



Making Markets Work Better for the Poor

Linking farmers to markets through

# CONTRACT FARMING

Proceedings of an M4P / An Giang University Workshop



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**LINKING FARMERS TO MARKETS  
THROUGH CONTRACT FARMING**

Hanoi, October 2005



# FOREWORD

In January 2005, the ADB-DFID-ADBI Making Markets Work Better for the Poor (M4P) Project and An Giang University jointly supported a workshop in Long Xuyen in An Giang Province to share experiences and discuss **Contract Farming in Viet Nam**.

The M4P Project conducted two value-chain studies during 2004 on tea and cassava; a third on supermarkets is in progress. Research from these studies has indicated a number of cross-cutting issues that have importance in the context of value-chains in general and warrant further discussion. During 30 November and 1 December 2004, two of these issues were discussed in depth: branding/labeling and contracts. A third cross-cutting issue -producer associations and cooperatives - was also identified and discussed in the context of both branding and contracts, as it is one of the unifying themes behind both of these issues.

The feedback from these discussions highlighted contracts and contract farming as an area of significant interest in the Vietnamese agricultural sector. The workshop in An Giang brought together national and international researchers, policy makers, civil society representatives, businesses, and farmers to share experiences and ideas related to contract farming in Vietnam and to discuss ways to further strengthen the rapidly developing contract farming systems in Viet Nam. This volume contains a number of the presentations made at the workshop and a summary of the group discussions undertaken at the workshop.

Dr. Dao The Anh and Dr. Vu Trong Binh from the Agriculture System Department of the Viet Nam Agriculture Science Institute discuss practical examples of the development of agricultural production contracts and the effects of cooperative action on the livelihoods of the poor, based on experience gained in projects in Northern Viet Nam.

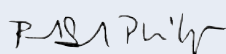
Dr. Nguyen Tri Khiem from the Economics and Business Administration Department of An Giang University discusses examples of the development of agriculture contracts in An Giang province, including case studies of agricultural contracts for rice, fish, and cabbage. The case studies highlight elements of the contract process including the legal framework of the contract, its contents, and arrangements for management, and implementation of the contracts.

Martha Roberts and Nguyen Tri Khiem from An Giang University present an analysis of the linkages between product quality level and contract fulfillment, using the example of rice production in An Giang province. The paper highlights the fact that contract farming has a higher chance of success when products are more specialized and of higher quality level.

Le Van Tam, Chairman of the Lam Son Sugar Joint Stock Company, presents an interesting overview and discussion of the challenges and methods for achieving successful cooperation with farmers and farmer groups. The discussion is based on the successful experience of the development of the Lam Son Sugar Company in Thanh Hoa Province and its transformation into a joint stock company.

Nguyen Van Dam, Director of the Hoa Thuan Cooperative in An Giang Province, presents some of the achievements of the Hoa Thuan Cooperative and outlines the lessons learned in the process of developing cooperative through contract farming. Finally, the proceedings volume concludes with a summary of the results of group discussion among the participants.

We hope you find the collection both stimulating and useful. The full set of papers is also available at <http://www.markets4poor.org>.



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# MAKING MARKETS WORK BETTER FOR THE POOR

Alan Johnson  
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## 1. Summary of Making Markets Work Better for the Poor

Making Markets Work Better for the Poor (M4P) is a 3-year<sup>1</sup> Regional Technical Assistance Project covering Viet Nam, Laos, and Cambodia, financed and administered by the Asian Development Bank (ADB) and co-financed by the Department for International Development (DFID) (UK), and the Asian Development Bank Institute (ADBI) (Tokyo). The project has an original total value of USD2.4 million. The project value has been increased to USD2.5 million as a result of co-financing from The Australian Agency for International Development (AusAID) effective in 2005.

There are two main purposes to the M4P Project. Firstly, the project aims to conduct analytical work on the functioning of markets and the extent to which the poor are able to benefit from markets.

Secondly, the project is involved in building capacity to support pro-poor market development through research activities, networking, and policy dialogue.

## 2. Major Research Topics

Under the M4P Project, research has been undertaken on a number of topics related to the functioning of markets and their impact on the poor.

### Strategy

- Research on cross-cutting issues related to institutions, markets, and growth

### Globalization

- The increasing commercialization and global linkages of the agriculture sector
- Value chains: supermarkets, cassava, tea, cross-cutting issues (contracts, branding, associations).

### Factor Markets

- Rural land market processes
- Labor market segmentation

### Livelihoods

- "Formalizing" the household enterprise sector.
- "Listening to the poor": participatory market assessment in Da Nang.

## 3. Process of Commercialization

Agricultural commercialization refers to the transition from subsistence or "own" production to an increasingly complex production and consumption system based on markets and other forms of exchange between producers and consumers. Agricultural commercialization is a process involving the transformation of the rural economy into a system where nonfarm activities are the main source of income and employment. Central to this process is the development of agriculture into a commercial system, including agribusiness. While agribusiness enterprises are recognized to be fundamentally motivated by profit-making

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<sup>1</sup> Implementation period is from November 2003 to December 2006.

opportunities, enterprises engage in investment, create employment, and add value to agricultural commodities, thus stimulating growth in the economy.

Agricultural commercialization is defined by varying degrees and dimensions. A low degree of commercialization would be farm production essentially taking place for subsistence purposes with any surplus sold to the market. At high degrees of commercialization, farmers produce only for the market and are integrated with dynamic urban and international markets. In the latter case, farming is a profession rather than a way of living; production is specialized and based on modern technology; and income stabilization and profit-making, rather than food security, are among the major concerns of farmers.

In the movement from subsistence to higher degrees of commercialization, different dimensions such as farming systems, technology, marketing, finance, infrastructure, and the role of consumers take on different values.

### Key challenges

A new view of agricultural development has emerged. Developing countries that have already achieved a basic level of food security should address the key challenge: How to accelerate the transformation of an agricultural system still largely focused on production of grains to a system that is able to meet the changing demand for food within the context of a global agri-food system, while ensuring food security for the population, generating adequate income for producers, and smoothing the transition to an economy where most of the employment will be in nonfarm activities.

The challenge is formidable. Given that majority of the population is rural, most of them derive their livelihood from agriculture, and most of the farmers are smallholder households. To face competition from the global agri-food system, smallholder farmers will require new organizational forms that allow them to benefit from integration with global food chains. Small farms will not be able to generate sufficient productive employment for a growing labor force; declining commodity prices will set in motion a process of land consolidation and increased generation of value in off-farm activities; and the agricultural system will increasingly be dominated by enterprises involved in the

transformation, finance, distribution, and trade of agricultural products.

In the context of Vietnamese agriculture, the challenges can be summarized as:

- Increasing the competitiveness of Vietnamese agriculture and rural businesses;
- Linking the poor to this process;
- Generating higher returns to labor;
- Participating in global value chains to achieve these aims.

## 4. The value chain approach

Value chains are organized linkages among groups of producers, traders, processors, and service providers (including non government organization [NGOs]), who join together in order to improve productivity and the value added of their activities. By joining together, the actors in a value chain increase competitiveness and are better able to maintain competitiveness through innovation. The limitations of each single actor in the chain are overcome by establishing synergies and corporate governance rules aimed at producing higher value.

The main advantages to commercial stakeholders of being part of an effective value chain consist of being able to reduce the costs of doing business; increasing revenues; increasing bargaining power; improving access to technology, information, and capital; and, by doing so, innovating production and marketing processes in order to gain higher value and provide higher quality to customers.

A value chain approach focuses on the interaction of actors along each step of the supply chain. Such an approach thus considers trade relations as being part of a series of networks of producers, exporters, importers, processors, retailers, and service providers, where knowledge and relationships are developed to gain access to markets and suppliers. The success of stakeholders in adding value to their production lies in their ability to access these networks.

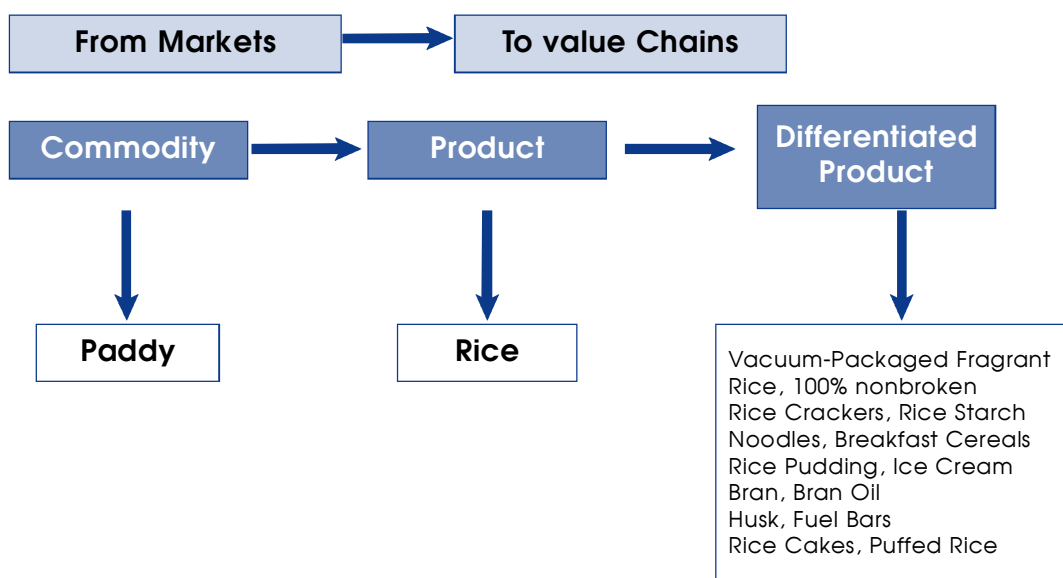
Several concepts are central to the understanding of value chains, including the concepts of linkages, coordination, corporate governance, consumer demand, competitiveness, innovation and distribution. Box 1 and Figure 1 summarize the key concepts.

**Box 1. Key Concepts in Value Chain Analysis**

- The value chain organizes business linkages by encouraging stakeholders to work together.
- Effective coordination of decisions and exchange are required for different actors in a value chain to work together effectively.
- The rules regulating the coordination within a value chain constitute the governance of the chain.
- Increase value, the value chain needs to meet consumer demand.
- Meeting consumer demand is not enough. The actors in the value chain need to meet consumer demand better than actors outside of the value chain: the value chain actors have to be competitive.
- The value chain needs to innovate continuously in order to maintain competitiveness, otherwise their initial gains in competitiveness will be eroded over time.
- For the chain to establish effective linkages, it needs to distribute benefits that provide incentives to the participants. If only one party in the value chain appropriates all the benefits, the chain will not be sustainable in a market system.

Source: (Goletti 2004b)

**Figure 1: From Markets to Value Chains**



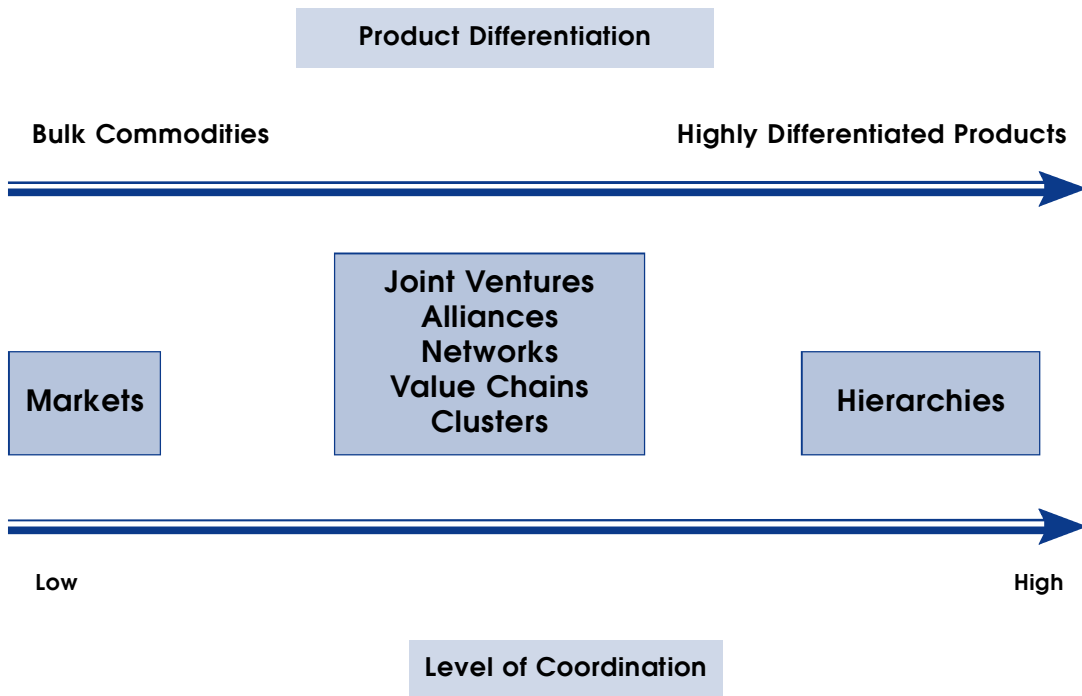
**5. Contract farming and complexity of coordination**

Whilst the above outline of the importance of value chains may give the impression that contract

farming<sup>2</sup> is the most suitable response to the increasing commercialization and globalization of agriculture, contracts may not be the most appropriate form of procurement in some cases.

<sup>2</sup> A contract (in agriculture or otherwise) codifies the rules of transactions through the allocation of three key elements: value, risk, and decision rights. A successful contract will thus allocate value, risk, and decisions in a way that is mutually beneficial, ideally sharing risk, and improving quality and production. (Sykuta, M. and Parcell, J. 2002. *Contract Structure and Design in Identity Preserved Soybean Production*. Contracting and Organizations Research Institute (CORI) Working Paper No. 2002-01. Columbia: University of Missouri.

Figure 2: Increasing Complexity of Coordination



In this regard, some of the questions to ask are: How specialized is the product produced by the factory? Are there specialized quality or production practices that require greater coordination? As shown in Figure 2, as specialization of the product increases, the greater the efficiency and suitability of procurement by contract.

Organization of farmers and value chains to facilitate contract farming systems incurs

transaction costs that are higher than those incurred when farmers sell directly to the market. Are the transaction costs of increased coordination through contracts worth the additional benefits gained?

The key question in regard to contract farming systems is: Can the market provide as well as a contract? If the answer is "yes," then contract farming may not be the most suitable modality for the exchange of products.

# ISSUES OF CONTRACTS: APPLICATIONS TO VALUE CHAINS IN VIET NAM

**Alan Johnson**  
**Project Coordinator**  
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## 1. Overview

The Making Markets Work Better for the Poor (M4P) Project conducted two value chain studies during 2004 on tea and cassava; a third on supermarkets is in progress. Research from these studies has indicated a number of cross-cutting issues that have importance in the context of value chains in general and warrant further discussion. From 30 November to 1 December 2004, two of these issues were discussed in depth: branding/labeling and contracts. A third cross-cutting issue - producer associations and cooperatives - was also identified and discussed in the context of both branding and contracts, as it is one of the unifying themes behind both of these issues.

The feedback from these workshops highlighted significant interest in these topics and demonstrated the need for further in-depth research. This concept note summarizes some of the issues with respect to contracts, offers such research questions, and presents a proposal for research for 2005.

## 2. Background

Contracts are an important mechanism in which to coordinate production, distribution, and retail arrangements between different actors in the value chain. In the context of agriculture, Eaton and Shepherd (2001) define contract farming 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". However, the

main idea behind contracts is that they establish the "rules of the game". Specifically, following Sykuta and Parcell (2002), a contract (in agriculture or otherwise) codifies the rules of transactions through the allocation of three key elements: value, risk, and decision rights. A successful contract will thus allocate value, risk, and decisions in a way that is mutually beneficial, ideally sharing risk, and improving quality and production.

Contracts will typically specify various details regarding the terms of trade (e.g. prices, quantities, delivery dates, payment terms), and input provision and production specifications (i.e. the use of particular production practices). At the same time, not all terms will be formally specified; indeed, there are often good reasons to leave certain terms unwritten to prevent future holdups in the wake of changes in market conditions (Klein, 1996; Gow et al., 2000). However, it is important in any case that enforcement mechanisms exist, whether formal or informal, that mediate disputes and sustain long-term relationships between parties. Indeed, where risk is a major component of transactions, contract flexibility is common, requiring high levels of social capital to enforce such relationships (Bigsten et al., 2000).

Contracts tend to work better where markets are stable and demands for quality and coordination in the value chain are greater. Where production is less specialized and relatively undifferentiated, contracts may be suboptimal compared to market forms of procurement, due to the high levels of transaction costs in coordinating small producers (Williamson, 1989). Indeed, anecdotal evidence

from Viet Nam has indicated difficulties in contracting lower quality products-the Viet Nam News (28 January 2004) reports an instance in the Mekong River Delta in which only 10% of rice that was contracted was actually delivered, most of which was high quality. In addition, balance between actors in the value chain - in terms of market concentration, power, and organization - needs to be balanced to facilitate relationship-building. Poulton et al. (2004) recently noted that contracts in Africa were more successful where there was neither monopsony buyer power nor perfect competition among buyers.

Many different types of contracts can be employed depending on the type of product and partners in the relationship. In the context of agriculture, Eaton and Shepherd (2001) identify five types: centralized, estate, multipartite, informal, and intermediary contracts. Centralized and estate contracts are strict forms of vertical coordination between producers and buyers in which quotas are allocated to producers to produce a pre-specified amount of goods. Such contracts are common where processing specifications are high, such as in export crops, tree crops, and meat products. Estate contracts differ from centralized contracts only in the sense that buyers also own the land used by producers. Multipartite contracts involve multiple actors, such as government and companies that are coordinated in relationships between producers and buyers. Informal contracts are often oral contracts between parties to meet demands for seasonal production and are found in fruits, vegetables, and other products that require minimal processing. Finally, intermediary contracts are made between buyers and traders rather than directly between buyers and producers. These are often utilized in situations where there are too many producers for buyers to monitor and thus such decisions are subcontracted to traders; these contracts are quite common in Viet Nam. In such contracts, traders and producers usually interact according to a market or informal type of relationship. Such contracts are often imbued with the difficulties of managing consistent quality. Other contracting forms undoubtedly exist, though all contracts have at their core some aspect of how trade, value, and risk are to be shared, either explicitly or implicitly.

The enactment of Decision 80<sup>3</sup> in 2002 by the Government of Viet Nam has attempted to increase the use of contracts to improve procurement and efficiency in the rural economy. The Government has attempted to provide incentives for parties to engage in contract arrangements by providing favorable access to finance, land, and infrastructure. However, contracts under Decision 80 have largely been unsuccessful to date.

Anecdotal evidence from the value chain studies conducted under the M4P Project for tea and cassava suggests that three main issues have compromised such contracts. Firstly, farmers have been accused of renegeing on contracts when higher prices are offered from traders. This has particularly been the case with cassava, where large factories have had difficulties procuring consistent volumes of cassava from producers, who tend to prefer sales to traders with more transparent buying arrangements. Secondly, when buyers are faced with oversupplies of products from contracted producers, quality standards are sometimes tightened so processors can reject unwanted output. Thirdly, knowledge of contractual obligations by parties in the contract is often lacking. Other issues with contracts under Decision 80 have been product-specific. In tea, contracts are sometimes procurement contracts that are not based on price, which disadvantage the farmers who linked to state-owned enterprises during the market downturn in 2003. Contracts have largely failed in cassava, as most are made between factories and traders, with limited coordination with producers. While there is a rationale for making contracts with traders due to lower monitoring costs, the end result has been inconsistency in both quality and volumes delivered.

For contracts to be successfully employed in Viet Nam, several key areas need to be improved. First, it must be recognized that contracts may not work for all products and that the "one size fits all" approach of Decision 80 may hurt, rather than help, producers and buyers. Second, the failure of contracts in Viet Nam is due in large part to coordination failures among parties that stem from the limited organization of producers and imbalances in market relationships. Third, greater

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<sup>3</sup> Decision 80 in the context of this paper refers to Decision 80/2002/Ttg of the Prime Minister.

education will be required in both the public and private sectors to educate those engaged in contracts on their contractual obligations and to develop enforcement mechanisms (formal or informal) that improve the governance of contracting relationships. Combined, these issues suggest greater strengthening and tightening of the value chain through improved organization, particularly among producers. At the same time, this has implications for the poor in terms of their participation in contracting relationships and whether they can benefit from the development of such long-term relationships to raise quality and improve production practices.

### 3. Research questions

The background in the previous section suggests a number of potential research questions that could be pursued further. Three research questions are provided.

**Research question 1:** *In what sectors can contracted production successfully facilitate marketing arrangements between buyers and sellers?*

As noted earlier, contracts do not work for every product. Where products are relatively undifferentiated, the costs of organizing the value chain to utilize contracts are high relative to engaging in market-based transactions. As products become more specialized and issues of quality and process more important, greater coordination is required and contracts are potentially more useful. Determining the "crossing point" for specific products, in terms of the level of quality or product specificity required, is an empirical question and can verify whether such contracts are a more useful form of value chain governance than reliance on the market.

A related question on this topic asks whether the poor are engaged in producing goods that would benefit from the increased use of contracts. If so, are the poor better off if they engage in contracted relationships and what are the key factors for success? If the poor are being excluded from such types of production, what are the preconditions that are lacking that preclude their participation (e.g. limited organization, lack of technical capacity, limited resources, or high transactions costs)? Are there interventions that could be conceived that

alleviate such constraints? What role then do donors, NGOs, and Government play in assisting the poor to engage in this type of higher-value production?

**Research question 2:** *What aspects of contracts need to be improved in Viet Nam and what roles do the public and private sectors play in facilitating such improvements?*

Contracts in Viet Nam are beset with many problems, particularly in terms of enforcement issues among all parties. A key issue is how the enforcement of contracts can be improved in Viet Nam. Contracts require developing both formal and informal enforcement mechanisms that bind parties to the pre-agreed conditions embodied in a contract. In some instances, this could simply mean designing better contracts, or formalizing different or additional conditions to the contract. More fundamentally, however, is the development of credible forms of arbitration that resolve disputes and make contracts enforceable. Such types of enforcement could be either formal or informal, or both. Formal means of enforcement include strengthening legal systems that recognize and respect contract law and resolve disputes in a transparent way. Informal means of enforcement involve relying on and/or creating sufficient social capital among parties or using third parties to mediate when contracting conditions break down.

The means by which contracts need to improve will vary depending on the type of product and relationship formalized by the contract; thus, issues revealed in the first research question will play a major role in this discussion. Moreover, further elaboration of the roles of the public and private sector are necessary. Clearly, the public sector has a major role to play in terms of improving laws and the means of enforcing them. In addition, the private sector needs to work with Government to help inform Government to develop laws and regulatory frameworks that promote contracts and facilitate business relationships, while not creating regulatory rigidities that stymie improved coordination and the generation of added value in the value chain.

The private sector also has a crucial role. In particular, greater capacity needs to be given to the private sector in terms of understanding the rules and obligations of contracts. More importantly, the private sector needs to develop nonmarket means that help sustain value-creating relationships. One

means of doing this, following Prahalad (1993), is to concentrate first on managing the "performance gap" to improve the efficiency of operations among parties that need to develop trust before taking market-based risks that exploit the "opportunity gap" in terms of new product or business areas. By developing such nonmarket investments in relationships, the sustainability of contractual forms may be strengthened. At the same time, the Government, donors and NGOs may need targeted interventions to facilitate bringing groups together through better and stronger organizational forms that serve to add value to value chains.

**Research question 3:** *Can the poor benefit from the development of and participation in contracting arrangements?*

The final research question is the most important in the context of the M4P Project. Assuming that contracts themselves can be improved and applied in sectors where they can best coordinate actors and add value, the relevant question is whether the poor can become a part of the process. As noted previously in the background section, a key component in improving coordination through contracts is better organization of actors in the value chain, particularly among primary producers. Indeed, negotiations by organized parties can result in the development of terms that add more value, build relationships, and ensure compliance with contracted standards. However, even if the poor are engaged in production areas where contracts may help to add value, it is not clear whether the poor can be organized, or organize themselves, to link with other actors in the value chain to effectively use such types of mechanisms.

This suggests two particular areas that need further examination. Firstly, what types of organizational forms among producers could be employed to coordinate activities with other parties in the value chain through contracts? Cooperatives, producer associations, and producer groups could potentially be used in this capacity, though the legal issues behind such forms need to be clarified. How do these organizational forms vary by product? And, most importantly, can organizations be developed that are in the interests of those participating in them? Secondly, how can coordination in the value chain itself be managed to sustain contracting relationships over time? In particular, what are the potential "choke-points" in the value chain that

could compromise the use of contracts, and how could these be better managed?

#### 4. Research proposal

The proposed research methodology to examine issues of contracts in the context of value chains in Viet Nam consists of two parts: (i) in-depth case study research on contracts; and (ii) design of pilot projects to develop alternative contracting approaches between groups of poor producers and buyers. This proposal will focus on the motivation of using a case study approach.

Case study research is suggested to study contracting for a number of reasons. Fundamentally, developing well-crafted, detailed cases of experiences with contracts from a number of sectors in Viet Nam will allow researchers to take stock of current practices. While much debate and enthusiasm towards the use of contracts in Viet Nam exist, there has not been a systematic study of what currently works, what issues are problematic and why problems exist. The use of case studies can provide researchers with some of those answers. Case studies are naturally not representative of all experiences in Viet Nam, but can nonetheless give a flavor of the current situation with respect to these issues, develop a typology of contracts that are presented being used, and can be synthesized to draw some lessons from past and present experiences with contracts. Particular emphasis should be placed on the role of organization in such experiences.

Additionally, case study research methods are employed in the context of value chains in Viet Nam in the '50 case studies. The outline adopted in this research has the benefit of being thorough, insightful, flexible, and applicable to a range of sectors. Moreover, this methodology places considerable emphasis on the evolution of the case - highlighting strategies, obstacles, and threats to the business. Such an approach is crucial to better understand and take stock of current practices in contracts. Ideally, one would conduct case studies over time following a longitudinal approach that traces the experiences of the case at different points in time. This could potentially be utilized as a follow-up to the initial case study approach in lieu of implementing pilot projects on contract development.

Finally, as the utility to any good research program lies in its ability to be applied and implemented in practice, a case study methodology can assist researchers in designing practical, pilot studies to implement new, improved types of contracts. Through the study of individual cases, one can observe areas of good practices that could be adopted in implementing pilot projects that attempt to design sustainable contracts and relationships between producers and buyers.

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Contract farming



Contract farming

# AGRICULTURE CONTRACTS, COOPERATIVE ACTION BY FARMERS, AND POOR PEOPLE'S PARTICIPATION IN NORTHERN VIET NAM

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Northern Viet Nam accounts for 35% of the country's natural acreage and 36% of the total population. The characteristics of agriculture in this region is that the land for cultivation by a small farming household, i.e. one household of two to three people, is very small. Between 1991 and 1998, the average acreage of land for one farming household reduced from 0.29 hectare (ha) to 0.25 ha. In the past, rice played a key role in the structure, but due to the reducing acreage, farmers find it more difficult to earn their living by solely cultivating rice. Therefore, they have been diversifying their crop to include subsidiary crops, short-term industrial crops, fruit trees, animal husbandry, and aquaculture.

Since 1988, surveys of farming households in Northern Viet Nam have shown that different types of farming households have different types of relationships with the market. A majority of households, especially poor households, are still situated in the autarkic economy, without having entered into commodity production. Some households sell their products on the market, but with the aim of buying other necessities they can not produce. Their purpose is still autarkic. These two types of households are common in northern Viet Nam. Their difficulties lie not just in lack of access to markets but also in lack of services to support them to shift from an autarkic to a market economy. Research on the relationships between households and the market shows that the development strategy of poor households is to diversify, while that for rich households is to specialize. Households with specialized production have an unstable link with the market.

Their main difficulty in selling their products is high transaction costs with traders due to small production scales, leading to a low purchasing price.

The question is whether agriculture contracts are a good solution for small farming households in northern Viet Nam that have different levels of involvement in the market and under what conditions they should be applied.

## 1. The actual situation of the agriculture contracts in the region

Government Decree 80 (dated June 2002) promotes the sale of agricultural produce through contracts between state-owned enterprises (SOEs) and farming households. According to statistics released by the Ministry of Agriculture and Rural Development, in the 6 months after the Decree was enacted, SOEs signed contracts with farmers to buy rice in over 1 million ha, accounting for 40% of total rice output, 50% of total tea output, 90% of total cotton and milk, and 70% of total sugarcane. Many held that this was the result of cooperation between the state, the private sector, researchers, and farmers, or "four-party" cooperation. The Ministry of Agriculture also promoted the signing of contracts to buy agricultural produce directly from farmers, especially rice, tea, rubber, coffee, sugarcane, pineapple, and pork for export. Foreign-invested companies in animal husbandry only signed contracts to sell animal food, not to buy animal products.

**Table 1. The number of enterprises in agricultural produce processing and trade according to ownership in 2001**

	State owned	Private	Limited liability	Foreign investment	Others
<b>Viet Nam</b>	<b>927</b>	<b>2530</b>	<b>72</b>	<b>52</b>	<b>22</b>
North East	160	9	4	3	8
North West	40	5	3	3	1
Red River Delta	206	25	13	5	3
North Central	153	1	8	0	2
South Central Coast	55	143	6	9	1
Central Highlands	187	2	10	13	0
South East	83	648	24	17	0
Mekong Delta	43	1697	4	2	7

Source: General Statistics Office.

In reality, only some SOEs implemented this decree, while most of the export companies did not have a legal basis, mechanisms, or networks in which to implement the contract system. The sale of agricultural produce under the contract system cannot be implemented without an effective legal environment.

The number of SOEs involved in agricultural produce processing and trade is reducing and the number of private companies is increasing. Most of these companies are in southern Viet Nam. In the Mekong Delta, SOEs cannot, by themselves, ensure outlets for farmers as proposed in Decree 80.

Under such circumstances, farming households are selling more products. The amount of agricultural produce in the Mekong Delta has increased from 39% in 1993 to 62% in 2002 (most of the increase was during the 1993 - 1998 period). Nationwide, this ratio increased from 48% in 1993 to 70% in 2002. The increase was rapid but the difficulties, due to unstable markets and low prices, also increased. An institution that will provide a vertical link between farmers and market factors is an urgent need.

Many forms of market arrangements have been established to solve the difficulties that exist in

market access, in situations where farmers need to establish links with market factors.

According to the World Bank (2001), the signing of an agriculture contract is a method by which companies can take charge of works previously handled by the State, notably providing information, inputs, and credit. According to various international reports on agriculture contracts, one of the prerequisites for the success of contract system with small-scale farmers is good coordination and organization of production, and a selection of households that have the same economic aim (Easton and Shepherd, 2001). The negative impact of the contract system is that households can be controlled and exploited by big companies and lose their bargaining power (Singh, 2000). Poor people often have more difficulties in implementing contracts because these difficulties cannot be resolved without assistance (Warning M. et al., 2002).

Different types of contracts - production or sales contracts - will dictate the farmers' dependence on the company. Production contracts are usually applied to high-quality produce, where production should be controlled (Valcheschini, 2002). Experiences in the South Sahara region show that a

**Table 2: Commercialization according to region**

		Percentage sold (%) in		
		Total plantation	Agricultural output	Total revenue
1993	Northern mountainous region	22	36	68
	Red River Delta	23	39	81
	Viet Nam	40	48	84
1998	Northern mountainous region	33	44	75
	Red River Delta	29	45	88
	Viet Nam	54	59	87
2002	Northern mountainous region	33	50	69
	Red River Delta	34	62	83
	Viet Nam	61	70	83

Source: VLSS 1993, VLSS 1998 & VHLSS 2002

close combination between farmers' cooperatives and the sales contract is an effective way for farmers to approach the contract system (Coulther et al., 1999).

In Viet Nam, besides the formal contractual system, verbal commitments, through informal contracts, also assist farmers sell their products. A recent survey indicates that commitments between farmers and markets can be broadly categorized into five varying forms currently existing in Viet Nam's rural areas:

- *Direct contract with state processing companies:* Violations by both parties are usually due to high transaction costs, low purchasing 'on the spot' prices, and ineffective quantity and quality input coordination. Poor farmers usually have difficulties in production services and credit when attempting to organize their production according to the terms of the contract. Because no mechanisms can ensure accurate and effective contract implementation if prices change, the contract is usually breached. However, there have been some successes, such as the linking of the Lam Son Sugar Company with farmers through contract and cooperative systems.

Lam Son has a realistic strategy to assist farmers develop their input. Sugarcane-cultivating households are organized into groups or cooperatives to implement the contract while investment and purchase are the responsibility of the company. This model has been very active since 1990 and includes technical support for farmers to enable them sell all their products and reduce their risks.

- *Production contract with foreign companies:* Production contracts mean that farmers become fully dependent on the company. Only big farms can implement this type of contract, while poor people cannot access it. Therefore, there is no agreement in the contract to buy the output, only to provide inputs for the farmers.
- *Sales to private traders through oral commitment:* Oral commitment appears to be an effective method, but the bargaining power of the farmers is low because of the high transaction costs. This method is often used for products created for the domestic market, notably vegetables or pork.
- *Sales through cooperatives:* The outcomes are diverse, but are very effective in some

cases, with good distribution of added value. However, the outlets are not stable in some cases.

- Rural craft and industrial villages: This market mechanism has existed for a long time in various regions throughout Viet Nam.

In reality, all these forms of links encounter difficulties in Northern Viet Nam because most companies do not have the capacity to organize farmers. This is a challenge for contract implementation with small-scale agriculture. The difficulty is not that farmers are incapable of grasping new techniques, but that they need advice and training to be organized into a cooperative or network.

The following experiences of the agriculture contract system in establishing cooperatives or associations under the advice of the Agricultural System Department (ASD) in the Red River Delta region show that small-scale farmers, if organized, will be able to effectively produce for the market.

## 2. Alliance of high quality pork-processing cooperatives in Hai Duong

The demand for lean pork in the domestic market is rapidly increasing, but analysis of the pork-processing industry in the Red River Delta indicates that producers' profits are low, especially because of the high costs of animal food. Profit from most factors in the industry is low. This analysis also highlights weaknesses in managing pork quality, including price risks and low quality production. In such a context, the farmers not only need to improve their techniques, but also their skills in organization and bargaining to consolidate and heighten their position in the pork industry. A research project conducted by the ASD of the Vietnam Agriculture Science Institute (VASI) encouraged local people's participation in the market through farmer participation in production development and cooperative activities. This enabled the participants to gain skills in exploiting the economies of scale in inputs, production, and sales of their products. Farmers not only develop cooperative activities, but also build their organizations, institutions, and relations with other factors in the pork industry, notably banks, local authorities, and development agencies.

The project developed from 1 group of high quality

pork producers with 12 members at its inception in 1998 to 17 groups with 200 members in 2003 (each of member raised 150 - 500 imported pigs and three quarters of imported breeds), who were later united into an alliance of high quality pork producers in Nam Sach District, Hai Duong Province. Within the alliance, some groups developed into four cooperatives that specialize in high quality pork. Farmers have been involved in veterinary activities, animal food production, bank loans, and input and output sales. Farmers in the same group share the same goal of establishing a common technical procedure to produce similar quality products within the group. This will help them organize common sales through the contract system.

Cooperatives of small-scale households do not always use the contract system with the slaughter houses in Hai Phong and Ha Noi. However, collective organization will assist farmers access a larger amount of buyers, as reduced transaction costs attract more buyers. A local pork market has been established; therefore the cooperative no longer depends on the previous long-term contract. Low competitiveness is a factor when farmers work independently, so collectives also assist small farmers produce high quality pork. When the heads of the cooperatives are also the producers, transaction costs for management and organization are reduced. The benefit for the heads of the cooperative is that the cooperatives' production will increase; meanwhile, poor households can enjoy the services of the cooperatives.

The authorities in Nam Sach recognized the role of cooperatives in organizing farmers and facilitated the establishment of the alliance of pork cooperatives in the district. This model has been an appropriate response to farmers' needs. Not only it is located in the Nam Sach District, Hai Duong Province, but also in other northern provinces, notably Bac Ninh, Hai Phong, Ha Tay, and Nam Dinh.

## 3. Association for Tam Xoan Hai Hau fragrant rice production and trade (Nam Dinh Province): making a brand name based on a product's origin

Before 1954, the acreage under cultivation for Tam fragrant rice was 22% of the total acreage in the Red River Delta. Tam fragrant rice has diverse

variations of more than 20 types (Bui Huy Dap, 1957), but there are only two favorite types - Tam Xoan and Tam Thom - because they possess a special fragrance and taste. However, they are difficult to cultivate, especially Tam Xoan. With a life cycle of around 160 days and the fact that it falls over easily because of its height, this rice plant requires good soil, with a pH level from light aluminous to neutral. The quality is high but depends on various factors such as soil, cultivating procedures, preservation, and processing. Tam Xoan is difficult to adapt to new soils and climates. Hai Hau is one of the few localities in the delta that boasts favorable conditions to develop this special type of rice, and Tam Xoan cultivation has become a cultural and spiritual characteristic of farmers in Hai Hau district. Its name is known among consumers nationwide. In recent years, the quality of Tam Xoan has been reducing because different types of rice are being mixed and farmers are not paying much attention to increasing the quality of Tam Xoan or organizing their production. There has been a risk of losing this product's value on the market.

To produce high quality Tam Xoan rice using such small-scale production, farmers and traders must unite, otherwise they cannot control the different steps involved in plantation, harvesting, and processing. In addition, a local professional economic institution should be established to build a brand name associated with the product's origin, as well as access markets. In 2003, upon the advice and assistance of the ASD, two farmer groups and one processing group were established. The farmer groups experimented with the application of new techniques in plantation and harvesting, and the trade groups have experimented with processing, preservation, packing using the association's brand name, and organizing direct sales in Ha Noi. For the 2003 crop, both sides established a mechanism to share profits, and an initial link was set up. By the end of 2003, the two production groups and the trade group had established the Association for Tam Xoan Hai Hau Fragrant Rice Production and Trade. By June 2004, the Association had developed to such a scale that it could cover 42 farmers' groups (of 432 households), based on voluntary and mutual assistance in four communes cultivating Tam fragrance rice in the district. The 42 production

groups and 1 processing group structured themselves into 12 chapters for cultivation and 1 chapter for processing and trade within the association. One executive committee of 20 members, 1 president, and 2 vice-presidents were democratically elected.

The association's technical monitoring system operates according to the following content:

The monitoring system was divided into three levels:

- Monitoring within members: During the production phase, members will monitor each other for compliance with technical standards.
- 2<sup>nd</sup> level monitoring: Heads of chapters and group leaders will monitor their own chapters and groups' activities.
- 1<sup>st</sup> level monitoring: The Association's leaders and board of inspection will establish inspection teams to monitor the activities of its members during important phases of production to ensure compliance with technical standards.

The Association manages and gives direction to monitoring activities. Monitoring activities are based on concrete criteria and the member who violates the criteria will bear responsibility, with related charges directed to the heads of groups and chapters. Local authorities will assist in the settlement of violations by members.

In 2003, the Association's Tam Xoan fragrant rice was sold successfully in the retail market in Ha Noi and through on-the-spot contracts at a price of dong (D) 12,000/kilogram (kg), compared to only D7,000/kg for other Tam rice varieties. Thanks to its success, the association's production has rapidly expanded, assisted by the active and serious involvement of the farmers.

In 2004, although the rice had just been harvested, the number of companies and buyers wanting to sign contracts continued to increase. This reflects the prestige and quality of the association's product, particularly as buyers wanted to sign on-the-spot contracts to ensure its quality. The establishment of the association has resulted in an increasing number of signed contracts.

**Table 3: 2003 - 2004 Production characteristics**

No.	Items	2003	2004
1	Number of households participating in the Association	26	432
2	Total acreage	04	60
3	Communes	Hai Toan, Hai Phong	Hai Toan, Hai Phong, Hai Duong, Hai Anh
4	Productivity (kg/sao)	105	120

#### 4. Conclusion

Empirical evidence from the ASD survey suggests that small farming households in northern Viet Nam can benefit most from using a system of sale contract that was developing establishing cooperatives or associations. This is due to the system's reduced production costs, which are achieved by organizing cooperative sales with a common product quality and reducing transaction costs through coordination. The ability of small farming households to organize cooperative action can turn them into partners of big companies and traders during the implementation of the agricultural produce sales contract. When contracts are established, companies should provide advice and assistance to farming households because the agriculture extension service does not offer support in this area.

Developing of poor farming households from autarkic economies to market economies requires cooperative action to enable production and marketing activities. Development of the market economy requires market institutions. Poor farming households need both cooperative and market institutions. However, as well as the market economy, there is an economy based on the unity of the cooperative and this has not yet received the proper attention. Cooperative actions by small farming households, including poor households, is a necessity for the contract system to be effective.

Agricultural produce sales contracts are new to Viet Nam, and further studies on this aspect are necessary. Research on this economic organization

approach should focus on the following issues:

- Diversification: Vertically, this is the improvement of the product through processing, etc. Horizontally, it is the diversification of products within one branch.
- Definition of different market institutions: These should focus on the farmers' participation in the rural market (through processing and marketing cooperatives), influencing the different types of coordination between different market players, and including an analysis of poor people's participation.
- Creation of products' protected brand names: This is a way to improve the quality of the products. The Viet Nam Agricultural Science Institute is now supporting farmers build brand names based on product origins for the Tam Xoan rice, lichee fruit, and pork in ways that enable poor people to participate in and create added value. This also becomes a fair trade mechanism that can assist the poor.
- The development of nonagricultural activities: This is a way to develop the rural market. In various regions, there has been an emergence of 'industrial clusters' within the development of small- and medium-sized enterprises. This phenomenon should be studied to promote local initiatives and entrepreneurship by farmers.

Our analysis shows that the method of encouraging participation by various factors within the same

branch, or research action, is needed to promote cooperative cooperation and agricultural produce sales contracts in rural Viet Nam.

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C o n t r a c t   f a r m i n g



C o n t r a c t   f a r m i n g

# CONTRACT USE AND PADDY QUALITY IN THE RICE SUPPLY CHAIN IN AN GIANG PROVINCE, VIET NAM

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While Viet Nam has made impressive strides in rice production and rice export volumes in the past twenty years, farmer incomes and rice export values are still low. In an effort to improve incomes from rice production, the Vietnamese government and a variety of development Non Government Organizations (NGO's) have endorsed market contracts as a potential tool to improve rice quality and paddy price stability.

However, recent campaigns to encourage the use of contracts have met with high levels of failure. In order to support efforts to improve the rice supply chain in Viet Nam, our study sought to gain understanding about potential sources of contract failure and the attitude of rice farmers and their buyers toward market contracts. We also monitored quality control in order to identify alternate opportunities for improving quality management. Our method of study was to survey paddy farmers and buyers who buy paddy directly from farmers.

Our results indicate that farmers do recognize some potential benefits from using contracts, but a variety of significant obstacles hinder their ability to fulfill contracts successfully. Many farmers recognized that using a contract could potentially improve their income stability and offer assistance with input provision. However, numerous disadvantages, including higher quality standards, lower prices, and less convenient paddy pick-up, make contracts less competitive than selling to traders. Before these obstacles can be ameliorated, it is unlikely that creating better enforcement mechanisms will improve contract success rates. Just as farmers now sign and then break contracts because the conditions are too burdensome, they will likely decide not to sign a binding contract if the disadvantages outweigh the advantages.

Instead, our results identify increased vertical integration in other sections of the supply chain as a more feasible opportunity for improving quality control in the near future, though this change would have less impact on farmer income. It appeared that contract relationships between companies and millers or traders, where the company supplied capital in advance in return for delivery of a predetermined quality and quantity of rice, allowed millers and traders to overcome barriers to strict quality management. Some millers identified changing value added tax (VAT) rules as a simple option to incentivize this strategy.

## Introduction

While Viet Nam has made impressive strides in rice production and export volumes in the past twenty years, farmer incomes and rice export values are still low. In recent years, government agencies and multi-lateral donors have worked to ameliorate these problems by improving rice quality and paddy price stability. Market contracts have been promoted as a strategy to increase quality management in the supply chain and stabilize farmer incomes.

However, recent campaigns to encourage the use of contracts have met with high levels of failure. The Vietnamese government actively promoted the use of market contracts in Decree 80, leading to a marked increase in the number of market contracts signed between farmers and companies. However, contract completion has not been successful; in An Giang province in 2003, 90% of signed paddy contracts were not fulfilled (Nguyen Tri Khiem, 2004). Common opinion has hypothesized that the lack of a strong enforcement mechanism for contracts has been a major contributor to contract failure.

In order to support efforts to improve the rice supply chain in Viet Nam, our study sought to gain understanding about the attitude of rice farmers and their buyers towards using market contracts and potential sources of contract failure. We also monitored quality control in order to identify alternate opportunities for improving quality management through this stage of the supply chain. Our method of study was to survey farmers as well as traders and millers that bought paddy directly from farmers.

### Methods

Our survey team interviewed 73 farmers, 24 traders and 12 millers in Chau Thanh and Cho Moi districts in An Giang, a rural province 200 km southwest of Ho Chi Minh City in the Upper Mekong Delta, Viet Nam. For all interviews, local government and agriculture officials assisted our team in identifying potential interview candidates. Interview candidates were approached by the local representative, asked for permission to be interviewed for a survey, and were interviewed by one or two An Giang University (AGU) staff members if they agreed.

This method of surveying introduced a number of variables into data collection that should be recognized while considering the data and results. While it is impossible to discount these sources of variation, our study's results differ from the commonly believed assumptions regarding contract failure. This finding supports the idea that our results are the genuine opinion of rice farmers and buyers, rather than the product of outside influences.

### Survey Results: Farmers' Perspectives

**Table 1. Farmer characteristics**

Sold 100% of their paddy to traders last year	84%
Did not know who they would sell to in advance	88%
Received nothing from their buyer	86%
Never signed a written contract	59%
Never sold through a written contract	99%

We found that farmers had little variation in their method of selling paddy and were generally weakly linked to their buyers. Over 80% of farmers sold all their paddy to traders, did not know in advance who they would sell to, received nothing from their buyer aside from payment for their paddy, and had never sold through a written contract. It appeared that this sales strategy was the only option available to farmers. The only alternative option farmers mentioned was to store their paddy and sell it at a later time.

Contract use has been promoted as an alternative sales option that can improve farmer livelihoods. However, our study revealed that contracts are usually unable to compete with the benefits and service of traders, thereby leading to high rates of contract failure. Most farmers did recognize that signing and using contracts could potentially have benefits from improved income stability and input provision. However, in their current form, farmers agreed that these potential benefits were not realized enough to overcome the numerous burdens and disadvantages of contracts. Tellingly, of the 30 we interviewed who had signed a written contract with a rice company, only one had successfully sold through it.

Farmers in our two different survey locations had been exposed to slightly different types of market contracts. We interviewed 17 farmers in Cho Moi who had signed with a company to get free fertilizer at the beginning of the season in return for a promise to sell their paddy to the company and pay for the fertilizer after harvest. In Chau Thanh, farmers mostly had experience with jasmine rice contracts signed with state-owned enterprises (SOE's). Twelve farmers in Chau Thanh had signed contracts with SOE's with a minimum price that was to rise with the market, but were "flexible" and could be broken by the farmers with no punishment. One farmer had also signed and successfully sold through a fixed price contract with a Japanese company six years ago.

The majority of farmers had a balanced view of contract use and perceived that signing contracts could potentially have some benefits. Overall, the most important reason to use contracts was that it guaranteed a certain price. With a guaranteed price, farmers could budget costs and income in advance and eliminate risk from market instability. Farmers frequently commented that this stability was a

**Table 2. Farmer rankings of the advantages of market contracts**

Scale from 1 (lowest) to 4 (highest)

	Stable price	Guaranteed market	Higher price	More training	Supply Inputs
Overall	3.33	2.86	1.48	1.89	2.36
Chau Thanh	3.52	3.16	1.79	2.00	2.00
Cho Moi	3.11	2.54	1.09	1.77	2.75

significant advantage, even if the price might be lower than the market price. Cho Moi residents also saw input provision as a key incentive for using contracts. Farmers explained that purchasing all the inputs they need during the growing season was very expensive, and having a contract that gave inputs was essentially an inexpensive short-term loan.

However, farmers also identified a number of significant disadvantages of contracts. Farmers focused most on the lower price, the higher quality requirements, and the need to transport the paddy to company warehouses. Farmers in Chau Thanh particularly disliked the lower price and higher quality requirements. This could be explained by the fact that paddy price was the key incentive and characteristic of contracts in Chau Thanh, therefore a low price was particularly disadvantageous

(whereas in Cho Moi some farmers mentioned that the provision of free fertilizer could make up for a lower price). Many farmers complained that the price in contracts was "always lower" than the market price.

Farmers identified potential advantages and disadvantages of contracts; however, the success rate for the contracts they signed was almost zero. The long list of concrete disadvantages appeared to overwhelm the less tangible benefits of contracts. Consequently, selling to the open market was more competitive, and farmers avoided signing contracts or signed only "flexible" contracts that could be broken without punishment<sup>4</sup>.

Through interviews with farmers who had signed contracts, we identified a number of conditions and actions that led to contract failure. In Cho Moi province, 100% of the farmers did not sell through their contract. In the contract terms, the company was responsible for picking up and transporting the rice; however, the company chose not to buy the paddy because they could not organize transport. Ten farmers were aware that the company was responsible for paddy transport, and said that they had sold to traders because the company never came to pick up their rice. Nine farmers seemed unaware that the company was responsible for transport; they believed that they had broken the contract themselves by selling to the open market for a higher price. However, in either circumstance,

**Table 3. Farmer rankings of the disadvantages of market contracts**

Scale from 1 (lowest) to 4 (highest)

	Inflexibility	Lower price	Contract breaking	Company disinterest	Stricter requirements	Paddy delivery
Overall	1.62	2.53	1.60	1.53	2.41	2.59
Chau Thanh	1.35	2.86	1.61	1.50	2.72	2.52
Cho Moi	1.92	2.10	1.58	1.63	1.95	2.68

<sup>4</sup> Farmers often mentioned their appreciation of "flexible" contracts, or contracts with minimum price that could be broken without any consequences. While difficult to quantify, this attitude towards contracts was very common. These farmers signed contracts with the expectation that they would almost surely break them, reducing the contract to a kind of insurance that guaranteed a certain minimum income.

farmers were usually inclined to sell to traders to receive a higher price and better pick-up service.

In Chau Thanh, 100% of the farmers who signed the "flexible" contracts did not sell through them. In the contract terms, the farmers were responsible for picking up and transporting the rice; however, delivering the paddy was not beneficial for both price and convenience reasons. Ten farmers broke the contract because the price in the market was higher. The 2 other farmers appeared unaware that they were responsible for paddy delivery and said that they had sold to traders because no one came to pick up their rice.

The one example of a successful contract, the fixed price contract signed by one Chau Thanh farmer, had appreciably larger benefits and less onerous requirements than other contracts. The company provided the farmer with company seeds, training from Cuu Long Rice Research Institute, and a price 500VND/kg higher than the market. At the same time, the farmer was only responsible for paddy delivery to a collection point 200m from his field, and the quality requirements were comparable to traders'. This contract also differed from other Chau Thanh contracts because it had a set price, was inflexible, and was signed with a Japanese company. The farmer said the local farmers' association guaranteed the contracts; however, he did not know of any way to enforce it or any punishment for contract breaking. But with these competitive terms, the farmer said he was very happy to fulfill the contract.

While farmers did not attribute contract failure to lack of information, most farmers did display a low level of contract understanding and information. It appeared that local government officials or cooperatives played a key role in introducing farmers to contracts, to such an extent that farmers were weakly connected to the company they signed with and had inadequate information. Six farmers had never met anyone from the company they signed with, only local government or cooperative officials. Nine farmers did not know the name of the company they signed with. Eleven farmers, when

asked about requirements, did not have exact information because they had not read their contract or did not understand the terms.

While farmers perceived potential advantages from using contracts, the current design of contracts was unable to deliver them successfully. Farmers were constrained from filling contracts by the formidable disadvantages of consistently lower prices, high or unclear quality standards, general lack of information, and sometimes the need to transport paddy to the company's warehouse. Farmers acknowledged that, ideally, a strong tie to a company through a contract could offer them income stability and assistance with inputs. However, in reality, contracts appeared to be merely a form of price insurance that weakly tied farmers to a company whose name they might not even know. Selling through a contract was usually unable to compete with the benefits and services provided by selling to the open market.

### Survey Results: Buyers' Perspectives

Interviews with traders and millers<sup>5</sup> identified possible alternatives for improving supply chain quality management. Traders and millers usually recognized that there could be benefits from maintaining higher paddy quality through stricter buying standards and sorting; however, especially for traders, they were often constrained from maintaining quality because of a lack of capital. Many interviewed traders and millers were

**Table 4. Quality standards of traders and millers**

	Traders	Millers
Have a set moisture content maximum	42%	58%
Buy paddy with any moisture content	58%	42%
Sort into individual varieties	25%	8%
Sort into long grain and short grain	13%	50%
Mix all varieties together	46%	17%

<sup>5</sup> Because this survey focused on the relationship between rice farmers and those who buy paddy from them, our survey focused on millers who bought directly from farmers. However, one must keep in mind that many millers only mill for a fee and never buy paddy. Our survey only represents the opinions of millers who own some or all of the rice they process.

interested in contracts between themselves and companies, which would provide them with clearer incentives and capabilities to manage quality standards strictly.

Traders recognized the value of high quality, but did not always take steps to achieve it. Traders said they liked to buy clean and dry rice. But only 14 traders required that the paddy they purchased be below a certain moisture content, which varied from 15% to 18%. Five traders did not have any exact rule concerning moisture content; five other traders paid less for wetter rice, but had no maximum moisture content. Traders also commonly mixed varieties. Eleven traders said they did not sort their paddy and just mixed all varieties together in their boat. Of the remaining traders, 3 sorted rice into long and short grain varieties, 3 sorted into individual varieties, and 3 did not need to sort because they only bought one variety.

Traders who did not sort usually recognized that there were advantages to sorting. Only one trader said there were no advantages to sorting because companies did not notice the difference. Eight traders said sorting allowed traders to sell their paddy for a higher price and profit, 4 said sorting made the rice easier to sell, and 1 said sorting gave a better milling ratio. When asked about the disadvantages of sorting, the only disadvantage mentioned was that 8 traders (out of the 11 that did not sort) said that they did not have enough capital, boat space, bags, or time to buy only one variety or keep different varieties separate in their boat.

Millers were more likely to have stricter quality standards. Seven millers had a strict maximum moisture content, which varied from between 16 and 19%. Four paid a lower price after a specific

#### Paddy Mixing and Lack of Capital

Many traders mentioned that lack of capital, in a variety of manners, induced them to mix varieties. Some traders' boats were too small to keep varieties separate; however, they did not have enough capital to build new, larger boats. One trader did not own bags, and so had to put varieties all together into her boat. Another said that because of her low capital, she had to buy paddy when she could find it and could not take the time to look for only one variety.

#### Contracts with companies

When our interviews turned to the subject of market contracts, millers and traders both often expressed more interest in contracting with companies than with farmers. While traders and millers appreciated that contracts with companies gave them market stability, it also appeared that it could improve quality management. One interested trader said that, if she got a contract five days in advance that provided capital, she could ensure the correct delivery time and paddy quality for the company's needs. For her, this arrangement would ensure profitability, a major advantage. One miller already had a contract with a company where he acted as the company's representative, buying and milling rice with company money. All of his strict quality standards were determined by company requirements.

level was exceeded. Only one miller was entirely flexible about moisture content levels. Millers also had stricter sorting practices. Only one miller sorted into individual varieties, but 7 millers sorted into long and short grain. One more sorted according to his customer's requests. Only one miller did not sort rice at all, and another only sorted paddy into normal and specialty varieties (i.e. jasmine). Eight millers said that by sorting rice, they could gain higher prices for each type of rice, and thereby make more profit. Two other millers said they sorted in order to follow their customers' requests.

#### Recommendations

While market contracts have the potential to improve quality management and price stability in the Vietnamese rice supply chain, results from our survey indicate that efforts to promote contract use in the rice chain may be premature. The close relationship between contractor and contractee would be a significant change from the weak link that our survey found between rice farmers and buyers today. Moreover, while our results indicate that many farmers recognize that using contracts could potentially offer significant benefits, it appears that these benefits are outweighed by major disadvantages. In their current form, contracts offer

too many obstacles and disadvantages for farmers to fulfill them.

Companies are currently unable or unwilling to offer farmers contracts with enough benefits to ensure that selling through a contract is competitive with selling to traders. As one trader said, the two parties in a contract must find a way to share profit for both sides if the agreement is to be successful. Before this partnership can be achieved, it is unlikely that creating better enforcement mechanisms will improve contract success rates. If contracts cannot yield benefits for both sides, farmers are unlikely to sign them and companies unlikely to offer them.

Instead, encouraging millers and companies to buy through commissioned agents appears to be a potential intermediate step to strengthen links in the

rice supply chain and facilitate improvements in rice quality. Currently the rice market's instability and difficulty in acquiring operating capital make it difficult to prioritize buying high quality rice. By making contracts with their middlemen, millers and companies would give them market stability and clear, guaranteed incentives for buying only high quality paddy of a particular variety. Unfortunately, the downside of this strategy is that it would have little direct impact on farmer income.

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# AGRICULTURE CONTRACTS IN AN GIANG PROVINCE

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Agricultural production in An Giang province has reached high growth rates in the past 3 years (over 7% per annum), the province's two major products - rice and fish - have contributed a large portion to its GDP. Applying modern scientific and technological advances into agricultural production has somewhat changed farmers' production practices. However, most of An Giang's agricultural products have yet to reach high agricultural standards. Agriculture contracts are still unknown to the majority of farmers in Viet Nam, as this is certainly the case in An Giang.

Many of the province's initiatives, as well as the model for agriculture contracts in An Giang, have already been developed in various forms over the past few years. However, agricultural linkages have not yet been sufficiently developed to their full potential. The Proposal on Production Rearrangement, Attachment to Processing and Market of the province's people's committee was approved and implemented in 2001. It was designed to promote better linkages between enterprises and farmers, and included other indirect policies such as developing linkages between the 'four partners' (the state, private sector, researchers and farmers) and developing of agriculture cooperatives. On a national level, the Prime Minister issued decision No 80/2002/QD-TTg dated 24 June, 2002 on the "Policy on the Promotion of Agricultural Produce Purchase through Contracts".

International experiences show that contract linkages among farmers, or between farmers and processing enterprises or government market institutions, can be a solution for small farming households - helping to increase their links to the market. On the other hand, the production contract helps enterprises ensure that they have input in

both the quality and quantity of processing activities. This article summarizes an analysis of the current practice of using agricultural contracts and the linkages between farmers and enterprises in An Giang. It includes three case studies: one for a linkage in high quality rice production in Duc Thanh cooperative; a contract between Nam Viet Ltd Company with the Long Thanh Fish Farmers' Association; and the agriculture contract for young corn between Hoa Thuan Cooperative and ANTESCO Company.

## 1. Current status of agricultural contracts in An Giang

### 1.1. Types of contracts

To assist the parties to the contract, the provincial government proposed six types of contract (assessed through the determination of price) at different levels as follows:

- Type 1: Contract with agreed price at time of delivery.
- Type 2: Contract with floor price.
- Type 3: Contract with fixed price.
- Type 4: Contract for input provision and product purchase with fixed complementary price.
- Type 5: Contract for animal husbandry.
- Type 6: Contract with guaranteed production cost and purchase price according to instruction.

Parties can choose a suitable contract depending not only on the product type but also on the reliability of the partners. Contract types 1, 2, and 6 have low binding levels, and parties can change partners. These are often applied to normal agriculture products that attract a variety of sellers and buyers. These types of contracts are also used

**Table 1: Rice and aqua-product yields according to contracts in An Giang**

	Total productivity <sup>6</sup>	2003			2004		
		Contract signed	Implemented		Contract signed	Implemented	
			Tons	Tons		%	Tons
Rice	1,413,875	114,962	19,417	16.9	217,567 <sup>7</sup>	25,067	11.8
Aqua products	136,400	48,000	48,000	100.0	63,072	29,500	46.8

Source: Reports by the An Giang Agriculture and Rural Development Department and the An Giang Statistics Report 2003.

for partners who are new to each other and need time to build trust. Types 3, 4, and 5 have tighter binding levels, and these are used for special agriculture products where there are less sellers and buyers - notably Japanese rice, seedling rice, young corn, hybrid corn, and tilapia - or for those considered to be "close partners".

## 1.2 Implementation of contracts

Accounting for more than 70% of the value, rice and agriculture are considered to be the key products in the province's agriculture and aquaculture production. Local initiatives for agriculture contracts focused on these two groups of products.

Total agricultural production using signed contracts in 2004 increased significantly compared to 2003, nearly double in the case of rice and 30% in the case of aqua products. Although the growth is fast, it still accounts for a small percentage of the total production capacity.

**Rice:** Eight enterprises are currently participating in the agriculture contract system. Apart from these eight, many others are buying rice in the market through the normal trading method, and the percentage of contracted volume is only 2% of total production. Most enterprises exporting rice do not pay much attention to agriculture contracts, or do not see the necessity to establish their material zone. This may be because they usually export normal rice (not special rice) with no brand name

under short-term contracts. The situation may change if they expand their outlets, have a stable market for their rice, have long-term contracts and are able to export special rice. The ratio of implemented contracts is low due to low market pressure, which is not enough to force both sides to better links. Therefore, the method of using future prices or ceiling prices is usually adopted for most rice contracts. This practice means that if the price increases, farmers ignore the enterprises, and if the price decreases, enterprises turn their back on the farmers.

**For aquaproducts,** Three enterprises recently signed aquaculture contracts. The remaining enterprises are newly established and have not yet signed contracts. However, most production and purchase contracts are more like guidelines, providing the principles but not being legally binding. In the future, the number of enterprises buying aqua products will double, which is a good sign for local fishermen and the province's aquaculture. However, the fact that the successful implementation of contracts in the first 7 months of 2004 was lower than the same period in the previous year reflects the low effectiveness of the contract system. The same situation exists for rice. Therefore, to find an outlet for enterprises in the overseas market means the binding effect of the aqua-product contract must be higher.

Apart from these two products, purchase contracts

<sup>6</sup> Total production of the 2003 and 2004 crop did not vary much.

<sup>7</sup> Estimated figure.

are signed (with volumes from several hundred to several thousand tons per year) for other products like hybrid corn seedling, young corn, soybean, seedling rice, cassava, young pigs, and cows. However, the volume of these contracts is low and the rate of successful implementation is high, from 70% to 100%. The characteristics of these markets have contributed to stability and sustainable development of agricultural contracts because: (1) enterprises that have an export market act as sole buyers; (2) apart from selling their products to these enterprises through contracts, producers do not have other buyers; and (3) products can be spoiled if not processed immediately.

**Table 2: The implementation of contracts for some types of agricultural produce in 2003**

	Contract signed Tons	Implemented	
		Tons	%
Young corn	2,752	1,981	72.0
Young corn seeds	1,027	1,027	100.0
Cassava	40,000	40,000	100.0
White sesame	91	57	62.5

Source: Reports by An Giang Agriculture and Rural Development Department.

Green bean seeds and rice seeds are 100% bought under contract. Finding outlets for these products is difficult; therefore farmers only grow them when orders have been placed. Contract types 3, 4, and 5 are often used to purchase these types of products that ensure the interests of all parties. Enterprises who order these products from farmers often have access to stable markets, in terms of both volume and price.

### 1.3 Summary of the benefits of contracts

#### **A. For the farmers**

Under many contracting systems, farmers can receive inputs on credit, advances against future production, and technical guidance and assistance from the contracting processor or company. Under a contracting system, farmers are ensured that they can find markets for their production. Improved techniques and efficiencies under contracting

systems may lead to lower production costs and, hence, increased income for farmers. Farmers, upon signing contracts with enterprises, can apply for credit from banks.

#### **B. For the enterprises**

Upon signing contracts, enterprises have a guarantee of having stable supplies of inputs and a higher quality of input supplies. Entering into contracting arrangements can assist enterprises develop a higher quality and consistency of outputs, thereby enhancing the prestige of the enterprise. Contracting systems can enable enterprises to have a good foundation for the development of a reputable brand name and to enhance competitiveness.

#### **C. For the rural community**

Community awareness about farmers and farming has begun to change to a focus on commodity production in the market economy and the development of cooperatives, group action, clubs, associations, etc. The practice of individual, unlinked small-scale production is gradually changing towards a system where small-scale farmers are joining in a spirit of cooperation. The income and livelihoods of farming families can have increased levels of stability under contract farming systems and, through cooperation with enterprises, farmers can gain higher levels of technical knowledge for production.

#### **D. For scientists**

Scientists can benefit from the development of contract farming systems through the opportunities to earn increased income from the transfer of advanced technology to farmers and enterprises. Scientists can also benefit from the opportunity to evaluate the success of technology through practical experience in the field to improve results in future research activities.

#### **E. For government**

The development of contract farming modalities can assist in the process of planning of the material production zones for mass agricultural production for export and domestic consumption.

### 1.4 Current Difficulties related to Contract Farming

The proportion of agricultural products sold through

contract systems is low relative to the proportion sold on the open market. The ratio of success in contracts for nonspecialized products in particular is relatively low. The majority of products purchased by enterprises at the moment are procured through the open market, rather than under contracts.

In many cases, the producers have limited opportunities to find buyers, leading to an imbalance in market power between producers and enterprises.

### 1.5 Future forecast

The government will continue to play a leading role in facilitating better linkages between farmers and enterprises, with a focus on more qualitative relationships with the hope that this will bring more benefits to the parties involved. However, these challenges cannot be easily dealt with due to the following reasons:

- The motivation towards market mechanisms is not strong enough to force parties to really cooperate (for normal products with high volumes). Therefore, when the government issues incentives, they will cooperate. Otherwise, they will cease their relations.
- The consumption capacity of enterprises both in and outside the province has yet to meet the production capacity of farmers. Therefore, farmers will continue to suffer as they do not have as many choices in the future.

### 1.6 Conclusion

- **Agricultural purchase contracts have brought about benefits** to farmers, cooperatives, and enterprises and, due to the domino effect, this has created enhanced benefits for the whole society. This is the first step towards a practice of farm production based on what the market orders through enterprises.
- **Farmers' organizations**, such as clubs, teams, cooperatives, and associations have a **vital** and **positive** role in the production chain under the enterprises' purchase contract.
- **The consumption capacity of enterprises is low** and does not meet the production

capacity of the farmers in the province. Therefore farmers need enterprises more than enterprises need farmers.

- **The outlets for enterprises are not stable.** If the price goes up, enterprises cannot buy the produce, and if the price goes down, farmers suffer from losses.
- **Enterprises and farmers are not aware of all the risk factors.**

### 1.7 Policy recommendations

- A more favorable business environment is needed to encourage (both domestic and foreign enterprises) to invest in agriculture business. More enterprises will create a necessary competitive environment to help extend agriculture production in An Giang.
- Farmers' organizations should be developed to facilitate future links between enterprises and farmers.
- A favorable environment should be created for enterprises and farmers' cooperatives to better link and increase product quality with the view to establishing a brand name for An Giang agricultural produce.

## 2. Case study

Three case studies of agricultural contracts for rice, fish, and cabbage are briefly presented in this section. Each study will touch upon the basic components of agriculture contracts:

- Legal framework of the contract.
- Content of the contract: Regulating the responsibility, pricing method, and regulations on product quality and processing procedure.
- Management and implementation of the contract.

### 2.1 Case study of the Duc Thanh Agriculture Cooperative

The Duc Thanh Agriculture Cooperative, a cooperative of rice farmers, was established in 2001, after developing from an irrigation group. Since its establishment, the Duc Thanh Cooperative has signed two contracts for high quality rice cultivation (2002 - 2003) with the An Giang Food

and Foodstuff Company and two contracts for jasmine rice cultivation with the ANGIMEX-KITOKU joint venture company (spring crops, 2002 -2003 and 2003 - 2004). The cooperative signs contracts with the company and then signs individual contracts with member farmers.

The contract uses a floor price. If the actual price is higher than the floor price, then the two parties will renegotiate. If negotiations fail, then the contract is automatically terminated.

**Content of the contract with the An Giang Food and Foodstuff Company (Long Xuyen Cereal Enterprise)**

- Regulations on the quality of goods supplied by the cooperative: Rice should be of high quality, reaching export standards. The seeds should be one of the five types selected by the company. Regulations exist on the quality, such as moisture, ratio of foreign substances, low or mixed quality or broken rice.
- Regulation on quantity: The size of the contract is 1,500 tons per crop, equal to the productivity from a 250 hectare (ha)/crop.
- Special terms regarding capital support for cooperative members signing the contract: The cooperative will support each member for dong (D) 1 million/ha, including seedlings (45%), and technical training and agriculture extension services (55%). The money is taken from the fund contributed by the members.
- Conditions on the purchase price: The floor price is regulated in the contract. If the market price at the time of purchase is higher than the floor price, payment is made according to the market price.
- Implementation: Based on the size of the contract with the company, the Cooperative chooses 70 out of its 255 member households, who have enough prestige and capacity to sign and implement the contract. The cooperative is in charge of buying the farmers' rice, providing transportation to the company's warehouse and paying the farmers in cash. The initial capital is usually from the members' contributions and advances from the company.

- Results: The Cooperative has to pay the farmers immediately after taking in their rice. In reality, the cooperative does not have enough working capital to do this. In addition, some farmers breach the contract. The ratio of rice bought under contract is only 50% of the volume required. However, this is a rather high figure compared to other contracts in the region.

**Contract with ANGIMEX-KITOKU Joint Venture Company**

- Regulations on the commodity: Jasmine rice, only for the Winter-Spring crop.
- Regulations on the quality of rice: ratio of yellow, broken seeds, and the ratio of immature seeds and purity. In addition, there is a regulation on the maximum productivity per acreage.
- Scope of the contract: Acreage and productivity.
- Content of the terms: Enterprises provide the cooperative with standardized seeds (purity rate of 98%, living ratio of 90%), regulations on the price of seedling rice, delivery and payment upon harvest. The Company introduces the procedure for the production, together with the acreage and location. The rice should be delivered on time and should be of the correct quality. Productivity should not exceed 7,000 kilogram (kg)/ha. The Company monitors the production and quality control of the product. Regulations on the responsibilities of each party are included.
- Implementation: Cooperative members voluntarily register to sign the contract for jasmine rice cultivation with the cooperative under terms and conditions set by the contract. The cooperative delivers the rice to the company at the cooperative's warehouse. The company will pay 100% in cash, after deducting the seedling costs, immediately after delivery.

**Advantages of the contract:**

*For the farmers:*

- Able to estimate their profits before signing contracts.

- Receive financial support from the cooperative in the form of rice seeds and technical training on how to plant rice, fertilize, and protect the plant.
- Have stable outlets for their products with prices higher than market prices (D70 - 80/kg).
- Members signing the contract can sell their products at the field for the cooperative.
- Receive profit from the collection and transportation activities of the cooperative according to their contributions (30%/per year).
- Due to the lack of means of transportation, some farming households signing contract have to sell their rice to outside parties.
- Contracts that use the floor price are not really binding when the price goes up. Therefore, the company can hardly create a brand name for their rice and stabilize their market in the future.

**Some comments on agriculture contracts for high quality rice**

Agriculture contracts have a positive impact on farmers' production. However, the links between both parties are not so tight, so sustainability is not high.

*For the cooperative:*

- Gain more profit from the collection and transportation of rice (about D60 million/year).
- Create more jobs for the members and farmers in the region: six members have vehicles and 50 porters have seasonal jobs.
- When the cooperative signs the contract with the company, the cooperative's activities become more diverse.
- The cooperative's prestige increases significantly after implementing the contracts.

*For the company:*

- Has ensured input of high, stable, and relatively pure quality. Be active in their export activities.
- Able to overcome difficulties in the collection of rice, notably the shortage of personnel, inability to control the collection network and lack of transportation vehicles.

**Difficulties in implementing the contracts:**

- Farmers do not believe in the feasibility and benefits of contracts.
- Farmers are not acquainted with some of the strict technical requirements of high quality jasmine rice. Most products produced by farmers do not have the same quality (moisture, foreign substances), and therefore the purchase price is low.
- The cooperative does not have enough money to buy the farmers' products (the advance by the company is limited).

*For the company:*

- Besides export contracts with traditional customers, the companies should also pay attention to exploiting potential markets.
- Continue to provide technical assistance and training on the field for the farmers.

*For the cooperative:*

- The cooperative and farmers should arrange for delivery before the delivery time agreed between the cooperative and the company. This will mean that the cooperative can be more prepared for the delivery. Two weaknesses - capital and the means of transport - could therefore be overcome.

*For the government:*

- Promote agriculture extension services, with priority given to local economic institutions, such as agriculture cooperative.
- Create more incentives for enterprises to participate in agriculture contracts for rice.

**2.2 Case study of Long Thanh Fishing Association**

Different from agriculture and production contracts, the contract system for aquaculture has only been developed in An Giang Province in recent years. The content of these contracts is formalism, and the implementation is voluntary without any legal binding.

**Description of the contract**

The contract between Nam Viet Ltd Company and Long Thanh Fishing Association was signed at the

beginning of the crop season. It is not really an economic contract or a purchase contract. The contract's product item is tra catfish, with an average weight of 1 - 1.2 kilo each, and a total volume of 2.995 tons per season (+/- 10% outside factors). The fish is delivered to the farm on six occasions, from November 2004 to April 2005. The contract regulates the quality of fish, through color and appearance (for fish under standard). The price is calculated according to the market price upon purchase and as agreed by both sides. Payment is made after delivery of the fish and within 15 days of delivery. If the payment is made later, Nam Viet Ltd Company has to pay interest to Long Thanh Fishing Association, not longer than 30 days from the date of delivery. The contract includes an article on breaches of contract. If the Long Thanh Fishing Association breaches the contract, it has to pay Nam Viet Company the per diem for the company's workers and other workshop expenses of D12 million. If Nam Viet Company breaches the contract, it has to compensate Long Thanh Fishing Association for the cost of fish food and losses of D3.5 million/day/100 tons.

#### Advantages of the contract

- Upon signing the principle contract, farmers have the motivation to invest more in production.
- During breeding, aquaculture experts (from Chau Phu District Authority) come to monitor and check the quality of the fish for the farmers.
- Farming households receive assistance from the Association during the breeding process.
- Farming households can apply for loans for production.
- Plans exist for fish breeding and consumption for each season.
- Stable market for fish.
- Fish can be sold to other places if the market price is higher than the company price.

#### Difficulties in implementing the contract

- This type of contract between the Long Thanh Fishing Associate and the Nam Viet Ltd. Company is not binding for either buyer or seller.

- The price is largely determined by the market price at the time of purchase, which is not stable.
- The company does not have the support to influence farmers' input.

#### Some comments

The aquaculture contract has a low level of binding for implementation, and when the price goes too low or too high the chances of implementation are low. Farmers have difficulty in finding enterprises to sign this type of contract.

### 2.3 Case study of Hoa Thuan Agriculture Collective

The contract for cultivation and purchase of young corn between Hoa Thuan Cooperative and An Giang Agriculture Service and Technology Company (ANTESCO) Company is a case of an agriculture contract where the content has made the contract sustainable over the years. ANTESCO has a processing factory and access to export markets for young corn, seeds, and technological procedures. Farmers have access to proper production techniques. In addition, ANTESCO can maintain its monopoly for buying corn products from farmers as they do not have other choices.

#### Description of the contract

The young corn is cultivated and purchased through two contracts.

**Contract on the investment and purchase of young corn between Hoa Thuan Cooperative and ANTESCO:** This is an economic contract for young corn, grown in My Luong town, Cho Moi District, with acreage changes according to different contracts. ANTESCO supplies seeds for the young corn which can be paid for later ("Amazing" seeds, sourced from Thailand), regulates the time for planting, and purchases all the qualified young corn. Hoa Thuan Cooperative is in charge of implementing the contract with the seeds and schedule supplied by the company, and collecting and selling all the qualified young corn to the company. Farming of the young corn has to follow very strict standards (including objective ones). The company will pay for the young corn in cash after deducting the cost of seeds for each batch, within 10 days of delivery. The price of young corn is fixed, but over the years it has reduced from D8,100/kg in 2002 to D7,800/kg in 2003, and to D7,200/kg in 2004.

Contract on the plantation and purchase of young corn between Hoa Thuan Cooperative and representatives of agricultural groups (representing corn farmers in My Luong town): The cooperative sells the seeds, which can be paid for at the end of the crop harvesting, and will buy all the qualified young corn products according to schedules set by the My Luong Frozen Vegetable and Fruits Factory. Farmers have to plant the seeds according to the contract, cultivate according to technical instructions, and sell their products to the cooperative. The young corn product will be paid for in cash after deducting the costs of the seeds. The price of the young corn is the company's price after deducting D500 (cooperative's fees) for grade I and grade II. For grade III, it is the market price upon purchase.

**Advantages of the contract**

**For ANTESCO:** ANTESCO has established a material zone for the young rice product, ensuring quality input. Through investment in seedlings, the company can ensure that the schedule for plantation and harvest means that they obtain the products according to their schedule, as well as having input into stable production.

**For Hoa Thuan Agriculture Cooperative:** The cooperative has two new services: collection of young corn and raising of cows. The profits from young corn plantations have stabilized and increased over the years. In 2004, profit from raising cows was about D20.5 million.

The cooperative has generated 10 seasonal jobs for about D10,000/day/person.

**For the farmers:**

Buy seeds and pay later (when they sell their products to the cooperative), receive technical assistance for plantation, growing and harvest.

Have ensured outlets for 100% of their products at a profitable price, the profit ratio over revenue has always been over 35%.

Profits from the use of side products, such as leaves and trunks for feeding cows, are high, therefore more farmers are motivated to sign contracts for young corn cultivation.

Farmers who are members of the Hoa Thuan Agriculture Cooperative also enjoy annual dividends

from the profit of growing young corn and raising cows.

**Difficulties of the contract**

Quality control of the qualified products is sometimes not objective, dependent upon the agreed shape of the corn, or the absence of strange smells, or in particular, the knife cut which should not be over 01 millimeters (mm) deep and 03 mm long and which causes the biggest difficulties for farmers during harvest time.

The price of the product is fixed, but is reducing, while the price for input material is increasing, leading to reduced profits from the contract. Due to market competition, ANTESCO has had to reduce its purchase price for young corn.

The scheduling of the plantation and harvest through the supply of seeds by the company means farmers are unable to make their own farming plans.

The capacity of the farmers is high, but ANTESCO has no plan of tapping the potential any further.

**Conclusion**

Both parties have interests in this contract. The contract stipulates a fixed price, with higher binding effects, and it has been implemented well by both parties, bringing both economic and social benefits.

The following are recommendations that aim to increase the sustainability of the contract:

**For ANTESCO:**

- Develop a more attractive purchasing policy that will encourage the cooperative and the farmers to plant young corn.
- Try to export more corn with a higher value and to import seeds for the cooperative's supply according to the needs of the cooperative and the farmers. The company should ensure the purchase of all qualified young corn according to the terms of the contract, and should not disqualify any products because their stock can not be sold.

**For the Cooperative:**

- Continue to provide technical assistance to its members.
- Find more stable outlets, through contracts, for the farmers' redundant products.

# AN OVERVIEW ON COOPERATION WITH FARMERS IN THE ESTABLISHMENT AND DEVELOPMENT OF THE LAM SON SUGAR MATERIAL ZONE

**Le Van Tam**  
**Chairman**  
**Lam Son Sugar JSC**

The Lam Son Sugar Joint Stock Company, formerly the Lam Son Sugar Mill, was established in the early 1980s. In its nearly 25 years of development, the company has encountered 10 difficult years of debts and various challenges, sometimes verging on bankruptcy. Thanks to the application of the Party's renovation policy, and by bringing into play the internal strength of the company's leadership and staff - and cooperation with farmers, scientists, institutes, schools and the media - the Lam Son sugar company, with the brand name LASUCO, is now one of the country's leading sugar production companies. It is well known in both domestic and international markets.

From the verge of bankruptcy (1986 - 1987), the company experienced higher growth each year within just 10 years (1988 - 1999). Compared to 1987, sugar production has increased 120 times, revenue 172 times, contribution to the state budget 187 times, and profit 320 times. The company has been an exemplary model in effective economic cooperation between industry, farmers, and researchers, and this has received attention and applause from the Party and the State. The company has contributed to improving the rural face of the midland area - north of Thanh Hoa Province - including 87 communes and 4 farms under 9 districts. The area has been turned from an isolated agriculture region into a developing market economy. The company has helped generate jobs for 30,000 laborers, improving the material and spiritual life of the local people. No households live in hunger and the number of poor households has reduced. Local infrastructure and transportation

systems have improved, and Lam Son has now become the economic center of the whole region.

The company was honored to receive various awards and distinctions from the Party and State during its development process. During 1999 - 2000 period, the company's staff and director were awarded the title "Labor Hero in the Renovation Process".

In 2000, the state-owned company successfully shifted into a joint stock company, with a creative pilot sale of a portion of preferential shares to the farmers. This has now become a common practice throughout Viet Nam. As a joint stock company that has the largest registered capital and the biggest number of shareholders, 90% of the sugarcane farmers can buy shares and participate in managing of the processing mill for the first time in Viet Nam. The government holds 37.6% of the registered capital; the staff 32.4%; farmers 22.5% and outside shareholders 7.5%. After 5 years of operation under the new mechanism, the Company has undergone higher growth, with a sales revenue that is 2.5 times higher than before the company was equitized. The contribution to the state budget is two times higher, workers' incomes have increased by 1.5 times, and dividends are at 12%/per year (sometimes 20%), with more capital accumulation and investment. Before being equitized (prior to 2000), the company's main product was sugar. Now, the company has diversified its products to include food alcohol and energy alcohol, fertilizer, dairy cow husbandry, milk processing, animal foods, packing paper, tourism, real estate, and financial insurance. Currently, the company owns nine factories and

affiliates, and has the majority of shares in nine other companies. It is operating under the model of cooperation in agriculture, industry, service, tourism, and trade.

Today's achievements are attributed to the close cooperation fostered with farmers over the past 25 years, a cooperation that has enhanced conditions for farmers. Each initiative of the company has a practical and positive impact on the development of the region's agriculture, as well as in its assistance to farmers.

This report, based on the workshop presentation, analyzes completed works and other issues for discussion, to contribute to the discourse on agriculture development and poverty reduction.

## **1. Cooperation and assistance to farmers to develop and stabilize long-term material zones**

From the beginning despite shortage in capital, removal of the state subsidy system, and high inflation the Company was determined to cooperate with the farmers to help them solve the three problems of capital, techniques, and market. These problems occur during the process of agricultural cultivation, and affect poverty reduction and the development of a material zone for the mill. Solving these problems is part of the Company's daily tasks and the standard for every individual in the mill.

The Company focused on cooperation with the communes and localities growing sugarcane, and supported farmers to develop comprehensive agricultural products, not only sugarcane but also other crops and animal husbandry. The Company was committed to ensuring that farmers developed outlets for their products to generate jobs and income for the farmers.

The Company also established a systematic investment policy for stable and long-term sugarcane purchase from farmers, helping the farmers to clear land and build transportation routes. Contracts are now signed before crop cultivation to ensure stable markets, and the Company provides the seedlings, fertilizer, food, and advance money (with an increasing amount year by year).

Since the 1986 - 1988 period, the mill has

developed an investment encouragement policy to assist develop a stable and long-term material zone, attaching the company's benefits to that of the farmers, including the establishment of a tractor station, providing farmers with credit to clear 10,000 ha of land for sugarcane cultivation, and providing advance seedlings, fertilizer, food, and money. The pricing of the sugarcane is based on negotiation, with encouragement to intensive farming to increase productivity, while technical staff are sent to each commune introduce intensive farming techniques. Training on sugarcane cultivation techniques for farmers organize in each commune yearly. A center for sugarcane research was established, while new seedlings are imported and provided to the farmers. There are policies to provide employment at the mill to skilled children of the farmers and to provide scholarships to students who come from the area to study in universities.

## **2. Cooperation with the bank to meet the farmers' needs for loans to develop production**

Over the past 20 years, the Lam Son Sugar Company has established a link with the Viet Nam Bank for Agriculture to seek loans and find a channel to provide credit to farmers. Advanced capital is supplied (to clear land, make soil, and buy inputs, fertilizers, food, etc.) so that farmers have the necessities to develop the material zone. Overall, each year, the interest-free advance for farmers is around dong D 30 - 40 billion (the highest level was D 90 billion).

## **3. Cooperation with scientific agencies and scientists to apply science and technological advances to production and increase agricultural productivity**

The Company has cooperated with research institutes and sugarcane experts to establish a center for new seedling experimentation and multiplication, as well as a technical demonstration area to disseminate the new seedlings, and to train farmers in sugarcane in order to increase quality and productivity.

The Company has cooperated with the Institute of Chemistry at the National Center for Natural

Science and Technology to study the use of side products in sugar and alcohol production, and to produce synthetic chemical fertilizer for sugarcane, as well as to reduce environmental pollution.

Cooperation has also taken place with the National Institute of Soil and Fertilizers to survey and map the soil used by communes and farms for sugarcane cultivation to identify a suitable fertilizer for farmers' use.

#### **4. Cooperate with the localities in the sugar cane cultivation area to develop farm economy**

This has been facilitated through the building of small farms, and signing contracts with cooperatives and groups of households to sell their products to the mill on the principle of equality and mutual benefit. Cooperation has taken place with the local authorities and police to ensure safety and order, to protect the farmers' production, and to help establish 28 new sugarcane cooperatives under the new Law on Cooperatives to support farmers follow commodity production. Exchange visits for the farmers to other model localities in the region and the country are organized annually.

Over the past few years, the company has, by various means, supported the farmers and the locality to fully exploit the land and labor, expand production, and shift the economic structure from an autarkic economy to commodity production to increase farmers' income. New occupations have been developed, such as the cultivation of fruit trees or mushrooms, which have generated more jobs and income.

From barren land, a specialized sugarcane cultivation area has been developed. The acreage under sugarcane cultivation in the 2003 - 2004 crop was 16,400 hectares with a harvest of over 1 million tons of cane, producing over 110,000 tons of sugar.

Based on previous achievements, the Company

now continues to support the farmers in their new occupation of dairy cow husbandry to provide another stable and high income job for farmers.

Infrastructure in the Lam Son region has developed quickly. Since 1990, the company's capital and the community's labor contribution have resulted in the upgrade of 178 kilometers (km) of road (of which 16 km are asphalted and 162 km are stoned) and 226 bridges in the sugarcane cultivation area.

Since 1992, the company has supported 16 communes to build multi-storey schools and 6 communes to build electricity lines (90% of the households in the sugarcane cultivated area now have access to electricity).

Farmers have bought 200 trucks to assist in their production. More and more concrete houses have been built; the means of transport, and the numbers of radios and televisions have increased. The number of wealthy households has increased and the number of poor households has reduced.

To realize the Party's and the State's policy on renovating state-owned enterprises, the Lam Son Sugar Company was equitized and transformed into the Lam Son Sugar Joint Stock Company. During the equitization process, the company paid attention to potential benefits for farmers, and considered them to be part of their employee body, although located outside the premises. The company proposed that the government sell preferential shares to the sugarcane farmers. For the first time, tens of thousands of sugarcane farmers were able to purchase shares in the mill and became real owners of the mill. The relationship among entrepreneurs/business owners-farmers and researcher has been lifted to a new level, marking an important turning point in the Company's history, improving its competitiveness in the market, and furthering cooperative relations with the farmers in the progress towards industrialization and modernization.

Contract farming



Contract farming

# ON THE IMPLEMENTATION OF AGRICULTURE RESTRUCTURING, PROVISION OF AGRICULTURE SERVICES, ORGANIZATION OF AGRICULTURAL PRODUCE SALES, AND GENERATION OF JOBS IN RURAL AREAS

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In September 1997, I received training from the Cho Moi Farmers' Association on the implementation of the 1997 Law on Cooperatives. I then mobilized local farmers to contribute capital to establish the agriculture cooperative. On November 11, 1999, Hoa Tuan Agriculture Cooperative, My Luong township, was founded and I was elected director for three consecutive terms, a position I currently hold.

At the beginning, the cooperative had only 85 members, with 195 shares, each worth dong (D) 300,000, totaling D58,500,000 and providing the only irrigation service in an area of 195 hectares (ha). After one year of operation, the number of members increased to 101 with 248 shares, bringing the total capital to D74,400,000. The service area also increased to 260 ha.

From 1998 to 2001, with the irrigation service, our cooperative had:

- Revenue : D1,365,992,731
- Costs : D1,067,353,031
- Profits : D300,249,700

The profits were distributed as follows:

- Set up funds in the cooperative : D195,370,885
- Paying dividends : D104,278,851

After 4 years of operation, the dividends paid to the members have exceeded their initial contribution by 1.5 times.

From 2002 onward, the cooperative introduced the new services of plantation and purchase of young

corn, leading to a revenue in 2002 of D976,231,800 (of which D555,747,800 revenue from young corn). Revenue in 2003 was D1,256,736,600 (of which D555,747,800 was revenue from young corn). In 2004, the cooperative had four services as follows:

- Irrigation.
- Plantation and purchase of young corn.
- Raising cows for meat.
- Trading organic vegetables.

SERVICE	REVENUE
Irrigation	199,720,000
Planting young corn	1,280,258,400
Raising cow	115,680,000
Organic vegetables	20,550,700
<b>TOTAL</b>	<b>1,614,202,100</b>

The total revenue for 2004 is expected to be D1.8 billion

### Comments:

#### 1. The activeness and enthusiasm of the Cooperative's Board of Managers

From the small capital available at the time of establishment (D74.4 million), the board has exerted efforts to operate the cooperative and

claim increasing revenue from D210 million in 1998 to D1.256 billion in 2003, and D1.8 billion in 2004 (totaling 6 years of operation).

## 2. The services of the cooperative are for the interests of both the cooperative and the members

- Irrigation service: Although the price of oil and petrol increased continuously, the price for irrigation services reduced from D65,000/person/crop in 1998 to D60,000/person/crop in 2002 to the present (about 27 - 30 kilogram (kg) of rice/person/crop), while the cooperative also ensured services for all 3 rice crops/year and 5 subsidiary

crops/year. Although the cooperative often suffers from losses in the third crop, we still operate this service to stabilize farmers' production.

- Implement the restructure of agriculture and plantation of young corn: Being aware of the fact that planting young corn and raising cows at the same time will yield high benefits, the cooperative has developed a model ("corn-cow") which means that the planting of corn is attached to raising cows, and vice versa. This is a closed circle (the corn is sold to the cooperative, while the plant itself and the leaves feed the cows, and the cows' manure fertilizes the corn plants) bringing high effectiveness. Details are as follows:

	2002	2003	2004
Acreage	10 hectares	20 hectares	30 hectares
Total acreage for a year (5 crops)	10 hectares x 5 crops = 50 hectares	20 hectares x 5 crops = 100 hectares	30 hectares x 5 crops = 150 hectares
Total revenue from corn sale to the cooperative	555 million	944 million	1,300 million
Number of cows raised by cooperative members and farmers	250	400	560
Total revenue from sale of cow by members and farmers	1,500 million	2,800 million	3,900 million
Labor working days (from planting, caring to selling products for the cooperative)	10,500 person days	21,000 person days	31,500 person days
Total wage (D10,000/day)	105 million	210 million	315 million
Total value of the model	2,160 million	3,954 million	5,015 million

- Raising cows for meat:

The idea for implementing this service started from the fact that many members and farmers planted corn to sell, but did not have enough money to buy cows to raise. Therefore, the corn leaves were sold cheaply. The cooperative used its money to invest in raising cows at its members' households, with encouraging results as follows:

- + Investment in buying cows: D54,898,000.
- + Revenue from selling cows after 10

months: D115,680,000.

+ Profit: 60,789,000D.

- The profit was divided as follows:
  - + Eight household members who raised the cows received D33,430,000; on average, each received D4,200,000 (about D420,000/month/household)
  - + The cooperative received D27,351,000 (45%).
- Trading of organic vegetables:

Apart from shifting to corn planting and cow raising, the cooperative also thought of other ways to help members replace rice with other higher value plants on the same acreage. In 2004, the cooperative piloted on a small scale the planting of organic vegetables (each batch is worth about D1 million). At the initial stage, the cooperative has helped farmers sell the vegetables at prices of about D50 - 100/kg higher than the market price.

From such results, the cooperative is planning to expand the model to increase the acreage of organic vegetables while ensuring the members' outlets and safety for consumers.

### **3. Generation of stable jobs and incomes for the cooperative**

With such results, the cooperative has generated stable jobs for 35 poor people working directly for the cooperative with an average salary of D350,000/month, while the model 'corn-cow' has created jobs for hundreds of others in various stages, such as planting seeds, caring for the plant, harvest, etc.

These are the works that the Hoa Thuan Agriculture Cooperative conducted over the past 6 years of operation: reducing poverty in the local area, reducing the cost of production, and increasing members' incomes through cooperative services.

C o n t r a c t   f a r m i n g



C o n t r a c t   f a r m i n g

## GROUP DISCUSSION

### SUMMARY AND MESSAGES FROM WORKSHOP

#### 1. Discussion session on general issues relating to contract farming in Viet Nam

Participants discussed a number of issues relating to the content of the preceding presentations and to contract farming in general. Some of the key points discussed included:

**Role of government:** Participants discussed the role of the government in relation to contract farming, cooperatives, and developing markets. In relation to cooperatives, participants discussed whether the formation and operation of cooperatives needed to rely on government subsidies or not.

Some presented the point of view, based on their own experiences, that government must provide subsidies to facilitate the formation. In a number of other cited cases, cooperatives had formed and operated in a successful manner, with sustained growth, without subsidies from government.

Participants generally agreed that one of the primary roles of government should be as a facilitator of linkages between the 'four partners', and to promote an environment where contract farming and other forms of linkage between farmers and markets could successfully occur.

**Role of associations and cooperatives:** The need for the poor to organize to participate in markets and the form of this organization (including cooperatives and associations) were discussed. The core theme of the Making Markets Work Better for the Poor was discussed in this context - how to link the poor with markets in an increasingly globalized environment.

Participants talked about the merits of various forms of organizations, including the legal status of cooperatives and associations, and the ability of cooperatives to sign legal contracts (associations are not permitted to do so).

Participants agreed that one of the key factors in the success of a cooperative or association was to have a well-connected and dynamic leader. The participants suggested that the ability of the leaders is the key to the success or failure of a cooperative or association. Many participants also indicated that, for long-term success, the leader should be one of the farmers, not an external person. Of course, the leader would draw a salary from the cooperative, but the salary would not be the whole motivation. The motivation of the leader comes about because he is also a farmer-member of the cooperative.

**Contracts and incentives:** Participants agreed that contract farming can be one way of linking farmers to markets, but not necessarily the only way of developing such linkages. Contracts for production may not always be the most appropriate means of creating market linkages.

Participants also suggested that the notion of contract farming should be expanded to include nonformal commitments made by both parties. In reality, far more nonformal contracts and linkages are entered into than formal contracts.

Three reasons for the popularity of nonformal contracts were raised:

- i. It is easier to make a nonformal contract than a formal contract.
- ii. Nonformal contracts are a traditional way of doing business.
- iii. Nonformal contracts are a more suitable way for poor farmers to do business with traders.

Participants also raised the issue of incentives. They generally agreed that under a system of informal contracts and poor market linkages, levels of incentive to improve quality and meet market demands are very low.

In relation to subsidies for the formation of

cooperatives, participants generally agreed that, while small amounts of subsidy might be necessary to encourage organization, any long-term solution should not involve subsidies. The poor should have sufficient incentives to participate in the market, and this should be based on real market conditions.

Participants also agreed that if farmers are not getting what they want from contracts and organizations, then research should be undertaken to find out what needs to be changed to improve incentives.

## 2. Discussion session on lessons learned in contract farming in Viet Nam and internationally

Following the presentations, the participants held a discussion that focused on a number of issues. One of the main issues of concern was that the concept of contract farming as presented could work well when the contracts are made between large farmers and companies, but may not be suitable for small/poor farmers. This area is of particular concern because of the rapid developments of supermarkets in Viet Nam, and the consequent rapid changes to the value chain for agricultural products.

This led to a discussion on the concept of a "two-contract" system, where companies make contracts with cooperatives and the cooperatives subsequently make contracts with members and other farmers for supply. The key to the success of this model is a strong cooperative or other form of association that is well organized, able to coordinate and administer a large number of contracts, and includes poor members in supply contracts.

Participants discussed whether there was an "ideal" form of contract for the poor, and concluded that there was no single "ideal" form, as there are so many different types of poor people in completely different situations.

Participants also agreed that it is vital to ensure that other nonobvious matters (such as environment and health) are taken into account when calculating the benefits and costs of contract farming.

One of the key conclusions reached by participants during the discussion was that for contract systems

to truly succeed, an intimate relationship between the parties should exist. If the relationship is formed on the basis of trying to push the benefits of one party rather than the other, then the contract will not work.

## 3. Discussion session on practical experiences of contract farming and cooperative development in Viet Nam

The discussion after these two presentations pursued related themes - the secret of the success of the Lam Son Sugar Company model, and the relationships between farmers and companies in contract farming systems.

Some participants expressed the opinion that farmers are generally exploited under contract farming systems as they have lower levels of market power and information than large companies. In addition, the monopoly buying power of large companies makes small farmers vulnerable. This opinion was not accepted by the Lam Son Sugar Company.

Participants discussed the six key points that Lam Son Sugar Company viewed as leading to a successful contract farming relationship:

1. Establish close and long-term relationships with farmers, using 'farmers as partners' as a guiding principle.
2. Ensure long-term benefits for farmers, giving them priority; long-term benefits for both parties generates loyalty.
3. Provide good input and output services; ensure in-time payment, for example, of cash payments on delivery or within 15 days.
4. Negotiate and fix the price before the crop is harvested. Pricing must be beneficial to farmers.
5. Share profits with farmers.
6. Build a good relationship with local government to ensure a safe environment for farmers to solve security problems.

Despite the generally acknowledged failure of sugar industry development in Viet Nam, the Lam Son Sugar Company has proved to be an extremely

successful example of contract sugar - farming systems and the transformation of state-owned enterprises to joint stock companies in Viet Nam. One of the major initiatives of the transformation to Joint Stock Company has been that there is cross-ownership of shares, with many of the farmers owning shares in the company. This increases the close relationship between the company and their contracted suppliers.

The Lam Son Sugar Company attributes its success to developing a close relationship with contract farmers and workers and offering reasonable prices. Building and maintaining these good relationships means that the sugar mill generally operates at near full capacity and is profitable.

The importance of building good relationships, arguing that companies need farmers to obtain profits. It is to the benefit of companies to support farmers to obtain this profit. Lam Son is involved in a range of social activities in the community to increase the strength of the relationship between the company and farmers.

Participants also discussed the concept of "social capital" and social mechanisms to ensure that contract relationships preceded smoothly. Participants generally agreed that to ensure that a good business relationship is maintained, the relationship should also encompass social aspects to build trust and promote understanding between the parties to the contractual relationship.

Another key point discussed was the need for diversification to reduce risk. This was seen as a key initiative for cooperatives, where diversification away from single commodity production and reliance on a single buyer should be promoted. Also, diversification away from production of a single product and over-reliance on a single set of providers should be promoted for companies.

## 4. Results of group discussion

### Question 1

- a. What are the strengths of contract farming systems?
- b. What are the weaknesses of contract farming systems?

## sessions

### Strengths

- Enabling the state to plan the material zone based on comparative advantages.
- Creating conditions for changing the agricultural structure including agricultural diversification/specialization.
- Making it easier to apply new technology.
- Ensuring better input and output systems, including prices for producers.
- Possibility of mobilizing different resources for agricultural production.
- Predictable quantity and quality of produce for enterprises.
- Benefits shared between enterprise and farmers.
- Farmers confident in expanding production and increasing outputs.
- Farmers and enterprises can predict the price.
- Promoting farmers to work cooperatively.
- Farmers can access information.
- Improving the level of farmer's ability in applying technology.
- Reduce risk in agricultural production.
- Farmers benefit from assistance in technology, capital, seeds, etc.
- Creating conditions for branding of agricultural products.
- Reduce costs of agricultural products.

### Weaknesses

- Price fluctuations have impacts on farmers.
- Farmers, especially poor farmers, are in a weaker position or cannot participate in contracts.
- Asymmetric information disadvantages the poor.
- Contracts are often signed in terms of the floor price, which is much lower than the market price.
- Contracts are not flexible enough to enable farmers to look for better partners.
- Weak contract enforcement.
- Breaking of contracts is common when the market fluctuates.

- Enterprises have monopoly buying power and can put pressure on farmers.
- Good contracts are complex, while farmers are not good at negotiating a contract.
- A certain amount of time and capital is needed in the initial stages.
- May increase the risk of environmental pollution and public health problems.

### Question 2

**How can contracts and contract farming be improved? What is the role of:**

- Government
- Private enterprises
- State-owned enterprises
- Cooperatives/farmer groups
- Farmers?

### The role of government

- Provide adequate information in a timely manner to farmers.
- Provide technical assistance.
- Conduct research into new technologies.
- Assist and support certification services for agricultural products.
- Provide training in extension services, cooperative management, brand building.
- Provide rural infrastructure.
- Disseminate information about laws and regulations. Create a fair legal framework for agricultural production and business.
- Create an enabling environment for private companies investing in the agricultural sector.
- Support the formation and development of farmer organizations and cooperatives.
- Provide good weather forecasts.

### The role of enterprise

- Find markets and expand markets.
- Develop processing technology.
- Provide inputs for high quality products.

- Research for new technology.
- Maintain trust with farmers.
- Provide incentives for farmers by giving them shares.
- Support and strengthen production capacity for farmers.
- Ensure output markets for agricultural products in the long term.

### The role of state-owned enterprises

- Support and improve production capacity for farmers.
- Act as the link between farmers and markets.
- Remove monopoly.
- Participate only in public goods contracts.

### The role of cooperatives/farmer groups

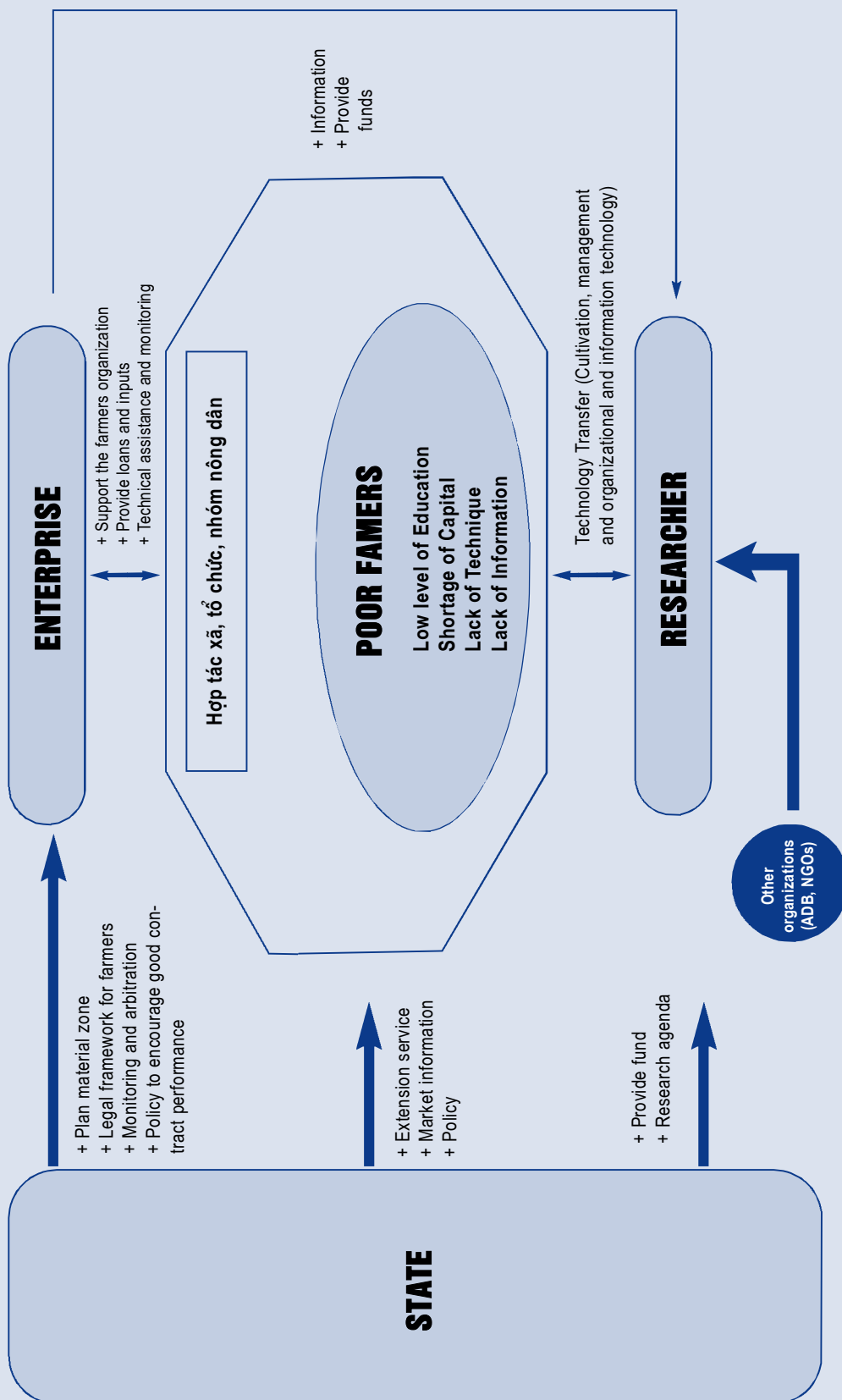
- Develop and invest in processing technology.
- Improve the ability of cooperative managers, provide training in marketing and foreign languages.
- Look for appropriate technologies.
- Organize farmers in production to create specialized production zones and increase quality.
- Maintain trust.
- Act as a focal point when farmers sign contracts with companies.
- Look for output markets.

### The role of farmers

- Further strengthen and regularly update market information and regulations.
- Work cooperatively and participate in cooperatives and groups.
- Be sure of the product's technical standards.
- Respect the signed contract.
- Buy shares in the cooperatives.
- Strengthen cooperation with other farmers.
- Update and improve knowledge.
- Produce high quality products.

## 5. Discussion of results presented by working groups

After the presentations of group results from the first



Schematic representation of the discussion output of links between the 'four partners' in relation to contract farming

two questions, there was a vigorous debate amongst participants regarding the level of education, information, and market power of farmers. While some participants argued that poor farmers lacked education, knowledge, and market power, and hence could not benefit from market linkages and contract farming, other participants argued that farmers are well informed and powerful in negotiations.

Examples were given on both sides of the debate, including the fact that contract farming involving large numbers of farmers in cooperatives has been very successful in An Giang Province.

Participants generally agreed that linkages had to be strengthened in the value chain and that the concept of the "four partners" should be expanded and strengthened.

Some other key points discussed:

- In contracts with farmers, relations should be well maintained and contracts should be written in simple-to-understand language.
- Different approaches to market linkages and contracting should be taken for different farmers.
- Extension services should disseminate information and promote market linkages.

### 6. Discussion of the following question

How can poor farmers join in contract farming systems and how can this be organized to provide real, sustainable, and long-term benefits to poor farmers and to the contracting enterprises?

Participants discussed the "two-contract modality" and generally agreed that cooperatives are in a good position to work on behalf of farmers to negotiate with companies. Cooperatives have to make individual contracts with many farmers and organize all collections, etc. This is an enormous amount of work. The cooperatives have to consider the benefits to three players - farmers, cooperatives, and companies.

Cooperatives need to make numerous visits to farmers to maintain relations and keep track of activities very carefully. Contracts have to be very

simply worded and very clear. Cooperatives have to make decisions about whether to have a fixed price or a floor price in the contract.

Participants also discussed the situation where contracts are made between cooperatives and 'representative farmers', the situation where clusters of farmers are promoted, and the case of Kien Giang Province, where the traditional role of traders and intermediaries has not been replaced by contract farming. Participants noted that the current legal framework is not clear if farmers can legally make contracts with traders if they are not grouped under a cooperative framework.

The key concept that participants agreed on was that it was vital for the poor to be involved in some form of organization to link effectively with markets. Dealing with markets as individual small producers would not be successful.

Another important point raised is that many poor households are relatively risk averse, and hence are not inclined to transfer from rice monoculture to diversified production of industrial crops for contracts, as these are seen as being at a higher risk level.

Trademarks and branding as a vehicle for protecting specialized products and aiding contract farming and the poor were also discussed. Representatives from An Giang Province indicated that An Giang supports cooperatives and households to register trademarks, by subsidizing 50% of the trademark registration fee. An Giang is particularly encouraging of registration of agricultural trademarks.

Contracting should be voluntary and should be needs - driven, not based on the idea that we 'should have' contract farming. It depends on the conditions of the people, the environment, and the unique situation of the area.

### 7. Concluding discussion

A number of key themes emerged from the discussions conducted during the workshop.

**Partnerships:** The contracting relationship should be seen as a partnership between the participants, rather than as a competitive relationship, or a relationship where one party exploits the other. Only

by building a high level of trust and interaction between the parties to a contract will the relationship be successful. This type of partnership arrangement can frequently extend beyond a purely business relationship to include social interactions and social relationships.

Partnerships are also important in regard to external organizations, such as local authorities, management boards, and mass organizations. Strong links can assist in facilitating and improving contracting arrangements.

**Incentives:** Strongly related to the issue of partnerships is the issue of incentives. For a contracting relationship to survive and to strengthen in the medium to long-term, there must be incentives on both sides. This means that both parties to a contract should derive benefits from the contractual relationship. Payment levels and negotiations must be attractive to both suppliers and purchasers and risk must be shared between the parties.

Other incentives include cross-ownership and convergence of interest of both parties, for example, where farmers are also shareholders in the purchasing company.

Incentives must be based on market forces. When the formation and operation of a cooperative or the participation in contracting systems is undertaken on the basis of subsidies, genuine long-term incentives for the relationship do not exist.

**Organization:** Some form of organization should take place. The organization acts as a 'peak body' for the numerous farm households, effectively representing their interests, coordinating logistics, and often entering into contracts on behalf of the group members.

In the Vietnamese context, the form of organization with the highest level of legal recognition and the ability to sign contracts is the cooperative. However, numerous other formal and informal groups exist in the sector, including farmer groups, farmer 'clubs', and community groups based around a representative farmer.

One of the vital ingredients for success of such organizations, or forms of cooperative action, is the ability of the organization's leadership. If the leader of the organization is dynamic and well-connected

to markets and information, then the organization has a higher chance of success. Another important factor is incentives for the leadership. If the leaders of the organization are also farmer - members of the organization, there is a stronger incentive for them to act in the interests of the farmer-members.

**Better contracts:** The form of contracts should also be suitable for the conditions of both parties. In the case of a contract between a cooperative and a farm household (which may be one of thousands of such contracts made yearly by the cooperative), both parties should ensure that the contract is as simple as possible.

Contracts should also involve cash payments, either on delivery or within a short period. Contracts should also provide sufficient incentives for both parties to participate in the contract. In many cases, a contract specifying the contract price as being the prevailing market price, plus a percentage markup, is sufficient to provide incentives to encourage loyalty of suppliers.

Above all, contracts should be fair and spread the risk and benefits amongst both parties.

**Enabling environment:** One of the key roles highlighted for the State was to provide a better enabling environment for contracts to succeed. This could include:

- Facilitation of linkages between farmer groups and companies.
- Support for registration of trademarks.
- Strengthened trademark protection and streamlined trademark registration procedures.
- Strengthened procedures for safeguarding the integrity and value of contracts.
- Provision of market and other information to participants in the value chain.
- Facilitation of farmer organization and grouping.

**Potential future research:** A number of potential future research topics have been derived from the workshop. These include:

- Undertaking a typology and analysis of the forms of contracts used in the rural sector in Viet Nam.

- Studies on cooperative action, including cooperatives and non-cooperative type organizations. This could include a study on the legal status of noncooperative groups and their abilities to conduct business and sign contracts.
- Best Practice Handbook for Contract Farming.
- Case Studies and Secrets of Success of Cooperatives and Contract Farming.





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