A WORLD BEYOND CERTIFICATION

A best practices guide for organic cotton trading models
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SUMMARY

Organic agriculture can be a “force for good” and is considered the gold standard mode of production, with regenerative capabilities to address soil health, stabilize climate and significantly contribute to the United Nations’ Sustainable Development Goals (SDGs). However, an open conversation about the price and trade of organic cotton is urgently needed and this report offers a starting point, which leads to tangible recommendations for progressing more responsible pricing and trade.

Overall when considering organic cotton, there is the expectation that the market would be willing to pay a differential for the added value of organic agriculture. Unfortunately, because of the way commodity markets operate, this is not working, and organic cotton is failing to be the market driven solution it was intended to be. There are a number of serious issues and challenges that must be addressed in this industry, and the conventional pricing and trading models that still dominate the organic market are increasingly seen as not “fit for purpose”.

Of utmost concern, is the lack of transparency across the supply chain. The general accepted practice of anonymous trade can create a disconnect between buyers and sellers and can allow participants to pursue their economic rationality with little awareness of the personal or moral consequences of their choice. The lack of transparency as to what the farmer gets paid creates opacity as to the cost of production. Furthermore, when commodity prices are driven down, the market is rewarding and incentivizing practices that can keep people in poverty and compromises the environment.

Various ways to address these issues, and for organic cotton to deliver on its promise as a “force for good”, is key that price and trade need a serious rethink.

In relation to organic cotton, brands, manufacturers and farmers all have very clear requirements from the market and from each other. One of the paths to developing a more responsible and ethical trade is to add a requirement – improving the procurement approach to ensure transparency and fair distribution of profits along the supply chain. Brands need to make sure that they are creating a market-driven solution when they choose and procure organic cotton. Trading responsibly and paying a fair price must be part of that solution; otherwise, all efforts to improve the situation will be undone by the poverty of the people at its heart. Where Luxury is concerned, there is much to learn from the traditional luxury supply chain. In these networks, brands are confident in the craftspeople whose skills define the quality of their products, and artisans themselves are linked through craft guilds that work to certify and improve their skills. It was this belief in respecting and rewarding quality and long-held relationships that led Kering and the Textile Exchange to publish this report.

This report fundamentally acts as a “how-to “ guide highlighting best practices and proven models in the organic cotton supply chain that can be used as a basis for replication by organisations aiming to improve their organic supply chain practices. Split into two main sections, there are clear approaches and recommendations to address many of the key issues, such as reducing anonymity, working together in the supply chain as partners rather than as buyers\sellers, and ensuring that all players in the supply chain are adequately rewarded for their work.

Section 1 demonstrates that there are answers in model “supply networks,” where risk and reward are shared transparently and where organic price differentials produce much needed social and environmental benefits. The best practice trading models and alternative pricing mechanisms that are illustrated require suppliers and brands to work as a network rather than as a top-down “chain”. Responsible trade is built on trust and recognition of the interdependence within the network. In order to compliment the information outlined in this first section, and give transparency to the current market, an analysis of cotton pricing in various geographies follows in Section 2.

Five years of data from the top five organic cotton producing countries is provided, proving that the market is not always supporting organic cotton farmers financially. And a comparative look at price in India shows that, while there is a considerable (± 20 percent) price differential at FOB (free on board), in general the farmers are not the ones enjoying it.

Kering and the Textile Exchange hope that this guide will serve as a blueprint for those organisations aiming to make significant and positive changes to their current and future organic cotton supply chain model. By revitalising their own supply chains, businesses can actively participate in improving the organic cotton market, so that it delivers value to all involved in the supply chain and ensures sustainable agricultural practices for the future.
Your company wants to convert its cotton use to organic. You reach out to suppliers only to discover that organic is either not available to the specification you want, or you are quoted a large price differential (premium). You are not sure if it is worth the extra hassle and expense and are unclear where the extra money goes. Does this scenario sound familiar to you?

**THIS GUIDE IS FOR YOU IF:**

- You are planning to go organic and want to know more about how to structure your supply chain.
- You want to be part of a movement to transform the way supply chains work, including the way raw materials are priced and traded.
- You recognize that price squeezing in supply chains can keep people poor and needs addressing.
- You believe the market should reward and incentivize regenerative organic farming communities.

**AN OPEN CONVERSATION ABOUT THE PRICING AND TRADE OF ORGANIC COTTON IS URGENTLY NEEDED.**

Throughout history, trading systems have been characterized by the anonymity of participants, encouraging fluidity in relationships and the freedom to move from one supplier to another in the search for the “best deal”. Anonymity allows the disconnection, which, in turn, can enable participants to pursue their economic rationality without concern for the personal or moral consequences of their choice.

By convention, cotton is a commodity crop, traded on the open market with a disconnect between the farm and the factory, and little concern for where it comes from. Cotton production and trade are a long way away from most brands’ core business activities and feel impossible to influence. However, as Kering’s Environmental Profit and Loss reporting reveals, it is in raw material production that some of the biggest environmental and social risks to the textile industry occur, and it is increasingly important for brands to know what these risks are and how they can be influenced.

**PROSPERITY FOR FARMERS IS FUNDAMENTAL TO SUSTAINABLE DEVELOPMENT.**

Almost 80 percent of the world’s extreme poor live in rural areas where most are dependent on agriculture. Alongside food grains and soya beans, cotton is one of the most important cash crops in terms of land use, accounting for 2.5 percent of arable land. There are around 100 million cotton farmers globally, and over 90 percent of them are small landholders in developing countries. Farmers are on the sharp end of climate change, water scarcity, and loss of biodiversity. Commodity market prices are volatile and not an adequate reflection of the costs and benefits to society and nature. Cotton prices – taking inflation into account – have fallen on the commodity market by 45 percent, from more than $3.00/kg in the 1960s to $1.73 in 2014.

One solution to mitigate risk and contribute positively to the cotton industry has been to opt for certified organic cotton. The benefits of organic agriculture to the environment and human health, such as the elimination of hazardous persistent pesticides, are clear and undisputed. In addition, the principles of “fairness and care” are integral to organic and benefits such as food security, gender opportunities, and community development are often associated with organic cotton programs.

Brands and consumers must be sure that they are creating a market-driven solution to sustainability issues when they choose organic cotton. Paying a fair price is part of that solution; otherwise all our efforts to improve the situation will be undone by the poverty of the people at its heart.

However, if organic is harder to source or if there is concern about quality (real or perceived), or product integrity, or if pricing is opaque, then organic can become a risky choice for a brand, instead of a sustainable one. It is time to address the root causes of these risks.
Organic cotton trading models – A “how to” guide

“This report shows the benefits of exchanging anonymity for closer relationships where everybody benefits.

Our examples of responsible trade have parallels with traditional luxury supply chains – the artisan networks that ensure quality and security of supply. In these networks, the high-end brands are confident in the craftspeople whose skills define the quality of their products, and the artisans themselves are linked in craft guilds that work to certify and improve skills. There is much we can learn about sustainability from this tradition.

The intention behind the pricing of organic has always been for there to be a market-driven solution.

The expectation was that the market would be willing to pay a differential for the added value of organic agriculture. This might have worked for some, some of the time, and continues to work for those in secure, long-term partnerships, but, in general, the mainstream it is not working. Therefore, organic cotton is failing to be the market-driven solution it was intended to be. When commodity prices are driven down, the market is rewarding and incentivizing practices that can keep people in poverty and compromise the environment.

Sadly, when pricing and trade are not benefitting farmers, the “good” of organic cotton unravels for all.

We hear reports of price squeezing, uncertainty of demand, and delays in pick-up and payment to farmers. There is also a lack of transparency of what the farmer gets paid, which creates opacity as to the cost of the fiber. In these situations, integrity can be compromised, as suppliers cannot meet lower prices without compromising somewhere else. This can potentially lead to “cheating” or fraud through the supply chain, as corners are cut in order to lower costs11 or to “side-selling” where trade takes place on the spot market, resulting in organically grown cotton ending up in conventional processing streams.

So, on the one hand organic agriculture is a force for good - the “gold standard” mode of production - with regenerative capabilities to address soil health, stabilize climate12, and significantly contribute to the SDGs13. On the other hand we have a pricing and trading model that is increasingly seen as not fit for purpose.

EMERGING FRAMEWORKS FOR BEST PRACTICES

WHICH TRADING MODEL AND PRICING MECHANISM IS RIGHT FOR YOU?

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<td>Joint venture between companies with a common goal to leverage business benefits for all</td>
<td>Supporting long term business sustainability and stability within supply networks and regions</td>
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Conclusions

- As demonstrated throughout this report, new business models, based on innovative trading mechanisms and pricing policies, are emerging.
- The entrenched model of commodity pricing, and supply chains built on individual gain, will not deliver a sustainable product.
- The challenges and opportunities presented here are not unique to organic cotton but are relevant for all business where sustainability attributes are valued.
- Getting trade and price right for commodities will be critical to meeting the Sustainable Development Goals.

Evidence shows that we cannot wait for the market to correct itself and to adequately value sustainability. We must take the necessary steps ourselves, which include:

1. **Increase awareness and broaden participation in this discussion.**
   Further consultation and wider stakeholder input is needed and this report aims to catalyze that process.

2. **As an industry initiate actions identified at the Organic Cotton Round Table in Hamburg:**
   - Coordinate the development of regional sourcing hubs and round tables.
   - Create a Fair Financing platform.
   - Take organic cotton “beyond certification.”

3. **Start asking questions and taking practical steps.**
   There will be multiple answers to these questions, and one size will not fit all.

Next steps

THIS REPORT HAS IDENTIFIED THE FIRST GREEN SHOOTS OF THE NEW WAYS OF WORKING THAT COULD TRANSFORM THE COTTON SECTOR AND THE LIVES OF THOSE WHO WORK WITHIN IT.
SECTION I

Identifying organic cotton trading models with promise
### PART A: EVERYBODY NEEDS SOMETHING

#### What brands want

1. **SUPPLY SECURITY**
   Access to a reliable, limitless supply of organic cotton year-after-year. Organic farmers need security to meet a brand’s need for supply security. Ideally, a brand should signal demand to suppliers before the sowing season commences, which may be up to 14 months ahead. This information, along with the reliability of uptake and mutually agreed trading terms and conditions, will go a long way towards building business security for all.

2. **CONSISTENT QUALITY AND PRICING**
   Securing organic cotton in the right quality and at the right price. Suppliers may be resistant to source organic. There may be preconceived doubts about the quality of organic cotton, so any ‘prejudice’ or reluctance to change from conventional to organic must be overcome. Concerns also arise from a lack of transparency or understanding of how organic is priced.

3. **PRODUCT INTEGRITY**
   Authentic organic cotton, free of genetically modified organisms (GMOs). Getting hold of GMO-free seed, alongside other pressures, has led to a higher risk situation for brands operating in countries where GMO cotton is the norm. Ensuring the entire supply chain is using a Chain of Custody standard (OCS or GOTS) is the first step. However, there is no quick fix, so working together with suppliers is going to be critical in addressing root causes of contamination and/or non-compliance.

4. **ASSURANCE THAT FARMERS ARE BENEFITING**
   A guarantee that farmers are benefiting from an investment in organic. Trade agreements need to identify the price differential on the fiber. Tools and technology that enable mapping and transparency are rapidly improving and opening up capabilities to track organic differentials back to farm.

5. **RELIABLE INFORMATION AND DATA**
   Access to sound, well-vetted sustainability impact assessment data. The business case for organic cotton needs to be clear. Reliable impact data is important for basing decisions and justifying choices. Investment is needed in frameworks and systems for collecting and reporting on impact data.

#### What manufacturers want

1. **COMMITTED CUSTOMERS**
   Business security allows companies to signal demand to suppliers and back to farms. For manufacturers, having commitment from the brand is critical. Ideally, your customers’ demand can be signaled to you and passed on to farmers before the sowing season commences.

2. **VALUE SHARING**
   A price that covers the cost of doing the right thing so everyone benefits. Each actor along the way needs to incorporate the cost of being certified, in addition to other costs, into their pricing. More transparency may be needed within your supply network to insure the organic differential is reaching the right places.

3. **RISK SHARING**
   More balanced sharing of risk and reward to relieve pressure on the most vulnerable. Farmers and suppliers often carry most of the risk in the marketplace. When brands blow hot and cold on organic, or pick and choose suppliers, especially if based on lowest cost, this puts even more stress on the most vulnerable in the chain.

4. **ASSURANCE OF PRODUCT INTEGRITY**
   Being able to procure authentic organic product and sell it on with integrity intact. Dealing with GMO contamination, as well as unintentional or intentional mixing of organic and conventional cotton is a complex problem. Working together is critical to addressing root causes of contamination and integrity challenges. Developing closer and longer-term trade relations should lead to more trust between suppliers and customers. The use of third party Chain of Custody standards builds assurance and confidence in organic content claims.

5. **CLEAR TARGETS FOR SUSTAINABILITY**
   Achievable targets for price, delivery, and sustainability. Manufacturers need clear messages. Being asked to ensure sustainability and integrity whilst at the same time being asked to meet unrealistic delivery times and price points is unfair and not achievable over the longer term. It’s (potentially) a disaster waiting to happen.
What farmers want

1 COMMITTED BUYERS
Receiving timely demand signals from buyers. Demand signals help farmers with strategic planning, volumes, and generally managing risk and opportunity. If farmers are dealing directly within a supply network, there is more likelihood of commitment to purchase and timeliness of payments.

2 A FAIR PRICE
Farmers want a price that grows their business and delivers on the organic promise. Purchasing agreements, favorable pricing mechanisms, and forward contracting can enable farmers to plan scales of production confidently. A timely payment helps manage risk and support stability on the ground.

3 AFFORDABLE FINANCE
Trade agreements that incorporate input costs or provide cash flow. Upfront costs on the onset of planting include seed, biological inputs, training, etc. Access to credit can be tough for farmers with few assets, and interest rates can be high, potentially triggering a debt spiral. Support with pre-financing or affordable working capital can make a huge difference to balancing the books.

4 PROTECTION AGAINST AN UNPREDICTABLE MARKET
Agreeing to a price that protects against commodity price volatility. At the start of the chain, farmers are “price takers.” The price for organic cotton is based on the fluctuating conventional price, which is a major problem in price discussions. Decoupling from the conventional market is tough but not impossible and, over time, may result in more efficient and cost-effective trade for farmers and customers alike.

5 TRADE NOT AID
Leveraging the market as a force for good. Internalizing environmental and social costs and benefits and incorporating the full cost of sustainability in the price of cotton is a challenge. However, by teaming up with responsible partners, organic farmers can make a difference and contribute to reaching the global SDGs.

A FULL COST APPROACH AT THE FARM

To maintain sustainability within the organic cotton farm system, prices need to reflect:

THE COST OF PRODUCTION
Costs of production need to be met by the price at the farm gate in order for farmers to persist with value-addition agriculture such as organic. Without a fair return, any investment in converting to organic (such as farmer training, developing rotation systems, and book-keeping for certification) will be considered too risky. Costs of production include producing natural inputs, ensuring soil fertility, optimizing the use of water, and improving biodiversity.

THE COST OF LIVING
It is essential that farmers can cover food, education, health and shelter through the income they generate. Sustainable development includes maintaining healthy, happy people and ensuring that the next generation of farmers are well equipped to farm for the future.

THE COST OF DEVELOPING AND MAINTAINING A HEALTHY RURAL ECONOMY
Pricing must ensure that organic cotton farming remains economically attractive to rural communities. Loss of labor and farm concentration puts strain on rural communities and economies. The “best and brightest” need to be attracted to remain in rural occupations, rather than migrate to towns and cities. Surplus wealth is necessary for developing or maintaining the rural economy. Any extra wealth generated will also pay off for the investor, since it will, in turn, be invested in improving product quality and productivity.

THE COST OF ECOLOGICAL SUSTAINABILITY AND LANDSCAPE
The ecological sustainability, biodiversity (including indigenous species), and rural landscape (e.g. woods, lakes, rivers) are vital to healthy rural economies and also to urban populations who value diverse landscapes. The intrinsic value of natural capital needs to be recognized and conserved for future generations.
A word on quality

Much progress has been made over the years, however, when it comes to quality, buyers of organic cotton are still faced with challenges. Some challenges are related to scale; less availability results in lower production efficiencies and higher costs. Others are related to a less mature market and the need for more investment to bring market success to the next level.

Whether we are talking about harvested seed cotton, ginned cotton (lint), spun yarn, fabric or finished goods, the quality of an organic product should be comparable to conventional. Remember to keep in mind that different cottons display different traits and different “qualities”. For instance, Pima cotton is a finer, longer staple cotton and Upland is a shorter, multi-purpose fiber. Both have qualities suitable for different purposes.

Product quality issues in organic are more likely to be related to the factors listed below, rather than to its being organic: nevertheless, they are often cited as “a problem with organic” rather than a problem that happens to coincide with organic. We must be careful to distinguish between cause and effect.

1 AVAILABILITY
The quality of conventional and organic cotton will range from excellent to very poor. However, because there is so much more conventional cotton than organic, the effect on organic is more pronounced. Organic cotton is still less than 1 percent of the world’s cotton supply. This means that every organic cotton plant counts and, because volumes are small, it will be more difficult to build up a reliable and consistent source of quality fiber. This, in turn, can impact yarn consistency and availability. It is a problem of scale, not a problem “caused” by organic.

2 MATCHING ORGANIC FIBER TO PRODUCT SPECIFICATIONS
Not all fibers are born equal when it comes to staple length, color, strength, and so on. Different cottons meet different needs. The challenge of availability, in general, has a deeper impact for some products over others. For example, the luxury market will require longer staple, finer cotton for “luxury-quality” products and, just like conventional, this will require seeking out specific varieties and suppliers.

3 REGION AND GEOGRAPHY
Organic cotton is grown in the same regions as conventional cotton. It suffers from the same challenges – and opportunities - as conventional. For instance, long staple Pima organic cotton associated with parts of China, Turkey, Peru and Egypt has the same qualities whether it is organic or conventional. However, in other parts of the cotton growing world, where cotton seed may be older and of poorer quality, rainfall unreliable, and soils thinner, the cotton crop (both conventional and organic) will suffer from the same challenges, and this may result in problems with quality and yield.

4 TECHNOLOGY AND LOGISTICS
Another challenge in the production of quality cotton products, whether ginned fiber, spun yarn, knitted or woven fabric, etc., is the state of the machines and infrastructure available. Where machines are well maintained (or replaced with more modern and more effective technology), and where energy supply is constant, the chances of a higher quality processed product are naturally higher.

A WORD ON MANUAL PICKING – most of the world’s cotton in developing countries, whether conventional or organic, is picked by hand. There are many advantages to hand picking (such as reduced soil compaction and reduced use of defoliant chemicals) but it can be a source of contamination, with dirt, stones, human hair, plastic and other “trash” or physical debris mixing with the harvest. This can be remedied with training in good practices, cleanliness and the use of natural cotton bags for picking.

5 KNOW-HOW AND EXPERIENCE
Other challenges for the organic sector may relate to the extent of knowledge and experience held by suppliers. Preparation of samples, appropriate fiber quality testing and classification are all vital to the successful trade of organic cotton, as they are with conventional. Since organic is less likely to go through conventional commodity exchanges, there is a higher likelihood that the people involved will have less commercial know-how. On the other hand, they need to have marketing skills beyond their conventional peers since they need to manage the sample preparations and negotiations in ways that their conventional counterparts do not. Sometimes the challenges lies in “connecting the dots” within a supply chain, especially when a new supplier (of organic) is introduced to a well-established conventional supply chain.

6 INTEGRITY
Finally, integrity of product is always on the radar, whether it is a product sold as 100% organic cotton (but has actually been blended with conventional cotton or polyester) or mixed-origin cotton being sold as Egyptian. Authenticity and integrity can be compromised in conventional as well as organic. It is so important that supply networks work together, that trust is built, and solutions found.
As societal demand increases, natural resources become more scarce. At the same time, technology improves and more companies are looking deeper into their supply chains and are beginning to trace their products back to source. Questions that were once too difficult to ask are beginning to surface, such as “do the farmers get a fair price for the organic cotton they are producing”? Topics such as the development of long-term, integrated supply networks, which build and operate on trust and allow all partners in the network to prosper, are beginning to challenge the simplistic belief that the market will – with an invisible hand – take care of business. They also strengthen the belief that managing interdependence ethically within supply networks is the way forward.

We believe there are three common themes that are important:
1. Moving away from anonymity to relationships and reward.
2. Adapting to more integrated supply networks.

These are common themes across the models that will be explored in this section.

WE ARE MOVING FROM ANONYMOUS TRANSACTIONS TO TRANSFORMATIONAL RELATIONSHIPS BUT THE TRANSITION WILL NOT BE DICTATED BY ONE MODEL.

The conversation at the Organic Cotton Round Table (OCRT) continues to deepen as topics such as buying clubs, open book costing and fair financing are not only put on the table but are evolving into pilots, trials and new collaborative ways of working.

One thing is for certain; there will not be a “one size fits all” solution. Differently sized and shaped companies will find a natural fit with some of the ideas but not others. All models contain some form of pre-competitive collaboration and increased transparency.

“Spotlights” have been provided in this report to show real life examples of where new models are being explored. These include the Chetna Coalition and OrganiMark’s work in South Africa. All models put forward in this report have the potential to expand and/or replicate, and the choice of which model is right for a particular brand or organization is for each to decide. The organizations included in the following “spotlights” and case studies have been interviewed by TE for this report.

The hope is that, by sharing ideas and pilots, iteration will take place as people test, innovate and invest in different solutions. The OCRT will be a good repository for sharing experiences and best practices.

RESPONSIBLE TRADE THROUGH INTEGRATED SUPPLY NETWORKS

In each scenario, best practice tends to involve increased integration, transparency, and commitment upstream and downstream to achieve better risk and opportunity management, more innovation and greater efficiencies. Integrated supply networks allow all partners to develop closer and longer-term business relationships, including the producer group. Ultimately, the benefits help everyone to “get what they want” (think back to Section A: Everybody Needs Something).

Benefits include:
- Improved security of supply for the long term.
- Improved integrity, loyalty and reputation.
- Shared responsibility, risk, opportunity and reward.
- A predetermined price for farmers, which factors in organic differentials and helps all parties plan and calculate costs.
- Closer understanding of each other’s needs, which helps everyone identify and manage risks earlier.
- Demand signals, agreements and contractual terms and conditions made at an earlier stage in the cotton cycle.
- Transparency back to farm and confirmation of farmer differentials paid.
- A confidence that investment in organic cotton is resulting in real and meaningful change on the ground.
- A market-driven solution that is based on trade not aid.

THIS IS RADICALLY DIFFERENT FROM SUSTAINING CONVENTIONAL SUPPLY CHAINS AND WILL TAKE TIME AND EFFORT TO REACH CRITICAL MASS.

Over the next few pages, we will look at a number of different trading models and initiatives that appear to offer many of the benefits listed above and generally contribute to the overall goal of building an integrated supply network. The positive attributes of many of these models do not exist in isolation, and there will be common traits between them. Our job ahead is to work as a community to identify the best traits and most workable solutions and to get started!
Essential components of a responsible organic cotton supply network

A responsible organic cotton supply network shares risk and reward through the production system, taking into account the costs and benefits, particularly for the farmers who are the most vulnerable/least visible.

Costs include: Start-up costs, in-conversion to organic ("transitional cotton"), approved seed, biological inputs, administration book keeping (ICS), certification and inspections, additional labor (manual applications), product storage, segregation and machine cleaning, finance/pre-financing, R&D investment.

Benefits include: Group ICS and certification, aggregated (larger) volumes, centralization or sharing of resources and inputs (seed, machinery, transportation, logistics, warehousing, extension services), bargaining power and negotiation, seed breeding, R&D outcomes, Fair Trade certification (depending on country).
Model I: Direct sourcing

NEGOTIATION AND AGREEMENT BETWEEN BRAND AND SUPPLIER TO INCREASE TRANSPARENCY AND SECURE PRICE AND TERMS OF TRADE

(a) Spinner-Centric Model

OBJECTIVE
The objective of this model is for the brand to have greater control of business decisions and negotiations closer to raw material production. By working with nominated spinners to set prices and other aspects of fiber requirements, such as volume and quality, in the early stages of production, brands can influence the remaining processing stages up to final garment. Importantly, the brand can also work with the spinner to support sustainability measures and price transparency back to the farm.

OVERVIEW
In the spinner-centric model, the brand works directly with the spinner. The brand can nominate the producer groups (PGs) and the gins from which the spinner must buy the cotton. Alternatively, if the brand does not want to go right back to farm level, they can request their nominated buyer or the spinner to source the organic cotton. It can be the spinner, ginner, or the PG that holds the ICS (Internal Control System). The spinner may also provide additional support to the PG, or be involved in pre-financing. These services should be costed and included in the model. The brand should actively engage in the fiber pricing, or at least check that the price paid to the farmer is fair. The brand should also check, or ask for, GMO test reports.

EXAMPLE
Integrated textile manufacturer, Armstrong Knitting Mills, in India works directly with organic Fair Trade cotton farmers and a number of end customers.

HOW IT WORKS
- The brand identifies a suitable spinning mill partner, in line with the company sourcing strategy and country of operation.
- The brand agrees to a Memorandum of Understanding (MOU) with the spinner based on quality, delivery, spinning cost, yarn price, and an open book policy on fiber price. A system for sharing fiber pricing information should also be agreed to with the spinner.
- The brand’s buying team, or nominated buyer, works with the retail team and fixes the quantity of yarn as forecasted by last year’s sales data and according to the season (Autumn-Winter or Spring-Summer).
- The brand and spinner set the yarn price and spinning cost for 3-6 months.
- The delivery time will be agreed. Payment is made once the yarn (which the brand now owns) is shipped from the spinner, and the brand supplies the yarn through the rest of the processing steps.
- Yarn may need to be stored at the spinning mill, brand warehouse (if it has one), or directly delivered to the production factory to continue processing.
- OCS or GOTS Scope Certificates (SC) and Transaction Certificates (TC) from fiber to yarn can be requested and held by the brand.
- Further supply chain activities and processing are monitored by the brand’s production office. Note: the spinner may be independent or vertically integrated.

<table>
<thead>
<tr>
<th>SPINNER-CENTRIC MODEL - ADVANTAGES &amp; DISADVANTAGES</th>
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<tbody>
<tr>
<td><strong>ADVANTAGES</strong></td>
</tr>
<tr>
<td>• Security in supply/demand</td>
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<tr>
<td>• Control of supply process back to yarn</td>
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<tr>
<td>• Agreed price and quality of yarn</td>
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<td>• Chain of Custody records from spinner</td>
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<td>(potentially back to fiber)</td>
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<tr>
<th>DIRECT SOURCING (SPINNER CENTRIC) - MODEL ATTRIBUTES</th>
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<td>Securing supply</td>
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<td>Early demand signaling</td>
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<tr>
<td>Agreement brand - spinner</td>
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<tr>
<td>Guaranteed uptake</td>
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<tr>
<td>Quality control management</td>
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<tr>
<td>Open book costing</td>
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<tr>
<td>Pricing mechanism in place</td>
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<tr>
<td>Farm capacity building/input credits</td>
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</tbody>
</table>
(b) Producer-Centric Model

OBJECTIVE
The objective of this model is for the brand to have more control over business decisions and negotiations right at the beginning of production. By working with nominated fiber producers, ginners or non-governmental organizations (NGOs) to set prices alongside other aspects of fiber requirements, such as volume and quality, the brand has more control over the early stages of production, as well as the ability to influence the remaining textile processing stages up to final garment than in the existing model. Importantly, brands have the opportunity to partner with producers on sustainability measures and to agree on prices.

OVERVIEW
In this scenario, the brand works directly with the fiber producer or “aggregator” (i.e. the ginner or the PG, sometimes supported by a local NGO), to secure and manage fiber supply. Individual farmers, or the producer group (PG), or the gin may hold the ICS. The PG may own or lease the gin and the PG marketing arm controls sales. The brand may also provide additional support to the fiber producer, or get involved in pre-financing. This model only works if the brand is prepared to buy the fiber at the time of harvest. The brand must be prepared to keep the stock for up to a year and utilize it throughout the year. Alternatively, if they have storage facilities, the producer may hold onto stock and release it as per contractual agreement. This model works best where the fiber producer has a direct relationship with the farmers (as is the case in a cooperative).

EXAMPLE
- For over ten years now, British retailer, People Tree, has partnered Indian company, Agrocel, to grow organic cotton. More recently, German retailer, Tchibo, and Appache Eco-Logic Cotton joined forces to bring a new ecological cotton collection to market.

HOW IT WORKS
- The brand decides to work directly with the fiber producer (PG or ginner). To identify a suitable supplier, the brand will consider criteria such as fiber quality, volume, and location, as well as ginner capacity and farmer numbers. A fair price will be negotiated directly with the fiber producer.

- The brand, or brand’s buying agent, agrees to an MOU with the fiber producer (or through another network partner such as the spinner or CMT facility). The MOU will be based on quality, delivery, price, ginning costs, payment terms and conditions, and percentage differential for farmer and ginner. Sometimes the buyer will pay the PG’s or ginner’s ICS and OCS or GOTS certification costs.

- The brand, or nominated agent, will assess and confirm the quantity with the fiber producer. Once the quantity fiber quality and delivery time are fixed, the price will be agreed upon based on a fair pricing mechanism. This model allows for the split differential pricing mechanism to be used, if parties agree (please see Section 2 for a detailed explanation of the split differential pricing mechanism).

- Depending upon the agreement among all parties, the brand/buying agent will buy all the fiber immediately and pass it on to the spinner, or it will keep hold of partial fiber stocks (warehoused) throughout the year. This cost is paid by the brand direct to the warehouse operator. As agreed in the MOU, a percentage of the payment will go to the farmers as the organic differential.

- OCS or GOTS Scope Certificates and Transaction Certificates from fiber can be requested and held by the brand.

- Quality control and GMO testing should be carried out at the seed cotton and/or fiber level to manage integrity proofing.

PRODUCER-CENTRIC MODEL – ADVANTAGES & DISADVANTAGES

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
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<tbody>
<tr>
<td>Security of supply/demand</td>
<td>Human resource intensive</td>
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<tr>
<td>Control of supply process back to fiber</td>
<td>Warehouse, inventory, and insurance costs</td>
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<tr>
<td>Agreed price and quality of fiber</td>
<td>Ownership and responsibility for fiber</td>
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<tr>
<td>GMO testing is carried out on seed cotton and fiber</td>
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<tr>
<td>Open costing and traceability back to farm</td>
<td></td>
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<tr>
<td>Transparency in price differential paid to farmer</td>
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<tr>
<td>Chain of Custody records back to fiber</td>
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DIRECT SOURCING (PRODUCER CENTRIC)– MODEL ATTRIBUTES

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<td>Early demand signaling</td>
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<td>Agreements with fiber producers/gin</td>
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<td>Guaranteed uptake</td>
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<td>Pricing mechanism in place</td>
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<td>Farm capacity building/input credits</td>
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<td>Farm price transparency</td>
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<td>Risk and reward sharing</td>
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<td>Pre-financing</td>
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<td>Leveraging access to financial services</td>
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<td>CSR/Community investment</td>
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<td>KPI data collection and monitoring</td>
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<td>Consumer engagement</td>
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<td>Supporting Fair Trade certification</td>
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Model II: Special Purpose Vehicles

OBJECTIVE
A joint-venture model or Special Purpose Vehicle (SPV) provides a structure to take supply partners to the next level of formal commitment and business collaboration. SPVs are designed to create options for companies to raise capital, structure debt, and manage risk in an efficient way.\(^{15}\)

OVERVIEW
SPVs are traditionally legal entities created for a special task. Establishing an SPV is a practical way to delegate a specific entity to undertake negotiations and operations. It also provides a form of security for the delegating companies, and often one of the key ambitions of an SPV is to isolate risk. The company owners in an SPV will not usually finance all project requirements themselves; instead, they will provide a proportion as equity and either borrow the remainder of the required financing from financial institutions or place debt securities in the capital market. Importantly, an SPV needs to secure long-term debt maturities to match project cash flows. The SPV must therefore demonstrate to lenders how its estimated revenue over 15–30+ years will repay the initial investment costs, and also cover the regular maintenance and operation costs of the new project.\(^{16}\)

EXAMPLE
The Cotton Sourcing Company Limited (COCSO) in India is a large SPV, created by 53 businesses to buy cotton direct from farmers and gins (cutting out middlemen) and, importantly, to issue speedy payments to suppliers through a direct credit line with the State Bank of India. COSCO has also partnered with a professional logistics company to transport the cotton, creating additional efficiencies and savings in cotton transportation costs.\(^{17}\)

HOW IT WORKS
An SPV acts as a legally distinct entity, reducing liability to the parent company, intended to finance large new stand-alone projects off the corporate balance sheet.

### SPECIAL PURPOSE VEHICLES & DISADVANTAGES

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
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</thead>
<tbody>
<tr>
<td>• Security of supply/demand</td>
<td>• Costly to set up</td>
</tr>
<tr>
<td>• Control of supply process back to fiber</td>
<td>• Involves an element of risk taking</td>
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<tr>
<td>• Agreed price and quality of fiber</td>
<td>• Requires strong business knowledge and skills</td>
</tr>
<tr>
<td>• Quality control and price transparency</td>
<td>• Warehouse, inventory, and insurance costs</td>
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<tr>
<td>• GMO testing can be carried out as part of the agreement</td>
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<tr>
<td>• Open costing and traceability back to farm</td>
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<tr>
<td>• Transparency in price differential paid to farmer</td>
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<tr>
<td>• Chain of Custody records back to fiber</td>
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<tr>
<td>• Risk management and potential incorporation of lenders/financial institutions</td>
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<tr>
<td>• Power to leverage finance</td>
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</tbody>
</table>

**Organic cotton trading models – Section I**

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15. Wikipedia, [Special-Purpose Entity](https://en.wikipedia.org/wiki/Special-Purpose_Entity)
Jens Soth, from HELVETAS, spoke during the 2015 Organic Cotton Round Table (OCRT) about how an SPV model could work, and secure finance, for well-aligned organic cotton businesses in India.

“We started out by discussing what kind of producer models there are and how they relate to the value chain. We gave two examples of farmer association-based models and one private sector-based model, which is more or less contract farming.

Based on India’s experiences, we learnt there is a new model coming up, which is even backboned a little by government funding, and this is called a Special Purpose Vehicle (SPV).

In this context, an SPV is made up of a farmer association plus somebody called an “aggregator” who is bulking the product, plus somebody from the textile chain, lets say a gin or a spinning mill. Together, they form a new joint business entity – this actually enforces the collaboration between these entities within the supply chain rather than - lets say - the old school economic model where all the supply chain partners are not partners but fighting against each other.

So these new SPVs can be joint entities that banks could invest in, or give loans based on collaboration where the risk of failure is lower.”

- Jens Soth, HELVETAS Swiss Intercooperation, during the Eat and Greet discussion table at the OCRT 2015 in Mumbai.

Model III: Cluster Partnerships

PUBLIC AND PRIVATE SECTOR COLLABORATION TO SUPPORT LONG-TERM BUSINESS SUSTAINABILITY AND STABILITY WITHIN SUPPLY NETWORKS

OBJECTIVE
Cluster partnerships are designed to bring together entire networks of stakeholders and dedicated cluster management providers. They usually require an injection of public funding and/or commitment and investment from the private sector.

OVERVIEW
Cluster (sector or regional) partnerships are designed to bring all stakeholders together – such as farmers, manufacturers, brands, industry and trade associations, local and national governments, financial institutions – to work together in public-private partnerships on collaborative sector development. Responsible pricing and trading models are critical to the sustainability and success of the partnership and have the potential to fast-track entire regions in the mainstreaming of integrated supply networks and a decoupling from the commodity market.

EXAMPLES
The South African (SA) Sustainable Cotton Cluster; the Southeastern Anatolian (SEA) Organic Agriculture Cluster Project in Turkey.

CLUSTER PARTNERSHIPS – ADVANTAGES & DISADVANTAGES

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
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<tbody>
<tr>
<td>• Security of supply/demand</td>
<td>• Significant investment upfront</td>
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<tr>
<td>• Control of supply process back to fiber</td>
<td>• Potential for dependency on investor(s)</td>
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<tr>
<td>• Agreed price and quality of fiber</td>
<td>• Requires whole sector agreement and co-ordination</td>
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<tr>
<td>• Quality control and price transparency</td>
<td>• Considerable risk management and change management requirements</td>
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<tr>
<td>• GMO testing can be carried out as part of the agreement</td>
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<tr>
<td>• Whole sector investment/collaboration</td>
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<td>• Information sharing leveraged through technology platform</td>
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<td>• Open costing and traceability back to farm</td>
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<td>• Transparency in price differential paid to farmer</td>
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<td>• Farm level KPI collection</td>
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<tr>
<td>• Power to leverage finances</td>
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DIS/ADVANTAGE
• Requires long-term buying commitments

CLUSTER PARTNERSHIPS - MODEL ATTRIBUTES

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<tr>
<th>Securing supply</th>
<th>Farm price transparency</th>
<th>Early demand signaling</th>
<th>Risk and reward sharing</th>
<th>Agreements with spinners or ginners</th>
<th>Pre-financing</th>
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<td>Guaranteed uptake</td>
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<td>Quality control</td>
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<td>Open book costing</td>
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<td>Pricing mechanism</td>
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<td>Pricing mechanism in place</td>
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<td>Farm capacity</td>
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<td>Supporting Fair Trade certification</td>
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*Aggregator - pools seed cotton or fiber - can be a cooperative or legal entity, ginner, spinner, etc.

19. Sustainable Cotton Cluster. Why The Cluster? Note: This cluster is based on more sustainable cotton production (South Africa does not currently produce organic cotton).
The Sustainable Cotton Cluster is a program of Cotton SA. Cotton SA is made up of all role-players in the cotton industry, and operates as a non-profit company performing various essential functions, from providing information to overseeing the cotton sector strategic plan. To succeed, retailers, government and industry partners work together as a collective. The value chain focus (from farm to store) of the Sustainable Cotton Cluster makes it uniquely inclusive and comprehensive.

In 2013, OrganiMark, a privately owned supply chain engineering company, and Mr Price Group, a well-known clothing and homeware retailer in South Africa, in collaboration with Cotton SA, the Department of Trade and Industry (dti) and various other industry leaders and organizations, founded the Sustainable Cotton Cluster. The closed chain of the Sustainable Cotton Cluster’s Integrated Supply Chain Program (ISCP) comprises a whole region with an integrated supply network, an information technology platform, and an innovative pricing mechanism based on open book production costs (revised annually) plus a sustainable (fair) margin according to risk profiles. The price is decoupled from the global cotton commodity price and fixed before the time of planting. Through this method, the price has remained stable for over four years.

BUSINESS BENEFITS

For the Mr Price Group, the partnership with the Cluster has already resulted in:

- Cotton price stability
- Improved margin opportunities through waste elimination
- Visibility of, and data from, procurement sources
- Product differentiation to customers

The approach is to ensure that better quality is delivered at the same price to the customer. The ISCP has already delivered around five million garments and towels, designed and manufactured with local cotton content. This was possible through supply organization that reduced unnecessary waste and inefficiencies. Value is unlocked and everyone wins, from the farmer to the consumer.

The program has witnessed a significant increase in hope and collective commitment among cotton producers and industry players. This is resulting in bold targets being set to grow the industry. This collective has the potential to be one of the most important industry initiatives for the region since the demise of the SA cotton industry after the 1980s.


Model IV: Collaborative Communities

ALLIANCES WITHIN A SUPPLY NETWORK COMMITTED TO BEST PRACTICE AND A COMMON PURPOSE

OBJECTIVE

Collaborative Communities is the terminology used here to explain the coming together of motivated (usually small to medium sized) companies to leverage sustainability through their alliance. Collaborative Communities have a shared purpose for a greater good and operate in dynamic, high-trust, shared-value environments.

OVERVIEW

Collaborative Communities tend to be loosely structured, highly adaptive, and inherently creative. There are important rules the group must obey (such as open book costing, transparency, governance) and agreements must be made for the model to function. However, by creating dynamic spaces where connections are made, ideas are cross-fertilized and collective knowledge is developed, collaborative teams generate rich opportunities for innovation. When the right people are brought together in constructive ways and with the appropriate information, they are able to create powerful visions and robust strategies for change.

Collaborative Communities encourage people to apply their talents to a group project and to become motivated by a collective mission. By marrying a sense of common purpose to a supportive structure, these organizations can mobilize knowledge, talents and expertise for a collective good. The approach fosters not only innovation and agility, but also efficiency, scalability, and replication.

Success requires four new organizational characteristics:

- Defining and building a shared purpose
- Cultivating an ethic of contribution
- Developing processes that enable working together in flexible but disciplined projects
- Creating an infrastructure in which collaboration is valued and rewarded

HOW IT WORKS

See case study over page.


EXAMPLE

Dreamed up over dinner in a rooftop restaurant after the 2013 Organic Cotton Round Table in Istanbul, the Chetna Coalition (ChetCo) has now become a great business model for the organic sector and a fine example of a Collaborative Community. The right mix of progressive and agile representatives from the farming, factory and fashion worlds came together at the right time for the right reason.

Chetna Organic, Loomstate and Pi Foundation founded ChetCo in 2013, initially involving five textile and clothing brands and three production facilities. It has since grown into a multi-stakeholder sourcing alliance involving 12 small and medium-sized clothing and textile brand members representing seven countries across North America, Asia, and the EU, five facility members (including four garment manufacturers—one fully vertical, one partially vertical—and one spinning facility), two affiliate spinning facilities, two affiliate cotton gins, and the Chetna Organic cooperative of organic-Fairtrade cotton farmers located in the Indian states of Odisha, Andhra Pradesh and Gujarat.

ChetCo is a proof of concept project for scalable frameworks that provide support and partnership with best-practice organic cotton farming communities.

The key roles of ChetCo are to:

- Align and grow the supply network
- Form commitments for long-term sourcing
- Work together on shared-value investment for the quality, traceability, transparency, and sustainability of ChetCo’s cotton fiber and farming communities.

The coalition hopes to create and replicate a best practice model for organic and organic-fairtrade (OFT) cotton fiber sourcing.

ChetCo has already proven a success. Membership has doubled and fiber uptake has increased by 320 percent since its founding. Chetna’s organic and OFT cotton sales rate has grown from 17 percent of total production for the 2013/14 (pre-ChetCo) harvest season, to more than 49 percent of total production for the 2015/16 season— with almost 100 percent uptake against commitments made.

Brands and associated facilities have already committed to 100 percent uptake of OFT cotton produced by Chetna during the 2016/17 season and are working towards ensuring timely pre-finance to Chetna for full procurement from the member farmers. Procurement capital in the form of pre-finance, collateral guarantees, and working capital loans were put in place in advance of the harvest in October.
Explaining the organic differential

There is no universally accepted definition or formalized mechanism for arriving at a fair price for organic seed cotton or fiber. The rule-of-thumb is to take a reference price (this is usually the conventional cotton price quoted in the country of origin or on the international commodity market at a set time) and add a percentage increase to cover the organic value addition, and possible compensation for a loss in yields. This differential is often called a “price premium.” It is agreed to between buyer and seller, yet heavily influenced by conventional commodity market prices.

A lack of a formalized system or calculation makes quoting organic prices difficult and can result in a lack of transparency in sales transactions. Depending upon the situation, when a brand is procuring fabric or finished goods, or even yarn or fiber, there is no guarantee that the organic differential has reached the farmer.

The price differential is supposed to cover:
- Cost of production (and any losses in yield)
- Internal Control System (ICS), certification and inspections
- Training and extension services
- Investment in farming operations
- A percentage may also go towards the collective needs of the community such as schooling, health care, and housing

Differentials on the seed cotton or fiber can range depending on factors such as: market conditions and price elasticity, product quality, country of origin and arrangements between the buyer and seller. The average price differential is somewhere between 5 and 20 percent.

Costs during manufacturing, such as factory certification, bookkeeping, chain of custody, product segregation, possibly machine cleaning and running smaller volumes, need to be part of the final costing, but it is the value-addition at the growing stage where the majority of the organic benefits are made.

The objective of the price differential is to help both parties arrive at a price that incentivises farmers. The ambition is to have the “true cost” of sustainable production reflected in the market value.

Pricing for success

Problems occur in value chains when prices to small suppliers and farmers come under pressure, especially in markets where there are situations of near monopoly or control over all or part of the value chain, with squeeze points and long distances to users and consumers. These situations can be offset by the trend towards preferred supplier arrangements to ensure stability of supply and quality, which give accepted suppliers some leverage.

Prices can be worked in various ways, including agreeing to a fixed price or flexing over a range and setting floor and ceiling prices, through Fair Trade minimums and community premiums. Cotton fiber prices can be fixed weekly or monthly and sometimes with a certain (pre-agreed) degree of variation permitted. In the “split differential” mechanism the fair price is paid directly to the farmer which results in transparency at the farm and decouples it from the manufacturing and final product price.

Contracts – Contracts are an important, if not the most important, tool to enhance producer sustainability. They set terms of trade, stabilize volumes and allow farmers some predictability on prices and what support can be expected. Contracts come in different shapes and sizes. For example, they can set a price for a portion of production, and they can cover multiple seasons to meet the requirement of stability, and they can allow prices to float for a remaining portion. This gives predictability to both parties but still allows for some speculation. Built-in price flexibility can also be set.

Open book costing – Prices become less impersonal, and more about value sharing in integrated supply networks. The raw material becomes less a commodity and more a key element of the supply network. Buyers and sellers need to be able to disclose and report on their practices to help improve

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* Organic cotton prices used to explain how the various trading models or pricing mechanisms work are either illustrative from TE or have been provided by interviewees. The data and commentary TE receives is aggregated, and common themes, trends and assumptions are made by TE.
relationships and sustainability. A culture that values openness, transparency, commitment, and information sharing, is important for arriving at fairness and reward sharing. Open book costing is one tool that can support this culture and provides a way of arriving at a fair price, as well as leading to better efficiencies. For an open book approach to succeed there has to be a relationship of trust and trustworthiness. It will not be successful if those in the system do not trust each other30.

**Price Setting Mechanism**

Price setting is based on mutually agreed contractual terms and conditions between fiber buyer and seller, which ultimately provides more income security and stability for the farmer. Price setting should take into account the market reference price (e.g. the Cotlook A Index or the Mundi) and information on commodity markets. Price trends can be communicated to farmers to show how commodity pricing works and the high volatility that is often at play. This understanding can assist in making a case for stability and for a measure of price setting in contracts31. It is also recommended that a price mechanism that shares risk to some degree with farmers to help them understand the market even while working on stability with secure contracts and prices. Prices should have an attractive “floor price” and should support sustainable production while contracting conditions should offer mutual business benefits to the buyer and seller. Potentially the goal is to decouple prices from the commodity market.

**HOW IT WORKS**

- Ideally, prices should be set at the producer group level to ensure that farmers receive a minimum price for seed cotton.

- Price should be set at a market reference price (e.g. Cotlook A Index or the Mundi) plus an organic differential.

- Terms and conditions need to be agreed and communicated to take into account fluctuating commodity prices as well as exchange rates.

**ADVANTAGES & DISADVANTAGES OF PRICE SETTING MECHANISMS**

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<tbody>
<tr>
<td>A set price and a set quantity of uptake ensures a secure income and stability for the farmer</td>
<td>Price control largely lies with the buyer</td>
</tr>
<tr>
<td>Should result in supply security and price smoothing for the buyer</td>
<td>Farmers will not be able to enjoy additional income if price of cotton goes up</td>
</tr>
<tr>
<td>Works best in a relatively stable market</td>
<td></td>
</tr>
</tbody>
</table>

31. Wageningenur, ICCO and EVD. Contract Farming Checklist
Flexible Pricing Mechanism

In the context of a free market economy, a flexible pricing mechanism can help keep organic farmers committed to an agreement even when the commodity market fluctuates in favor of the seller (the farmer) and side selling is tempting.

**HOW IT WORKS**

Elements of a flexible pricing mechanism include:

- Seller and buyer agree on an objectively verifiable reference price which is the basis to determine the purchase price from farmers. For cotton this can be the Cotlook A index.

- The price is defined on a daily basis.

- Seller and buyer agree on an organic differential based on quality, origin and certification (e.g. organic, or organic-fairtrade). This differential is added to the reference price and leads to the purchase price from farmers.

- Seller and buyer agree on setting a floor price. E.g. if the reference price (commodity price) is higher than the minimum price, the price difference and organic differential are paid. If the reference price falls under the minimum price the minimum price and organic differential are paid.

- The minimum (floor) price consists of the cost price of production and the service costs (certification, processing, export).

**ADVANTAGES & DISADVANTAGES OF FLEXIBLE PRICING MECHANISMS**

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Transparency and a floor price to the farmer and the buyer gets the required volume secured by a trusted representative</td>
<td>- Market price volatility can still upset this pricing scheme and side selling is always a risk</td>
</tr>
<tr>
<td>- Price elasticity to allow for fluctuation in the commodity market</td>
<td>- Inventory and insurance costs</td>
</tr>
<tr>
<td>- Business security for the farmer and a purchase guarantee</td>
<td>- Extra human resources to handle the logistics on the ground</td>
</tr>
<tr>
<td>- Supply security and reduced risks of non-fulfilled contracts</td>
<td>- Trust and increased farmer loyalty</td>
</tr>
</tbody>
</table>

*FIGURE 5: FLEXIBLE PRICING MECHANISM*
Split Differential Pricing Mechanism

An interesting mechanism that allows more transparency of the organic differential reaching the farmer is the “split organic differential” (or “split premium”) model. Advantages include the decoupling of the organic differential from the value addition through the processing to final product. The brand must be willing to control the buying of the ginned fiber (or seed cotton, and cover the costs of ginning).

HOW IT WORKS

- The brand teams up with a PG or an NGO and works together on an “open costing” to segregate the seed cotton price, the cotton fiber price, and the organic differential.
- The brand and PG/NGO fix the organic cotton fiber price (based on quality, class, etc.) along with the percentage of organic differential (this can be at the seed cotton stage or ginned fiber). The brand needs to buy all the agreed volume of organic cotton within just 5 months following harvest.
- The brand may pay in advance, pre-financing some or all of the seed cotton production, and the ginning costs are fixed.
- The brand has to then decide how much fiber stock to store or keep the stock with the PG or gin (with insurance), and how much is sent to the spinner to start producing yarn.
- The cost of the fiber is fixed so it will pass on to the ginner right through to the garment at the conventional price, and the differential is paid directly into the PG/NGO account separately, which will be passed on to all the farmers in the PG.

ADVANTAGES & DISADVANTAGES OF SPLIT DIFFERENTIAL PRICING MECHANISMS

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Full transparency in organic differential</td>
<td>• Cost of pre-financing</td>
</tr>
<tr>
<td>• Fixed cost of fiber for a year</td>
<td>• Inventory and insurance costs</td>
</tr>
<tr>
<td>• GMO testing can be requested to be carried out at the farm level</td>
<td>• Extra human resources to handle the logistics on the ground</td>
</tr>
<tr>
<td>• Consistent quality of fiber for the year</td>
<td>• Still affected by market price volatility</td>
</tr>
</tbody>
</table>

FIGURE 6: SPLIT DIFFERENTIAL PRICING MECHANISM

A diagram illustrating the Split Differentials Pricing mechanism, showing the standard pricing and split differentials pricing, with various stakeholders involved, such as the brand, CMT, Knitter/Weaver, Mill, Gin, Producer Organization, and the differential pricing structure, including standard and split differentials.
Fair Trade Pricing Mechanism

One approach to guaranteeing a transparent and fair price for the organic fiber is to opt for Fair Trade-Organic (FTO) in countries where Fair Trade (FT) operates.

HOW IT WORKS

The Fairtrade Labeling Organization (FLO) system guarantees a Fairtrade Minimum Price (FMP) and a Fairtrade Premium (FP) on the seed cotton.

The FMP is the minimum price that must be paid by buyers to producers for a product to become certified to the Fairtrade Standard. The FMP works as a floor price, which is calculated to cover producers’ average costs of production and allows them access to FT markets. The FMP represents a formal safety net that protects producers from being forced to sell their products at too low a price when the market price is below the FMP. It is therefore the lowest possible price that the buyer may pay to the producer. When the relevant market price for a product is higher than the FMP, then at least the market price must be paid. In July 2008, FLO introduced regional FMPs, representing an average price increase of 24 percent per kilo in comparison to the previous FMPs (See Appendix B: Fairtrade Pricing By Region).

The FP is an amount paid to producers in addition to the payment for their products. The use of the FP is restricted to investment in the producers’ business, livelihood and community needs or to the socio-economic development of the workers and their community. The producers democratically decide its specific use. The FP is valued at €0.05 per kg of seed cotton. When the market price rises above the FMP, the FT price is the market price plus the differential.

For FT farmers that are also certified organic, a minimum organic differential is set on top of the FMP. This price differential is the lowest possible differential that producers must receive, in addition to the FMP, or market price, whichever is higher. The FP also applies to the organic product, unless stated differently.

ADVANTAGES & DISADVANTAGES OF FAIR TRADE PRICING MECHANISMS

**ADVANTAGES**
- Takes the uncertainty out of determining a fair return for farmers and whether it gets to them
- Pricing calculations and methodology is transparent
- FT complements organic and farmers can use both standards to prove all aspects of sustainability are covered
- FT helps cover additional expenses, conversion years, and any yield loss during transition to organic

**DISADVANTAGES**
- Fair Trade is not recognized in all countries – it’s reserved for the most vulnerable
- Additional set up and certification costs, and bureaucracy
- Volumes of FT cotton are currently very small – so investment and time is needed

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ENABLERS

Changing the status quo is never easy. In the case of the organic cotton supply chain, to buck the existing transactional way of doing business and move toward one that is more responsible, it is imperative to work with others who will help in the transition from current to best practice methods. These enablers may consist of supportive organisations and individuals and are key in achieving the effective implementation of new trading and pricing models. Some potential enabling partners are described below.

The private sector

The private sector must be part of the solution for organic cotton and accelerate new ways of doing business. More companies have a genuine interest in sharing profit and finding solutions to combat economic, social and environmental poverty or degradation.

CottonConnect36 is a social business born from a commercial need for developing sustainable supply chains. The company’s aim is to deliver a market-driven approach that provides opportunities for retailers and brands, as well as farmers, to simultaneously expand economic opportunity, reduce poverty and protect the environment. CottonConnect is headquartered in the UK and operates in India, China, and Peru. The for-profit business with a social purpose works with their clients to build tailored solutions based around organic or other cotton sustainability portfolios and help brands connect right back to farm.

SOCIAL ENTERPRISE

A social enterprise is an organization or initiative that marries the social mission of a non-profit or government program with the market-driven approach of a business.33 In recent years, traditional businesses have begun to integrate greater levels of social responsibility and sustainability into their operations. There has also been an increase in the number of for-profit businesses with a social purpose. Social purpose businesses34 strive to create “blended value,” a non-divisible combination of financial, social and environmental value that, in turn, generates blended returns.34

Examples of successful social businesses can be seen in some commodity sectors such as coffee, tea and cocoa. Leading brands include Cafedirect and Devine Chocolate Limited with a focus on Fair Trade and organic agriculture.35

ETHICALLY-ORIENTATED INTERMEDIARIES

A trusted intermediary can play a vital role in supporting responsible pricing and trade, as well as providing brokering and logistical services37. While most intermediaries (traders or agents) are exclusively concerned with brokering sales, some are evolving into “ethically-orientated” or “doubly specialized” intermediaries, supporting more sustainable and more responsible ways of doing business.

Reinhart38 has been deeply involved in the cotton industry since 1788, when there were no pesticides and the industry was truly organic. Today, Reinhart sources its organic cotton from a number of regions and acts as an intermediary between growers and spinners, providing its customers quality assurance, logistics and documentation. Reinhart supports best practice in the organic sector, prioritizes transparency and integrity in production, and is a partner of the Swiss development organization Helvetas which runs projects on organic cotton in Burkina Faso, Mali and Central Asia. Through Reinhart’s commitment to sustainability and long-term partnerships, the company is involved in many cotton sustainability initiatives and has built up expertise as a “doubly specialized” (trading and sustainability) intermediary.

COTTONCONNECT

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33. Social Enterprise Alliance
34. UNLTD. Profit With Purpose Business: The New Frontier For The Social Economy
35. Green Economy Coalition. Social Enterprises
36. CottonConnect
37. The 4 Lenses Strategic Framework. Market Intermediary Model
38. Reinhart
The public sector and civil society

The public sector (local, regional and national governments), NGOs and civil society play key roles in the delivery of sustainable development. Poverty and other socio-economic issues associated with trade, are felt most profoundly in commodity dependent economies. Rectifying trade and pricing mechanisms in the global context cannot be left entirely to the market. Markets themselves have inherent features which prevent them from performing their functions effectively. Wherever that leads to harmful consequences, policy should seek a way to remedy it.³⁹

From public policy, to seed breeding, to financial schemes such as Social Impact Bonds, the public and ‘third’ sector have critical roles to play alongside the private sector in reaching the UN Global Goals. Radically changing the way commodities, such as organic cotton, is priced and traded could provide an exemplary model for others.
STAKEHOLDER INITIATIVES

Stakeholder initiatives are another effective means by which to work with likeminded organisations to achieve change in the organic cotton market as a whole, or on specific aspects of the sector. Some relevant multi-stakeholder initiatives and convening platforms are highlighted below.

The global organic cotton round table

The Organic Cotton Round Table (OCRT) is a multi-stakeholder initiative organized by TE. The OCRT has created an important platform for conversations on business models, trade, pricing and financing to take place between organic cotton stakeholders and uses the ‘power of community’ to find progressive solutions. Many OCRT participants recognize the urgency of pricing and trading issues and, through dialogue and in-person meetings, momentum is building fast.

At the 2016 OCRT, proposals put forward for working groups included:

- **FAIR FINANCING PLATFORM**
  - **Working Group remit:** Develop a platform for sharing ideas on ways to innovate, replicate, and scale fair financing to improve the lives of organic cotton smallholder farmers. Three key approaches were identified, a case study on open cost accounting with companies in cotton and across different sectors, the potential to set up a social impact bond and producer consortium to support farmers (pilot proposed in India), and a platform to share financial models that are seen to be working and to assess them for effectiveness.

- **A thought about fair financing**
  - Farmers need access to affordable working capital and cash flow finance. Access to finance and financial services is a major issue and constraint for smallholder inclusion. There is a lack of adapted and innovative financial products, such as access to loans, advances for crop finance, recoveries, default arrangements, crop insurance and the like. Financial services are usually also poorly adapted to small farmers and their organizations. Many Farmer Organizations and supporting NGOs find it difficult to find or access adapted financial service providers, and this can constrain development of projects or their future growth.

- **REGIONAL ORGANIC COTTON ROUND TABLES AND SOURCING HUBS**
  - **Working Group remit:** Coordinate the development of regional sourcing hubs and round tables, including identifying the market opportunities and appropriate business models that reward farmers for their investment in organic, and to better connect growers to supply networks.
  - The regional round table for Turkey, Egypt, and Central Asia is now established in partnership with the Izmir Municipality (IZFAS). Textile Exchange commissioned Change Agency to carry out a Market Opportunity Scoping Project (MOSP) to catalyze regional action. A similar approach is under development for Africa.

### Beyond Certification Towards Organic 3.0

#### Working Group remit:
Carry out an assessment of the business case for going “beyond certification.” Proposals include a performance improvement system and enabling technology - with a framework and tools for data collection, information management, and impact assessment.

#### Responsible trade will be part of the movement to Organic 3.0.

The organic sector has been through a number of transitions since its formalization. From Organic 1.0 and the initial defining of organic, to 2.0 and the development of the standard, certification, and a consumer-labeling scheme.

Organic 3.0 goes beyond certification. This is in part due to society’s evolving understanding of sustainability and the growing urgency to address things such as full costing, value sharing, and innovation in financing, plus ways to incentivize and reward best practice in organic communities.

Organic 3.0 is now being developed through IFOAM Organics International and its members (including Textile Exchange) to address a wider sustainability remit.

### Organic cotton trading models – Section I

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41. Simon Ferrigno, Freelance consultant and writer on cotton and sustainability.  

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COLLECTIVE IMPACT

One step beyond a stakeholder initiative is one that is structured to deliver collective impact on a given subject by a number of actors who join forces to achieve this goal.

What is collective impact?

Collective Impact is the commitment of a group of important actors from different sectors or organizations to a common agenda for solving a specific problem.

Collective impact initiatives involve a centralized infrastructure, a dedicated staff, and a structured process that leads to a common agenda, shared measurement, continuous communication, and mutually reinforcing activities among all participants.

ORGANIC COTTON ACCELERATOR

The aim of the Organic Cotton Accelerator45 (OCA) is to create a prosperous organic cotton sector which benefits everyone—from farmer to consumer. In the period of 2016-18, OCA is developing prototype solutions to be scaled and implemented sector-wide from 2018 onwards. By bringing buyers, processors, producers and enablers together, OCA aims to align incentives for a viable and prosperous organic cotton industry.

BACKGROUND AND INCUBATION

OCA evolved out of a multi-stakeholder inquiry by Change Agency and Textile Exchange into the biggest barriers to the growth of the organic cotton sector. Results were presented at the Organic Cotton Round Table in Istanbul in 2013. This call to action resulted in a number of the biggest brands in organic cotton including C&A, H&M, Inditex, Eileen Fisher, and Kering, joining Textile Exchange, C&A Foundation and CottonConnect to set up OCA, the first pre-competitive collective impact initiative in organic cotton at this scale. More recently this group has been joined by Tchibo and KappAhl, and Pratibha.

PROTOTYPING

During the prototyping phase, NewForesight was assigned to act as the OCA secretariat and further shape and drive the strategy, structure, and activities. In the prototyping phase, OCA will enable a viable business case for organic cotton, both for producers and the industry. OCA will align sector front-runners on priority issues, identify systemic and pre-competitive issues, and design solutions to jointly tackle them. Additionally, OCA will support sharing and acting upon results and best practices to support learning, and work with value chain partners for implementation.

NewForesight will support OCA in building a strong platform to convene the sector around a shared strategy and goals, as well as develop, support and roll out different interventions at the supply and demand side, for example the coordination of action and support with regard to organic farmers’ access to seeds, training & organization, and finance46.

What is collective impact?

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Collective impact initiatives involve a centralized infrastructure, a dedicated staff, and a structured process that leads to a common agenda, shared measurement, continuous communication, and mutually reinforcing activities among all participants.

**FIGURE 8: COLLECTIVE IMPACT FRAMEWORK**

44. ibid.
45. Organic Cotton Accelerator
PART C: EMERGING FRAMEWORK

What conclusions can we draw from the models we have identified?

Brands, manufacturers, and farmers all have very clear requirements from the market and from each other. For organic cotton to deliver on its promise of environmental, social, and economic sustainability for all and over the longer term, it is apparent that pricing and trade need to be rethought.

Not surprisingly, the challenges and opportunities presented here will not be unique to organic cotton but relevant for all business where sustainability attributes are valued. However, what is key to declare is that the entrenched model of commodity pricing and supply chains built on individual gain, will not deliver a truly sustainable product.

Trading partners need to work as a network rather than a top down “chain.” Integrated or semi-integrated supply networks built on trust and recognition of the interdependence within the network will be key. For all to stay engaged and committed, trade needs to deliver benefits to all in the network.

Which approach is right for you?

It is important to recognize the need for multiple answers (no one size fits all). Trading models, enablers and initiatives need to avoid competing by recognizing their core membership, and potential members should find it easy to work out which is right for them.

QUESTIONS TO ASK ARE:

- What can my company do independently?
- What requires collaboration?
- What can we do right now?
- What is going to take a longer-term approach and investment?

The models, enablers and initiatives identified in this report are summarized in the tables and diagrams on pages 31 and 32. The information they contain is for guidance only and should help you identify what is right for your company today and over the longer term (page 32). The examples presented are not the only options, nor is any one example mutually exclusive of another.

THE AIM IS TO PROVIDE A FRAMEWORK FOR DEVELOPING RESILIENT AND ADAPTABLE MODELS THAT WILL SUPPORT A VIABLE FUTURE FOR ORGANIC COTTON.

“‘The market’ sounds like a natural system that might bear upon us equally, like gravity or atmospheric pressure. But it is fraught with power relations. What ‘the market wants’ tends to mean what corporations and their bosses want.”

– George Monbiot, author and political/environmental campaigner
Neoliberalism - the ideology at the root of all our problems,
The Guardian (April, 2016).
# SUMMARY OF RESPONSIBLE PRICING AND TRADE BEST PRACTICE MODELS

<table>
<thead>
<tr>
<th>TRADE MODEL OPTIONS</th>
<th>DIRECT SOURCING</th>
<th>SPECIAL PURPOSE VEHICLES</th>
<th>CLUSTER PARTNERSHIPS</th>
<th>COLLABORATIVE COMMUNITIES</th>
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<tbody>
<tr>
<td>Agreement between brand and supplier to secure product, price, and terms and conditions of trade</td>
<td>Joint venture between companies with a common goal to leverage business benefits for all</td>
<td>Supporting long term business sustainability and stability within supply networks and regions</td>
<td>Alliance of SMEs aggregating demand and committed to rewarding best practice sustainability</td>
<td></td>
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</tbody>
</table>

## EXAMPLES

<table>
<thead>
<tr>
<th>EXAMPLES</th>
<th>Brand-Spinner Brand-Producer/Ginner</th>
<th>Cotton Sourcing Company Ltd (COSCO)</th>
<th>SA Sustainable Cotton Cluster SEA Organic Cluster</th>
<th>Chetna Coalition</th>
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<tbody>
<tr>
<td>Securing supply</td>
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<tr>
<td>Early demand signaling</td>
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<td>Agreements with spinners or ginners</td>
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<td>Guaranteed uptake</td>
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<td>Quality control management</td>
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<td>Open book costing</td>
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<td>Pricing mechanism in place</td>
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<tr>
<td>Farm capacity building/input credits</td>
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<td>Farm price transparency</td>
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<td>Risk and reward sharing</td>
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<td>Pre-financing</td>
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<td>Leveraging access to financial services</td>
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<td>KPI data collection and monitoring</td>
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<td>Consumer Engagement</td>
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<td>Supporting Fair Trade certification</td>
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<td>CSR/Community investment</td>
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</tbody>
</table>

## TRADE MODEL ATTRIBUTES

### PRICE SETTING

- Flexible Pricing
- Split Differential
- Fairtrade Minimum Pricing
The model presented here illustrates the role of some key actors and initiatives in the development and delivery of new business models for organic cotton. These actors/initiatives provide the community and support mechanisms needed to establish new models of responsible trade. Through a combination of pre-competitive collaboration, partnership, investment, policy, and business enterprise, the pathway to new business models can achieve a breakthrough, and the critical mass necessary to transform the trading and pricing of organic cotton can be realized.
CONCLUSIONS

Sustainability in textiles will require business to address trade and price.

- The challenges and opportunities presented here are not unique to organic cotton but are relevant for all business where sustainability attributes are valued.
- The entrenched model of commodity pricing, and supply chains built on individual gain, will not deliver a truly sustainable product.
- As demonstrated throughout this report, new business models, based on innovative trading mechanisms and pricing policies, are emerging.
- Getting trade and price right for commodities such as cotton, will be critical to meeting the SDGs.

Next steps

THIS REPORT HAS IDENTIFIED THE FIRST GREEN SHOOTS OF THE NEW WAYS OF WORKING THAT COULD TRANSFORM THIS SECTOR AND THE LIVES OF THOSE WHO WORK WITHIN IT.

This research is intended to be a conversation starter. It aims to raise awareness of the issues in pricing and trade and to identify emerging models that have the potential to break through or disrupt current models that are not working.

THE GOAL IS TO BUILD A COMMUNITY OF PRACTICE OF RESPONSIBLE PRICING AND TRADE WITHIN THE ORGANIC COTTON SECTOR TO FACILITATE AND SUPPORT BUSINESS TRANSFORMATION.

The Organic Cotton Round Table offers a framework for focused collaboration on key areas of activity, and informs wider collaborative efforts such as Cotton 2040,47 which brings a broader group of stakeholders together.

Everyone in the market can take steps to make things better. Reflect on the summary tables presented earlier and decide where you could join an initiative or increase your involvement. Individual actions add up to significant outcomes, and every player has the power to move the system through their own decisions.

However, alongside individual actions, we can strengthen collaborative action.

RECOMMENDED NEXT STEPS FOR THE WHOLE INDUSTRY INCLUDE:

1 Increase awareness and broaden participation in this discussion.
   Further consultation and wider stakeholder input is needed on trading models and pricing mechanisms. This report should catalyze that process.

2 Initiate actions identified through the annual Organic Cotton Round Table:
   - Coordinate the development of regional sourcing hubs and round tables, including identifying the market opportunities and appropriate business models that reward farmers for their investment in organic, and better connecting growers to supply networks.
   - Create a Fair Financing platform. Develop a platform for sharing ideas on ways to innovate, replicate, and scale fair financing. Plus, monitor financial models that are seen to be working and assess them for effectiveness.
   - Take organic cotton “beyond certification.” Responsible pricing and trade is a key component of a wider call to action to take organic beyond the current requirements of regulation and certification, and into a performance improvement system that incentivizes best practice. It is proposed that a program for assessing and monitoring sustainability impacts and performance improvement against a set of natural and social capital indicators should be developed in collaboration with key stakeholders.

3 Start asking questions and taking practical steps. Questions to ask are:
   - What can my company do independently?
   - What requires collaboration?
   - What can we do right now?
   - What is going to take a longer-term approach and investment?

There will be multiple answers and not one size that fits all. Trading models and initiatives need to avoid competing by recognizing their core membership, and potential members should find it easy to work out which initiatives are right for them.

The evidence tells us that we cannot wait for the market to correct itself and value sustainability properly. We must take these steps ourselves – as Gandhi said, “We must be the change we want to see in the world.”

47. Forum For The Future. Cotton 2040
### A GUIDE TO WHAT IS RIGHT FOR YOU

<table>
<thead>
<tr>
<th>BRAND/RETAILER</th>
<th>SME (Small volumes)</th>
<th>MEDIUM-LARGE (Average volumes)</th>
<th>LARGE (Significant volumes)</th>
<th>COLLABORATION</th>
<th>TIMELINE</th>
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<td>ORGANIC COTTON ROUND TABLE</td>
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<td>★</td>
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<td>★</td>
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</tr>
</tbody>
</table>
SECTION II

Background study on organic cotton pricing strategies & trading models
Conventional cotton pricing

Three concerns are at the heart of the problem of commodity trading:
- Price volatility (discussed below)
- The widespread collapse in prices (refer to the Prebisch/Singer thesis, which argues that the price of primary commodities declines relative to the price of manufactured goods over the long term, causing the terms of trade of primary-product-based economies to deteriorate).
- The distribution of value along the supply chain (see example on pages 36-37).
- These concerns often arise from the free operation of market forces.

The price of cotton has been steadily falling since the historic spike of 2010 when, due to a panic over availability, prices increased by over 300%. Over the past 50 years (taking inflation into account) cotton prices have fallen on the commodity market by 45 percent. Currently, fiber price continues to fluctuate between US$0.60 and $1 per pound (€2/kilo).

There is a deep-rooted dependency on the commodity market to regulate price.

Commodity prices are volatile, offer little security for farmers (and buyers), and at times may not cover the cost of production - let alone allow farmers to prosper. At other times (less often) the market may work in the producers’ favor. A number of commodity sustainability initiatives such as the Better Cotton Initiative (BCI) choose not to “interfere” with commodity pricing and rely on the systems used for conventional cotton trading. BCI aspires to be a mainstream, sustainable commodity and focuses on improving productivity for the farmer, which in turn increases farmer income.

While it is true that productivity is important for increasing income, it is unlikely that the commodity market will single-handedly adjust to account for the wider environmental and social costs and benefits (soil, water, carbon emissions, biodiversity, food security, health and safety, etc.), associated with sustainability.

The commodity market responds to supply and demand signals. In general it does not understand the value of sustainability.

Increasing yields will not be enough to address complex development issues in poor countries dependent upon commodities. Keeping the commodity market at the center of trade can be at the expense of people and their communities.

Influences on pricing

Supply and demand

Commodity prices are primarily driven by supply and demand. Aspects such as fiber quality (staple length, strength, color, leaf grade, trash content, etc.) also play a part. Other price influencers and considerations include stocks and subsidies, logistics, transportation and
Competition between crops
The prices of competing crops influence farmers' decisions about what to grow. Higher prices for crops such as corn and soybean obviously make those crops more attractive to farmers - and, as a result, can displace cotton production and drive up prices. Additionally, of course, there is competition between fibers and, with polyester being so competitive in price, for example, the price of cotton is impacted.

Water shortages and climate change are also beginning to influence price
Droughts, floods and other weather-related issues have always impacted supply and thus influenced price. This is made worse by changing weather patterns and global warming. In 2006, for example, droughts in Texas forced cotton farmers to ration water and, as a result, yields were lower than expected.

BEYOND THE MARKET
Procuring cotton from countries or suppliers where human rights have been abused, where people have suffered in the production, or where the environment is being severely degraded must at all times be avoided.

DUE TO THE LACK OF TRANSPARENCY IN SUPPLY CHAINS AND COMMODITY TRADING, THE ENVIRONMENTAL AND SOCIAL “COSTS” ARE GENERALLY NOT ACCOUNTED FOR.
Just as the impacts are interconnected, so too are the solutions. Alongside business, governments, multilateral organizations and civil society must play a strong role in improving commodity pricing policy, and play their role in driving business transformation. A sobering recognition of the persistent impact of commodity prices, and how they are hampering achievement of the Global Goals, may revive efforts.

The following table compares the production cost of a 145-gsm soft jersey round-neck T-shirt between conventional cotton, Better Cotton (BCI), Fairtrade conventional cotton, organic cotton, and Fairtrade organic cotton. The cotton in this example has been grown and manufactured in India. The cotton t-shirt pricing is for illustrative purposes only and does not represent a particular brand or company. It is a generic example of supply chain pricing and does not take into account variables such as cotton quality, garment complexity and craftsmanship, production volume, etc.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD/kg</td>
<td>B/down</td>
<td>USD/kg</td>
<td>B/down</td>
<td>USD/kg</td>
</tr>
<tr>
<td>Seed cotton price farm gate</td>
<td>0.61 6.4%</td>
<td>0.62 6.1%</td>
<td>0.67 5.9%</td>
<td>0.64 5.6%</td>
<td>0.69 5.8%</td>
</tr>
<tr>
<td>Ginning, bailing, transportation, handling &amp; seed recovery</td>
<td>0.84 8.8%</td>
<td>0.94 9.2%</td>
<td>1.03 9.1%</td>
<td>0.96 8.4%</td>
<td>1.08 9.2%</td>
</tr>
<tr>
<td>Fiber price ex mill</td>
<td>1.45</td>
<td>1.56 7.7%</td>
<td>1.70 17.0%</td>
<td>1.60 10.4%</td>
<td>1.77 22.4%</td>
</tr>
<tr>
<td>Spinning, packing, transportation &amp; margin</td>
<td>1.50 15.8%</td>
<td>1.55 15.2%</td>
<td>1.61 14.2%</td>
<td>1.57 13.7%</td>
<td>1.65 13.9%</td>
</tr>
<tr>
<td>Yarn price ex mill</td>
<td>2.95</td>
<td>3.11 5.6%</td>
<td>3.31 12.3%</td>
<td>3.17 7.5%</td>
<td>3.42 16.2%</td>
</tr>
<tr>
<td>Knitting, dyeing, finishing, loss, transportation &amp; margin</td>
<td>1.47 15.5%</td>
<td>1.50 14.7%</td>
<td>1.54 13.5%</td>
<td>1.51 13.2%</td>
<td>1.56 13.2%</td>
</tr>
<tr>
<td>Fabric price</td>
<td>4.42</td>
<td>4.61 4.4%</td>
<td>4.85 9.6%</td>
<td>4.68 5.9%</td>
<td>4.98 12.7%</td>
</tr>
<tr>
<td>Certification &amp; traceability</td>
<td>0%</td>
<td>0.06 0.6%</td>
<td>0.15 1.3%</td>
<td>0.15 1.3%</td>
<td>0.15 1.3%</td>
</tr>
<tr>
<td>Total fabric price</td>
<td>4.42</td>
<td>4.67 5.7%</td>
<td>4.99 13.0%</td>
<td>4.83 9.3%</td>
<td>5.13 16.1%</td>
</tr>
<tr>
<td>Fabric usage per t-shirt @ 13% fabric usage</td>
<td>0.57 2.2%</td>
<td>0.61 2.2%</td>
<td>0.65 2.0%</td>
<td>0.63 2.0%</td>
<td>0.67 1.9%</td>
</tr>
<tr>
<td>Standard marking</td>
<td>0.03 23.0%</td>
<td>0.03 21.3%</td>
<td>0.03 20.0%</td>
<td>0.03 19.1%</td>
<td>0.03 19.1%</td>
</tr>
<tr>
<td>Accessories / printing</td>
<td>0.11 6.6%</td>
<td>0.11 8.0%</td>
<td>0.11 7.2%</td>
<td>0.11 7.8%</td>
<td>0.11 7.8%</td>
</tr>
<tr>
<td>Cutting, making &amp; trimming</td>
<td>0.24 19.7%</td>
<td>0.24 18.3%</td>
<td>0.24 16.5%</td>
<td>0.24 16.4%</td>
<td>0.24 16.4%</td>
</tr>
<tr>
<td>Integrity, certification &amp; traceability</td>
<td>0.06 4.5%</td>
<td>0.06 4.9%</td>
<td>0.16 11.1%</td>
<td>0.19 13.1%</td>
<td>0.21 13.6%</td>
</tr>
<tr>
<td>FOB price per t-shirt</td>
<td>1.23 100.0%</td>
<td>1.33 100.0%</td>
<td>1.48 19.6%</td>
<td>1.48 19.6%</td>
<td>1.54 100.0%</td>
</tr>
</tbody>
</table>

Analysis assumptions:
- Seed cotton was purchased from one Indian state, Gujarat, but a number of different producers groups, ginners, and traders were involved (as no single project produces all the different types of cotton).
- The cotton fiber quality was 29mm, 3.8 to 4.2 mic, 28 gpt based on USTER HVI testing.
- All processing costs are actual quotes provided by the production facilities.
- Organic certification in place. Whether OCS or GOTS is undetermined.
- Fairtrade and Fairtrade Organic is third party FLO certified at the seed cotton level.

61. Information and analysis by Textile Exchange’s Regional Manager for India. The costings have been collected directly from the manufacturers.
WHAT THE COST COMPARISON IS TELLING US ABOUT FARM PRICING

In the example here, it is interesting that, when comparing the different cotton farming systems, the differential for organic seed cotton — at 5.6 percent — contributes the least to the overall production costs of a t-shirt, compared to conventional at 6.4 percent, Better Cotton at 6.1 percent, Fairtrade at 5.9 percent, and Fairtrade Organic at 5.8 percent.

While the organic differential is 4 percent above conventional at the seed cotton price, it is 20.3 percent at the FOB price per t-shirt. In addition, while the seed cotton share makes up 6.4 percent of the total production cost of a conventional t-shirt, it only makes up 5.6 percent of the production cost of an organic cotton t-shirt.

Another interesting point is that, at the seed cotton level, Fairtrade conventional cotton trades higher than organic and farmers enjoy a higher differential of 8.9 percent compared to an organic cotton farmer’s 4 percent. However, at FOB price per t-shirt, Fairtrade is priced on par with organic cotton.

COSTING BEYOND THE FARM

In organic cotton, the differential affects each and every stage of processing, from ginning to garment making because, to be certified organic, the cotton needs to be segregated from conventional cotton during all steps of processing.

Each processing unit should be certified, and hold a current Scope Certificate (SC) to the Organic Content Standard (OCS) or the Global Organic Textile Standard (GOTS).

At each step, a Transaction Certificate (TC) should be issued by the certification body and this TC accompanies the movement of the organic cotton from gin to spinning mill to fabric maker to final product.

Both SCs and TCs will cost money. Our analysis indicates that suppliers are usually incorporating certification costs into production costing.

While this may be feasible for larger volumes, it would appear that the knock-on effect is to pay the farmers less for their seed cotton.

This model is not truly sustainable. Without additional CSR funds or other financial benefits coming to the farmers, the market must improve the business case for the farmer. For organic cotton to remain a viable option, trading models and pricing mechanisms will need to more equally spread risk and reward and, ultimately, result in higher prices reaching the ground.

ORGANIC COTTON PRICES AND MARGINS

Figure 11 below and Table 2 on page 37 provides an overall picture of the trading price of organic cotton fiber for key producing countries. Reference prices are compared to the Cotlook A (global) commodity market price for conventional cotton. Note that all information is based on fiber and not seed cotton, and no differentiation between fiber quality (staple length) has been drawn unless stated otherwise.

The global commodity market price for conventional cotton has been on a downward trend since a record high in 2010/11 (a result of panic buying due to a shortage of cotton). The sudden rise in price on the commodity market disrupted the organic cotton trading model which is based on a differential above conventional. It was difficult for long standing trading partners to accommodate the radical increase in value of conventional cotton. In some cases this resulted in side-selling of organic into the conventional market. High production and surplus the following year resulted in a significant price dip between 2010/11 and 2011/12, with the exception of China. On a downward trend, India records the lowest price range, dipping below conventional in 2015/16. China, the USA and Turkey (Aegean and SEA) maintain a higher price compared to conventional.

**FIGURE 11: ANALYSIS OF COTLOOK A-INDEX AND ORGANIC COTTON PRICES FOR CHINA, INDIA, TURKEY (AEGEAN & SOUTH EAST ANATOLIA) AND THE USA**
Organic cotton trading models – Section II

Table 2: Analysis of Cotlook A-Index and Organic Cotton Prices for China, India, Turkey (Aegean & South East Anatolia) and the USA

<table>
<thead>
<tr>
<th>USD/kg</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
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<tbody>
<tr>
<td>Cotlook-A Index</td>
<td>2.91</td>
<td>2.07</td>
<td>1.97</td>
<td>1.78</td>
<td>1.56</td>
<td>1.53</td>
</tr>
<tr>
<td>China OC price</td>
<td>3.85</td>
<td>4.55</td>
<td>2.55</td>
<td>2.93</td>
<td>3.00</td>
<td></td>
</tr>
<tr>
<td>India OC price</td>
<td>3.59</td>
<td>2.59</td>
<td>2.30</td>
<td>1.83</td>
<td>1.63</td>
<td>1.50</td>
</tr>
<tr>
<td>Turkey Aegean OC price</td>
<td>4.23</td>
<td>2.70</td>
<td>2.56</td>
<td>2.60</td>
<td>2.11</td>
<td>2.04</td>
</tr>
<tr>
<td>Turkey SEA OC price</td>
<td>3.89</td>
<td>2.51</td>
<td>2.40</td>
<td>2.49</td>
<td>1.96</td>
<td>1.90</td>
</tr>
<tr>
<td>US OC price</td>
<td>3.69</td>
<td>3.80</td>
<td>3.83</td>
<td>3.91</td>
<td>3.78</td>
<td>2.89</td>
</tr>
</tbody>
</table>

Figure 12 and Table 3 show the organic cotton margin (differential) above the global commodity market conventional price. The margin for Turkey has been relatively stable with the Aegean organic enjoying a slightly higher margin than SEA. The margins in China and the US are significantly higher although towards 2015/16, margins appear to be converging. The margin for Indian organic remains the lowest and a declining trend with 2015/16 dipping below the Cotlook A Index. It should be noted that the spike in margin for the US in 2014/15 was artificially maintained due to shortage in supply caused by severe drought and resulted in a margin dive in 2015/16 when production picked up.

Organic cotton prices follow the trend of the conventional market. In most countries, the organic differential (premium) sits at a minimum of 5% above conventional market prices. However, in India the price differential ranges more widely depending on the agreement between buyer and seller. On the open market, Indian organic can be found at the same price as conventional cotton.

Figure 13 presents a range of organic cotton prices recorded for a number of organic cotton producing regions during 2014/15. Factors affecting price will be quality, fiber length, supply-demand ratios as well as the range of price differentials on offer. In countries where only one data point has been provided/colllected by TE this is either the average price of the organic cotton during the year, or the only price provided.

Table 3: Analysis of Organic Cotton Margin Above Cotlook A-Index for China, India, Turkey (Aegean & South East Anatolia) and the USA

<table>
<thead>
<tr>
<th>USD/kg</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
</tr>
</thead>
<tbody>
<tr>
<td>China OC margin</td>
<td>0.94</td>
<td>2.48</td>
<td>0.77</td>
<td>1.37</td>
<td>1.47</td>
<td></td>
</tr>
<tr>
<td>India OC margin</td>
<td>0.68</td>
<td>0.52</td>
<td>0.33</td>
<td>0.05</td>
<td>0.07</td>
<td>-0.03</td>
</tr>
<tr>
<td>Turkey Aegean OC margin</td>
<td>1.32</td>
<td>0.63</td>
<td>0.59</td>
<td>0.82</td>
<td>0.55</td>
<td>0.51</td>
</tr>
<tr>
<td>Turkey SEA OC margin</td>
<td>0.98</td>
<td>0.44</td>
<td>0.43</td>
<td>0.71</td>
<td>0.40</td>
<td>0.37</td>
</tr>
<tr>
<td>US OC margin</td>
<td>0.13</td>
<td>1.43</td>
<td>2.03</td>
<td>1.70</td>
<td>2.57</td>
<td>1.15</td>
</tr>
</tbody>
</table>

Figure 13 presents a range of organic cotton prices recorded for a number of organic cotton producing regions during 2014/15. Factors affecting price will be quality, fiber length, supply-demand ratios as well as the range of price differentials on offer. In countries where only one data point has been provided/colllected by TE this is either the average price of the organic cotton during the year, or the only price provided.
ORGANIC COTTON PRICES - COUNTRY SUMMARIES

India
The Indian organic cotton price maps most closely to the Cotlook\textsuperscript{67} price trends with diminishing gap for an already low differential (premium) margin. The current cotton price in India is 0.78 USD/kg (Cotlook 0.79 USD/kg) and the differential in price of organic cotton is 0.02 USD/kg as of November 29, 2016. Price differentials are so narrow that Indian farmers are not finding a business case for organic cotton. The root cause of this low differential in price is not completely clear. As India supplies over 70 percent of organic cotton, the diminishing differential is affecting international production as well, the USA, Turkey, China, Latin America, Africa, etc. struggle to compete.

See over page for a closer look at India.

China
The organic cotton price in China does not seem to be as affected by India, as other countries have reported. This may be due to the import restrictions and the certification requirement imposed on the domestic market by the Chinese government, which could probably explain the rise in local certification in the past 2 years. While the margins have been somewhat maintained (at US$2.08-3.20 per kg), the Chinese prices are moving in sync with the dropping trends of conventional prices. It was reported that unless the price improves, it would not be possible for Chinese organic cotton farmers to remain competitive in the international market.

Turkey
One of the first countries to grow and manufacture certified organic cotton for the market, Turkey produces long staple Izmir cotton in the Aegean and a medium staple in the South East Anatolian region. Before India took over, it was the biggest producer globally. There is a modest organic agriculture subsidy/credit (US$30 per hectare). Due to market dynamics and the diminishing price differential, farmers have shifted out of organic cotton, some of them switching to organic corn and other food crops. Fiber prices in 2015 sat around US$1.60 to US$2.15, depending upon pre-set contracts, fiber quality and fiber length.

USA
The USA is the only country that is reported to maintain a relatively healthy differential for organic over conventional cotton fiber prices although this margin has been diminishing since 2014 to 1.15 times conventional in 2015. In early 2016, organic grains in the USA were bringing 2-3 times conventional prices. To maintain American farmers, organic cotton prices need to stay at least double conventional prices – at least at the current conventional price of US$ 1.32/kg (US$ 0.60/lb).

Africa
Producer groups in West Africa (Benin, Burkina Faso, Mali, Senegal) tend to be doubly certified and sell their seed cotton (before ginning) at an agreed Fairtrade-Organic price set earlier in the year. Data from 2014/15 shows the organic seed cotton price in West Africa at US$0.49/kg. Fairtrade International recorded FT-Organic fiber (post-ginning) from Senegal fetching US$2.20\textsuperscript{68}. Seed cotton prices for Tanzania were similar with data showing prices sitting around US$0.43-US$0.46.

“Among the most stable [commodity markets] are phosphates and iron ore. They operate with long-term price agreements between buyers and sellers, which do not exist on most international commodity markets.”

– George Monbiot, author and political/environmental campaigner

Neutralism - the ideology at the root of all our problems.
The Guardian (April, 2016).

\textsuperscript{67} Cotton Outlook, Cotlook A' Index
\textsuperscript{68} Fairtrade Africa
Organic Cotton trading models – Section II

ORGANIC COTTON PROFITABILITY – A CLOSER LOOK AT INDIA

Table 4 provides a snapshot of the organic cotton prices in India in 2016 (for LS/29mm, 3.5–4.3 mic and 28 gram per tex which is the most commonly used fiber for knitted products). At USD 1.947/kg, the Indian organic cotton prices appear to have increased compared to USD 1.52/kg for the equivalent fiber quality in 2014/15. This is due to lower supply compared to demand, but most likely reflecting the fluctuation in USD to INR from 60 to 66 between 2014 and 2016.

<table>
<thead>
<tr>
<th>December 2016</th>
<th>Gujarat</th>
<th>Odisha</th>
<th>Madhya Pradesh</th>
<th>Maharashtra</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lint Cotton (USD/kg)</td>
<td>1.730</td>
<td>1.774</td>
<td>1.739</td>
<td>1.752</td>
</tr>
<tr>
<td>Seed Cotton (USD/kg)</td>
<td>0.800</td>
<td>0.692</td>
<td>0.708</td>
<td>0.692</td>
</tr>
<tr>
<td>October 2016</td>
<td>Gujarat</td>
<td>Odisha</td>
<td>Madhya Pradesh</td>
<td>Maharashtra</td>
</tr>
<tr>
<td>Lint Cotton (USD/kg)</td>
<td>1.968</td>
<td>1.947</td>
<td>1.925</td>
<td>1.947</td>
</tr>
<tr>
<td>Seed Cotton (USD/kg)</td>
<td>0.738</td>
<td>0.677</td>
<td>0.662</td>
<td>0.646</td>
</tr>
</tbody>
</table>

Note: The above are based on 29mm organic cotton 3.5–4.3 mic and 28gpt converted at a USD to INR exchange rate of 1.65. (Source: Discussion with producer group & Brand, India)

Figure 14 provides a comparison of the profit and loss (P&L) between a sample of organic cotton farmers and conventional cotton farmers in Madhya Pradesh (MP). Based on this assessment led by CottonConnect, the organic cotton farmers received 47 percent less profit (on average) over a year compared to their conventional equivalents. The reasons for this less attractive P&L were given as: a difficult enabling environment, strict/expensive standard, short contracts/low prices, and few viable alternatives.

In Figure 15, a higher profitability scenario has been presented (from the same study), showing an improved P&L for the sample group of organic cotton farmers in MP. Conditions to make this happen included farmer training, improved sourcing practices, organization of inputs, and better rewards for farmers.

71. Ibid.
ORGANIC COTTON TRADING TERMS & CONDITIONS

The following data on trading terms and conditions is taken from TE’s Organic Cotton - Sustainability Assessment Tool (OC-SAT). It felt relevant to include here since it is not only the price paid to the farmer for the product, but the way in which payment is carried out.

Africa

FIGURE 16: ORGANIC COTTON TRADING TERMS AND CONDITIONS IN AFRICA

Timeliness of payment
While approximately 51 percent of PGs in Africa (Benin, Burkina Faso, Mali, Senegal, and Tanzania) are paid within the month (sometimes immediately) by their trading partner, 33 percent of respondents reported a lag time of up to 2 to 3 months before payment.

Trading Profile
One-third of PGs hold relationships directly with brands or retailers, even if direct payments are not the norm. Equally, PGs may be selling to a ginner or spinner or are operating through a trader.

Although ongoing contracts are 50:50 with seasonal sales, two-thirds of the PGs are in long-term business relationships, which reportedly provide some security in terms of agreed prices, timely trading and overall business security. Pre-financing is also a benefit experienced by 25 percent of the groups. Most PGs agreed long-term business security is critical to their success.

“We give interest-free loans to our farmers and pay the premium on organic cotton.”
– PG, Tanzania

“We are still vulnerable in term of business relationships. We need more secure contracts for long term planning.”
– PG, Mali

China

**FIGURE 17: ORGANIC COTTON TRADING TERMS AND CONDITIONS IN CHINA**

<table>
<thead>
<tr>
<th>TIMELINESS OF PAYMENTS</th>
<th>PG to Farmers</th>
<th>Buyer to PGs</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-7 Days</td>
<td>100</td>
<td>Yes</td>
</tr>
<tr>
<td>8-14 Days</td>
<td>100</td>
<td>Yes</td>
</tr>
<tr>
<td>15-30 Days</td>
<td>100</td>
<td>No</td>
</tr>
<tr>
<td>2-3 Mths</td>
<td>100</td>
<td>No</td>
</tr>
<tr>
<td>&gt;3 Mths</td>
<td>0</td>
<td>No</td>
</tr>
<tr>
<td>Undetermined</td>
<td>0</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TRADING PARTNERS</th>
<th>Spinner</th>
<th>Vertically Integrated Chain</th>
</tr>
</thead>
<tbody>
<tr>
<td>PG to Farmers</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Buyer to PGs</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TYPES OF TRADE</th>
<th>Do not sell fiber</th>
</tr>
</thead>
<tbody>
<tr>
<td>PG to Farmers</td>
<td>100</td>
</tr>
<tr>
<td>Buyer to PGs</td>
<td>100</td>
</tr>
</tbody>
</table>

**WHAT THE DATA SAYS**

**Timeliness of payment**
The PG representative reported to pay the farmers within 8 to 14 days of stock transaction, and the PG is usually paid by the buyer within the same time frame.

**Trading Profile**
This PG provides to a vertically integrated manufacturer which can improve business security for the farmers. The farmers also reported to sell a small amount of organic cotton to external buyers (but less than 1 percent of production).

India

**FIGURE 18: ORGANIC COTTON TRADING TERMS AND CONDITIONS IN INDIA**

<table>
<thead>
<tr>
<th>TIMELINESS OF PAYMENTS</th>
<th>PG to Farmers</th>
<th>Buyer to PG</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-7 Days</td>
<td>65</td>
<td>35</td>
</tr>
<tr>
<td>8-14 Days</td>
<td>35</td>
<td>18</td>
</tr>
<tr>
<td>15-30 Days</td>
<td>18</td>
<td>47</td>
</tr>
<tr>
<td>2-3 Mths</td>
<td>35</td>
<td>6</td>
</tr>
<tr>
<td>&gt;3 Mths</td>
<td>7</td>
<td>59</td>
</tr>
<tr>
<td>Undetermined</td>
<td>12</td>
<td>41</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TRADING PARTNERS</th>
<th>Ginner</th>
<th>Spinner</th>
<th>Trader/Exporter</th>
<th>Vertically Integrated Chain</th>
<th>Direct to Retailer/Brand</th>
</tr>
</thead>
<tbody>
<tr>
<td>PG to Farmers</td>
<td>100</td>
<td>100</td>
<td>76</td>
<td>76</td>
<td>76</td>
</tr>
<tr>
<td>Buyer to PG</td>
<td>76</td>
<td>76</td>
<td>24</td>
<td>24</td>
<td>24</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TYPES OF CONTRACT</th>
<th>Ongoing Contract</th>
<th>Season Contract</th>
<th>A Mix of Ongoing &amp; Season Contracts</th>
<th>Do not sell fiber</th>
</tr>
</thead>
<tbody>
<tr>
<td>PG to Farmers</td>
<td>25</td>
<td>5</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>Buyer to PG</td>
<td>76</td>
<td>24</td>
<td>76</td>
<td>76</td>
</tr>
</tbody>
</table>

**LONG TERM CONTRACTS**

<table>
<thead>
<tr>
<th>PG to Farmers</th>
<th>Buyer to PG</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>76</td>
</tr>
<tr>
<td>No</td>
<td>24</td>
</tr>
</tbody>
</table>
WHAT THE DATA SAYS

Timeliness of payment
PGs (65 percent) were reported to make payments to their farmers within seven days of stock transaction. It is not uncommon to pay farmers on transaction of stock. Yet almost half of PGs reported waiting up to a month for their payment. This means PGs are absorbing the time lag between paying the farmers and being paid.

“Normally farmers are calculating number of days from sauda (bargain) and we pay within 7 days from the sauda.” – PG, Gujarat

“The purchased cotton leaves the farm gate and reaches us in a day’s time. After quality checking of cotton at the gin, we release our payments within 3 days time.” – PG, Tamil Nadu

Trading Profile
PGs sell mostly to spinners. Almost half reported to have a direct relationships with brands and a quarter are selling to middlemen. 41 percent reported having multiple trading strategies.

PGs listed business security and timely payments as key benefits when it comes to long-standing trade relationships. Agreed prices and guaranteed sales were also important.

“We have our specified long term buyers as well as getting new buyers from market, however, there is no formal contract. We keep doing business with each other considering market forces at times. Seasonal contracts happen only with new customers for security of goods and payment.” – PG, Odisha

Turkey

FIGURE 19: ORGANIC COTTON TRADING TERMS AND CONDITIONS IN TURKEY

WHAT THE DATA SAYS

Timeliness of payment
Transactions in the Aegean tended to be more prompt than those in South Eastern Anatolia (SEA), especially from the buyer to the PG.

“Farmers usually get paid within one week. Some farmers do not fix prices immediately. They can do partial price fixing whenever they want.” – PG, Aegean

Trading Profile
The PG in the Aegean had more established buyers than the PG in the SEA region (who tended to sell to traders). Where on-going trade relationships exist, this was reported to provide improved business security and was a significant benefit.

“We sell to local spinners, to our sister company, and export overseas.” – PG, Aegean
Organic cotton trading models – Section II

TRADING MODELS

Whereas in Section 1 best practice trading models were examined, in this part of the report we are looking at the current situation of the different types of trading that occur within the organic cotton sector. It is organized by region and country, and their dominant trading models for organic cotton. Countries are listed in order of size of production.

While farmer organization and trading models are not necessarily rooted in their geography or the associated politico-economic systems, politics, policies and economic profiles certainly play a role in shaping the way trade works. Another significant factor is the globalization of commodity markets and textile supply chains.

PRODUCTION, CERTIFICATION FACILITIES & RETAIL

The graphic below provides an overview of the top countries for organic cotton production and certified facilities, as well as the top users of organic cotton by volume at the brand/retail level. In 2015, there were 19 countries producing a total of 112,488 mt organic cotton, 48 countries with a total of 3,126 units certified to OCS, and 68 countries with a total of 3,814 units certified to GOTS. Our research shows that organic cotton is most likely to be manufactured into general apparel (t-shirts, basics, intimates, babywear, kids-wear), outdoor/sportswear, and home textiles, and that the main retail markets for organic cotton products are North America and Europe.

TABLE 5: TOP 10 COUNTRIES FOR ORGANIC COTTON PRODUCTION AND CERTIFIED FACILITIES, AND TOP TEN USERS BY VOLUME


TRADING MODELS

Whereas in Section 1 best practice trading models were examined, in this part of the report we are looking at the current situation of the different types of trading that occur within the organic cotton sector. It is organized by region and country, and their dominant trading models for organic cotton. Countries are listed in order of size of production.
### Types of trading models

There are a variety of ways organic cotton is traded, and this report does not claim to be exhaustive. However, the most common approaches are summarized in the table below, and the following pages explain the adoption of these models in different countries. It is important to note that due to the number of possible variations (and hybrids), only the typical and commonly adopted trading models and scenarios are presented.

<table>
<thead>
<tr>
<th>TYPICAL TRADE MODEL OPTIONS</th>
<th>CONVENTIONAL SOURCING</th>
<th>AGENT/TRADER ASSISTED SOURCING</th>
<th>GOVERNMENT INTERVENTION MODEL</th>
<th>NOMINATED SOURCING</th>
<th>VERTICALLY INTEGRATED SOURCING</th>
</tr>
</thead>
<tbody>
<tr>
<td>The brand works directly with their primary supplier. Each level of the supply chain trades with its direct client. Price and payment is made directly to the downstream supplier.</td>
<td>Business arrangements are handled directly by an agent or trader on behalf of the brand. The brand pays the agent directly and the agent will control the sourcing, supply chain activities, and payments.</td>
<td>The gins are government owned and play a dominant role, particularly when it comes to price setting, sales and marketing, and export. Most common in West Africa.</td>
<td>The brand nominates suppliers back to spinner (potentially ginners and producers) and creates a selected supplier list for all business transactions.</td>
<td>The textile company supports farmer organization. Contracts are agreed where possible. The PG is part of an integrated supply network.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXAMPLES</th>
<th>Global</th>
<th>Global</th>
<th>Benin</th>
<th>Global</th>
<th>Countries that both grow cotton and manufacture e.g. India, Turkey, Egypt, Peru</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securing supply</td>
<td></td>
<td></td>
<td>★</td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>Early demand signaling</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agreements with spinners or ginners</td>
<td></td>
<td></td>
<td>★</td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>Guaranteed uptake</td>
<td></td>
<td></td>
<td>★</td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>Quality control management</td>
<td></td>
<td></td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Open book costing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pricing mechanism in place</td>
<td></td>
<td></td>
<td></td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>Farm capacity building/Input credits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>★</td>
</tr>
<tr>
<td>Farm price transparency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>★</td>
</tr>
<tr>
<td>Risk and reward sharing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>★</td>
</tr>
<tr>
<td>Supporting Fair Trade certification</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSR/Community investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>KPI data collection and monitoring</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leveraging access to financial services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer Engagement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

There are a variety of ways organic cotton is traded, and this report does not claim to be exhaustive. However, the most common approaches are summarized in the table below, and the following pages explain the adoption of these models in different countries. It is important to note that due to the number of possible variations (and hybrids), only the typical and commonly adopted trading models and scenarios are presented.
### Farmer Organizational Models

Most organic cotton farmers work within some kind of organizational structure, formally or ad-hoc. This structure is commonly termed a farmer or producer group (PG). PGs are typically clustered geographically and share an Internal Control System (ICS). PGs can fall into a number of different structures ranging from informal through to formally registered farmer “associations” or “cooperatives.”

<table>
<thead>
<tr>
<th>TYPES OF FARMER ORGANIZATIONAL MODELS</th>
<th>CONTRACT FARMING</th>
<th>FARMER ASSOCIATION</th>
<th>FARMER COOPERATIVE</th>
<th>NGO-SUPPORTED INITIATIVES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farmers may be independent or have formed associations, companies, or cooperatives to grow cotton under contract to a ginner or textile company. The contractor may hold the ICS.</td>
<td>Small scale farmers come together to share costs, inputs, resources, and knowledge. Farmers benefit from larger scales and other efficiencies. Associations usually have a backbone organization that holds the ICS.</td>
<td>Similar to above but often with a more formal and official structure. Decisions are made by consensus within the cooperative. The farmers will have joint ownership of the ICS.</td>
<td>Farmers funded, organized, trained and otherwise supported by an NGO partner. Usually the ambition is for the “project” to graduate to an independent and autonomous status such as an association or coop.</td>
<td></td>
</tr>
<tr>
<td>69% global organic cotton production.</td>
<td>15% global organic cotton production.</td>
<td>4% global organic cotton.</td>
<td>15% global organic cotton.</td>
<td></td>
</tr>
</tbody>
</table>

#### BEST PRACTICE EXAMPLES

- Appachi (India)
- Bergman Rivera (Peru)
- Egedeniz – Kadiaglu (Turkey)
- Esquel (China)
- Pratibha – Vasudha (India)
- Remei – bioRe Ltd. (Tanzania, India)
- SEKEM (Egypt)

- Agrocel (India)
- Bio Services (Kyrgyzstan)
- Planta Ltd. (Tanzania, India)
- EcoFarms (India)
- Vasudha (India)
- YAKAAR NIANI WULLI (Senegal)

- Bio Kishovarz Coop (Tajikistan)
- Chetna Organic (India)
- Texas Organic Cotton Marketing Cooperative (USA)

- ADEC & ESPLAR (Brazil)
- Helvetas & UNPCB (Burkina Faso)
- JHC & CAPROEXNIC (Nicaragua)
- PAN & OBEPAB (Benin)

#### PROS

- May include: volume aggregation, capacity building, extension services, community investment, guaranteed uptake and other terms and conditions of trade.
- May include: volume aggregation, capacity building, extension services, community investment, group marketing, shared costs, inputs, resources, and knowledge.
- May include: joint ownership and decision making, shared risk and reward, volume aggregation, capacity building, extension services, community investment.
- May include: investment in group development and capacity building, volume aggregation, community investment.

#### CONS

- May include: dependency on the contractor, trade/price vulnerability, low bargaining power and other trade relation vulnerabilities.
- May include: uncertainty of sales, trade/price vulnerability, low bargaining power and other trade relation vulnerabilities.
- May include: uncertainty of sales, trade/price vulnerability, low bargaining power and other trade relation vulnerabilities.
- May include: dependency on the NGO, uncertainty of sales, trade/price vulnerability, low bargaining power and other trade relation vulnerabilities.

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India trading models

FARMER ORGANIZATION

India produces the majority of the world’s organic cotton, and is an importer and exporter of fiber to and from other producing countries. India is an important manufacturing hub for the organic sector.

Most organic cotton farmers in India are small scale, occupying 2 ha or less of land on which they tend to grow a number of rotation and intercrops (such as oilseed crops, beans, lentils, grains, and spices). They tend to be organized into producer groups (PGs) of no more than 200 farmers as required by APEDA (the Indian government regulation and certification scheme/NPOP).

Producer groups are orientated around villages, usually with centralized bookkeeping schemes and sometimes extension teams. Some are supported by either local or global NGOs, ginners, or mills, who help out with training, inputs, and sometimes pre-financing.

Although formal contracting is not legal in India (i.e. the farmers are free to sell to whomever they wish) there are often agreements in place between producers and their ‘partners.’ PGs may be more formally structured as associations, cooperatives, or private companies.

TRADING MODELS

There are a number of trading models in place in India, including:

- Conventional Sourcing
- Nominated Sourcing
- Direct Sourcing
- Trader (or Agent) Assisted Sourcing
- Farmer Integrated Sourcing

78. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C: Methodology).
China trading models

FARMER ORGANIZATION
Farmers in China are typically organized in one of three ways:

- Small-scale farmers who own the land they are farming. Some may lease land from neighboring farmers to increase their production. This is the likely scenario in most parts of China where big land plots are scarce. This is also typical for conventional cotton farming.

- A small percentage of farmers are organized in cooperatives. The Puhan Farmers Association in Shanxi province with a membership of 3,800 farmers covering 35 villages is one such example. The project is managed by Mecilla and is based on a model of sustainable rural community producing organic crops.

- Government owned and operated farming companies. This model is only common in the Xinjiang province where large land plots are available and where historically the government has disbanded the military corps to settle. In such cases, the farmers working on the field are not farmer/owners but workers who are employees of a government run organization. These organizations operate under the directive of the Chinese government. Of the eleven organic cotton projects in China, six operate within the Xinjiang province.

TRADING MODELS
There are three typical trading models in China for organic cotton textiles.

- Conventional Sourcing

- Conventional/Nominated Sourcing - The brand agrees on the fiber price with the ginner (or producer group) and the ginner sells the fiber to a spinning mill, then the mill to the knitter/weaver, knitter/weaver to dye house/finisher, and dye house/finisher to a garment manufacturer that has been nominated by the brand.

- Trader Assisted/Direct Sourcing - The gin sells lint to a trader who typically sells either to a garment manufacturer (CMT) or possibly direct to a brand. In this case, the CMT (or the brand) purchases fiber from the trader and then supplies it through its own supply chain while maintaining ownership of the raw materials. If maintained by the CMT, they will, in turn, sell to the brand.

79. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C: Methodology).
Turkey trading models

FARMER ORGANIZATION
Organic cotton is predominantly grown in the Aegean/Izmir region and in Southeastern Anatolia (SEA). There are typically three models of organic cotton production:

- Independent farmers with their own land, providing their own labor, family or hired workers.

- Organic cotton project owners or traders with their own gins and contracted growers. There are several large traders running organic cotton projects in different parts of Turkey. Some have their own land and own gins, especially in SEA. Some have their own contracted growers. Some operators hold stock in the gin, others in warehouses. Usually most of the cotton is consumed from one season to the next, and stock piling is not common.

- Integrated cotton and textile production. For example the Kadiaglu-Egedeniz model. Kadioglu Tarım A.Ş, the agricultural company contracts growers, and the sister company Egedeniz (an integrated textile manufacturer) buys the organic cotton. Kadioglu trades many types of organic fruits and foods as well as fiber. The company employs agricultural engineers who provide support to the growers and may also help with financing.

THE GAP PROJECT
The Regional Development Administration of the Ministry of Development (GAP RDA), is implementing the “Southeast Anatolia Project” (GAP), a large scale multi-sector regional development project. This project aims to foster regional prosperity, eliminate regional disparities, and put regional water and soil resources to the best use to raise the region to the same level as developed regions of the country. The GAP Organic Agriculture Cluster (GAP-OAC) Project is being implemented in cooperation with the United Nations Development Programme (UNDP).

TRADING MODELS
In the past, some brands used to nominate the spinner or grower, but according to sources, this is not so common anymore because the focus has been on cheaper prices and ‘playing the field.’ Brands are more likely to simply inform their garment producers (CMTs) on how many organic cotton pieces they want in a year, and the CMT goes to the fabric producer or spinner to source product.

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80. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C. Methodology).
USA trading models

In the USA, the majority of organic cotton farmers operate within a cooperative or as independent farmers. They are relatively larger landholders compared to the farmers in the Global South.

At harvest, farmers typically apply for a government loan for the amount of cotton they harvested at an interest rate of US $1.10/kg (US $0.50/lb). The interest received helps farmers finance their inventory. The seed cotton is then passed to the cooperative for classing, grading, then ginned and stored in a warehouse until a sale is made.

Ginning is usually a leased service paid by the farmers whereupon farmers maintain ownership of the cotton. Ginning fees are typically subtracted from the value of the cottonseed (byproduct). Cottonseed is sold on behalf of the farmers, mainly to organic dairies. As the market for cottonseed has been strong, the gins pay the surplus back to the farmers – this has acted as a buffer for the farmers against the falling cotton price.

Most ginners will have their nominated warehouse with a designated area for organic cotton. Cooperatives arrange storage terms and conditions. Sales are normally completed with spinners and the cooperatives will arrange for transportation of the fiber from the warehouse to the mill.

The cooperative sells the fiber throughout the year. The funds are accumulated by the coop and distributed to the farmers according to the volume and quality of the cotton delivered at harvest. For this reason, it is possible that the farmers do not receive their full return until over a year later.

The government loan is available for nine months which means farmers have means to finance their inventory for the same period. If the cooperative does not manage to sell all the cotton within the nine months, farmers will need to source for alternative means of financing.

TRADING MODELS

There are typically three trading models in the US.

- **Nominated Sourcing** - The cooperative agrees on the fiber price with a brand but sells its fiber to the spinning mill nominated by the brand. For this model, ginning services are leased.

- **Trader Assisted Sourcing** - The cooperative sells to traders (or ginners who occasionally act as traders). This is the preferred trading model for exports, as cooperatives can pass over the payment risk, storage and shipping costs. Cooperatives work with their preferred traders and would typically know the brand, which they are selling to.

- **Direct Sourcing** - The less common means of trading is selling fiber direct to a brand. In such cases, the cooperative negotiates and sells directly to the brand and delivers the fiber to a mill specified by the brand.

As the production of organic cotton in the US is predominately rainfed, production varies significantly from year to year. In the last five years, the US production of organic cotton has been low due to drought. With the shortage of supply, organic cotton farmers could maintain their prices and did not have to compete in the world market. With excess supply in 2015, the US farmers are now more vulnerable to the low prices in India as they will need to compete in the global arena. For this reason, the target market for the US organic cotton is primarily domestic – to companies who are likely to support US farmers and jobs. These companies are also likely to be on the higher end.
Organic cotton trading models – Section II

Farms are organized in three ways: Contract farming or independent projects with workers.

The trading model is applicable across each of the farm organizations irrespective of how it is organized.

Farmer Organization may own or lease gin.

Mill, Knitter/Weaver and CMT may be vertically integrated.

--- Fiber US 1.20-1.25/kg

--- Seed Cotton US 0.90-1.00/kg

81. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C: Methodology).
Africa trading models

TANZANIA

In Tanzania, there are two main, well-established producers of organic cotton, bioRe Tanzania Ltd and BioSustain Ltd. Both bioRe and BioSustain are privately owned cotton companies, working with a little over 2,000 farmers each in the regions of Shinyanga and Singida, respectively. BioRe Tanzania is part of a wider network of organizations including bioRe India Ltd, which works in partnership with the bioRe Foundation and Remei AG, based in Switzerland.

There is vast potential for organic cotton to expand in Tanzania (in terms of suitable land and income opportunities for farmers). Emerging investment interests could lead to an increase in the future, providing regional support and capacity building.

FARMER ORGANIZATION

In Tanzania, farmers are organized into producer groups and are under contract with bioRe or BioSustain. The term “contract” farming may be more appropriately defined as an agreement whereby the cotton company agrees to buy from the farmers, and the farmers agree to sell to the cotton company. Obligations aside, the farmers have no legal responsibility to sell to the cotton company. Organic cotton prices are negotiated each year between the farmers and the cotton companies. The cotton companies own or lease ginning services.

TRADING MODELS

Tanzanian fiber tends to be shipped to India, China, Bangladesh, or Turkey for manufacturing. However, Sunflag, a fully integrated textile and clothing company, offering value-added products (spun yarn, fabrics, and finished product) is located in Arusha, northern Tanzania. In the case of bioRe-Remei, the company offers an integrated textile production service from fiber to finished garment.
BURKINA FASO

Burkina Faso trades differently to the rest of West Africa. Organic cotton farmers in Burkina Faso operate within the UNPCB cooperative. The Coop has had NGO support from international NGOs; Helvetas, Catholic Relief Agency (RECOULT) and USAid. UNPCB, as a business, has partial share of Sofitex, which is the biggest gin and organic cotton company in the country. In 2014/15, there were 8,382 certified organic cotton farmers, farming on a total of 4,928 ha of land.

For five years UNPCB held a contract with a leading brand. The contract with the leading brand came to an end in 2015 and was not renewed by the company. UNPCB is currently looking for new partners.

Brand-Producer Group – Direct Sourcing:

- Under contract, the leading brand paid €1.50/kg directly to UNPCB farmers for their certified Organic-Fairtrade seed cotton (inclusive of transport and services). This price is significantly higher than the market average of €0.50/kg which is the Fairtrade Minimum Guarantee Price (MGP).
- A separate ginning fee was negotiated and paid by a leading brand to Sofitex. As UNPCB has shares in Sofitex, they can obtain a better ginning rate at €100/mt (€0.10/kg) while the market ginning cost is around €120/mt (€0.12/kg). The cotton fiber was picked up by a logistics company and shipped to India for spinning and weaving. The fabric was then shipped to Sri Lanka for further processing.
- UNPCB would sell the remaining seed cotton that was not taken up by the leading brand to a cotton trader. The organic cotton fiber price is estimated between €2.50-3.20/kg.

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83. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C: Methodology).
**BENIN & MALI**

The trading models for Benin and Mali are similar. Organic cotton farmers belong to a cooperative. Coops are supported by NGOs; OBEPA and PAN (in Benin) and Helvetas (in Mali). All cotton produced by the cooperatives must be sold to a government owned gin that receives a seed cotton price (in 2016 it was US$0.57/kg (€0.50/kg). This price is the minimum Fairtrade Guarantee Price. The gin then sells the fiber to either a trader or a brand, which specifies to which mills they should ship.

**FIGURE 26: TYPICAL TRADING MODELS AND SCENARIOS BASED ON ORGANIC COTTON PRODUCTION IN BENIN AND MALI**

- **Farmer Organization**
  - Seed Cotton US 0.57/kg (Fairtrade Minimum Price)
- **Farmers**
- **Cooperative**
- **Gin** (Gov’t Owned)
  - Farmers Cooperative
- **Mill**
  - Knitter/Weaver
  - Trader
- **Brand**
  - CMT

*Farmers are part of a farmers cooperative.
Gin is government owned and all cotton must be sold to government owned gin.*

**SENEGAL**

Yakaar Niani Wulli (YNW) / Koussanar is a farmer cooperative. YNW produces only a small quantity of organic cotton. There is no monopoly in Senegal, and the seed cotton is sold to a local ginner or further afield. Clarity has not been established on the trading model except to say the majority of fiber is likely to be exported for processing. It’s possible that some remains for local handicraft.

**FIGURE 27: TYPICAL TRADING MODELS AND SCENARIOS BASED ON ORGANIC COTTON PRODUCTION IN SENEGAL**

- **Farmer Organization**
  - Seed Cotton US 0.57/kg (Fairtrade Minimum Price)
- **Farmers**
- **Cooperative**
- **Gin**
- **Trader**
- **Brand**

*Baled lint exported for spinning and further processing

84. Textile Exchange. Pricing & Trading Model Interviews (Refer to Appendix C: Methodology).
85. ibid.
E-DISCUSSION SUMMARY

The Global Organic Cotton Community Platform (GOCCP) is a web-based platform managed by HELVETAS Swiss Intercooperation and Textile Exchange. The GOCCP is set up to share knowledge about organic cotton with the organic cotton community worldwide and has a membership of over 800 practitioners and academics. A key function of the GOCCP is to coordinate and mediate community discussions on themes important to the community (with topics agreed by the community). Following below is the summary of the community’s discussion on pricing systems.

TOPIC: WHAT IS A PRICING SYSTEM THAT WORKS FOR ALL IN THE SUPPLY CHAIN?

The discussion tended to be split between those who believe market forces will ultimately dictate organic cotton prices and that attempts to intervene will prove fruitless, and those who think a floor price or any other pricing mechanism for organic cotton is achievable since the apparel industry is willing to acknowledge the true cost of organic cotton production (which incorporates environmental and social costs). Kering’s use of Environmental Profit and Loss accounting was cited as one working example of this. Using social and environmental externalities as additional ways for markets to set prices would add to the quality and transparency of information that is currently lacking.

The “polluter pays principle” was discussed and it was suggested that the fee could contribute towards organic certification costs, helping to keep certification costs at an acceptable level. IFOAM explained that their organic standard will be revised and that Organic 3.0 aims for true value and fair pricing. Organic 3.0 shall enable more possibilities to show the full spectrum of sustainability of organic cotton (e.g. on food security, soil fertility, biodiversity, etc.) and leverage policy changes by true cost accounting. It was questioned whether a premium should be mandatory under certification, however, there was no answer from certifiers or standard setters on this point.

It was mentioned that many companies in Europe are sourcing organic cotton or textiles from India and thereby revealing their sensitivity to price. This point was reinforced by statements that growers are only price-takers, and that buyers are not willing to pay to keep growers in business if they can buy somewhere else at a lower price. Furthermore, most postings from members representing farmer organizations explained the difficulties of selling organic cotton at a premium price, and how, consequently, they can end up selling considerable shares as conventional (30-40% in the case of Tanzanian production). One US producer still holds good quality organic cotton in stock. He wrote: ‘there are plenty of interested buyers that say they want to buy organic cotton, but very few buyers!’ It was therefore questioned whether a sustainable market for organic cotton really exists, and at the same time it was noted that organic cotton gets a lower premium than organic vegetables. Some argued that the organic cotton market is always linked with the conventional price (which is low at the moment) and that the price for organic cotton should be disconnected from the stock exchange.

Experiences with the price model of Fairtrade International were shared and a further need to better understand costs and premiums in the supply chain was noted: we need to understand if these are correct and/or whether they are unnecessary inflations, for example through inefficiencies linked to poor economies of scale or rent-seeking. It was discussed whether premiums are sustainable or just affect the potential size of the organic market, or whether better pricing for organic cotton should come through making conventional cotton reflect its true cost.

The definition of a premium, however, is not standardized. Often it is determined as a percentage of the conventional price, rather than taking into account the quality of the fiber or the environmental or social costs. As fiber quality differentials are of such huge significance to spinners, it was recommended to move towards universal HVI (high volume instrument) testing. It was also recommended that more effort should be put towards transparency, timely reporting and quality measurements rather than on trying to establish a floor price or distribute risks of production, which have been tried in the past and found to fail in the long run.

It was recommended that efforts should concentrate on investment in the efficiency, timeliness and availability of data from the organic cotton market (something that Textile Exchange is currently working towards) rather than simply continuing to test pricing models that ‘will never succeed.’

However, some more optimistic contributions came from those sharing experiences of successful closed-chain systems. One example given was of a system used in India where a simple (one page) contract is setup with farmers, describing his/her duties and an agreed price. If the conventional price is lower than the agreed price at the time of sale then the producer is happy. If the price goes up the farmer would still need to give a certain percentage of the
harvest at the agreed price. This example illustrates how knowing the price upfront is not only of interest to the farmers, but also to the buyers.

The closed chain of the South-African Sustainable Cotton Cluster was presented, which comprises a whole region with an integrated supply chain, an information technology platform and an innovative price mechanism based on production costs (revised annually) plus a sustainable (fair) margin according to risk profiles. The price is decoupled from the global cotton price and fixed before the time of planting. Through this method, the price remained stable for over four years.

It was also discussed whether a floor (and ceiling) price should be determined globally, or whether the price for organic cotton should vary geographically (e.g. by country/region or even village). While the idea of a minimum price met some resistance, the current system has not allowed for the stability required to grow organic. Income levels are often insufficient to support farmers’ transition to organic, particularly smallholders, and extension services are often needed that are not provided by existing support structures. Time is also needed for farmers to improve their productivity (which can take 5-7 years). It was not clear how to effectively meet these needs, especially when prices are declining and other market forces, such as government interventions and speculation, further increase price volatility.

There was a suggestion to only add the premium at the final stage, to avoid inflation throughout the supply chain. Towards the end of the e-discussion, the potential value of the Fonds de Lissage (applied in Burkina Faso and Ivory Coast) was discussed. The publisher of the paper “Capturing margins: World market prices and cotton farmers income in West Africa” reported his findings on the mechanism: the Fonds de Lissage strongly favors cotton ginning companies and traders rather than farmers.

At the end of the three week e-discussion, many aspects of cotton pricing had been explored but it seemed obvious that there was no consensus on what a sustainable pricing model for organic cotton should look like. The most successful examples provided seemed only to work in closed value chains.

- Summary prepared by Andrea Bischof of HELVETAS Swiss Intercooperation following the GOCCP E-discussion in March 2016.

86. Global Organic Cotton Community Platform - part of www.organiccotton.org
## APPENDIX B: FAIRTRADE PRICING BY REGION

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<tr>
<th>REGION</th>
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The position and findings put forward in this report are the result of almost 12 months of deep enquiry by the authors into the pricing and trading of organic cotton. The authors have also drawn on their years of experience in researching and analyzing the organic cotton market.

Specific quantitative and qualitative information on pricing and trading models has been sourced in the following ways:

1. Site visits – During the year, visits were made by TE staff and ambassadors to producer group headquarters and farms, gins, spinning mills, and other textile processing factories. Face-to-face discussions and tours of facilities were made to better understand the trading of organic cotton products through the processing chain.

2. Market reports – Each year production and consumption data is collected by TE staff and ambassadors. See the Organic Cotton Market Report 2016 (page 77) for a comprehensive overview of the farm and fiber data collection methodology. Year-on-year pricing data allows for regional comparisons and trend analysis as presented in Section II of this report.

3. In-depth interviews with regional ambassadors based in the top 4 producing countries: Africa, China, India, and Turkey. Representatives from the USA (the 5th largest producer) were also involved.

4. In-depth interviews were conducted with selected industry experts.
   - Arun Ambatipudi, Executive Director, Chetna Organic, India
   - Rhett Godfrey, Co-founder and Coordinator, Chetna Coalition (ChetCo), USA
   - Kelly Pepper, President, TOCMC, USA
   - Heinrich Schultz, Coordinator, SA Sustainable Cotton Cluster, South Africa
   - Aydin Unsal, Owner, Egedeniz, Turkey
   - Tong Yeong, Founder, Mecilla, Hong Kong (HQ) and China

5. Online market references and tools – Conventional commodity market was also obtained through websites such as the Cotlook Index, the Mundi Index, International Cotton Advisory Council (ICAC), and Cotton Incorporated.

6. Information on trading and pricing of Fair Trade cotton was obtained from Fairtrade International and the Fairtrade Foundation.

7. Organic cotton prices used to explain how the various trading models or pricing mechanisms work are either illustrative or have been provided by interviewees.

DISCLAIMER

A World Beyond Certification: A Best Practices Guide for Organic Cotton Trading Models is based on data and information collected in accordance with the methodology referenced above. While TE has followed a sound data collection and management process, TE does not verify the data provided and reported.
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This list of organic cotton suppliers acts as a sample, and not as an exhaustive list of suppliers. For a full list of up to date organic cotton producers or for further details please contact Textile Exchange: materials@textileexchange.org
AGGREGATOR
Organisations which have started to play a major role in collecting raw cotton from farm gate and selling on the consolidated produce. Often, the aggregator will be the ginner or producer group, and is often supported by an NGO.

CERTIFICATION BODY (CB)
A CB is an accredited third party organisation that allows for transparent, consistent, and comprehensive independent evaluation and verification of organic material content claims on products.

CHAIN OF CUSTODY (COC)
A chain of custody standard verifies that certified materials (e.g. organic, recycled, FSC) have been identified and segregated from non-certified materials through the various processes of the supply chain. It helps establish traceability and verify content but does not address other social and environmental criteria.

CUT, MAKE, TRIM (CMT)
This is a pricing term used in the garment industry to represent the part of the textile process where manufacturing is undertaken in a production facility. Namely, design elements and fabric are sent to the CMT operation, which will cut the fabric, sew it as indicated, and add any trim or embellishment needed.

FREE ON BOARD (FOB)
A term of sale under which the price invoiced or quoted by a seller includes all charges up to placing the goods on board a ship at the port of departure specified by the buyer.

GENETICALLY MODIFIED ORGANISM (GMO)
An organism or microorganism whose genetic material has been altered by means of genetic engineering. GMOs are also referred to as genetically engineered (GE), herbicide-tolerant (HT) or Bt crops. The use of GMO seed is prohibited in organic production.

GLOBAL ORGANIC TEXTILE STANDARD (GOTS)
The Global Organic Textile Standard (GOTS) was developed through collaboration by leading standard setters with the aim of defining requirements that are recognised world-wide and that ensure the organic status of textiles from harvesting of the raw materials through environmentally and socially responsible manufacturing all the way to labelling in order to provide credible assurance to the consumer. See http://www.global-standard.org/.

INTERNAL CONTROL SYSTEM (ICS)
An Internal Control System is the part of a documented quality assurance system that allows an external certification body to delegate the periodical inspection of individual group members to an identified body or unit within the certified operator. This means that the third party certification bodies only have to inspect the wellfunctioning of the system, as well as to perform a few spot-check re-inspections of individual smallholders (IFOAM).

OPEN BOOK COSTING
A collaborative pricing model between customers and their suppliers where suppliers reveal their true cost structure to reach a mutually agreed upon price. Open book costing improves transparency between customers and suppliers and allows the formation of long-term relationships based on this transparency. In organic cotton, this model can ensure equitable distribution of profits to all actors in the supply chain.

ORGANIC CONTENT STANDARD (OCS)
Relies on third-party verification to verify a final product contains the accurate amount of a given organically grown material. It does not address the use of chemicals or any social or environmental aspects of production beyond the integrity of the organic material. The OCS uses the chain of custody requirements of the Content Claim Standard (CCS), another standard developed by Textile Exchange verifying the inclusion of certain content in a product. See http://textileexchange.org/wp-content/uploads/2016/06/Organic-Content-Standard_v2.0.pdf

ORGANIC DIFFERENTIAL (OR "PRICE PREMIUM")
There is no universally-accepted or formalised mechanism for arriving at a price for organic cotton; ironically, making the process of sales transactions far from transparent. The rule-of-thumb is to take the commodity price (this is usually the price quoted in the country of origin or on the commodity market at a set time) and add a percentage increase (often called a ‘price premium’). This percentage can range from 5 to 50 percent depending on a number of factors such as market conditions/price elasticity, arrangements between supply chain players, and product quality. The premium is supposed to cover cost of production (for farmers), organic certification, training and extension services, and investment in farming operations. Depending on the way the producer group is structured, a percentage of the premium may go towards the collective needs of the community such as schooling, health care, and housing. The objective of the price premium is to help both parties arrive at a fairer price; one that is more likely to reflect the cost of production and viability of the business.
However, pricing organic in this way is still vulnerable to the volatility of the commodity market.
See [http://farmhub.textileexchange.org/learning-zone/pricing-organic](http://farmhub.textileexchange.org/learning-zone/pricing-organic)

PRODUCT SEGREGATION
Separating an agricultural commodity or product from other varieties of the same commodity or product during production and harvesting, with assurance of continued separation from similar commodities during processing.

PRODUCERS GROUP (PG)
A group of farmers working collaboratively to produce organic cotton to economic scales. The group is usually defined by geographical location such as village. The cooperative nature of the group enables the structure, organisation and various specialised roles to develop (such as leadership, marketing, administration, ICS, training management) necessary to build a successful business. A producer group may be a cooperative, NGO-supported project, company, independent farmer association and so on.
See [http://farmhub.textileexchange.org/learning-zone/glossary](http://farmhub.textileexchange.org/learning-zone/glossary)

SCOPE CERTIFICATE (SC)
A certificate issued by an accredited certification body for a processing facility to verify that it has met requirements to process organic material.

 TRANSACTION CERTIFICATE (TC)
Document issued by an accredited certifying body to verify the origin and organic status of products sold by organic certified operations. The TC is the proof that the product sold/purchased was grown in accordance with organic standards. The TC is sent to the buyer of the product. A TC is also sent to the seller to include with his/her audit trail documents. TCs should be requested and used at the time of each organic sale.

VALUE CHAIN
A chain of activities in which the product (cotton) gains in value on its downstream journey from production to final consumption.
[http://farmhub.textileexchange.org/learning-zone/glossary](http://farmhub.textileexchange.org/learning-zone/glossary)