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INTERNATIONAL
COFFEE
ORGANIZATION

CF 5/13

15 August 2013
Original: English

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3rd Consultative Forum on Coffee Sector Finance
10 September 2013
Belo Horizonte, Brazil

Case Study C
The growth phase:
Reaching critical mass

Background

1. The 3rd Consultative Forum will take place on Tuesday, 10 September 2013 from 09:00 to 17:30 in Belo Horizonte, Brazil; during the week of the 111th Session of the Council (information about these meetings is contained in document ED-2153/13). The objective of the event is to identify best practices and disseminate information to Members about aggregation as a platform through which access to finance and risk management could be achieved more effectively. The terms of reference developed by the Core Group were circulated in ED-2158/13. The Forum will be attended by ICO Members, observers and private sector representatives. In addition, experts in farmer aggregation from different geographical and coffee-growing regions have been invited who will form an 'Expert Nucleus' for the session. The programme for the Forum will be circulated separately.

2. A set of seven case studies with discussion questions has been prepared by consultants as the basis for small group discussions amongst delegates and experts. The purpose of the scenario exercise is to engage the entire audience in identifying best practices and the challenges that farmers face in developing farmer organizations or efficiently achieving the objectives of their organizations. This document includes the following case study: **The growth phase: Reaching critical mass.**

Action:

The Consultative Forum is requested to review and discuss this case study.

Managing and Growing Farmer Groups Group Discussion

Case Study C:

THE GROWTH PHASE: REACHING CRITICAL MASS

Background

The Growth phase is perhaps the most crucial time in a cooperative's life. Even after a successful launch, cooperatives—like other businesses—must, within the first decade, reach a critical size in terms of members, volume, and business complexity if they are to remain competitive and survive. In addition to meeting the challenges of a growing enterprise, cooperatives must also be able to satisfy members' rising expectations.

This Case Study is based in a country where a change in government resulted in a rapid transformation from a well-functioning para-statal cooperative system to one based on free market autonomy. The country had a long history as a coffee growing area, however, nearly 25 years of civil unrest and uncertainty led to a severe decline in quality, leading to the loss of most of its export market. As international buyers turned elsewhere, prices dropped to such low levels that many producers stopped harvesting their plants and turned to subsistence agriculture to feed their families. This case study covers the first decade during which the Organic Coffee Cooperative Federation (OCCF) was assisted by an international donor-funded co-op organization to organize more than 20,000 farm families into a three tiered network of 500 democratic producer groups.



Cooperative Members, by Sam Filiaci

THE CASE STUDY

Strategic Approach

The cooperative development focus was on supporting:

- The production and value-added processing of specialty crops, primarily directed at the export market;
- Transferring to producers and their downstream processing and marketing enterprises the skills and knowledge necessary to meet the volume and quality requirements of the market;
- Extension services and coffee-related information via the farmer groups: for organic certification, coffee and shade tree maintenance, harvesting schedules, and up-to-date crop prices;
- Grassroots democracy via the farmer groups that elected the boards of the primary cooperatives;
- Stringent management to achieve cost efficiency in all operations;
- Tapping into personal initiative to complement collective action by individual enterprises (e.g. licensing private buying agents; individual farming service providers);

- Developing in-house, value-added wet-processing facilities and drying operations to assure high quality of the final product in order to sell at specialty market prices with Fair Trade/organic premiums;
- Operating as a joint venture with the business adjunct of the international co-op organization in order to secure working capital, trade financing, and markets, while using donor funds to build co-op infrastructure and expand production;
- Using donor funds judiciously to address major bottlenecks impeding cooperative development. One of the most serious constraints in the country was the absence of a financial system that could serve the needs of the privatized cooperatives. To address this, the donor project included an Enterprise Development Fund (EDF) to provide financing for project-related activities. The EDF proved to be a key element in allowing the OCCF to move ahead quickly with product development and to take advantage of important marketing opportunities.

ACHIEVEMENTS

1. Coffee sector improvements

Assisted by project extension services, enough producers adopted the required techniques to achieve quality improvements so that their specialty coffees came to command a premium price on the world market:

- Establishment of 20 major coffee research and demonstration farms;
- Establishment and operation of a coffee shade tree nursery capable of producing and distributing 150,000 shade tree seedlings per season;
- Expansion of coffee extension activities to include 800 farm families per season in semi-intensive pruning operations;
- Expansion of the project's coffee cherry wet-processing and green bean dry-processing operations by 50%;
- An improved policy and regulatory environment achieved through educating and advising the new government on policy and technical issues relating to coffee farming, processing, trade, export regulations, taxation, land reform, and transport logistics.

2. Diversification

In response to needs identified during the coffee activities, additional programs were undertaken:

- Vanilla production, procurement, processing and export operations for diversification and to offset some of the risks of being dependent on a single crop;
- A smallholder tree forage and beef cattle production activity;
- A small-scale retailers' food and consumer goods purchasing and distribution cooperative;
- A host tree (vanilla) and shade tree (coffee) reproduction program;
- A network of health clinics.

3. Human Resource Development

In response to the extreme lack of qualified personnel, a non-formal training institution aimed at developing and improving basic business and language skills was established and subsequently the country's first university-level business education institution was created in conjunction with the Ministry of Education.

4. Member loyalty

The producers demonstrated loyalty to their farmer groups and cooperatives through their continued participation, largely due to higher farm-gate prices and quality premiums, as well as benefits of the health care services. Also, because the cooperatives purchase and process the coffee cherry, producers are spared the time-consuming process of washing, hulling and drying that they must do when selling to other buyers, allowing them

to focus on harvesting a greater portion of their crop. Higher prices were certainly a determining factor in fostering their loyalty; in 2002, OCCF paid each member an average payment of \$120 USD plus a dividend of \$14 USD in a country with an average annual income in urban areas of \$156 USD and in rural areas of just \$102 USD. The creation of 300 permanent and 4,000 seasonal jobs in an economy with a rural unemployment rate of 40% also helped bind the members to their co-op.

5. Transparency/Accountability

As part of the joint venture contract, an external CFO was seconded to the OCCF as a safeguard to ensure financial integrity. Accountability extended beyond finances to encompass the entire chain of production, procurement, processing, and export by informing everyone of standards and holding them accountable. Senior management closely followed the progress of each activity and responded to problems as they arose.

6. Mastery of the marketing equation that buyer interest is closely tied to meeting three important export requirements: quality, quantity, and reliability

OCCF learned that attaining the marketing edge means having a product that meets or exceeds current international standards, with a price/value benefit that is more attractive than the competition. Given that an enterprise usually gets only one chance as a supplier in the international marketplace, the farmers and cooperatives came to realize how important it is to build a reputation of reliability. The OCCF approach has been that, even if it results in a financial loss, they must provide a product exactly as contracted with the buyer. Marketing assistance from the joint business partner played a key role in both this learning process and operationally by providing OCCF with the equivalent of a full-time office in a major market to communicate with buyers and follow up on all aspects of the business transactions (shipping documentation, credit checks, payments, etc.), while also providing the sense of assurance and confidence to buyers who might otherwise have been hesitant to engage in direct transactions with cooperatives they didn't know. This marketing strategy has been very successful. In 2002, 1800 mts of coffee was exported, and two years later the 13,156,000 kgs of cherries secured from members resulted in the export of 2,600 mts at a price 60% higher than any alternative coffee buying channel. The associated export taxes paid to the central government meant that the OCCF became the country's major taxpayer.

7. Financial Sustainability

A financial analysis conducted in 2001 found that, even under the existing market conditions of low international prices, the OCCF "would be profitable and sustainable" without continued support from the project. The analysis indicated that OCCF would generate an annual profit of US\$267,000. In just eight years, the OCCF had acquired assets valued at US\$7.25 million.

Case Study Discussion Questions

1. What were the most important achievements realized by OCCF?
2. What strategic approach factors were most responsible for these achievements? How did they contribute to achieving the results?
3. What lessons can be drawn about cooperative development from reviewing OCCF's history?