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Drivers and barriers to sustainable purchasing practices in the cocoa sector

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David Phillips and Anne Tallontire

Summary

- Sustainability is an area of growing concern for both the cocoa producing countries and the chocolate manufacturing industry
- There is a growing consensus on principles underlying sustainable purchasing practices
- Industry sustainability practices do not necessarily include sustainable purchasing practices
- Better understanding of the roles, responsibilities, and motivations of key stakeholders in cocoa value chains is required to promote sustainable purchasing practices
- Support for extending 'alternative' trading and pilot projects is required to build on initiatives that demonstrate best practice in purchasing can meet economic, social, and environmental aims.

With the growth and success of Fair Trade, Organic, and other alternative approaches to the trade in cocoa products, the concepts of responsible purchasing and sustainability have entered the vocabulary of mainstream purchasers more widely. Sustainability is an area of growing concern for both the cocoa producing countries and the chocolate manufacturing industry, and the debate has begun to turn to sustainable purchasing and trading practices. In order for the benefits to reach more cocoa farmers than just those operating in niche market supply chains, sustainable purchasing practices will need to be integrated into the criteria and culture of mainstream cocoa buyers.

This paper builds on recent publications and on-going debates from a number of practitioners and advocates of responsible and sustainable purchasing practices. Publications of relevance here include: a) 'Buying Matters', a report published by Traidcraft (2006) identifying future challenges for companies to align commercial and ethical agendas; b) a report in 2005 from the Natural Resources Institute (NRI) and the International Institute for Environment and Development (IIED) that reviews the opportunities and risks in incorporating fairness into mainstream trading; c) a publication from the Institute of Business Ethics (IBE) which outlines the successes and failures of supply chain management efforts to improve the life of workers around the world (Jamison & Murdoch, 2004). Interviews with buyers operating in the European chocolate industry and other stakeholders in the UK were also conducted from April to July 2006.

With a focus on the cocoa sector, this paper firstly analyses the evolution of sustainable purchasing practices, rooting them in the practices of alternative and fairer trading initiatives. Using the example of cocoa, it then assesses the drivers and barriers to mainstream cocoa buyers adopting these practices. It also investigates the extent to which, and in what ways, the mainstream cocoa industry is responding to this challenge in adopting purchasing practices that move towards a more sustainable trading system and which may improve livelihoods of smallholder cocoa farmers.

The of this paper is to increase our understanding of the approaches of different actors in meeting the responsible purchasing challenge in the cocoa sector, and to ask what may encourage or prevent adoption of more sustainable practices or new ways of working together by the major players in coca supply chains.

Cocoa value chain governance

The conventional cocoa value chain[1] is highly complex, consisting of various actors including local collectors, various intermediary traders and wholesalers, exporters, brokers, cocoa processors, and chocolate manufacturers. Therefore, in the course of converting cocoa beans the raw material will be traded several times, with value different stages, at each of which a margin is taken.

The 'governance[2]' of value chains such as this is therefore of crucial importance. According to Blowfield (2004), Fold (2002), and Haque (2004), governance structures in the cocoa value chain are 'buyer-driven', where some organisations (typically multi- national companies, MNCs) hold considerable power. Fold (2002) describes the governance of the chain as bi-polar, i.e. a market dominated by two sets of MNCs, chocolate manufacturers and cocoa traders / processors. Blowfield (2004) defines the second group (traders / processors) as 'invisible companies' who hold considerable power in the value chain, but are less exposed to campaign pressure as their operations are generally unknown to consumers. Such concentration of control of the cocoa market, it can be argued, reinforces a colonial form of governance that exacerbates the uneven share of value through the cocoa value chain.

Representatives of the cocoa industry and major buyers point out that if the business community is to better serve the needs and priorities of smallholder farmers, there is a need for an improved enabling environment. Investment in infrastructure such as roads and other improvements in communication links are required to enable better access to often quite remote and dispersed groups of smallholder producers. This highlights a need to look to develop sustainable agriculture communities by targeting infrastructure issues in rural areas to encourage more direct relationships.

If an intermediary (e.g. a trader or processor) is expected to invest in a sustainability project, there has to be a market to justify capital expenditure. Evidence from discussions with traders suggests that some markets do exist that justify such investment, in particular in premium sectors such as Fairtrade and Organics. However, a lack of widespread consumer pressure or significant demand from a manufacturer toward a trader in the concentrated 'bi-polar' cocoa market could heighten inertia among MNCs, making such investments less likely as neither traders nor manufacturers take full responsibility for issues facing cocoa producers. The bi-polar governance in the value chain, combined with lack of market

[1] According to Kaplinsky & Morris (2000: 4) value chains are the 'full range of activities that are required to bring a product from growth of a primary commodity, through intermediary phases, to delivery to final consumers'.

[2] Governance refers to the concentration of power, i.e. the institutions, structures of authority and collaborators most able to allocate resources and coordinate or control benefits from trade in the chain.

incentives creates a weak 'business case'[3] for action on sustainability in purchasing practices.

Evolution of Sustainable Purchasing Practices

In the context of a weak business case and the uneven distribution of power in the chain, sustainable purchasing practices in the cocoa sector have in the main emanated from experiences of various alternative trading models. These range from private sector schemes in response to market demands, to organisations that have a primary concern for producers rather than consumers, and research institutes and donor development agencies. Probably the most widely understood and popular approach is Fair Trade,[4] particularly the standards and certification systems developed by the Fairtrade Labelling Organisation (FLO) and the practices of Alternative Trading Organisations (ATOs).

FLO aims to improve the conditions of trade for organisations of smallholder producers of tropical commodities by specifying the conditions for Fairtrade[5] production (for both small scale producer organisations and 'conditions of hired labour') and importantly trade certification. Fairtrade standards focus on the trading relationship, covering contractual and price issues. ATOs such as Twin Trading and Traidcraft adopt a partnership approach and aim to connect producers and customers through direct relationships,[6] increasing market knowledge, and adding greater value to the primary product.

In addition to Fairtrade, other initiatives have gained prominence in the field of sustainable sourcing. Few of these cover contractual terms, although a premium price, based on quality or preferred supplier status is now being introduced into some schemes particularly in the coffee sector such as by Starbucks (see below) and the independent certification systems developed by Utz Kapeh and the Rainforest Alliance. In addition the products certified as organic generally offer farmers a price premium, dependent on market demand.

Starbucks' C.A.F.E. practices sets a number of standards for producers based on environmental, social, and economic criteria, assessed by an independent auditor (at producers' cost), to determine which producers achieve preferred supplier status. Those who meet the sustainability requirements accrue a better deal for their coffee through the receipt of 'outright prices' negotiated directly between co-operatives, private farms or traders, direct purchase, and long-term contracts of 3-5 years.[7] Elsewhere in the beverage sector, Taylors of Harrogate pay a sustainable price by asking farmers to outline costs of production to ensure that the price paid gives farmers a decent return.[8] A number of other initiatives focus on improving quality and promoting good agricultural practices to return greater value to the farmer. Examples include the Sustainable Agriculture Initiative Platform (SAI-Platform)

[3] The business case here represented as a justified reason for a business to take an action that will be seen to increase financial return to a company

[4] Fair trade, defined by FINE, as a trading partnership, based on dialogue, transparency and respect, which seeks greater equity in international trade.

[5] Fairtrade refers to the specific labelling system controlled by the Fairtrade Labelling Organisation (FLO), versus the more general Fair Trade, a term that encompasses a set of business initiatives that seek to provide an alternative approach to conventional international trade, including more equitable trading relations for producers and farm workers (Barrientos & Dolan 2006:6).

[6] Trade relations must be as direct as possible and aimed at long-term trading relations (www.fairtrade.net); the aim in so doing, according to Twin, is so that producers can improve their lives and assume greater control over their own destinies (Twin Annual Report 2004/5: 2)

[7] See Starbucks' C.A.F.E. practices at http://www.starbucks.com/aboutus/supplier_code.asp

[8] Taylors' principles via http://www.taylorsofharrogate.co.uk

developed by MNCs including Unilever, Nestle, and Danone. This however focuses on sustainable production rather than trading practices.

The sustainable purchasing practices outlined in Table 1 are ways in which interventions or changes in the current system can address the issue of the distribution of wealth and benefits in the cocoa market. One thing that was clearly evident from the initiatives investigated was the wide range of companies and organisations who in various ways have demonstrated recognition of the need to address issues in commodity supply chains by adopting some of these practices.

The practices and perceived benefits in Table 1 are drawn from a number of sources, including Fairtrade principles,[9] and also elements from recent policy-focused reports on responsible purchasing such as Traidcraft (2006). They represent a set of measures to both shift balances of power in trading relations to ensure that producers appropriate a greater share of margins from the cocoa value chain, and to build sustainability in supply through the employment of longer term strategies that provide enablers such as access to credit, market information, and contracts that commit beyond one season.

It became apparent in interviews that key stakeholders in mainstream cocoa trading sectors are aware of these best practices and principles, but do they put them into practice? What is preventing or encouraging major cocoa buyers in rising to the challenge of wider use of these practices in the cocoa industry? Factors which drive sustainable purchasing practices and the barriers to their implementation are summarised in Table 2, see page 8. This was developed on the basis of a comparison between cocoa chains and interviews with key stakeholders in the chain.

[9] FLO Standards. Available from: http://www.fairtrade.net/sites/standards/general.html

Table 1: Sustainable Purchasing Practices

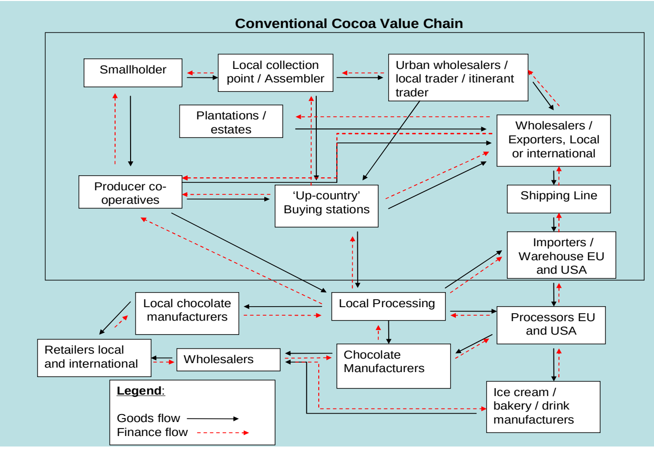
Sustainable Purchasing Practice	Perceived Benefit/s of Adoption
'Fair' share of the export price of cocoa to return to the smallholder farmer.	To cover costs of production and provide a sustainable income.[10]
Longer term contractual commitments.	Assist production planning and reduce volatility in prices.
Direct relationships.	Build trust and stability in the chain. Reduce the number of 'middlemen'.
Improved access to affordable credit and pre-harvest finance.	Improve cash flow of farmers to purchase agricultural inputs and cover harvest expenses.
Timely payments and communication with mutually agreed payment terms.	Greater trust and clarity; reduce uncertainty at end of harvest.
Differential pricing and community premium payments.	Creation of greater local capacity through small-scale investments in appropriate technology, diversification initiatives, and community development projects.

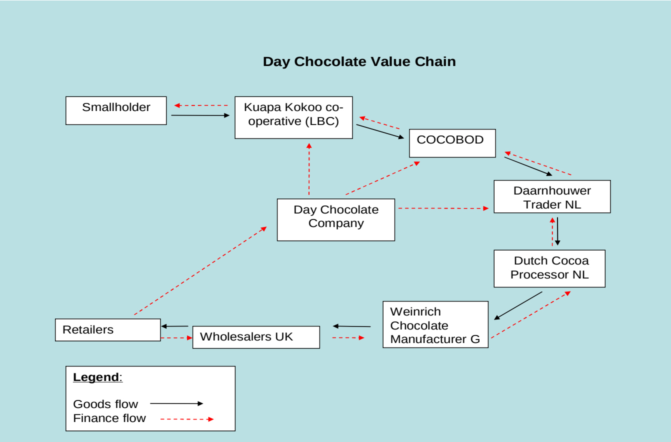
Conventional versus Alternative Value Chains

Using value chain analysis as a framework, we can make distinctions between a 'conventional' and 'alternative' cocoa value chain.

[10] Measured by use of gap analysis between income received and cost of living based on an internationally recognised tool such as CREA (www.crea-inc.org)

The complexity of the chain, high transaction costs associated with direct links with producers mean that in a value chain such as that for chocolate there is not a simple, direct business case for action on responsible purchasing for individual chocolate companies.





The alternative value chain provides an example of how, given a certain set of criteria, a chain can work better for smallholder farmers. By reducing the need for some of the middlemen, farmers may benefit from the more direct relationship. They benefit through receipt of a greater share of the price paid for cocoa, better market information, and community benefits from the social premium.

A key question for value chain analysis is who holds key positions of influence in the chain. In the mainstream market, it is the major buyers who have most influence. In the interesting case of the Day Chocolate Company,[11] a purchasing strategy that sources cocoa in a sustainable manner where the buyer chooses to empower others has created a challenging benchmark to mainstream buyers in the industry.

Whether real or perceived, concerns exist amongst major buyers which means there is a high level of risk aversion to dealing directly with a large number of representatives of smallholder farmers. In the conventional value chain it is easier to maintain the status quo by passing risk onto local exporters and traders who engage with smallholder farmers as they possess greater knowledge of their country and may be willing to take on board the risk. For smallholders this restricts their chances of receiving a 'fair' price for their cocoa as competition amongst exporters in the market reduces prices, and therefore returns less value to the farmers.

In interviews, major buyers recognised that the low value returned to the commodity producer is an issue for smallholders and claimed to be seeking to overcome barriers and develop long-term relationships. International traders stated that they have some co-operation with local partners such as shippers and warehouses. If such ventures succeed the hope would be that increased levels of trust and transparency in trading relations would lead to improvements for farmers. Nevertheless, in practice despite some success in these relationships, major buyers admit purchasing directly from co-operatives accounts for a only small percentage of cocoa purchased.

For both ATOs and representatives of trading companies, the structure of conventional value chains explains the small percentage of direct purchasing, and the lack of incentive for major buyers to bring about significant change in the market. For instance, traders highlight difficulties in buying from millions of

[11] For an overview of the approach of Day, see Doherty, B. & Tranchell, S. (2005)

dispersed farmers. The unwillingness of certain farmers to form co-operatives and poor accountability within some producer organisations were cited by traders as reasons for limited direct purchases. In areas such as West Africa, security issues related to civil war, political instability, civil unrest, and corruption, were cited as constraints to building up trust, long-term relations and contractual commitments which may promote sustainable sourcing. Also it was argued that climate change impacts and incidence of crop disease may restrict the employment of long-term contracts in what are often volatile markets.

Other issues raised in literature on sustainable trade such as the power vested in certain actors in the cocoa value chain, the dispersed nature of the cocoa market, and lack of enabling environments were seen by interviewees as key barriers. All interviewees agreed that where consumer demand exists, such supply chain challenges may be overcome. However, there is widespread recognition that in order to ensure security of supply and to alleviate poverty, major buyers must be encouraged to build on opportunities to adopt sustainable purchasing practices that address social and environmental issues in supply chains.

Both the Fair Trade community and the cocoa industry firmly believe that to achieve greater sustainability in cocoa sourcing, there is a need to create additional drivers (push factors) to create significant change in the conventional supply of cocoa in order to sustain and develop smallholder farming communities. One such driver may relate to new pressures for implementing traceability. In a number of food sectors where increasing pressures for implementing traceability systems exist,[12] major buyers are more willing to invest in systems that circumvent or streamline some elements of the conventional value chain, making purchasing more transparent and direct. Some requirements on behalf of importers and manufacturers are being driven by food safety legislation[13] and others from consumer demands for wanting to know the origin of the foodstuffs they purchase. For example, to cater for manufacturers' demand for traceable quality cocoa, the trader ED&F Man introduced a new division, Corigins, to supply high quality organic and Fairtrade ingredients to the growing natural foods sector.

Whilst some drivers exist, more incentives are required to overcome the large number of real or perceived barriers currently preventing more widespread introduction of sustainable purchasing practices. Business has a responsibility to shareholders to produce return on capital employed in purchasing raw materials and producing consumer goods. There is, therefore, a need to strengthen the business case to expand responsible purchasing.

Regulation may be an important driver in this regard suggested some interviewees from the Fair Trade and industry sectors. Regulation may force buyers to be more accountable for social and environmental responsibilities, especially in the light of ever toughening EU regulation. For example, the ICCO predicts that the EU is likely to increasingly focus Maximum Residue Level (MRL) legislation on cocoa.[14] Also, more innovation in the marketplace will increase the pressure on those less willing to make change. Where some companies are demonstrating success in implementing contemporary business management and sustainable

[12] For instance, in the horticultural industry where systems have been developed to trace products back to the site of production as a response to food safety legislation.

[13] For instance, on 1st January 2006 the EU introduced a range of legislation such as EC/852/2004 – Hygiene of Foodstuffs. To comply, EU food business must ensure food safety. Prevent contamination through: traceability; and Good Agricultural Practice (GAP).

[14] By including cocoa in EU food traceability Regulation No. 178/2006.

purchasing strategies, others will increasingly need to recognise market signals and follow suit. Furthermore, by 'raising the bar' of what is an acceptable way to do business, ATOs and companies such as the Day Chocolate Company, are gathering consumer support and pressure for changes in conventional purchasing practices.

To more effectively translate the sustainable practices and lessons learnt from Fair Trade and other initiatives to allow more smallholders in the mainstream trade of cocoa to benefit, there is a need for improved co-ordination between private and public bodies to overcome complexities and reduce some of the barriers in the cocoa value chain. Some interesting partnerships and pilot projects (such as the Day Chocolate Company and the ICCO Quality Improvement Project)[15] have shown effective co-operation can lead to better structures and systems that develop more sustainable trading and responsible cocoa purchasing strategies.

In conclusion, the experience and evidence from recent innovations in cocoa sourcing have been recognised by key stakeholders in conventional cocoa value chains. In order for recognition to be converted into wider employment of sustainable purchasing practices however, further drivers are required to take the good intentions more into mainstream purchasing channels. Examples of regulatory drivers that policy-makers may look toward could include legislation to encourage major buyers to extend 'sustainability' payments to cocoa producers, or to stipulate that manufacturers label country of origin of raw materials, thereby increasing traceability and transparency in cocoa sourcing. Increased donor support to scale up and improve co-ordination between pilot projects would help to demonstrate that responsible sourcing strategies do not represent commercial suicide. More targeted investment into capacity building through infrastructure and communication provisions in rural areas of cocoa exporting countries could help to develop smallholders' skills and empower producer co-operatives, and improve enabling environments to assist major buyers in extending sustainable purchasing practices.

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[15] Information on cocoa QIP projects of ICCO can be found at: http://www.icco.org/projects/Projects1.aspx?Id=vnn2270 , and the CFC website: http://www.common-fund.org/?pid=0&sort=&country=0&commodity=5&x=34&y=12

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Table 2: Drivers, Barriers, and Sustainable Purchasing Practices

Sustainable Purchasing Practice	Drivers	Barriers
'Fair' share of the export price of cocoa to return to the smallholder farmer.	Increase trust in partnership; keep farmers in cocoa cultivation; consumer/NGO pressure	Sustainability of Fairtrade price / market; bi-polar control; lack of co-ordination; market controls price; lack of transparency; local fiscal policy
Longer term contractual commitments.	Appropriate legal support; niche market opportunities; manufacturer pressure on 'invisibles'	Mistrust of co-operatives; corporate inertia; dispersed cocoa market
Direct relationships.	Reliable co-operatives; protect brand image; innovative companies; traceability regulation; demand for provenance	Distance to dispersed producers; lack of trust; no direct contact; lack of enabling environments; limited capacity and capabilities of some producer groups; role of local exporters
Improved access to affordable credit and pre-harvest finance.	Premium quality demand; improve storage conditions; micro-finance programs in place	As above, plus quality unimportant; cannot deal direct with individual farmers; role of intermediaries
Timely payments and communication with mutually agreed payment terms.	Premium quality demand; secure future supply	Quality unimportant; lack of traceability requirement; dispersed market
Differential pricing and community premium payments.	Urban drift and ageing population; producer empowerment; demand for premium cocoa	Raw material cost small to MNCs; price inelasticity of chocolate; lack of innovative companies; lack of large speciality market

This is based on David Phillips' Masters dissertation (MA World Trade and Development, University of Greenwich). He is now a PhD student at the University of Newcastle. Anne Tallontire is Manager of the Natural Resources and Ethical Trade programme, Natural Resources Institute, University of Greenwich.

Address for correspondence: david.phillips@ncl.ac.uk