Rural finance of coffee smallholders in Vietnam- Case Study in Dak Nong Province

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There are more than half million smallholder coffee farms in Vietnam, and the amount is growing. Virtually all of the farms are owned by rural households, with average one hectare of coffee land per farm. Coffee is the main income of these people. Vietnam's coffee industry has grown at a rapid pace to become the world's second largest coffee producer with current annual exports of around 1,5 million tons in 2014. The overall production volume expanded sharply, from around 700-800,000 tons in the year 2000 to about 1,800,000 in the year 2014.

Global market demand for coffee is increasing and the potential profits from coffee farming are high. However, the access to formal financing is limited due to households' insufficient collateral assets, and a range of production and market risks in coffee sector. Thus, the smallholders would either have to grow their coffee with insufficient input materials, diminishing the annual farm income down to below USD 1000. Or alternatively, they ought to approach informal sources of financing for the required input material loans. Increased demand of such coffee farm financing has led to dynamic informal capital markets. These markets in turn enable the continuous growth of the coffee sector, further increasing the financing demand. Though, there is very limited information available about the present conditions and dynamics of such informal financing. The purpose of this case study is to understand the Vietnamese coffee smallholders' investment needs, and explore the local practices of financing such investments.

The coffee household revenue streams in Vietnam have increased by over threefold over the last fifteen years. However, to achieve such higher revenue flows, intensified farming method with increased input use is required. Also, the prices of input materials are increasing due to high demand. Thus, the poor households have difficulties in financing the required investments for high-yielding coffee. The poor farmers' extensive coffee farming does not make enough profit for investment, and banks do not lend to households without collateral. The poorer smallholders are left with the choices: 1) borrow from informal sources with varying conditions and level of risk, or 2) limit their investment and thus stay with lesser extensive farming method and lesser revenue.

In Dak Nong province, 87% are rural households and 85% coffee growers, thus nearly all rural households of the province are involved in coffee production. For the poor farmers in Dak Nong, it is difficult to save or borrow the required input investments for intensive coffee. Thus, the overall productivity and quality of coffee beans is low. An average coffee farm invests annual 20-40 million VND to fertilizers and pesticides, thus the total market volume of coffee input material trade in Dak Nong is in the scale of 3000 billion VND (about 140 million USD), creating a significant business opportunity in this rural province.

In the context of this summary, the author only focused on informal microcredit which is the main source of credit to smallholders. These formal and semi-formal financing can be looked up in the full report. Two typical forms of informal microcredit: 1) loans by friends and relatives, and 2) farm investment by agricultural input traders. Traders include informal traders, registered business households and small size enterprises. . The price offer, reputation and ease of access mostly determine farmers' selection of trading partners.

The small-scale agents would advance fertilizer/pesticide to farmers, in form of an in-kind loan, expecting to receive the payment with interests during the harvest season. Farmers need to pay average 6% increase in product price, and a monthly interest rate of about 2-3% to the in-kind loan. Repayment is made in cash or coffee stock along with sales of harvest (the farmers would sell their product to the same trader they received the input advance from). Loan amounts are deducted from the sales price, the whole loan mechanism involves no cash, and such schemes can to some extent function as farming contracts between the farmers and the traders. About 80% of interviewed coffee farmers were found to receive in-kind loans from the same traders they sell their coffee products to.

However, the informal loans are problematic due to lacking control mechanisms for interest rate fluctuation and varying practices of enforcing repayment. There is no protection of law in any of the transactions. Thus, the nature of lending practices depend on the character of the financier, leaving the poor households vulnerable. The Dak Nong coffee farmers, compared to farmers in other provinces and value chains, have a relatively good position with the traders. This is due to large amount of traders in the area and thus high competition between these. Farmers can competitively select the trader offering best conditions.

The risk management for informal financiers is secured by business reputation and value chain fund flows. (i) business is based on long-term trade relationships with the local communities and farmer households. (ii) loan customers also buy the materials and trade their coffee product, the trader is the access point to all production elements of the local farmers. The financiers directly reduce the loan repayments from the sales revenues, providing for a strong loan security. (iii), traders have engaged into collaboration with grass root farmer organizations. The traders would negotiate commodity prices and loan terms with farmer groups instead of individual households, and the whole process is recorded to written agreements.

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