



Ghana: Cocoa sector is facing new challenges

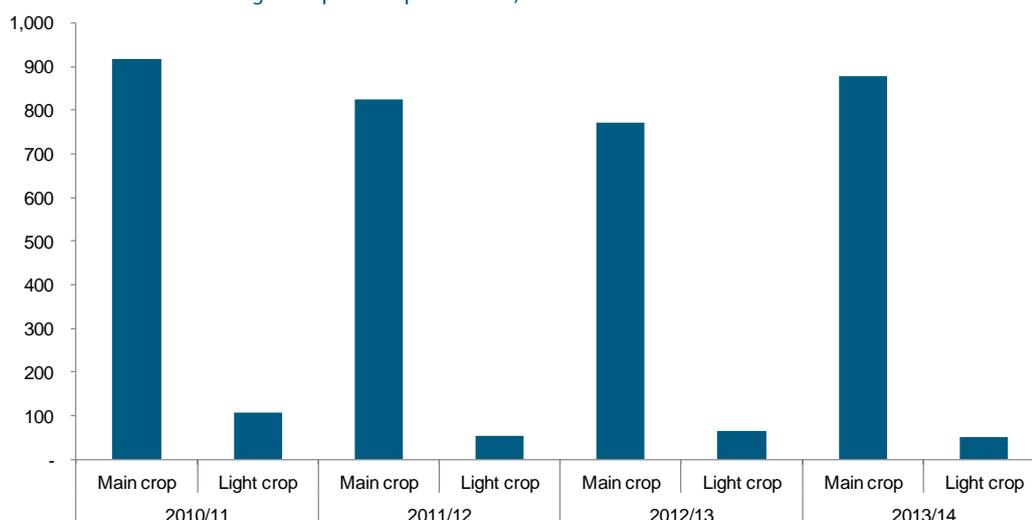
Highlights

- Ghana is the world's second largest cocoa producer, with estimated output of 930,000 MT in 2013/14, and is a major exporter of cocoa beans and cocoa products to the global market.
- Cocobod controls the cocoa sector, and has built a strong reputation for supplying high-quality beans and cocoa products to the global market, in stark contrast to Côte d'Ivoire which underwent a disastrous liberalisation drive in the early 2000s.
- The cocoa sector is dominated by a handful of players, with a dozen local buying companies (LBCs) accounting for 98% of bean purchases, and four grinders 55% of grinding capacity.
- High inflation is eating away at farmers' incomes, as the farmgate price was fixed in October, which has fuelled a surge in smuggling of Ghanaian beans to Côte d'Ivoire.
- Although Cocobod may have benefitted from the currency depreciation owing to its US dollar borrowing, its finances are constrained by a large overhang of unpaid receivables.
- High inflation, currency depreciation and the likely return of the El Niño weather phenomenon cloud the outlook for the 2014/15 crop, which Cocobod hopes to increase substantially.

Ghana is the world's second largest cocoa producer

Ghana is the world's second largest cocoa producer, after its western neighbour Côte d'Ivoire, together producing around 60% of global output. Ghana's production has almost doubled over the past decade, rising from 340,000 MT in 2001/02 to 632,000 MT in 2009/10, owing to the improved provision of inputs, new plantings and better husbandry. Since then, production has fluctuated. Output peaked at 1,025,000 MT in 2011/12 (October-September), buoyed by the surge in smuggling of Ivorian beans into Ghana during Côte d'Ivoire's short civil war. Output subsequently returned to more characteristic levels, falling to 878,500 MT in 2011/12 and 835,400 MT in 2012/13. Ideal growing weather during the 2013/14 season has raised expectations of a strong crop in 2013/14, after main crop purchases reached 879,000 MT by the end of June (Chart 1). Purchasing for the smaller light crop (July-September) officially started on July 4th, and a light crop in excess of 50,000 MT is expected. If achieved, this would result in a total crop of around 930,000 MT, close to the record outturn achieved in 2010/11.

Chart 1: Ghana's main and light crop cocoa production, 000s MT



Sources: ICCO, Cocobod, Ecobank Research.

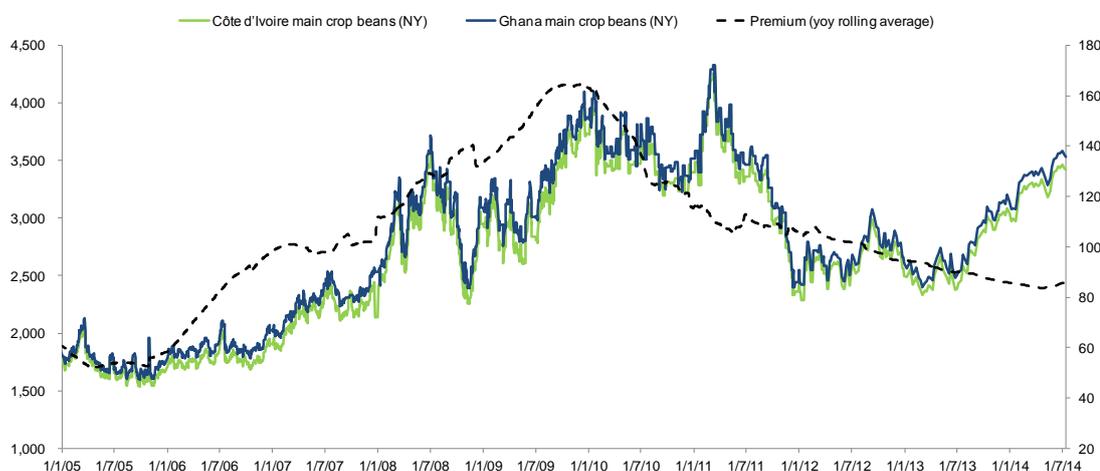
As is the case across West Africa, Ghana's cocoa sector is highly fragmented, with thousands of small-scale family farmers working average plot sizes of less than two hectares. Average yields

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are low, ranging from 400-500kg/ha, which is on a par with yields in Côte d'Ivoire (400kg/ha), Cameroon (380kg/ha) and Nigeria (320kg/ha). However, Ghana has developed a reputation for superior bean quality, which has enabled Ghanaian beans to consistently command a premium on the international market (Chart 2). Although Ghanaian cocoa is of the same Forastero variety grown in Côte d'Ivoire, its mild flavour and high butter content give it a 7-10% premium over other West African origins. Other factors in ensuring a premium for Ghanaian beans include the reliability of bean quality – given that Ghana's strict quality controls ensure that only bean counts lower than 100/100g are exported – reliable weights and delivery schedules. According to Bloomberg data, over the past decade Ghanaian main crop beans have enjoyed an average premium over Ivorian main crop beans worth US\$106/MT, rising to a peak of US\$160/MT in late 2009, before moderating to around US\$85/MT currently.

Chart 2: Ivorian & Ghanaian main crop bean prices (left scale) & premium (right scale), US\$/MT



Sources: The Public Ledger, Ecobank Research.

Cocobod has total control of the cocoa sector

Ghana is exceptional in that its cocoa sector is directly controlled by the government through the cocoa regulator, the Ghana Cocoa Board (Cocobod), unlike other cocoa producers in West Africa. During the 1980s the Ghanaian government refused to dismantle Cocobod, despite falling production and heavy pressure from the World Bank to liberalize the cocoa sector, instead opting for a series of piecemeal reforms. These included raising the fixed producer price to 70% of the FOB international price and permitting private companies to enter internal marketing of cocoa beans. Crucially, Cocobod retained control over the key functions of the sector, from the setting of producer prices to the export of beans. The government has been vindicated by its decision as Ghana's cocoa sector – under the aegis of Cocobod – is widely recognized as the best managed in Africa, especially when compared with Côte d'Ivoire whose cocoa sector became fragmented after a disastrous liberalization in the early 2000s.

Cocobod sets guaranteed producer prices at the start of each season by forward-selling 70% of next season's crop, with the remaining 30% sold in spot sales. In order to finance bean purchases, Cocobod raises funds in a syndicated loan that has attracted consistent and growing interest from international banks. Cocobod's US\$2bn syndication in 2011/12 was 20 times oversubscribed by local and international banks, and it remains the all-time largest soft commodity trade finance deal in Sub-Saharan Africa. Cocobod distributes funds to Licensed Buying Companies (LBCs) at $\pm 1\%$ of the 18.5% prime rate. Cocobod's attractiveness reflects the body's sound credit history, the use of future contracts as loan guarantees, and Ghana's political stability. In addition, given that LBCs are required to provide bank guarantees, Cocobod is never exposed to credit risk. Cocobod is negotiating a pre-export financing (PXF) facility for the 2014/15 season which could be as high as US\$2bn, US\$800m higher than its 2013/14 financing round. This is a reflection of Cocobod's conviction that output could rise as high as 1mn MT next season.



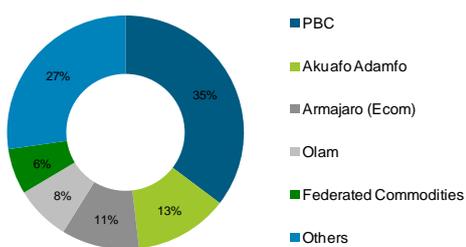
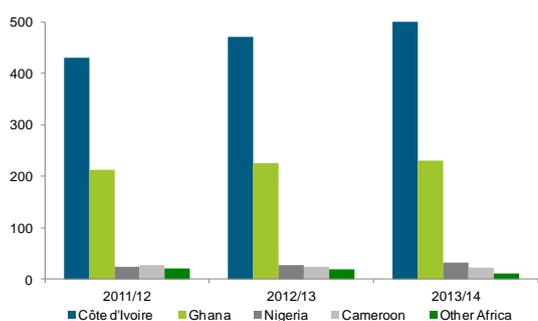
LBCs play a key role in cocoa purchasing

Central to the marketing of Ghana’s cocoa crop are the Local Buying Companies (LBCs), private companies that are licensed to buy cocoa upcountry from farmers and bring it to port, where it is officially taken over by Cocobod’s export subsidiary, the Cocoa Marketing Company (CMC). Farmers bring cocoa to up-country buying centres where they are paid and the beans undergo an initial quality check. Given that LBCs receive a commission for every kg they deliver, they need to secure high volumes, which drives strong competition in the field. LBCs typically pay in cash as prompt payment is the most effective way to win suppliers’ loyalty. The relationship between the LBCs’ buying agents and farmers is critical. In the past LBCs offered farmers inputs on credit, but this practice has stopped in the face of ‘side-selling’, the practice of farmers selling their cocoa to another buyer offering a better price, despite contractual obligations. After a sufficient amount of cocoa is collected at the buying centre, it is transported to depots (“the district level”) where it is graded and sealed by Cocobod. LBCs then transport the beans to Tema and Takoradi ports where they receive payment from CMC. Tema and Takoradi ports each account for around 45% of Ghana’s cocoa exports, with the balance of 10% being exported from Kaase port.

Last season a total of 26 LBCs were licensed to buy cocoa, but a dozen of them control 98% of purchases. Produce Buying Company (PBC), a former Cocobod subsidiary that is now publicly listed, is the market leader, commanding 35% of purchases (Chart 4). Akuafo Adamfo, the subsidiary of the Swiss agri trader, Finatrade, has the second largest market share of 13%, followed by Armajaro (owned by Ecom) with 11% and Singapore’s Olam with 8%. Federated Commodities, a subsidiary of a local haulage company, is the only other company with a significant market share, estimated at 6% in 2014. PBC retains a competitive edge over other LBCs due to its vast network of buying centres and the loyal suppliers it has developed over the years it operated a purchasing monopoly. Cocobod’s practice of allocating funding to LBCs based on their previous performance and market share has also helped maintain the status quo.

Chart 3: West Africa’s cocoa grind, 000s MT

Chart 4: Market share of LBCs in Ghana, 2014



Sources: ICCO, Cocobod, Ecobank Research.

Ghana is second-largest cocoa grinding hub in Africa

Given the high volume of cocoa production and strong government support to develop grinding, Ghana is Africa’s second largest cocoa processing hub, after Côte d’Ivoire. Ghana has an estimated installed capacity of 430,000 MT, although only around 245,000 MT is currently being used, giving a capacity utilisation rate of less than 60%. According to ICCO forecasts, Ghana’s grind will rise by 2.2% to 230,000 MT in 2013/14, the equivalent of 28.9% of West Africa’s cocoa grind (Chart 3). This means that Ghana has been losing market share to its rival, Côte d’Ivoire, whose own grind has risen by a stronger 16% over the past two seasons to a forecast 500,000 MT in 2013/14. Ghanaian grinders are dependent on a 20% discount for smaller beans, which are mainly produced during the June-September light crop and which are used for blending with main-crop cocoa, which is too expensive for exclusive use in blends. Ghana’s grinders produce a variety of cocoa products, dominated by cocoa liquor (103,768 MT in 2011/12), but with significant volumes of cocoa butter (22,280 MT) and cocoa powder (18,555 MT).



Ghana's cocoa grinding sector is dominated by a handful of multinationals and the former state-owned grinder, Cocoa Processing Company (CPC). Between them, Switzerland's Barry Callebaut, the USA's Cargill and CPC vie for the top share of the grind, with capacities of 67,000 MT, 65,000 MT and 64,500 MT, respectively (Table 1). The USA's ADM is not far behind, with a 42,000 MT capacity. Wamco, a joint venture between German investors and the Ghanaian government, has a capacity of 47,000 MT, but the company is not currently operating owing to severe financial and management problems, contributing to the country's high level of unused grinding capacity. Numerous small-scale grinders exist, but currently few are grinding cocoa products. The market leaders have a varied output of cocoa products. Barry Callebaut only produces cocoa liquor and nibs at its Tema-based factory (which are intended for sale to other domestic subsidiaries), while ADM only produces liquor. In contrast, Cargill produces cocoa cake and butter, while CPC produces all cocoa products (liquor, cake, butter and powder).

Table 1: Ghana's cocoa grinders, 2014

Company	Installed capacity (000s MT)	Market Share
Barry Callebaut	67.0	16%
Cargill	65.0	15%
CPC	64.5	15%
ADM	42.0	10%
Others	191.5	45%
Total	430.0	100%

Sources: Cocobod, Ecobank Research.

The depreciation of the Cedi has had varying impacts

Despite having built a sound reputation over the past decade, Ghana's cocoa sector is facing challenges. In the short term the most serious is the depreciation of the cedi, which has lost 41% of its value since the start of the year. Ghana's yawning budget deficit, the result of heavy spending on public sector salaries, coupled with high inflation (which averaged 15% in June), have caused the cedi to slide against the US dollar. This has eroded farmers' real incomes – which are linked to the fixed price – and has driven a surge in bean smuggling to Côte d'Ivoire in search of better prices. Currently the Ivorian fixed price of XOF750/kg is 58% higher in dollar terms than Ghana's fixed price of GHS 3,392/kg (Table 2). Another factor has been the delay in Cocobod advancing funds to the field at the start of the season. Given that most LBCs work under tight financing constraints, this has forced them to periodically suspend purchases, in turn forcing cash-strapped farmers to sell their beans over the border. The industry estimates that at least 60,000 MT of beans have been smuggled to Côte d'Ivoire so far this season, with some estimates ranging as high as 100,000 MT. In response Cocobod has stepped up its efforts to recruit local communities in the border area to help identify smugglers and intercept smuggling routes.

Chart 4: International cocoa prices, US\$/MT

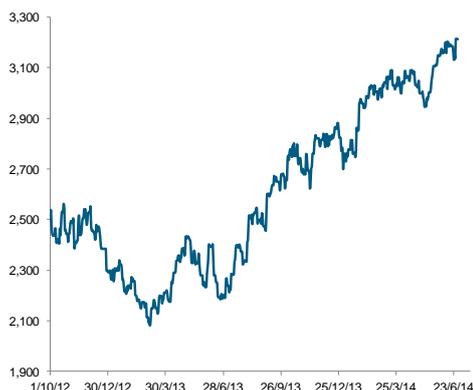


Table 2: Farmgate prices, local currency & US\$

	2012/13	2013/14
Côte d'Ivoire (XOF/kg)	725	750
Ghana (GHS/MT)	3,392	3,392
Côte d'Ivoire (US\$/MT)	1,479	1,554
Ghana (US\$/MT)	1,578	982
ICE cocoa futures (US\$/MT)	2,312	2,945
Côte d'Ivoire (% ICE price)	64.0	52.8
Ghana (% ICE price)	68.2	33.4

Note: Cocoa futures average for 2013/14 season so far.

Sources: Bloomberg, CCC, Cocobod, Ecobank Research.



The impact of the depreciating Cedi has not been entirely negative, however. This is because the annual financing Cocobod raises is denominated in US dollars, as are the supply contracts with traders and exporters, which has insulated Cocobod from currency volatility. In addition, Cocobod advances all of its funds for field purchases in Cedis; given the depreciation of the Cedi and the fixing of the farmgate price, this has meant that Cocobod has saved substantial dollar funds over the course of the season, by some estimates as high as US\$700mn. Cocobod may choose to return some of this surplus to farmers as an end-of-season bonus, as has occurred in previous seasons, but its ability to use these funds will be constrained.

Cocobod has substantial unpaid receivables

A more serious financial concern is the level of Cocobod's unpaid receivables, which has surged. In May the Ghanaian press reported that five local grinders had outstanding repayments to Cocobod totalling US\$250mn, ranging from US\$3mn to more than US\$50mn per company. Under the Old Beans Supply Agreement, grinders were not required to provide a guarantee or pay for the beans in advance, but were advanced funds for bean purchases which were to be repaid after the beans had been processed into products and sold. But owing to the unprofitability of several grinders' operations, five grinders – CPC, WAMCO, Plot Enterprise Ghana, Afro Tropical and Real Commodities – steadily built up arrears to Cocobod which they were unable to pay. Cocobod is also believed to have substantial unpaid receivables from exporters and offtakers, putting further financial pressure on the body. Although the external receivables are likely to be fully paid, and short-term financing is being secured to cover the shortfall, Cocobod may have to write off some or all of the US\$250m debt owed by the grinders.

Cocobod's current financial situation, coupled with the dip in international cocoa prices in 2010-13, has forced the body to reduce its subsidised inputs programme. Cocobod invested significant resources in providing subsidised fertiliser and pesticide, but the majority of inputs did not reach the right farmers, and large volumes of subsidised fertiliser were smuggled abroad. So popular did smuggled Ghanaian fertiliser become in Niger that farmers thought the letters 'NFS' were a brand name (they stand for 'Not For Sale'). In addition, the mass spraying programme proved insufficient to protect cocoa trees against black pod disease, which led to an estimated US\$300mn of losses in 2008-2010. In response Cocobod cut funding for both inputs by half in 2013/14, and it plans to phase out subsidies altogether over the next three to five years.

Given the high cost and inefficiency of the previous subsidy programme, Cocobod is considering allowing the private sector to take over the provision of fertilisers and pesticides. One solution could involve setting up Licensed Input Companies (LICs), based on the LBC model, to purchase and distribute fertiliser to farmers. Cocobod is also looking to expand the role of the private sector in its Public Private Partnership (PPP) extension services initiative. For the time being, however, Cocobod will continue to distribute inputs to farmers, and it has pledged a further US\$200mn worth of fertilisers and pesticides ahead of the 2014/15 season. But it remains unclear how this will be financed, given the body's financial constraints.

The grinding sector faces an uncertain future

Cocobod's substantial arrears from local grinders point to a deeper malaise in the grinding sector, which faces an uncertain future. A key concern is the low level of capacity utilisation, estimated at less than 60% this season. The causes of Ghana's high level of unused capacity are unclear, and may reflect ageing equipment or the financial difficulties of some grinders who have been forced to scale back their grinding activity. But its impact has been to disincentivise investment in additional lines. As a result, grinding capacity has grown by just 2.8% over the past three seasons, compared with 11.6% in Côte d'Ivoire. Ghana's high costs of production (notably for electricity to power plants) are a further constraint, undermining competitiveness. This has led several grinders to built up arrears with Cocobod, forcing the body to stop deliveries of beans to certain grinders, notably Wamco which has suspended its operations.

Logistical bottlenecks increase LBC costs

A final challenge for Ghana's cocoa sector is the high level of congestion in the cocoa supply chain, which disrupts cocoa flows, raises costs and eats into margins. This is a particular concern



for LBCs which face long processing times at the district level, and even greater delays at ports, before they receive payment. Although Cocobod has 400,000 MT of warehousing capacity at Tema port, it often lacks storage space because offtakers do not take their beans by the contracted shipment date. Cocobod ends up having to store these beans, which results in higher warehousing costs. These must be absorbed by the LBCs, as they are not paid until Cocobod takes over the beans. Moreover, while LBCs are waiting to deliver beans and receive their commissions, they must continue to make interest rate payments—which have reached levels as high as 24% from some local lenders—without being able to roll over their profits into securing more volumes. Given that LBCs work on a fixed 8% margin, delays in warehousing and shipment have severely eroded their margins, as has the ongoing depreciation of the Cedi.

The outlook for the sector is uncertain

In addition to the challenges facing LBCs and grinders, the outlook for Ghana's 2014/15 cocoa crop is uncertain. This season remains on track for a strong – and potentially a record – crop in excess of 900,000 MT. However, the impact of the fall in real terms of farmgate prices, owing to high inflation and the depreciation of the Cedi, could act as a major disincentive for farmers to invest in inputs and improve husbandry for the 2014/15 crop. Moreover, the likely return of the El Niño weather phenomenon – which tends to bring drier weather to West Africa – has increased the risks of a strong Harmattan during the December to March period, which could substantially reduce cocoa yields. Coupled with the reduction in Cocobod's spraying and subsidised fertiliser programme, this has greatly increased the risks of a weaker crop in 2014/15. As in most of Africa's agricultural sector, weather remains the key factor, and should West Africa experience a repeat of the ideal growing conditions in 2013/14 then another strong crop is a possibility.

Despite rising competition from Côte d'Ivoire, which has seen the quality of its cocoa improve substantially over the past two seasons, reducing the premium of Ghanaian beans over Ivorian beans, Ghana is in no danger of losing its reputation for consistently high-quality cocoa, thanks to Cocobod's well-established quality control systems. However, Ghana's current macroeconomic challenges are impacting the welfare of actors in the value chain, from the farmers who have seen inflation erode real incomes, to the LBCs struggling with liquidity shortages, to the grinders, many of whom are struggling to operate at a profit.

Further reforms are needed to address the sector's challenges

In order to address these problems, Cocobod needs to implement urgent reforms to the cocoa regime. Key areas to address include:

- Substantially increasing the fixed farmgate price for the 2014/15 season, bringing it into line with international and Ivorian prices. This will be challenging for Cocobod, given its financing constraints, but it is an essential step to restore farmers' confidence in the sector and encourage further increases in production.
- Reviewing the system for advancing funds to LBCs for field purchases, to ensure they have ample liquidity at peak purchasing periods, and speeding up the process for payment once LBCs have deposited cocoa with Cocobod so that they can reinvest the funds in purchases.
- Resolving the issue of Cocobod's outstanding receivables, notably from local grinders, in order to secure the body's long-term financial stability.
- Carrying out a comprehensive review of the grinding sector in order to establish why capacity utilisation rates are so low, what is the level of grinders' debt, and what is needed to ensure the commercial viability of the sector; this process may require recapitalising some grinders and/or rationalising their operations.
- Reviewing the system of fiscal incentives for grinders (including discounts for light crop beans) in order to ensure Ghana is competitive with rival grinding hubs (notably Côte d'Ivoire and South-East Asia) and to increase the proportion of the crop that is processed prior to export.
- Investing in measures to ease the bottlenecks in the cocoa supply chain, notably in port, warehousing and road infrastructure directly related to cocoa flows.



- Opening up parts of the value chain to the private sector, notably for the management and distribution of inputs to farmers.

Negotiations are under way between Cocobod and industry stakeholders to address these issues, and there are expectations that there will be a substantial increase in the fixed price and changes to grinders' fiscal incentives at the start of next season. These will be essential to secure the long-term health of Ghana's cocoa sector and ensure the country retains the reputation it has built as a reliable supplier of high-quality cocoa beans and products for the global market.



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For any question, please contact: Paul-Harry Aithnard, Group Head, Research, Les Collines de l'Arche, 76 route de la Demi-Lune, 92057 Paris La Défense Cedex France

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