breaking up the contract with the enterprises. Therefore, the management board of the cooperative (was elected by members) monitors closely the process of safety vegetable production of each household member to ensure the quality.

The cooperative works as a private trader and it is considered as a non-benefit organization as well. The cooperative only charges about 300-500 VND per kg per product while it spends lots of money for transaction cost such as promoting the products or finding the markets.

## 4. Contract Implementation

In implementation process of the contract, major advantages can be seen in the specific and practical support from Vinh Long DARD. Aside from the money of the DARD's safety vegetable production support program, the knowledge on safety vegetable production is also provided by Department of Plant Protection and Agriculture Division of the district. Besides, the cooperative is supplied vegetable seeds free of charge (in some promotion program of seed trading companies). Thereafter, the cooperative distributes vegetable to its members, controls the seed amount and guides the members in seeding following the signed contract.

During the first days of establishment, the cooperative was supported in term of borrowed land for production by the commune committee. Another important support was found in the dispense of revenue tax for the cooperative.

At present, the quality of safety vegetable is better than 3 years ago because farmers get more experienced, especially in harvesting, packaging, categorizing and transporting and therefore, they get more benefit from the vegetable products. Production and business scale of the cooperative has been increasing significantly since 2006 due to better knowledge on marketing of the products, methodical organization in production and clearer accountability distribution. As a result, the trade mark of Phuoc Hau safety vegetable becomes popular in the local areas around Vinh Long province.

The proportion of the break up in contract is quite few, mostly in the past time (2004), for example some safety vegetable stores in Vinh Long market who already ordered but did not take full amount as signed. However, all parties in the linkage are aware of the benefit if they implement in compliance of the contract, hence, they take the responsibility in the contract seriously.

Cooperative members always give the priority for the contract and they do not want to sell to other partners because the price is not much higher than the price of the contract (about 50-100 VND/kg). Meanwhile, they recognize that if they sell to the cooperative, aside from selling at the same price in market with stable amount, they are also shared the benefit from their contribution in the cooperative. That's the reason why the number of the cooperative members increased constantly (from 20 persons in 2003 to 36 persons after three years) and no one wants to step out of the cooperative. The interviewed farmers all mentioned that they want to take part in this kind of contract in long run.

Enterprises do not have any support to either the cooperative or farmers. Nevertheless, the good point is that they always purchase vegetable with stable price and relatively higher than market price with exact amount following the signed contract. In general, the cooperative and enterprises have a good relationship and often get the same point of view in quality issues. Therefore, delivered products of farmers are not imposed in term of price and quality or returned back the delivered products.

However, Phuoc Hau cooperative's contract farming still meets some difficulties in expanding its production scale and maintaining the product quality. First, members of the cooperative still sell the products for the cooperative following the form of trading one time like trading with private traders or vegetable stores before although the cooperative was established by their own capitals. The cooperative fell in difficulty due to this form, especially in the first period when they did not have many contracts. At that time, the produced vegetable was oversupplied and therefore they had to sell at low price. Second, signed contract with the enterprises is delayed the payment in one month (if the cooperative does not agree, the

enterprises will not buy the products) while the cooperative has to pay for farmers within 2-3 days after the delivery of the products. Finally, current capital of the cooperative (mostly the capital contributed by its members: 200 thousand VND per household) is just enough for administrative cost. They, therefore, may fail to expand their activities without additional support from outside.

## 5. Success Factors

The considerable development of contract farming in Phuoc Hau cooperative thanks to following factors:

- The boom of domestic demand on safety vegetable with moderate requirement on product quality.
- Active support from the DARD and local authority in terms of providing inputs, technical training, office, partner introduction, etc.
- Effective management board of the cooperative was selected by farmers.
- The participation of farmers in discussion of the business strategies.
- The form and content of the contract is suitable and understandable. According to the head of the cooperative's opinion, for each agricultural product, it is necessary to have specific contract farming, for example the content of contract farming for paddy can not be the same with that of contract farming for vegetable. Moreover, it should have the principles for the contract with clear time and place for delivering the products. Also it is required a standard system on quality and price for each product with the referring to the opinions of the members, the cooperative and the enterprises. The management board should have experiences on trading in order to identify quickly the kind of vegetable to negotiate for a better price.

## 6. Lessons

The success of Phuoc Hau cooperative gives a good lesson for developing contract farming:

- The success of Decision No 80 depends greatly on the roles of the DARD and local authority.
- It should have the support from Government in initial capital, policies and knowledge (technique, management, business for farmers and the cooperative). Therefore, the support in establishment of the cooperative, the selection of the appropriate head of the cooperative and participation of farmers in discussion are all important.
- To achieve a stable and sustainable linkage, the cooperative should be equipped with lots of knowledge on market, promotion, marketing, building trademark. Actually, the cooperative wants to expand the activities to increase their revenue but do not have enough capacity to find more markets. Therefore, they can not invite more people into the cooperative although the numbers of farmers who want to join the cooperative are increasing.
- Contract farming is very important for development of safety vegetable production.
- Trademark plays an important role in safety vegetable production, especially in domestic market.
- This kind of contract is successful but it should not be applied the same to other products. Safety vegetable in Phuoc Hau only supplies for domestic market (not for export) with relatively small amount, therefore, the contract condition is not so complicated and it is really suitable with farming pattern of small households. The quality standard depends mostly on safety of the product but the equal size or design; therefore it is easy to implement the contract if farmers follow the right farming pattern and technique. It is found a few break up in the contract and normally it can be solved easily if any.



# TRUNG TIN

## WORKSHOP OF RICE PAPER



Address: Phu Hoa village,  
Phu Hoa Dong commune, Cu Chi district,  
Ho Chi Minh City  
Product: Rice Paper  
Contract Scheme: Intermediary and Informal

**T**rung Tin workshop of rice paper was found in 1991, focusing on producing and trading rice paper with the manual production. Workshop has "head-quarter" in Phu Hoa hamlet, Phu Hoa Dong commune, Cu Chi district, HCM city. Since 2002, the factory had moved on to the production combined with procurement of rice paper for export and domestic consumption. Along with this transformation, the methodology of production also switched to semi-industrial production with application of processing machines in combination with manual works.

## 1. Introduction

Regarding to the production scale, Trung Tin workshop is one of few rice paper workshops having large-scale production and large export. Currently, the management board of the workshop is quite compact with one owner, two accountants, two cashiers, four foremans with 250 workers. Apart from the output produced by the factory, there are 20 households specializing in rice paper produce who supply the products to Trung Tin factory.

Since establishment, basically there was no change of workforce but there was a considerable change about the technology, switching from manual production to semi-industrial production. Recently, volume of products and market share has increased by 20% per annum. Similarly, the capital has increased to catch up with the production needs and market share. The fixed property is about 10 billions VND including two processing factories. Company chose rice paper as a main product since it is a traditional product of the local and owner has senior experience in this sector.

This is a suitable contract typology to the small-scale household production and high risk of competitive market. The knot of this contract is the households located in the same village and cooperation based on trust.

## 2. Emergence and Evolution of Contract

Production of rice papers in Cu Chi is a traditional trade village and mainly based on manual production with small-scale to serve for domestic consumption. Recent decade, however, due to the increasing demand both domestical and international market, this commodity had an opportunity to recover and expand the scale of production. Therefore, many households have participated in production of this good and supplied rice papers to different markets as supermarket, small businessman with small amount or export to international clients with large amount depends on the requirement of quality, especially the Japanese clients.

In addition, local authority also interested in the

maintenance and development of the traditional occupations, in particular focusing on exceeding labour of the local through the cooperation linkage between production and consumption of the goods. This is one of advantages facilitating the fast growing of rice paper production as well as an opportunity for investment in rice paper and expanding the workshop.

It is clear that the owner should invest to renovate the manufacturing technology and produce new commodity at early stage in order to gain a big freight of products as well as the standard quality of the goods. Furthermore, it should expand the typologies of association of production and consumption for the goods. Respecting to the expansion of manufacturing, the company has two workshops producing rice papers by semi-industry with 250 workers, mainly are wage-earners and average wage is over one million VND per month, who are local labour.

Regarding to manufacturing association and good consumption, workshop owner always determines to cooperate with capable households with experiences in production, trust and being honesty in long term relationship. Vice versa, the households should select partner with the same criteria in order to stabilize the income, invest to expand the production. Therefore, it has formed a linkage between manufacturing and good consumption through an oral agreement.

There is a need to perform the oral contract since the outlet for commodity is domestic and overseas market; and goods need to meet the requirement of clients about quantity, quality and time of delivery. Currently, freight of good always varies depending on clients' needs, there may be consumption of 100-300 tons of rice paper/month but export accounted for 60% of freight while domestic consumption held 40%. The total volume of goods was divided by 50-50 of self production from workshop and procurement from small-scale households.

The procedure of performing the contract has certain terms. Regarding to the input, investor sponsors bamboo screens to households about 4000 screens/machine and buys whole products of households at the market price, but the quality of products is informed before manufacture.

Regarding to the outlet, owner has to sign the economic contracts in each turn of goods and the main clients are EU, America, Japan, and Australia, Asian countries, domestic super markets and small businesses.

In addition, there are some objective factors impacting upon manufacturing procedure and business of rice papers like weather. For example, when there is much raining which affects on drying rice papers and leads to the deficient quantity, in turn it affects on market price. Moreover, demand of goods at recent significantly increased, so the trade village greatly expanded. Many households started production and run business of rice papers with a variety of scales like manual or semi-industrial manufacturing, which certainly impacts on environment of production and business. Therefore, the association typology of manufacturing and outlet of good was formed to reduce risk in investment and business of both enterprise and households. In particular, enterprise can be proactive in source of input with quantity and quality while producer households can be proactive in organization and investment to expand the scale of manufacture if possible.

### 3. Terms of Contract

Terms of oral contract includes price, quantity, quality, time and location of good delivery...these terms have been already negotiated and discussed in advance by both parties. The terms of quantity and quality can be changed according to clients' requirement. On the other hand, the demand of good quality also was increased.

The purpose of contract for production and commodity consumption was quite clear. Farmers do not need to worry about the market for the big freight of good hence just focusing on production as well as knowing in advance about the income. Business can be clear about the volume of commodity available to adjust the production and signing the contract for export.

The price of rice paper normally follows the market price while the amount of products is not restricted but there is a need to base on the household's capacity. Similarly, there are other standard criteria like particulates in face cover of

rice paper or number of bamboo signs stucked on the face cover. The checking unit of the enterprise appraises batch of commodity after procurement as well as categorizing before packing. Time and location for delivery of goods were also negotiated in advance, producers usually bring goods to the enterprise and after handing over/receival of goods, they were paid straight away in cash.

There are two kinds of rice papers, the purely flour has price of 11000d/kg while the 80% rice (with 20% flour) has price of 10000d/kg. The quality standard depends on clients' demand, for example, the high class standard held 20% of the total products, mainly Japanese market; the average quality accounted about 50% of the total products to other international market; and the bad quality took 30% left of total products and mainly consumed domestically.

Based on the demand of quality, enterprise would re-categorize the products, the qualified products would be assigned for export while worse products would be consumed internally although the quality standard was informed in advance to the households.

Regarding to the exported commodity, appraising the quality would be done by Centre of Quality Measurement III or City Centre of Health. Cost for appraise of good quality ranges from 500.000 to 1.000.000d each batch of commodity (for exported good). Then, the qualified products are packed into nylon bags in certain way and contained in hard-paper boxes with individual label.

### 4. Contract Implementation

In general, since establishment of production-consumption linkage through oral agreements between business owner and producers, both parties have tried the best to execute this contract as it was a sustainable linkage and brought benefits for both.

However, avoidance of insignificant mistakes was impossible and they were mainly caused by producers. Since procedure of producing rice papers importantly depends on weather, dry season is advantage for drying so output was

stable; meanwhile the output in raining season seems to be reduced so there were contracts breached involving the quantity of products as they sell goods to other clients who offered the higher price. Hence, the enterprise has worked out the solution to overcome the problem by delaying the deadline of delivery but still ensuring the contracted quantity. Eventually, producer may sell the products on-spot with same price contracted to other dealer so it cuts down the cost of delivery and time. Enterprise owner mainly convinced produce households based on long term relationship and stability of household's livelihood.

Regarding to quality, there was very few breaching due the insignificant difference in level and experience of households. Some breaching cases were due to dust, smokes or bamboo screen stick on face of rice papers. With these batches of goods, enterprise owner usually returned the products and convinced producers taking more caring to the products and being more responsible for their goods as the clients demand, especially goods for export.

The most hindrance was the request of product quality, especially the Japanese clients as they did not want to have additive in the rice paper. Therefore, the owner had to renovate the manufacturing technology in order to satisfy custom's demands. In addition, the owner of enterprise usually keeps informing to the producers about the demand of quality as well as instructs them the right procedure in order to meet the quality. Moreover, owner has gifts to producers at annual Tet festival apart from the keeping in contact.

## 5. Success Factors

The long existence of contracts between Trung Tin rice paper enterprise and producing households was based on following aspects:

- Promoting the potential strength of the traditional trade village including production experience, demand and availability of the consumption market
- Owner had a close business relationship with cooperating producers (long term of oral contracts without serious breaches in cooperation)
- Owner always grasps the market demand, and be courageous to expand the scale of production as well as innovate the manufacturing technology in order to upgrade the good quality so satisfying the demand of exporting market as well as the domestic market. Resultly, the export market has been expanded including EU, America, Japan, Australia and many Asian countries, which leads to the increasing revenue of the enterprise.

## 6. Lessons

The farming contract between Trung Tin rice paper and producers brought up some lessons as followed:

- This contract typology was suitable to small-scale of production and high risk of market.
- The critical factor for the sustainability of this contract type was neighborhood and trust among households in the same village.
- The market outlet was a determining factor of the sustainability of this informal agreement.



## CHOLIMEX

Address: C40-43/I and 51-55/II Street  
No. 7 Vinh Loc Industrial Zone,  
Binh Chanh District, HCM City.  
Product: Chilly  
Contract Scheme: Multipartite

**E**xport Food and Seafood Processing Enterprise (CHOLIMEX), established in 1983, is a state enterprise and also be a member of CHOLIMEX system producing and dealing with food supplied for domestic markets and for exporting. The Enterprise has been privatized since July 2006.



## 1. Introduction

Products of the Enterprise labeled CHOLIMEX hold an important place in the markets. They hold a good competition in markets and are favour of many consumers through competition fairs so-called "Vietnam High Products" organized every year. The main products of the Enterprise are spicy sauces (Chilly sauce, Tomato sauce, Fish sauce, Soya sauce, Dry soup power with mushroom flavour, Satay shrimp), frozen products (spring roll, grilled shrimp paste, meatball cake (hoanh thanh), raviolis aux crevettes (ha cao)), dry seafood (dried cuttlefish, dried fish (kho ca thieu), instant anchovy fish preserved), export frozen seafood (shrimp, fish, cuttlefish, crab). Every year, the Enterprise produces about 24 million bottles of soya sauce and other sauces, 2000 tones frozen and processed seafood products, and its sales reach about 25 billion VND. Moreover, the Enterprise has over 200 wholesale dealers and distributors all over the country. Besides, it exports to several big markets such as Japan, Korea, Taiwan, EU, East Europe, North America... with export turn-over 2,5 million USD. There are about 600 staff working in the Enterprise. The Enterprise works by quality management system of HACCP, SSOP, GMP.

During working, CHOLIMEX has tested to sign contract for having stable and quality material (including traders, purchasing station) but not succeed as products were not qualified and procedure of transferring product. The constrains in the contract farming of CHOLIMEX show that even with the support from the State by the Decision 80, the role of the support of Department of Agriculture and Rural Development will be reduced without the formation of cooperative and volunteer farmer units.

## 2. Emergence and Evolution of Contract

Not since the Decision 80/CP issued, but over 20 year working on agricultural product processing, the Enterprise has been dealing with farmers to have material, therefore, board of managers always try to cooperate with farmers for stable material.

However, in fact, to summerize the contract

implementation of contract farming on many products such as tomato, chilly, seafood..., the Enterprise reveals that the formation of contract was rather difficult and it often failed. After each failure, the Enterprise learnt from experience and tried to find new contract.

- The first period in the 1980's, the Enterprise often signed contracts with traders at material area, but the price was too high and moreover, material was not enough both in quantity and quality because of the limited competence of traders and lack of labour to classify, no equipment to preserve, transport ...
- In the 1990's, many regions started to form areas specializing in agricultural crops such as specializing in chilly in Ninh Thuan, Quang NGai, specializing in seafood in Binh Dai, Ben Tre.... Known this information, the Enterprise sent staff to this area to sign contract with farmers, built local purchasing material points in order to reduce the price and avoid being ruined when harvesting. However, it was still failed because farmers could not deliver enough material in both quantity and quality. Therefore, the Enterprise had to spent lots of time to classify and weigh the material ... and this made the expenses for classification increased. Moreover, output and productivity of the material in the household could not be the same, therefore, farmers often broke the contract's law. The Enterprise could not bring that to court for trial because almost 90% of those farmers were the poor.
- In reality, the Enterprise now would like deal with groups of producers, but they are not set up yet. In the suggestion of the Ho Chi Minh Department of Agriculture and Rural Development (HCM DARD), since Nov. 2005 the Enterprise started the experiment to sign with chilly producers of Nhuan Duc Cooperative in Cu Chi District, Ho Chi Minh City through HCM DARD.

## 3. Terms of Contract

CHOLIMEX Enterprise through HCM DARD signs contract to purchase chilly from farmers of Nhuan Duc Commune, Cu Chi District where is famous in planting vegetable in Ho Chi Minh City managed



by HCM DARD. Non of cooperatives for chilly producers is formed here in this commune, hence, chilly producers have no legal status to sign contract with the Enterprise and they also do not want to sign paper contract while HCM DARD has a strategy to help them reduce risk of the unstable output.

Articles in the contract are just principles, but not setting up figures.

- HCM DARD will undertake the chilly production, support farmers with techniques of putting down fertilizer, taking care, avoiding disease in order to increase the productivity and quality of the product. On behalf of the farmers, HCM DARD is responsible for keeping the articles in the contract signed with CHOLIMEX such as delivery time, delivery place and quality of the product.
- CHOLIMEX also orders products in quantity, quality, specification of classifying products that can be possibly supplied. Each delivery time, the Enterprise has to liquidize 30% of product value, and 70% of the value will be paid after 15 days.

## 4. Contract Implementation

Comparing with several big processing groups such as Vedan, Bourbon ... the market of CHOLIMEX is still small and separated, therefore, contract is only made when there is an order from distributors or exporters. Hence, CHOLIMEX could not sign contract a time before the cultivation time. This is the reason CHOLIMEX could not have contract for support capital or material such as breeding, fertilizer as other big enterprises can do to protect the contract.

After many contracts signed with producers, the Enterprise learnt that it was best if HCM DARD signed the contract when farmer groups were not formed. This would help farmers understand that it is necessary to cooperate together for selling the product.

Farmers in Nhuan Duc reveal that they only sold their products to the Enterprise several times, therefore, they had still doubt, but they admitted that chilly output and income increased when the

production area and price unchanged compared to previous season. Moreover, it is more convenient as they do not have to carry to market for traders.

The reason is, farmers are trained improved techniques how to produce and take care of the plant (taught by Department of Plant Protection, HCM DARD), therefore, productivity of chilly increased due to little of no diseases, output is larger and more stable. The Enterprise comes to buy at the local gate and package and transport, hence, chilly quality can be saved.

However, this is only the beginning, some farmers are not really interested in participating in the contract in the future. This means that the contract between CHOLIMEX and farmers through HCM DARD can be ended at any time.

## 5. Success/Failure Factors

This is only a typical cooperation in current situation when agricultural production is in a small scale and farmers' knowledge on cash crop production is limited. Moreover, cooperatives and farmer groups are not formed in many rural areas, whereas the markets for agricultural products are developing very much. Here, the State, more specifically the HCM DARD has an important role in the contract farming.

In the short term, this type of contract is going rather well. However, due to the constraints that farmers stated between selling to Enterprise and traders, it shows that this type of contract is not sustainable if no changing.

Surely, in the long run HCM DARD cannot sign contract for farmers, and it is not easy to encourage farmers to form cooperatives as they are not willing to do so. Farmers are known much about many cooperatives have failed.

To establish a cooperative is quite difficult as commune has no capital for their operation, building...

In addition, the technical requirement set up by the Enterprise is not interesting for farmers. For example, in contracts buying chilly, the Enterprise requires to remove the chilly's stem and it is quite costly to do so due to high labor wage (traders do not require this).

A very important thing is that if farmers sell their product to traders, they would receive capital at any time. This is very important because farmers in Nhuan Duc are the poor, whereas it is required a big investment, about 50 million VND for 1000m<sup>2</sup> (for breeding, nylon to cover, irrigation system). Hence, even traders buy with cheaper price compared to the Enterprise, farmers still like to sell to them to get capital in advance.

## 6. Lessons

Lessons learnt from the cooperation between CHOLIMEX and farmers of Nhuan Duc commune for purchasing-selling chilly products are:

- Contract farming benefits farmers though the increase of output and lost reduction
- The role of Department of Agriculture and Rural Development for supporting will be reduced without the formation of cooperative
- It is necessary to check carefully the characteristics of the product area and farmers before signing the contract
- Disseminate well information in the contract for farmers
- It is necessary to receive help from local authority (encourage to form cooperatives of agricultural product service, financial support for cooperative activities, building product name) and the most important is to help the farmers access to financial sources for the contract farming success.
- For the Enterprise, to have a stable material, it requires investment strategies such as supplying capital in advance, otherwise, outside traders would buy the material such particularly chilly



Address: No. 6/19, No. 3 road, Lu Gia,  
Commune 5, District 11, Ho Chi Minh City  
Product: Safety Vegetables  
Contract type: Centralized Model

## SAO VIET CENTRE

**S**ao Viet center was established on December 20th 2002, belonging to The An Giang Corporation of Plants Preserving. The Center has the head office in Ho Chi Minh City (in terms of address above). The primary objective of the Center is to establish a system of producing Safety Vegetables (SV) comprehensively, cyclically producing - purchasing - transporting - processing - preserving - distributing to consumers.

## 1. Introduction

The primary field of production and business of the Center are SV and kinds of vegetables such as: leaf vegetables include green mustard, sweet mustard, spinach, amaranth, Malabar nightshade; fruit vegetables includes gourd, calabash, cucumber, colocynth, loofah; temperate vegetables include French bean, tomato, potato, cabbage, cauliflower. And this is also the duty assigned from the Corporation and is general guideline of the City.

Currently, the Center has about 60 cadres and staffs mainly signed by contracts, has a network of farmers producing SV by 25 farmer households in Tan Quy Tay commune, Binh Chanh district, HCM City with total area of 15 ha, but now just remaining 22 ones in Tan Quy Tay commune and 3 ones in Da Lat (Lam Dong) specifically produce sorts of temperature fruit and vegetable. The vegetables sown area size of households varies from 500 to 5000 m<sup>2</sup>, the average is of 2000 m<sup>2</sup>/household.

From the date of establishing up to now, basically, there has been no change in human resource, technology, capital. However, there is change was a change in sorts of vegetables, specifically: At the beginning just producing some sorts of tropical vegetable, then expanding the field of producing temperature vegetables and applying the technique of green house to produce safety house. The quality was addressed past two preceding years such as sampling to examine 3 day before reaping and the current quantity increase 2-3 times compared to year 2003 mainly due to intensive cultivation to increase number of crops (Past: cultivated 2-3 crop/year, now 8-10 crops/year).

For successes, be able to say that in a short period of time 2-3 year invested in a comparative brand-new field as producing and making business SV but the Sao Viet Center was rather successful in, firstly, establishing a system of producing SV comprehensively, cyclically producing - purchasing - transporting - processing - preserving - distributing to consumers. Secondly, the Center well organized patterns of associating production and selling products through economic contracts. Thirdly, the Center constructed a bar-coded

system for each kind of product to improve management as well as quality of products. Finally, the Center established a system of agents to decrease intermediate costs in delivering products.

This case is a typification for the success of the implementation Decision 80 in spite of lack of supportive capital from the State. The support from Department of Agriculture and Rural Development played a decisive role for the Corporation to make commitments for long-term contract and share benefit with farmers.

## 2. The formation of contracts

Because of the huge demand for vegetable of HCM city, while the ability of supply just covers 30%, hence vegetables are mainly imported from the Mekong River Delta provinces, the Southeast and Da Lat (Lam Dong), meantime the demand for SV increases more and more due to increasing in food poisoning, in which there is a reason of un-safety of vegetable quality.

From the 2000s, the city focused on programming a specific vegetable-producing area to supply for vegetable demand of the city, associated with the supporting for capital and technique transfer, especially technical measures in producing SV such as producing vegetable in net-house, applying the comprehensive production process, using kinds of organic fertilizer, examining the quality of products (excess in quantity of plant protected medicine in products), and organizing patterns of producing association and selling product etc. Currently, the vegetable production size is approximately of 3000 ha, gathering in areas of 3 rural districts as Hoc Mon, Cu Chi, and recently, Binh Chanh. And to meet the successive increasing vegetable demand, the city advocated to expand the area of specializing in cultivation up to around 5000-6000 ha (2006) and 8000 ha (2010).

From the situation of more and more increasing in production size meanwhile producing participant-agents and supply SV are still limited (there are some patterns of association in producing SV such as group/club producing SV, but up to now just 2 agents still keep on this activity as Tan Phu SV producing collective and Sao Viet Center with

very limited capability in producing and supplying), therefore, from the beginning of establishing, the Sao Viet Center started to perform signing the product SV producing and selling contracts to limit the risk of quality, quantity, price and time of purchasing, handing products over.

The chosen area is Tay Quy Tay Commune, belonging to Binh Chanh district, as one of three objective districts of the City to develop SV. Farmers chosen for producing association all have understandings and experience in vegetable producing, having needs of association to stabilize output and income, having expectation in acquiring and applying the efficiency of TBKT in producing SV to improve ability and intensive cultivation level of ability.

To support for the farmers, in the beginning years, the Center focus on helping to invest vegetable seeds, training technique and transferring cultivation process to apply comprehensively, assigned technical cadres always to be at producing area to give expert on technique and follow the application of technical process, and direct product purchasing. When farmers got used to the technique of producing SV, the Center gradually went to the pattern of seed and essential material supply services, make expert on technique to produce products according to requests, and just assist at the beginning to apply new technique such as for new seeds, new specific fertilizers and pesticides ... Most associating farmers had no need to borrow capital.

### 3. The terms of the contract

The purpose of signing contract aims: For enterprises, to ensure quantity, quality of product and the time for receiving and delivering according to requests. For farmer households, initiatively organize producing in terms of assigned plans, to be able to expand the scale of production if having condition, and to be able to predict income and stabilize employment.

The terms of the contract include price, quantity, quality, design, time and place for receiving and delivering products... all have negotiation, careful discussion with farmer and to be presented clearly in the contract. The contract is signed only

when the terms are accepted by both parties. Beside the terms, the technique training and TBKT transferring, if yes, are also clearly presented in the contract.

The terms of contract usually do not change; if yes, it is usually adjusted at the beginning of the year signing contract for a new year of production. The adjusted terms are usually price and product specification that will be reaped. For instance, the reason for adjusting price mainly dues to fluctuation in price of inputs of production, from that the related terms are adjusted. For specification of reaped product, if yes, also is adjusted, for instance, for spinach that can be cut at medium length (not too long) ...

The pricing in the contract mainly base on the costs of input of production process which was unanimous, and the price in the contract ensured the benefit for producers. According to this method of pricing, depending on each kind of product, the farmers can yield 10-15% compared to the cost invested for production. Moreover, due to vegetable production strongly depends on climate, for instance, dry season is a good advantage for bearing and growing of plants then the vegetable quantity is large and stabilized, so it is necessary to refer price in the contract to make the farmer keep mind on their work. Inversely, in the rainy season, the production situation is more difficult, then the vegetable quantity is not stabilized, so the price in the rainy season is usually higher than in the dry season.

Beside the constraint terms, annually before entering producing crop, the Center organizes technical training for farmer, supply seeds with nonprofit price, signed contract for investment - production and product purchasing with group of farmers. Through the meeting, farmers initiatively make plans of production in terms of quantity of each vegetable that the enterprises required basing on negotiations, discussions. The quantities of vegetables daily supplied include: spinach 350 kg, sweet cabbage 200 kg, green cabbage 200 kg, malabar nightshade 150 kg, amaranth 150 kg, salad 20 kg, cucumber 60 kg, luffa 20 kg, pumpkin and cucurbit 40 kg, temperature vegetable, including tomato, 150 - 200 kg, cress 100 kg, ... 100 kg, potato 100 kg, French bean 100 kg. The Center has 2 cadres, one technical

cadre and one purchasing cadre to purchase daily products for signed contract.

Formerly, as just signing contract the quantity and price in the contract are also discussed for each year. But due to the price of product strongly fluctuates in terms of season then now the prices presented in the contract are also adjusted and discussed in terms of seasons, while the quantity is in terms of years. To improve the management, control the source and quality of product, the SV products of the Center all used bar-coded system which is suit for each product. The Center daily receives products from producing place which was made agreement for a convenience in transporting.

The standard criteria examining the safety of products include 5 criteria for safety of food according to the Decision 867 of Ministry of Health and 5 ones for heavy metals, the content of nitrate and excess in plant-preserved medicine. The examining for quality standard and safety of food are implemented periodically by state authorized agents.

#### **4. The situation of contract implementation**

Quality of products generally ensures the safety. However, the design is an complex problem, for instance, the crops, that insect occur intensively and damage before reaping 2-3 days, according to process it cannot spray chemical pesticides, or in much rainy years make the design reaped not nice... makes the price cheaper, causing obstacles for producers. The adverse natural factors for producers affected on the common quantity in the direction of decreasing meanwhile the demand still tends to increase.

Similarly, quantity also has constraint in the contract, if purchasing a larger quantity compared to the one in the contract, then amount of the larger component will be computed in terms of the market value if the market price is high, otherwise if the market price is low compared to contract price, all will be computed in terms of the price addressed in the contract, generally it tend to be profitable for farmers and disadvantageous for enterprises.

The pre-pricing in the contract has advantages such as ensuring producers to get income and know how much they will get after signing contract. However, there are some limitations such as no strictly supervising the input of production, and it is very difficult to have general price system which is suitable for regions with differences in production conditions, specially the factor relating to investment for production and productivity of plants, for instance, if the soil is good then the investment will decrease but the productivity is still high ... so the price of products must be lower compared to the place having high costs of production with low productivity.

On more limitation is that producing according to plans (determining quantity of each kind of vegetable) but the market demand always fluctuates and cannot adjust other supply resources because of inability in supervising the quality of products. For example, cultivate 6 kg of spinach seed and get 200 kg of spinach but the market demand can increase/or decrease, the Corporation still purchases even though the market price strong decreases and cannot force on prices due to affecting on quality.

#### **5. The reason for successes/failures**

To have these successes, firstly, mention to the Center's addressed objectives which is suitable with general policy of the City as developing SA to gradually improve the living standard of the citizens, especially in the context of food poisoning increasing. Secondly, there are a relationship and strict combination with local government and the group of farmers in choosing partners, applying technique for cultivation process and technology for processing, comprehensive preserving, management and supervising to improve the quality of the products. Hence, from signing the contract and selling SV products of the Center there are mainly no contract violations, the quantity of product sold through contract increases more and more (2-3-fold increase compared to at the beginning time of signing contract in year 2003), the incomes of farmers also improve considerably and number of associated farmers basically does not change.



Beside the successes of the Sao Viet Center, limitations are unavoidable, especially the beginning years investing for production and business of SV products. Firstly, the business of the Center had had no profit due to specific characteristics of products as vegetables which has undergone quite a loss, production depends much on climate, costs for renting agent areas for selling product are high (22 million Vietnam Dong/month excluding fees for electricity, water, and transporting...). Secondly, the scale of pattern of associated producing and selling SV products is still small (about 15 ha with 25 households), and the quantity purchased is still limited compared to production capability of farmer households and compared to the demand of SV which increase more and more. Currently, there appear some enterprises having ability to invest and purchase larger quantities. And, one more limitation is that the Center has no strategy to expand the scale of production and business in the coming time. Hopefully, when the consumers have habit of consuming SV more and more, the market for selling to be larger and larger, the scale of production and business will be expanded and stabilized will increase revenue and profit of the Center.

Necessarily to say more that, the An Giang Company of plants protection medicine is the biggest enterprise in the field of producing and making business on plants protection medicine and to be very successful. Annually, the Company

saves a large amount for charitable activities, especially activity of improving the community health. Therefore, choosing producing and making business on SV of the Center is also a duty of the Company and general policy of the City for developing SV.

## 6. Experience lessons

The case of the Sao Viet Center gives some experience lesson as follow:

- The support of the Department of Agriculture and Rural Development plays decisive role in implementing the Decision 80 in spite of lack of State capital. This is a premise for the Corporation to commit long-term contract and share benefit with farmers
- In implementing agricultural products contract, the Corporation should strictly coordinate with Group of farmers
- It is necessary to have a considerable preparation and disseminate to encourage farmers before establishing agricultural products contract. Especially in the process of establishing contract, necessarily having democratic discussion with the farmers.
- It is necessary to create a flexible and suitable form for contract, associating with sharing benefits and risks between partners.



## **THANH NAM THANG HONEY-BEE PRODUCTION AND TRADE COMPANY LTD.**

Address: 34/10 Yen The street, Tan Binh district, Ho Chi Minh city.

Product: Honey

Contract type: Centralized Model

**T**hanh Nam Thang Honey-bee Production and Trade Company Ltd. was established in 2004, the company has head office in HCM City (Address above). The company was established by basing on (retired) people who worked for managing honey and people keeping bees, they had understanding each other, ability and experience on keeping bees and they cooperated to produce, to process and to export honey. And this has been the main business operation of the Company.

## 1. Introduction

Due to just to be established and go on operating for two years so the structure of the company is rather simple, one director, one chief of accountant, one export-import staff, one manager, one administrator and one accountant. Following the company, there are 5 farm of keeping bees with capability of 1000-2000 barrels/farm (average volume of 30-40 kg honey/barrel) specifically produce and supply honey for the Company to process and export to American and European Markets.

From the foundation date to now, there has been mainly no change in human resource; but technology has had a considerable change, as mainly improve the capacity from 150 kg honey/hour (prior) to 500 kg honey/hour (currently). The company also expects to expand the scale of production in the coming time, this, however, depends much on efficiency of investment on production and business of the Company in the coming time.

The company belongs to the association net between farmers producing honey and customers as export markets, the Company plays an intermediary role. Up to now, this type of contract has been rather successful, the proportion of violation is negligible.

This is the contract for agricultural products for high valued products and need to be considerably invested, so the successes of the contract need supports and commitments from purchasing party. However, the contract is hard in improve associative ability and help the poor get benefit.

## 2. The construction of the contract

The job of keeping bees and getting honey in our country has long age, however the production scale is just non-associative and small level with manual technology of processing and the selling is mainly in domestic scope. In the recent decades, due to having export market then getting profit from keeping bees, processing and making business on honey so the number of household keeping bees has increased and the scale of production, processing have been expanded to increase honey amount for export and domestic consumption. Confronted with this situation,

beside the Central Bee Company, the agent specifically produces and makes business on honey with large scale, there have been some small companies investing in this field and mainly serving for export in which including Thanh Nam Thang Company.

Hence, beside of the advantage of this company such as having understanding and long-time experience in producing, processing and making business on honey, the company should also consider choosing farmers to cooperate in keeping bees and supplying honey, as well as consider developing investment relationships and purchasing products to get stable amount to serve the business of the company. Beside that, because investment for keeping bees to get honey is rather large so to avoid risks in investment and purchasing products, investors must sign economic contract which is tie down with farmers cooperating in producing and supplying honey. Similarly, for farmers, because honey is special product, cannot be kept in long time and to produce a large amount, it definitely requires place for selling, especially, in order to expand the scale of production, the credit demand is unavoidable. From the real situation, an economic contract was implemented basing on the terms discussed by the company as an investor and farmers as bee keepers and honey suppliers.

In the contract process - for input, the company invests a part of costs of production (for lending or providing sugar to keep bees) with average of 30-50 million Dong/household and purchase honey through signing contract with farmer. The farmer households, which are chosen to invest to supply honey, are capable and experienced in keeping bees and produce honey, they have good virtue, permanent accommodations; and specially, the investor and producers have good understanding of each other. For output, the company signs foreign trade contract to export to American and European markets.

Besides the subjective reasons above, there are many objective elements due to characteristics of keeping bees requiring the investor has to consider contract of producing and selling product to limit risks, that are: firstly, due to keeping bees depends much on climate since annually the producers keep bees in rainy season and get honey in dry season (from January to June), so in

years raining much on dry season (reaping honey season), the amount of honey will decrease considerably, so affecting on income of bee keeper and revenue of the company. Secondly, in the recent years, because the bee honey keeping job had markets for selling so the number of bee keeper increased meanwhile the sown area for kinds of tree did not much increase, so the flower sources supplying honey for bees restricted leading to average productivity of honey decreased (formerly 40 kg/ barrel, now 30 kg/ barrel). Beside that, intensively praying chemical insecticides to protect crops, particularly, in years, insect harmed trees badly to be cause directly affecting on density of bees then affecting on amount of honey. So, in order to stabilize amount of honey, bee keepers always consider in expanding the scale of production, move the bee's nest (in terms of flower blooming time of trees) to limit the reduction in productivity and amount.

Therefore, being able to see that due to unstable characteristics of keeping bees and rather large production, so from the beginning of establishment, the company applied the contract of investment for production (for lending or providing sugar to keep bees) and being with farmers to sell product to get: for farmers, knowing the amount of aided (lent) capital to make plan of production or expand the scale of production (if possible). And for the company, knowing the possible amount of product in terms of crops to sign contracts of export with foreign parties to reduce risks in the process of investing for production and business.

### 3. Terms of the contract

The process of constructing a contract mainly bases on: the capital capability of the company, production capability of bee keepers, and quality requirements for product from customers. From these basics, the company design the main content (terms) of the contract and discuss about terms of contract with farmers, presenting clearly the duties of each party. The contract is just signed if and only if all terms in the contracts are accepted and implemented by all parties.

The main terms in the contract include price, amount, quality, time and place for receiving and

delivering product ... which are all considerably negotiated and discussed with farmers and represented clearly in the contract. The terms are adjusted annually as beginning a new crop due to market's changes and successive requirements for product.

For price, mainly in terms of market price at the time of purchasing or receiving and delivering, not in terms of floor price as well as predetermined price) and the price is affected by output price for export. For amount of product, be mainly based on the scale and capability of production of bee keepers and be clearly presented in the contract. Similarly, the criteria for quality of product included in the contract are content of water, saccaro, color of honey, antibiotic content. Finally, time and place of delivering product are also element considered and clearly presented in the contract.

Determining standards for product is done through the result of testing quality of product by the Center 3 for measuring quality criteria of product or the Center for testing quality of product of the Department of Science and Technology, Ho Chi Minh City ... Each batch of product is tested before exporting.

The types of making payment for producers: Paying in cash after receiving and delivering product, or deferred payment as pay a partial in advance as receiving product, the remaining will be paid after exporting product; or pay a partial in advance (in the form of lending) and repurchasing product.

### 4. The situation of implementing the contract

The company always has cadres who frequently keep contact with associative bee-keepers to keep track of situation of production, evens occurring or possible changes; Keeping track of implementing contract, collecting debt or complementing capital for whom needing loan to expand scale of production (if possible), purchasing out-contracted products to sell, if there exists markets.

Annually, beside of supports by loans, the company also informs more about criteria for quality of products from customers, support

associative farmers by presents if the business activities are effective.

Because the company have been just established and gone on production and business for two years, so the scale of production is still small, there are only 5 households specifically produce and supply product for the company according to contracts with capability of 100-300 tonnes/year. Therefore, in adverse climate years, amount of honey is shortage leading the company to buy honey from free market, and the supply is not much, resulting to competing in buying and selling, creating a pressure of increasing price.

In the beginning time of implementing contract, it had also cases of violating contract such as the amount delivered was not enough compared to investment capital; and the undelivered amount of product was usually sold outside with higher price. And these cases just occurred in adverse-climate years reducing supply. For these cases, the cadres of the company had to explain, persuade bee keepers making sense the benefit of the association relationship in producing and selling product, particularly stabilizing jobs and incomes for them, even in the good producing years, the amount of honey produced is purchased by the company basing on discussion. Therefore, the cooperation relationship becomes better and better, better understanding each other, because of basing on cooperation in producing and selling, the output and income can be stabilized.

Beside the violation on amount of product, there also are other violations on quality which are usually content of water contained in honey; however, this problem can be overcome through processing stage (using machine to reduce content of water). And in this case, the cadres of the company also persuade producers to limit this situation. To encourage farmers well implementing the contract, the company has priority policies on prices, investment in the next years for whom well implementing the contract; otherwise, no investment.

## 5. Reason of success

Thanh Nam Thang Honey-bee Production and Trade Company Ltd. is a small enterprise, the scale of production and business are limited. But due to rich of experience in producing, processing and exporting honey, so from the beginning of establishment the company promoted its own advantages, organized patterns of cooperation for producing, processing and selling product through signing contract with capable and experienced bee keepers, had good relationship with partners for exporting honey. Therefore, in spite of being just established, annually the company could purchase and export a large amount of honey, 100-300 tonnes, and revenue was about 2-4 billion dong, the company intend expanding the scale of production in the next years. The reasons for success of contract included:

- Keep patience in persuading, creating faith to producers (purchase all with given price in spite of in bumper crops of honey).
- Discussing carefully with bee keepers for terms of the contract
- The bee keeping job is highly risky and requires large investment so the producers have motive to sign investment contract.

## 6. Lessons of experience

The case of contract of Thanh Nam Thang Honey-bee Production and Trade Company Ltd. draws some lessons of experience as follows:

- Agricultural product contract has highly valuable and need to be considerably invested, therefore, the success of the contract needs supports and commitments from purchasing party.
- Necessarily to be careful in choosing producers who have capability and capital to sign the contract
- This type of contract faces of difficulty in increasing cooperative capability and helping the poor getting benefit.



## **TAN PHU TRUNG COOPERATIVE**

Address: Dinh Hamlet, Tan Phu Trung commune, Cu Chi district, HCM City

Product: Safety vegetable

Contract Scheme: Multipartite

**T**an Phu Trung cooperative was established in 2003. The cooperative works as a limited company with the salary following the principle of shared investment. The management board of the cooperative consists of one head, one accountant and one monitoring staff.



## 1. Introduction

At present, major business of the cooperative is regarded to safety vegetable with five types of vegetables: mustard greens, water morning glory, amaranth, basella alba. In addition, the cooperative also acts as an agent selling Sai Gon biology organic fertilizer and providing vegetable seeds for farmers at the service cost of about 5 %. The cooperative purchases various kinds of seeds from different sources and receives the discount pursuant to the number of seasons during the year (8-9 seasons/year).

Tan Phu Trung cooperative belongs to the linkage chain between safety vegetable farmers and Metro supermarket. The cooperative signs the contract with Metro and make a verbal contract with farmers to produce safety vegetable for Metro. Up to now, this kind of contract farming has achieved some certain successes with a few number households breaking up the contract. More important, the linkage model through contract farming helps to transform production and business pattern of farmers in accordance with the trend of modernization.

The success case of contract farming between Tan Phu Trung cooperative and Metro supermarket is an evidence for the dynamic support of the DARD in connecting farmers with consumption side. Moreover, this case also points out a bright way for agriculture development in peri-urban producing safety vegetable for high-income consumers.

## 2. Emergence and Evolution of Contract Farming

Ho Chi Minh city has Cu Chi and Hoc Mon provinces as traditional vegetable providers. However, due to high demand of vegetable of the city, these two providers only meet around 30% of the demand. Most of vegetable consumed in HCM city has to import from other provinces in Mekong River Delta, South East and Da Lat city (Lam Dong province). Especially, the demand of safety vegetable is increasing because recently there appear many food poisoning cases mostly due to uninsured vegetable quality.

Since 2000s, the leaders of HCM city has determined to focus on planning the areas

specialising in vegetable production to meet the demand of the city. This is also in combination with other activities such as technical transformation support, especially technique in safety vegetable production like producing vegetable in net house, applying comprehensive production pattern, utilizing organic fertilizer, checking up the quality of the product for example the existing amount of plant protection chemical substance in the product as well as other forms of the linkage between production and consumption. Currently, total area for vegetable production of HCM city is about three thousand hectares mainly located in three peri-urban districts including Hoc Mon, Cu Chi and Binh Chanh. In order to meet the increasing demand for vegetable, the city has the plan to expand vegetable specialisation areas up to 5000-6000 ha in 2006 and about 8000 ha in 2010.

In the context of the increasing demand for production expansion but limited vegetable providers, the Extension Center and Department of Plant Protection assigned from the DARD have taken the initiative to facilitate and support for the model linking production and consumption for safety vegetable with special attention on the bridge role of the cooperatives and groups of farmers. Through this model, the cooperative works as the representative for farmers will purchase safety vegetable from farmers and then signs the contract with Metro supermarket to reduce the risk and protect farmers from the price fluctuation in the market.

In 2001, there was a group of farmers (the basis of current Tan Phu Trung cooperative) consists of twenty nine people with specialisation in production of green vegetable and root vegetable. Total area for vegetable of this group is approximately 10 ha, with an average of 3000 m<sup>2</sup> per household. However, because the root vegetable area was scattered and seasonal, the consumption of the products did not run smoothly. Hence, the households decided to transform to produce green vegetable only because it can be cultivated all year round. This is the first step to formulate the cooperative namely Tan Phu Trung in 2003 with the contract farming between 15 households specialising in green vegetable and Metro supermarket.

Farmers selected for this contract farming are knowledgeable and experienced in this field. They have the demand to cooperate with the desire of stabilising output and income, receiving and applying new technologies in safety vegetable production.

Initially, when the model in production and consumption of the product was set up, the members of the cooperative were supported in terms of inputs (seeds, fertilizers, plant protection chemical substance, net house) and technical training through extension programs held by Ho Chi Minh city Extension Center and National Extension Center. Therefore, the pattern for producing safety vegetable is applied comprehensively for all members. The cooperative has the responsibility to collect products from farmers and then sell to Metro. When the farmers get familiar with this kind of contract, the cooperative added some more activities such as providing vegetable seeds and other necessary inputs to help farmers making a plan for their production in terms of amount and type of vegetables which are suitable with the requirement of Metro.

In sum, up to now, the number of cooperative's members was reduced a half compared to before. Similarly, total area was reduced and type of vegetables was changed to green vegetable as well. However, there was a basic change in terms of technique and quality. Techniques are applied more comprehensively, the quality of the products are tested three days before harvesting. All products are supplied for Metro and over twenty kindergartens in Tan Binh district.

### 3. Terms of Contract

The purpose of the contract is to help the cooperative ensure the amount, product quality and delivery time following the requirement of Metro. As for farmers, contract farming ensures their output and therefore and stabilises their income (they may know their income after signing the contract) and livelihood. As a result, they may take the advantage to organize their production following their plan as well as expand their production scale if possible. In contrast, if they sell to private traders in free market, it does not ensure

the stabilisation in terms of amount, type of vegetables and quality requirement and the price is not stable as well.

The conditions in the contract consists of price, amount, quality, design, time and place for delivery of the products are all negotiated and discussed carefully with farmers. After that, the cooperative represents for farmers to sign the contract.

Every year, before starting the vegetable season, the cooperative will hold a meeting with its members to inform about the production plan for all kind of vegetables. On the basis of this, farmers make their own plans following the requirement. The formulation of the plan for production is discussed and come to an agreement in this meeting. In implementation of the contract, any change must have to be exchanged directly or through telephone (almost households have the telephones) or set up a meeting. In the past, the cooperative lent money for farmers but at present, there is no demand on capital, therefore, the cooperative only provides seeds and fertilizers.

In term of price, Metro is the one who sets the price following common price in the market and the price is adjusted every month whenever there are any change of price seasonally or significant change of input price. When the market price fluctuates sharply, the price in the contract can be adjusted after few days. The amount of the product is determined by the cooperative and farmers, thereafter, the cooperative collect everyday and then sell to Metro. As a whole, Metro only purchase the certain amount in signed contract, therefore, if farmers produce more than of the amount in the contract, they have to sell to the market.

Regarding type of vegetables, members of the cooperative produces five types of vegetables: sweet cabbage, mustard greens, aramant and basella alba. The cooperative plays an important role in assigning the plan for each household to cultivate one or more type of vegetables. Farmers have to register and commit the certain outputs for five types of vegetables.

If the cooperative wants to check out product quality, they may ask Department of Plant Protection to do that and the checking cost is 110

thousand VND per one time for one kind of vegetable. However, this check does not value to Metro because they only believe in their own checking system.

## 4. Contract Implementation

In general, either farmers or enterprises follow the conditions of the contract seriously because Tan Phu Trung cooperative has high capacity management board who can negotiate fluently to ensure the benefits for the parties. The price of the contract is negotiated and fixed every month, and then it has proved its stabilisation compared to the price of private traders (the price changes everyday high or low depending on the amount of the products). Therefore, even though sometimes the price in free market increased sharply but farmers did not sell to private traders. In addition, private traders rarely purchase safety vegetable; hence there is no competition for this kind of product. Finally, due to strict management and monitoring of the cooperative, the situation of incorrectly pesticide utilization is also reduced. There is almost no break up of the contract because the members want to work for the cooperative with stable contract in long run.

Beside the above mentioned advantages, contract farming still faces some certain difficulties. Price of Metro is stable but the adjustment of the price following the change in the market goes slowly. Therefore, more or less, it affects to the income of producers, especially at the time of wide price fluctuation. Sometimes, Metro also imposes the price to farmers. In such case, the cooperative has to be the negotiator for the situation. Thereafter, Metro will recheck the market price before making a decision on price adjustment in few days later.

As a whole, Metro only purchases with limited amount while the production capability of the cooperative's members is gradually increasing. This is one of major difficulties in participating in

the linkage of production and consumption. If Metro could not consume all safety vegetable produced, members of the cooperative have no choice but selling to private traders. The point is that their safety vegetable has high quality associated with high cost but they have to sell at the same price with other vegetables in the market.

On the other hand, safety vegetable is produced following the plan in the contract while the demand of the market changes regularly. Therefore, the cooperative can not adjust other supplying sources whenever there is any new demand for safety vegetable because it is not able to control farming pattern and product quality of farmers who are not the members of the cooperative<sup>1</sup>.

Tan Phu Trung cooperative also face difficulty in term of content for training and transferring the technique which are not implemented seasonally and put as one of the conditions in the contract. The support of Metro includes the technical training for farmers during the first years and currently the technique on pre-processing, packaging and conserving the products.

When the market is expanded and safety vegetable demand increased, the cooperative is hardly to compete with larger businesses because of the small production scale (15 households with about 50 hectares) and limited amount of purchasing products. At present, some large scale enterprises appear with high investment and large amount of purchasing products. Meanwhile, with limited capability, the cooperative itself does not have clear future strategy to expand its production and business scale in forthcoming time.

## 5. Success Factors

Tan Phu Trung is one of the communes situated in peri-urban area with traditional specialisation in vegetable production supplying for the city.

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<sup>1</sup> Latest two years, demand for safety vegetable of Metro has been increasing. Therefore, Metro had tried to work with other providers in Long An, Ba Ria-Vung Tau provinces. However, the business was not as good as the supermarket expected. Hence, at present, the best partner is still Tan Phu Trung cooperative. Meanwhile, production and business scale of the cooperative is still not expanded, only within 15 households.

However, the production is still operated individually. Although the linkage model of production and consumption of safety vegetable has been implemented just in recent years but it highly shows the effectiveness in production and business. This model should be applied into other localities as well. In short, it can be noted that the success of Tan Phu Trung cooperative is owing to these factors below:

- The cooperative has promoted local traditional advantage as a vegetable production specialisation area with land characteristic and socio-economic conditions which are appropriate for vegetable cultivation.
- The selection of safety vegetable for production is also suitable with the development plan and strategy of the city as well as favors the increasing demand on safety vegetable.
- There was an effective cooperation with HCM city Extension Center, Department of Plant Protection in training and transferring techniques in vegetable production for farmers, especially at the young age of the cooperative.
- Management board of the cooperative is very dynamic in finding markets, promoting production linkage and upgrading product technology.
- There was a good selection of experienced farmers to participate in production of high quality products fulfilling the requirement of customers.
- The production and consumption model of safety vegetable is well organized with strong

cooperation of farmers through contract with negotiated conditions. In addition, the cooperative has been keeping close relationship with Metro which helps to develop the consumption of farmers' product sustainably.

## 6. Lessons

The success of Tan Phu Trung cooperative has given some good lessons for developing contract farming:

- The cooperative has identified appropriate product to make a contract, in which it favors the products which need specific technique. Development of safety vegetable in peri-urban area is a suitable way for the developing contract farming.
- The success of Decision no 80 depends greatly on the important role of the DARD, especially in disseminating the contract and technical support.
- This new kind of cooperative takes practical effect on small scale producers, helping them to transform crop structure and consume their products through contract farming.
- Contract farming should assess the price flexibly following each type of crops.
- There is a need to have a discussion of all parties about the conditions of the contract.
- In future, major threat for the sustainability of the contract for safety vegetable is the valid product quality registered system.



Address: My Loi B Commune, Cai Be District,  
Tien Giang Province  
Product: Paddy rice  
Contract Scheme: Multipartite

## LOI THUAN COOPERATIVE

**L**oi Thuan Cooperative, established in 1998, plays as a link to connect households planting rice, Tien Giang Food Company and Tien Giang Agricultural Material Company. The Cooperative is included 1 cooperative head, 1 vice head, 1 technical staff, 1 accounting staff, 1 cashier. The total Cooperative's members are 600 households and the total area of households is 900ha. In the near future, the Cooperative intends to cultivate more crops and implement other activities to increase the exchange of products between the Cooperative and its members.

## 1. Introduction

The Cooperative has so far 2 contracts: contract of buying rice between Tien Giang Food Company and the Cooperative members (Thanh Loi Cooperative helped to sign the contract) in 2001 was failed. And currently, the Cooperative has only 1 existing contract of agricultural material service signed in 2000.

The study of Loi Thuan Cooperative has shown that it should not apply contract farming for all agricultural products, particularly product as such rice.

## 2. Emergence and Evolution of Contract

Loi Thuan Commune is not situated near any highway and the transportation is mainly through waterway; therefore, very limited services for agriculture such as fertilizer. Loi Thuan Cooperative set up to supply the local demand of fertilizer and pesticide. In 2001, Tien Giang Food Company intended to purchase rice for their business and therefore signed contract with the Cooperative. Taken this opportunity, the Cooperative made verbal contract with farmers to sell rice. The contract was only existed for a short time because farmers could not supply the company requirements.

The need for agricultural material, fertilizer, pesticide in order to invest in rice production is quite big while transportation is such a problem here. Moreover, quite a number of households do not enough money to buy fertilizer and pesticide. To satisfy this need, contracts for agriculture material service have been signed between the Cooperative and members since 2000. The Cooperative is considered as a connection point between Tien Giang Agriculture Material Company and farmers producing rice. According to this contract, farmers were supplied fertilizer, pesticide in advance and paid the Cooperative capital and interest later on, after harvesting rice. The Cooperative did not help the its members to sell rice. The members liked to sell their rice to traders more than sell to the Food Company because the traders could accept and buy easily.

## 3. Terms of Contract

The main articles in the contract between Cooperative members/farmers and Tien Giang Food Company (The Cooperative was responsible to buy rice for the Company) in 2001 were the Cooperative supported farmers in advance agricultural material (fertilizer, pesticide) and got the payback later on. The farmers then sold their rice to the Food Company (the Cooperative was responsible to buy). Price to purchase was market price. For the material that farmers got, the Cooperative included interest rate and farmers only paid all after each crop season. The Cooperative helped farmers production techniques as well as pest disease protection.

The most important thing in this contract was that the standard of the rice was set up by only the Food Company, but not by the agreement of farmers. In the contract, the standard of rice included: grain moisture not exceed 15%, ratio of un-rounded grains not above 10%, impurity ratio not above 30%, mixed not above 10%, ruined grains not above 2,5%, cracked grains not above 8%, white-felt grains not above 8%, red-strike rice not above 2%, yellow grain (by fungus...) not above 0,5%, no pest affected grains.

Major articles in the contract between the Cooperative and Tien Giang Agricultural Material (the Cooperative is representative to sign the contract) signed since 2000 include the Cooperative supports in advance agricultural material (fertilizer, pesticide) and gets the payback later on. The Cooperative is the intermediate one between Tien Giang Material Company and Cooperative's members. The Cooperative receives material from the Company and supplies farmers (supply farmers material in advance to invest in rice production and farmers pay back after each crop). Paper contract was signed between the Cooperative and farmers. The Cooperative supports farmers production techniques and pest disease protection. In the case of having natural calamity or diseases, the Company and Cooperative consider and can prolong the payback for the farmers. Price of the material is based on the market and interest is followed by the bank. To encourage the Cooperative, the Agricultural Material Company



rewards the Cooperative 30 VND per kg of material sold. According to the cooperative head and other staff, the reward is fine and it could help the Cooperative to maintain their activities.

## 4. Contract Implementation

Most of the rice production area of the Cooperative's members is situated in a rather bad condition for transporting and furthermore, farmers do not have enough space to dry rice. And they could not afford to buy drying machines. Drying rice is a very big problem for farmers, particularly in a bad weather.

Though having drying problem, the Company still requires the rice grain moisture not above 15%, in fact, most of farmers could not meet this requirement. Besides, the impurity ratio that the Company requires is not suitable for the rice production in this area and also most of farmers could not meet this requirement, too. The criteria of no disease is too high, the majority of the farmers could not meet. Technical criteria that the Company applied are not suitable for farmers, and this leads to the contract broken.

Even though the failure of the contract, there is no harm for the Company as they did not invest anything to the farmers. When the contract broken, farmers easily sold their rice to traders even with cheaper price comparing with the Company proposed. Traders who understand the difficulty of drying rice in the region, therefore, they accept that. This is a more flexible character of traders than the state companies.

Though the contract between the Company and farmers failed, the contract of providing agricultural material was still valid till now. As cooperation with the Company, the Cooperative has stable material, little or unchanged price and capital for their business. The contract between the Cooperative and farmers could help farmers

solve the capital to invest in fertilizer and pesticide.

This is a preeminence because if not existing the contract with Cooperative, most of farmers would not have capital to invest in rice production. Moreover, price of material outside is normally more expensive. On the top of that, farmers could receive techniques how to cultivate rice and protect pest diseases. The Company could also benefit from this contract as they could sell the material. The income of farmers has increased comparing with before the contract signed.

## 5. Success/Failure Factors

The reasons failure of the contract farming between Loi Thuan and Tien Giang Food Company can be summerized:

- The requirements of the Comapny is too hard for farmers and farmers did not receive techniques equally
- The Company really did not want to purchase rice from the farmers due to high transaction cost and with the inconvenient transportation condition
- The main purpose of the company is only to sell agricultural material to farmers but not want to purchase their product

## 6. Lessons

In this case study, 3 lessons can be learnt:

- Mechanical applying contract farming is not suitable for rice product
- The Cooperative plays an important role in supplying agricultural material for farmers
- Reduce the requirements for purchasing rice in the contract if one wish to succeed.

**H**TX Mỹ Lương là một tổ chức nông dân tự nguyện, thành lập năm 2003. Chủ xướng thành lập là ông Huỳnh Nguyên Anh, hiện là chủ nhiệm HTX. Trụ sở HTX dùng ngay nhà ông Huỳnh Nguyên Anh.

Address: Luong Le Village  
My Luong Commune - Cai Be District  
Tien Giang Province.  
Product: Fruit  
Contract Scheme: Multipartite



## MY LUONG COOPERATIVE

## 1. Introduction

My Luong Cooperative, established in 2003, is a volunteer farmer group. Mr. Huynh Nguyen Anh, who set up the group, is the head of the Cooperative. The office of the Cooperative is situated at Mr. Huynh Nguyen Anh's house.

The Cooperative works as a share unit; farmers together gather their products, divide the work such as product classification, package, product protection. Their product, mainly fruit, is sold to big supermarkets in Ho Chi Minh City, Hanoi, Commercial Centers and some export and import fruit enterprises....The fruit mostly comes from Mekong River Delta, however, so far farmers deal with Long Co Co grapefruit, the famous fruit from Cai Be District, Tien Giang Province.

During 2 years (2003 - 2005), the Cooperative had not been able to earn any money but only since the beginning of 2006. However, the Cooperative only purchases about 30 - 35% the total amount written in the contract with farmers, the rest is from outside because farmer's products do not meet the customer's requirements.

The problems in maintaining and extending contract farming at My Luong Cooperative show that with the special product, the contract only can be succeeded when vertical corporation and strong support for registration of product's origin.

## 2. Emergence and Evolution of Contract

The formation of the contract was based on the need of farmers producing grapefruit. All the farmers as well as the head did not know anything about Decision 80/CP which encourages cooperation and selling agricultural products.

The official paper contract is signed between Cooperative (all members agreed) and fruit distribution enterprises. As it is not a single trader but a cooperative, therefore the contract formation from the Cooperative side is not easy. It needs high degree of unanimity of all members about articles in the contract, therefore, the association of all the members here is of great importance for the contract formation.

With the cooperation signing the contract with

enterprises, My Luong Cooperative asks for the capital contribution from farmers producing orange, grapefruit in My Luong Commune. Mr. Huynh Nguyen Anh asked permission of the My Luong commune authority to introduce all households in the commune the purpose, requirements and interests and obligation when joining into the Cooperative. After several months mobilizing, 12 household members together with Mr. Huynh Nguyen Anh established the Cooperative. They gathered and discussed activities and the way how the capital is contributed. Also, they elected a head, a vice head, a cashier and assigned work for each member in the cooperative based on their ability. However, as most of them are farmers, low education level (mainly primary school), therefore, they all elected and believed in Mr. Huynh Nguyen Anh who has the highest education level - completed high school- and he can register for operation as well as other activities such as marketing strategy.

The total initial capital of the Cooperative was 63 million VND, gathered from 21 shares from 13 volunteer household members. Average each share was 3 million VND in which 2 members contributed 4 shares (12 mil. VND), the rest was almost from each share (3 mil. VND). The Cooperative members are almost grapefruit producers. The total grapefruit production area of 13 members is about 10 ha, accounting for 12% grapefruit production area in the commune (My Luong Commune has about 690 ha producing grapefruit). With the yield of Long Co Co grapefruit at the moment 20 tones/ha/year, the amount of grapefruit of all members in the commune is about 200 tones/year.

Currently, average a month, the Cooperative signed contract with contributors with the amount of 7 tones/month, therefore, if collecting all the grapefruit of 13 household members, it can only sell 50% of the amount of grapefruit of the farmers. In fact, this figure only reaches 30 - 35% because of the requirement of the distributors. The Cooperative has to collect from other households that do not belong to the Cooperative because of the big amount of grapefruit of the farmers does not meet the requirement.

Post harvest activities such as cleaning, classification, packaging, labeling...as well as

marketing the products, building brand name...are done by cooperative members. The wage for the members doing post harvest activities is paid based on labor market price and the marketing product activity or selling-purchasing service is paid with real expenses...

Understanding the important role of advertizing the local special product, since its establishment, the Cooperative agreed to invest in building a brand name of Long Co Co grapefruit and has been issued certificate for the product.

After 2 year established, the Cooperative has to find partners to sign contract. Members, but mostly the head, take turn to go to main markets, supermarkets, commercial centers, fairs, business and export-import fruit companies ... They now have many contracts with supermarkets such as Intimex in Hanoi, Hai Phong; 4 Maximart supermarkets and Citymart system in Ho Chi Minh City and some fruit business companies...

### 3. Terms of Contract

Depending on conditions of each enterprise, the contract has specific articles, however, the following are main articles in the contract:

- The Cooperative has to distribute exactly the quantity and quality of the product that is ordered.
- The price is based on the agreement of both sides in each time, and with market price. Normally, the Cooperative informs the price 10 days earlier, the enterprise orders if accepting.
- The Cooperative has to supply all detailed information of product and be responsible for its origin, quality, hygiene, label under the current law.
- Payment to the Cooperative is normally 7 - 10 days after product distributed, but in some cases, after 1 month is accepted

### 4. Contract Implementation

Since the contract was signed, no one broke the contract law because both sides followed well the contract. However, according to some farmers and the head, breaking the contract law is likely to

happen at any time. From early 2006 to now, the Cooperative has been trying to maintain the signed contracts because the products selling to the distributors is increasing. However, the Cooperative has now high risk of breaking the contract law with enterprises because of lack of capital for activity implementation as well as many difficulties written in the articles on quantity and quality of ordered products of enterprises.

For instance, an average every month, 7 tones grapefruit is purchasing or selling with the price of 6,000 - 7,000 VND/kg. If culculated one time of product distribution, the enterprises own the Cooperative about 45 - 50 million VND, almost the same with the total capital of the Cooperative (63 million VND), excluded the late pay after 1 month and other expenses such as: transaction cost, office cost, wage for workers for classifying, packaging, transporting...

In addition, it is quite difficult for the Cooperative to follow the requirement of the product's quantity and quality applied for grapefruit. The Cooperative collects only about 30 - 35% of grapefruit from member's garden, because of the quality requirement, a big amount of grapefruit is not met. Output grapefruit is large but not equality, low quality because of the variety and missing the techniques of how to take care of. About 65 - 70% amount of grapefruit collected from other places, and this makes the Cooperative more difficult to maintain the contract.

Moreover, the purpose of farmers when joining in the Cooperative is to sell their product, but now they could not sell it, therefore, it makes them discouraged. According to many farmers, to reduce the risk of not be able to sell the product, they are trading with outside traders just in case the Cooperative does not buy their products.

### 5. Success/Failure Factors

All the members as well as the head of My Luong Cooperative reported that the purpose they gather together is to collect all their product that can be enough in quantity and quality for the enterprises. And they together build a brand name of their product so that more people would know about it. Joined in the Cooperative, farmers would officially

be able to deal with distributors, that means they could sell the product to final consumers but not through intermediate traders, hence, the price is higher. This is the reason that after 2 years nobody wants to get out of the Cooperative.

However, it is obviously seen that the main constrain here is the capital and grapefruit production techniques.

My Luong Cooperative totally uses the capital gathered from members to run the business, because of no collateral, the Cooperative could not borrow money from banks. Moreover, the Cooperative could not access to special credit or support from local authority. Household income of the members is just medium. The advantage of uniting the farmers is not been used. If all product from the members is collected, the pressure of lacking capital is not such a problem because they could receive the late payback. But in fact, grapefruit collected from the members is not much. The Cooperative could not delay the pay if buy product from outside. Nevertheless, product name is built, many contracts are signed, but the Cooperative could not develop.

The second constrain is the access to technical science of the My Luong Cooperative members. They stated that each year they participated 5 - 6 times in the production technique organized by Cai Be Extension Center but the subject was not suitable. For example, they could not follow the instruction of protection of the greening disease by

isolating between grapefruit garden with distance of 5 km. Grapefruit variety is not the same in the household, hence, the quality must be different.

It is clearly shown that the contracts of My Luong Cooperative is unstable; only one contract failed would lead the Cooperative owning a big debt and slowing down the activities. The reason can be seen is because the Cooperative could not receive any financial support from authority as well as production techniques from scientists for improving product quality.

## 6. Lessons

The case study of My Luong Cooperative shows us 3 lessons about contract farming:

- Due to the constrain of supporting the collaboration between state enterprises and farmers, the Decision 80 is far reaching to volunteer farmer organizations in the development of contract farming, including product such special grapefruit.
- One of the main encouragements for farmers to establish a cooperative is the demand to protect the product name and signment of selling product
- With special product, contract only success with vertical coporation and support for original registration.

Address: Tan Tinh Hamlet - Tan My Chanh -  
My Tho - Tien Giang Province  
Products: Vegetables  
Type of contract: Multiparty



## TAN MY CHANH COOPERATIVE

**T**an My Chanh Cooperative, which the full name is Tan My Chanh agriculture and general business Cooperative, founded since 1987 in the trend of cooperativeness national wide with 1200 cooperative members. In 1990, almost these cooperative members left the cooperative, leading the cooperative to bankrupt.



## 1. Introduction

Tan My Chanh Cooperative, which the full name is Tan My Chanh agriculture and general business Cooperative, founded since 1987 in the trend of cooperativeness national wide with 1200 cooperative members. In 1990, almost these cooperative members left the cooperative, leading the cooperative to bankrupt.

In the period 1992-1993, with the support of Tien Giang Province government, the cooperative has been reinforced and transferred to act as a dealer, collecting agricultural products, providing these products to big size consumers such as canteens, fruits and vegetables stores, fruits and vegetables processing factories... Furthermore, the cooperative also provided agricultural services such as constructing water supply station; constructing cattle slaughter centers to ensure the safe and hygienic condition.

The organization of the cooperative is professional, including the Board of chairman (3 persons), one Chief accountant, one cashier and Head of departments (i.e. Head of cattle slaughter center, Head of water supply station...). The total 20 officers in the Board of management are entitled salary and social insurance.

As reported by the chairman of the cooperative, some several business activities of the cooperative are profitable such as water supply services and cattle slaughter services (through cattle slaughter centers). However, dealing agricultural products activities are facing with difficulties, bearing the high risk although the cooperative are under support of commune government and Tiengiang Province agricultural sector. The cooperative is now taking profit from water supply services and cattle slaughter services to make up for activities relating to agricultural products dealing, especially vegetables.

The difficulties in developing agricultural products dealing activities in Tan My Chanh Cooperative this kind of activities is hardly to be success if the business size is small. In addition, well-managing the material zones and source of investment have helped resolve this problem.

## 2. Agricultural products dealing contract forming

As soon as reorganizing the management system of the cooperative in 1994, chairman of the cooperative, Mr Nguyen Ngoc Thanh (still be in power now) could foresee the demand of the market - large quantity, diversified and consistent categories and provided in time. These requirements could not be complied by individual farmers. Mr Nguyen Ngoc Thanh therefore reorganized the Tan My Chanh Cooperative as dealing agent between enterprises and individual farmers in distributing agricultural products.

To coordinate with individual farmers in distributing agricultural products, the cooperative cooperates with province agricultural sector to encourage individual farmers producing agricultural products, explain the benefit of coordination with the cooperative. All individual farmers thereafter feel comfortable as they have left the worry of selling products. However, due to the fear of cooperative model previously failed, no one sign on the writing contract, except for contract by mouth.

Otherwise, the cooperative actively contacts with enterprises and agricultural products distributing agents. This is favourable in the first step as there is a strong demand on agricultural products supplier that is professionally provided (specialized, regular and in order).

## 3. Terms of contract

The contract between individual farmers and the cooperative still not be in writing. However, the cooperative take the responsibility to provide capital and input materials. In addition, the cooperative sign contract with Agricultural Promotion center of Tiengiang Agricultural and Rural Development Department to provide the farmers with advanced cultivate techniques. This therefore will be a strong relationship between individual farmers and the cooperative.

Tan My Chanh Cooperative provides agricultural products under order of enterprises and distributing agents. The quantity, category and quality of products under the order of the

customers, mostly are daily order, order this afternoon should be carried out in the noon of the day after at the latest. The price is the market price of that day. The certified price table of the cooperative will be delivered when delivering products. The payment is implemented once at the last day each month.

Before signing contract, the cooperative and enterprises sign on a description on size, standard, quality, category of provided products. If the cooperative failed to meet with the requirement stated in the description,... or the distributing agents do not make payment or delay in payment, they will be penalized or brought to court.

## 4. Contract implementation

Tan My Chanh Cooperative is not an organization of individual farmers (they do not contribute capital) but is necessary as they bring about the market for their products while agribusiness enterprises are unwilling to sign contract with them directly. In addition, the cooperative acts under the market orientation. Whatever the market demand, the cooperative try to satisfy after considering gain and loss. The cooperative is in strong position as it has experience and abundant capital. This is the sufficient condition for the success of distributing agricultural products activities.

In fact, from the beginning, there is not any conflict among the cooperative and individual farmers, distributing agents. However, small dispute incur daily with subjective and objective reasons. The result is usually the agreement among three parties: the cooperative and individual farmers, distributing agents as they all acts unprofessionally. This leads to the difficulties for implementing the contract, as follows:

- The individual farmers produce separately; each household has average 1-2 ha but produce many kinds of products (no one produces only one kind). This household rears chickens and pigs; that one rears goat and grow aubergine, Chinese pea, pumpkin buds; the other grow cucumber and many kinds of vegetables and rice. In addition, due to invested capital is limited (although the cooperative lending, households dare not to

borrow a lot as the interest rate is 0,3-0,5%/month), households cannot meet the requirement of the consumers on the high quality and productivity products.

- The cooperative should provide many kinds of products in too short time (after order under 1 day and the labour cost therefore will be high to meet this requirement), the monitoring agricultural products collected from households has not been done well and professionally, the rejected products rate is high (20% for rau an 1) doubled the cost of good sold make the distributors unsatisfied. They therefore threaten to cease the contract or delay in payment. Because of the above drawbacks, it is difficult for the cooperative to broaden the market, the most contracts are with minor distributors. The administrative expense is high but profit is decreasing in line with the harsh competition (from distributors, enterprises).
- On the enterprise side, the distributors are making petty dealing, tend to force the producers (delay payment, good or bad quality of products are justified emotionally) make them get bored as they cannot cope with.

## 5. Reason for failure

There are two reasons for the decreasing of the cooperative's revenue and the unstable agricultural products contract, i.e. capital and approach market capability.

Contract signing method is common and uneven. Although this kind of contract is considered flexible and suitable to the small producing condition of individual farmers, the limited managing capability of the cooperative and the unprofessional business style of buyers are the obstacle for success of this kind of contract if parties wish to increase profit.

The contracts between the cooperative and individual farmers are passive as the contracts with distributors are generally common and in principle. The orders are made in advance several days, even 1 day. The quantity order is small (maybe tens of kilograms vegetables). Price in the contract is the price at the delivery and the payment is only made at the end of each month.

This forces the cooperative to have abundant fund as it commit to pay for individual farmers 3 days after delivery.

On the other hand, the cooperative is incapable of creating and developing the market (i.e. marketing, collecting, clarifying products in large size, creating brandname...). There exists risk of breaching the contract with enterprises while losing reputation with individual farmers as being in passive position in the quantity and price as enterprises may not agree despite of signed contract. The product selling is still be unstable. The individual farmers do not know the required quantity to make plan from the beginning leading to the instability, the price is forced to be unfair. In fact, in case the cooperative do not have orders and individual farmers should find other dealers to sell their products.

Due to these weaknesses, there are distributors around My Tho signing contracts with the cooperative in small size but diversified categories make the cooperative difficult to increase profit.

## 6. Experiences

There are experiences from Tan My Chanh Cooperative as follows:

- Agricultural products contracts is difficult to be success if the production size is small and separated.
- Well-managing the material zones and source of investment have helped resolve this problem
- Improving business skill of the Board of Management of the cooperative
- The contract is considered as succeed if parties are satisfied and trust each other. In the relationship between individual farmers and the cooperative, individual farmers suffer loss and take the high risk. In the relationship between distributors and the cooperative, the cooperative feel uncomfortable as quantity and price is forced by the distributors, the cooperative therefore in unstable position.

Address: Long Dinh commune,  
Chau Thanh district, Tien Giang province  
Product: Pineapple  
Contract Scheme: Intermediary and Informal



## TIEN GIANG FRUIT AND VEGETABLE JOIN-VENTURE COMPANY

**O**riginal of Tien Giang fruit-vegetable joint-venture company was Tien Giang fruit - vegetable company under the management of Tien Giang Provincial People Committee, which was equitized in the late 2005. The company focuses on fruit-processing, in which pineapple is a main product since establishment. The enterprise has pineapple processing factory with the use of the most modern technology in Vietnam and the capacity is 10tons of product per annum. This was a case of co-failure in the years 2000-2002 but it has been successful since 2003.

## 1. Introduction

This typology of contract mainly serves materials for processing company and it is hard to upgrade the products due to the informal relationship model. Simultaneously, the beneficiary of farmers is very low compared to dealers and enterprise regarding to this contract type.

## 2. Emergence and Evolution of Contract Farming

It is necessary to have huge volume of fresh pineapple in accordance with certain standard and timely supply in doing the business of pineapple processing for export. Therefore, the enterprise needs to sign contract of production and fresh pineapple supplying with other parties. There are two parties which supplied fresh material to the company which are households allocated before 2003 and mainly dealers since 2003.

Along with the establishment and development of pineapple processing factory, the factory's input-supply zone has been established and developed since 1980s and its area was 3500ha in 2002. During this period, the company signed the contract with households who got land allocation through their representative as farm. The signature of agreement mainly came from the company's needs of materials, and the allocated households had to sign contract with farm, then they could be allocated land for production as land was farm's property. Therefore, the agreement formed in this time was not a result of voluntary agreement from both parties but mainly was from company's interest. In the implementation of agreement, the benefit conflict raised and was a big problem in 2000-2002 when the allocated households reacted and reneged the contract. Since then, the input procurement was a major constraint for the company and as the business still needed to have fresh pine-apple, company has signed agreement for fresh input with the dealers from 2003 forward.

## 3. Terms of Contract

Before 2003, Tan Lap farm was a representative of the company for signing agreements with

households who got allocation (Tan Lap farm was controlled by Tien Giang fruit-vegetable company). The main terms of agreement were that, households received supply of materials and fund under the service of advanced receival and back payment, technical instruction, supervising production and procurement. Contract farmers had to make commitment in the contract to grow pine-apple on the relocated land and deliver allocated-produce to the sponsor (land still was controlled by farm).

According to contract, the households were not allowed to sell the produce to other except their sponsor and the price was completely decided by the company. Annually, company balanced among the value of pine-apple supplied by households with the advanced credit support and the responsible payment, if there was any portion left then household might be further received and if there was any deficiency then this would be accounted to the next season.

As time of contract went by, households recognized that the calculation of the sponsor was not transparent and contract prices were often set lower than the spot-market prices, which made the disadvantage for the households. Initially, only few households reacted, then it spread out. Then, the company and local authority had to jump in but the conflicts could not be solved. As a result, the agreement was breached, and land was not completely managed by farm any longer. Some households got allocation, which have already paid discounted credit for land reclaiming and fee for growing pine-apple to farm, have right to use the land, and right of self investing for production and sell their products to any one with the spot-market price.

Since then the role of Tan Lap farm changed completely, households themselves could buy materials and fertilizer, self invested and sell their pine-apple to any dealer with the market prices. Tien Giang company then lost their control of input and new cooperative was formed as the company moved to buying contract with dealers.

Therefore, Tien Giang fruit-vegetable company started signing contract of input directly to the traders or co-operative group of growing pine-apple instead of contracting with the

households. It moved from dealing with hundreds of contracts with individual households to only 70-80 agreements with dealers only and the supply of fresh pine-apple reached to 25000-35000tons/year.

Terms in agreement between the enterprise and traders were quite clear. Tien Giang fruit-vegetable company (party A) signs a trading pine-apple agreement with dealer (party B). Party B sells products to party A with the volume, rules, prices and output progress according to the time set in the contract. In addition, party A will be responsible for paying according to the volume, price and method of payment set in the contract. Furthermore, party A did not invest capital and material to party B. Moreover, party A has responsibility in checking, supervising and reminding party B in implementing the agreement as well as checking quality of products delivered by party B. Before signing the agreement, both parties negotiated about the price, product standard, output of product types and time for delivery the products as well as the method of payment. The set up of price for the next six months would be based on the factual price of the past 6 month contract and annually changing price rule.

#### 4. Contract Implementation

Before 2003, market of pine-apple strongly changed and many dealers procured pine-apples not only from farmers who grew pine-apples on the farm's land but also from other farmers in Tien Giang. However, households received allocated land and signed contract with company could only sell their pine-apples at the price set by the company but not by the market price. This raised the conflict and households did not accept the fixed price of the company.

According to households, price fixed by enterprise was lower than the spot-market price and the fee for fertilizer and materials was not transparent, leading to the disadvantage for the households. In addition, the categorization of qualified pine-apple and the price of materials were not clarified and households lost the trust to the company.

In general, the enterprise did not get the significant disadvantage, but instead it got the

high quality and quantity of input at the lower price than the market price due to the allocated contracts and tight management of processing procedure and delivered input.

The enterprise did face the constraints of input only since the breach the contract between firm and households (2000-2002). This difficulty was soon overcome as firm cooperated with dealers for input materials, however, the company has been challenged by the difficulty of monitoring the input quality especially the amount of nitrate contained in pine-apples.

The business has started procurement of input from local dealers since 2003. Because the input supply was variable and there was a crowd of dealers nearby the firm, finding partners and signing the agreements were quite convenient, resulting in stable supplying source of input with stable prices (as the agreed price lasted for 6 months of contract) and this helped company having secure scheme of processing and trading products regarding to quantity and prices.

Regarding to the dealers, they had a stable market outlet of the products based on their agreements with company. However, it was not easy to implement the contracts especially having the uniformed products. The traders themselves have to find the material zones and contracts (normally oral contracts) with farmer households in order to meet the deadline of the contracts. Though, there was no close relationship between dealers and farmer households, dealers could not manage the production procedure as well as the quality of pine-apples.

In addition, although the technicians of company also trained farmers and gave instructions on using fertilisers and agro-chemistry two months in advance of extraction, it was difficult to manage the growing procedure of the farmers (farming land now is private property). Moreover, there is no legal binding between the company and pine-apple growers, so that farmers put down additional fertilizers and use stimulating substances to have big pine-apple when the price of pine-apple went up, leading to existence of chemical in pine-apple products.

Due to the procurement of pine-apple from many spots, the quality of input was not the same, the



amount of nitrate was high which affects the processing pine-apple for export, this is a difficulty and constraint that company was facing at the moment.

Regarding to the dealers, they had to face with the challenge of changing market-price of pine-apples meanwhile the contracted price with enterprise was fixed. As market price goes down, dealers get benefit. Vice versa, as market price of pine-apple increases, dealers get disadvantage, eventually they can not accomplish the contract with company due to the competition with other traders.

In fact, there were some cases of breaching the contract since dealers could not meet the deadline of product delivery or failure of input categorization. The interested point in this linkage (farmers-dealers-firm) was the loose binding of the farmers with dealers as well as the enterprise. Therefore, there was a difficulty in managing the productin procedure and the output resulting in unequal quality of input and the instable supply.

## 5. Success/Failure Factors

The failure before 2003 was the unfair participation of farmer households in appraising pine-apple price in the agreement. The price was fixed by company only, which did not match with the market price. Furthermore, the calculation and balancing between farmers' input and their advanced loan were not transparent. The farmers' benefit was violated for a long time without the caring of the company, so definitely the contracts were breached.

The agreement between company and dealers since 2003 has been successful because it still remains the number of cooperating dealers and the total of input was not declined. However, the shortcoming was the insufficient management of fresh pine-apples for input due to the non-existence of legal binding between farmers and enterprise.

The success of agreement between enterprise and traders was the harmonizing combination of benefit for both parties: enterprise had input for processing, the traders had stable market for output, the terms of contract was clear and straight payment. According to Tien Giang fruit - vegetable company, the enterprise did follow the Decision 80/2002.QD-TTG dated on 24/06/2002 issued by Prime Minister which was an encouraging policy for agro-product consumption through contract, but the sanctions for excution of the breaching contract were invalid.

## 6. Lessons

The lessons learnt from this case study were:

- The contracts through intermediary and informal may appear just due to the material needs of the enterprise, which did not take into account the needs of farmers.
- It's difficult to promote the products with this typology of contract
- The beneficiary of farmers was very low in comparison with dealers and enterprise with this typology of agreement.

# M4P Publications

The Asian Development Bank-Vietnam Resident Mission is currently implementing a regional project covering Cambodia, Laos and Viet Nam entitled "Making Markets Work Better for the Poor" (MMW4P). The purposes of the project are to: (a) conduct analytical work on the functioning of markets and the extent to which the poor are able to benefit from them, and (b) to build capacity to support pro-poor market development through research activities, networking and the promotion of policy dialogue in the three project countries.

In order to make the results of the various research activities more widely available, the project produces the following types of regular publications. These are:

- The **Markets and Development Bulletin**, a bimonthly newsletter on topical market-related issues produced jointly with the Mekong Private Sector Development Facility (MPDF) and the Central Institute for Economic Management (CIEM).
- **M4P Briefing Papers** - Short, four page, summaries of research work aimed at a general non-technical audience
- **M4P Discussion Papers** - more in-depth 20-30 page reports on research projects covering methodologies, results and policy implications. These are aimed at practitioners and policy makers in the subject area of the research.
- Other reports



## MARKETS AND DEVELOPMENT BULLETIN (MDB)

- No. 1 Adding Values to Vietnam's rice industry and Improving the Incomes of the Poor
- No. 2 Linking farmers to Markets through Contract Farming
- No. 3 Empowering the Poor by Strengthening Formal Rural Land Titles
- No. 4 Pro-poor Branding Labeling and Trademarks for Agricultural Products
- No. 5 Taking the next step: what influences the Decision of Household Businesses to Formalize into companies
- No. 6 Migrant & Non-migrant workers: positions & opportunities
- No. 7 The Participation of the Poor in Supermarket and other Distribution Value Chains
- No. 8 Agricultural land conversion: competing interests of the poor
- No. 9 Collective action: Make it Work Better for the Poor
- No. 10 Public Private Partnerships to improve infrastructure services in Viet Nam
- No. 11 Making Markets Work Better at the Base of Pyramid (BOP)
- No. 12 Rural Labor Market and Migration: Impacts and Solutions

- No. 13 Improving street vending management and support in Hanoi
- No. 14 Public Private Partnerships to improve infrastructure services in Viet Nam

## **BRIEFINGS**

- No. 1 Linking the Poor with Rice Value Chains,
- No. 2 Private Enterprises Formality and the Role of Local Government,
- No. 3 The impact of Land market process on the poor: Implementing De Soto,
- No. 4 The participation of the Poor in the Value Chain for Tea,
- No. 5 Efficiency and Effectiveness of Microfinance in Viet Nam - Evidence from NGO schemes in the North and South Regions
- No. 6 Issues of Contracts: Applications to Value Chains in Vietnam
- No. 7 Lessons of Transition for Understanding the Functioning of Markets
- No. 8 Functioning of Markets and the Livelihoods of the Poor
- No. 9 Strategies For State-Led Social Transformation: Rent Management, Technology acquisition and Long-Term Growth
- No. 10 Commercialization and Poverty Reduction
- No. 11 Participatory Livelihood and Market Assessment in Da Nang city
- No. 12 Labor Market Segmentation and Poverty
- No. 13 The Participation of the Poor in Supermarkets and other Distribution Value Chains Synthesis
- No. 14 Industrial and commercial markets and their impact on the Poor
- No. 15 Facilitating Market Integration of the Upland Poor into Bamboo Value Chains: Upgrading Strategies for Local Producer Groups
- No. 16 Rural labour markets and Migration

## **DISCUSSION PAPERS**

- No 1 The Participation of the Poor in the Value Chain for Tea
- No 2 Private Enterprise Formality and the Role of Local Government
- No 3 The Impact of Land Market Processes on the Poor: Implementing De Soto
- No 4 Market Systems and Poor Communes
- No 5 Factor Markets in Viet Nam: Capital - Labor - Land
- No 6 Communication Strategy: Engaging and Connecting People
- No 7 Agricultural Commercialization, Value Chains, and Poverty Reduction
- No 8 Participatory Markets and Livelihood Assessment in Da Nang City

- No. 9 M4P - An introduction to the concept
- No. 10 Labor Market Segmentation and Poverty
- No. 11 The Participation of the Poor in Supermarkets and other Distribution Value Chains Synthesis
- No. 12 How can research-based development interventions be more effective at influencing policy and practice?
- No. 13 Vietnam: Towards Universal Social Protection: Private Mechanisms to Reach the Poor Policy Issues and Research Implications
- No. 14 Industrial and Commercial land markets and their impacts on the poor
- No. 15 Facilitating Market Integration of the Upland Poor into Bamboo Value Chains: Upgrading Strategies for Local Producer Groups
- No. 16 How Can Cohesive Networks of Exchange Help the Poor in An Giang Province?
- No. 17 Trends and Regional Variations in Household Consumption Patterns in Vietnam: Analysis of Vietnam Households Survey data
- No. 18 Rural labour markets and Migration

## OTHER PUBLICATIONS

- 1 Entrepreneur - Overcoming poverty through enterprise (15 cases)
- 2 Institution workshop: Which institutions are critical to sustain long term growth in Viet Nam?
- 3 Inception Workshop: Making Markets Work Better for the Poor, November 2003
- 4 Linking Farmers to Markets through Contract Farming
- 5 M4P week 2005 - workshop proceedings
- 6 Entrepreneurs: The road to success (30 cases)
- 7 Supermarkets and the Poor in Viet Nam
- 8 Entrepreneurs - successful links to markets
- 9 Collective Actions: Ideas and Opinions (download only)
- 10 Participatory Markets and Livelihoods Assessment (PMA) Handbook
- 11 Value Chain Handbook
- 12 Contract Farming - 30 case studies book
- 13 Public-Private Partnerships (PPPs) workshop proceedings
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