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Café-REDD

Cooperation from PPPs against deforestation in Viet Nam

Policy Brief

Lessons from Implementing Credit Scoring to Advance Green financial inclusion for Smallholder Farmers

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Background

The Café-REDD+ project is funded by The International Climate Initiative (IKI) - The German Ministry for the Environment, Nature Conservation, Nuclear Safety, and Consumer Protection (BMUV), is dedicated to ensuring the long-term sustainability of forest landscape conservation within Vietnam's Lang Biang Biosphere Reserve. Since its inception in 2018, the project has positively impacted over 3,355 farmers, leading to enhanced coffee quality, diversified income streams, and heightened resilience to climate challenges.

In response to the financial access barriers faced by these farmers, the project collaborated with two partner banks, Agribank and Lienvietpostbank (LPBank), to initiate Credit Scoring for smallholder farmers. The principal aim was to extend the bank's customer base, especially within the Lac Duong district of Lam Dong province. The implementation of credit scoring has demonstrated its potential to reduce the time required for loan appraisals and enhance banks' willingness to provide loans to farmers.

Context

In 2023, producers are still facing a significant challenge – the scarcity of capital. Primary sources of credit include input credit from suppliers and loans from moneylenders or family. Coffee farmers often rely on credit to obtain essential inputs, settling debts by selling their products during the harvest season. Both farmers' cooperatives and off-takers, crucial links in the value chain, struggle to secure capital. Small-scale enterprises in coffee processing face similar challenges. Banks face supply-side constraints, especially in efficiently assessing small-scale loans.

The Credit Scorecard, developed collaboratively with Bank partners, integrates KYC - Know Your Client - norms and credit underwriting standards. It provides objective criteria and a scoring system, streamlining credit decisions and addressing the challenge of administering modest-scale loans. The collaborative effort involved consultations with SNV and banking partners, and details of the process are outlined in the next section.

Key findings

Demographic Overview

The survey encompassed a total of 375 farmers across 6 communes in Lac Duong. Among the respondents, 44% were male, while 56% were female farmers. The average age of these farmers was 38 years, with the majority falling within the age range of 30 to 50 years. 93.6% of the surveyed farmers were married, while the remaining 6.4% were single. Notably, all households in Lac Duong were permanent residents.

Sources of Income

In terms of income diversity, most households relied on 1-2 additional sources of income besides coffee farming. These supplementary income sources were primarily derived from agriculture and external wage labor.

Coffee land

All surveyed farming households cultivate coffee alongside other crops such as vegetables and flowers. The median farm size was approximately 1 hectare, with some farms as small as 0.3 hectares and others as large as 3 hectares. Importantly, 95% of households with coffee land were awaiting the Land use right certificates.

Key findings

Access to Finance

Regarding access to finance, over 60% of respondents mentioned obtaining loans from input dealers. While the majority of farmers (82.67%) had accessed loans from Vietnam Bank for Social Policies (VBSP), 5.3% had accessed loan packages from Agribank. Additionally, a small percentage of respondents (1%) accessed loans from Lienvietpostbank and other commercial banks such as Vietcombank and Vietinbank.

Access to market

A significant portion of farmers (89.3%) sold their coffee to local shops or traders. This practice was often driven by outstanding debts for fertilizers acquired at the start of the season, as traders typically made direct purchases at the farms. A smaller portion (17.3%) of respondents indicated selling coffee to cooperatives or enterprises. However, it's noteworthy that these farmers lacked formal contracts or agreements with these off-takers.

Credit Scoring for Smallholder Farmers

Group	Criteria
A: Household General Information	Gender, Marital Status, Residency Status, Number of Dependent Members, Sources of Income, Land Ownership Status, Average Annual Household Income
B: Coffee Productivity and Business	Land Ownership for Coffee Cultivation, Average Annual Coffee Income, Annual Coffee Cultivation Cost, Coffee Farm Yield, Farmer Engagement in Coffee Drying and Processing, Coffee Selling Methods, Cooperative Membership
C: Financial and Credit Information	Debt-to-Income Ratio, Expected Repayment Methods, Savings in a Bank Account, Loan Purposes, Loan Demand

SNV with the help of VietED Center and in consultation with the partner banks developed a credit scorecard. The judgmental credit scorecard for coffee farmers was developed to assess the creditworthiness of smallholder farmers participating in the Café-REDD+ project.

The comprehensive scorecard, consisting of 19 criteria, each assigned a range of scores, culminates in a final score for each farmer ranging from a maximum of 50 points to a minimum of 14 points, based on the information they provided during the survey. In addition to incorporating criteria from the banks' standard underwriting guidelines, the scorecard also included criteria that assessed the farmers' progressiveness in agricultural and coffee farming practices.

Out of 375 surveyed smallholder farmers, the credit scorecard assigned scores ranging from a minimum of 38% (19 out of 50 points) to a maximum of 78% (39 out of 50 points), based on evaluations across 19 criteria within three distinct categories. Out of the 19 criteria considered, a significant number of households experienced score deductions in two specific areas: average annual coffee income and coffee farm yields. The usage of cash for loan payments and the lack of fixed sales contracts also accounted for reduced scores.

Key Takeaways from the Implementation of the Credit Scorecard

The implementation of the credit score card offers the following lessons for the stakeholders in improving the flow of green finance to smallholder farmers.

Government and development agencies

Improving farm income and diversifying income sources can enhance credit scores

Some households faced ineligibility due to a lack of positive net income, indicating their vulnerability to economic shocks. Reliance on a single source of income adds to the vulnerability of the farmers. Training in Good Agricultural Practices and promoting income diversification significantly improves both farmers' livelihoods and credit scores. Initiatives like Rainforest Alliance, Fairtrade, and Organic certifications further contribute to this enhancement.

Promoting financial literacy

Financial literacy can help the farmers not only plan their farm operations better but also develop their non-farm businesses. Additionally, banks look at the well-informed farmers positively. This could also enhance digital transactions, which is something preferred by the banks. Programs promoting financial literacy empower farmers to plan operations, develop businesses, and align with banks' preferences. This enhances the likelihood of a positive reception of digital transactions by banks.

Value chain integration and value chain-based financing have the potential to benefit all stakeholders involved

Strengthening the collaboration between off-takers and farmers, as well as farmer cooperatives, can not only enhance farmers' incomes but also instill greater confidence in the banking institutions. Establishing robust transaction mechanisms through contractual agreements between buyers/off-takers and farmers can help mitigate price risks for farmers and reduce product and quality-related risks for the off-takers. Offtakers can play a crucial role by providing valuable transactional information about the farmers, which should be a key component of credit scoring. However, it may necessitate advocacy efforts to formalize the tripartite agreement involving farmers, off-takers, and banks, aligning with the objectives. This arrangement would not only enhance the efficiency of credit administration but also reduce risks, with farmers offering fulfillment warranties and off-takers committing to purchases, presenting a win-win scenario for all parties involved.

Official Support Policies

Government and international organizations play an important role in creating supportive policies. The promotion of sustainable financial activities through such policies contributes to the establishment of comprehensive and sustainable financial systems. This can be observed in the collaborative efforts of international organizations such as the World Bank, IFAD, and ADB. The work of these international organizations, combined with the targeted efforts of the Vietnamese government, supplements the strategies outlined in this report. As a result, an increasing number of coffee farmers in Lam Dong province can now access the financial resources they need to invest in their businesses, improve their livelihoods, and contribute to the development of a sustainable coffee sector.

Key Takeaways from the Implementation of the Credit Scorecard

Banks and financial services providers

Leverage credit scoring to enhance scoring criteria

Both banks, Agribank and LPBank plan to utilize the CSC toolkit for customer screening. They particularly find the Group B criteria quite innovative and of particular significance and intend to integrate the scorecard into their lending practices, particularly for unsecured lending. This reflects a commitment to improving the accessibility of formal financial services for smallholder farmers.

Using Credit Scorecards to Generate Data for Statistical Credit Scoring Models

Credit scorecards can be subjective, as they rely on human judgment to assess creditworthiness. This subjectivity can lead to inconsistencies in scoring and potential biases. Initially developed to assess the creditworthiness of borrowers lacking traditional credit data, these scorecards can also serve as valuable tools for generating data to build statistical credit scoring models. By tracking borrower performance over time, banks can gather insights into the relationship between specific credit factors and loan repayment outcomes. This data can then be used to develop more sophisticated statistical models that can more accurately predict creditworthiness. This, in turn, can help the banks expand their lending base to include more smallholder farmers. Credit scoring benefits from linked data, including crop history and personal financial information. Utilizing comprehensive data sources creates an accurate financial picture, supporting effective credit scoring. Tracking farmers' income enhances the reliability of financial data, contributing to the sustainability of the credit system.

Seize the opportunity to embrace Responsible Banking and provide green finance

Expanding financial access to farmers within a sustainable supply chain, like the one championed by SNV in the coffee sector, presents banks with a unique opportunity. This endeavor encompasses not only reaching out to smallholders and SMEs but also actively contributing to the long-term sustainability of the entire supply chain, aligning with the broader climate change agenda. Banks can position themselves as active participants in the responsible banking movement by adhering to green finance principles. This commitment not only promotes financial inclusion but also fosters a greener, more sustainable financial landscape that benefits both the banks and the environment. Including environmental considerations in scoring promotes resource efficiency and environmental protection. Aligning with this promotes sustainable coffee production to enhance farmers' livelihoods.

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