

MicroSave Briefing Note # 132

BPR Arta Kencana – Loan Product Development for Onion Cultivators

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Background

KBPR Arta Kencana was established in the year 1991 through the merger of 12 village unit cooperatives (KUD). The rural bank, based in city Madiun, in the province of Java Timur, was established to empower and develop micro, small and medium entrepreneurs spread across rural, sub-urban and urban areas of Madiun.

As part of its growth and downscaling strategy, the bank opened a new branch in Nganjuk Regency. This was in an effort to increase the pace of client acquisition by increasing outreach to farmers, especially to those growing cash crops.

During the first two months after the branch was set up, the bank saw only a lukewarm response in terms of product uptake. The bank realised that it needed to develop a product that specifically suited the farmers growing onions and sought *MicroSave's* support.

The mandate for *MicroSave* was to develop a product to attract and retain new clients from amongst the onion farmer community. *MicroSave* conducted a 2-week study that included market research, prototype designing and field testing, and developed structured a product pilot plan.

Specifically, the following were the objectives of study:

- Understand supply of credit to onion farmers from formal, semi-formal and informal avenues.
- Develop an understanding of the loan products offered by competitor financial institutions.
- Understand the costs of onion crop production to assess the volume and timing of credit requirements. In addition, analyse other issues that an onion grower might consider when making a decision to take credit.
- Risk profile the onion sub sector through value chain analysis, to understand the risk minimisation strategies at the grower's end – as an input for product design attributes.
- Design an appropriate cash flow based product prototype for onion growers and perform field-based concept testing.

Approach

The assignment was divided in three broad phases:

- **Market research** with a focus on the onion subsector – we studied and mapped the entire onion value chain. We employed two main

methods: focus groups discussion (FGD) and individual interviews using *MicroSave's* research methodology. In the process, facilitators interacted with major value chain actors - farmers and traders.

- **Loan prototype design** using *MicroSave's* 8Ps framework,¹ which highlights the loan product concept, associated processes, recommended pricing and characteristics of the client segment to which it will be targeted. Institutional budgets and goals were also considered while designing the prototype.
- **Field/concept testing** to present the product concept to potential customers, listen to their feedback and thus understand whether the design meets the intended segment's needs and expectations.

Findings

The Market

Nganjuk Regency is ranked first in East Java in onion production. In the region, and elsewhere, the demand for local onions is high because of their unique taste and use in Javanese cooking. Local onions are also sold in bulk to corporate houses for readymade food production.

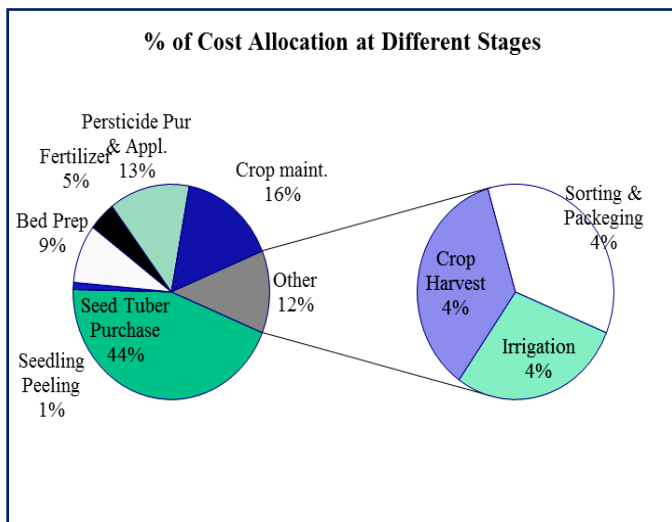
In Nganjuk, farmers produce their own seed, and only at times buy from the market. As onion production is cash intensive, farmers are careful in crop management and follow good agricultural practices learnt through years of experience.



Availability of daily wholesale markets close by makes it easy to sell the produce; the market supports all players in the onion value chain – the collector, small trader and big corporate traders. Markets open daily and are exclusively for onions during the harvest season, when 100-150 tonnes of onions are sold per day.

¹Product, Process, People, Price, Place, Promotion, Positioning, Physical evidence

Credit demand is highest at the time of land preparation, sowing and purchase of inputs. Since the cost of production is high, farmers usually take credit from all available sources - formal, semiformal or in-formal; this includes commercial banks, cooperative, farmer groups, agri-input kiosk, relative/ friends and moneylenders. Personal savings also is an important source of finance, but only for big farmers.



Key Challenges with Existing Financial Arrangements

The majority of the farmers have to depend on credit for onion cultivation because of the high cost of production. Loans sanctioned by MFIs and commercial banks are not need based – in many cases the loan amount is reduced substantially from what is originally applied for, forcing the farmer to resort to other, usually more expensive, funding options.

The inadequacy of the loan amount is the primary reason for multiple borrowing. Small to medium scale farmers have to take supplementary loans (mostly combining credit and kind) from informal sources such as seed merchants, fertilizer / pesticide kiosk owners, and red onion traders in the market. Market research highlighted the need for a credit product with an in-built saving component to reduce farmer dependence on credit, and thus to reduce repayment obligations.

Commercial banks and other formal service providers take a lot of time to process loan applications, resulting in delayed disbursements. Farmers are very particular about the timing of disbursement – they want credit to be delivered at least 15-20 days before planting.

Repayments are tied with the harvesting period – a farmer pays only monthly interest for a typical six month loan, and the principal is repaid at the end. The majority of medium to large scale farmers have to take additional credit to harvest, sort, package, and market the produce. All this makes it difficult for the farmers to repay the loan amount immediately upon harvesting. They want to

settle the loan amount within two months of harvest instead of the current practice of requiring repayment during the early harvest period.

Most formal service providers ask for collateral to compensate for loan losses forcing small and medium scale farmers to opt for informal sources as they have few or no assets. Small farmers are particularly sensitive to transaction costs and administration charges. They also prefer credit assessment, appraisal, and intimation of loan decision to be done at their doorstep.

Price fluctuations in the market might affect repayment. The bank needed to integrate strategies, such as including the income cycle analysis of the household into loan appraisal and tailoring repayments, to reduce late payment and default.

- The general inclination of East Javanese population is towards spending. After harvest and sale of the crop, the farmer spends the money earned to repay loans and to buy inputs for next crop. He retains a little to meet contingencies and spends the rest on non essential consumption.
- It seems crop growers do not have much knowledge of savings instruments available with commercial institutions.

Designing an Exclusive Onion Loan Prototype

Based on the field research outcomes, a loan product prototype was designed to respond to clients' preferred attributes such as competitive interest rate, easy collateral requirements, flexible repayment terms, simplicity in documentation, swift processing of loan applications etc. and to build in a savings component with an option for life insurance cover. The prototype also addressed situations of financial distress/crop failure – where the client is encouraged to report her challenges to the KBPR. This would help the KBPR to take adequate delinquency management measures and, where feasible, to help the client.

The prototype product was piloted with 312 onion growers and Arta Kencana lent IDR2.05 million (approx. USD 220,000 as on March, 2012). The product was offered in carefully selected village locations of Nganjuk Regency. The pilot phase has helped the bank understand key factors for success of the product, and also the challenges it will face as it rolls out the product. The overall feedback on the loan product from the farming community is very positive. Uptake of the loan was swift and large, with many clients switching from competitors (who were offering generic loan products) to take up the onion loan offered by Artha Kencana.