Financing the Cocoa Trade

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Introduction

• Reasons why some banks offer this service and others do not
• What the financiers;
  – consider when looking at a financing deal;
  – the process they undertake;
  – What are the components making up the price of a transaction
• Types of finance transaction available throughout the trade flow from farm to factory
Commodity Finance

• Reasons why some banks like it:
  – Usually short-term transactions
  – Security provided by
    • Assets
    • Title documents
    • Ownership
  – Structures are self-liquidating
    • Sale of goods provides repayment

• Reasons why some do not:
  – Lack of knowledge on Commodities in general
    • Volatility of markets
    • Margin calls
  – Origin country risks
    • Perceived as being too high
  – Infrastructure of bank not optimised to offer financing service

Parameters Banks Consider

The Borrower
• Financial status
• Internal rating (by the bank)
• General management of risk
• History
• Place in the market
• Strategy

Structure of the Transaction
• What is being borrowed and nature of the deal
• Collateral structure
• Advance rates
• Financial and operational covenants

Credit Monitoring
• Collateral position
• Overdue payments
• Counterparty limits
• Audits
Bank Credit Process

- Amount
- Structure
- Pricing
- Know Your Client

Agree Terms and Conditions with Client

Bank Internal Approval Process

- Capital Approval
- Formulate Credit Proposal
- Credit Committee discussions
- Adjustments, if needed

Documentation

- Bilateral
- Syndicated loan
- Standard

Components of the Transaction Price

Base Rate
Euribor/Libor
1M/3M/6M

Liquidity Premium
Cost of the bank having to borrow/use money

Margin
Counterparty risk
Financing Structure risk
Country Risk

Cost of Funds

Financing the Cocoa Trade
Role of Trade Financing – Helping the Flow of Trade

1. **Farmer Pre-harvest finance**
   - Allows farmers access to money to pay for inputs

2. **Origin finance**
   - Allows up-country buyers to source beans for the exporters

3. **Shipment finance**
   - Allows the volume of shipments to occur during the season

4. **Warehouse finance**
   - Allows the merchant/owner to hold supplies throughout the year
   - Related to 4., allows optimal return for cocoa being processed

5. **Factory finance**
   - Financing the Cocoa Trade

### Pre-harvest Financing

- Required by farmers for either;
  - Set-up costs; or
  - On-going input costs and harvesting
- Financing by banks done through intermediary on the ground with recourse by the bank to the intermediary
- Unsecured

#### Risk
- Fraud
- Crop-related
- Political
- Non-delivery

#### Security
- Unsecured finance
- Recourse to client
- Limited by amount
- Future production pledge

#### Insurance
- Political risk insurance
Origin Storage Finance

- Cocoa purchased by client and delivered to port of export
- Client hedges position with short futures through Inventory Management
- Cocoa stored at export warehouse, receipt issued and held by the bank as security and given up on export

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<th>Risk</th>
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<th>Insurance</th>
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<tr>
<td>Fraud</td>
<td>Pledge on stock</td>
<td>Political risk insurance</td>
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<tr>
<td>Theft</td>
<td>Warrant/Warehouse Receipt</td>
<td>Warehouse insurance</td>
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<td>Physical</td>
<td>Collateral Management Agreement</td>
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Financing the Cocoa Trade

Shipment Finance

- Cocoa exported, Bill of Lading (B/L) issued
- B/L used by bank as collateral
- Cheaper finance

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Warehouse Finance

- Cocoa stored and warehouse warrant issued to the order of the bank
- Bank finances against the warrant
- Cocoa remains financed until sold

Note: Financing rate can be reduced by having the cocoa deliverable against an Exchange position

Final Receiver Finance

- Client offers term financing (backed by the bank) to final receiver
- Financing against pledge of receivable funds from the final receiver
If this looks familiar...

- 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

Thank You!