

ESG Now Podcast

“Children are still in the Cocoa Field”

Transcript, 4 April, 2024

Mike Disabato (00:00):

Hello everyone. This is the weekly edition of ESG. Now I'm your host Mike Disabato, and I hope some of you have had work off in one way or the other this week. As some around the world celebrate Good Friday or Ramadan or the seemingly more playful Easter. Now me, I don't really celebrate much, but I do enjoy the fact that chocolate is an important aspect of Easter because I certainly do celebrate chocolate. And whenever I am celebrating chocolate, I usually do so while thinking about the sort of challenges cocoa workers and producers face as they harvest the delicious cocoa bean. As you can tell, I'm not a very fun person. Still for this week's episode, we wanted to play you an episode we did way back in March of 2022 that was a chocolatey favorite of ours called Children in the Cocoa Fields. And it's all about the growing problem of child labor in cocoa harvesting. Wonderful. But since it was published back in 2022, some things have changed for the cocoa industry. And so I thought before we replayed that episode, I would call up the original guest of that episode, Canada's favorite Foghorn, and my colleague Cole Martin, and ask for a quick chocolate update before this episode began. Cole, thanks so much for joining me again. How is the world of the dark and creamy?

Cole Martin (01:21):

Basically, we've seen a significant move higher in cocoa prices in recent months. Prices have essentially quadrupled since the end of November, and we're now at a point where cocoa prices are higher than what coppers are and what's really been driving this recently has been basically very volatile weather during the growing season. We just experienced our third El Nino in a row over the Northern Hemisphere winter in 2023, early 2024, and that brought a lot of rainfall to West Africa, and this basically led to disease outbreaks that significantly curtailed production. And if you combine with the fact that the trees in this part of the world are already aging anyway, this has led to a severe shortfall in supply and therefore a very large global market deficit. I think what's interesting about this going forward is that when we think about what climate change could bring to the agriculture industry, when we think about spiking prices, it's often the case that we assume, wow, there must have been a drought, and that's why prices are where they are. But in actual fact, you could have a situation where production is very poor because of too much rainfall, because rainfall is poorly distributed, there may be too much all at once. And so based on the IPCCs report that came out last year, it isn't necessarily the case that every region is going to be drier as a result of climate change. Some regions may actually be wetter as a result of climate change, but that is necessarily going to help boost agricultural supply. It may be just as detrimental as too dry weather.

Mike Disabato (02:59):

So what do those price fluctuations do to what the episode that's coming up talks a lot about deforestation and labor abuses that are sometimes prevalent in the industry.

Cole Martin (03:08):

I think there are going to be two things that are worth watching as we see price movements over the next several months. One is how this affects the EU deforestation law. One of the key elements of that law is essentially assigning to every country either a high, medium or low risk of deforestation designation. And up till now, basically every country is being considered standard risk. However, one thing we know from the IPCC reports as well is that when prices spike, agricultural acreage tends to go up and agricultural deforestation tends to go up. And it could be the case for the cocoa countries involved here that if prices stay where they are, deforestation may increase and agricultural acreage may increase. And what that could mean is that potentially

all of these countries in two to three years, these major cocoa producing countries could end up in the high risk list of deforestation and that could potentially bring extra due diligence requirements and potential headaches to cocoa manufacturers and cocoa importers.

[\(04:16\)](#):

So the other thing worth watching are the price support systems that companies have vis-a-vis cocoa farmers in West Africa. So essentially what companies do now, many companies that are operating cocoa companies that are operating in the region is they basically have a scheme where they give cocoa farmers additional money on top of what they already receive at the farm gate as a way to help boost their incomes. However, those income support schemes are kind of predicated on prices being relatively stable and probably were not designed to support cocoa prices that are, let's say four times higher than they have been traditionally, which is where they are now. So it'll be interesting to see going forward if these cocoa and chocolate companies which may be facing higher input costs as a result of higher cocoa prices, end up making any adjustments to those price support schemes as a result of where prices are now.

Mike Disabato [\(05:14\)](#):

Okay, great. Thank you Cole, and thank you all for still listening at the moment. I hope you enjoy the episode that was published in March of 2022, called Children in the Cocoa Fields. Happy holidays to everyone out there, and I'll talk to you soon.

[\(05:36\)](#):

Specialty crops like fruits and certain vegetables require a lot of labor to cultivate labor costs account for around 40% of the total cost of a raspberry, for example. Now, compare that to corn. The labor costs account for around 5% of corn's total cost. And the difference in that price is automation tractors at the moment are basically million dollar autonomous vehicles at this point, and corn is easily cultivated via a tractor, whereas specialty crops require the gentle hand of man to pick, harvest and package. So you might think, okay, handcrafted though, that means the price goes upright. Artisanal products always get the bank well, herein lies the sadness around farming. Handcrafted doesn't equate to higher profits for your typical farmers. It just means more labor is needed to get your product to market. And in the agriculture sector, more labor typically means more labor abuses. It's an unfair system to say the least.

[\(06:37\)](#):

And that isn't just my opinion. Academics from the Royal Tropical Institute, the University of Chicago, you don't want me to list them all. They use the academic equivalent of unfair in their field of research when talking about the agriculture system and specialty products. And there are a few specialty products in a more unfair state than cocoa. The global cocoa and chocolate market size is around 45 billion US dollars. 50% of the world's cocoa is grown in the Ivory Coast. Ghana grows around 19%. And then there are smaller sections in Nigeria, Cameroon, Indonesia, Ecuador, Peru, and Brazil. But Western Africa is really where a majority of the bulk cocoa is grown because even those Latin American countries that I mentioned, they produce what's called fine or flavor chocolate, which is different and it's sold different. And the big candy bar companies, for example, buy bulk cocoa. And the challenges in growing cocoa are pretty extensive.

[\(07:36\)](#):

There's deforestation that's a massive problem bigger than in most specialty crops, human rights abuses, impoverished workers, lack of transparency and corruption. It has all the bad tones. So you might be thinking, this all sounds extremely bleak and you're hitting me with two human rights abuses story in one day, but there's a change happening in the agricultural market, not just for cocoa but globally. And this is due again to enhance technology, specifically enhance mapping technology, which we will get to, but I don't want to take away from the story, but just note that companies are getting better at tracking their supply chains. And when it comes to companies, Nestle is the largest by usage chocolate brand in the world, and it's attempting to pilot a newer version of an old system in 2022 to combat these challenges in its supply chain because it wants to fix its supply chain.

[\(08:27\)](#):

Cocoa's a big part of that. It has to fix cocoa. What it's going to do is Nestle is going to pay its farmers up to 500 extra Swiss francs a year that's around \$540 US if they can fulfill certain requirements set by Nestle. And when the business model of bulk cocoa is poverty, around 90% of all cocoa farmers are below the poverty line. So an extra \$540 is a huge deal. Okay, so why does Nestle think that this program specifically is going to work? Well, here's my colleague Cole Martin to tell you why they think. So.

Cole Martin ([09:01](#)):

What the payment and the broader policy are based on is a realization that the programs that have been created in the past to help alleviate farmer poverty, cocoa farmer poverty in West Africa simply haven't worked well enough. And the incidents of child labor, which various policies in the past have tried to fix, haven't worked. And in fact, even though there was a 2001 protocol passed by the US government, which included various NGOs and companies and governments in West Africa to reduce the prevalence of child labor in the cocoa industry, despite that happening, child labor over that time has actually increased. And this has been a black mark on the industry, and it's ultimately led to lawsuits by former child laborers against very large chocolate companies, including Nestle, Mars and Hershey.

Mike Disabato ([10:05](#)):

The lawsuit got all the way to the Supreme Court in the US where it accused Cargill, a major commodity trader that's actually privately owned and Nestle of knowingly helping to perpetuate slavery at Ivory Coast Cocoa Farms for technical reasons, the case was thrown out, but it was another wake up call for the major chocolate companies that they haven't done enough to combat the endemic of child labor in the cocoa supply chain, to which there's definitely an endemic at the moment, and it's been exacerbated by the COVID-19 pandemic, which closed schools all over the world. And these companies have really tried a number of programs. The World Cocoa Foundation estimates that cocoa and chocolate companies have invested at least 215 million US since 2001 in sustainability programs to fight child labor such as boosting farmer income through increased productivity programs, rolling out what's called Child Labor Monitoring and Remediation Systems or C-L-M-R-S building schools and other programs.

([11:07](#)):

The big difference here though with Nestle's new program that was announced late January, 2022, is as long as the families can be traced, they can get up to 500 Swiss francs regardless of the farm's productivity. They just have to do four things. They have to provide school enrollment for all children in the household ages six to 16. They have to implement good agriculture practices such as pruning, which can increase crop productivity. They have to perform agroforestry activities to increase climate resilience like planting shade trees, and they have to generate diversified income, for example, through growing other crops, raising livestock such as chickens, beekeeping or processing other products like cassava. And Nestle has started off with about 10,000 families and hoping to get around 160,000 by 2030. So talking about Nestle as a company, they have multiple strong supply chain policies at the moment. These include identifying almost all tier one suppliers. Those are high risk suppliers. They have a robust labor code of conduct, and they have supplier audits that include at least some tier three or raw material suppliers that's good for the industry. So the question is why are they implementing another program right now? Was it just the lawsuit or was it something else?

Cole Martin ([12:27](#)):

I think there are a couple of other factors that may have prompted Nestle or may have affected their consideration a little bit. One is there are new regulatory laws that are coming into effect which force companies to pay a lot more attention to their supply chain and do a lot more due diligence on their supply chain. There are laws in France. In Holland, there's a variation of a due diligence law in Switzerland. The EU recently announced a new due diligence law for a company supply chain. And so there's much more regulatory pressure now on these companies than there would've been let's say five or 10 years ago. There's a couple of other things I think that are helping to drive this. One is the technology is a lot better. Satellite mapping, for example, has improved tremendously in recent years. And what that's allowed to do is allowed companies to

significantly improve the traceability of their supply chains. And so now we're seeing some of the major chocolate companies in the region, including Mondelez and Nestle and Mars. They're coming out and saying that they will have full traceability of their cocoa supply chain by 2025. And these are all relatively new pronouncements. And to some degree that is being enabled by the improvements in geomapping and satellite technology, et cetera.

Mike Disabato ([13:53](#)):

By the way, at the moment, Nestle only has 44% traceability of its supply chain to the cooperative model. S is 63%. Mars has 51%. Hershey's actually reports a hundred percent traceability, but it buys its cocoa from a massive trader and processor called Berry Kaaba, which only has about 33% traceability to the co-op except for Hershey's. Those numbers seem small, but there are even problems with those small numbers. Approximately half of the cocoa is still bought via indirect supply chains, and the involved companies don't really know its origin. The second problem is the definition of traceability differs from company to company. Some companies just rely on standard setting organizations, but there's others like Nestle that rely on technology. And here is where the technology piece comes into play that Cole mentioned, and we can show its importance. In recent years, enhanced and proliferated satellites are making it easier for businesses to track their supply chains. They use satellite mapping, which gives companies a much deeper insight into how the cooperatives or farm groups are actually operating. And being able to monitor your supply chain from afar for a company is important for the kinds of programs that they want to employ, such as the one that Nestle is piloting.

Cole Martin ([15:13](#)):

And so it's a lot easier to do a specific program like this if you're able to find out and understand exactly who you need to be supporting with this type of program. And as part of that, there are also improvements in, for example, banking technology. So if this program were to have been created, let's say 20 years ago, how would the money have actually been distributed to farmers? It may have had to go to the governments of the countries, it may have had to go to the cooperatives. The transmission mechanism was a little bit more complicated. But now the companies can give the farmers money directly, and that cuts out a lot of middlemen. It cuts out a potential for corruption if that were to happen. And so it's easier for companies to do a program like this and they can do it in a much more targeted way.

Mike Disabato ([15:59](#)):

And here's why. Nestle might assume it can spend at the high level around a billion US in total for this program in its entirety and not catch the ire of shareholders new evidence that this program might actually work.

Cole Martin ([16:14](#)):

There's been a lot of research come out recently that has really shed a light on the problem, one of which is the Cocoa Barometer. And another one is the Newark study from the University of Chicago, which detailed not only how prevalent child labor is in West Africa, but also they've showed empirical evidence or they've provided empirical evidence that when there are systematic well-targeted programs that are implemented effectively, the incidents of child labor in these places and on these farms does actually decline. That

Mike Disabato ([16:46](#)):

Is the rosy picture of the situation. The intent may match the effectiveness. We have the technology to make it happen. Regulation is starting to get behind these type of policies. Yet shareholders that have been good on pressuring Nestle to change and Nestle has been willing to change its practices. As I noted before by our measurements, Nestle is a leader in the food industry. We rate it at a AA on ESG factors and its shoulders above a lot of other companies out there still, those shareholders cannot clap their hands and apparent success because the beginning of the program is when the work really starts for Nestle and other chocolate brands that may follow suit. And there are a number of institutional constraints that these companies will need to pay attention to if they hope to be successful in this important social impact program.

Cole Martin ([17:35](#)):

Giving money into farmers' hands could certainly help increase the wealth of farmers. And as we've seen in empirical studies, it may lead to an increase in the attendance rates, children in school. But I don't think that's the entire story. I think there are other factors that suggest that even if you put this amount of money into farmer's hands, it may not fully eliminate the problem of child labor on cocoa farms. And the reason why is because the nature of the cocoa industry itself, cocoa farming is a very labor intensive process. It requires cutting pods off the trees, cutting the pods open with machetes, and then taking out the pulp and leaving it to dry in an open area that requires labor. And it's not apparent to me at this point that any part of that process is easily automated. Within the agriculture industry where we've seen massive reductions of labor requirements, it's usually come in the context of improvements in harvesting technology.

([18:45](#)):

So things like tractors, for example, in the case of cocoa, you don't necessarily have that. And so even in a situation where productivity increases, so for example, you have better farming techniques or better application of fertilizer, pods get bigger or there are more of them per tree, that won't necessarily improve farm income because someone then has to harvest all of that. And in a situation where labor in West Africa is already relatively scarce, there are other industries in the region that are growing the civil service mining and energy, it may not be that easy for farmers to replace the labor that they're losing by sending children to school. And one other note I'll mention on that is there are other institutional factors simply beyond the industry. And the main one being that it is true that companies are helping to build schools in the region, but there are 1.6 million children in Ghana and KO Devar right now who are engaging in some sort of farm labor activity.

([19:57](#)):

Obviously, not all of them are going to be working on the farm and not in school at all. There's probably a range of school attendance within that group, but even if a small percentage of them are not in school at all, if you create a program where they're all sent to school, that requires a relatively large infrastructure investment for the schools, not just for the schools, but teachers and potentially transport. These are rural areas and it may not be that easy to send kids from, send pupils from one place to another. So ultimately, there are a lot of systemic challenges within the cocoa industry that may not necessarily be fixed immediately, even if a program like Nestle is rolled out and rolled out relatively widely with other chocolate companies.

Mike Disabato ([20:49](#)):

And that's it for our show. I want to thank Cole Martin for joining me today to talk about the news with an ESG twist. And I wanted to thank you so much for listening. It really helps. If you like what you heard, don't forget to rate and review us. That will push us up higher on podcast lists and more people can listen, which is great. And if you want to hear me every week, don't forget to subscribe at wherever you get your podcasts. That will help as well. Thanks again and talk to you next week.

Speaker 3 ([21:24](#)):

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Speaker 4 ([21:29](#)):

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