Economic viability of ethical cocoa trading in Ecuador. Final report (NRI report no. 2519)

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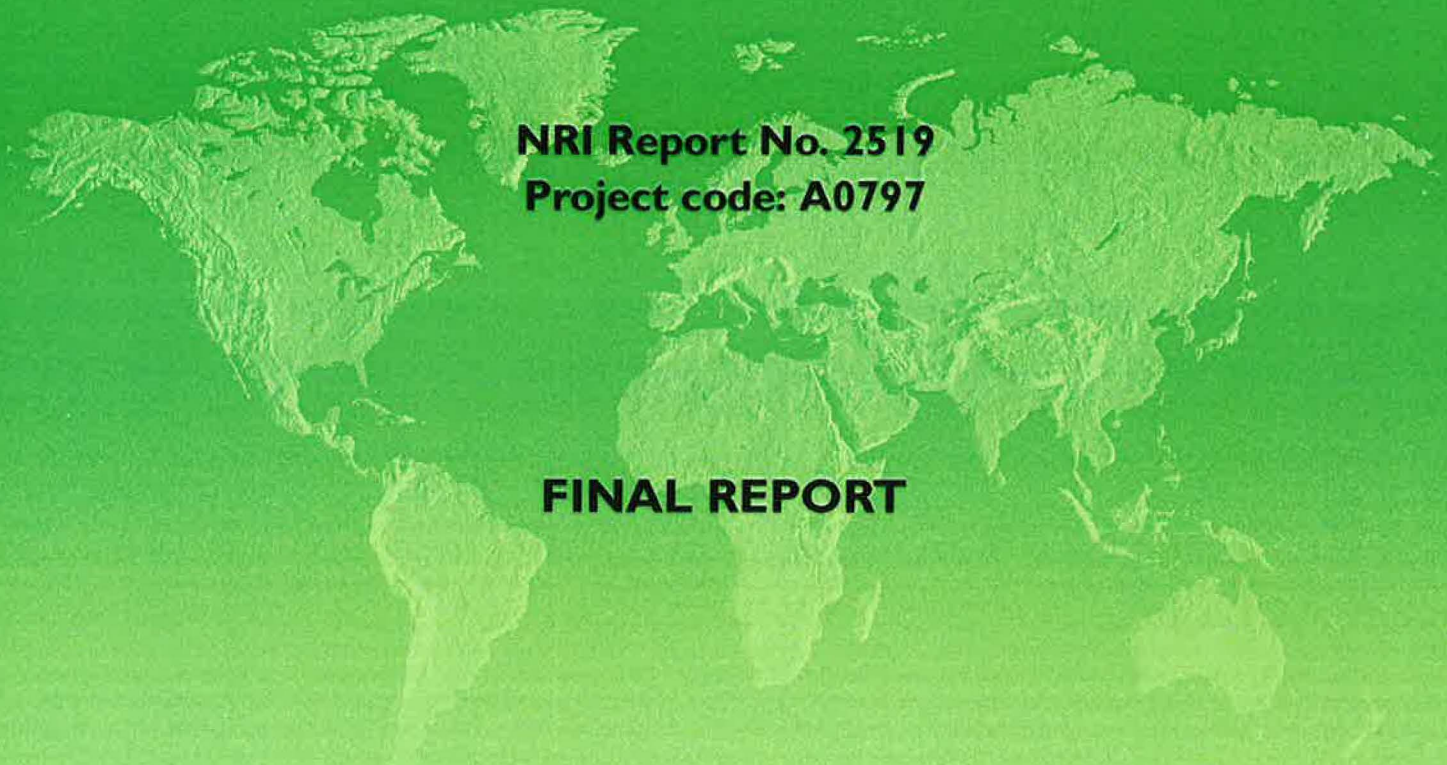

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FINAL REPORT

Economic Viability of Ethical Cocoa Trading in Ecuador

by

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Natural Resources Institute

DFID Department for International Development

Natural Resources & Ethical Trade

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Report 2519

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Glossary

Sucre	The Ecuadorian national currency (soon to be replaced by the US dollar)
MCCH	Maquita Cushunchic Commercializando como Hermanos. Ecuadorian church based development organisation.
Maquita	Agroexportadora Maquita. The trading arm of MCCH that exports cocoa.
FOB	Free on Board. Describes a commodity that has been loaded onto a ship at the port of origin.
CIF	Cost, Insurance and Freight. Describes a commodity that has arrived in the port of destination.
Fair-trade	A certified trading system that aims to provide fair remuneration to small commodity producers, preferential pre-finance and a stable trading environment.
FLO	Fairtrade Labelling Organisation.
Fine or Flavour	A type of cocoa that finds favour especially among Swiss chocolate manufacturers.

Summary

Introduction

DFID's Forest Research Programme is funding a three-year project to research the role that ethical trade can play in improving the lives of forest dependent people in developing countries. The project asks fundamental questions about whether such trade can deliver appropriate benefits, how effectively current ethical initiatives operate, and what practical steps can be taken to improve performance.

The research summarised in this report forms one of three comparative studies that will address the questions of how current ethical trade practitioners operate in the forest products context and whether the trade brings incremental benefits to forest dependent people. It examines ethical trade of cocoa in the context of Agroexportadora Maquita (shortened in this report to "Maquita"), an alternative trade organisation operating in Ecuador. Evidence was gathered on the type of financial improvements that Maquita brings to smallholder cocoa growers, the size of these benefits, and how the organisation manages to deliver them. The research also analyses the international part of the ethical cocoa trading chain and draws conclusions on the appropriateness of the commodity for ethical trade. The basis for the study is a comparison with the conventional cocoa trade. Although fair-trade is discussed, this report does not present a detailed evaluation of fair-trade cocoa systems. Rather it focusses on Maquita's ethical trading strategies, of which fair-trade plays a minor role.

A separate study conducted by a social development expert examines the social impact that ethical and conventional trading has had on cocoa growers in Ecuador.

Key findings

- The Ecuadorian economy is currently a difficult environment in which to conduct business.

- The Ecuadorian cocoa marketing system does not restrict competition.

- Against this background, Maquita's business performance has been impressive. The company has out-performed most of its conventional trade competitors. Its success is the result of high calibre management.

- Maquita's cocoa operations are subsidised to a small extent. Donor grants have provided the organisation with capital to invest both in its marketing operations and in improving bean quality at the farm level. However, such financial assistance has only recently been available and played no part in the company's establishment.

- Maquita trades on a preferential basis with approximately 15% of the smallholder farmers in the two provinces where it concentrates its activities.

- Maquita runs a transparent marketing system that reduces transaction costs for both growers and traders.

- Under its preferential buying programme, Maquita pays a price premium of between 8 and 15% over the standard buying price.

- Maquita has provided training in cocoa cultivation, post-harvest issues and farm management to its target smallholder growers. The impact that this recently implemented programme has had on grower incomes has yet to be measured.

- Fair-trade cocoa helped Maquita to establish itself. Since 1996, Maquita has sold only a very small part of its cocoa through fair-trade channels.

- Although European companies that have become involved in fair-trade make profits from their fair-trade activities, they could probably make more money if they concentrated their resources on conventional trade.

- Motivations among these European companies are varied. Good-will and the capacity to serve a niche market seem to play the greatest roles.

Conclusions

- Maquita's impressive commercial performance has allowed it to deliver substantial financial benefits to its target smallholder cocoa producers. This has only been possible because Maquita's management has excellent commercial skills.

- Maquita's managers combine ethical awareness with business acumen.

- A sustainable future for international fair-trade cocoa will only be secured if the market grows. The most likely source of growth is through supermarkets. Increased scale will improve profitability for the existing participants and will attract new companies to engage in the trade.

- The lack of scale also limits the impact that fair-trade cocoa can have on grower's incomes.

- Cocoa is an appropriate commodity for ethical trade. It has been traded for many years, is consumed in large quantities, and has all the necessary infrastructure to support its trade. Furthermore, it is processed into luxury items that have few substitutes and have a high profile in consumer's minds.

- However, with the current low level of fair-trade cocoa sales and in the absence of a recovery in international cocoa prices, one of the few paths to widespread increases in producer incomes is to improve marketing skills and efficiency within countries of origin. Maquita has achieved this in Ecuador.

Part 1. The Ecuadorian Ethical and Conventional Trading Chains

1.1 Introduction to the Ecuadorian economy

Ecuador is one of the poorest countries in Latin America. In 1998, its GDP per capita was US$1,614, significantly lower than neighbouring Peru's and Colombia's figures of US$2,536 and US$2,522 respectively.

Ecuador's foreign debt in 1998 was 82% of its GDP, one of the highest levels in the region. Rather disturbingly, the country's ability to service this debt has been consistently handicapped by large balance of trade deficits (US$1.36 billion in 1998).

The economy is experiencing one of its worst recessions for many years. In the first quarter of 1999, GDP was 3.2 % lower than in the same period of 1998. Despite the recession, the annual rate of inflation in the first half of 1999 was a high 53%, driven in part by the devaluation of the Sucre, which had lost more than half its value against the US dollar in previous 12 months. The nominal interest rate in 1999 was approximately 60%, giving a real interest rate (nominal rate minus of the rate of inflation) of 7%. By developing country standards, this real rate of borrowing is not high.

Until the Sucre exchange rate was recently fixed in preparation for dollarisation of the economy, Ecuadorian exporters' Sucre earnings were rising more quickly through devaluation than the Sucre was losing its purchasing power through inflation[1]. With much to lose, cocoa exporters have been among the most vociferous critics of the government's dollarisation policy. Most of these companies will have to become considerably more efficient if they are to survive the transition to the dollar economy.

In early 1999, a liquidity crisis in the banking sector meant that simple monetary transactions became extremely difficult and time consuming. The situation became so severe that the government ordered most bank accounts to be frozen. Some of these funds remain inaccessible to account holders.

The Ecuadorian economy is currently not an easy environment in which to conduct business. Civil unrest and subsequent political instability in recent months have only worsened the situation.

1.2 Introduction to the cocoa sector

Between 1965 and 1998 agriculture's contribution to national GDP fell from 25% to 12% (see Table 1). At 0.6% of GDP, cocoa's importance to national income is not large but its position as an export is rather more significant, accounting for between 3 and 5% of total export earnings.

[1] However, for commodity exporters, the widespread fall in international prices will have partially offset this advantage.

Table 1. Agriculture's position in the economy

SECTORS	Millions US$	Market Share	Growth
	1998	%	98/97
Agriculture	2,355	12.0%	-1.86%
Oil	1,119	5.7%	-36.06%
Manufacturing	4,371	22.3%	3.15%
Electricity	57	0.3%	5.80%
Construction	976	5.0%	5.98%
Commerce	3,966	20.2%	0.89%
Transport	1,906	9.7%	3.14%
Financial Services	1,095	5.6%	0.76%
Government Services, Social Services and Public Services	2,558	13.1%	3.30%
Other elements of the GDP	1,197	6.1%	4.91%
GDP	19,599	100.0%	-1.23%

Source: Central Bank of Ecuador

Ecuador's 60,000 cocoa farmers devote approximately 300,000 hectares to cocoa cultivation. 54% of cocoa farms are smallholdings of less than 10 hectares, while a further 33% are between 11 and 50 hectares in size. Large well-managed plantations constitute the remainder. Of the smallest farms, many have poor access to markets.

Ecuador produces two types of cocoa, CCN51 and National Cocoa. The latter is the variety on which Ecuador has built its reputation as an origin of "fine or flavour" cocoa. National Cocoa trees are low yielding and are mostly restricted to small and medium sized farms. CCN51 by contrast is a high yielding hybrid and is mostly produced on large-scale plantations. Its closest substitutes are the bulk cocoas from West Africa but it has yet to find a significant export market due to problems with high acidity. Ecuador's local cocoa processing and chocolate manufacturing industries prefer CCN51 because it has high cocoa butter fat content and suffers no mould problems, a result of the careful post-harvest practices that are followed on commercial plantations.

Most cocoa exporters are adamant that the dominance of National Cocoa should not be threatened by CCN51. They are concerned that Ecuador should not lose its "fine or flavour" reputation, but more importantly, they worry that they will lose the generally positive price differentials[2] for the higher grades of National Cocoa. Exporters' profitability relies heavily on these differentials. In response, the exporters have formed ANECACAO, an association that safeguards the integrity of National Cocoa exports and certifies quality. The association also sets a daily reference price that is used to calculate the fees that exporters pay for export certification. It is calculated on the basis of the New York Coffee, Sugar and Cocoa Exchange (CSCE) prices minus exporters' costs and margins.

[2] Premiums that buyers are willing to pay over standard commodity exchange prices.

Ecuadorian cocoa is marketed without government interference. Local prices are driven by international prices and by local supply and demand. Demand from Ecuador's cocoa processing industry and from neighbouring countries occasionally causes local prices to move out-of-sympathy with New York and London prices.

In contrast to its pre-eminent position early this century, Ecuador is now a minor cocoa exporter. Cote d'Ivoire, the world's leading producer with exports of more than a million tonnes of cocoa a year, dwarfs Ecuador's exports by a factor of more than ten.

1.3 Competition, efficiency and transparency within the cocoa sector

Ecuador's cocoa bean export marketing system does not restrict competition. Monopolies and cartels are absent, government interference is minimal, levels of horizontal and vertical integration are low, and no barriers to entry exist.

A useful indicator of marketing efficiency is the proportion of the export cocoa price that is paid to producers. As a rough guide, a high ratio indicates low marketing costs. Ecuadorians involved in the cocoa industry often quote proportions as high as 80 to 85%. Unfortunately, these figures are somewhat misleading. The export price used in the calculation refers to the CSCE price with no adjustments made for average price differentials, while the "producer price" is in fact not the price that most producers receive but the price that exporters pay at their yards. Most producers are located far away from exporters' yards and are unable to sell directly to exporters. Transport costs and intermediaries' margins bite significantly into ex-yard prices, leaving producers with a much smaller share of the export price. The more candid informants that we interviewed estimated that smallholder producers receive between 40 and 50% of the CSCE price. (Our estimate for 1999 puts the proportion at no more than 57%). Equivalent figures from West Africa suggest that Ecuador's cocoa bean marketing system is more efficient than the systems in Cote d'Ivoire and Ghana, although probably not as much as is commonly perceived. For instance, Ghana's producers receive approximately 40% of the FOB price that the country's Cocoa Board receives .

Information relevant to the cocoa sector is readily available through newspapers, and radio and television broadcasts. It extends beyond just prices to cover items on production techniques and market conditions. However, as with almost any marketing system in developing countries, the wealthy marketing chain participants have the greatest access to high quality information. This information asymmetry disadvantages smallholder producers in price negotiations with traders. In the more remote areas, growers with limited quantities of produce to sell have even less bargaining power because of the scarcity of buyers.

Transaction transparency also suffers as a result of the sharp practices that many cocoa traders employ. Scales often understate the true weight of cocoa sacks, and discounts for high moisture and extraneous matter are often higher than they should be.

1.4 The conventional marketing chain

All cocoa exported from Ecuador is handled by at least some of the following types of marketing chain participant:

- Cocoa growers
- Village assemblers (often the local shopkeeper)
- Area assemblers
- Itinerant traders
- Urban wholesalers
- Exporters

Large cocoa growers are usually able to by-pass intermediaries and sell directly to exporters. However, this study is concerned with disadvantaged smallholder cocoa growers, whose cocoa is subject to the full marketing chain. The large number of intermediaries reflects the need to assemble cocoa beans in rural areas. The type of smallholder production relevant to this study is very small scale and exists in scattered, remote locations. Cocoa must therefore be assembled in sufficiently large quantities before urban buyers are willing to bear the costs of coming to collect it.

The village assembler conducts the first level of assembly. Such people are often the owners of local shops and therefore have more capital than most villagers. Village assemblers are usually constrained to buying the small quantities of cocoa offered by most local growers. At purchase, the beans are usually fermented but not dried. Consequently, once the assembler has graded, weighed and purchased the cocoa, he must spend time drying it. The accuracy of the scales and methods of grading used to calculate the purchase price are often alleged to be biased against the grower, who often has little choice other than to sell within the village. Assemblers often extend credit in cash or kind to villagers.

Once the village assembler has gathered tradable volumes of cocoa, he has several options depending on his remoteness from major trading centres. He can sell to an itinerant trader, transport the beans to an area assembler, or if he is near enough to a major town, he can sell directly to an urban wholesaler.

Area assemblers perform the same functions as a village assembler but operate on a larger scale and across a larger area. Itinerant traders offer a link between rural and urban areas. They operate on a high capital turnover basis by avoiding cash advances to assemblers, and by moving the product (usually using their own transport) as quickly as possible to urban wholesalers or exporters.

Urban wholesalers operate on a large scale and are usually well established in the business. Their role is to assemble large quantities of well-dried cocoa and to store it until they can sell it in bulk to cocoa exporters. As a way of ensuring a sufficient flow of product into their warehouses, wholesalers often provide cash advances to rural assemblers with whom they have built up a history of trust.

95% of cocoa bean exports leave from Guayaquil, Ecuador's major industrial area and port. Remaining exports are handled at the port in Manta. Once exporters have made an assessment of quality of the cocoa offered by wholesalers, exporters purchase, sort

the beans into export grades, bag in sisal sacks and fumigate for insect pests. If the exporter sells through a broker, he relinquishes the responsibility for shipping. If selling directly to an overseas buyer, the exporter must make port handling and shipping arrangements. The company must also contact ANECACAO which is responsible for checking and certifying the quality of cocoa bean exports.

1.5 Ethical trade - Agroexportadora Maquita

In contrast to the conventional chain, several alternative trading organisations operate on a more vertically integrated basis. The largest and most successful is Agroexportadora Maquita (shortened to Maquita in this report), a component of one of Ecuador's largest church based development organisation, Maquita Cushunchic Commercializando como Hermanos (MCCH). Maquita started exporting cocoa in 1992. The following table shows the rapid increase in its export volumes.

Table 2. Maquita's Growth.

Year	Total US$ Earnings	Total Tonnes Sold	Tonnes Exported
1992	20,700	68	12
1993	43,500	159	24
1994	95,160	591	60
1995	170,700	523	132
1996	1,150,606	926	879
1997	1,826,399	1263	1227
1998	1,457,478	863	846
1999	5,827,446	4915	4866

Source: MCCH

Maquita's rise has been so quick that by the end of 1999 it was ranked in the top five Ecuadorian cocoa exporters.

1.6 The Maquita marketing chain

Maquita concentrates its operations in two of Ecuador's largest cocoa producing provinces, Esmeraldas and Manabi. They account for approximately 85% and 10% of Maquita's purchases respectively. Maquita has focussed on Esmeraldas partly through an accident of history (the founder of MCCH first worked in Esmeraldas) but also because it is one of the most under-developed provinces. Manabi, adjoining Esmeraldas on the coast to the south, became part of Maquita's cocoa buying area when the need to expand became apparent.

Maquita operates a vertically integrated marketing system which, it claims, rewards the loyalty of affiliated smallholder co-operatives. It also purchases from conventional traders on non-preferential terms in order to realise economies of export scale.

Apart from the control that Maquita extends along the entire length of the marketing chain, there are few operational differences that distinguish the conventional and Maquita systems. While each locality in which Maquita buys requires slightly different arrangements, the basic operation is set out below:

Maquita's community agents (assemblers) purchase on preferential terms only from smallholder growers who belong to affiliated grower associations. The criteria for becoming affiliated are that the association should operate in remote areas, should be well organised and its members should possess smallholdings of less than approximately 7 hectares.

Either Maquita or one of its partner organisations provides the agents with working capital to initiate local purchases. The agents are then responsible for assessing the level of extraneous matter among the unfermented wet beans, for weighing and for paying a preferential price (minus any deductions for excessive extraneous matter) to the member smallholders. Weighing is done in the presence of the grower and on scales that are regularly checked for accuracy by Maquita or partner organisation staff. Once the purchase has been made, the agent ferments, dries, sorts and bags the beans. Maquita expects their agents to make a reasonable profit, although poorly performing agents are liable to make a loss.

Maquita operates yards in the cities of Esmeraldas and Guayaquil. Depending on the region where purchases are made, the responsibility for transporting the beans to the yards falls either on Maquita or on its rural agents. How Maquita is able to afford to pay preferential prices is examined in section 1.10.

Maquita also buys at market prices from third parties who are not part of its preferential purchasing programme. In 1999, it purchased approximately 55% of its cocoa in this way. Before the effects of El-Nino were fully felt in 1998, only 40% of purchases were on a non-preferential basis, an indication that the most disadvantaged cocoa farmers (for instance, those within Maquita's preferential purchasing programme) were affected most severely by the disaster. The proportion of preferential purchases is reportedly recovering.

On receiving the cocoa, the yards are responsible for grading, assessing moisture content, weighing, calculating and paying the purchase price, drying beans to a storable moisture level, bagging and storage. The purchase is designed to be as transparent as possible in order to allay suspicions of cheating. For purchases of less than 500lbs, Maquita uses a published table against which visual grading can be performed consistently. For larger purchases, Maquita uses an electronic moisture meter. Discounts for excessive moisture levels are applied on a sliding scale for both methods. Maquita is unusual among exporters in using such precise methods.

All Maquita's cocoa sooner or later arrives at the Guayaquil yard. In the case of cocoa from Esmeraldas, the organisation contracts private hauliers. In Manabi, the farmer association is responsible for transporting cocoa to Guayaquil, and does so at its own risk and expense.

Maquita's head office in Guayaquil is responsible for setting prices, which it does with reference to its FOB export earnings. Maquita's prices are valid for a week and

information on them is readily available, thereby simplifying planning along the marketing chain.

Figure 1. The conventional trading chain compared with Maquita's preferential trading programme.

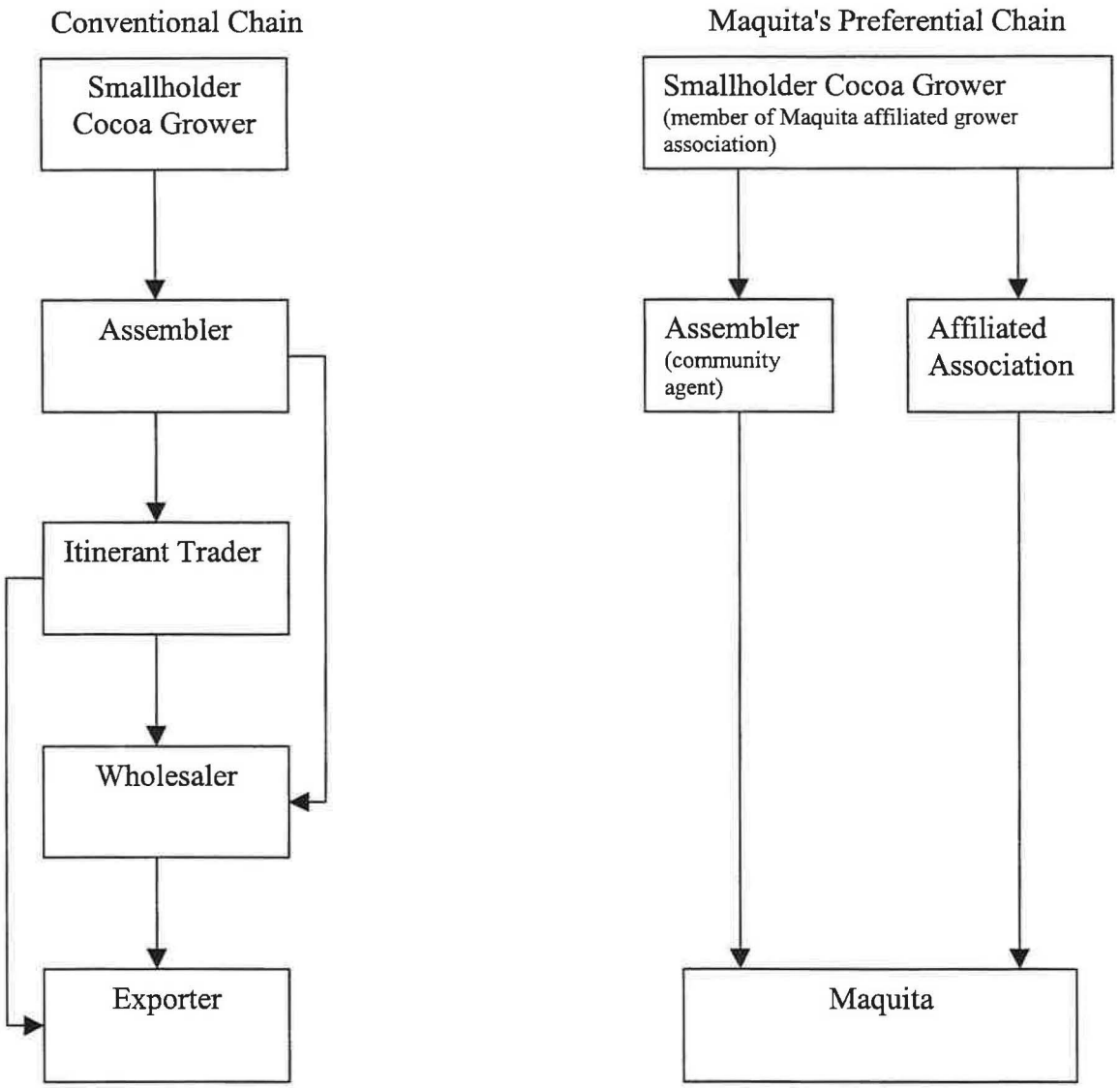

Figure 1 indicates how streamlined Maquita's preferential trading chain is in comparison with the conventional chain. Although exactly the same roles are performed in both chains, Maquita and its partners have internalised activities to their operations. Consequently, the number of times the cocoa changes ownership has been reduced. Fewer transaction, at least in theory, should mean lower costs.

1.7 Maquita's Smallholder Coverage

According to its own figures, Maquita trades on a preferential basis with 1017 smallholder growers. This figure represents approximately 3% of Ecuador's total number of smallholder cocoa growers (those with less than 10 hectares of land). However, Maquita's smallholder coverage is more appropriately judged on its performance in Esmeraldas and Manabi, where its operations are concentrated. We

estimate that Maquita's preferential purchasing programme deals with 15% of the smallholder growers in these two provinces.

1.8 Costs, revenues and profits along the Maquita trading chain

Table 3 indicates how value is added along Maquita's preferential purchasing marketing chain, and forms a "snap-shot" of trading in June 1999 (using field data collected during that time). A more detailed summary of costs and assumptions appears in appendix 2.

Table 3. Costs, Revenues and Profits, June 1999

	US$/tonne of cocoa
Producer	
Revenue	800
Costs	314
Gross profit	486
Community assembler	
Revenue	880
Costs	840
Gross profit	40
Maquita*	
Revenue	1128
Costs	1021
Gross profit	107

Notes:
Revenue figures assume that beans are sold at 7% moisture throughout the chain
* An unweighted average of ASS and ASE bean qualities has been for used calculating costs and revenues.

While the producer's profit is high compared with costs, the low volume of smallholder output means that net earnings are low.

From figures in Table 3, producer revenue is approximately 70% of Maquita's revenue. In other words, producers received about 70% of the export price in June 1999. This compares favourably with the conventional trading chain, which we estimate paid producers no more than 60% of the export price in the same period[3]. Costs and margins must therefore be lower in the Maquita chain than they are in the conventional chain.

1.9 Maquita's trading strategies

Maquita takes a low risk export strategy, thereby promoting long-term business sustainability. Many Ecuadorian cocoa exporters have gone bankrupt by speculating on long and short positions (speculating on price movements either holding or not holding stocks), and few exporters operating ten years ago are still in business. Maquita prefers to spread its risks by speculating with only 10 to 15% of its sales.

[3] Maquita probably earns higher export prices than any of its competitors (refer to section 1.11). Consequently the comparison is not direct. However, it is close enough to be meaningful.

The strategy allows Maquita to engage in speculation while not exposing itself to large price risks.

Another cause of risk is exchange rate variability. From the beginning of 1999 until January 2000 when the Sucre exchange rate was fixed against the dollar, the value of the Sucre exchange rate both fluctuated considerably and suffered a downward trend. When buying in Sucres and selling at some future date in dollars, stable exchange rates assist business planning. Although a devaluing currency gives exporters greater local currency earnings over time, exchange rate volatility greatly increases trading risks. Maquita's strategy was to plan on the basis of pessimistic exchange rates, thereby reaping rewards from favourable movements without incurring major risks.

Another feature that distinguishes Maquita from many of its competitors is the liquidity that it maintains in its trading system. This allows prompt cash payments to agents and therefore to smallholder growers. Maquita contributes to a buffer fund that is held centrally within MCCH. This fund can be accessed by any of MCCH's trading operations in case of financial difficulty. As far as we are aware, Maquita has never drawn upon this fund.

Perhaps the most important of Maquita's recent successes has been its ability to trade directly with chocolate manufacturers in Europe. Most Ecuadorian exporters prefer to sell to local brokers who represent large international cocoa trading houses such as E.D.& F. Man and Walter Matter. This arrangement relieves exporters of the burdens of arranging shipment and managing price risk. For their part, European chocolate manufacturers are generally unwilling to trade directly with exporters because the potential costs of late or non-delivery are too high (manufacturers' stocks are usually small). Maquita however, has earned the trust of European manufacturers and therefore reaps the reward of higher export prices.

1.10 Fair-trade

By far the greatest part of Maquita's exports are sold on conventional markets in the US and Europe. Fair-trade markets, while having had some significance in the early days of Maquita's operations, are now of marginal importance.

Table 4. Maquita's overseas clients by % of total sales

Importing client	1996	1997	1998
E.D.& F. Man (USA)	67%	48%	18%
E.D.& F. Man (UK)		3%	12%
Daarnhouwer & Co. (Hol)	25%	17%	43%
OS3 (Switzerland)	3%	1%	
Walter Matter (Switzerland)	4%	29%	8%
Max Havelaar (Hol)	1%	2%	
Atlantic Cocoa co. (USA)			19%
Total	**100%**	**100%**	**100%**

Source: MCCH, internal documents supplied by J. A. Santos

Of the international buyers listed in Table 4, only OS3 (now called Claro) and Max Havelaar are fair-trade buyers. Maquita has proven its ability to compete in the

conventional market place, and although fair-trade buyers provided useful revenue, credit, stability and contacts in the early days, Maquita has graduated beyond the need for such help.

The premium from the fair-trade price (which in 1999 was approximately US$600 above Maquita's average export price) is distributed evenly among the members of Maquita's affiliated smallholder associations.

1.11 Maquita's business performance

Growth and profitability

With the exception of 1998, when El Nino caused a dramatic decline in national cocoa production, Maquita's growth has been impressive (refer to Table 2). Table 5 clearly shows El Nino's effect on Maquita's profits. The first five months of 1999 were considerably more profitable for Maquita than the whole of 1998.

Table 5. Maquita's Income Statements for 1998 and Jan - May 1999

	Jan - Dec 1998 (US$)	Jan – May 1999 (US$)
TOTAL SALES (A)	1,457,479	2,360,500
DIRECT OPERATING EXPENSES (B)	1,262,812	1,890,486
GROSS PROFIT (C = A – B)	194,667	470,139
INDIRECT OPERATING EXPENSES (D)	161,509	232,325
OPERATING MARGIN (E = C – D)	33,158	237,814
OTHER INCOME		
Project Income	97,208	2,645
Other Income	44,106	170,770
OTHER EXPENDITURE		
Project expenses	14,633	7
Other expenses	106,823	103,127
NET OTHER INCOME (H)	19,859	70,282
NET MARGIN BEFORE TAX (I = G – H)	53,016	308,096

The item in Table 5 entitled "OTHER INCOME" merits closer examination. These non-operating funds come from overseas donors and are mainly earmarked for farmer training. However, in recent years a small proportion of this money has been available as working capital. Furthermore, in 1996 Maquita spent donor money purchasing productive assets. Of the US$ 210,000 that the organisation spent acquiring and equipping its drying yards in Esmeraldas, US$ 90,000 was a grant from USAID's PL480 (a food aid related funding programme).

One way of looking at this non-operating income is to ask, "what advantage have these funds given Maquita over its competitors?". Since at least some of the funds have been invested as fixed and working capital, Maquita must have gained some advantage because, unlike its competitors, Maquita bears no cost from using the money.

Maquita claims that the advantage has been small. It argues that donor funds were not available during the early years of its development, when it proved its financial sustainability. Furthermore, as an unknown exporter, Maquita initially had to borrow internationally at relatively high rates of interest.

Maquita perhaps overlooks another advantage that donor funds give the organisation. A significant portion of the funds are spent on training farmers to improve the quality of their cocoa. Given that exporter profitability is based on the ability to receive positive price differentials for higher quality cocoa beans, the money spent on improving quality must help Maquita's financial position.

Ultimately however, the financial advantages that Maquita derives from donor funds should not be regarded as unfair providing it passes the benefits to the target smallholder growers. Its performance in delivering these benefits is assessed in section 1.12.

As a company, Maquita receives no special treatment from the Ecuadorian government. For instance, it pays taxes in exactly same way as its competitors.

Export earnings

According to official figures from 1999, of the top ten Ecuadorian cocoa exporters, Maquita received an average export price of S$1,156 per tonne of cocoa, while the rest could manage an average of only US$965 per tonne. Furthermore, Maquita reportedly earned US$155 per tonne more than its second placed rival. These figures should however be treated with a degree of caution. During our fieldwork, all key informants agreed that Maquita is an honest organisation that publicly declares accurate figures of its performance. Conversely, we received tacit acknowledgement that other exporters may understate their financial performance in order to pay less tax.

Despite this, there are still good reasons to believe that Maquita receives more per tonne of cocoa than its competitors. Perhaps the most compelling reason is that most of our informants, including rival exporters, believe that Maquita does out-perform its competitors. They cite several reasons:

- Maquita concentrates heavily on exporting higher quality beans. In 1999, of all Maquita's exports, 50% was Arriba Superior Epoca (ASE – the lowest National Cocoa grade), 45% was Arriba Superior Summer (ASS – a higher grade) and 5% was Arriba Superior Summer Selecto (ASSS – usually the highest grade exported from Ecuador). Although we have no comparative figures for the same period, the national averages in the three years 1996 to 1998 were 66% ASE, 19% ASS and 15% ASSS.

- As already noted, Maquita has developed a strategy of exporting directly to chocolate manufacturers in Europe, thereby earning higher export prices. Few of its competitors have followed this approach.
- Maquita's manager, Jose-Antonio Santos, is able to read the market well. Furthermore he maintains excellent direct relations with his overseas buyers.

Marketing efficiency

An alternative trading organisation can only expect to provide substantial financial benefits to its target group if it is at least as efficient as its conventional competitors. Unfortunately, for reasons of confidentiality, Maquita's competitors were unwilling to give us access to information that would allow us to make a quantitative comparison of Maquita's marketing costs. However, most of our informants agreed that Maquita has lower costs than any of its competitors. They gave several reasons:

- Maquita employs a minimum of managers and no administrative staff. All administration is conducted by the management team.
- Maquita's facilities are appropriate for its scale of operation. In Guayaquil, the organisation rents unsophisticated premises. Furthermore, it uses drying, sorting and grading machinery that are of appropriate capacity. Cost inefficiencies from under-utilisation are therefore minor.
- Maquita specialises in cocoa and operates throughout the year. By contrast, several of its competitors trade a number of different commodities and only export cocoa seasonally.

Innovation

It appears that where Maquita goes, others follow. For instance, Maquita's vertically integrated approach to buying cocoa is now being adopted by other exporters. Likewise, ANECACAO has recently implemented a cocoa grower training scheme but only after Maquita had started its own scheme one year previously. Finally, with the advent of dollarisation, there is considerable pressure upon exporters to become more efficient and to export directly to overseas buyers, rather than trade through brokers. From its beginnings, Maquita strove for efficiency, and over the last two years, it has achieved direct exports.

Perhaps conventional exporters do not follow Maquita's lead directly, but merely respond to similar pressures. However, Maquita is clearly better than most at reading and reacting to market and economic developments.

Management

Maquita's good business and innovatory performance is rather an anomaly. Efficiency and innovation are usually associated with competition among profit seeking companies. Maquita is part of MCCH, a not-for-profit organisation. The part of Maquita's profits that is not re-invested in the company goes directly to MCCH, where the money is used to fund farmer training and other socially motivated activities.

Maquita provides an example of where good business and good ethics appear to complement each other. However, we believe that none of Maquita's success would

have been possible without the sort of experience and skill that its manager, Jose-Antonio Santos, brings to the organisation. He is an unusual man of unusual talent, who is motivated as much by social responsibility as by personal gain.

1.12 Maquita's ethical performance

Price

For cocoa purchased through its preferential scheme, Maquita claims to pay 8 to 15% over the standard price paid by other exporters. The exact premium depends on the FOB prices that Maquita receives at the time of setting the preferential price.

Table 6 presents average cocoa buying and export prices for 1998[4]. Although the information came from Maquita, we have no reason to doubt its accuracy. A simple subtraction of the figures in columns one and two of the table reveals that Maquita's preferential buying price was on average US$217 higher than conventional exporters' buying price. In proportional terms, Maquita's average price was 12.3% higher. Furthermore, Maquita's efficient marketing chain ensures that its target smallholder growers receive the full benefit of this premium.

Table 6. Average Cocoa Buying and Export Prices in 1998

Conventional Exporters' Average Buying Price	Maquita's Average Buying Price	Maquita's Average Export Price	Average New York Exchange Price
US$/tonne	US$/tonne	US$/tonne	US$/tonne
1,585	**1,703**	**1,780**	**1,570**

Source: Maquita.

Table 6 also indicates the very small margins on which Maquita operated in 1998. The average difference between its buying price and its export price was just US$77.85. This reflects the extraordinary market conditions that prevailed in 1998, when supply was very tight due to the effects of El-Nino. In order to fulfil export contracts, exporters were forced to bid highly for the limited local cocoa supplies. Another point to note from Table 6 is that the average New York Exchange price was marginally below the average price at which conventional exporters were purchasing. Clearly, any exporter that survived 1998 must have received a considerable differential over the Exchange price.

Transparency

Maquita maintains a high level of transparency in its operations by using accurate measuring equipment and publicly available grading tables. Publicising and guaranteeing weekly purchase prices also contributes to transparency. Such practices decrease the likelihood that growers and traders will be cheated, and the subsequent

[4] Official government statistics suggest that the average conventional exporter buying price for 1998 was approximately US$250 less than the figure provided by Maquita. However, government statistics only present the "reference" or "minimum" price that should be paid by exporters. Actual buying prices are usually significantly higher. This was especially so in 1998, when supply was extremely tight due to the effects of El-Nino.

trust that this engenders almost certainly reduces transaction costs. For example, growers are likely to spend less time negotiating with Maquita's agents if they know that weighing scales are accurate and the methods for assessing quality are fair. Likewise, the agents are less likely to spend time questioning Maquita's prices and quality discounts because information on these is readily available before the sale.

Anecdotal evidence gathered during fieldwork indicates that Maquita is more transparent than its competitors.

Influence on other traders

In Manabi and especially in Esmeraldas, traders have been forced to match Maquita's nominal buying prices in order to maintain a presence in the market. Unfortunately this may have been at the expense of transparency. Unable to compete genuinely with Maquita on price, traders are suspected of understating weights and overstating quality defects. So, although traders may quote competitive prices, such underhand practices may mean that their actual buying prices are substantially lower. This view was offered by Maquita. Unfortunately we were unable to investigate its veracity.

Training

MCCH provides training on the following activities:

- Production techniques
- Post harvest management
- Farm management (accounting and planning)

Training is delivered by a mobile "cocoa school" that travels to Maquita's affiliated grower associations. Since the end of 1998, when the training programme started, between 600 and 700 farmers have been trained. These individuals are expected to pass their new knowledge on to other farmers. 30% of the training costs are met by Maquita and the rest comes from donors.

Maquita believes that training is more important than the direct financial benefits that it delivers to its affiliated smallholder growers. Higher productivity, higher quality and better planning will, it believes, have a greater impact on farmers' lives than preferential prices. Unfortunately, because the training programme is in its infancy, its impact has yet to be measured.

1.13 Comparative Summary

Table 7. Business and Ethical Performance: A comparison of Maquita's preferential trading chain with the conventional trading chain.

	Conventional Chain	Maquita's Preferential Chain
Smallholder grower	• Receives standard market price • Price received is no more than 60% of the export price • Is unlikely to receive training from traders	• Receives a price that is 8 to 15% higher than the standard market price. • Price received is about 70% of the Maquita's export price • Receives training on how to maximise revenue and minimise production costs
Assembler	• Is often suspected of cheating growers • Often sells to itinerant traders	• Maquita and its partners regulate and monitor assemblers to ensure that dealings with growers are fair and transparent.
Itinerant Trader	• Provides link between rural and urban areas • Buys and sells in quick succession.	• Maquita or its affiliated organisations arrange transport, thereby avoiding change of ownership = one less transaction
Wholesaler	• Buys, bulks, stores and sells to exporters • Buying procedures are not always transparent	• Maquita has integrated this function into its operations, thereby negating two transactions. • Buying is highly transparent
Exporter	• Often sells through a local broker • Often deals in more than one export commodity • Open to bankruptcy through unwise speculation	• Maquita earns export prices that are 10 to 15% higher than those of its competitors • Maquita sells directly to overseas customers as well as selling through local brokers. • Maquita has lower costs than its competitors. • Maquita specialises in cocoa • Maquita minimises speculative risk in order to maintain business stability. • Maquita contributes to grower training from its profits. • Maquita is subsidised by donor funds to a small extent

Part 2. Fair-trade Cocoa and Chocolate

Although over 99% of Maquita's cocoa is traded on conventional markets and therefore loses its "ethical trade" dimension at the point of export, a small percentage continues an "ethical" existence through fair-trade marketing channels in Europe. This part of the report examines the cocoa and chocolate fair-trade system.

2.1 Fair-trade cocoa and chocolate

Fair-trade cocoa and chocolate are market developments that are largely restricted to Western Europe. In 1999, for the first time, imports of fair-trade cocoa to the region may have exceeded 1,000 metric tonnes. While this would represent an increase of over 50% on the 1998 figure, it would still only be 0.1% of total cocoa imports to Western Europe. This lack of scale, and the problems it creates, currently limits the impact that the cocoa fair-trade system can have.

Although fair-trade cocoa and chocolate have been available for over two decades, it is only since the early nineties that fair-trade labelling has brought a degree of uniformity to sales across Europe. The existence of a fair-trade label on the wrapper of a chocolate bar guarantees that a proportion of the ingredients has been purchased according to ethical rules laid down by the labelling organisation[5]. The rules relate to "fair" terms and conditions of purchase, and the democratic responsibilities of the fair-trade farmer organisations (refer to Appendix 4 for details). Certification and regular checks ensure that the rules are followed. Farmer organisations that do not meet the criteria are not excluded from fair-trade, providing they can provide evidence that they are making progress towards criteria fulfilment.

The majority of fair-trade cocoa comes from Kuapa Kokoo, a sizeable farmer co-operative in Ghana. Supplies from this source reflect the generally high quality of Ghanaian cocoa, and the reliability of service guaranteed by the Ghanaian Cocoa Board. Other fair-trade cocoa comes from Bolivia, Ecuador and Cameroon.

Commercial fair-trade participants in Europe hold licenses to operate within the fair-trade system and have individual contracts with the Fair-trade Labelling Organisation (FLO). The companies are restricted to purchasing only from registered producer organisations and to sell to other licensee companies further down the supply chain. Fair-trade distributors who use fair-trade labels are obliged to pay royalties to the labelling organisation, which uses the funds to maintain, monitor and promote fair-trade systems.

2.2 Major Commercial Fair-trade Cocoa Participants in Europe

Daarnhouwer & Co. BV. This long established Dutch commodity trading company has been involved with fair-trade cocoa since 1991. It currently handles between 70 and 80% of all fair-trade cocoa imported to Western Europe. Although now part of a multinational company, Daarnhouwer has maintained its flexible and compact

[5] The exact proportion varies between types of chocolate. Some manufacturers abide by a minimum of 51% fair-trade content (including other ingredients such as sugar).

structure, as well as its reputation for dealing in speciality cocoa, coffee, tree nuts and dried fruit.

Dutch Cocoa BV. Unusual in the increasingly concentrated cocoa processing industry, this relatively small company has remained independent of large multi-nationals. Its flexible processing facilities allow it to serve a particular market niche that requires limited production runs of specialised cocoa products. The company has been involved in fair-trade cocoa since 1991 and currently processes over 70% of fair-trade cocoa in Europe.

Chocolat Bernrain. In addition to its own-brand conventional and organic chocolate, this family owned Swiss company produces about two hundred tonnes of fair-trade chocolate annually. The company's involvement in fair-trade chocolate pre-dates the advent of fair-trade labelling. For many years, the company has manufactured the "Mascao" brand of fair-trade chocolate, made from cane sugar from the Philippines and cocoa and cocoa butter from Bolivia. Bernrain now offers another brand of fair-trade chocolate made from cocoa beans of various origins.

Weinrich & Co. GMBH. This German chocolate manufacturer produces fair-trade chocolate for several fair-trade distributors within Europe.

2.3 Fair-trade cocoa roles and responsibilities

This section examines who does what in the European fair-trade cocoa and chocolate system.

Pre-financing (financing trade)
Under their contracts with FLO, importers are obliged to extend 60% of the FOB value of fair-trade cocoa purchases as credit to the exporter. By conventional standards, this advance is generous especially because there is no requirement for the exporter to present a warehouse receipt to prove that he has possession of the contracted quantity of cocoa. The buyer is therefore exposed to considerable risk of default. However, in practice, the 60% prefinancing arrangement is infrequently taken up by exporters. Kuapa Kokoo, for instance, benefits from selling through the Ghanaian Cocoa Marketing Board and therefore requires no trade finance from foreign sources. Maquita, while it initially required pre-finance, is now sufficiently large that it can find its own sources of credit. Only MACEFCOOP, the Cameroonian fair-trade exporter, currently uses the credit facility. The unpredictability of the Cameroonian supply chain has occasionally forced MACEFCOOP to default on their loans.

Freight, insurance, handling, insurance and warehousing
These arrangements are the responsibility of the cocoa trading house.

Hedging (using international futures markets to manage price risk)
This activity is responsibility of the trading house. In practice however, hedging only occurs when the international price of cocoa is above the minimum fair-trade price. FLO cocoa criteria (refer to Appendix 4) state that fairtrade prices should move in sympathy with international exchange prices unless the latter go below US$1,600 a

tonne. This price plus the fair-trade premium of US$150 a tonne establishes the minimum fair-trade price. International cocoa prices have been below US$1,600 a tonne for several years and therefore hedging has been unnecessary. Daarnhouwer and the other fair-trade importers currently face no price risk because fair-trade prices can not decline in the period between purchase and sale of fair-trade cocoa.

Inventory (stockholding)
Holding inventory of fair-trade cocoa is a service that Daarnhouwer provides for its customers. It means that chocolate manufacturers are usually able to purchase the type of fair-trade cocoa when and in the quantities that they want it. Previously, Daarnhouwer had been operating on a back-to-back basis (only purchasing when an order had been taken), but the lengthy delays that this caused prompted a rethink. Daarnhouwer's stockholding involves the company in considerable expense in terms of warehouse charges, insurance and the cost of working capital. To cover these expenses, a small levy is charged to buyers on each tonne of cocoa.

Fair-trade cocoa processing
All processing of fair-trade cocoa into its products (liquor, butter and powder) is conducted by FLO registered specialist cocoa processing companies, among whom Dutch Cocoa dominates the market. By contrast with these specialists, fair-trade chocolate manufacturers do not possess the scale to process cocoa profitably.

Pricing fair-trade cocoa products
This task, which is the responsibility of cocoa processors, is more complicated than may be apparent. Cocoa is initially processed into cocoa liquor, some of which goes straight into chocolate manufacturing, while the rest is further processed into cocoa butter and powder. The butter is used primarily for adding texture to chocolate (although is also used in cosmetics and pharmaceuticals) while cocoa powder is used in the baking industry. Although cocoa liquor yields a ratio of butter to powder that is on average equal to the ratio of fair-trade demand for the two products, instances frequently occur when demand and supply are out of balance. Given that Dutch Cocoa does not hold inventory of fair-trade butter and powder, the price the company charges for fair-trade product has to reflect the price that the counterpart product receives on the conventional market. For instance, if Dutch Cocoa has an order for fair-trade cocoa butter, yet cannot find a fair-trade buyer for the powder, the price that is charged for the butter has to be weighted upwards in order that the company covers the cost of purchasing the relatively expensive fair-trade cocoa beans. This situation is made worse when the price of conventional cocoa, and hence the price of conventional cocoa powder, are as low as those currently prevailing in the conventional market. Dutch Cocoa often finds difficulty in explaining to customers why low conventional cocoa prices should drive fair-trade cocoa product prices upwards.

Fair-trade chocolate manufacturing, distribution and retailing.
Manufacturing and distribution are done under licence from the labelling organisation members of FLO. Distributors pay a royalty to labelling organisations for the use of the registered trademarks. This money is used to monitor fair-trade cocoa and chocolate supply chain, and to promote awareness of fair-trade chocolate and cocoa. Retailing is done both through specialist fair-trade outlets (such as those run by Oxfam) and, to a lesser extent, through supermarkets.

Traceability
All participants from fair-trade cocoa exporters to fair-trade chocolate distributors are contractually obliged to report purchases and sales to FLO. This degree of openness allows FLO and its member organisations to monitor the flow of fair-trade cocoa and chocolate, with the aim of ensuring traceability of cocoa to its fair-trade origin. Occasionally, buyers in Europe require fair-trade cocoa that can not be sourced from stocks. In order to avoid costly delays, the buyers are supplied with conventionally traded cocoa of the same quality and from the same origin, while an order of the same specification is placed with the relevant fair-trade exporter. When it arrives, the fair-trade cocoa enters the conventional market, thereby ensuring that the fair-trade exporter benefits from the original buyer's order and that the fair-trade importer does not benefit from selling conventional cocoa as a fair-trade commodity. This activity is sanctioned and closely monitored by FLO.

2.4 Maquita's fair-trade export performance

Maquita has a good reputation as a fair-trade exporter. It never defaulted on pre-finance provided by Daarnhouwer, and the quality of its service and product are generally high. When product quality has become an issue, usually through occasional incidences of mould, solutions have always been found through allowances (deductions from the agreed FOB price).

Maquita's position among other fair-trade cocoa exporters from other origins is strong. As the only supplier of fair-trade fine or flavour cocoa, Maquita's cocoa is particularly favoured by Swiss fair-trade chocolate manufacturers, who tend to use 50:50 fine or flavour to bulk cocoas in their recipes. However, fair-trade cocoa from Kuapa Kokoo is likely to remain the most popular cocoa because it is the cheapest (the positive price differential Ghanaian cocoa receives is generally lower than differentials for the other fair-trade origins), is of uniformly high quality and produces a higher yield of liquor.

Apart from the Swiss, most other buyers in Europe are indifferent to the perceived superiority of fine or flavour cocoa, meaning that Maquita's share of the fair-trade cocoa market is always likely to be limited. However the fair-trade market has helped to give Maquita access to much larger conventional cocoa demand. The company has also been very successful at promoting itself without the help of fair-trade partners in Europe.

2.5 Incremental costs incurred by European fair-trade participants

The peculiarities of the fair-trade cocoa and chocolate market in Europe mean that participants incur costs that they would not face on conventional markets. These can be summarised thus:

- Reporting: Fair-trade rules require participants to regularly report transactions to FLO. Although this may initially involve significant management time, once the procedures are in place, the cost of the reporting is minimal.
- The size of the fair-trade cocoa market: The small size of the market means that efficiencies in processing and manufacturing have yet to be realised. Modern

capital intensive production techniques benefit from high volume production runs because disruption to production lines is minimised.

- Transaction costs: The small size of each fair-trade transaction means that a disproportionate amount of staff time is spent on purchasing and selling, leading to higher transaction costs. Additional features of the fair-trade system, such as the necessity for Dutch Cocoa to load fair-trade cocoa product prices in response to low conventional market prices (as described above), mean that much time has to be spent maintaining customer relations. Similarly, Chocolat Bernrain, which is restricted to cocoa from just one fair-trade source for its production of "Mascao" chocolate, regularly spends time explaining to customers why the chocolate is not always available and why, in the absence of the ability to blend cocoa liquors from different origins, the taste of the product changes slightly between production runs.

2.6 Incremental benefits enjoyed by European fair-trade participants

Just as they incur costs, companies involved in fair-trade cocoa and chocolate also receive benefits from participating in the trade:

- Limited competition: Fair-trade cocoa trading and processing are dominated by Daarnhouwer and Dutch Cocoa respectively. However, while this situation may have the appearance of being a monopolist's paradise, in reality, given the small size of the market, there is little room for competition. Daarnhouwer further justifies its position by pointing out the significant overhead investment it made in establishing the trade in Europe.
- Trust: Some participants feel that the transparency of transactions and the good-will among fair-trade participants, means that trading is both more pleasant and less likely to lead to costly disputes.
- Risk reduction: While conventional prices are below the minimum fair-trade price (leading to constant fair-trade cocoa prices), the price risk borne by Daarnhouwer and other trading houses is minimal. Good will may play a part in reducing risk by decreasing the chances of poor contractual performance.

2.7 Margins and profitability

No attempt was made during the research on European fair-trade participants to ask for financial information. There are two reasons why this was the case. Firstly, given the dominance of certain companies in parts of the trading chain, any presentation of financial data in this report would reveal confidential information on company performance. Secondly, nearly all the companies involved in cocoa and chocolate fair-trade also operate in conventional markets, thereby making the task of distinguishing between fair-trade and conventional trade profitability using aggregated company accounts highly arbitrary.

However, even without financial information, several useful observations on margins and profitability can be made. Companies involved in fair-trade are free to set their own margins, and generally claim that margins are approximately equivalent or slightly less than those earned through conventional trading or production.

A peculiarity of margin setting is revealed in the case of Dutch Cocoa. The pressure that the company feels from customers who complain about the increasing price of fair-trade cocoa products that occurs as a result of decreasing conventional market prices, has persuaded the management to reduce its margins for the sake of maintaining price stability.

While fair-trade cocoa and chocolate is profitable, it is probably less profitable than conventional trading. The incremental costs of engaging in fair-trade cocoa and chocolate trading, particularly those associated with lack of scale, almost certainly outweigh the benefits.

2.8 Motivations for becoming involved in fair-trade

Given this conclusion about profitability, why do commercial companies become involved in cocoa and chocolate fair-trade? Several companies offer the motivation of making money, but they could probably make more money if they concentrated their resources on conventional business. A more convincing motivation is that fair-trade principles closely coincide with individual company policies. For instance Dutch Cocoa's policy clearly states the importance of maintaining the continuity of the business, its relations with other organisations, and the welfare of employees. Similarly, Chocolat Bernrain is a family owned business that follows philanthropic and environmentally sound principles.

Another motivation for becoming involved in fair-trade may simply be that certain companies can. The capabilities of several participating companies mean that they are particularly suited to dealing with the peculiarities of the trade as it currently exists. In practice, this means that they are small, flexible and not answerable to external shareholders.

Another common feature of such companies is that they possess individuals who are motivated to support good causes. Furthermore, company management allow their staff to follow these interests.

Part 3. Findings and Conclusions

3.1 Key findings

- The Ecuadorian economy is currently a difficult environment in which to conduct business.

- The Ecuadorian cocoa marketing system does not restrict competition.

- Against this background, Maquita's business performance has been impressive. The company has out-performed most of its conventional trade competitors. Its success is the result of high calibre management.

- Maquita's cocoa operations are subsidised to a small extent. Donor grants have provided the organisation with capital to invest both in its marketing operations and in improving bean quality at the farm level. However, such financial assistance has only recently been available and played no part in the company's establishment.

- Maquita trades on a preferential basis with approximately 15% of the smallholder farmers in the two provinces where it concentrates its activities.

- Maquita runs a transparent marketing system that reduces transaction costs for both growers and traders.

- Under its preferential buying programme, Maquita pays a price premium of between 8 and 15% over the standard buying price.

- Maquita has provided training in cocoa cultivation, post-harvest issues and farm management to its target smallholder growers. The impact that this recently implemented programme has had on grower incomes has yet to be measured.

- Fair-trade cocoa helped Maquita to establish itself. Since 1996, Maquita has sold only a very small part of its cocoa through fair-trade channels.

- Although European companies that have become involved in fair-trade make profits from their fair-trade activities, they could probably make more money if they concentrated their resources on conventional trade.

- Motivations among these European companies are varied. Good-will and the capacity to serve a niche market seem to play the greatest roles.

3.2 Conclusions

- Maquita's impressive commercial performance has allowed it to deliver substantial financial benefits to its target smallholder cocoa producers. This has only been possible because Maquita's management has excellent commercial skills.

- Maquita's managers combine ethical awareness with business acumen.

- A sustainable future for international fair-trade cocoa will only be secured if the market grows. The most likely source of growth is through supermarkets. Increased scale will improve profitability for the existing participants and will attract new companies to engage in the trade.

- The lack of scale also limits the impact that fair-trade cocoa can have on grower's incomes.

- Cocoa is an appropriate commodity for ethical trade. It has been traded for many years, is consumed in large quantities, and has all the necessary infrastructure to support its trade. Furthermore, it is processed into luxury items that have few substitutes and have a high profile in consumer's minds.

- However, with the current low level of fair-trade cocoa sales and in the absence of a recovery in international cocoa prices, one of the few paths to widespread increases in producer incomes is to improve marketing skills and efficiency within countries of origin. Maquita has achieved this in Ecuador.

Appendix 1

Table A1. Ecuador's Demography

POPULATION*	12,646,095
Men	6,350,427
Women	6,295,668
Urban	8,098,436
Rural	4,547,659
Population density (per km ^{2})	50.3
Rate of population increase	2.2%
Life expectancy	64
Rate of open unemployment	18.2%
Rate of underemployment	54.3%

Source: INEC, Proyecciones de Población y Encuesta Urbana de Empleo (Population Projections and Urban Employment Survey)
* Year 2000 projection

Table A2. Ecuador's Cocoa Exports

YEAR	1996	1997	1998
Metric Tons	69,904	41,148	12,766
Thousand US$	91,036	59,647	18,897

Source: www.sica.gov.ec

Appendix 2

Table A3. Costs, revenues and profits in the Maquita trading system (June 1999)

	US$ per Tonne
PRODUCER INCOME	
Selling price	800
PRODUCER COSTS	
Direct Farm costs	
Cleaning	240
Harvesting	45
Total farm costs	225
Direct post harvest costs	
Fermenting	15
Drying	60
Delivery	7
Total costs post harvesting	83
Indirect costs	
Depreciation of farm equipment	7
TOTAL FARM COSTS	314
PRODUCER PROFIT	486

STORAGE AGENT	US$ per tonne
Purchase price	800
Storage agent work: grading etc.	14
Drying and packing in storeroom,	3
Transport from the storeroom to the canoe (mule)	2
Canoe transport	6
Loading onto truck	2
Truck transport to Guayaquil	10
Various, incidental expenses	3
TOTAL costs storage agent	840
SALE PRICE in Guayaquil	880
PROFIT storage agent	40

MAQUITA GUAYAQUIL	US$ per tonne
Purchase price	880
Drying	
Labour	3
Gas for dryer	2
Electricity	1
Screening	
Labour	3
Fumigation	
Chemical, two days	1
Packaging	
Pita sack	15
Loading	1
Port paperwork	10
SUBTOTAL ASE COCOA (sold through broker to USA)	915
PLUS OTHER COSTS FOR ASS for Europe:	
Screening	3
Extra labour for ASS	3
Transport	16
Flat-bed truck for the port	4
Loading the truck	2
SUBTOTAL COCOA ASS	924
GENERAL EXPENSES	102
Rental expenses ***	2
Communication expenses ****	0
Other estimated administrative expenses *****	100
TOTAL ASE COCOA COST	1017
TOTAL ASS COCOA COST	1026
EXPORT PRICE PER TONNE	
ASE Cocoa	1098
ASS Cocoa	1157
GROSS PROFIT MCCH ASE	80
GROSS PROFIT MCCH ASS	132

* The FUE is the Formulario Único de Exportación (Single Export Form). The ASE variety is exported to the USA and the brokers take it from the MCCH yard, they don't have to deliver it to the port

** The ASS variety is exported to Europe and has to be transported to the port and they have just included the costs when paying for the FUE

The cost of customs paperwork - the FUE-, is 500,000 sucres, we have calculated this cost pro rata for 1,000 quintals of export, thus the unit cost is 5,000 per quintal

*** The rental cost of the drying yard is US$ 1000 per month. The costs has been calculated pro rate for the number of quintals sold in June 1999 - 11.500 quintals

**** The cost of sending documents: shipping note and others come to 35 dollars.

Appendix 3

Maquita's income statements for 1998 and Jan to May 1999.

	1998	Jan to May 1999
VARIABLE	US $	US $*
Sucre exchange rate	6,119	7,172
SALES		
Public	28,438	125
Organisations		
Foreign	1,429,041	2,360,500
Related	-	
TOTAL SALES	1,457,479	2,360,625
COST OF SALES		
Public	28,036	
Organisations	-	
Foreign	1,234,776	1,890,486
Related	-	
TOTAL COST OF SALES	1,262,812	1,890,486
GROSS PROFIT	194,667	470,139
CONTRIBUTION MARGIN		
BUSINESS EXPENSES		
Marketing	100,163	179,486
TOTAL BUSINESS EXPENSES	100,163	179,486
BUSINESS MARGIN	94,504	290,653
OPERATIONAL EXPENSES		
Administration	34,557	11,644
Finances	14,734	32,041
Head Office	12,055	9,154
TOTAL OPERATIONAL EXPENSES	61,346	52,839
OPERATIONAL MARGIN	33,158	237,814
OTHER INCOME		
Project Income	97,208	2,645
Central Services Income	-	
Other Income	44,106	170,770
OTHER EXPENDITURE		
Training expenses		
Project expenses	14,633	7
Other expenses	106,823	103,127
TOTAL OTHER INCOME AND EXPENDITURE	19,859	70,282
NET MARGIN	53,016	308,096

Appendix 4

Cocoa Criteria - Fair-trade Labelling Organizations International (Max Havelaar/TransFair/Fair-trade/Rättvisemärkt)

November 1998

1. Introduction

The Fair Trade Labelling Organizations International (FLO) members seek to change, with Fair Trade conditions for cocoa, the unfair international trading structures and improve the social and economic circumstances of small cocoa farmers in developing regions. In particular they aim to give their organisations direct access to the market at fair trading conditions, thus enabling them to operate independently of intermediary traders and providing them with tools enabling them to master their own developmental process.

2. Criteria regulating the participation of cocoa producers organisations in the Fair Trade market under the Label of one of the FLO members. Producer organisations meeting the following criteria can apply for inscription in the FLO Cocoa Producers Register (FLO-CoR):

2.1 the majority of the members of the organisation are small scale producers of cocoa. Small scale producers are understood to be those who are not structurally dependent on hired labour, managing their own fields mainly with their own and their families' labour-force, except in labour intensive peak seasons;

2.2 the organisation is independent and democratically controlled by its members. The members of the organisation participate in the decision-making process which determines the general strategy of their organisation, including decisions related to the destiny of the additional resources available through advantageous Fair Trade conditions;

2.3 Management and administration of the organisation are structured in a transparent way, members are informed regularly allowing them an effective control over activities and finances of the organisation;

2.4 the organisation is based on the concept and practice of solidarity and mutual help;

2.5 no form of political, racial, religious or sexual discrimination is practised;

2.6the organisation is statutarily open to new members;

2.7 the organisation is independent from any political party.

3. Sustainability

The FLO-CoR and the producer organisations both engage to improve the basis for sustainable development in the production by giving room to: social development, creating better living conditions for the members, their families and the communities they live in; organisational development, encouraging and facilitating full participation of all members in the definition of policies and improving the managerial and administrative capacity of the actual and future leadership of the organisation; human participation, allowing women in particular to play an active role in developmental issues in general and specifically in decision making processes within the organisation; economic development, encouraging diversification of production in order to diminish dependency on one single product and the improvement of the quality of the product enabling the producers to realise their opportunities on Fair Trade and regular markets; agricultural practices which respect the specific ecosystems and contribute to the conservation and sustainable use of the natural resources, minimising and where possible eliminating the use of chemical inputs

4. Product description

Cocoa; commercially the term refers to the whole seed of the cocoa tree (Theobroma cocoa) which has been fermented and dried.

5. Quality *

Quality requirements and procedure for quality control have to be agreed upon in the buying contract according to normal trade practice.

6. Pricing

All Fair Trade cocoa prices are calculated on world market price quotation plus respective Fair Trade (FT) premiums. The price fixed for any transaction of Cocoa under "FLO-International Conditions" can in no case be inferior to the following fixed minimum prices.

6.1 Premium and Minimum price for Standard Fair Trade cocoa. The Fair Trade premium for all standard qualities is USD 150.--/ton.

The minimum price for FT standard quality cocoa inclusive premium is USD
1'750.-- / MT FOB.
If world market price rises above the basic price of 1'600.-- USD the prices will be fixed as follows: World market price+ Fair Trade premium= Fair Trade price (for type of cocoa contracted)+ (USD 150)

6.2 Premium and Minimum price for certified organic cocoa

The additional minimum Fair Trade premium for certified organic cocoa, which
is sold as such, is USD 200.--/ton.
The minimum price for FT organic cocoa inclusive premiums is USD 1'950.-- / MT FOB.

If market price rises above USD 1'600.-- the prices for organic cocoa and locally produced semifinished products are calculated using the price scheme for standard qualities (6.1) incl. the premium for organic quality (USD 200.--), and by applying the conversion factors mentioned under 6.3.

6.3 Cocoa butter and -powder produced in the country of origin

For the price calculation of locally (in the country of origin) produced semi-processed cocoa products the following conversion factors are used:
Beans to butter: 2,4
Beans to powder: 0,5
Therefore minimum prices are for standard quality/organic quality:
Cocoa butter USD 4'200/USD 4'680.--
Cocoa powder USD 875/USD 975.--
All prices mentioned under 6.1. to 6.3. are per metric ton (MT) FOB sea port of
the producing country. Any additional handling/packing, packing materials and additional labour costs for retail packing have to be met separately.

7. Payment

Unless other mutual agreement payment shall be net cash against a full set of documents on first presentation (FOB), minus eventual advance payments.

8. Credit

On request of the seller, the buyer shall make available up to 60 % of the minimum value of the contract in credit facilities in favour of the seller upon the signing of the letter of intent, or at any date thereafter at the wishes of the seller, however at least six weeks prior to shipment. The corresponding interest charges shall be covered by the seller at current commercial interest
rates (or better) in the country of destination. Reimbursement of the loan and the interest charges shall be according to the terms and conditions mutually agreed upon in the separate credit contract.

9. Continuity

Buyers and sellers intend to establish a long term and stable relationship in which the rights and interests of both are mutually respected. All purchasing should possibly cover a period not less than one crop-cycle with the intention to allow both sides a better planning and preparation of all business agreed upon. These long-term agreements should be confirmed by the exchange of binding letters of intent not later then three months before harvesting time. Annual renewals should be confirmed at least three months prior to the expiration of the previous Letter of Intent.

10. Arbitration

In case of dispute, parties are held to inform the Fair Trade mark organisation of the buyer's country. If possible, the latter will work out a settlement proposal to be presented to both parties. If this settlement proposal is not acceptable to either of the parties, the dispute will be submitted to
arbitration according to the CAL conditions, latest edition.