CBI
Ministry of Foreign Affairs

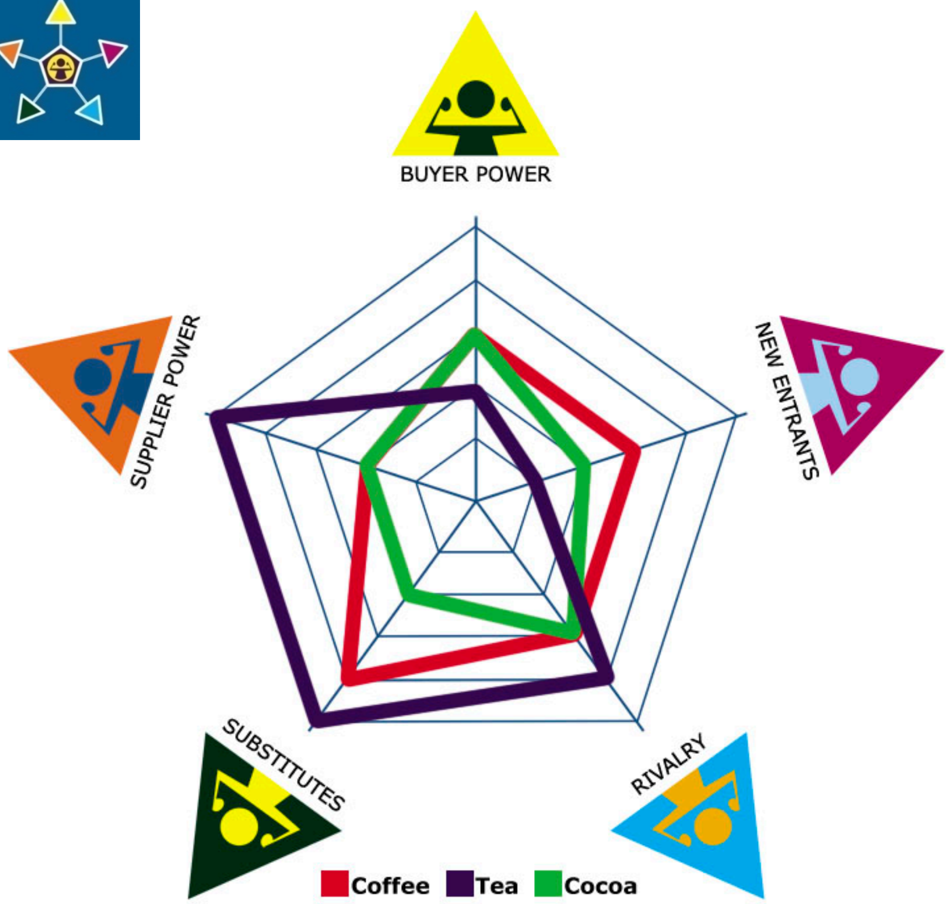
CBI Competition:

Cacao

Introduction

Cacao production is concentrated in West Africa. A few big multinational companies dominate trade. Volatile market prices, diverse EU consumer demands and increasing sustainability and health requirements characterise the market. At the same time, new production regions are emerging (Vietnam and India) and processing capacity is moving to producing countries (Cote d'Ivoire and Ghana) where local consumption is rising. This brings new dynamics to the competitive environment of cacao trade. Scarcity and a more differentiated/segmented demand from traditional and new consumers are two key drivers that open up opportunities for exporters.

Five Forces Model



Substitution: Rising demand in emerging countries, segmented markets and increasing competition.

Rising demand in emerging countries.

A further rise in demand for cacao in developing and emerging countries is expected. India and Turkey are earmarked as standout markets for the future (Confectionery news, 2014). Eastern European chocolate consumption is on the rise, especially in Lithuania and Estonia (4.2 kg and 6 kg per capita in 2014 respectively), while Western European consumption is expected to stabilise (Euromonitor, 2014. The latter is especially true for the mass-market segment.

Tip:

- Be aware that opportunities might arise in your own region or continent. Nigeria for example is an upcoming market with an increasing middle class, with an increase in chocolate bar consumption of almost 100% from 2008 to 2013 (Business Day, 2014).

Segmented markets: mainstream products and premium chocolate.

In certain mass-market segments, higher value cacao is substituted with lower quality products. Discounters Aldi and Lidl for example, produce cheap private label products for the German and Dutch market using lower cacao contents and/or partly substituting cacao butter for other vegetable oils. Due to their growing strength in these markets they are forcing local chocolate manufacturers to look for opportunities in other markets. Furthermore, certified beans for the mass-market segment are basically used to produce the chocolates of the large international brands (Mars and Côte d'Or), where large volumes of non-certified beans are substituted for certified beans without increasing (retail) prices. This could affect smallholders and exporters as they are confronted with larger volume aggregation requirements and lower prices. At the same time, next to the increase of mainstream certified cacao products, the popularity in the premium segment of healthy and innovative chocolates is growing. More expensive, better quality cacao is used such as fine flavour cacao from specific (single) origins.

Tip:

- In general, Fairtrade and organic certified cacao is not easily substituted as consumers specifically demand this type of cacao in their chocolate (physical link between certified bean and chocolate product). Rainforest Alliance and UTZ certified might be substituted more easily at consumer level as they permit a virtual link (the mass balance principle, i.e. administrative traceability). Recently, Fairtrade also permitted mass balance processing, causing quite a stir among the public, which generally still demands a fully segregated supply chain. With this in mind, if you consider producing cacao following a sustainability standard, make sure you investigate your end-consumer's expectations regarding traceability: do they demand a physical link (which is compulsory in organic), or are they happy with just an administrative link. To learn more about the different forms of traceability check this link.

Competition from alternative products.

A serious threat for cacao, especially its butter, is the emergence of other vegetable fats. EU regulations allow palm, mango kernel and shea butter as substitutes to make chocolate. Another threat comes from increased health awareness. As an energy-rich food, chocolate is unhealthy when eaten in large quantities. German consumers for example increasingly buy savoury snacks in the search for healthier products. Raw cacao beans are considered healthy however consumption is still limited.

Tip:

- The substitution of cacao butter by other vegetable oils may be a threat as importers will import less cacao for this quality. At the same time however, increased demand for palm oil for example, may create opportunities for crop diversification, both for the farmer and exporter.

Buyer power: Strict buyer requirements and the fierce power of multinationals

Complex industry standards enforced by buyers.

EU buyers demand compliance with several buyer requirements. Buyer requirements regarding health, food safety, quality, MRLs, heavy metals (e.g. cadmium), traceability and sustainability do not always match the capacities and reality of exporters or producers. Having to choose from and comply with these standards can lead to serious investments in time and money for producers.

Tip:

- Note that standards (quality, health, social, environment, traceability and labour) are set by international bodies (UN, OECD, ISO), the public sector (government authorities, the United States, European Commission, etc.) and the private sector. Before investing in compliance with standards, always check with your buyers what criteria they adhere to and/or check whether you can find buyers for your products. Also the EU export helpdesk, ITC Standards Map and CBI buyer requirements can help you.

EU buyers do not favour unstable environmental or political conditions.

Political tensions in Côte d'Ivoire (the largest cacao producer in the world) and the recent Ebola outbreak in West Africa threaten much of the world's cacao supply. Furthermore, West Africa is faced with low and decreasing cacao yields as a result of relatively old farmers and little interest among young farmers in terms of replacing them. On the one hand this has led to programmes to boost West-African cacao production and, on the other, it causes EU buyers to look for alternative countries (e.g. Vietnam and Indonesia). Examples of such programmes are the Cocoa Improvement Program and the African Cocoa Initiative. Sellers from unstable countries will have to put extra effort into remaining a reliable trade partner.

Tips:

- Invest in long-term relationships based on mutual respect and trust: the number of cacao producing countries is limited (and they are politically often unstable), making cacao production vulnerable to issues such as the high impact of unfavourable weather conditions. In addition buyers are worried about scarcity. Therefore invest in partnerships. This makes it economically more interesting to invest in productivity.
- When negotiating a sales transaction, make sure that the contract at least stipulates the buyer specifications in terms of quality, quantity and price of the goods, the shipment period, terms of payment and delivery and the period during which the offer or bid is firm (valid).

Fierce power and further consolidation of multinationals.

Cacao beans are traded through the commodity market. In commodity markets, buyer power is relatively high (there only few buyers) and buyers control large parts of the supply chain in terms of prices, margins and quality standards. The buyers are already concentrated and with the recent takeover of ADM's Chocolate business by Cargill and ADM's cacao business by Olam, the industrial cacao sector will further consolidate into two major players: Cargill and Barry Callebaut, increasing buyer power even more. This is also true for most certified beans, especially the mainstream labels such as UTZ Certified and Rainforest Alliance, as these are traded along the same trade channels as non-certified (bulk) beans.

Tips:

- If a modification to an existing contract is agreed then confirm it in writing (both parties).
- Improve your bargaining position by staying up-to-date with current market prices. Monitor the local exchange markets for hedge contracts and futures in cacao. World trade is still dominated by the NY, Chicago and London Stock Exchanges.

More direct purchases by multinationals

Multinationals increasingly source their cacao beans directly from cacao farmers. Barry Callebaut, ADM and Cargill for example, set up branch offices to buy directly from smallholders. In addition, there are also examples of companies (such as Ritter Sport in Central America) initiating their own cacao plantations, thus bypassing the local cooperatives,federations and exporters. In this way, the power of these local market players is reduced.

Tip:

- Be aware that as a result of direct bean purchases by multinationals, your role as a DC exporter may be eliminated. Therefore, demonstrate your added value, such as guaranteeing high quality beans, in-time supplies and a secured (continuous) supply. Furthermore, look for opportunities in direct trade with smaller partners. Distinguish yourself by engaging in fine flavour cacao, single origin cacao and/or bean-to-bar concepts for the speciality (niche) market.

Supplier power: potential improvement of weak position of suppliers, mutual interest in farm productivity and local government programmes

The relatively weak position of the supplier is potentially improving.

Due to scarcity, product differentiation, certification, added value and speciality products, supplier power increasing. Smallholder farmers, however, need to organise themselves into cooperatives. On the other hand, farmers and exporters still face a number of constraints that are out of their direct control, such as poor infrastructure, weak organisations, pests and diseases and the wide range of different sustainability requirements. Certifiers are put under pressure to be aligned with the various industry commitments regarding the sourcing of sustainable cacao.

Tips:

- If the demanded cargoes are higher than your production capacity, try to engage in a cooperative.
- If the demanded cargoes are higher than your production capacity, and it's not possible to participate in a cooperative, middleman traders may be able to connect several sellers and set you up with buyers.
- Find out what potential direct trade partners exist for you in the EU. Select your partner based on the qualities you would like to develop for your farmers and on existing opportunities in the EU. Your trade partner might have ideas about how to create opportunities for quality-differentiated products in the EU.

Speciality beans to avoid the commodity market: Direct trade.

Fine and flavour beans meant for the speciality market, single origin beans and/or bean-to-bar concepts can avoid the mainstream commodity market. These beans are generally traded through alternative channels, using smaller specialised traders that generally have more direct contacts with their suppliers.

Tip:

- Gender and cacao farming are also high on the agenda. If you want to learn more on how to increase productivity amongst female farmers see for example the action plans of Mars and Nestle.

Increased attention and funding for farm-productivity.

Productivity is one of the focus points for EU buyers. Direct improvements can be made by adequately processing (fermenting) and storing beans, better and more efficient use of inputs and by improving insights into the costs and benefits of the farm.

Tip:

- Try to engage with organisations that are able to co-finance smaller projects. Nowadays Non Governmental Organisations (NGOs) are more willing to work with private companies for private sector development. Look for multi-stakeholder cooperations or other finance opportunities. Refer to organisations like Solidaridad, Sustainable Trade Initiative, TechnoServe and SwissContact for more information.

Pro-active measures by governments in supplying countries.

Governments (combined with international institutions, certifiers or buyers) provide extension services to farmers to improve their productivity. The reinstalled cacao commodity board in Côte D'Ivoire is an example of active participation in the cacao chain. The board aims to encourage certainty and stability in the country's cocoa industry, and help enhance the prosperity of growers.

Tip:

- Check your national Ministry of Agriculture and other local programmes from FAO, IFC, ICRAF and other organizations for possible programmes to support your crop. See for example the recently signed Cocoa Action Plan, a joint agreement with the Government of Côte d'Ivoire and the largest cacao and chocolate companies to make cacao farming in the country sustainable.

New entrants: 'hard to enter but easy to sell'

The barrier of strict buyer requirements: little room for DC exporters to enter EU market.

As a result of strict food safety requirements (set by governments and companies) and EU legislation, only those suppliers that are able to adhere to high standards can enter the European market. This includes the minority of cacao farmers. The stringent requirements thus create a serious barrier to most cacao producers. Furthermore, DC exporters need to compete with the large multinationals that control large parts of the supply chain and market. Their size allows them to compete strongly on price. In other words, most opportunities for DC exporters lie in fine favour cacao and/or the speciality market.

Tips:

- Standards can enhance competitiveness, both for producers and exporters, through improving product quality, production efficiency and access to finance. Requirements in standards to implement good agricultural practices and soil conservation, as well as improving traceability systems, have resulted in productivity gains in quality and yield and reduced human exposure to pesticides. As an exporter you can inform, align and facilitate your suppliers/ farmers on this issue.
- Try to bypass the bulk (commodity) market by engaging in direct trade. Actively look for smaller partners in the speciality market.

Small-scale farmers.

Historically cacao is linked to small-scale farming. A single farmer will not produce enough beans for exports. Therefore, farmer cooperatives, exporters and buyers need to work together to achieve a certain economy of scale that is needed to operate on the EU market.

Tip:

- Direct trade cuts out the middleman so more money potentially stays with the farmers. Make sure that this cost saving is to you and your farmers' benefit and not to the benefit of your trade partner who may pay the same low price.

Financing new activities remains complex.

Small companies in particular find that financing can be a difficult issue. If the market requires a change of products or services, farmers may not be able to adapt, as a result. Further cooperation along the chain to finance and increase productivity between farmers, exporters and buyers is expected. EU buyers are increasingly aware that suppliers need investments to increase their harvests. A growing number of initiatives have arisen in this field; see for example the Progreso Program and The Growth Fund, the latter being a funding facility that provides loans. Also check this site to learn more.

Tip:

- To find financing, note that large importers or distributors and non-governmental organisations may have access to government money in the EU for sustainability projects.

Competitive rivalry: price, market and sustainability

Pricing system at stock exchange obstructs the market.

Speculation has caused the price of commodities to fluctuate heavily. Cacao is no exception. This will disturb 'normal' price-relations that permit a stable buyer-producer relationship. Some collaborations between buyers and producers may therefore opt to work out long-term price policies. However, in reality buyers would like to benefit from low world market prices and producers from high ones. A common compromise among speciality or certified (niche) actors is to keep the premium flexible; in times of high stock prices a buyer may agree with a cooperative to pay relatively less premium on top of this world market price, while in times of low stock prices he will pay a relatively high premium.

Tips:

- Speciality products or products with a sustainability certificate or documentation are increasingly popular. Is this an opportunity for you?
- Add extra value to your products, such as high quality service or a signature story behind your product.
- Monitor developments regarding new pricing systems. Ask your buyers about possible scenarios for guaranteed prices and orders

Degree of rivalry:

More than half (54%) of the cacao beans exported to the EU is supplied by Ivory Coast and Ghana. This article illustrates the competition between the countries. A few large players (both in terms of grinding and chocolate manufacturing) dominate the cacao bean and chocolate market. As a result the degree of rivalry between them is quite high, especially at times when cacao beans are scarce.

Tip:

- Note that the market for certified cacao is one of the fastest growing markets in Europe. The supply and demand for certified beans is not (yet) balanced and currently one third of the beans is not sold as certified. When considering exporting certified beans, make sure that your buyers make long term commitments regarding the volume and type of certification they want.

Rivalry between buyers in sustainable market.

Manufacturers, grinders, blenders and retailers of cacao have all made sustainability claims for the coming ten years. This has increased the competition for (mainstream, such as UTZ) certified beans. The certified (mainstream) chocolate products serve the mainstream retail market, where competition is comparable to conventional (non-certified) products. In the EU almost half of the chocolate products are sold in this market segment (supermarkets and discounters).

CBI Market Intelligence

P.O. Box 93144
2509 AC The Hague
The Netherlands

www.cbi.eu/market-information

marketintel@cbi.eu

This survey was compiled for CBI by CREM BV
in collaboration with CBI sector expert Jeroen Kruft en Lisette Zewuster

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