



# Essential elements of product market combinations: vegetable production on contract

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### Product market combinations

**A product market combination (PMC) is a pilot implemented with partners in the supply chain, including small farmers (with holdings of less than two hectares), who produce vegetables in a coordinated way and according to specific market demands. PMCs contain improvements and innovations in terms of aspects such as varieties, marketing concept, packaging materials, branding and supply chain configuration. Supply chain partners make arrangements to improve existing market connections or create new market opportunities. PMCs are considered as a 'proof of concept' which shows that innovations and cooperation in market-oriented supply chains can potentially benefit all supply chain partners and small farmers in particular.**

Ten PMCs were developed within vegIMPACT and implemented with small farmers in five Indonesian provinces. Most of these farmers sell vegetables individually, without contractual agreements with collectors and traders. As a consequence, farmers do not have a great deal of control over price levels or payment terms. In other words, they are principally 'price takers'. As the horticulture sector in Indonesia frequently has periods of over and undersupply of vegetables, prices tend to fluctuate heavily.

Most farmers participating in the PMC pilots indicated that limited access to markets is one of their biggest problems. Supply chains are long and not very transparent. Five to ten intermediate parties tend to be involved before a product reaches the market.

In PMC pilots, farmers have been introduced to working on contract in short and transparent supply chains with just one or two trusted traders. This was expected to stabilise and increase farmers' incomes and reduce risks. An additional benefit of having a formal contract with a trader is that organised small farmers may become eligible for bank loans.

### Contract farming

Contract farming can be defined as agricultural production carried out according to an agreement between a buyer and farmers which establishes conditions for the production and marketing of a farm product or products. Typically, it involves farmers agreeing to provide specific quantities of a particular agricultural product (Source FAO).

### Checklist of farm contracts:

- Contract partners clearly mentioned (as well as roles and representation).
- Clear product and quality specifications and volumes.
- Transparent and simple pricing and payment system.
- Defined actions to be taken in case of force majeure.
- Determination of sanctions against parties who violate contract rules.
- Clear date agreements including end date.

### Types of contracts and price

Farmers and traders alike are often hesitant to sign formal contracts with fixed contract prices. Knowing the fluctuating market prices, both parties find it difficult to trust that the other could credibly commit to any price agreement. However, both parties also agree that more stable prices would be beneficial for both of them.

Parties often do not know that there are a range of systems to fix prices for those who wish to produce on contract. Some systems have a built-in mechanism to protect both parties at times when market prices diverge greatly from the contract price.

### There are also many different types of contracts, such as:

- Formal or informal
- Written or verbal
- Based on planting rounds or on time periods

The PMC pilots showed that, even without being formalised, a contract can already be an improvement on traditional working relations between farmers and traders.



*"Having a formal contract with a trader has been very beneficial, as it resulted in a more stable financial situation for me and my family." – Mr Winarto, hot pepper farmer in Guci*

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