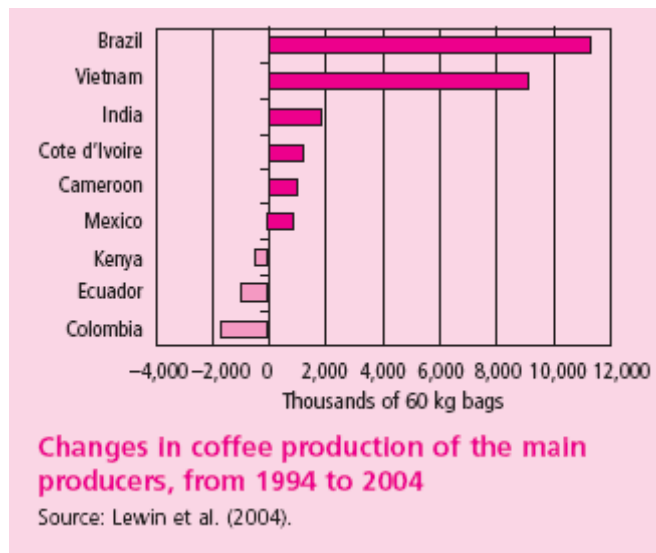


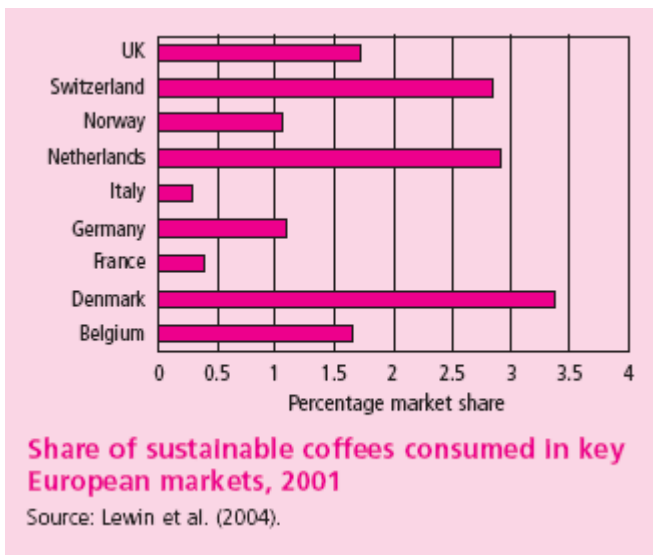
Vibrant coffee culture contrasts with woes for producers

Case taken from The International Business Environment, second edition (Palgrave, 2006), by Janet Morrison

While affluent consumers sip their cappuccinos in Starbucks and other coffee bars, the behind-the-scenes story is one of a world coffee crisis which has impoverished field workers and devastated rural economies, particularly in Central America, which depend on coffee production. More than 2 billion consumers around the world drink coffee regularly, and about 20–25 million families depend on coffee for their income. These producers are mostly smallholder farmers in developing countries, in many of which coffee accounts for a high proportion of export earnings. Surging demand and high prices encouraged farmers to switch to coffee from other crops from the 1980s onwards, but the result was eventually oversupply and falling prices. Production increased particularly in Vietnam and Brazil (see figure below) sending the prices of green, unroasted coffee beans tumbling. The world price has fallen from \$3.30 a pound in the 1980s to 60 cents, which is below the estimated 80 cents a pound it costs farmers to produce them. In the mid-1990s, farmers' share of the final price to the consumer was only 10 per cent, but this has fallen to 7 per cent. The lion's share of the price goes to middlemen. These are roasters, retailers and global buyers, or brokers. Each of these sectors is characterized by a few dominant firms, creating a market in which buyers are concentrated and powerful, while producers are mainly small farmers in a weak bargaining position.



Responses to this deteriorating position can be grouped together under the heading 'sustainable coffee' initiatives. These include organic, ecofriendly and fair trade coffee. Demand for sustainable coffee has come mainly in the more developed consumer markets (see figure below). The fair trade movement, exemplified by Cafédirect, was set up in 1991 by the charity, Oxfam. The principle behind fair trade coffee is to pay the producer a price above market price, for a premium product, and cutting out the middlemen. It also works with farmers to improve expertise in production. Fair trade coffee has grown to a 15 per cent share of the coffee market in the UK, and now operates on a commercial basis. In 2004, Cafédirect was floated as a public company, appropriately, on a small ethically based stock exchange. Despite the unconventional IPO, the issue was oversubscribed, as investors snapped up the shares, making the £5m. issue a success.



A second response to the coffee crisis has come from the large companies in the industry. The world's two largest coffee brokers, Neumann and Volcafe, entered an agreement with the Rainforest Alliance to promote the production of ecofriendly coffee, based on environmental and social standards. A spokesman for the companies says: 'the image of coffee is endangered ... It is becoming a product where farmers are dying and birds are being denied habitats' (Silver, 14 May 2003). If farmers convert their farms to sustainable practices, they will raise the quality of the coffee, curb environmental damage and improve the prospects of a better livelihood than they have at present. Ecofriendly coffee will require an industry-wide set of standards and their implementation. Meanwhile, four of the world's largest coffee companies – Nestlé, Sara Lee, Kraft Foods and Tchibo – have made an agreement with producers to improve working conditions and environmental standards. Called the Common Code for the Coffee Community, it will apply to coffee producers in Brazil, Central America and Africa, and it has been signed by Oxfam, Greenpeace and trade unions representing coffee workers. This code, to be monitored by independent auditors, is targeted at the mainstream market, rather than the fair trade segment. It represents a response to pressures from consumers, retailers and NGOs. At the same time, there is a 'business case' for these moves, in that, as Cafédirect has shown, consumers are willing to pay a premium price for quality coffee, which benefits all in the coffee industry.

Sources: Lewin, B., Giovannucci, D. and Varangis, P., 'Coffee markets: new paradigms in global supply and demand', World Bank Agriculture and Rural Development Discussion Paper 3 (Washington, DC: World Bank); 'Growers left tasting dregs of coffee culture', editorial in Financial Times, 23 May 2002; Silver, S., 'Coffee's crisis stirs traders to take action', Financial Times, 14 May 2003; Harford, T., 'Fair trade coffee has a commercial blend', Financial Times, 12 September 2003; John, P., 'Cafédirect floats with its ethical principles', Financial Times, 12 February 2004; Williamson, H., 'Coffee trade pact on better standards', Financial Times, 10 September 2004.

Case questions

How did the coffee industry come to be in such a perilous state?

How do the fair trade initiatives and sustainable coffee initiatives differ from each other?

@ The website of the Fair Trade Foundation is <http://www.fairtrade.org.uk>

Cafédirect is at <http://www.cafedirect.co.uk>

Starbucks is at <http://www.starbucks.com>