



Robin Dand Commodities Ltd

Overview of the Cocoa Supply Chain and Associated Risks

Robin Dand

Abidjan
February 2014



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Robin Dand

- Independent Authority on Cocoa and Robusta Coffee, Managing Director of **Robin Dand Commodities Ltd.**
- Currently working for Chicago Mercantile Exchange (**CME**)
- Recently ICCO World Cocoa Conference Co-ordinator and NYSE Liffe in Commodities
- Member of the Technical Committee of CRUK
- Earlier Chairman of FCC Contracts and Regulations Committee
- Author of “**The International Cocoa Trade**” first published in 1992, currently in its third edition
- Fifth decade of working in Cocoa...



Introduction

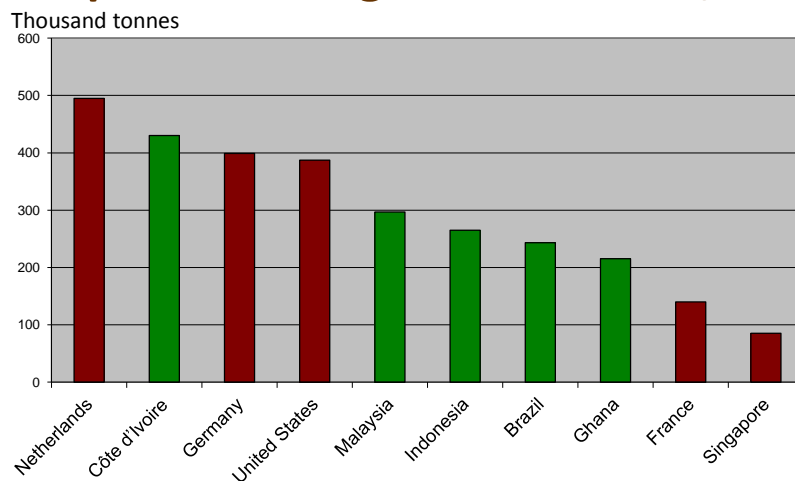
- Physical Cocoa Trade
 - Overview of trade flow of cocoa beans
 - Categories of main participants
 - Main terms on which cocoa is traded
 - Link between the Physical and Futures Markets
- Risk Management
 - Understanding the nature of risk
 - What are the main risks; and
 - How they can be mitigated

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Concentrating on Beans, but... Top 10 Grinding Nations, 2011/12



Source: ICCO

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Role of the Physical Cocoa Trade

To expedite the sale of cocoa beans from the grower to the international market and users of the beans – the **'Physical'** market

– Two main parts to the Physical market:

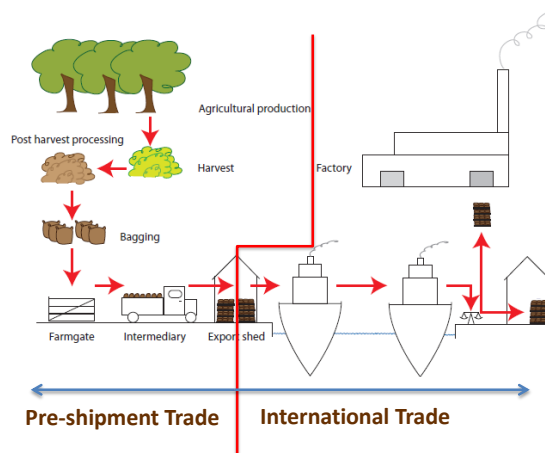
- Pre-shipment, origin trade
 - Subject to national control and local trade practices
- International trade
 - Standard contract terms compliant with international trade practices well understood law; and
 - Subject to arbitration services in the event of disagreements

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Cocoa Bean Shipments – Generalised Trade Structure



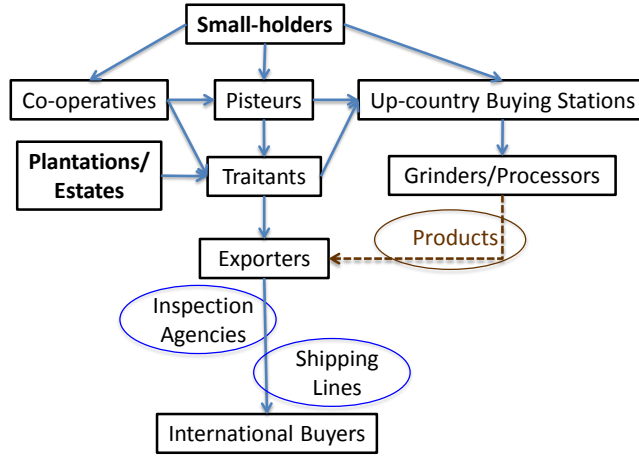
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Côte d'Ivoire – An Example of Pre-Shipment Trade Flow



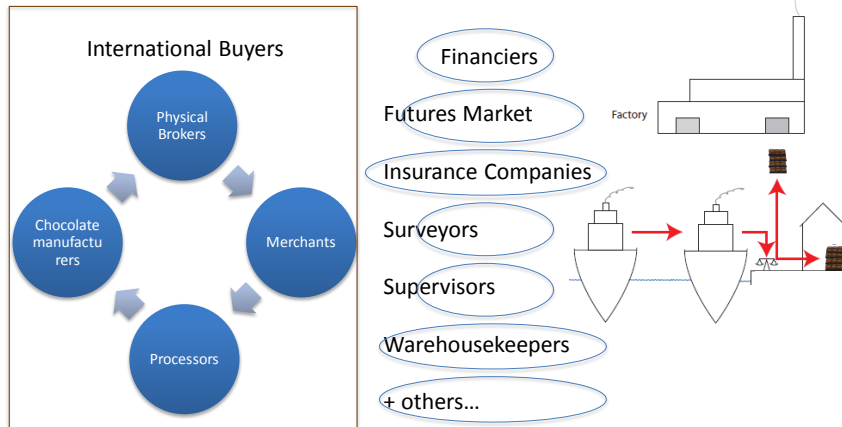
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International Trade Flow



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Standard and Particular Contract Terms

- **Physical Contract Terms**
 - **Standard** contract terms – Parties able to agree any contract terms, however
 - Freedom to contract bears responsibilities, hence the importance and need for **Standard Contract Terms**
- **Futures Contract Terms**
 - **Particular** contract terms – Parties not able to specify the main details, e.g.
 - Quality
 - Quantity
 - Delivery

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Who issues Physical contracts and when should they be used?

- Two trade bodies:
 - **Cocoa Merchants' Association of America, Inc. ("CMAA")**
 - Based in New York
 - Subject to U.S. Food & Drug Administration
 - Contracts subject to the Laws of the State of New York
 - Issues specific contract forms
 - **Federation of Cocoa Commerce, Ltd. ("FCC")**
 - Based in London
 - Contracts subject to the Law of England
 - Issues terms which apply to contracts incorporating them
- When to use CMAA or FCC terms:
 - Shipments to or transiting through USA – **CMAA**
 - Shipments to other destinations – **FCC**

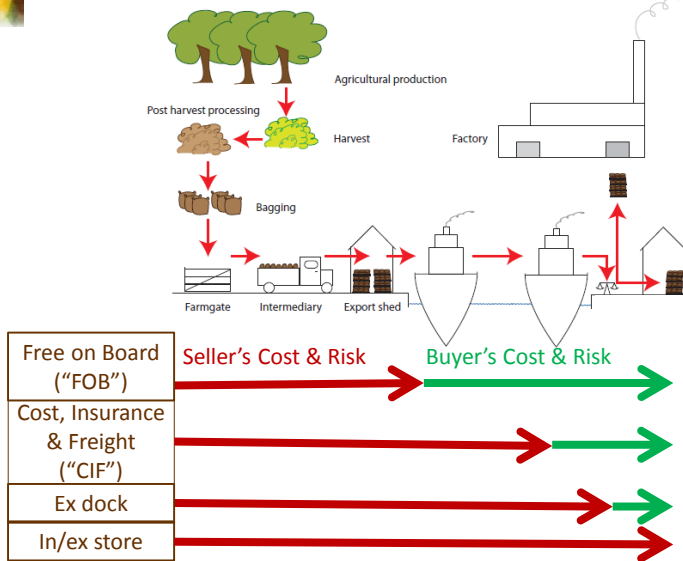
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International Trade – Basic Shipment Terms

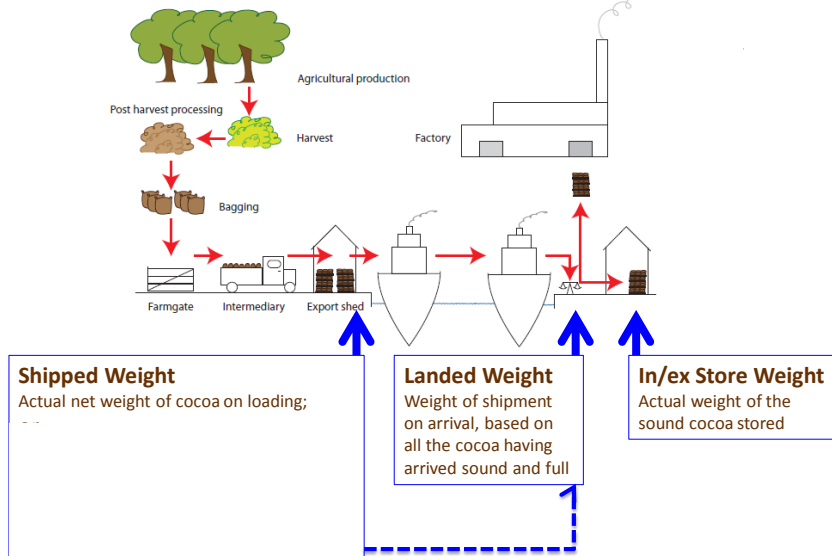


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Standard Weight Terms



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Contract Terms

Delivery	Weight	CMAA			FCC
		1A	2A	3A	FCC-terms
FOB	Shipping		✓		✓
	Shipped				✓
	Landed		✓		✓
CIF	Shipping			✓	✓
	Shipped				✓
	Landed			✓	✓
	Store				(✓)
Ex Dock	Shipping				
	Shipped				
	Landed				
	Store	✓			
In store	Shipping				(✓)
	Shipped				n/a
	Landed				(✓)
	Store	✓			✓

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Short-form contract

This contract is subject to the FCC Contract Rules for Cocoa Beans (which rules shall be deemed to incorporate the FCC Quality Rules, the FCC Sampling Rules, the FCC Weighing Rules and the FCC Arbitration and Appeal Rules) in force on the date of this contract. Any dispute arising out of or in connection with this contract shall be referred to arbitration in accordance with the FCC Arbitration and Appeal Rules in force on the date of this contract. Any changes made to this document shall not be deemed to have been accepted by us nor incorporated into the contract terms unless countersigned by an authorised signatory of Armajaro Group.

We have this day SOLD TO YOU:

- Quantity : 200.00 (two hundred) metric tonne
- Description : Ghana main crop 11/12 cocoa beans
- Quality : Good Fermented
- Shipment : April 2012 - May 2012 shipment
- Arbitration location : London
- Destination : Amsterdam
- Price : Price to be fixed by Mutual agreement at [redacted] per metric tonne premium to May 2012 delivery position of the LIFFE No. 8 Cocoa contract, Cost, Insurance & Freight Amsterdam
- Payment : Net Cash Against Documents
- Weights : Nett landed weights
- Insurance : Insurance to be paid by the seller.
- Freight : Freight to be paid by the seller.
- Special Clauses : 100mt for April shipment, 100mt for May shipment

Would you please sign and return the attached copy of this letter as confirmation.

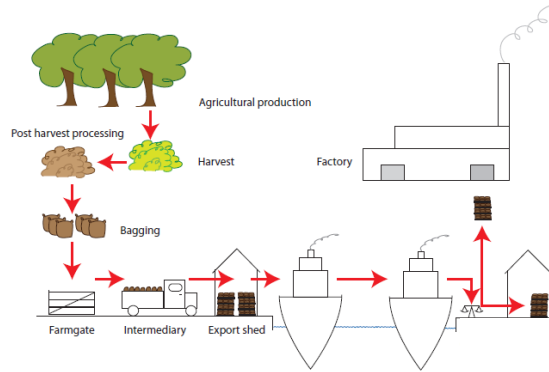
FOR AND ON BEHALF OF
Armajaro Trading Limited





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Use of Cocoa Futures Price in Physical Market



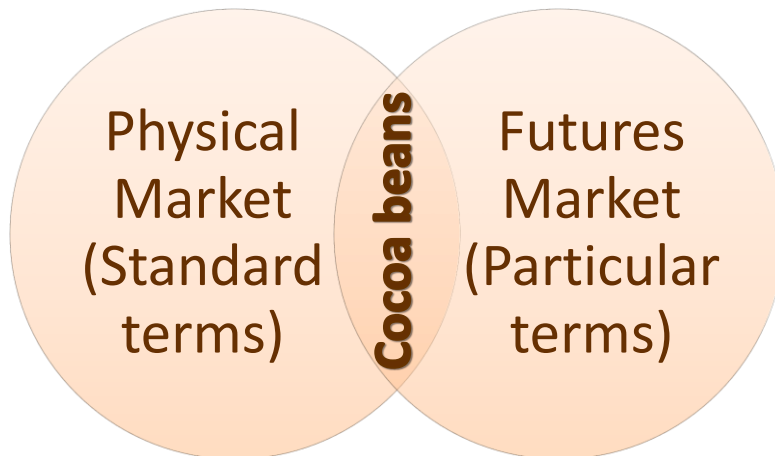
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Connection between Physical and Futures Markets



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RISK MANAGEMENT

- Risk Management in cocoa transactions
 - Understanding the nature of risk
 - What are the main risks; and
 - How they can be mitigated

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Categories of Risk

Risk is exposure to unknown developments

“There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know.”

Donald Rumsfeld

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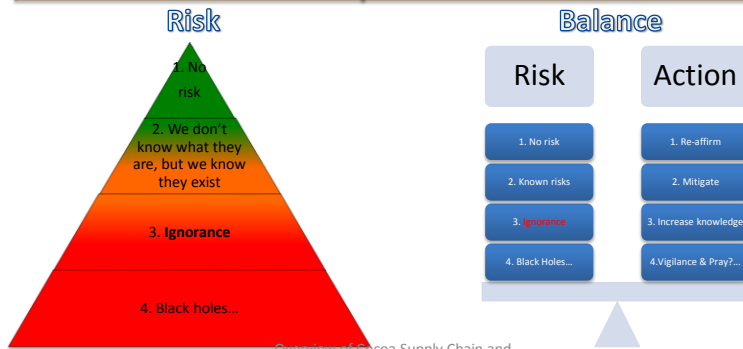
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What Donald meant...

What we know	What we don't know
<ol style="list-style-type: none"> 1. Known knows; e.g. Current price 2. Known unknowns; e.g. Forward price 	<ol style="list-style-type: none"> 3. Unknown knows; i.e. What we should know, but don't 4. Unknown unknowns; e.g. ?



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Main Areas of Risk

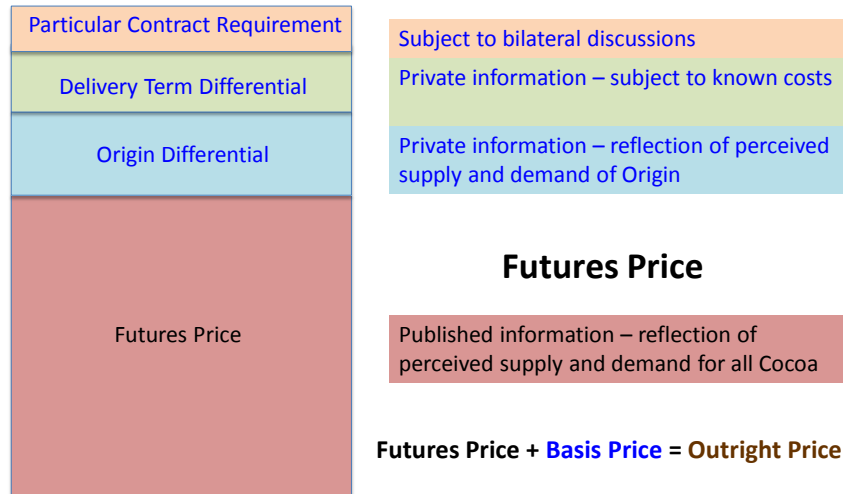


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Market Risk – Make-up of Cocoa Bean Price



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Market Risks – Some Examples

- Price movement of product
 - Outright
 - Basis
 - Structural
- Cash flow
 - Margin calls on futures
- Currency
 - Contract denominated in different currencies
- Credit and Counterparty risk
 - Price movements may cause your counterparty difficulties
- Interest rates
 - Affects carry costs and therefore forward prices

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Product Risks – What could happen

- **Weather**
 - El Niño Southern Oscillation (ENSO) effect
- **Pests and diseases**
 - Affecting production
- **Production**
 - Less than expected
- **Transport**
 - Service adversely affected by roads disrupted by excessive rains
- **Storage**
 - Poor ventilation in damp conditions
- **Quality**
 - Health issues (unauthorised use of banned pesticides on farms)
 - Too high level of mould, parcel rejected by the buyer



Political Risks – Some Examples

- Exports banned
- Limits on where exports may go
- Currency restrictions imposed
- Imposition of taxes
- Imposition of nationalisation of industry
- War or coups



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People Risks – Some Examples

- Fraud/unauthorised trading
- System malfunctions
- Lack of training
 - Not knowing the contracts
 - Physical Sales
 - Futures markets rules
 - Transport
 - Insurance
 - Storage
 - Supervision
 - Currency
 - Financing

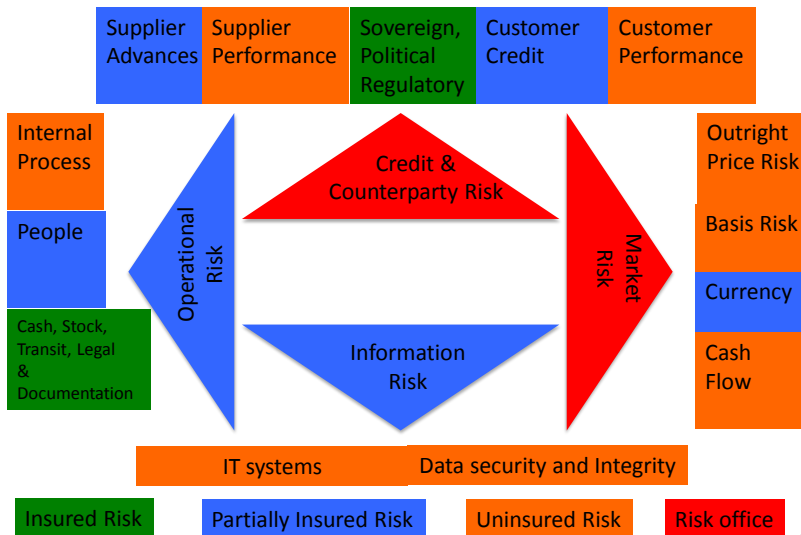
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Enterprise Risk Framework



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Managing Risk

- Know your contracts
- Ensure that the company systems work; checks and balances
- Use the futures markets
- Know your counterparty
- Stay in touch with your counterparty
- Manage your physical contracts

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Thank You!



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