Spearheaded by **Ani Wells** and **Anne Oudard**
and supported by **Cotton Diaries** and **Simply Suzette**

Who Made My Cotton

#3

Conducting an investigation within the denim industry to identify the roadblocks toward radical transparency on cotton's origins

step 3

the cotton traders

Cotton Diaries

SIMPLY SUZETTE
ESTD 2018
- DILIGENT DENIM -

INTRODUCTION

We are on a quest to uncover the roadblocks and solutions in the denim industry for full cotton traceability. The denim supply chain is complex, with many winding roads, making it difficult to create truly traceable jeans from farm to shelf. However, a segment that is often overlooked and deserves attention are the cotton traders of the world.

Working our way down the denim supply chain, phases one and two of the #WhoMadeMyCotton qualitative research study interviewed individuals involved in the business of making jeans and denim fabric, and uncovered that traceability becomes challenging at tiers 3 and 4, which include yarn spinners and raw material providers. We also learned that spinners obtain their raw cotton via cotton traders.

In this third step of our research, we conducted interviews with prominent figures in the cotton industry. These individuals included traders from three of the most established cotton trading companies, an independent cotton broker, an organic cotton merchant, and a member of the International Cotton Association (ICA) board.

The initial section of this report provides a comprehensive overview of the role of cotton merchants in the cotton supply chain. It examines the mechanics of cotton trading and explores the process that occurs when spinners request cotton supply from merchants.

In the second part, we engage in discussions with these merchants to understand their views on transparency and uncover their roadblocks and solutions for a radically transparent cotton supply chain.

The final segment of our report opens the discussion on future opportunities and challenges of the cotton trading industry.

We would like to thank all the trading experts who kindly granted us their time and shared their expertise with us during the interview process. Their patience and willingness to educate us on the intricacies of the cotton trading industry have been invaluable to our research.

We'd also like to give a special shout out to Steven Beckert for his book, "Empire of Cotton: A Global History," that guided us through the history of cotton trading.

Last but not least, we extend our sincere appreciation to the **Cotton Diaries** team for their support and insightful feedback throughout the course of our project!

step 3
the cotton traders

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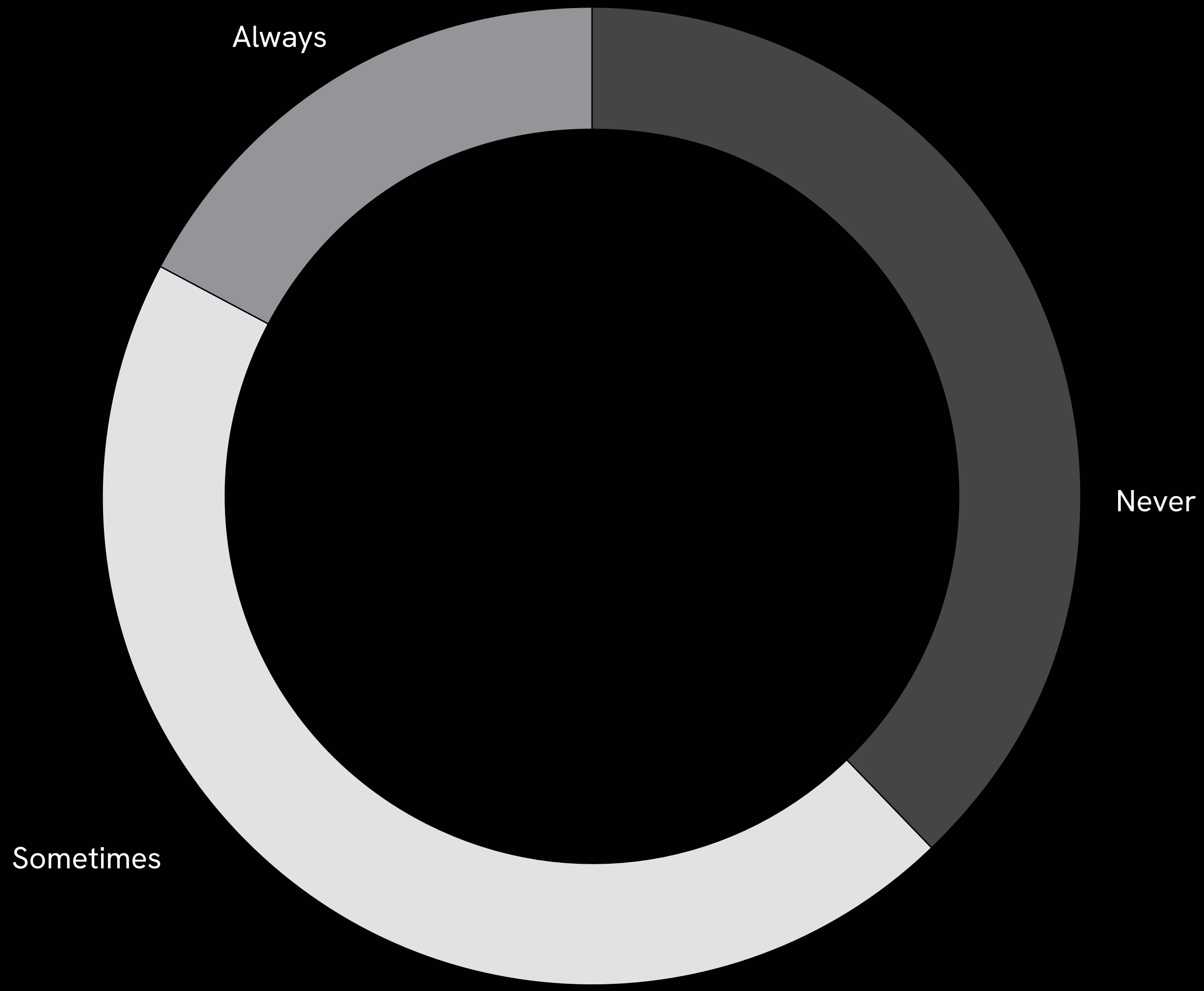
When we started this research study, we asked denim brand professionals if, when buying denim, they knew who the cotton traders were. 44,8% answered "sometimes", 37,9% "never" and only 17,2% "always".

Do you know who the cotton merchant is?



As a matter of fact, denim professionals working at the brand level don't come across cotton traders very often! So who are the cotton traders and what do they do exactly?

who are the cotton traders

Image by Carsten Vollrath

The denim supply chain is complex, with many winding roads, making it difficult to create truly traceable jeans from farm to shelf. However, a segment that is often overlooked and deserves attention are the cotton traders of the world.

“THEY ARE SPECIALISED NOT IN GROWING OR MAKING, BUT IN MOVING”

- Sven Beckert - Empire of Cotton

HISTORY OF THE COTTON MERCHANTS

Until the 18th Century, European cotton cloth production was very slow to grow. But everything accelerated when in 1784, in Quarry Bank Mill near Manchester, a man named Samuel Greg started to use the water power from the river next to his factory, to put his spinning machines into motion. In 1794, on the other side of the Atlantic, Eli Withney received the patent for the Cotton Gin allowing to separate the cotton fiber from the cottonseed much faster. These innovations were the sparks that allowed industrial capitalism to explode.

In about 3 decades, the productivity of British mills increased by 370 times (Empire of Cotton: A Global History)! Britain's ever increasing need for raw cotton supply consequently drove the rapid expansion of cotton plantations in the United States. Powered by the industrial revolution and slave labor, the cost of cotton dropped and exports rose exponentially.

As the cotton trade boomed, it also started to become more organized and cotton trading companies were created. Not only were these companies in charge of buying cotton from the farms and selling it to the spinners, but they also provided loans, insurances and logistics.

In the book Empire of Cotton, Sven Beckert describes cotton trading in the 1850s as follows :

> "For a planter in Mississippi to provide cotton to a Manchester manufacturer, a local Mississippi merchant, a so-called factor, had to first provide the planter with credit to acquire slaves, land, and implements. This factor probably drew on London or New York bankers for these resources. Once the cotton had ripened, the factor would offer the cotton for sale to exporting merchants in the ports of New Orleans, who would sell it to importing merchants in Liverpool, who would also provide insurance on the bales and organise their shipment to Europe. Once in Liverpool, the importing merchant would ask a selling broker, another type of merchant, to dispose of the cotton. As soon as a buying broker found the cotton to his liking, he would forward it to a manufacturer."

Some of today's largest cotton trading companies were founded as early as 1788 and 1818. But, how has their role evolved throughout the past two centuries?

fun fact:

BEFORE TRADERS WERE PROPERLY ESTABLISHED, CAPTAINS OF COTTON SHIPS COULD END UP BEING IN CHARGE OF FINDING COTTON TO FILL THEIR SHIPS! “EVERY TIMES JAMES BROWN, CAPTAIN OF A LIVERPOOL COTTON SHIP ARRIVED IN THE PORT OF NEW ORLEANS IN THE EARLY 1840S, HE WASTED WEEKS IN THE STRUGGLE TO FIND BALES OF COTTON TO FILL HIS BOAT”

SVEN BECKERT - EMPIRE OF COTTON

THE RECASTING OF THE TRADE

A crucial change in cotton trading (and traceability!) happened during the first decade of the 19th century, when traders started to buy cotton based on a set of quality criterias instead of buying a particular bale.

The historian Sven Beckert called this shift "**A radical recasting of the trade**".

> "Brokers hurried around the port of Liverpool inspecting hundreds of bags and bales, trying to match specific lots of cotton to the needs of specific manufacturers-manufacturers who needed particular qualities to produce particular kinds of yarn. Soon this became all but impossible. Pushed by manufacturers' needs, brokers sought new institutional solutions.
>
> First they moved from physically inspecting each sack of cotton to buying by sample. A small batch of fiber was drawn from each bale and on the basis of that sample a price was determined and sale effected. These samples, unlike the bales themselves, could easily be carried around and even mailed.
>
> In a second step, brokers developed clear standards and a precise vocabulary for cotton ; eventually, manufacturers would acquire cotton without even inspecting samples. They would, in effect, not order a particular bale from a particular place, but from a particular quality. This was a radical recasting of the trade."
>
> - Sven Beckert - Empire of Cotton

The intensification of the trade and the immense volumes of cotton supplies arriving in Liverpool made it impossible for brokers to sell each bale individually. In order to optimize trading, a set of cotton quality standards, defined by a specific vocabulary, was set up.
Samples would be drawn from bales, analyzed and described by these standards, and bales would be sold based on these descriptions.

In the Step 2 of this research study, we talked with denim mills about how they order cotton through traders. They explained that they had specific requirements regarding the quality of the cotton they were buying and those quality standards are defined by fiber length, length uniformity, fiber strength, micronaire, color, leaf, and extraneous matter (aka trash).

THE PROCESS OF SELLING AND BUYING COTTON BASED ON THE DESCRIPTION OF ITS QUALITIES DEFINES COMMODITY TRADING AS WE KNOW IT TODAY.

side note:

THOSE CRITERIAS, DEFINED BY THE INDUSTRY STANDARDS, LED TO MUTATIONS OF THE COTTON PLANT ITSELF. IN OTHER WORDS, THE MARKET PUSHED NATURE TO ADAPT TO THE INDUSTRY’S NEEDS.

THE ROLE OF COTTON TRADERS IN TODAY'S SUPPLY CHAIN

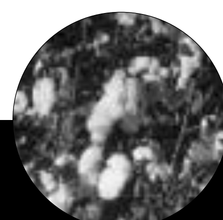
Cotton traders are individuals or companies that buy cotton around the globe, mostly from ginners but sometimes also from farmers, and sell it to yarn spinners. As an international cotton trader described their job to us : "Buy at origin and sell at destination".

Their business relies on "3 pillars : finance, logistics, risk management" said one of our interviewees.

Traders manage financial risks associated with buying and selling cotton. They try to mitigate any potential loss from price fluctuations by "hedging", which involves buying and selling cotton contracts at different prices and different times. (We'll get deeper into "hedging" in the next section) They also ensure cotton producers are paid on time and that spinners get their goods delivered.

After the harvest, cotton goes through the ginning process where it's cleaned and fibers are separated from the seeds. The cotton, in the form of large bales typically weighing around 500 pounds (227 kilograms), is then loaded into trucks then containers, and finally is shipped to the spinning country. Traders, as well as local or national cotton companies, finance and take care of organizing all the logistics of storage and transportation as well as insuring the goods throughout these steps.

Additionally, cotton traders provide market information and insights to farmers, processors, and other suppliers. They advise them on market trends, prices, and other information that can help them make informed decisions about buying and selling cotton.



TO EACH COUNTRY, THEIR OWN TRADING SPECIFICITIES

When buying cotton from the USA, traders deal directly with the ginners unless the gin belongs to the farmer. In Brasil, often large farm owners have their own gins but bales are commonly bought from the ports! Indian and West African farmers usually bring their cotton to a gin whom traders buy from. And in Australia, the transaction is made directly with the farmers, after they've paid the ginners themselves...

Got it?

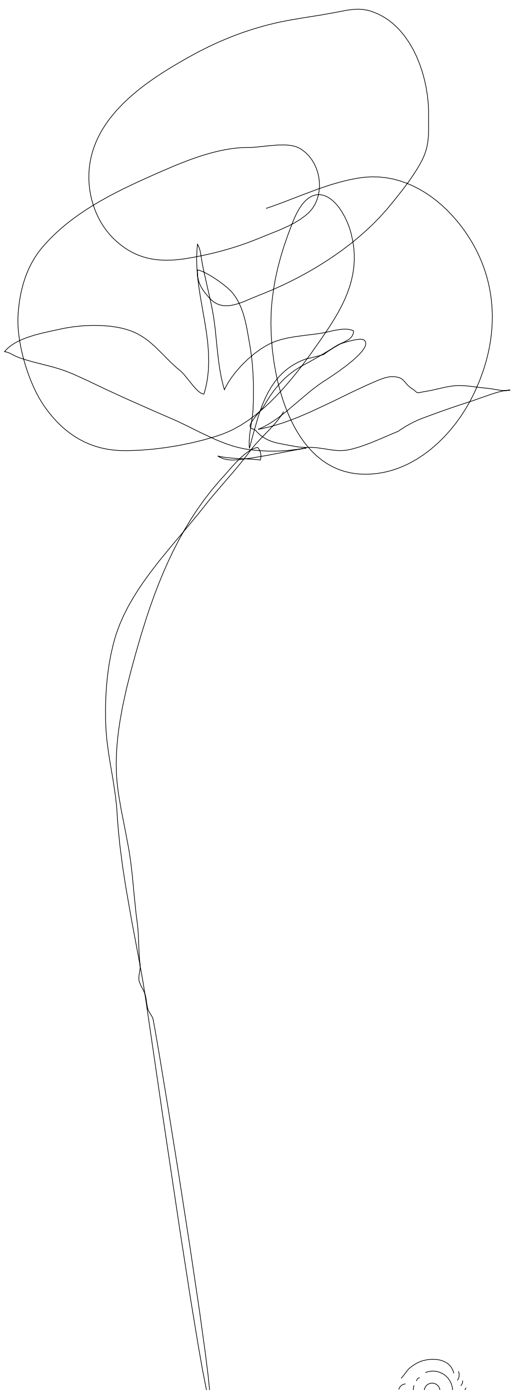
THE ROLE OF COTTON TRADERS IN TODAY’S SUPPLY CHAIN

A trader we spoke to pointed out that “trader” might not be the right word to describe their role and that “Supply chain manager may be more accurate” as they are responsible for overseeing the end-to-end coordination and optimization of activities involved in the production, procurement, and distribution of goods or services within a company's supply chain network.

In the trading process, a broker or agent might also be involved.

Ben Eaves, Director at Wizcot Ltd, defines the role of a broker as “the middleman between the merchant and the producer and/or spinning mill in terms of correspondence”.

He further explains that when a spinning mill contacts them with a request for raw cotton, they would call cotton merchants to obtain price offers. These offers are then presented to the spinning mill, and negotiations would continue until a mutually agreed-upon price is reached.



> “OUR ROLE AS THE AGENT IS TO TRY AND GET THE TWO ENDS TO MEET AT A PRICE THAT WORKS FOR BOTH.”
>
> - Ben Eaves, Director at Wizcot Ltd

glossary of the various actors of the cotton trade

TRADER	A trader is an individual or a company that engages in buying and selling cotton as a principal. Traders take ownership of the cotton and assume the associated risks. They may operate on their own behalf or on behalf of clients. Traders actively participate in the market, seeking profitable opportunities by analyzing market conditions, supply and demand dynamics, and price fluctuations.
BROKER	A broker acts as an intermediary between buyers and sellers in cotton trading. Brokers facilitate transactions by matching buyers with sellers and negotiating the terms of the trade. They do not take ownership of the cotton but earn a commission or fee for their services. Brokers have extensive knowledge of the cotton market, maintain relationships with buyers and sellers, and provide market insights and assistance in executing trades.
MERCHANT	A merchant is typically a company or entity that buys cotton from producers or suppliers and sells it to buyers, often taking ownership of the cotton in the process. Merchants may also engage in other activities such as storage, processing, and logistics. They play a crucial role in connecting producers and consumers, ensuring a smooth flow of cotton through the supply chain. Merchants assume the risks associated with price fluctuations and market conditions.
AGENT	An agent acts on behalf of another party, representing their interests in cotton trading. Agents can work for either buyers or sellers and assist in various aspects of the trading process. They may provide market information, negotiate deals, coordinate logistics, handle documentation, and ensure compliance with regulations. Agents work closely with their clients and act as their trusted representatives in the cotton trading business.

THESE ROLES CAN SOMETIMES OVERLAP, AND INDIVIDUALS OR COMPANIES MAY PERFORM MULTIPLE ROLES SIMULTANEOUSLY OR INTERCHANGEABLY DEPENDING ON THE CIRCUMSTANCES.

trading 101


The cotton market at Bombay, India, 1895

This section discusses the basics of commodity trading, with a focus on cotton as an example. It covers the two main markets for cotton trading, the factors that influence cotton prices, the quality premium and discount system, and the types of contracts used in cotton trading.

COMMODITY TRADING

Cotton is a commodity, a "primary agricultural product that can be bought and sold" (Oxford Languages). It is a raw material bought and sold on global markets.

> "Commodities are the physical goods that are bought and exchanged for the purposes of a final end use."
>
> Tameka Peoples - Seed2Shirt

During one of the interviews we conducted, a trader used this example to better define what a commodity is :

> " When you choose to fill up your car with gas, do you have a preference of which gas company you buy from? No, you buy for the lowest cost. Commodity market by definition is: looking at a list and choosing the cheapest option."

In the case of cotton, this would translate in the lowest cost for the desired criteria, as not all cotton is equal. We will dive into cotton prices in the next section.

There are many exchanges around the world where cotton is traded. Some of the major cotton exchanges are the Intercontinental Exchange (ICE) Futures U.S. in the USA, the Euronext (formerly Bremen Cotton Exchange) in Germany, the Zhengzhou Commodity Exchange (ZCE) in China and the Multi Commodity Exchange (MCX) in India. Most cotton producing countries have their own exchanges too (KEX in Japan, KCA in Pakistan, ACE in Australia, BM&FBOVESPA in Brazil, CEZ in Zambia and the EAX that gathers various East African countries.)

These exchanges facilitate the trading of cotton futures contracts, options, and other derivative instruments. They provide a platform for market participants, including producers, traders, and consumers, to buy and sell cotton contracts based on specific quality standards and contract specifications. The exchanges play a crucial role in price discovery and risk management within the global cotton market.

BUYING ON THE SPOT OR IN THE FUTURE

The trade of cotton can happen on two markets, the “Cash Market” and the “Futures Market” and traders work simultaneously on both of them.

CASH MARKET

The cash market is probably the most intuitive way of trading. In this market, already available cotton is traded for immediate delivery and payment, and the price is based on the current cotton price. It is also known as the “spot market,” as transactions are settled “on the spot”.

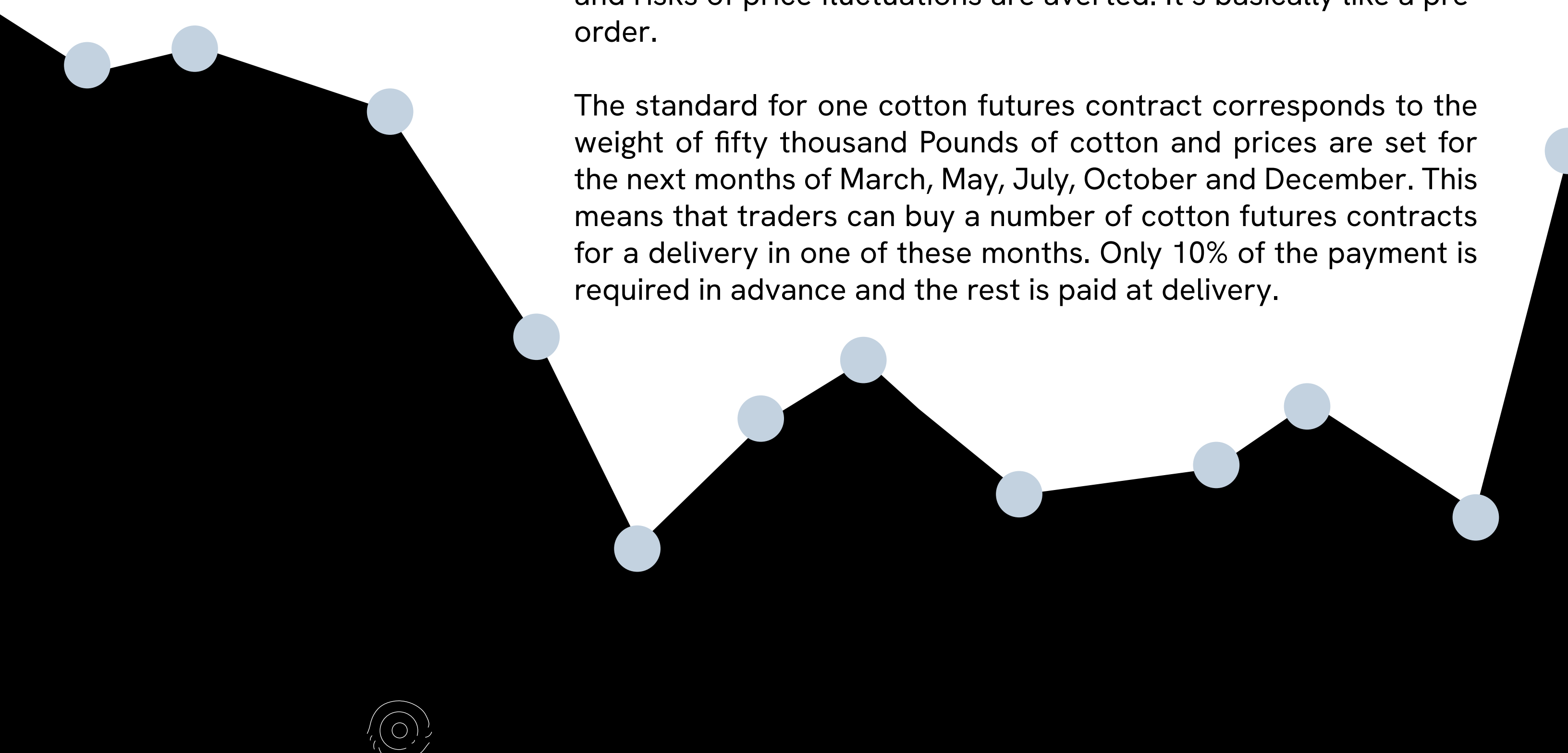
The trade can happen either on centralized exchanges, such as the New York stock exchange, or off-exchange. These off-exchange trades are called “over-the-counter” (OTC) transactions and are made between two parties via a broker.

FUTURE MARKET

> A futures contract is an agreement to later buy and sell a commodity - Thomas A. Hieronymus

Buying cotton futures is a way for traders to secure a supply of cotton at a pre-agreed price for a delivery in the near future. This cotton might not even be planted yet but at least, its price is known and risks of price fluctuations are averted. It’s basically like a pre-order.

The standard for one cotton futures contract corresponds to the weight of fifty thousand Pounds of cotton and prices are set for the next months of March, May, July, October and December. This means that traders can buy a number of cotton futures contracts for a delivery in one of these months. Only 10% of the payment is required in advance and the rest is paid at delivery.



BUYING ON THE SPOT OR IN THE FUTURE

Futures contracts are traded on commodity exchanges, like the Intercontinental Exchange (ICE) in the US, and they're a lifesaver for traders because they can use them to manage the risks against price fluctuations (see paragraph on “Risk Management - Hedging).

HISTORY OF FUTURE CONTRACT

In 1858, the Chamber of Commerce in Liverpool started regulating the first futures contracts, formerly called “to arrive” contracts. These first kinds of “future contracts” of cotton that had not arrived were still rare.

> “Yet gradually the connection between a particular contract and a particular batch of cotton began to weaken. Cotton began to be sold that had not yet been shipped, indeed that would only come onto the market in distant months, and might not even have been planted yet.”
>
> - Sven Beckert - Empire of Cotton

Futures dealings increased during the American Civil War when US supplies were seriously threatened and prices went through the roof.

> “The quantifiable, steady, and ongoing demands of mechanical production encouraged an ever greater abstraction of its essential raw material inputs, protecting manufacturers against price fluctuations and enabling them to price their finished goods across global markets.”
>
> - Sven Beckert - Empire of Cotton

COTTON PRICES

The price of a pound of cotton is set according to its current market price and its quality.

COMMODITY PRICE

The current cotton market price, also called "commodity price" is the real time price of cotton.

The current market price of cotton in USD per pound can be found here. It represents the current supply and demand of cotton.

Anything that impacts the supply and demand of cotton will make its price fluctuate.

As Sven Beckert in Empire of Cotton puts it,

> "Expectations about future price movements obviously mattered a great deal, and thus information about factors that could possibly influence prices—the weather in cotton-growing areas, the effects of wars, the state of regional economies—was precious."

For example, weather conditions directly impact the cotton harvest, leading to variations in the cotton supply and therefore its price. In order to accurately predict upcoming prices, traders must be aware of the weather forecast!

Other events such as the COVID-19 pandemic affected cotton prices, as productions were put on-hold, the demand for cotton decreased, cotton supplies accumulated... and prices eventually went down.

Another less direct factor could be the price of other grains. If soybean's price was becoming higher than cotton's, farmers could decide to switch crops to make more profit and consequently the supply of cotton would go down...and prices up!

QUALITY PREMIUMS & DISCOUNTS

Cotton exchanges that define cotton's market price generally work with a system of premiums and discounts. Premiums and discounts are commonly applied to reflect the quality attributes of the cotton being traded. Higher-quality cotton with desirable characteristics typically commands a premium, while cotton with lower-quality attributes may face a discount.

In the previous section, we explained the difference between local markets and futures contracts

How are cotton future prices determined?

Cotton future prices are regulated by the Commodity Futures Trading Commission (CFTC) and according to the International Cotton Advisory Committee (ICAC) : " the futures price should be equal to the present cash price plus the cost of storage, insurance and interest charges necessary to carry the commodity to the delivery month of the contract."

Futures prices also vary depending on its "underlying assets" which include stocks, bonds, commodities, interest rates, market indexes, and currencies....

Some certified cotton programs also use a premium system in addition to quality premiums or discounts.In some cases, the premium may be a fixed or set amount per unit of cotton (Set Price Premium). For example, buyers may agree to pay an additional $1 per pound for organic cotton compared to conventional cotton. In other instances, the premium may be calculated as a percentage of the prevailing market price for conventional cotton (Percentage-Based Premium). For instance, buyers may agree to pay a 10% premium above the market price for organic cotton. Or the premium could also be determined through negotiation between buyers and sellers (Negotiated Premium).

Organizations and certifications, such as the Global Organic Textile Standard (GOTS) and the Organic Content Standard (OCS), provide guidelines and standards for organic cotton production, including pricing aspects.

COTTON PRICES

> ““Most of the price is defined by the quality of the cotton, which is graded, essentially, immediately after it's ginned” - Tameka Peoples, Seed2Shirt

The specific factors considered for premiums and discounts can vary between exchanges, regions, and contracts. Each exchange typically has its own grading standards and specifications that define the criteria for determining premiums and discounts.

The quality of cotton is determined by a specific set of criteria including: color, leaf content, staple length but also micronaire, length uniformity, fiber strength and extraneous matter. The most common method in use for assessing the quality of cotton is the High Volume Instrument (HVI). This automated system has become dominant but alternatives also include other technologies as well as manual testing methods and visual inspections.Depending on the results of these tests, a “premium” or a “discount” will be attributed in addition to the current market price.

In the case of the New York cotton exchange (ICE Futures U.S), the premium and discount system is based on points, 100 points = 1US dollar. You can find the “2021 Cotton Premiums and Discounts” provided by the USDA linked. In 2021, a pound of WHITE cotton, of “MID 31” color, with a leaf content between 1-3 and a staple length of 35 will be sold with a premium of 120 points. This means 1,20 US$ will be added in addition to the price of cotton at the moment of the sale (either on local or futures market).

FIXED PRICE V/S BASIS PRICE

In cotton trading, “**fixed price**” refers to a contract in which the price for a specific quantity of cotton is set in advance and remains constant, regardless of any fluctuations in the market. This means that the buyer and seller have agreed upon a fixed price for the cotton that will not change, even if the market price for cotton rises or falls.

On the other hand, “**basis price**” is a price that is set in relation to a benchmark or reference price. In cotton trading, the benchmark or reference price is usually the price of a specific cotton futures contract traded on a commodity exchange. The basis price is **determined by adding or subtracting the difference between the futures price and the actual price of the cotton being traded.**

For example, if the benchmark price for a cotton futures contract is $1.00 per pound, and the actual price of the cotton being traded is $0.95 per pound, the basis price would be -$0.05 per pound.

RISK MANAGEMENT (HEDGING)

As explained in the Cotton Prices section, the price of cotton fluctuates depending on the market's supply and demand. The increasing or decreasing value of cotton is considered a "price risk" for both cotton producers and traders. and this is where hedging comes into play.

Hedging means placing "opposite orders" on both cash and futures markets in order to offset the risk of changing markets.

First thing to do before hedging is to estimate the "local basis" of cotton. This will help guessing if the futures market price will be beneficial or not. The local basis is the difference between the futures price and the local cash price at the time the cotton will be sold.

Traders use historical records to estimate local basis and a "futures price formula" to predict how futures prices will evolve. Another important thing to keep in mind is that physical markets (the cash market) often follow the future markets. With all this information in hand, they can proceed to hedging.

Let's use an example to understand how hedging works.

example:

A cotton producer has estimated a break-even price (price required to cover all costs of production) of 68 cents per pound. It is currently May and it is estimated that 1,000 bales of cotton will be harvested in December (therefore, the producer uses the December cotton futures contract). The producer would like to hedge price risk for 50% of the estimated production.

The December futures contract is currently trading at 75.50 cents per pound and the estimated local December price is 1.74 cents per pound less than December futures price (meaning that the local basis estimation is 1.74 cents per pound under).

This example has been pulled from Introduction to Cotton Futures by Blake K. Bennett.

SCENARIO #1 : PRICE DECREASE

When December comes, the cash market price has fallen down to 57.51 cents per pound!

But luckily in May, this producer had sold 5 “December Cotton Futures Contracts” at 75.50 cents per pound. And later in December, they’d bought 5 “December Cotton Futures Contracts” at 59.25 cents per pound. These positions generated a profit of 75.50-59.25=16.25 cents per pound of cotton.

Adding this profit of 16.25 cents per pound to the cash market price of 57.51 cents per pound allowed the producer to sell 50% of their production for 73.76 cents per pound, covering their production cost (68 cents per pound) and even generating profit.

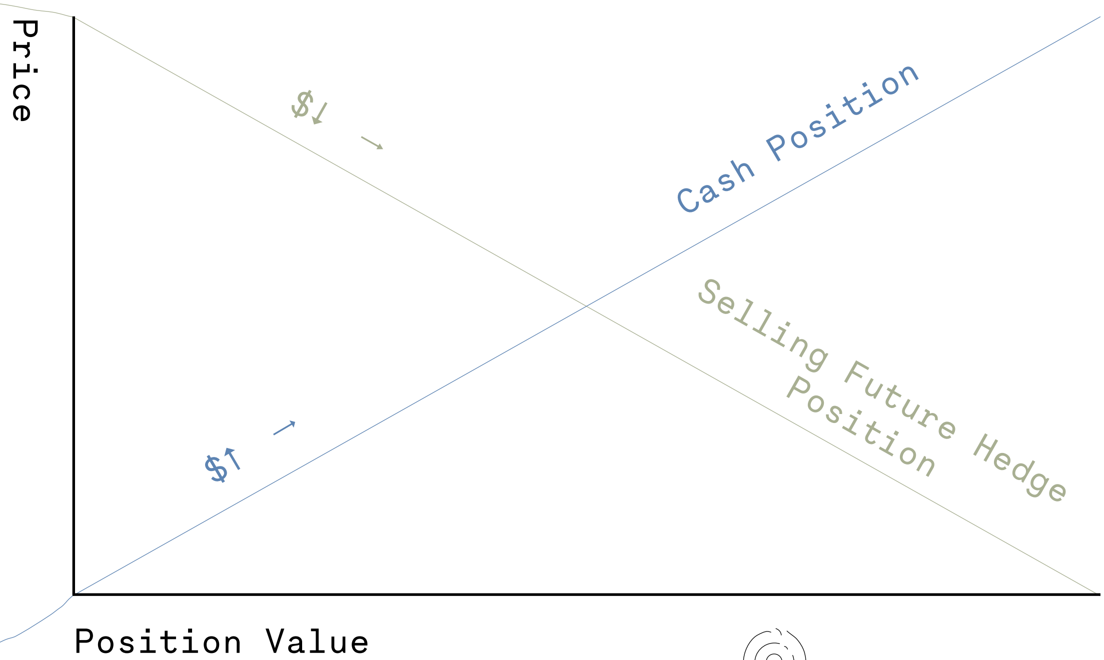
SCENARIO #2 : PRICE INCREASE

In May, this producer had sold 5 “December Cotton Futures Contracts” at 75.50 cents per pound. And later in December, these Future contracts prices increased to 81.25 cents per pound... generating a loss of 75.50-81.25=- 5.75 cents per pound of cotton.

But as the cash market price rose too, the producer was able to sell 50% of their production for 80.51 cents per pound !

All in all, they were able to sell 50% of their production for 80.51-5.75 = 73.76 cents per pound... covering once again their production cost and generating profits.

In short, by placing “equal and opposite orders” on cash markets and futures markets, traders can efficiently balance the price risks. If they lose money on futures, they’ll make money on the cash market... and vice versa.



As prices increase, cash positions become more profitable while selling futures contracts generate losses... and vice versa.

SPECULATION

Speculation is the practice of buying and selling futures contracts with the primary goal of profiting from anticipated price movements. Speculators in the cotton market are typically not directly involved in the physical production or consumption of cotton but engage in trading activities to take advantage of price fluctuations.

How does cotton speculation work?

Speculators often trade cotton through futures contracts. As explained in the Futures Market section, futures contracts are standardized agreements to buy or sell a specific quantity of cotton at a predetermined price and future date. These contracts allow speculators to take positions on the expected direction of cotton prices without needing to physically possess the cotton.

Cotton speculators aim to profit by accurately predicting future price movements. They may analyze various factors such as supply and demand fundamentals, weather conditions, global market trends, economic indicators, and geopolitical factors to form expectations about future cotton prices.

Speculators can take either a long or short position in cotton futures. Going long means buying contracts in anticipation of rising prices, with the intention of selling them later at a higher price to generate a profit. Going short involves selling contracts that the speculator does not own, aiming to repurchase them at a lower price in the future, thus profiting from a price decline.

Speculators often utilize leverage when trading cotton futures, which means they control a large contract value with a relatively small amount of capital. Leverage can amplify potential gains but also increase the risk of losses.

Speculative activities can influence cotton prices by increasing trading volumes, market liquidity, and price volatility. Large speculative positions or sudden changes in speculator sentiment can have significant short-term impacts on cotton prices, potentially affecting the market sentiment and behavior of other participants.

It's important to note that while speculation brings liquidity and helps with price discovery, excessive speculation or market manipulation can disrupt the market's functioning and introduce additional risks. Regulatory frameworks and oversight aim to maintain fair and orderly markets while minimizing the potential negative impacts of excessive speculation on cotton producers, traders, and consumers.

FINANCIAL SUPPORT

Trading companies can also provide financial support to cotton producers. During an interview, a cotton expert gave us one example of the financial support traders can bring to their supplier.

When transporting cotton from Brazil to China, the journey typically takes around 25-40 days, and noting cotton is not always bought and sold on the same day (ie. back to back), the merchant plays a very important role in financing both sides of the transaction. Even in an event when the cotton is bought and sold on the same day, the merchant may have to pay the farmer in advance and then wait a month for payment from the buyer.

As large commodities dealers with strong finances, they are able to provide this service. This is particularly important for smaller-scale producers who cannot afford to wait for several months before receiving payment, as they have already invested time and money into planting and cultivating the crop. Often merchants will also buy cotton from producers before it has even been planted and the advance payment is necessary to allow the farmer to grow the cotton.

By providing this service, the merchant is able to support smaller producers and ensure they have the financial means to plan for and cultivate crops in the future, while making a profit.

HOW DO TRADERS MAKE PROFITS?

One might think traders make money only by making good deals. Of course, if they were to buy cotton in July for, let's say, 75 cents and come October the price has risen to $1... they could make a nice profit. But the risks are way too high and they could also lose a fortune if the market was going the other way.

> "The strategy is to be basis traders."
> - Anonymous cotton trader

That's why merchants rely on being "basis traders". They lock their fee into a basis which means that they agree on a fixed fee for their services in relation to the current market price of cotton. We explained earlier that the "basis price" was the difference between the current market price of cotton and the price at which the cotton will be delivered in the future. By locking in their fee based on this "basis price", traders are able to provide their services without being affected by changes in the market price of cotton.

HOW DO TRADERS MAKE PROFITS?

The basis fee is typically expressed as a percentage of the current market price of cotton. Some traders mentioned a 1% basis fee. This might look like a small portion but as one of our interviewees puts it :

> “We make money on volumes, not just on the marginal gain we make on a single trade”.

Additionally, some traders engage in speculation, buying and selling cotton futures contracts with the hope of profiting from price fluctuations.

Want to learn more about cotton trading? We recommend the “Cotton Exporter’s Guide” by the International Trade Center.

COTTON CREDIT

Cotton credits, as mentioned in the book “Empire of Cotton ”, refer to a system of credit that emerged in the 19th century as a way for cotton merchants to finance the purchase of cotton from producers in different parts of the world. Cotton credits involved bankers in financial centers such as London and New York extending credit to cotton merchants in exchange for promissory notes secured by the cotton that the merchants had purchased.

This system allowed cotton merchants to obtain financing for the purchase of cotton before it was harvested, which helped to stabilize prices and ensure a steady flow of cotton to textile mills. The use of cotton credits also helped to fuel the expansion of global cotton production and trade, particularly in colonized regions such as India, Egypt, and the American South.

However, the use of cotton credits also led to a concentration of power in the hands of a few large cotton merchants and bankers, who were able to manipulate prices and exert control over the cotton trade. Additionally, cotton credits played a significant role in the colonization and enslavement of people in the Americas. Cotton credits allowed colonizers to borrow money to purchase land, equipment, and enslaved individuals to work on their cotton plantations.

It’s important to note that the cotton credit system was built on the backs of enslaved people, it was a system that relied on their forced labor, abuse, and exploitation to generate wealth for the colonizers and it was a key factor in the perpetuation of slavery.

> “Credit was the magic wand that allowed merchants to recast nature, clear land, remove native inhabitants, purchase labour, produce crops in definite qualities and quantities, and meet the voracious appetites of manufacturers and their modern cotton machinery.”
> - Sven Beckert - Empire of Cotton

traders, traceability and transparency

Image by Jessie Luna

In this section, we dive into the roadblocks and solutions that traders experience with a special case study on best practices.

When cotton is sold from a trader to a spinner, a contract is drawn up with information including the quantity, quality (HVI data), technical specifications, shipping period, price, and payment terms. Additionally, information such as country of origin, the ginner, and the farmer may also be included.

“OF COURSE WE KNOW [WHERE THE COTTON COMES FROM], THAT’S OUR BUSINESS”

- Anonymous cotton trader

TRADERS, TRACEABILITY AND TRANSPARENCY

When we asked the merchants: ***Do you think radical transparency can be achieved in the cotton industry?*** (or at least at your level?), the answers we got were not entirely positive.

For Tameka Peoples, founder of Seed2Shirt, **direct connection** and **transparency** is the backbone of her company. It was built on transparent practice and it is their direct connection with farmers in the field that make their service unique and so valuable.

However, this level of traceability seems a lot more difficult to achieve when the amount of cotton traded is much higher. A merchant from one of the biggest trading companies said that full traceability will not happen in the immediate future because the industry is too fragmented.

Today, traders are sourcing cotton from all over the world, and the challenge of tracing cotton is compounded by **fragmentation** and differing farm sizes from country to country. Each country may have (or not) a **unique tracking system** that is not compatible with others, making traceability an admin-intensive and very **time consuming** process.

Cotton-Connect and CMiA cotton, for example, can offer a higher level of transparency, where the customer can know the ginner and sometimes the farm. Some would say that they can confidently share the village the cotton came from, versus the specific farm. One trader said, however, that they were working on a project in Tanzania where a customer wanted to gather primary farm data of their organic cotton and was able to do so. Now this is not always achievable in all regions, but usually these types of projects start with organic programs and grow from there.

Before transparency became an important aspect of the sustainability agenda, brands and retailers could hide behind the opaqueness of the supply chain. There was also a lack of will to be transparent and aware of their partners' operations. Thus, they could turn a blind eye and never be held accountable.

Although some trading companies view measures to improve traceability as a means to only comply with Corporate Social Responsibility (CSR) laws, we found that other merchants prioritize transparency and hold strong values for it.

Another cotton merchant from an international trading company explained that traceability was a way to clarify the role of each member of the supply chain. In a transparent supply chain, he said, “There is no room for cheating or playing games”.

A cotton broker also added: “At the end of the day consumers want to know where the cotton comes from, they want to know that farmers have received fair pay, or actually, that everybody in the supply chain has received a fair payment for their role”.

Let’s have a closer look at what’s blocking our supply chain from being fully traceable and radically transparent and what solutions have been found by the cotton merchants we interviewed.

Let's have a closer look at what's blocking our supply chain from being radically traceable and transparent and what solutions have been found by the cotton merchants we interviewed.

ROADBLOCKS AND SOLUTIONS

ROADBLOCK #1

FRAGMENTATION AND LACK OF TRACING METHOD STANDARDS

With cotton being grown in many different countries and contexts, the size and structure of each farm can vary significantly from country to country, as well as the methods of recording data. This presents our first roadblock to traceability, the lack of standardization and fragmentation between countries and regions.

The lack of standardization across different countries and regions in terms of tracking and tracing systems is a big challenge, one we not only see here, but between all levels of the supply chain. Think about one brand using blockchain and its suppliers using physical tracers. These two tracking systems do not speak to each other and therefore, the brand will need to input their suppliers information into the both platforms. Not a very efficient method for the links in our supply chains to be speaking to each other.

In the same sense, each country may have its own unique system that is not compatible with others. As you can imagine this makes tracing cotton back a very manual, time consuming, and administrative process.

On top of this, fragmentation has resulted in cotton bales that can be composed of cotton from multiple farms and regions, sometimes as many as 300 - 500 different farms. So, when multiple sources of cotton are combined into a single bale, it can be challenging to determine which specific farm or region the cotton came from. Nonetheless, even knowing what group of farmers a bale came from is better than not knowing anything at all, especially from a due diligence and CSR perspective. This is especially true if the tracing methods used by each source are not compatible with one another. Therefore, implementing standardized tracing methods across the entire cotton supply chain is crucial for achieving greater transparency and accountability in the industry.

As one of our interviewees puts it, “when everyone works with their own systems, the systems don’t work together.”

TO CONSIDER

Our next challenge will be to harmonize track and tracing systems and/or create compatibility between tracing technologies.

ROADBLOCK #2

ROADBLOCKS AND SOLUTIONS

RESISTANCE TO CHANGE AND DISCLOSE INFORMATION

One challenge in achieving greater traceability in the cotton industry is the resistance to move towards more transparent practices. While some companies have started implementing digital tracking methods of traceability, others may still be hesitant to invest or co-invest in the necessary infrastructure to achieve greater transparency.

Traders do have a record of who bought the cotton, and what bales were shipped where making traceability possible, but as we just pictured, this can take a very long time. And by the time traders are being asked for traceability information, it is not the original customer making the request and the message loses its genuinity. Brands will ask their mill suppliers and mills will ask their spinners where the cotton is coming from. Traders get asked the question indirectly, via the mills and are not necessarily made to understand the motives for these questions. This creates less incentive for traders to disclose this information in an accessible way for brands and customers. But as one trader put it, those who are asking should find the original source of the information.

> “Don’t just demand traceability through your fabric suppliers, come and talk to us.”
>
> - An international cotton trader

However, it's worth noting that legislation is starting to push brands for greater traceability, and traders are becoming increasingly aware that they will soon be required to disclose more information. In order to overcome resistance and improve traceability, brands can open the line of communication to the direct people (e.g. the merchants) they need answers from and create relationships with everyone involved in making their products.

TO CONSIDER

Brands open the line of communication to the direct people/sources they need answers from, create relationships with everyone that participates in making your products.

ROADBLOCK #3

ROADBLOCKS AND SOLUTIONS

LONG IMPLEMENTATION TIME

The cotton industry is a very old business with very established processes and models. Some of the interviewees in this report came from cotton trading companies that have existed since the 1800s! This means that any changes to the way the industry operates would need a systemic overhaul that will take years to successfully implement.

While some niche products can achieve farm to shelf traceability, achieving it across the entire cotton industry is a much larger and complex task. We saw a wide discrepancy between companies' ability to implement traceability tools, which leads us to question if those who are not yet using traceability tools is only because of their reluctant company political decisions.

Solution: Trading companies not only trade cotton, but also other soft commodities like coffee, cocoa, sugar, wheat, soybeans, fruit and livestock. For many trading companies, traceability practices came from cocoa and coffee.

One of the methods used to trace cotton is through **Bale IDs**, which are used in resource rich countries such as Australia, Brazil and the USA, while other countries use lot numbers. Tracing specific bales is very important to ensure the quality of the cotton meets the needs/requirements of the buyer.

Cotton traders that are future-forward thinkers have also started implementing **digital tracking methods** of traceability.

Let’s look at an example from one of our interviewees.

TO CONSIDER

Using traceability tools to provide the necessary data and accountability to improve the system as a whole. Remember that traceability isn’t just a means to its end, or just about quality. It is also making sure that joint sustainability projects can be done, i.e. region agriculture, or inclusive employment.

CASE STUDY :

best practices in traceability

“WE ARE NOW ABLE TO UPLOAD ALL OUR CONTRACTS ON THIS PLATFORM AND PROVIDE A CODE TO THE SPINNER WHO CAN LOG INTO THE PLATFORM AND BASICALLY SEE THE STORY OF HIS CONTRACT FROM THE ORIGIN TO THE FACTORY.”

- DECLARED AN ECOM REPRESENTATIVE

One example of a best practice in the cotton industry is the implementation of a digital traceability platform to enhance traceability.

The trading company Ecom made the decision to implement a traceability system based on blockchain technology for their cotton supply chain. They developed a system in collaboration with the Swiss company Product DNA called the Respect Code, with the purpose of tracing the origin and journey of each cotton bale. Ecom can now provide their customers with detailed information about the cotton's source, including the country, specific land, and the name of the cotton farmer, as well as their own role and that of intermediaries involved, such as shipping agents or brokers.

Through Ecom's traceability system, their clients can access all the relevant documents related to their cotton purchases. They can also see information on the origin of the cotton, including details about the specific seeds used in its production. In the case of certified cotton, such as organic, certificates can be uploaded to the platform, gaining insights into the exact nature of the cotton being supplied. Ecom goes even beyond transaction certificates by gathering photos and videos of producers to add depth to its traceability efforts.

This collaborative effort ensures that the traceability system covers the entire journey, from delivering cotton bales to textile mills, where yarns, fabrics, and garments like jeans are produced. As a result, customers can purchase these products in stores and use a QR code to access a comprehensive overview of their origin and journey.

Overall, their Respect Code platform serves as an example of how traceability in the cotton industry can be improved through the use of technology and collaboration.

the future of cotton traders

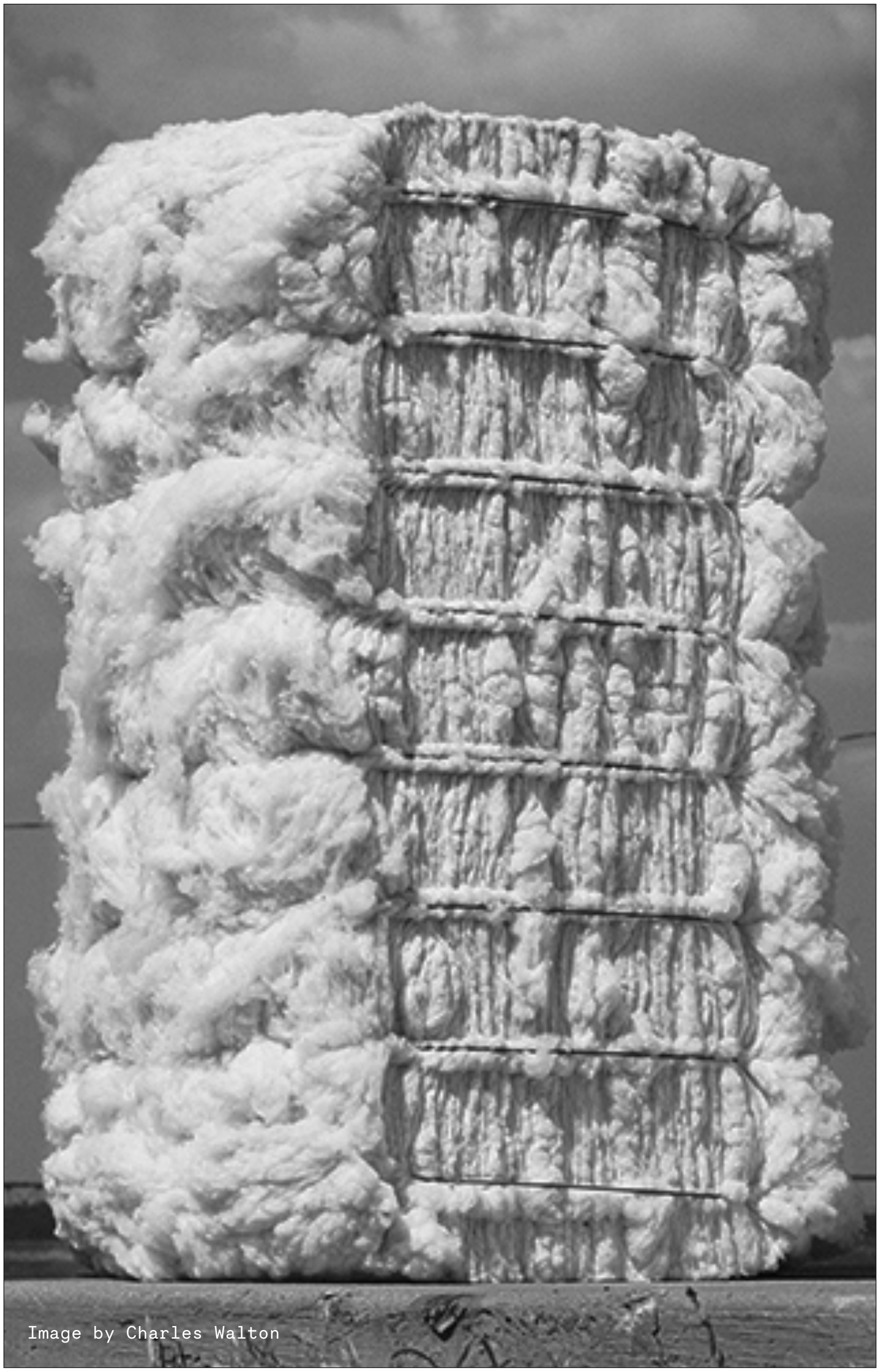


Image by Charles Walton

How do cotton traders see the future of cotton trading? In this following section, we explain the changing role of cotton traders, what "fair trading" can look like, and the future outlook on regenerative agriculture and carbon credits.

HOW DO COTTON TRADERS SEE THE FUTURE OF COTTON TRADING?

The role of cotton traders is changing rapidly due to the increasing demand for traceability and sustainability in the industry. While their trading positions will remain, they will need to take on additional functions to remain relevant in the supply chain. Brands are starting to take a greater interest in the work of cotton traders, but there is often a fundamental misunderstanding of what their role is. With legislation and net zero commitments, there is now more potential for brands and traders to collaborate and share data, but there is currently no easy way to share information about the cotton supply chain. There is a large opportunity for cotton traders to build genuine partnerships with brands in the pursuit of sustainability goals.

PARTNERING WITH BRANDS AND MILLS

During the interviews we conducted, we happily discovered that all the merchants we spoke to had been contacted by brands that were looking at ways to set up traceable cotton sourcing methods.

One of our interviewees mentioned cotton merchants who are already working with brands on their specific program for certified cotton (we note that it is important to keep farmers in the decision making seat as they have the local knowledge for specific and adapted local solutions). The purpose is to bring the spinning mill, the cotton merchant, and the brand to the table at the same time to educate the brand and to better understand the dynamics and the relationship upstream in the supply chain. In our ideal world, farmers, researchers, seed breeders and everyone along the value chain would have a seat at the table.

Partnering with brands and mills also adds security to the contract, as one big problem is that brand buyers sometimes change their orders from certified cotton to conventional cotton at the last minute, when the cotton has already been bought. This leaves the spinners with an eg. 10 cent/lb premium for the certified cotton that is no longer suitable for their production plan and can't then pass on to the brand buyer.

The interviewee further explained that the supply chain post-spinning mill is not as secure as the one from farmer to spinning mill, which is policed by the International Cotton Association. Brands are not held accountable when they change their minds and don't want to pay the premium for certified cotton in order to buy the cheapest cotton possible, or cancel orders altogether. This is partly because spinning mills do not want to name and shame their brand partners because of the damage it may do to their future relationship and underscores the deep power imbalance between brands and their suppliers.

This example echoes another one we heard at the first step of our research when a designer from a large denim retail company told us that despite their best intentions, sustainable design decisions might get lost along the way when the buying team has to make budgetary cuts. As we understand here, the consequences of such cuts directly impact the spinners who end up paying for the price difference.

It comes down to building relationships and creating a feedback loop between all of your partners and all of your partners' partners. You'd be surprised about how many of your production partners are interested in hearing why your customers want to know more about what's going on throughout the supply chain, especially with due diligence legislation on the horizon.

PARTNERING WITH BRANDS AND MILLS

Traceability is a crucial element in ensuring that spinners and farmers are paid fairly for their work. By tracing the origin of cotton, trading companies can ensure that the cotton they purchase is ethically and responsibly sourced. Someday soon, this could help "de-commoditize" cotton by making people willing to pay for the way it's been grown, rather than just its quality.

example of best practice:

Swiss company Haelixa, as mentioned in our last report, has developed a DNA marker to trace Egyptian cotton used in premium shirts as part of the UNECE initiative "The Sustainability Pledge."

Supima has partnered with TextileGenesis to create a blockchain platform for verifying and authenticating American-grown Pima cotton. The platform will connect the entire supply chain and utilize Fibercoin technology to create digital tokens for each kilogram of Supima cotton.

Lastly, The Sourcery is an organization that facilitates transparent, fair trade from growers to consumers and is changing the way we traditionally have sourced our cotton. As a member-driven global sourcing platform, Sourcery connects brands, manufacturers and growers who are committed to advancing commercial and environmental excellence.

FAIR TRADING

CASE STUDY: SEED2SHIRT

During our interviews, we had the great pleasure to meet with Tameka Peoples, founder, CEO, and Director of Operations at Seed2Shirt.

Seed2shirt is a small, unique, and boutique vertically integrated company that makes an ethically produced line and works closely with W. African, US Black cotton farmers and brands to procure organic and Climate Beneficial™ cotton. Before harvest season, they work intimately with brands to understand their commitment and volume needs. They educate the brands on the challenges and benefit of procuring cotton from the producers they work with, and their Farmer Enrichment program in US and Africa works with farmers to overcome the challenges of both these growing methods in a way that supports soil health center's balanced land stewardship and advocates for a more stable supply and relative price parity. Seed2Shirt manages expectations and prioritizes long-term relationships with farmers and brands to change the dynamics of cotton procurement and soil health. Despite being a small part of the ecosystem, their approach has been very successful and is very inspiring!

> "We offer cotton sourcing, as one might call merchant services, as a GOTS certified organic cotton and Climate Beneficial™ verified cotton as a cotton merchant, and partner with FiberShed-C4 for Climate Beneficial™ verified cotton program with our growers. Our Farmer Enrichment program essentially looks at how we support with direct resources such as tools, micro-grants and soil health training, the very farmers whom we've sourced our cotton from. A percentage of every operational sale goes back to this program, our farmers in the US and in West Africa - Burkina Faso in order to enrich their livelihoods, enrich their space on their land, and their stewardship."
>
> \- Tameka Peoples

While we love seeing this considered approach to sustainable procurement by Seed2Shirt, other more conventional traders seem to be more interested in turning to carbon credits than a whole overhaul of their business.

REGENERATIVE AGRICULTURE AND THE CARBON CREDIT MARKET

If you work in the denim industry and attend denim fairs, you have probably noticed that since a couple of seasons, more and more mills offer a new type of sustainable cotton : regenerative cotton.

As of today, there aren't any legal or regulatory definitions of the term "regenerative agriculture" but several programs are driving attention to these not-so-new farming practices. In the cotton industry, the most popular ones seem to be Kiss the Ground, Regenerative Organic Certified (ROC), Good Earth Cotton and Regenagri. From one program to another, guidelines may vary but their common principles include: increasing soil health, encouraging biodiversity, reducing greenhouse gas emissions and sequestering CO_2. More information on the definition of regenerative agriculture can be found here.

Regenerative programs usually come with strong traceability and are often backed up by tracing technologies (either physical or electronic tracers). Regenerative cotton is going to be a real game changer for traceability and as Ben Eaves, Director at Wizcot Ltd declared : "If we can get a bigger buy-in from the farmers to produce more regenerative cotton, I think the transparency and the traceability will naturally pick up."

All the traders we spoke to did seem very fond of regenerative programs. So what makes them so much into these holistic agricultural practices?

Is it because it restores biodiversity and traders are keen bird watchers? Not really... Traders gotta trade and the great thing (to them) about regenerative programs is that they open new markets for carbon credits.

TO SIMPLY PUT IT :

As regenerative farming aims at improving the carbon sequestration in soils, if this sequestration is monitored and data is collected, the farms can sell carbon credits to other companies who are looking to off-set their carbon emissions on voluntary carbon markets.

By selling carbon credits, cotton traders can create a new revenue stream and use this extra income to counterbalance the cost of premiums on regenerative cotton. Brands wouldn't have to pay extra for regenerative cotton, while theoretically contributing to mitigate climate change...

Carbon credits are intended to incentivize carbon emissions reduction and promote environmental sustainability, but there are concerns about their effectiveness and potential for greenwashing/greenwishing. Measurement of carbon emissions can be complicated, some projects may not truly reflect their claims, and credits may allow companies to continue emitting high levels of carbon. Additionally, carbon credits can become a commodity subject to market manipulation, leading to unintended consequences.

ONE SUCH NEGATIVE CONSEQUENCE IS CARBON COLONIALISM.

Carbon colonialism is a term used to describe the negative impacts of wealthy countries and corporations in the Global North using carbon offsetting mechanisms and other climate solutions to benefit themselves at the expense of communities in the Global South. The Global North may continue to emit high levels of carbon while purchasing carbon credits or investing in carbon offsetting projects in the Global South. This can lead to the displacement of local communities, as well as loss of their land and resources for the sake of carbon offsetting projects.

Additionally, collecting data on carbon capture implies investments and is far more complicated to implement on a small farming level. As explained above, carbon credits could be a way to counterbalance the premium price for regenerative cotton. But those who might not be able to collect carbon data and sell credit will eventually be less competitive on the cotton market. We can foresee that smallholder farmers in developing countries are more likely to be left out of this trade while large farms in the Global North will greatly benefit from it, ever increasing inequalities.

The focus on carbon reduction might detract from broader issues of environmental justice and social inequality that disproportionately affect people in the Global South.

Want to know more on carbon colonialism, click here.

When it comes to carbon credits, ultimately, a credit can be given when we witness the long-term buildup of carbon in the soil, almost as if it's returning to its pristine, untouched state. It's not just about the "how" – it's about the bigger picture, the impact we're making. And to truly understand if our efforts are working, we need solid data spanning at least a decade.

what about biodiversity credits?

The concept of biodiversity credits is a market-based mechanism proposed under the Convention on Biological Diversity (CBD) at COP15. These credits would be a form of financial incentive to encourage the conservation and restoration of ecosystems and the biodiversity they support.

As explained in this article by the World Economic Forum : "Unlike carbon or biodiversity offsets, which are payments made by a business to compensate for its damaging impacts on location-specific ecosystems, biodiversity credits allow companies to support nature-positive action, funding long-term conservation and restoration of nature, a higher order contribution than simply offsetting negative impact."

The hope is that this system would create a more sustainable economy that values biodiversity and incentivizes actions to protect it.

CONCLUSION

Cotton traders make our denim world go 'round' and it is time we start engaging them further in our sustainability conversations, as well as within our own work. Traders are economically minded, and it may be wise to seek traders' advice on how to make 'sustainability' economically viable in the short term. Their economically wired brains are also, in part, the reason why carbon credits are so appealing to traders. Turning to carbon credits allows traders to continue operating in the same ways they are used to operating in, ie. trading contracts. However, to truly create sustainable change requires a deep understanding of the complex systems at play and a willingness to go beyond traditional economic models.

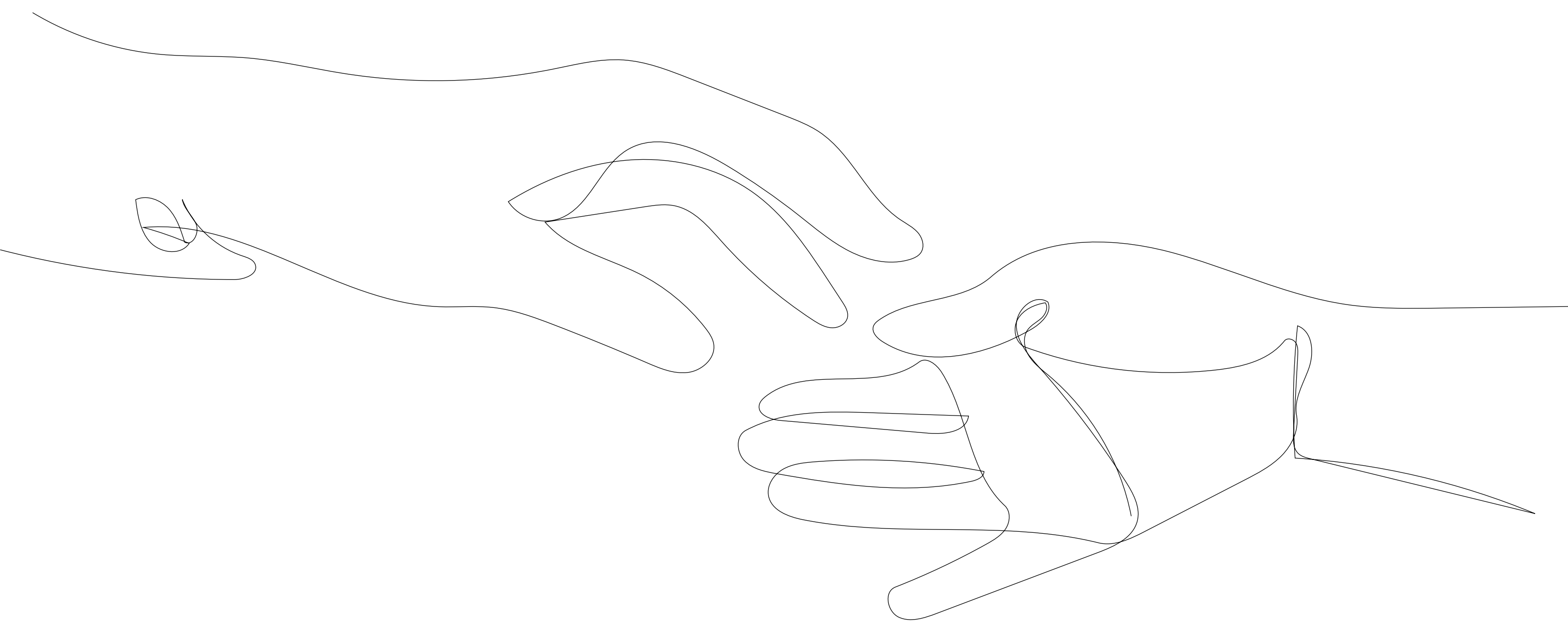
Traceability and transparency are crucial components in achieving sustainability goals, as they provide the necessary data and accountability to improve the system as a whole. By building relationships and creating a feedback loop between all partners, traders can help ensure that farmers are paid fairly for their work, and that cotton is ethically and responsibly sourced alongside brands.

> "Transparency can only help to clean this [trading] process and to make the whole chain much more sustainable."
>
> Luca Massardi - Cotton trader at Ecom

Despite facing several challenges such as fragmentation and lack of tracing method standards, lagging visions, a resistance to disclosing information, and long implementation time, it is evident that traceability is possible in the cotton supply chain. The issue does not lie in the lack of technological tools but rather in the lack of prioritization and standardization. However, there are wonderful examples of cotton merchants and traders that take a farmer first approach and are thinking to the future by implementing advanced digital tracing systems that easily allow them to share this data with customers.

WE WANT TO LEAVE YOU WITH A FINAL QUESTION:

What would you ask a cotton trader after reading this report? And how will you engage with them next?



the next step: farmers

Image by Cotton Diaries

The quest for a transparent cotton supply chain has led denim mills to reconnect with the farmers and set up direct-to-farm pilot programs. We previously speculated that this may change the role of a cotton trader forever, but we now know that cotton merchants and traders are an essential part of our supply chain network.

In the next step of our research on #WhoMadeMyCotton we will consult cotton farmers to understand better their perspective on their role in the cotton supply chain and how they picture a future of radical cotton traceability.