

Agricultural Risks in the Cocoa Sector

**“challenges in sourcing from
developing countries”**

**Forum for Agricultural Risk Management
in Development (FARM)**



Understanding Risks in the Cocoa Supply Chain

Financial Risk

- Non-performance against contracts (default)
- Poor availability of financial instruments for farmers
- Exposure in Market through “position”

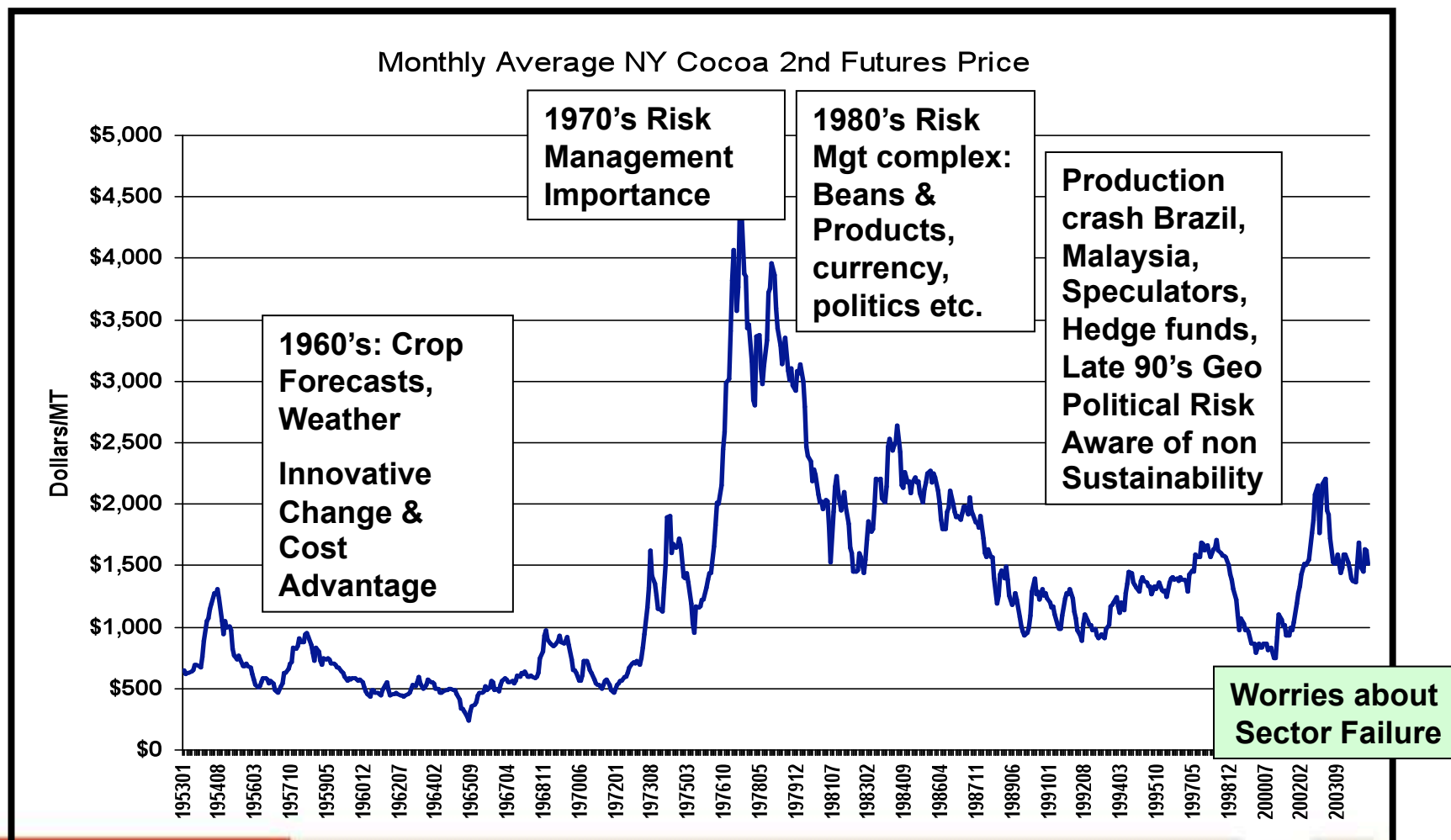
Price and Availability Risk – Short/Medium Term

- Crop Failure (weather, pest and disease)
- Trade Chain Issues (logistics, political)
- Poor Quality (flavour, out of specification, residue)

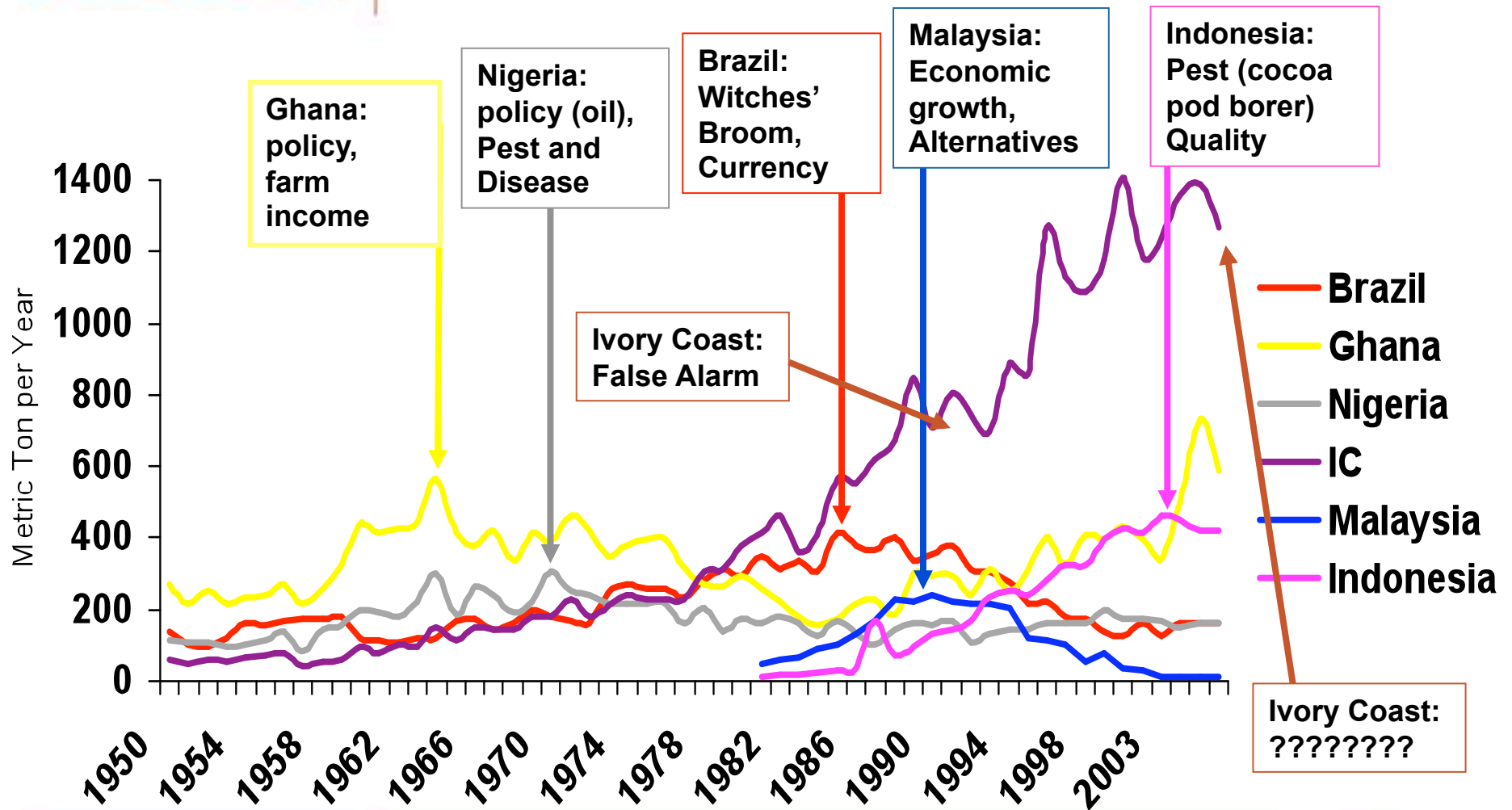
Price and Availability Risk – Long Term Production Failure

- Cocoa not an attractive livelihood for Young Farmers
- Failure to move from extensive and subsistence farming to ‘farming as a business’
- no more land available for new cultivation

Historical Manufacturer's Focus: Price Risk Management

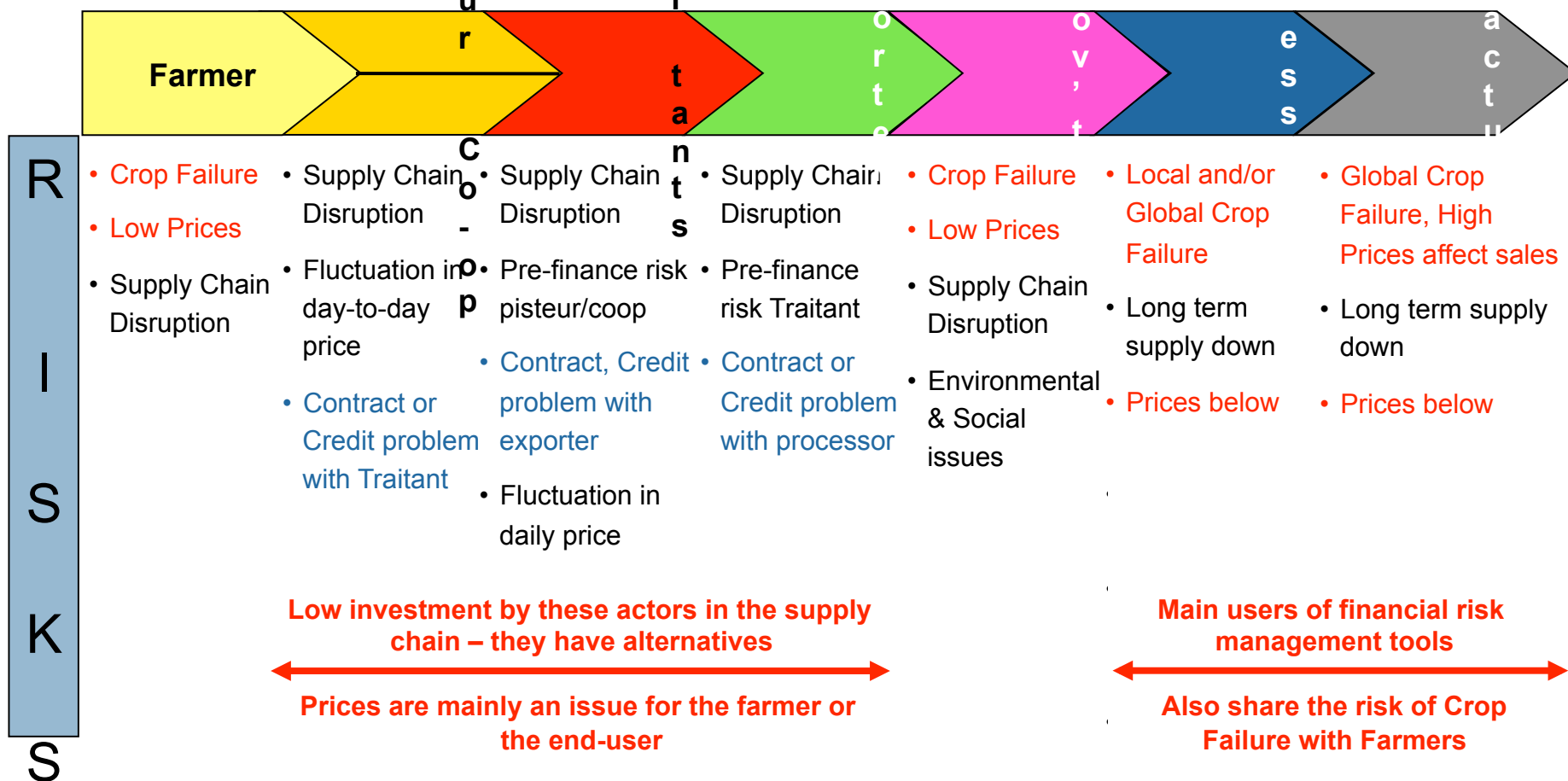


Issues with Cocoa Production



Only Ghana ever made a real recovery from its' decline – and it took 20 years

Value Chain – Who carries what sort of Risks?



Different Stakeholders, Different Risks – Do Risk Management Strategies Connect?

Risks & Risk Management Strategies by “Local” Stakeholders

Farmers: Dependent on World Market and Value Chain for prices - no financial instruments available. To avoid risks, farmers choose extensive, low investment farming systems and additional subsistence crops

- Strength: ?
- Limitation: risk management strategy leads to non-sustainability of farming system, decline in yield and income, and abandonment of farm

Pisteur/Co-op, Traitant: Relatively low investment, can change to other crops or activities. Some pre-finance risks, managed through ‘relationships’

- Strength: Limited investment, limited dependence on crop
- Limitation: mostly function as ‘agents’ or ‘logistics provider’ only, with little interest in the health of the value chain or quality of product



Farmers' Un-managed Risk: **Declining Farm Productivity**

Risks & Risk Management Strategies by “International” Stakeholders

Exporter: Significant risks through pre-financing and failure to meet contract volume and specifications, and availability and quality of cocoa beans. Management of in-country risks through ‘preferred and trusted suppliers’, relatively small pre-financing and fast turn-around cycles. Exporters have access to (all) financial instruments

Processors, Manufacturers: High dependence on availability and quality cocoa beans. Manufacturers faced with consumer choice related to price, reputation, quality of final product. Management through use of multiple trusted suppliers and full access to all financial instruments.

- Strength: information, financial instruments
- Limitations: (i) high investment in sophisticated factories but dependent on rather basic supply chain, (ii) no protection to long-term high prices or insufficient quality and (iii) risk of long term supply due to farming sector failure as a result of non-sustainability of farming systems

MARS

Rainforest in Cote d'Ivoire change from 1955 to 1999



Industry's Un-managed Risk:
No Land, No Cocoa....

Risk Management Options?

- **More Price Management Tools & Systems**
 - More sophistication in financial tools, Buffer Stocks, Cocoa Boards etc.
- **Vertical Integration from Manufacturer to Bean Production**
 - Contract Farming, Owning Plantations
- **Mars' Choice: Risk Management for Long Term Supply through Sustainability efforts and Certification**
 - Building Capacity with Farmers & Institutes to meet Challenges, increase Productivity and Income, and make cocoa a Preferred Livelihood
 - Providing incentives for 'behaviour change' and create loyalty
 - Influence Quality (flavour, specification, residue) and price signals
 - Traceability and Link of Consumer to Farmer

Price Risk Management or Supply Risk Management?

Price Risk Management

the 'traditional' tool for Industry
(but managing price risk is not enough)



Supply Risk Management

Ensure the long term availability of affordable, good quality cocoa beans and products, produced in a Sustainable way



Partnerships to Develop Tools for Supply Risk Management

- **Financial Sector**
 - Professional credit & risk management systems (insurance) to farmer, traitant
- **Research & Extension**
 - Propagation of Planting Material, define Good Agricultural Practices
 - Training of Farmers on Agricultural Skills and Business Insight
- **SME, local industry**
 - Making planting material and farm Inputs available (credit institutes)
 - Laboratories, Credible Surveying Companies
- **NGO's, Civil Society**
 - Develop Value Chain Interactions, Mainstreaming of Certification
 - Building Capacity in national institutes
- **Donors, Governments**
 - Investment in Infrastructure and other Public Goods
 - Policies and Institutional Support



