MEASURES TO IMPROVE PERFORMANCE OF STATE- RUN COFFEE COMPANIES

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I. Situation

In recent years, coffee production in Vietnam has made very good progress. The output amounts to 600,000 tonnes a year making Vietnam the world second biggest exporter of coffee, after Brazil. For many reasons, however, state-run coffee companies have suffered losses for the past three years and this situation raised the question of their business performance.

Regarding the performance of state companies, they should make profit, fulfil financial obligations, enhance living conditions of workers, and complete socioeconomic targets set for them. The performance of a state company is estimated through its new investment and relations with other companies of the same or different industry.

Prices of coffee in the world market vary over time depending on changes in the supply and demand forces, that is, it has its own cycle. Brazil supplies some 30% of coffee consumed by the world market and thus having a role in deciding the price of coffee. The grand cycle of price usually lasts for some 10 years. In the last cycle the price peaked when Brazil suffered bad weather: frost in July 1975 and July 1995 or drought in 1985. This price cycle 1992- 2000 in HCMC is as follows:

The average FOB price is US$1,377 per tonne (or VND19,760 a kilogram at current exchange rate). If the production cost is VND11,500, the profit is VND8,280 and the profit- cost ratio is 71.8%. Thus in this price cycle, the coffee business ran well. In this price cycle, the world price was at times lower than US$700. If the estimated price for 2001 is US$550, the average price for this 10-year cycle is over VND18,000 a kilogram. In the next cycle, the average price is estimated at lower level.

State-run coffee companies suffered losses in the past two years because they had to carry out too many tasks assigned by the State: advances to farmer – supplier, investment in coffee purchasing, transporting and processing stages, etc. because state-run coffee companies control only 14% of the total output. In fact, these companies are main buyers in the coffee market. According to the Dak Lak Service of Tourism and Trade, state companies purchased 95% of the coffee output in Dak Lak in 1998-99 crop (95% of the Vietnam's coffee output is for export).

The world price of coffee also has a shorter cycle that last for three years. From the 1998-99 crop, the price changed in different way: in March 1999, the export price fell from VND18,630 to 7,000 a kilogram in October 2000. The Table 2 shows changes in the price of coffee in the last four crops.

State companies usually purchase coffee when the price is high and sell when the price goes down. Because the price went down continuously in the past two year, most of them suffered losses.

When the price equaled the production cost (before March 2000), part of losses suffered by state companies turned into profit for farmers. For example, in 1999, companies purchased at VND19,688 a kilogram and sold when the price fell to VND12,000 (equaling the production cost), they suffered a loss of VND7,688 while the farmer made a profit of 7,688.

Profit and loss from the output from their own plantations are almost meaningless because they didn't control the whole output for export. The following are reasons for this situation:

- After receiving a piece of land and some advances from the state company, coffee planters will pay a percentage of the output fixed by the company by way of tax, insurance, social benefit, interest rate, amortization and other fees. This percentage is usually 35% of the fixed output, 65% of the fixed output and the extra output if any are held by planters and

Table 1: FOB price of coffee from HCMC ports 1992- 2000

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001 (*)
US$/tonne	720	900	1,677	2,454	1,717	1,221	1,530	1,372	800	550
VND1,000/tonne	10,332	12,915	24,065	35,215	24,639	17,521	21,956	19,688	11,480	7,893

(*) estimated price
Source: Dak Lak Service of Tourism and Trade

Table 2: Price of coffee exported from HCMC (VND/kg)

Year crop	December	January	February	March	April	May	June	July	August	September
1996-1997	20,621	19,900	22,885	24,442	23,101	28,177	26,908	26,432	22,495	23,216
1997-1998	17,900	18,450	19,000	19,560	22,570	22,870	19,540	17,870	19,000	19,210
1998-1999	20,800	20,830	20,830	18,630	16,950	15,910	15,720	14,280	14,860	13,720
1999-2000	15,053	13,245	11,781	11,394	10,734	10,074	9,873	9,902	8,467	8,553

Source: Dak Lak Service of Tourism and Trade couldn't be under control of the company.

- The fixed output offered by the company to planters has been fixed and remained unchanged since 1996. The real yield capacity has increased by some 30% since then. So numerical data worked out by the companies based on this fixed output and 35% of it controlled by them seem meaningless.

As for the purchased output, part of the loss suffered by the company originates from bank interest because they have to borrow from banks to purchase coffee. In Dak Lak alone, state coffee companies borrow some VND300 billion to purchase coffee every year. The government has allowed them to be exempt from bank interest payments for loans for purchasing coffee.

From March 2000, the price was lower than the production cost and all coffee companies are suffering losses. Their workers didn't meet great difficulties because they are paid wage for their piece work and they could gain some income from the extra coffee output (part beyond the fixed output). In the next crop, if the price is still low, their living condition will be lower.

Generally, state coffee companies ensure socioeconomic targets in the last price cycle. All of them could make new investment and gain some profit. Profit represented in their financial statement, however, didn't reflect their performance.

The Vinacafe Corporation is a special case: Its productivity rose from under 1 tonne per hectare in 1986 to 2.2 tonnes in 1995. This productivity is of the world highest level. Its output increased from 30,000 tonnes in 1995 to 44,000 tonnes in 2000 and its fixed assets from VND472.7 billion in 1995 to 1,100.0 in 1999. Its working capital increased and its competitiveness enhanced. It could export coffee to 45 countries and earned US$1.291 billion in the years 1995-99. Living conditions of workers were improved. There was no hungry family and poor ones represented only 4%. Some 60% of worker families made about VND20 million a year. Vinacafe subsidiaries provided jobs for 25,000 laborers, 10% of them are from minority groups. State coffee companies in Dak Lak employed 20,956 workers in 1999 (7,475 of them are from minority groups).

State coffee companies have played a leading role in introducing new techniques and equipment, improving productivity and product quality, developing infrastructure, purchasing and exporting coffee, etc. Many new towns with power supply, road network, schools and health care offices have come into being around factories of state coffee companies. These companies also helped with stabilizing the market price.

State coffee companies contributed a lot to the treasury. The Vinacafe paid VND316.8 billion to the Treasury in the years 1996-99. In Dak Lak, earnings from coffee business represent over 40% of the provincial budget income; 10 state coffee companies here paid VND272 billion in the years 1995-99.

Due to efforts by state coffee companies, zones specializing in coffee are now well under way. In Dak Lak, coffee output from private plantations rose from 2,180 tonnes in 1977 to 304,440 tonnes in 2000. The national output increased from 8,400 tonnes in 1980 to 600,000 tonnes in 2000. The development of coffee business has stipulated other industries (fertilizer, insecticide, farm machinery, package, etc) to new progress.

Thus, the policy to develop the coffee industry into a big one based on different sectors and the leading role of the public one has produced good results. State coffee companies have become good "rural factories". All developments, however, contain new shortcomings to deal with. One of the problems arising from the development of the coffee industry is the poor performance of state coffee companies.

Statistics about the years 1986-99 supplied by the Vinacafe Corporation show that its profit ratio started to lower. The same has also happened to 10 companies in Dak Lak.

Table 3: Profit ratio of state coffee companies (%)

Enterprise	1986	1988	1989	1990	1995	1996	1997	1998	1999
Vinacafe	91.0	36.9	19.5	15.0	31.0	9.0	8.3	1.0	-2.3
Companies in Dak Lak					54.3	9.4	9.1	8.7	0.5

Decreases in the profit ratio are reasonable when the labor productivity rises but it is a paradox that the ration becomes negative. Besides falls in the coffee price, there are other causes of this situation:

a. There is no price stabilizing fund for the coffee industry,

b. The general production cost is still high because:

- Failure to make the most of machinery and equipment: Utilized capacity of most production lines is only 30% - 40%. Costly investment in irrigation system and pumping stations didn't produce good results because most farmers have their own wells and pumping machines.

- Farming cost covered by farmers and processing cost by companies are high (equaling one third of the farming cost). Table 5 presents costs in a 4-year period in one of the best coffee companies in Dak Lak.

The production cost in some coffee companies is unreasonably high. When the productivity rises and the profit ratio falls, the unit cost will fall accordingly. Experts from LMC International Ltd., after studying changes in the coffee production cost in the last decade also concluded that "the coffee production cost in 1997 price being adjusted after inflation has fell by 2% a year." In Vietnam, however, everything seems to change in different direction.

- The army of indirect labor is large. In 10 coffee companies in Dak Lak, this army represented 9.5% of the labor force in 1998 and 9.3% in 1999. This figure in the Vinacafe was 12.3% in 1999.

c. The product quality isn't as high and stable as expected. This makes the price of Vietnam's coffee

Table 4: Costs in a typical coffee company (VND/ kg)

Item	1996	1997	1998	1999
Farming cost (1)	8,624	10,465	10,053	11,863
Processing and housing cost (2)	2,469	2,901	4,453	3,394
Production cost (1+2)	11,093	13,366	14,506	15,257

from US$150 to 250 lower than that from other countries.

The processing plant doesn't have enough facilities. The area of drying field is too small. This area owned by the Vinacafe meets only 50% of the demand. The system of warehouses is small and doesn't reach requires standards. Most purchasing agencies have no appropriate warehouse.

Processing machinery is still lacking. In the crop 1999-2000 the processing system in Dak Lak handled only 35% of the output. There are many defects in locally- made processing machinery while the imported one is too large and expensive, unsuitable to local companies.

There is no agency checking the quality of coffee for export. The product quality may only reach Vietnamese standards but not international ones. Supervising organizations have tried their best to improve the quality but it could only be improved by introducing the quality control system to all production stages.

d. Other difficulties in improving the business performance of state coffee companies are:

- Some 86% of coffee growing area is in the care of private planters who pay more attention to the output than to the quality and lack appropriate facilities (drying field or drying machine).

- Coffee is planted even in poor land because coffee promises good income. Of the coffee growing area in Dak Lak, 25,560 hectares are appropriate to coffee tree and 11,620 are not.

- The supply of water to coffee plantations is short. The irrigation system built by the Dak Lak provincial government, according to calculations, can provide water for 162,175 hectares while the actual coffee growing area has reached 264,000 hectares. Although planters have tried their best to water their plantations, some 30,000 hectares aren't watered properly.

II. Solutions

When the selling price is higher than the production cost, loss of one company turns into profit or income for others. When the price is lower than costs, the whole coffee industry suffers losses. Looking at the problem from socioeconomic aspect, state coffee companies in the last price cycle achieve acceptable performance.

To enhance their performance, the coffee industry needs a managing organization acting as a link between companies and the world market, working out strategy to ensure sustainable development for the industry, directing the distribution of wealth among participating parties and preventing unnecessary competition.

In areas where the soil is unsuitable to coffee growing or the water supply is short, coffee could be replaced by other crops. In areas where the soil is suitable, the proportion of arabica coffee should be raised in comparison with robusta coffee with a view to improving the product quality.

In building processing plants, the installed capacity should be appropriate to the farming capacity in order to avoid waste of investment. Capacity of private processing concerns should be also taken into account when building these state-run ones.

The state commercial banks help state coffee companies to secure loans needed for new investment and supply soft loans to private planters who want to apply new processing technology. The engineering industry had better produce better processing machinery for the coffee industry.

A Coffee Trading Center could be established in Buôn Mê Thuột or HCMC whose aim is to facilitate the trade in coffee, by taking part in futures markets, such as London Commodity Exchange, for example.

The quality control system could be applied easily because 95% of the coffee output is for export. Price ceiling and floor could be fixed with a view to facilitating operation of state coffee companies and purchasing agencies. The price ceiling could be lower than the estimated highest export price. The difference between the export price and the ceiling could be used for forming a contingency fund or price stabilizing fund for the whole industry. The price floor should be high enough to cover production cost and overheads.

In carrying out the sharecropping system and allocating land to planters, state coffee companies had better purchase the whole output to process and distribute profit after coffee is exported instead of maintaining the existing way of distributing income.

The General Department of Measurement and Quality Control had better set standards of coffee for export in order to control the quality of exports and help companies and planters to produce goods of higher standards. ■