

Co-operatives in the Latvian agri-food business

– Agents of change?

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Abstract

In transition countries, like in Latvia, agri-food sector meets wide range of problems. Firstly, after Western investments started to flow in the country, it has changed traditional store- by- store business model to western. It leads to the fact that nowadays most of shopping are done in supermarkets, instead of markets or small shops. These supermarkets, often owned by other nationals, bring their requirements of safety to the country. These requirements are mostly higher than it was before, and completely change retail field from how it was traditionally. Supermarket chains generally have high standards of quality, as well as requirements for quantity. This situation leads to the necessity of vertical cooperation in sector, because these standards are mostly inaccessible for small farmers, which are dominating in Latvian agriculture.

Introduction

During the transition process in Central and Eastern Europe, relationships along the whole food chain - from farm suppliers to retailers – have broken down. The result has been disruptions of supply and inferior-quality food products. Thus, with regard to the Latvian agri-business we can say that it is still characterized by many transition specifics such as dualistic production structures on farm level as well as disruptions in food supply and shortcomings in regard to food quality. However, retail sector, for example in Latvia, has transition from state-run shops and cooperatives and farmer's markets to western-style, large format retailers was accompanied by heavy foreign investments. At the same time, changes in consumer demand as well as the accompanying entry of ‘western’ investors (retailers and processors) made adjustments in the

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structure of the food chain necessary to overcome these problems. In the context of retail internationalization it can be observed that 'western' retailers are taking their own business models into the new markets (Hanf and Pieniadz, 2007). Thus, one can say modern management concepts and their demands on the business partners are exported. This results in the following changes: The traditional, local, store-by-store procurement must be shifted to centralized, large, and modern distribution centers and external specialized logistic firms must be used. Furthermore, modern retailers set their own private standards of food quality and safety that are often much higher than those of the local governments (Dries et al., 2004).

One of the examples how retail investments enforce transition process is found in Latvia. Until 1991, business was fully controlled by government, and only after 1991, when Latvia declared independence from Soviet Union its market structure began to change. Since then, Western investments are flowing into country and it experience boom after EU and NATO accession in 2004. Example how Western investments changed business model are seen in Investigations of The Nielsen Company (Frut news online, 2007) which shows, that between years 2000 and 2007 number of super and hypermarkets in Latvia are multiplied by nine, reaching number of 259 in beginning of 2007; while number of traditional shops reduced by 30% and number of kiosks reduced by 70%. On this basis currently almost 60% of purchases are made in supermarkets. Some years ago the shares of supermarkets, small and medium shops and markets in the retail were almost equally distributed, presently markets account only for 7% (Krievina, 2009). In 2007, value of food retail market in Latvia was about 2 billion Euros. An important characteristic of Latvian food market is that sector cannot fully ensure local demand. Its maximum is 68%, and more than 30% is imported (Pārtika un lauksaimniecība online, 2009). Although manager of biggest supermarket chain explains, that consumer in Latvia prefers local products. He also assumes that, in their supermarkets, from essential goods- milk, bread, meat, vegetables- 80% is locally produced. 95% of milk products are local production. From fresh products, except products which are not grown in Latvian climate, about 85% is local production (Latvijas Avīze online, 2007). As explained, role of supermarkets are increasing, and nowadays in Latvia more than half of market is ruled by two dominant supermarket chains, both are owned by foreign entities. Biggest is Maxima, with 33% of market (subsidiary company of Lithuanian Vilniaus Prekyba) and second biggest is Rimi, which owns more than 20% of market (subsidiary company of Swedish ICA AB) (NRA online, 2009).

The requirements of the newly established procurement systems demand that suppliers be able to guarantee both disruption-free product flows and delivery of products of a certain quality. Thus, domestic producers must keep up with the demanded quantity and quality or products will be imported instead. Thus, foreign direct investments are particularly regarded as a catalyst for vertical coordination. Vertical coordination can be described as the coordination of each link in the food chain to overcome problems of supply and quality. Thus, traders, agribusinesses, and food companies contract with farms and provide inputs and assistance in return for guaranteed supplies of a certain quality. Overall, there are two main forms of contractual arrangements – marketing and production contracts. Marketing contracts solely address the issue of supply disruptions by private contractual initiatives (Dries and Swinnen, 2005; Gow and Swinnen, 1998; Swinnen, 2005). Production contracts address quality (Gorton et al., 2006). For both types of contracts Swinnen states in the World Bank Report (2005) that “these private contract initiatives can be quite substantial. Empirical evidence indicates that they include farm management assistance, extension services, quality controls, farm input assistance programs, trade credit, and even bank loan guarantees. The programs generate important improvements in the credit situation of the farms, as they contribute directly to improved access to finance (e.g., through trade credit), and indirectly as they improve contracting farms’ access to loans from banks or external financial institutions (through loan guarantees, enhanced farm profitability, and improved future cash flows).” Two reasons for the breaching of contracts have been detected. First, producers mistrust their buyers and are afraid they will not be paid. Second, they may not be able to fulfill a contract because they cannot access basic production factors (Gow and Swinnen, 1998).

In this situation, where agricultural sector is controlled by retailers – in Latvia market, by two big supermarket chains – and processing sector is also controlled by big processing companies, especially in milk sector, producers often have difficulties to access these markets. Furthermore in Latvia, farm structure shows high rate of small farmers. According to CSP (CSP online, 2009) data and calculations of authors, almost 98 % of all farms in Latvia in 2007 were very small, small or medium small, in measurements of European Size Unit (ESU). Small farmers cannot influence process in markets, as well as price. Also farms are short of funds, and are not able to invest in developments, new technologies, which also cause shortages in quality.

Nowadays main aim to set up cooperative in Latvia is to have more control and influence over these processes, especially producer price.

Aims and methodology

In the introduction we have shown that the topic of vertical coordination is of high importance in transition countries such as Latvia. Thus, our first aim is to study the degree of vertical coordination in the Latvian agri-food business. In this context we will firstly research the usage of marketing and production contracts as well as vertical integration by secondary data. Secondly, we will carry out an empirical survey. Because Latvia disposes over a dualistic production structure – many small and only few large farms are exist – we pay particular emphasis to cooperatives in the sector. We ask our self and try to answer the question whether cooperatives can act as agents of change linking small farmers in vertical coordinated chains. We will answer this question in the course of our survey.

Vertical Coordination and Contractual Arrangements

Driven to close the gap between their supplies and their needs, supermarket chains in developing regions have been shifting over the past few years away from the old procurement model based on sourcing products from the traditional wholesalers and the wholesale markets, toward the use of four key pillars of a new kind of procurement system: (1) specialized procurement agents we call “specialized/dedicated wholesalers”; (2) centralized procurement through Distribution Centers (DCs), as well as regionalization of procurement; (3) assured and consistent supply through “preferred suppliers”; and (4) high quality and increasingly safe products through private standards imposed on suppliers (Reardon et al. 2003). Reardon et al. (2003) have found that supermarket chains have a dual objective – one qualitative (to increase quality and eventually safety of the product) and one quantitative (to reduce costs and increase volumes procured). Supermarket chains have a difficult time meeting those objectives by using the traditional wholesale sector to procure their products (Reardon et al., 2003). It explains changes of business model from traditional to western, due to role of supermarkets are increasing.

To fulfill needs of customers from one hand, and criteria of supermarket chains from other, it is found that vertical coordination can be used. Swinnen (2005) shows that vertical coordination (VC) in agri-food supply chains is an important and growing phenomenon in the

transition countries of Europe and Central Asia (ECA). VC is more important and more widespread than generally recognized. He also admits that the key engine of VC is search for quality. The shortage of quality supply, which is typical of transition countries, induces vertical coordination and spillover effects through farm support packages. The issue of quality has both efficiency and equity implications. Swinnen (2005) explains that major problem in the transition countries of Europe and Central Asia (ECA) during the transition was the breakdown of the relationships of farms with input suppliers and output markets. The simultaneous privatization and restructuring of the farms and of the up- and downstream companies in the agri-food chain has caused major disruptions. The result is that many farms and rural households face serious constraints in accessing essential inputs and in selling their products (Swinnen, 2005). Thereby, VC is aimed to overcome two important problems in transition country such as Latvia-disruptions in supply chain and shortcomings in food quality (Swinnen, 2005).

To overcome problems in agri-food chain contractual arrangements are wide used, to deal about standards of quality and quantity between suppliers and customers. Swinnen (2005) explains that traders, agribusinesses and food companies contract with farms and provide inputs and assistance in return for guaranteed and quality supplies. A contract is described as simply an institutional construct that outlines the mutually agreed upon rules (and expectations) of how these fundamental elements will be addressed in the transaction relationship. The legal essence of a contract is that of a "legally enforceable promise." From an economic perspective, the contract serves as a governance mechanism, outlining the agreed upon and expected allocations of value, risk, and decision rights associated with the transaction. In short, the contract outlines the agreed-upon "rules of the game." There is a large literature examining the completeness-or rather, incompleteness of contracts in the presence of positive transaction costs, bounded rationality, and information asymmetry (e.g., Crocker and Reynolds, 1993; Williamson, 1993; Hart, 1993; Mahoney, 1992). The general conclusion is that contracts are necessarily incomplete. It is impossible to write a contract that fully specifies all of the rights and responsibilities of both parties or to cover every possible contingency such that neither party will ever have an opportunity to take advantage of some "loophole" or ambiguity to the detriment of the other. According to Crocker and Reynolds, both contractual incompleteness and costly (or imperfect) monitoring and enforcement give rise to the possibility of ex post opportunism. In the case of contractual incompleteness, either party may take advantage of ambiguity in the contract's

language or of situations that may arise that the contract does not explicitly cover to improve his ex post payoff. Costly or imperfect monitoring and enforcement may create incentives for either side to take advantage of information asymmetries and shirk their contractually defined responsibilities. Contracts that are written to minimize the ex post costs of opportunism subject to the ex ante costs of contract design and negotiation-where the marginal benefits and costs of completeness are equal-are considered economically efficient (Crocker and Reynolds, 1993).

(Finding 1.) Thus, even **economically efficient contracts leave potential for opportunistic behavior** (Sykuta and Parcell, 2003).

Successful vertical contracting typically includes conditions for product delivery, prompt payments, and farm assistance programs for suppliers. Farm assistance can include input supply programs, investment assistance, trade credit, bank loan guarantees, extension and management advisory services, etc. As Swinnen (2005) shows, successful vertical contracting has important positive effects, both direct and indirect. The direct impact is on increased output and productivity of the processing company that initiates vertical contracting. Indirectly, contract support measures have positive effects on farm productivity and product quality. Measures with the greatest impact on yields were specialist storage (cooling equipment in dairy), veterinary support and physical inputs. Prompt payments, guaranteed prices, and market access also had large positive effects. Quality of output improved strongly in response to specific programs. Direct loans and loan guarantee programs stimulated farm investments. Programs which assist farms in accessing inputs (mainly feed) enhance investment indirectly by lowering input costs, or reducing transaction costs in accessing inputs, improving profitability.

There are different factors influencing participants in use of contract arrangements. The main motivating factors in marketing and production contracts are the following according to the report of USDA (1998):

(Finding 2. - 5.) As the main reasons why farmers enter into contracts include the following:

- **income stability**, (to reduce risk compared with other way of selling on traditional marketing channels)
- **improved efficiency** (management decisions are transferred to the farmers),

- **market security** (entering the contract provides a certain security for that the product will be sold if it meets with the requirements) and
- **access to capital** (contractor often provides inputs for farmers, which reduces the usage of credits).

(Finding 6.) Main reasons that processors and other entities enter into contracts include the control over input supply.

By asserting more control over the production process, contractors can better respond to changing market conditions. Processors use contracts because they desire uniformity and predictability to suit consumers, but they also benefit from lower costs in processing, packing, and grading. (USDA, 1996)

For example, processors introduced programs to improve farms' access to inputs as part of enforcing contracts on the downstream side of the farms. Inversely, input suppliers got involved in harvesting and marketing farms' output to enforce contracts on the upstream side of the farms (Gow and Swinnen, 2001). Thus, marketing and production contracting are becoming increasingly important (Tsoulouhas and Vukina, 1999, Sykuta and Parcell, 2003). Drabenstott (1999) describes that as a result of increasing role of contracts, producers are trying to meet these discriminating consumer demands are developing new products and services and seeking more production efficiencies by more closely coordinating their buyer and supplier relationships (Sykuta and Parcell, 2003).

Production contract is often a multi period agreement between a large firm and a farmer which require the farmer to meet specific production standards (Martin, 1997). It specifies in detail the production inputs supplied by the contractor (processor, feed mill, other farm operation or business),

(Finding 7. - 8.) the quality and quantity of a particular commodity,

and the type of compensation to the grower (contractee) for services rendered (USDA, 1996). According to MacDonald (2006), in production contracts farmers provide grower services, and in these contracts main negotiation parts are grower services, contractor responsibilities, and compensation.

Marketing contracts solely address the issue of supply disruptions by private contractual initiatives (Swinnen, 2005). It has focus on the delivered commodity to the contractor (MacDonald, 2006),

(Finding 9.) specifying the commodity's price or a mechanism for determining the price,

quantity to be delivered and a delivery outlet. The pricing mechanisms may limit a farmer's exposure to the risks of wide fluctuations in market prices, and it often

(Finding 10.) specifies price premiums to be paid for commodities with desired levels of specified attributes (Macdonald, 2006).

Most of the management decisions remain with the growers since ownership is retained while the commodity is being produced. The contractor also assumes all risks of production, but

(Finding 11.) shares price risk with the contractor (USDA, 1996).

Latvian cooperatives in vertical coordination

In that situation, where agricultural sector is controlled by retailers – in Latvia market, by two big supermarket chains – and processing sector is also controlled by big processing companies, especially in milk sector, producers often have difficulties to access these markets. Furthermore in Latvia, farm structure shows high rate of small farmers. According to CSP (CSP online, 2009) data and calculations of authors, almost 98 % of all farms in Latvia in 2007 were very small, small or medium small, in measurements of European Size Unit (ESU). Small farmers cannot influence process in markets, as well as price. Also farms are short of funds, and are not able to invest in developments, new technologies, which also cause shortages in quality. Nowadays main aim to set up cooperative in Latvia is to have more control and influence over these processes, especially producer price.

Until now, in Latvia mostly horizontal cooperation is developing. Farmers, growing the same crop, set up cooperatives, to have more influence in market. According to statistics, till September 2008, in Latvia was operating 108 approved cooperatives. Milk and grain sectors are dominating in field of cooperation, forming in total 62 from 108 coops, and around 60% of total turnover every year is concentrated in milk and grain sector. Average number of members per cooperative is 51. There are some signs of vertical cooperation in milk sector. Three milk cooperatives are processing production from its members before sales and there are two

cooperatives, which owns majority stake in milk producing company. In other sectors vertical cooperation is seen in one meat cooperative and biological fruit and vegetable cooperative which are also processing part of production before realization. In overall, vertical cooperation still needs to be developed in Latvia. In July 2008, 14 milk cooperatives sign agreement about collaboration in building milk producing company or overtaking existing one (Bille, 2008). Main aims are to avoid price fluctuations, to ensure stable price for farmers and to get control over milk sector. Milk cooperatives now are working on market research and negotiations with Minister of Agriculture for possibilities of co-financing. If the plans of 14 milk cooperatives will be realized, it will be huge step in development of vertical cooperation and integration of small farmers into vertical chain.

The forms of cooperatives in Latvia are regulated in National Law of Cooperative Companies, which defines cooperatives in agriculture as providers of services, and can not produce any goods. So in case of Latvia, we can speak more about marketing, than producer cooperatives. From different functions which cooperative can do: (1) supply with raw materials, (2) ensure technique and equipment for common use, (3) run common property, (4) realize production from its members, (5) rent of agricultural machines from one member to other, (6) finance cooperatives, savings- and- loans bank (LLKA online, 2009) in Latvia cooperatives generally work with suppliers of raw materials, ensure common techniques and sells production of its members. Generally in this scheme are working most of vegetable, grain, milk cooperatives, although, as mentioned before, there is milk cooperatives owning major stake in milk processing company or owning milk processing company, biggest in this case is milk cooperative “Piena ceļš”. Also grain cooperative “Latraps” are offering first- stage processing to its members, biological meat cooperative “Zaubes kooperatīvs” process part of meat before realization, and biological fruit and vegetable cooperative “Zaļais grozs” process part of its members production. Remaining cooperatives deals with functions of marketing cooperatives.

Best example how cooperative act as agent between suppliers- farmers- processors is seen in biggest grain cooperative in Latvia- Latraps. Established in year 2000 by 12 farmers, it has grown to biggest cooperative of Latvia, collaborating 497 farmers in January 2009. As executive director of Latraps Edgars Ruža tells (Galeja, 2008), in center of cooperative is farmer and all activities are leaded to increase profit of farmer. One of main activities is supply of raw materials for farmers; as biggest market player Latraps gets around 20 % cheaper materials for

its members, acting as agent between suppliers and farmers. The other important activity is price negotiation and regulation. The main problem of market is seasonality of production- because every farmer harvest grains in autumn, prices are decreasing. Latraps offers its members dry-houses and storage, which allows waiting for price stabilization and then cooperative can decide where to distribute it, in this case acting as agent between farmers and processors. Mechanism for financing dry- houses and storages are working successfully, offering each farmer to choose amount of grains it will bring there, and according to its quota, farmer is paying bank loan for buildings while part of it becomes its property. This example shows how cooperative can successfully act as agent between suppliers- farmers- producers.

In sum, cooperatives might act as agents, which are linking suppliers and processors or retailers in one chain. However, according to recent research and available information, vertical cooperation is not developed in Latvia. Despite vertical cooperation is not developed, still vertical coordination in form of contracting between suppliers and processors is working in country. Before closing sugar factories, sugar sector was mostly dominated by contractual relationships between growers and factory, dealing with price, expected and maximum amount of beets per grower and paying conditions (Agropols online, 2009). Nowadays, most of contracts are found in milk sector between farmers and processing companies and also in grain sector between growers and bakeries or processors and exporters.

Interviews with Latvian cooperative managers

This study investigates contractual relationships between cooperatives and farmers (members of the cooperative) and between cooperatives and buyers in Latvian cooperatives. The aim is to understand better how these cooperatives could be integrated as agents into the new agri-food environment, therefore question is arising how the different forms of contract (marketing and production contracts) which are used as tool of vertical coordination, are applied in case of Latvian cooperatives. Therefore, the study is investigating the above described **Findings (F.) from the literature**. The respondent were asked personally, or on phone (approximately 20-30 minutes long) or in email. The questions were structured or opened. In this paper only the results of structured part are introduced.

Data collection

Data were collected among 16 cooperative managers in agricultural sector and were asked about usage of contracts with producers and with buyers. Thus, this investigation covers the 15 % percent of all cooperatives in Latvian agri-food business. All respondent cooperatives are members in a Latvian cooperative association.

Among these cooperatives, three have higher than 100 members and in sum cooperatives have 721 members, in average 45 members. In average, 63% of the members were small producers and the rate of small producers was higher in cases of smaller cooperatives. Six respondent cooperatives produce milk, six vegetable, two grain and two provide services(Figure 1). In average, milk coops have 61 members, vegetable coops 12.5 members; grain producer cooperatives 27 members and service cooperatives 111 members. Cooperatives have wide range of buyers. Generally, they sell products to processors, wholesalers, retailers, specialized stores and on other different markets (Figure 2). Most of the milk producers sell to processors. Only vegetable producer coops sell to retailers.

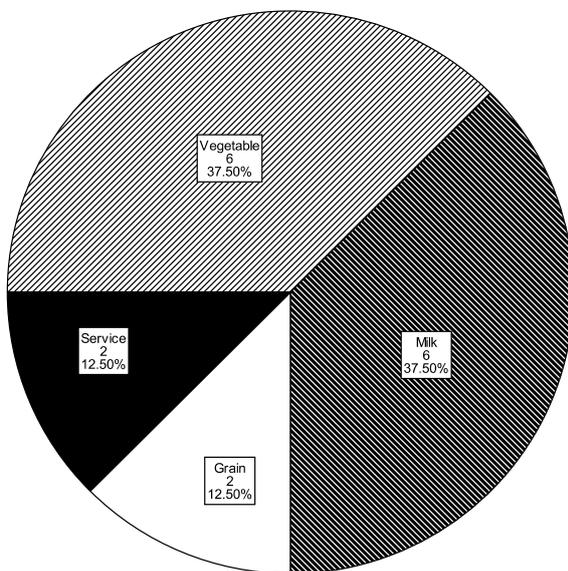


Figure 1.: Production of cooperatives

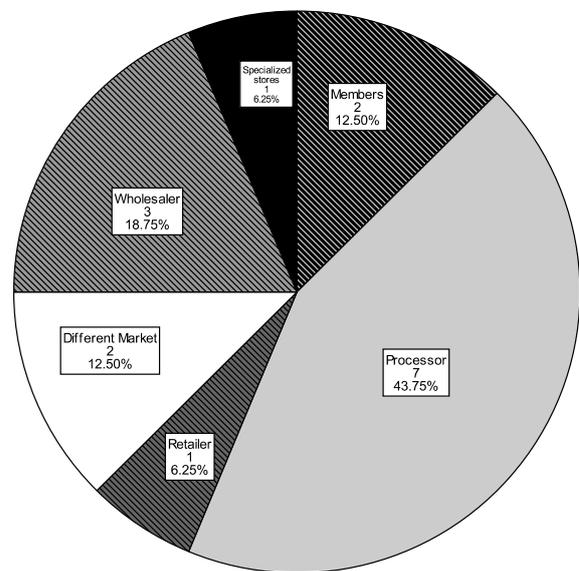


Figure 2.: Buyers of cooperatives

Results

Contracting with producers

Seven respondent cooperatives use contract with producers. As it is observable in Figure 3, three of them produce milk, two vegetable, one grain and one provided services. Five coops sell to processors and one to retailer.

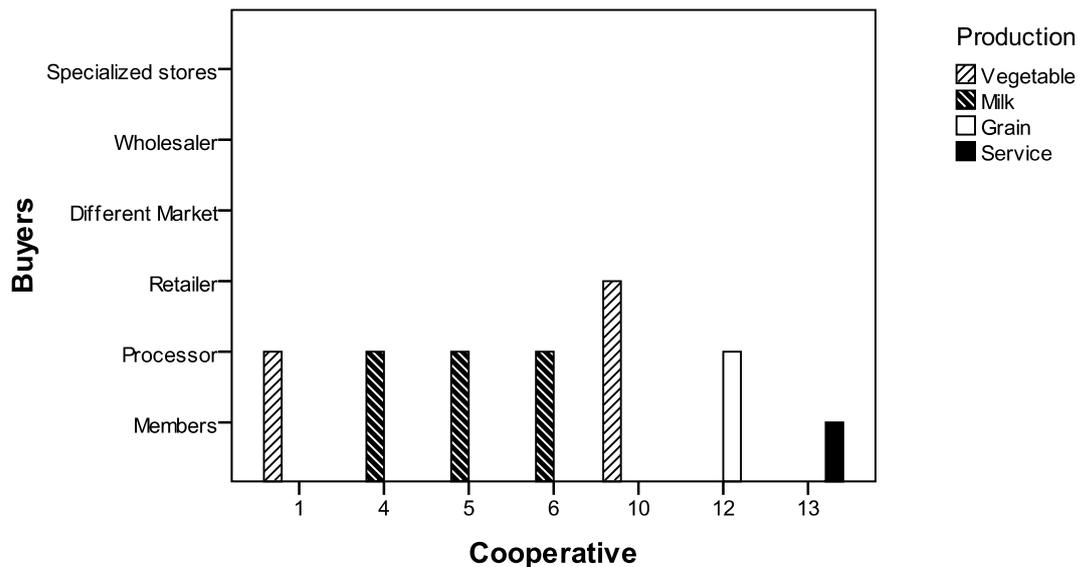


Figure 3.: Buyers and production of cooperatives using contract with producers

Managers of these cooperatives were asked about their and their members' (producers') aims in contracting. We asked them about importance of the relevant factors in a production contract. It is observable that for coop managers definition of quantity (F8) is important in all cases; but defining quality (F7) is not important in all cases. Furthermore, the aims of 'control over production' (F6) and 'improvement of efficiency' (F3) are less important, even not important for almost the half of the respondent managers.

At the same time, for producers (according to managers' opinion) the 'improvement of stability' (F3) in all cases, 'income stability' (F2) and 'market security' (F4) in almost all cases is important aim. 'Reduction of price risk' (F11) and 'access to capital' (F5) is important aim only for five respondents.

Reward system (F10) is used for cooperatives in four cases and for producers only in two cases. However, punishment systems are used for every cooperatives and for producers only in every second cases. Contract is alone efficient only in 50 % of the cases and all of not satisfied

respondent sell to processors. Contract is not sufficient for avoiding opportunistic behavior (F1) only for two cooperatives and all of them selling to processors.

Contracting with buyers

Ten cooperative managers use contract with their buyers. Five of them produce vegetable, three milk and two grain. Three of them sell to producers, other three to wholesalers, two on different markets and only one to retailer. (Figure 4)

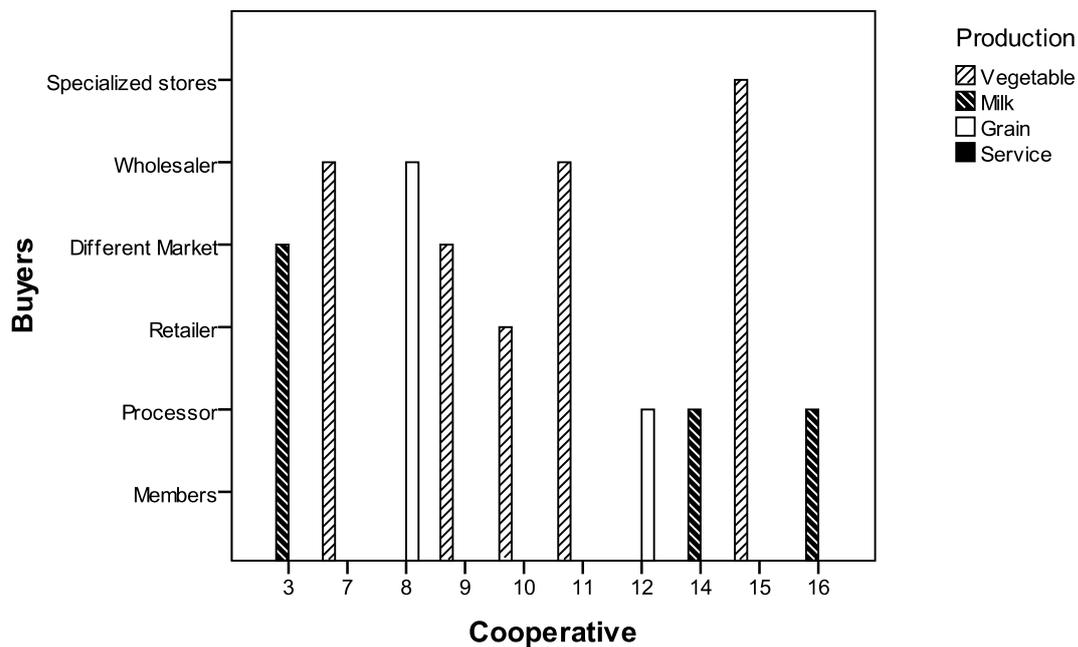


Figure 4.: Buyers and production of cooperatives using contract with buyers

Cooperative managers were asked about their and their buyers' aims in contracting. For seven from ten managers the improvement of efficiency (F3) is important aim and for half of them to control pricing mechanisms (F9) is important.

On the other side of the contract, for the buyers (according to the coop managers' opinion) mostly important aims are the improvement of stability (F3) and control over supply (F7) (both for nine from ten respondents), and reduction of price risk (F11) is important in seven cases.

Reward system (F10) is used for cooperatives in eight cases and for producers only in two cases. The usage of punishment is almost the same in 8 cases for cooperatives, but five of the cases use punishment system for buyers as well. These contract are enough efficient in 50 % and only in 30 % of the managers said that contract is efficient tool for avoiding opportunistic behavior (F1).

Contracting with both of producers and buyers

Among 16 respondent cooperative managers only two use contracts with both of producers and buyers (Figure 5). These two cooperatives produce vegetable and grain selling their products to retailers (supermarkets) and processors (bakery).

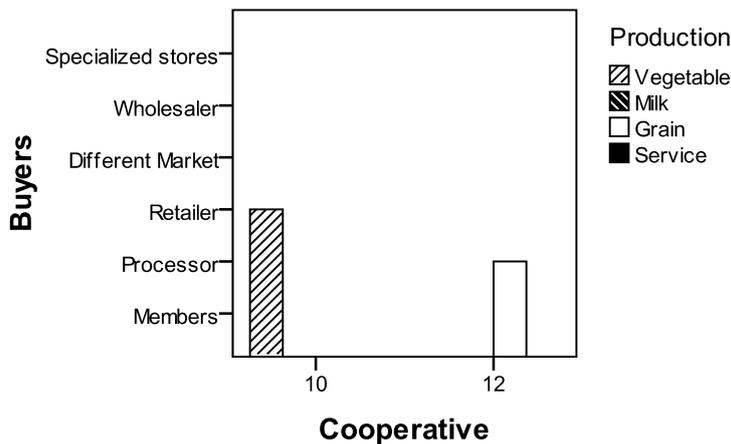


Figure 5.: Buyers and production of cooperatives using contract with both of producers and buyers

As we asked the managers about their and the other negotiating parties' aims in contracting, we found that almost every aim was important. Little differences are observable (Table 1) for example, that manager of cooperative, which sells to processor, control over pricing mechanisms was totally not important.

| Cooperative | | 10 | 12 | |
|------------------------|--------------------|---------------------------------|----|---|
| Contract with producer | Aim of cooperative | Control over production | 4 | 4 |
| | | Defining quality | 4 | 4 |
| | | Defining quantity | 4 | 4 |
| | | Improved efficiency | 4 | 4 |
| | Aim of producer | Reduction of price risk | 4 | 4 |
| | | Income stability | 4 | 3 |
| | | Improved stability | 4 | 4 |
| | | Market security | 4 | 4 |
| Contract with producer | Aim of cooperative | Access to capital | 4 | 4 |
| | | Control over pricing mechanisms | 4 | 1 |
| | Aim of buyer | Improved efficiency | 4 | 4 |
| | | Reduction of price risk | 4 | 4 |
| | | Improved stability | 4 | 3 |
| | | Controlling supply | 4 | 4 |

Table 1.: (1= totally NOT important – 4=fully important)

Furthermore, according to this manager's opinion, 'income stability' is only 'rather important' for producers and at the same time, for buyer improvement of stability is also not so important.

Both reward and punishment systems were used but not for every direction. Reward systems for buyers and for cooperatives in contract with producers are not used. In these two cases contracts were appropriate tool as a governance mechanism and were enough to avoid possibilities of opportunistic behavior.

Satisfaction level

Questions were asked about satisfaction level of producers and buyers. According to coop managers' opinion in 47 % producers are satisfied, and 26 % rather satisfied with their benefits in the cooperatives. The same question was addressed to coop managers about their opinion to what extent buyers are satisfied with their products. According to their answers, buyers are satisfied in 42 % and only rather satisfied in the 14 % of the cases. Other respondent have no information about buyers' satisfaction level. It is interesting that the managers of that cooperative, where contract is used only with producers, do not have information about buyers satisfaction in the 100 % of the cases and all of them sell product to processors.

Summary

For many years it has been observable that in the agri-food businesses there is an ongoing request in efficiency gains and quality enhancement by the alignment of actions of all players of food chains. The establishment of strictly vertically coordinated chain organizations is a worldwide phenomenon that does not stop at transition countries. By contrast, well known scientists such as Johan Swinnen and Tom Reardon assume that retailers and foreign direct investments can be regarded as more powerful sources of structural changes in transition countries than WTO and trade policy. Today, there are no significant differences between Eastern and Western Europe in regard to procurement systems and quality demands and thereby vertical coordination. However, the agricultural sector in CEEC is a mixture of small scale – even household – production and large scale farming. And often the majority of goods are still produced by small scale farmers. Thus, the questions arise as to whether and how small farmers can be integrated into the modern marketing channels of retailers. Hence, strictly coordinated chain organizations evolved and consequently supply chain networks have emerged. Taking into

account agricultural production characteristics, most often supply chain networks are still composed of many farmers.

To overcome problems in agri-food chain contractual arrangements are widely used, to deal about standards of quality and quantity between suppliers and customers. Generally, the aims of negotiating participant are different, but in the environment of vertical coordination, producers address the question of income stability; improved efficiency; market security; access to capital; shared price risk with the contractor and specified price premiums to be paid for commodities. For processors the control over input supply, quality and quantity of a particular commodity, commodity's price and price mechanism are important parts of contracts.

Therefore, we investigated the way of using contracts in the case of Latvian cooperatives with the question whether they can be agent between modern procurement systems and undeveloped small producers. The results showed that these cooperatives mostly are still not integrated in the modern chains, and coop managers have low level of coordination system between buyers and producers. It is observable that these contracts are often (in the half of the cases) not effectively used for doing businesses, probably because the actors' interests are not aligned. This assumption is also confirmed by the knowledge of cooperative managers' about their satisfaction level of buyers and producers.

In sum, we can conclude that the respondent Latvian cooperatives have still difficulties in the new agri-food business environment and they can hardly be the agents in the vertical coordinated supply chains.

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