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CAPACITY BUILDING ON PRICE RISK MANAGEMENT STRATEGY FOR COCOA SMALLHOLDERS IN AFRICA

SUMMARY OF PROJECT COMPLETION REPORT (PCR)

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I. PROJECT SUMMARY

Project Title:	Capacity building on price risk management strategy for cocoa smallholders in Africa
Location:	Cameroon, Nigeria, Sierra Leone, Togo
Project Code:	CFC/ICCO/44/FA
Project Executing Agency:	TWIN
Supervisory Body:	International Cocoa Organization (ICCO)
Starting Date:	July 2014
Completion date:	March 2017

Financing:

Total Project Cost:	US$ 654,217
CFC Grant	US$313, 828
Co-financing (AFD)	US$52,647
Co-financing (Others)	US$34,797
Counterpart contribution in cash	US$125,580
Counterpart contribution in kind	US$127, 365

II. BACKGROUND AND CONTEXT IN WHICH THE PROJECT WAS CONCEIVED

1. In the short term, the world demand for cocoa beans is fixed[1], whereas the world supply is subject to a degree of uncertainty[2]. The resulting inability of the supply to adapt quickly to the market's needs can cause large variations in prices. The concept of volatility is often used to measure both magnitude and frequency of the price changes over time[3].

2. Volatile cocoa prices cause wide fluctuations in the farm income. And this in turn reduces the ability of producers to save and to make investments in their farms. For the less fortunate smallholders, this often means to forgo the basic needs as the cost of food represents a large share of their income.

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[1] This is because the industry plans ahead its chocolate production schedules and, therefore, its purchases of cocoa semi-finished products which in turn determine the demand for cocoa beans.
[2] Production volumes strongly depends on weather conditions among others.
[3] The price volatility is commonly measured as the annualized standard deviation of the percentage changes in the daily price.

3. In the aftermath of the Structural Adjustment Programmes in Sub-Saharan countries, the issue of the volatility of agricultural prices was at the forefront of political debates and discussions among development economists. Farmers were now fully exposed to the seasonal volatility of the international prices. And they were made worst off in the absence of any safety-net programme.

4. Through a series of working papers, the World Bank explored the idea of using a combination of market-based instruments to cope with volatile prices. As a follow up, the ICCO Secretariat developed and implemented a pilot project, entitled *Pilot Project on Price Risk Management for Cocoa Farmers in Côte d'Ivoire*, to assess the feasibility of these instruments. These pilot operations were implemented during the period 2006 to 2008, and their results were mixed. On the one hand, these tailored price-risk instruments addressed effectively the issue of price volatility *de facto* setting a minimum farm-gate price. On the other hand, these instruments were out of reach of the average cocoa producers because of their knowledge gap.

5. After some consultations with the Common Fund for Commodity – the donor agency –, it was agreed to empower cocoa farmers with simpler price-risk management practices. It is against this background that the project entitled *Capacity Building on Price Risk Management Strategy for Cocoa Smallholders in Africa* was developed and implemented by the ICCO Secretariat in Cameroon, Nigeria, Sierra Leone and Togo from July 2014 to March 2017.

PROJECT OBJECTIVES AND OUTPUTS

6. The overall objective of the project was to implement a major programme of awareness-raising and capacity building on price risk management strategies to mitigate the negative impact of the intra-seasonal price volatility.

7. The specific objectives of the project were:

- to identify both the impact of price volatility on the cocoa farm sector and the strategies currently in place to cope with it;
- to deliver awareness-raising workshops on the price volatility and risk management strategies; and
- to build capacity on price risk management strategies for the members of cooperatives and producer organizations.

8. The components of the project and expected outputs are as follows:

Component 1: Survey on the impact of price volatility and strategies in place

Outputs:

1.1. A baseline data on the effects of the price volatility on cocoa farming and on the current price risks management strategies

1.2. Evaluation of the current policies and business practises adopted by cocoa cooperatives and/or farmer organizations

Component 2: Raising awareness of cocoa stakeholders on price risk management strategies

Outputs:

2.1. Assessment of the impact of price volatility and the effectiveness of price risk management strategies

Component 3: Training and capacity building on price risk management strategies for the members of cocoa cooperatives and/or farmers organizations

Outputs:

3.1. Practical use of business practices reducing the exposure to the volatility of cocoa prices

Component 4: Project management, coordination and supervision

Outputs:

4.1 Efficient coordination, supervision and management of the project

PROJECT BENEFICIARIES

9. The direct beneficiaries of the project were members of cooperatives and producer organizations in implementing countries.

10. The capacity building programme also targeted permanent staff members of interprofessional organizations. The latter would act as trainers of trainees over the course of the 18-month project and provide continuous technical support after the conclusion of the project.

11. The exporting and the financial sector in implementing countries also benefited through awareness raising activities so as to provide a supportive environment for the cocoa farming sector.

12. The Project Executing Agency (PEA) was TWIN and ICCO was the project Supervisory Body (SB).

13. The National Project Implementation Agency (NPIA) in each of the four participating countries were as follows:

- Cameroon - Conseil Interprofessionel du Cacao et du Café (CICC)
- Nigeria - Cocoa Association of Nigeria (CAN)
- Sierra Leone - Produce Monitoring Board (PMB)
- Togo - Comité de Coordination pour les Filières Café et Cacao (CCFCC)

14. The approved budget for the project was US$ 654,217.

III. PROJECT RESULTS ACHIEVED

15. The results achieved for each of the expected outputs are outlined below.

OUTPUT 1.1: Baseline data on the effects of the price volatility on cocoa farming and on the current price risks management strategies

16. The survey on the impact of price volatility and current strategies to cope was conducted only in Cameroon and Sierra Leone because of budget constraint. The results of the survey showed that in Sierra Leone, 30% of cocoa producers did not enter into written contracts with buyers and that 43% of sale contracts were based on fixed price terms. In addition, cocoa price volatility limited savings (in 50% of the cases), increased indebtedness (in 57% of the cases), and reduced farm investments (in 16% of the cases).

17. In Cameroon, 9% of cocoa producers did not enter into written contracts with buyers, 48% of contracts were based on fixed price terms and 26% on price-to-be fixed terms. Also, price volatility limited saving (in 68% of the cases), increased indebtedness (in 73% of the cases), reduced farm investments (in 60% of cases).

18. The above results highlighted that less than half of the farmers were adopting simple but effective risk management practices (i.e. sale contract with locked prices) and that informal cocoa sales were still used exposing those farmers to additional risks (i.e. contract default from the buyer).

OUTPUT 1.2: Evaluation of the current policies and business practices adopted by cocoa cooperatives and/or farmer organizations

19. In Sierra Leone, 40% of producer organisations had regular access to a computer and 30% to the internet, whereas in Cameroon 23% had regular access to a computer and 20% to the internet. Among those with internet access, less than half (48% in Cameroon and 40% in Sierra Leone) monitored international cocoa prices. No farmer in Cameroon indicated they understood the negotiation mechanism on the international market while only 2% in Sierra Leone said they understood.

20. Furthermore, just over half of the interviewed farmers (52% in Cameroon and 64% in Sierra Leone) received regular pre-financing.

21. To address these gaps, training materials were developed which included an analysis of market fundamentals as well as the access to micro-credit through social lenders.

OUTPUT 2.1: Assessment of the impact of price volatility and the effectiveness of risk management strategies

22. Using the results of surveys conducted in Cameroon and Sierra Leone, workshops were created in each country to raise awareness and the beneficiaries were encouraged to consider adopting new strategies based on the following three elements.

- Long-term analysis: understanding the market fundamentals in terms of production, export, consumption and stock, in order to assess the main dynamics of the world market.

- Medium-term analysis: risk management through physical stock management, monitoring “short”/“long” position, understanding the breakeven point, and buying and selling at the right price.

- Short-term fixing strategy: when an operator has taken delivery of the bulk of the volume for a specific contract (around 75%), the operator has about a week to set the right moment to fix the selling price.

OUTPUT 3.1: Practical use of business practices reducing the exposure to the volatility of cocoa prices

23. Using a cascading model of training sessions from local experts to cocoa farmers, capacity building programmes on price risk management strategies were delivered in each implementing country. Firstly, a selected group of 130 local experts (40 experts in Cameroon and Nigeria, 25 in Togo and Sierra Leone) received an initial training on the practical use of price risk management strategies. Subsequently, 20 experts (6 in Cameroon and Nigeria, 4 in Togo and Sierra Leone) delivered the same training to a total of 384 members of cocoa cooperatives and producer organizations.

24. Based on the limited trading experience, the PEA advised producer organisations in Sierra Leone, Togo and Cameroon to focus their strategies on stock management (rapid roll over) so as to reduce the exposure to the price volatility. In Nigeria where producer organisations were more experienced/advanced in exporting their cocoa, the concept of hedging was introduced as a complementary strategy. It was emphasised to all participants in these capacity building programmes that it was important to understand the dynamics on both the international and local markets.

25. The training also highlighted some governance issues affecting cooperatives and producer organizations *vis-à-vis* their primary aims (social or trading e.g. collective marketing, extension support, savings, etc.), structure (primary or second/third level unions), gender representation and product flows from each farmer to the point of sale (based on formal and informal arrangements, payment systems and range of trading activities).

26. This element of the training appears to have been heeded with many producer organisations reviewing their structures and decision making, with a review of roles and responsibilities in relation to price fixing for cocoa buying from producers as well as price fixing for cocoa sales.

OUTPUT 4.1: Efficient Coordination, Supervision and Management of the Project

27. The Project Executing Agency (PEA) TWIN coordinated and managed all project activities in the participating countries with the support of the National Project Implementation Agencies (NPIAs). The PEA provided regular backstopping, six-monthly reports and annual reports.

28. The ICCO Secretariat monitored and supervised the project regularly in coordination with the PEA through the review of progress reports and participation in supervisory missions to the project sites.

IV. LESSONS LEARNED

DEVELOPMENT LESSONS

29. The PEA identified eight lessons learnt through the project's implementation.

i. Choice of beneficiaries in the cocoa value chain – there is a need to clearly identify each target group of beneficiaries.

ii. Insufficient time to train local trainers – the PEA should have adequate time to develop and implement training of trainers.

iii. The structure and system of the cocoa sector in the participating countries – although all the countries have liberalised their domestic cocoa sector, there were significant differences in their local market dynamics. These differences should be accounted for in future project designs.

iv. Differences in sizes and capacities of producer organizations in each country – there is a need for a robust capacity analysis, a focus on basic business skills and a tailored training.

v. Benefits of membership of producer organizations – since cooperatives and producer organizations benefit more from the project, more support should be given to them.

vi. Duration of project implementation – adequate time should be given to implement a project of this nature.

vii. Links with social lenders – there is a need to investigate the potential role of these initiatives in projects of this nature.

viii. Price differential by origin "imposed" by buyers – need for greater awareness and understanding on how the market is pricing cocoa beans of different origins in relation to the cocoa quality characteristics, its consistency over time and across various exporters and, the likelihood of contract default.

OPERATIONAL LESSONS

30. The following operational lessons were learnt during project implementation.

- Choice of collaborating institutions with requisite expertise
- Selection of qualified national Coordinators for project implementation
- Timely release of funding from all sources for project implementation and application of adequate accounting principles
- Sustainability of local structures providing technical support

V. CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

31. The following major conclusions can be drawn from the project which achieved its aim of equipping cocoa producers with knowledge and skills necessary to employ an appropriate mix of business practices to mitigate price risk associated with local and global markets.

- Strong engagement from the four participating countries, with 514 people trained in price risk management (130 trained directly by the PEA and 384 trained by the local trainers).
- Solid baseline data were gathered in Cameroon and Sierra Leone to identify the impact of price volatility, the existing strategies adopted by producers and the constraints for market-based

price strategies. The findings are useful in understanding the cocoa value chain in Cameroon and Sierra Leone, as large and small producer countries.

- Tailored training materials were developed to train members of cooperatives and producer organisations that cover key topics such as (i) Market Fundamentals on the cocoa sector, (ii) Risks associated with producer organisations, (iii) Types of contracts, (iv) How to monitor exposure, (v) Futures & Options, (vi) How to fix your price. The training materials were also used confidently by local trainers, with good feedback.

- Anecdotal evidence from project participants confirmed the project was of value to the producer organisations who benefited from the training (both directly delivered by the PEA, and indirectly by the local trainers) with 90% developing price risk management strategies, 88% implementing changes following the training and 35% making savings of, on average, $2,695 over the 2016/17 cocoa season (as reported in January 2017 before the end of the season). The result should be taken with caution since only 7% of farmers targeted by the capacity building on price risk management responded to the final survey.

- There is a strong likelihood of continuity of price risk management training and producer support in 3 of the 4 countries (Sierra Leone, Togo and Cameroon) as local trainers are now established within the NPIA, and equipped to replicate the training for producer organisations in these countries, benefiting the larger cocoa producer community.

RECOMMENDATIONS

32. To sustain and improve on the gains of this project, the PEA has recommended three complementary project areas to strengthen the capacity of producers to tackle appropriately their exposure to cocoa price risks. These include:

- Expand the capacity building programme to producer organisations, through several growing seasons. This would involve producer organisations capacity assessment, setting Key Performance Indicators for selected organisations, building links to existing local market information services. This project could include a component on monitoring progress in incomes, livelihood strategies and food security of producer organisation members.

- Support producer organisations to build links with social lenders who can help to address their lack of liquidity, especially at the start of the cocoa season with short term seasonal loans and can support producer organisations to implement effective price risk management strategies. This would aim to strengthen business basics and financial planning of producer organisations trading in their own account. This could draw on the baseline survey findings about buyer and producer organisation practices around advance and split payments, and focus on specific elements of exposure to price risk and improving producer organisations' financial management.

- Develop a programme of support linking quality and pricing, including a component on awareness raising for all partners in the cocoa value chain, with an introduction/refresher on price risk management and explaining the elements of price, cocoa quality and standards, systems of quality control, with a component on quality training from field to sale (production, harvest, drying and storage). This project could introduce careful monitoring to assess improvements in traded cocoa quality and price of cocoa.