Social Finance Brief

October 2022

Responsible finance in the cocoa supply chain in Côte d'Ivoire

The leverage role of the financial sector in eliminating child labour

Key points

- Largest volumes of financial flows for the purchase of cocoa takes place between international and regional banks and international cocoa trading companies
- Banks are expected to use their leverage to mitigate child labour in cocoa to the greatest extent possible
- Banks are recommended to take actions to align with expectations in norms and regulations regarding child labour

Background

This brief is based on a study conducted as part of the ACCEL Africa Project, a regional project implemented by the ILO, funded by the Government of the Netherlands, and focusing on the issue of child labour in selected supply chains in six countries in Africa. The study seeks to assess the responsibility as well as legal obligations of financial sector actors in eliminating child labour in the cocoa supply chain in Côte d'Ivoire, especially those actors financing cocoa transactions at the level of exporters, buyers, and cooperatives. Current practices and potential roles of financial sector actors to address the issue of child labour in this context are assessed, and recommended actions are presented.

Côte d'Ivoire is the world's top producer of cocoa, accounting for 40% of world production. For Côte d'Ivoire, cocoa is the most important crop for export, accounting for 40% of the country's total export value, and 10% of the country's GDP. For about 1 million households in Côte d'Ivoire, production and sale of cocoa is a significant part of their income. According to UNICEF, 3 million children between the ages of 5 and 17 live in cocoa-producing communities in the country; of these, approximately 1.3 million children are working in the cocoa sector, and 30.9% of them are engaged in hazardous work.[1] Child labour is driven by root causes such as poverty, lack of access to social protection services and quality education, and gender-based discrimination. To eliminate child labour, it is necessary to address these root causes. Over several years, the Ivorian government has made substantial efforts to address the issue, as have several private sector-led initiatives. While challenges remain, in 2019, Côte d'Ivoire was one of 12 countries that received the US Department

1 https://www.unicef.org/cotedivoire/sites/unicef.org.cotedivoire/files/2019-01/Côte%20d%27Ivoire_MICS%202016.pdf

of Labor's (USDOL) highest assessment of "Significant Advancement" for its work on child labour in cocoa production. However, the COVID-19 crisis threatens to further erode global progress against child labour unless urgent mitigation measures are taken. According to the ILO and UNICEF, new analysis suggests a further 8.9 million children will be in child labour around the world by the end of 2022 due to rising poverty driven by the pandemic.[2]

To purchase cocoa, national and international exporting companies take loans from commercial banks. According to several sources, it seems reasonable to conclude that the largest volumes of finance flows to prepay for the purchase of cocoa takes place between international and regional banks (partly through their local branches) and international cocoa trading companies. In turn, such resources are channelled to intermediary traders, so called *pisteurs*, and cooperatives. They in turn purchase cocoa from producers, almost entirely in cash. According to a cocoa sector analysis by KPMG in Côte d'Ivoire, from 2012/2013 to 2019/2020, the total amount paid to producers was about 1,500 billion XOF (about USD 2.6 billion) per cocoa-growing season. Subsequently, the produce goes through quality checking, packaging tax administration procedures, before being shipped to the final buyer.[3]

Generally, cooperatives lack financial resources to obtain such loans, which does not allow them to pre-finance cocoa purchases from their members. Thus, cooperatives are forced to pay producers only after the cooperative has been paid by its customer – typically a larger trading company. As a result, some members prefer to deliver their produce to buyers who have access to finance from exporters or from private funders in their business networks and are able to make direct cash payments at the time of the purchase. This lack of funding weakens cooperatives, and limits the technical and livelihood support they provide to their farmer members. Some multinational companies have tried overcoming this problem, and thereby securing their supply and traceability, by developing their own network of cooperatives. Some producer organizations have raised concerns about this, due to the dependency of the cooperatives on the multinationals, leaving less market shares to national actors.[4]

While the majority of the funding seems to run through the channels presented above, it is also indicated by informants that smaller national trading companies take loans from regional and local banks, or through private financiers in their business networks.[5] There are also examples of international banks financing smaller national cocoa trading companies in Côte d'Ivoire, as well as producer cooperatives, together with partners.[6]

In terms of regional and international banks involved in financing cocoa purchasing in Côte d'Ivoire, the following banks have been identified: Société Général, DBS Bank, Rabobank, BNP Paribas, Citibank, Standard Charter Bank, Deutsche bank, ING, Ecobank, Attijariwafa Bank, Societe Ivoirienne de Banque, NSIA Banque and Bank Atlantique. As indicated by informants, a common set up seems to be open credit lines between international banks and international trading companies, with short term loans of a few months at a time, with more lending during main cocoa seasons, and the least lending happening in the low season (July/August). There also seems to be a high degree of long-standing relationships between banks and international trading companies, with traders returning to the same banks for finance over several years' time. It should also be noted that not all cocoa is financed by loans, as parts of the sourcing are simply financed by international cocoa traders from internal financial means.[7]

Why banks are expected to use their leverage to mitigate child labour in cocoa to the greatest extent possible

Child labour is not only prohibited according to Ivorian law, but also a violation of two ILO fundamental conventions: C138 - Minimum Age Convention, 1973 (No. 138) and C182 - Worst Forms of Child Labour Convention, 1999 (No. 182), both ratified by Côte d'Ivoire. It is also regulated in US trade law. In several European countries, companies are also legally mandated to conduct human rights due diligence

[2] https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_800090/lang--en/index.htm

[3] KPMG, 2020. Rapport d'évaluation de la réforme 2012 de la filièrecafé-cacao.

[4] KPMG, 2020. Rapport d'évaluation de la réforme 2012 de la filièrecafé-cacao.

[5] Interview with APBEF, 22 November, 2021

[6] Interview with Rabobank, December 10, 2021.

[7] Interview with APBEF, 22 November, 2021: interview with Barry Callebaut 11 November, 2021; interview with Cargill 19 November, 2021.

across their business operations, including those of their business partners, and act on findings. As the European Commission is currently preparing a proposal for an EU-wide legislation on mandatory human rights due diligence for companies, it is also highly likely that such a legislation will be in place in the next few years. Similarly, human rights due diligence processes are expected by companies according to the UN Guiding Principles on Business and Human Rights (UNGPs), the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) and the OECD Guidelines for Multinational Enterprises. These three prominent and widely recognized normative documents also include specific expectations of companies to eliminate child labour in their sphere of influence, including references to the two fundamental ILO conventions listed above. Clearly, there are legal requirements and well recognized expectations on companies, including those in the financial sector, to act on child labour.

Building on these business and human rights principles, there are a number of resources available providing guidance to companies, including banks, to use their leverage to mitigate adverse human rights conditions to the greatest extent possible. The study builds on these resources, which include international and national child labour conventions and legislation, as well as general and banking sector specific regulations, principles and guidance on corporate responsibility to respect human rights. The study concludes that banks financing cocoa transactions likely contribute to cocoa being produced with child labour, and they possess leverage to improve the situation.

Recommendations: advancing the leverage role of financial actors in eliminating child labour

Banks are recommended to take actions to align with expectations in norms and regulations regarding child labour.

Drawing from a strong analysis, the following recommendations are made in the report on how banks can meet the expectations in the UNGPs to use their leverage to mitigate the prevalence of child labour to the greatest extent possible.

Recommendation 1: Banks should engage borrowers to increase efforts to eliminate child labour

Drawing from due diligence practices discussed in the study, as well as the ways in which financial sector actors are engaging companies on the issue of child labour, a few good practices can be picked up. Based on those, suggestions are made below on how banks can engage trading companies to improve their practices to eliminate child labour. This is however only the first part of the recommendations, as the overall recommendation is that banks should not only use their leverage to engage with traders to undertake remediation, but that banks themselves should get involved in addressing the root causes of child labour. The latter will be addressed in the subsequent recommendations.

To align with the UNGPs Human Rights Due Diligence (HRDD) principles, assessments of the borrower's actions against child labour should be conducted not just at the inception of a new lender-borrower relationship, but as an ongoing assessment process with key performance indicators (KPIs) and timebound action plans to improve them. Such KPIs and follow-ups should be regulated as part of loan agreements to be effective. The lender should also follow-up on the effectiveness of mitigation measures to ensure they are fulfilling their purpose of addressing the adverse human rights impact, in this case child labour. To have an impact, the KPIs should not be set to match current levels of actions, but rather seek to raise the bar, address root causes, and accelerate and scale-up effective measures against child labour. Banks should also consider conducting spot checks at farms themselves to verify that actions are implemented in practice. The implementation and follow-up of KPIs are more likely to be successful and easier for trading companies to manage if banks use similar or the same set of KPIs and agree on them together with trading companies, and in consultation with relevant stakeholders.

All this requires robust governance of human rights risks at banks, with clear policies, risk assessment systems, procedures and capacity to follow-up on the most salient adverse human rights risks and impacts. Sufficient staff is needed, with adequate expertise, as well as a clear mandate for them to integrate findings from HRDD procedures into the bank's financial products and business relationships. The necessity for child labour to be part of ongoing due diligence is also highlighted in a 2021 report by The Work: No Child's Business Alliance[8] in collaboration with VBDO[9] named 'Child Labour and Institutional Investors – a study on incorporating child labour in responsible investment'. The same report adds the point that it is important for investors to establish an explicit position on child labour and incorporate it into their responsible investment policy. While the report targets investors in their role as shareholders of companies, it makes an important point to treat child labour as a complex enough and salient issue that requires specific responses from the investors. This is also true for banks in their role as cocoa trade financiers.[10]

Emerging set of KPIs

The following are examples of KPIs that aim to provide initial guidance for banks to monitor progress in how their clients, cocoa trading companies, are addressing the root causes of child labour in their cocoa supply chains and going beyond remediation.

Community based child labour monitoring systems to identify, prevent and remediate actual cases

- Percentage of communities sourced from by the trader in Côte d'Ivoire which have a child labour monitoring system or alike in place
- Percentage of community-based monitoring systems effectively linked to the national child labour monitoring system, SOSTECI, where applicable
- Additional measures taken in communities, with higher numbers of child labour identified, addressing the root causes

Access to education for children in cocoa-growing communities

- Percentage of communities sourced from with long distance to the closest school
- Spending in the last 5 years on improved access to education for children in communities sourced from (such as school constructions and renovations, canteens, quality education programmes, school kits, and birth certificates)

Improving livelihoods for cocoa-growing households

- Percentage in improved income by farmers participating in the trader's sustainability programmes, including other household members like spouses
- Percentage in improve yield by farmers participating in the trader's sustainability programmes
- Extent of programmes for increased and effective income diversification
- Percentage of cocoa sourced in Côte d'Ivoire with premiums paid for certified cocoa (Rainforest Alliance, Faitrade)
- Percentage of cocoa-growing households having access to national social protection programmes (cash transfers, in-kind transfers, health insurance – CMU, RSTI)
- Percentage of cocoa farmers improving their occupational safety and health conditions at work

Red flags suggested for further discussion and dedicated action plans

- How to reach children most at risk, for example a) in communities not yet reached by sustainability programmes or monitoring systems; b) in the most marginalized cocoa-growing households with smallest land areas or in single parent households; c) in communities with longest distances to school
- How to provide extra support to farmers not otherwise having a chance to earn a living income
- How to reach farmers not organised in a cooperative, generally more vulnerable to be paid less for their produce and having less access to sustainability programmes

Besides banks, trading companies and relevant key stakeholders such as Ivorian authorities, farmer organisations (including representatives of women and youth), civil society organisations, UN bodies and the Ivorian Banking Sector Association (APBEF) may play important roles in the dissemination of improved due diligence processes and practices by banks to engage borrowers to increase efforts in the elimination of child labour. APBEF is carrying out similar work on other compliance issues[11], and would therefore be a natural forum to gather the local banking sector also on the issue

[8] *The Work: No Child's Business Alliance* is run by the Save the Children Netherlands, UNICEF Netherlands and the Stop Child Labour Coalition. Hivos is the lead organization and hosts the programme management unit. The programme is supported by the Netherlands Ministry of Foreign Affairs. https://wncb.org/who-we-are/

[9] The Dutch Association of Investors for Sustainable Development

[10] https://wncb.org/child-labour-an-underexposed-topic-for-the-dutch-financial-sector/

[11] Interview with APBEF, 22 November, 2021.

of child labour in cocoa. Banking associations in countries in which banks are head-quartered (if not in Côte d'Ivoire) may also be involved. Moreover, in all areas above there are many activities, initiatives and databases that banks can draw from to monitor progress on the suggested KPIs above. One such example is private and public sector child labour monitoring and remediation systems, such as the Ivorian government led child labour monitoring system SOSTECI.

▶ Informant views on current due diligence practices by banks

In informant interviews with international cocoa trading companies, they confirm that they are being asked social and environmentally related questions from banks financing their cocoa sourcing transactions. However, one trader pointed out that such questions are posed in the beginning of a relationship between the trader and a bank, but are not integrated into ongoing due diligence checks and conversations. Another trader noted that they get more ESG questions from banks, but also that they have lots of data to provide responses. According to the trader, most of the questions evolve around policy commitments and how often the trader itself monitors its supply chain and visits farms. The trader welcomes banks going beyond asking questions and also becoming involved in risk sharing finance of farm-level sustainability initiatives.[12]

In interviews with UNICEF and the IDH Farmfit Fund,[13] both organisations point to the need for banks to consider how best they can support the creation of an enabling environment to address the root causes and eliminate child labour in cocoa.[14] According to IDH Farmfit Fund, it comes down to, in general, low income-levels of farmers as a root cause behind child labour.

Recommendation 2: Banks can issue loans to cocoa traders with social criteria to incentivize increased efforts to eliminate child labour

As banks financing cocoa purchasing are expected to use their leverage to mitigate adverse human rights conditions to the greatest extent possible, it is reasonable to conclude that "only" engaging trading companies to take the remedial actions is not enough. This section and the next suggest that banks themselves can take an active role in addressing the root causes of child labour in the cocoa supply chain.

Social bonds and social loans are on the rise in recent years, with an eight-fold increase in 2020 compared to year before. Guiding principles for such loans were also issued in April 2021 by the three loan market associations in Asia (APLMA), Europe (LMA) and the US (LSTA), which together issued the Social Loan Principles (SLP). As noted in the principles '*The social loan market aims to facilitate and support economic activity which mitigates social issues and challenges, and/or achieves positive social outcomes.*' Included in the framework are also indicative categories of eligibility for social projects being funded by social loans. Food security and sustainable food systems are particularly mentioned and, in relation to those, resilient agricultural practices and improved productivity of small-scale producers. The framework also has examples of target populations and particularly mentions people living below the poverty line and vulnerable youth.[15] In terms of scope, this would fit well with loans not only financing cocoa transactions, but that also aims to improve livelihoods for cocoa-growing farmers, households and their children. One could imagine loans with such dual purposes where cocoa traders get favourable interest rates for both cocoa purchasing, but also to scale-up programmes to improve farmer livelihoods. KPIs to measure progress and determine the interest rate and other loan conditions could draw from the same set of emerging KPIs drafted in the section above, or an agreed percentage of what would otherwise be paid in interest rates by the trader to the bank

[12] Interview with Barry Callebaut, 11 November, 2021; interview with Cargill 19 November, 2021.

[13] IDH (the Sustainable Trade Initiative) works with businesses, financiers, governments and civil society in the area of sustainable trade in global value chains.

[14] Interview with IDH Farmfit Fund, 15 November, 2021; interview with UNICEF, 4 November, 2021.

[15] https://www.lma.eu.com/application/files/1816/1829/9975/Social_Loan_Principles.pdf

in a cocoa-sourcing loans could be earmarked for programmes to improve farmer livelihoods. In terms of monitoring and evaluation, this would also be aligned with the SLP framework where the use of qualitative performance indicators and, where feasible, quantitative performance measures are recommended, as is the monitoring and regular reporting of achieved impacts. As broader sustainability-linked loans already have been agreed between cocoa trading companies and some banks, there seems to be opportunities to build on such relationships by including social loan arrangements.

It should be underlined that setting aside part of the bank's income from interest rates would align its practices with the case brought to the OECD National Contact Point in Australia, where a bank agreed to pay its profit from a loan to a sugar company to communities adversely impacted by the sugar company's actions (where the bank's loan was an enabler of the company's actions). It should be noted that this is not charity by the bank, but a way to participate in the remediation of a harm that the bank has enabled. In other words, the motivation behind channelling the profit to the communities is to align the bank's practices with international human rights norms (i.e. the UNGPs and the OECD Guidelines for Multinational Enterprises).

Recommendation 3: Banks can participate directly in financing of farmer livelihood initiatives in cocoa-growing communities

Besides providing loans with dual purposes of funding cocoa transactions and farmer livelihood programmes, banks may also assist by financing farmer livelihood programmes directly and/or financing smallholders through microfinance solutions. This is another way in which banks can participate in the mitigation of child labour in cocoa.

According to IDH, there is a global funding gap of around USD 170 billion to carry out investments and initiatives needed to support smallholder farmers. This funding gap also applies for cocoa. In interviews with cocoa trading companies, risk-sharing models with participation from commercial banks are seen as attractive and needed.[16] However, several challenges were identified:

- A (perceived) high risk by financial institutions in lending to smallholder farmers. Generally, substantial collateral is therefore required, which in practice are often not available or are not well documented by smallholders.
- Also, the loans may need to be for long terms as farmers want to make investments that are likely to take several years before resulting in increased yields and profits.
- On top of that, agricultural commodities generally experience price volatilities making the farmers' ability to repay uncertain.
- For international banks, there are also a barrier to lend in local currencies, at least if not represented by a local branch in the country in question.[17]

All of this results in poor access to finance and high interest rates. To overcome the barriers, or perceived high risks in smallholder finance and enable a lending proposition at lower interest rates, the IDH FarmFit Fund and the IFC-SIB examples discussed in the study aim to tackle this through multi-stakeholder de-risking models. They have so far attracted some financial actors, but are in need for more financiers. Exploring these types of opportunities is an action recommended for banks.

It should be noted that there are initiatives trying to overcome the lack of financial records by smallholders, to overcome the perception by banks that this a high-risk client segment. An example of a company working on this topic is BanQu. Using block chain technology, BanQu has set up a system to track financial records of smallholders, supporting them in getting access to a regular bank account.[18] This and other similar initiatives also use mobile phones as the main platform for financial transactions. Another example is Advans Côte d'Ivoire, which has developed a project with mobile operator MTN and cocoa traders Cargill, Barry Callebaut and CEMOI to pay producers by mobile money via savings accounts.[19]

[16] Interview with Barry Callebaut, 11 November 2021; interview with Cargill 19 November, 2021.

[17] Interview with IDH's FarmFit Fund 15 November, 2021; Interview with the Dutch Ministry of Foreign Affairs, 22 November, 2021.; Rural 21, 30 June, 2021. https://www.rural21.com/english/news/detail/article/financing-agriculture-in-west-africa-challenges-and-paradigm-shift.html?no_cache=1

[18] https://banqu.co/

[19] https://www.cgap.org/sites/default/files/publications/slidedeck/digitalfinancialservicesforcocoafarmerscotedivoire2-160804224654.pdf

To further overcome barriers of international banks lending in local currencies, more players, such as the local Central Bank and/or collaborations with local branches of other banks are likely needed.

There is also an opportunity to review and build on already existing examples of banks participating in smallholder finance. Rabo International Advisory Services, a subsidiary of Rabobank, helps to establish and professionalize cooperatives, for example by introducing mobile banking services. ABN AMRO's Social Impact Fund has a private equity participation in a company that has worked on the improvement of business skills of leaders in cocoa cooperatives in Côte d'Ivoire.[20]

Recommendation 4: Collaboration and joint principles in agricultural commodity trade finance

As noted in in the recommendations above, there are current practices and opportunities for further development of those in relation to trade financiers' role in the elimination of child labour and improve livelihoods in cocoa. Some financial actors have created examples for others to follow covering due diligence practices, sustainability-linked loans, and financing of farm-level initiatives. Examples of such exist beyond the cocoa supply chain. In palm oil, several financial institutions are directly involved as members in the Roundtable on Sustainable Palm Oil (RSPO).[21] Something similar would be possible in cocoa, with financial institutions joining cocoa sustainability initiatives, and/or those focused on the elimination of child labour. Importantly, financial sector actors should involve and collaborate with the Ivorian government and its already existing child labour initiatives when doing so, as well as other private sector-led programmes and projects. The need to collaborate with the government in the producing country were also explicitly highlighted by informants, such as Rabobank and the Dutch Banking Association NVB.[22]

Finally, beyond cocoa, what is seemingly missing in the agricultural commodity trade financing space are clear principles/standards and expectations for financial institutions to adhere to and use as foundation for further action and collaboration to address salient human rights issues like child labour, as well as environmental challenges. Such principles would serve as a useful platform to deepen financial sector involvement in environmental and social issues in cocoa, but also in other agricultural supply chains with similar challenges.

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[20] https://www.imvoconvenanten.nl/en/banking/about-this-agreement/-/media/1C66016FC721457EB4B90E082310AFCE.ashx

[21] https://rspo.org/members/all

[22] Interview with NVB, December 9, 2021; interview with Rabobank, December 10, 2021.

Ministry of Foreign Affairs of the Netherlands

This publication is released as part of the ILO's project "Accelerating action for the elimination of child labour in supply chains in Africa", made possible with support from the Ministry of Foreign Affairs of the Netherlands.

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