

COCOA BEAN TRADERS AS SAVING AGENTS

Why use a cocoa trader as an agent and how does it work?





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Cocoa Bean Traders as Saving Agents

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Introduction

Lack of Access to Finance (A2F), especially Access to Loans and Access to Savings, is an ongoing hurdle for cocoa farmers in Indonesia. It's important for cocoa farmers to be able to either accumulate their own funds or borrow larger amounts of money for productive and non-productive purposes like business investments, school fees, emergencies, or health care.

Access to Loans is still challenging because of various reasons such as the absence of appropriate collateral and the bank's perception that agriculture is a risky business. Savings could play a crucial role in cocoa farmers' financial management. Technically, a loan is nothing more than a future saving, but savings come with some advantages. With savings, there is no collateral needed,¹ no interest to be paid, and it is impossible to go into arrears. Every willing farmer could participate and even if funds are used for non-productive purposes, at least it is the farmer's own money.

Disadvantages are that a lack of discipline might hinder the farmer's capability to save (while loans are somehow a forced saving, since otherwise collateral might be lost). There may be temptations to access the funds, money might get lost if not properly stored (e.g. in a rural or commercial bank), or family, friends and neighbors might request funding for "emergencies." Loans can be more beneficial if used for productive purposes, because it could increase the income of a farmer quicker than a saving, as the amount is readily available.

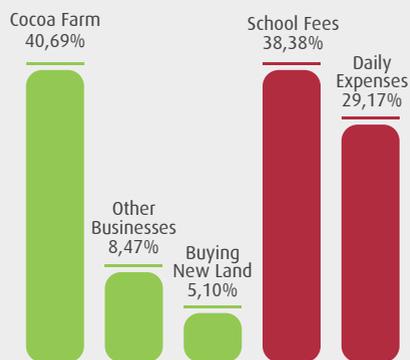
¹ Only 21.6% of the cocoa farmers in Swisscontact's Sustainable Cocoa Production Program (SCPP) have a notarial deed, which banks in Indonesia consider to be good collateral.





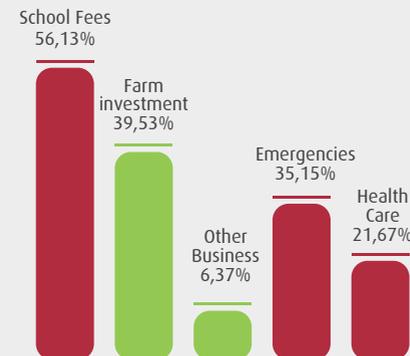
The following two charts show the use of previous loans and the need for money in the future. This illustrates why there is no way around savings.

Use of previously received loans:



Both red colored bars on the right side show that a significant amount of loans were used for non-productive purposes. This means that loan interests increase the price for those non-productive products and services, making them more costly for the cocoa farmers.

Future financing needs:



The red colored bars show the future financing needs for non-productive purposes. Those are clearly necessities that should be financed from savings rather than from loans. If no savings are built up for those needs, farmers might not be able to cover the expenses. This could result in less education for household members or chronic diseases left untreated, if fees are not paid and funds are unavailable. The farmer could be pressured into sourcing immediate funds, which could result in premature harvests or borrowing money with unfavorable conditions. Some farmers might say they are not disciplined enough to save, or that they tend to spend all their money on consumer goods. Some might genuinely be too poor to save, but the poor farmers should not get a loan anyway.

This short paper describes a saving approach that will hopefully be easy to replicate in the agricultural sector in general and the cocoa sector in particular. There are a few assumptions: (1) Before harvest, the farmer does not know how much he will sell (uncertainty about exact income), (2) the farmer has a somewhat regular income, because they sell their produce regularly (ideally, two to three times a month and not just once or twice a year), and (3) farmers are tempted to spend the

money that they have on hand (behavioral bias). Based on those assumptions, a trader saving system seems to be an appropriate way to support cocoa farmers' saving efforts and reduce the risks resulting from insufficient or lack of access to finance.

There are several possibilities as to how farmers can save. They could save at home, in a financial institution, in a group, in-kind, with private actors, or even as a form of investment. What method they use depends on personal preferences regarding security, trust, return and costs. A bank far away requires a lot of time to travel there, but avoids frequent visits for fund withdrawals. It also might mean that the farmer never goes there to deposit, resulting in lower savings. A saving account in a cooperative is not protected by the deposit insurance scheme and the distance constraints apply as well. Mobile banking transactions (SMS transfers or P2P transfers) done by an agent might incur relatively high costs compared to the transaction size and needs. The farmer might not trust the agent and/or they could be struggling with illiteracy.



Why use a cocoa trader as an agent and how does it work?

If farmers cannot access bank branches and savings at home are too easily spent/hard to control, the question is WHERE farmer receive money and is it possible to save it there? The answer is surprisingly easy: It is at a cocoa trader's place. There the farmer sells the crop. There the farmer receives money. If the money is deducted from their income, the farmer will not have the opportunity to spend it.

A cocoa trader is used to dealing with cash transactions and already maintains a cash position in order to pay clients immediately. This cash position must be restocked from time to time, either through cash payments from selling bean stock to the next off-taker in the cocoa supply chain, or through bank transfers. If the trader is paid through bank transfers, they would need to

go to a bank to withdraw cash. That is the moment when the farmer's savings can be deposited easily to the farmer's individual bank account, either with the same bank or with another bank (depending on the service fees though). Recent developments in Indonesia have led to branchless banking products, which can make handling savings even easier. Cash deposits can be made directly at the trader's place and transferred to the farmers account by using a mobile phone or other technical channels like EDC devices.

Saving amounts depend on the farmer's capacity and willingness to deposit. Obviously, a farmer with higher cash flows might be able to save higher amounts. Although a good rule of thumb is to save about 10% of the income, the value of 1 kg of dry cocoa beans per sales transaction (currently about USD 2 to 2.5) seems to be a good

start. During peak season(s), farmers should be able to save more, especially if they have an objective to save for, e.g. upcoming school fee payments, a wedding, fertilizer, or others.

Using a trader as a saving agent might bear both risks and opportunities for farmers. The advantages are that there is no distance to travel, no transport costs to pay for, etc. The trader handles the transaction. The risks are that the trader might not deposit the funds into the farmer's accounts as agreed (see model 1). This can be easily controlled with a receipt from a bank, which a trader has to distribute to "their" savers before getting the new saving during the next sales transaction. If the trader cannot show such a receipt, the farmer should look for another trader. Another option would be mobile phone transactions, e.g. SMS-banking from the trader's bank account to the farmer's bank account, peer-to-peer transactions within an mWallet system (the saving account is basically

"Don't save what is left after spending, spend what is left after saving." (Warren Buffet)

with a telecommunication company), card-based transactions and web-based banking applications. By using the aforementioned branchless banking products, banks and other institutions could use the trader as an agent (see model 2). At any point in time, the funds are available to be used/withdrawn by the account holder. The farmer will need to trust the service, be literate in using it, and have access to adequate IT infrastructure such as coverage and service availability.

But why should a trader act as a saving agent? It comes with additional administrative work and additional risk. The additional physical risk of keeping money for saving transactions is considered to be marginal, since the trader will need to keep cash positions regardless of whether they act as an agent or not. The amount of money saved compared to the overall turnover is rather low. The administrative work has to be compensated, either with a fee (which should be reasonable, knowing that the

amounts are rather low) or through additional benefits for the trader. For branchless banking transactions, the agent receives a small commission from banks for deposit and withdrawal transactions as well as account openings. An additional benefit might be that savings would allow the farmer to buy farm necessities such as fertilizer and thus increase their production. With a higher production, assuming that the farmer still sells to the same trader, margins could also be earned based on that additional output. The same applies if the farmer would invest in an additional piece of land, because they would be able to produce higher volumes of cocoa to be sold to the trader.

There might also be restrictions on this model, especially in case the trader is unwilling to act as an agent. The main reason for this might be the trader's 'side-business' of informal lending to farmers. Some traders might see an increase in farmer savings as a threat to their loan business, because if farmers save they will not need loans in the future. 30.8% of the farmers involved in the SCPP program have exper-

ience with loans from traders and 64.2% of the farmers believe they are required to sell their beans to the trader they borrow from.² Traders can use this mentality to secure their supply and income.

For savings, traders have the particular function of motivating farmers to save, without forcing or annoying them. The message has to be that farmers can be proud of building up savings and that they are capable to do so. By having better financial security with savings, farmers could smoothen consumption and absorb financial shocks better.

One limitation is the withdrawal option. Although traders could offer this in smaller amounts, larger cash payouts should not be the core competency of a trader agent. Therefore, farmers need to go to a financial institution for a counter transaction or use an ATM (whereby the ATM card could come with some extra costs). Another restriction that makes savings difficult is inflation. It might be more rational to spend money, rather than saving it, because the interest given may be lower than the inflation rate.

Conclusion

Using a cocoa bean trader as a saving agent to collect savings and deposit them into an individual farmer's account is a promising model to increase savings amongst farmers. The biggest constraints are trust in the product/service, literacy to use it, and the question as to why a trader should act as an agent. Specific incentives have to be set, e.g. commissions paid and/or the outlook of higher business volumes in the future. Farmers need a bank account (in a branch or branchless), which might bear costs. More important is that farmers must be motivated to save and the trader could function as an easily accessible intermediary to do so.

How it works (Model 1)



At any time the farmer could withdraw funds from his own account for agri-inputs, school fees, emergencies, etc.

How it works (Model 2)



In either model the farmer is of course allowed to withdraw funds at any time from his own account for whatever reason.

² Data from SCPP's internal data management system based on 8,067 farmer questionnaires, 26th May 2015

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