COCOA BEAN TRADERS AS SAVING AGENTS

ONE WAY TO INCREASE SAVINGS

Why using a cocoa trader as saving agent and how does it work?

Edition #2

SWISSCONTACT Head Office
Hardturmstrasse 123
CH-8005 Zurich
Phone: +41 44 454 17 17
Fax: +41 44 454 17 97
Email: info@swisscontact.ch
Website: www.swisscontact.org

Swisscontact Indonesia Country Office
The VIDA Building 5th Floor 01-04
Jl. Raya Perjuangan No. 8,
Kebon Jeruk, Jakarta 11530
Phone: +62-2951-0200
Fax: +62-2951-0210
Website: www.swisscontact.org/indonesia

Cocoa Bean Traders as Saving Agents

Text and Content
SCPP - Swisscontact: SCPP Team

Editor
Manfred Borer, Dirk Lebe - Swisscontact

Design & Photos
Roy Prasetyo, Tammi Suryani,
Megi Wahyuni/SCPP - Swisscontact

Introduction

Access to Finance (A2F), especially Access to Loans and Access to Savings, is an import issue for cocoa farmers to either accumulate own funds or borrow larger amounts of money for productive and non-productive purposes like business investments, school fees, emergencies or health care.

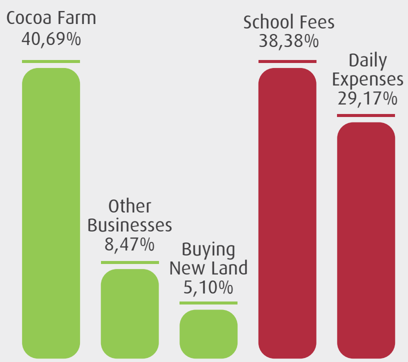
While Access to Loans is still challenging because of various reasons, such as the absence of appropriate collateral and the bank's perception that agriculture is a risky business, savings could play a crucial role in cocoa farmers' financial management. Technically, a loan is nothing else than a future saving, whereas savings come with some advantages: There is no collateral needed (which most farmers anyway don't have[1]), no interest to be paid, and no arrears possible. Every willing farmer could participate and even if funds are used for non-productive purposes, it is at least the farmer's own money.

Disadvantages are that a lack of discipline might hinder farmers to save (while loans are somehow a forced saving, since otherwise collateral might be lost), temptations to access the funds might be around, family, friends and neighbors might request funding for "emergencies" or money might get lost if not properly stored (e.g. in a rural or commercial bank) and most important, if used for productive purposes, a loan could increase the income of a farmer quicker than a saving, since the amount is faster available.

[1] Only 21.6% of the cocoa farmers in Swisscontact's Sustainable Cocoa Production Program (SCPP) do have a notarial deed, which banks in Indonesia consider as good (hard) collateral and has usually a higher value than e.g. other collateral like motorbikes with ownership certificates.

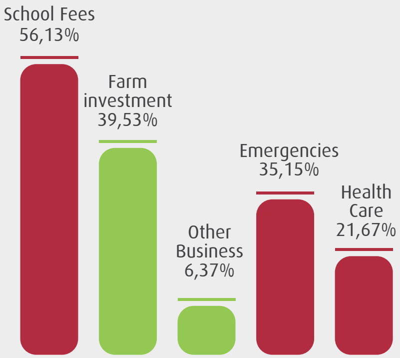
The following two charts show the use of previous loans and the need of money in the future. This illustrates why there is no way around savings:

Use of previously received loans



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

Future money needs



The red colored bars show the future money needs for non-productive purposes. Those are clearly saving topics and should be treated like that. If no savings are build up for these needs, farmers might not be able to cover those costs. This could result in lower education, if school fees cannot paid, or chronical diseases, if funds for health care are not available. Or the farmer could end up under pressure to get immediate funds, what could result in premature harvests or borrowing money at unfavorable conditions.

Some farmers might say they are not disciplined enough to save, or that they tend to spend all their little and big money for consumer goods, and some might be indeed too poor to save (but those shouldn't get a loan anyway).

This short paper describes a saving approach which might be replicated easily in the agricultural sector in general and the cocoa sector in particular. There are a few assumptions: (1) The farmer does not know before harvest how much he will sell (uncertainty about exact income), (2) the farmer sells regular/frequent, thus has a kind of regular income (ideally, two to three times a month and not only once or twice a year), and (3) farmers are tempted to spend money they have in hand (behavioral bias). Based on those assumptions a trader saving system seems to be appropriate to support cocoa farmers in their saving efforts and reduce risks resulting from the insufficient or lacking access to finance.

There are several possibilities how farmers can save, e.g. at home, in a financial institution, with some private persons or in a group, in-kind or even as a form of investments, depending on personal preferences on security, trust, return and (opportunity) costs. A bank far away requires a lot of time to go to (but avoids frequent visits for fund withdrawals). It also might be that the farmer never goes there to deposit (having in the end lower savings). A co-operative saving account is not protected by the deposit insurance scheme and the distance constraints apply as well. Mobile banking transactions (both, SMS transfers or P2P transfers) done by an agent might cause relatively high costs compared to the transaction size and needs or farmer might lack trust and/or literacy.

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

If savings at home are too easily spent, too hard to control or requested by family and friends, and banks are too far away, the question would be WHERE a farmer receives money, and if it would be 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. There he haven't had the opportunity to spend it.

A cocoa trader is used to cash transactions and keeps a certain cash position to pay his clients immediately. This cash position must be restocked from time to time, either through cash payments while selling his bean stock to a bigger trader, processor or exporter, or through bank transfers. In case the trader is paid by bank transfers, he needs to go to a bank to get new cash. This 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 led to branchless banking products, which can make the handling of savings even easier, because cash deposits can be made directly at the traders place and be transferred to the farmers account by using a mobile phone.

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 dry cocoa beans per sales transaction (currently about 2 to 2.5 USD) seems to be a good start. During peak season(s), farmers should be able to save more, especially if they have an objective what they save for, e.g. upcoming school fee payments, a wedding, fertilizer purchasing or others.

Using a trader as a saving agent might bear both risks and opportunities for farmers. The latter ones are that there are almost no opportunity costs to save. There is no extra way to go, no transport cost to pay for. The trader handles the transaction. Risks are, that the trader might not deposit the funds in the farmer's accounts as agreed (see model 1). But this can be easily controlled with a bank, receipt from a bank, which a trader has to distribute to "his" 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 a mobile phone transaction, e.g. SMS-banking from the traders bank account to the farmers bank account, peer-to-peer transactions within a mWallet system (the saving account is basically with a telecommunication company), web-based banking applications, if the trader uses a traceability system which requires online connectivity, or the mentioned branchless banking products, offered by commercial banks through a cocoa trader as agent (see model 2). Those funds could be transferred at any point in time to a bank account, and obviously, the farmer needs at least access to a mobile phone (what 83.2% of the farmers do[2]), trust the service, being literate to use it, and last but not least the technical requirements (like coverage and availability) must be in place.

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

But why should a trader act as 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 keeps anyway cash positions and the amount of money saved is compared to the overall turnover rather low. The administrative work has to be compensated, either with a fee (which should be reasonable, knowing that the

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

amounts are rather low) or through additional benefits for the trader. For branchless banking transactions, the agent receives a (small) commission paid by banks for deposit and withdrawal transactions as well as account openings. An additional benefit might be that savings would allow the farmer to buy (amongst others) agri-inputs, e.g. fertilizer. With a higher production (and assuming that the farmer still sells to the same trader), margins could be earned also based on that additional output. The same applies if the farmer would invest in an additional piece of land, producing higher volumes to be sold.

There might be also restrictions, especially the unwillingness of the trader to act as an agent. The main reason for this might be the trader's "side-business" lending, which might be reduced in case farmers start to save at scale. 30.8% of the farmers have experience with loans from traders and 64.2% of the farmers perceive, if they have a loan with a trader, they have to sell to that particular trader[3]. For the traders it is a possibility to secure their supply.

For savings, trader have the particular function to motivate farmers to save, without forcing or annoying them. The message has to be that farmers can be proud to be able to save; and they can. Having a higher financial security through some saving backup, farmers could smoothen consumption and absorb financial shocks better.

One limitation is the withdrawal option. Although this could be offered by a trader for smaller amounts, larger cash payouts should not be a core competency of an 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, which makes savings difficult at all, is inflation. It might be more rational to spend money, rather than saving it, because the interests to be received are lower than the inflation rate.

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

2 Models & Conclusion

Using a cocoa bean trader as saving agent to collect savings and deposit them on individual farmers' bank accounts or make a branchless banking deposit transaction 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 why a trader should act as an agent. Specific incentives have to be set, e.g. commissions paid and/or the outlook to higher business volumes in the future. Farmers need a bank account (in a branch or branchless), what might bear costs. More important is that farmers must be motivated to save and the trader could function as easily accessible intermediary to do so.

Model 1: Own banking or cooperative saving account

1. Farmer opens bank account in a rural or commercial bank, preferably the same bank as the trader is banking with.
2. Trader agrees on being an agent and is trained on that.
3. During the sales transaction, the farmer saves the value of e.g. 1 kg cocoa beans with the trader.
4. The trader deposits the value of the saving to the farmer's bank account and receives a receipt.
5. The trader gives the receipt to the farmer the next time he sees him.
6. The farmer checks the receipt and continues saving.

Model 2: Branchless banking account

1. Trader becomes agent for a branchless banking network.
2. Farmer opens bank account with branchless banking agent.
3. During the sales transaction, the farmer saves the value of e.g. 1 kg cocoa beans with the trader, instantly executed through mobile phone.
4. Farmer receives a SMS immediately, stating the amount received on his saving account.
5. Farmer is happy and continues saving whenever he wants/can.

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

Swisscontact Indonesia Country Office
The VIDA Building 5th Floor Kav. 01-04 Jl. Raya Perjuangan, No. 8
Kebon Jeruk 11530 West Jakarta | Indonesia
Phone +62-21-2951-0200 | Fax +62-21-2951-0210

Swisscontact - SCPP Sulawesi
Graha Pena 11th Floor Kav. 1108-1109 Jl. Urip Sumoharjo, No. 20
Makassar 90234 South Sulawesi | Indonesia
Phone | Fax +62-411-421370

Swisscontact - SCPP Sumatra
Komplek Taman Setiabudi Indah Jl. Chrysant, Blok E, No. 76
Medan 20132 North Sumatra | Indonesia
Phone +62-61-822-9700 | Fax +62-61-822-9600

www.swisscontact.org/indonesia