

Increased incomes for Indonesian cocoa farmers in sustainable markets.

Vredeseilanden/VECO

VECO's experience working in Sulawesi in partnership with the global cocoa trader Armajaro illustrates how partnering with the private sector can optimize our impact, improve smallholder farmers' livelihoods, and increase the likely sustainability of farmers' gains. A case study of NGO-private sector cooperation on Sulawesi island, Indonesia.

1. Context and background

Indonesia is the third biggest cocoa producer after Ivory Coast and Ghana, with a 15% share of total world production. Cocoa is cultivated here on over 1.5 million hectares, generating over \$1.2 billion in exports annually. Cocoa production provides the main source of income for over 1,400,000 smallholder farmers, mainly (71%) on Sulawesi. Despite the importance of cocoa cultivation in Indonesia's economy, productivity, bean quality and farm profitability have declined due to aging tree stocks and unsustainable farming practices, which lead to soil infertility, pest and disease pressures and poor product quality. This declining trend has begun to reverse in the last few years with on-farm investments in tree rejuvenation, replanting and sustainable farming practices.

Since the beginning of 2010, enterprises such as Cadbury and Mars announced that they would increasingly use Fair Trade certified cocoa beans sources certified as 'sustainable'. To meet these voluntary targets, it is estimated that over 25% of Sulawesi's cocoa crop will need to be traceable and certified by 2020. This represents a new and growing market opportunity for farmers. The challenge is that in order to offer high enough volumes and to make certification - and traceability - feasible, farmers will need to ally themselves in well-organized farmer groups.

The program area supported by VECO Indonesia is situated in Polman (Polewale Mandar) district in West Sulawesi province. The main commodity produced in this area is cocoa, with a total production of 79,029 MT on a total cocoa farm area of 119,884 ha. As in other parts of Sulawesi, the main problems in cocoa production in Polman are low quality and low yields because of pests, diseases and low use of fertilizers. Average yields are only 0.5 tons of cocoa per ha. per year, whereas 2 tons should be achievable under optimal conditions.

Traditionally, cocoa farmers break the pods of their cacao plants and sundry the beans up to 7% moisture. They then sell the beans to local traders, individually or collectively. Local traders in turn sell to bigger traders in port cities. Today, the big cocoa traders involved are Armajaro, Cargill, ADM and Olam. In this program, we only work with Armajaro. These traders sell to processors and confectioners such as Petra Foods, PT Mars, Nestle, Blommer and Hershey.

For companies like Armajaros, the work being done by NGOs to build the capacities of local farmer groups is a crucial missing link. These companies have neither the time to conduct such development work on the ground, nor the development concepts to fit their cocoa-trading activities into a framework to promote sustainable livelihoods and farming systems. The work of NGOs with farmer groups facilitates improvements in quality, traceability, labelling, and collective selling.

2. Underlying business model

VECO's goal is to promote the development of sustainable agricultural market chains, preferably at local and regional level, in which organized family farmers, male and female, are successfully influencing trade relationships and improving their net incomes. Specific program objectives and targets are:

- Better farming practices, which lead to greater productivity and quality improvement and hence, increased income from higher yields: the target for this program is a 68% increase in the net income of family farmers in the cocoa chain supported by the program between 2010 and 2013.
- An increase in the degree of influence of organized family farmers (male and female) in trade relations in the chain between 2010 and 2013.

Around 2008, together with Wasiat and AMANAH, VECO began developing and implementing strategies to facilitate market linkages between smallholder cocoa farmer groups in Polman and companies like Armajaro and, Mars. VECO designed and launched a more formal program in collaboration with Armajaro, to further strengthen sustainable cocoa chain development in Polman. VECO has been funding this program since early 2010.

We provide direct support to Wasiat and AMANAH in their efforts to improve cocoa quality and production, through:

- Capacity building on sustainable farming practices and post-harvest handling;
- Facilitation, together with Armajaro, of Wasiat's work on cocoa farmer field schools;
- Monthly trainings on group management and marketing management, and training on gender;
- Liaising with Gernas, a national government program to revitalize Indonesian cocoa production, and the Cocoa Sustainability Partnership.

Wasiat (Wahana Sukses Pertanian Terpandang = Centre of Success for Excellent Agriculture) continued the work of ACDI-VOCA, organizing trainings and farmer learning visits to improve production techniques and address farm management issues. Additionally, it worked with farmer groups in five sub-districts of Polman - now under the umbrella of AMANAH - on organizational strengthening to build their collective purchasing and selling capacities.

AMANAH was officially registered as a farmer-owned multi-business cooperative on 12 February 2007. Its membership has grown quickly - from 11 farmer groups to 84 farmer groups by mid-2011. Because of its broad program area, AMANAH developed cooperative clusters in each subdistrict. In mid-2009 AMANAH became a secondary cooperative, assisted in this task by Wasiat, and also by VECO in the registration process. The activities of the sub-district cooperatives are similar, covering production, postharvest management and collective marketing as well as housing. They have introduced a variety of innovations in these areas. For example, regarding post-harvest management: in the past, farmers simply spread their cocoa out on the roadside to dry, but now they use roofless racks, or in some cases, solar dryers with plastic roofs. Other more recent developments

Today, AMANAH is a professionally-run agribusiness organisation which implements innovative and ecologically sustainable farming practices based on clear work programs and business plans. Because of the high quality of the membership services AMANAH provides, it is trusted by both its own members as well as other actors in the Sulawesi cocoa chain.

With Armajaro as a leading global supplier of cocoa to the chocolate industry, Armajaro has a strong interest in resolving the problems of the cocoa supply chain in Indonesia. Armajaro is committed to sustainability since this is a priority issue for its clients. It is also committed to the inclusion of

organized smallholder farmers, since they by far supply the largest portion of cocoa production in Indonesia, and it must compete with local traders who can source from individual farmers. Armajaro is establishing rural and hinterland warehouses in several locations in Indonesia as an initial step to get closer to its suppliers, in order to develop traceability, quality and certified cocoa bean procurement. Armajaro only handles certified product when it has a buyer for it, in which case a memorandum of understanding is drawn up with the confectionery.

Armajaro has one pilot in the region of Polman, West Sulawesi together with VECO and another on Sumatra with Swiss Contact. Armajaro wants to engage and establish longterm relations with as many farmer groups as possible. Since Armajaro cannot buy from individual farmers because of low volumes, several modes of cooperation and support have been developed to ensure farmers get more profit through collective marketing and prices are more stable.

3. Evolution of the initiative

In 2006, Armajaro began giving financial incentives to AMANAH to promote collective selling by the farmer groups. AMANAH received a fee of IDR 50 per kg. sold to Armajaro. These funds allow AMANAH to reach out to other villages. From 2007 onwards, Armajaro raised the fee to IDR 100 per kg. if the quality is good and IDR 50 per kg. if the quality is below expectation.

1. In three years' time, AMANAH earned IDR 30 million (USD 3,500) and used this money to buy fertilizers and other inputs for its members.
2. In 2006, the farmer groups also received pre-financing from Armajaro amounting to 70% of the value of their projected sales. However, this was later stopped because the farmers also sell their cocoa to local traders when they receive better prices or have borrowed money from them (local traders can offer individual farmers credit in emergency situations and claim a longterm commitment in return). Although Armajaro no longer offers pre-financing to individual farmers, it does offer guarantees to enable farmer groups to access bank credit.
3. Until mid-2008, Armajaro collected the cocoa to transport it to Makassar – an eight-hour drive away. Farmers had little market information and the quality control was done at the destination in Makassar. It regularly happened that the quality assessment in Makassar was below the farmers' own assessment - which bred discontent. In 2008 Armajaro agreed to put a warehouse in Polman district and to organize quality control there in the presence of the farmers. Transparency and trust increased between farmers and the company.
4. Starting in 2009, Armajaro began sending daily mobile phone text messages containing cocoa market price information to the farmer group leaders, and has continued to do this up to now.
5. In 2010 Armajaro began supporting the certification process to enable AMANAH farmer groups to meet UTZ Certified requirements for Nestlé. Armajaro's next priority will be to explore opportunities to access Fair Trade and Rainforest Alliance certified markets. For the farmers in Polman district, Armajaro has proven to be an important lead buyer whose increased proximity has facilitated better prices, terms, and flows of market and quality information. Armajaro would like to see 50 -100% of its total volume procured through this mode of sourcing by 2020.
6. Recent developments and achievements Improved monitoring for improved performance Cocoa production volumes and quality vary a lot among groups and among farmers within the same groups. AMANAH has worked on mapping farmers' production by collecting data from the different farmer groups since 2005. AMANAH's farmer groups also routinely record elementary data for themselves as well as traceability-related data for Armajaro. Based on these data, the best-performing members today produce an average of 750 kg/ha per year,

which exceeds the average of 500 kg/ha for Sulawesi, but falls far below the potential of 2000 kg/ha.

In mid-2011, 67 AMANAH farmer groups qualified for UTZ certification of the unfermented cocoa beans they produce after a rigorous 10-month process. Armajaro will begin purchasing certified cocoa from AMANAH in the next harvest period of October to December 2011.

4. Impact

Armajaro's cooperation and increased proximity to cocoa farmers in Polman has generated better prices, terms, and flows of market and quality information for the farmers. With VECO's support, AMANAH leaders have gained marketing skills and established sales partnerships not only with Armajaro but with several other traders too. They are also skilled technical trainers, teaching what they know to a growing number of farmer groups in other districts.

One of AMANAH's greatest achievements to date has been to secure capital assistance from the Indonesian government. Initially, AMANAH was unable to compete with middlemen because it lacked capital. Today AMANAH manages funds of around USD 140,000 from its members and USD 1.09 million. Membership fees remain important to ensure the cooperatives a proper income. Member farmers are obliged to contribute a certain amount, which varies from one cooperative to another.

AMANAH farmer groups' sales to Armajaro have increased from 33 tons in 2006 to 46 tons in 2007, 88 tons in 2008 and 230 tons in 2010. Expectations for coming years are 500 tons for 2011, 750 tons for 2012 and 1,000 tons for 2013. The farmers get 75 to 80% of the Freight On Board (FOB) price in New York, which is a very high percentage (i.e. compared to 65 to 70% in Ghana). This means that only 10% to 15% of the FOB price is for the trader and for transport to New York or Amsterdam. The other 10% is export tax to the Indonesian government. The farmers' percentage works out to USD 1,000 to 2,500 per ha, which is a good income for an average Indonesian farmer. Thus, for organized cocoa farmers who improve their quality and productivity, the collective selling of cacao is a viable income source.

5. What are the key implications for scaling inclusive business?

Cocoa prices rose to a 32-year high in New York in early 2011. High cocoa prices are beneficial for traders like Armajaro because they receive a fixed margin for the trading. High prices also keep farmers motivated and trading volumes higher. Prices are expected to remain high in years to come since demand outstrips worldwide cocoa supply. The confectionery industry needs all the cocoa produced, including the produce of smallholder farmers.

Of course, prices do fluctuate a lot at the stock market in New York because of trading activities as well as unstable situations in producing countries such as Ivory Coast. The fact that fluctuations are transmitted in real time to the Sulawesi market greatly assists them in negotiating prices with buyers and in making decisions about whether or not to accept the price offered.

On Sulawesi, at least half a dozen international traders buy beans from smallholder cocoa farmers. However, the farmer groups are largely price takers and cannot significantly influence the prices these traders offer. To date, AMANAH is the only strong farmer organisation working on cocoa in Sulawesi, and there is no strong national federation to protect cocoa farmer interests. Therefore, farmer organisations need to get stronger and better organized at both national and local levels to improve their bargaining capacity. This is a key priority of the VECO program in coming years.

Another priority is to keep up scaling production. The president of Armajaro has declared that he wants to continue the project with VECO, in order to increase production. Results for up scaling so far have been excellent, resulting in a cocoa production of 0.5 tons per hectare. Through capacity building in cooperation with VECO, Armajaro aims to double production per hectare in the years to come. Farmer prosperity will continue to rise and cocoa production in Polman will be more sustainable, should this targeted production level be achieved.