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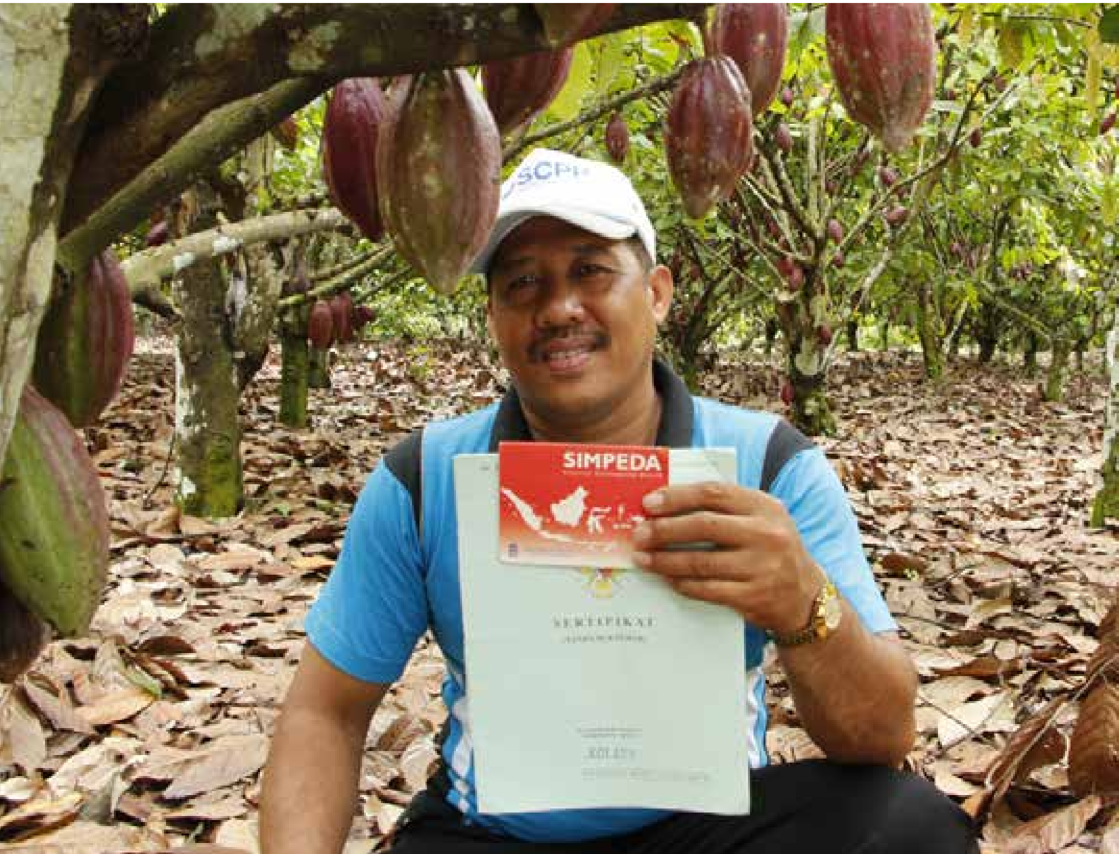
LAND FINANCING FOR COCOA FARMERS

HOW IT COULD BE DONE

Product Design | Limitations



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Land Financing for Cocoa Farmer
How it Could be Done

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Introduction

Indonesia intends to become the largest cocoa producer in the world. Access to Finance (A2F) is one of the holdups in the sector, mainly because of the limited availability of collateral[1] and the low repayment capacity of the average cocoa farmer[2]. Total production could be increased through better inputs (e.g. fertilizer), better farming practices (pruning, sanitation, etc.) or increased land use for cocoa. For some of those factors A2F is needed. Currently, only a few financial products are available, provided by the commercial banking sector, through government loan schemes or the cocoa industry.

One promising option to increase production and income of cocoa farmers, developed by Swisscontact and the private sector, could be realized by targeting professional and progressing cocoa farmers to finance additional land, either already with cacao trees planted or land without trees, where further investments are still needed. As professional we define cocoa farmers with at least 1,000 kg production per hectare (compared to about 450 kg/ha for the average farmer).

Assumptions

- If a professional cocoa farmer with at least 1,000 kg production per hectare per year would be able to buy an additional piece of land, he could replicate his/her current production of 1,000 kg per hectare on that additional piece of land sooner or later.
- Financial institutions should offer commercial loan products, which are profitable, scalable, and with an acceptable risk structure.
- Land is available at affordable prices.

It is assumed that a professional cocoa farmer knows his business well. And it is obvious that a professional cocoa farmer with more than 1,000 kg per hectare has (thanks to his/her higher production) a higher cash flow out of his/her cocoa farm than an unprofessional farmer with less than 500 kg per hectare. It still doesn't show obligations and/or expenses, but it is a good indication on repayment capacity of a farmer.

Financial institutions should offer commercial loan products, because only if they have an incentive like profits, they will stick to it long-term and develop that market segment.

[1] Only 21.6% of the farmers in Swisscontact's Sustainable Cocoa Production Program (SCPP) in Indonesia have a land title; considered by commercial banks as acceptable collateral with sufficient value. Due to the large number of data, this provides a pretty good picture about the situation in Indonesia.

[2] Who produces about 450 kg/ha/year (data as per 30 June 2015)

Product Design

- A financial institution finances 100% of the land value (purchasing price) and not (as it is often done) only 70% of the plain land value. This is a risk for financial institutions, but the pre-selection of the top 10% of the farmer, including collateral, could cover that risk, at least partially. (And still, the risk is much lower than choosing unprofessional farmers.)

- The farmer finances all necessary inputs (e.g. planting material). The most important input is labor, which the farmer can bring in as "muscle equity" at no costs. Seedlings or fertilizer might need financing too. A farmer should demonstrate that he believes in his future by investing his own time and money.

- Collaterals are the land certificate for the additional piece of land (obligatory!) and cocoa beans from the existing and the newly bought piece of land, although the latter can't be considered as hard collateral. The land title of the existing land (if existent) could be used as collateral as well, but shouldn't, because this would bear some major risks for the farmers. Seizing and selling the existence of the farmers' economic base of life could lead to a bad reputation for a financial institution doing so.

- Depending on the price of additional land, a time horizon of 3-5 years should be aimed as financing period. This short period limits the risk for financial institutions significantly, but shows the farmer too that after this time his production and income will be much higher.

- The repayment schedule should be in line with the agricultural calendar and cocoa cash flow intervals (peak season, low season). Monthly interest only payments and principal payments during the peak season (and possibly also mid-season) are feasible. The harvest seasons through different Indonesian provinces are highly diverse though.

- Considering that there is hard collateral securing the loan, the top 10% of the farmers are identified, the loan amount is not too small and the rejection ratio (and thus the workload) are lower than without those characteristics, the interest rate should be at an acceptable level.

- In case of arrears, cocoa beans as collateral could be seized (and sold). They are easy to collect/transport in the right volume, stable in value, easy to store (not even necessary) and easy to sell to any trader/collector close-by. So the financial institution is able to settle arrears fast, without effect on the loan loss provision. Cocoa grows throughout the year and there are always some pods on the tree to be collected.

  In case of larger repayment problems, the land could be seized and sold to another suitable farmer (who can be easily identified through Swisscontact's internal database). With that approach the cocoa related investments are not lost (and the value increase might be even paid by the new farmer), the collateral is still existent, and interest income is secured as well as cocoa supply and PAR (Portfolio-at-risk) and NPL (Non-performing loans) can be properly managed.

Limitations

AVAILABILITY &
PRICING OF LAND

EXISTENCE OF LAND TITLE
RESPECTIVE EASY ACCESS TO IT

AGRICULTURAL RISKS &
PRICE RISK FOR COCOA

LAND EXPANSION IN
PROTECTED AREAS

Conclusion

Addressed are professional (and progressing) cocoa farmers with sufficient cash flow/repayment capacity. Unprofessional farmers have to increase their production through the application of Good Agricultural Practices (GAP) first, before being considered as target group for this product or loans in general. For the cocoa industry the supply of beans can be ensured through farmers who know what they do and who take their cocoa business serious. For financial institutions this seems to be one of the most promising products in the cocoa sector.

As long as land is available, the product is scalable. The existence of collateral and targeting the best farmers only reduces risks significantly. A positive side effect is that farmers with large cocoa farms are more likely to create employment, since cocoa farming is a labor-intensive work. This supports the local economy.

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