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

Case Study G
Mature cooperative phase: Growing and consolidating a coffee relationship

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: **Mature cooperative phase: Growing and consolidating a coffee relationship**.

Action:

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

Managing and Growing Farmer Groups Group Discussion

Case Study G:

MATURE COOPERATIVE PHASE: GROWING AND CONSOLIDATING A COFFEE RELATIONSHIP

Background

This case study is based on a Latin American country with a tradition of agricultural cooperatives and a legal framework for their promotion and support. Cooperatives in this country exist within a context of internal conflict and the presence of illicit crops in some rural areas. The coffee sector has a private national institution that manages public resources and has implemented marketing mechanisms such as a minimum internal price and future contracts. Future contracts are with producers through their cooperatives, which influence both the internal and external marketing of coffee. Coffee-grower cooperatives receive technical support and resources for marketing from the national institution, but also have limitations on their ability to act autonomously in the market and interact with other buyers.

The average cooperative has 1,000 members and produces 60 containers of coffee a year (15,000 60-kg bags), 80 percent of which is considered specialty coffee (80 SCAA). All cooperatives are represented by a regional federation, which has about six members. Coffee can only be exported by registered exporters that hold an export license from the Ministry of Trade and that have the necessary financial capacity. The national and international private exporters have a national presence, while most medium and small coffee-grower cooperatives do not have an export license and cannot directly sign export contracts with clients abroad. Only a few large cooperatives have registered as coffee exporters in order to directly engage with the market.

The country is starting to see a fall in coffee production due to various weather-related factors and the resurgence of pests and diseases that affect coffee production. The buyers of commercial coffee and specialty coffees, such as exporters, importers and roasters, are starting to worry about the potential default of coffee contracts where medium and long-term commitments have been established. Coffee producers in this region do not have a lengthy tradition of producing organic coffee, given the influence of high-tech and non-organic coffee growing.

This case study is divided into three parts to highlight different approaches and perspectives: 1) A joint memorandum from the importer and a large specialty coffee roaster to the general manager of the Regional Cooperative Federation (RFC) proposing to expand a contract to gradually increase the supply of its differentiated high-quality coffee with single certification and/or double (Organic and Fair Trade) certification; 2) notes from the meeting of the RFC's board of directors (BOD) with key discussion points regarding the commercial proposal and the technical, commercial, and operative changes required for assuming this commitment; and 3) notes of the meeting held among the representatives of the RFC member cooperatives' board of directors.

MEMO: Planet Coffee Importers (PCI) and Big Sun Coffee Roasters (BSCR)

From: Executive Directors of PCI and BSCR
To: General Manager of the Regional Federation of Cooperatives (RFC)

Given the high level of interest of our main buyer, BSCR, its clients in the coffee shops and consumers in general, and the good profile of your certified coffees, we would like to expand our coffee supply contract with the RFC and its member cooperatives. The new contract would initially require the same volume of 50 containers per year as the current contract, which we have developed gradually during the four years of our commercial relationship, to a new volume of 150 containers per year, to be gradually increased over three years.

This necessitates the fulfillment of several conditions and requirements on both sides. The RFC must continue guaranteeing quality coffees above 80 points (SCAA scale); expand its quality coffee labs and create a cupper school with the technicians and children of coffee growers; increase the volume of Organic and Fair Trade certified coffees; and modernize the traceability system. On our side, we will jointly define the conditions for increasing prices through premiums and differentials for certified coffees; establish an incentive system for quality; and provide investments through the sustainability and corporate social responsibility fund of BSCR.

The identified actions and commitments must be reflected in a medium-term plan and memorandum of understanding agreed to by all parties. We await your response after consultations with the RFC BOD and its affiliated cooperatives in a term no more than 60 days.

RFC Board of Directors Meeting

The general manager of the RFC informs its BOD of the proposal presented by PCI and BSCR, to increase their contract from the purchase of 50 to 150 containers in a three-year term. The general manager indicates that RFC has to prepare an improvement plan, starting with a training program for their technical team in order to increase member production, productivity and quality control; improve accounting-financial systems and systems for productive and commercial information, and traceability; establish a working capital mechanism to improve coffee processing equipment and facilities at the farm level. The preliminary cost estimate on the needed investments is more than US$1 million.

The members of the BOD state their concerns regarding the amount of the investment, including the increase in technical, commercial and administrative staff; the commercial risk; and producers' aversion to productive investment in their farms given current low prices and the downward trend in regional coffee production. They express their fear that if they adopt a new commercial mechanism, they may not provide more coffee to the national coffee institution and consequently may risk losing its technical support and services. The general manager says that he might talk with national agricultural development banks, international donors and national governmental agencies supporting export initiatives, as well as with the regional and the municipal governments, to request support in procuring additional funds, working capital, equipment, infrastructure, staff, systems and the other requirements in order fulfill the commitments regarding volumes, quality and certifications required by the importer and the roaster.

BOD Representatives of the Cooperative Members of the RFC

After listening to the information given by their delegates in the RFC BOD, the representatives of the BODs of the RFC member cooperatives discuss the different aspects of the offer presented by the importer and roaster. Some representatives of the BODs express concern about accepting this commitment and assuming the high financial risk of the required investments at the producer, associate cooperatives and the regional Federation level. They worry about not being able to fulfill their commercial commitments. They also worry that they will lose the support and services of the national coffee institution if they modify the traditional commercial mechanism and do not supply them with coffee. Other representatives comment that this is an excellent opportunity to expand the cooperative and to enter a broader market of differentiated coffees by certification, origin and higher quality, thus improving the socio-economic condition of cooperative members and their families.

CASE STUDY DISCUSSION QUESTIONS

1) What should the RFC's main concerns be in evaluating this offer and tripling their volume of high-quality coffee? How could they get the necessary resources and commitments on behalf of the partner producers and the member cooperatives?
2) In your opinion what has the RFC done correctly to be offered such a dramatic increase in the purchase of their high quality coffee? How can these steps or actions become adopted by new or growing cooperatives?
3) What governance and decision-making mechanisms should the RFC or other cooperatives implement to properly manage the commercial challenges of an offer of this magnitude?
4) What would be an appropriate plan for capitalizing on and strengthening the RFC and its cooperatives to improve their entrepreneurial capacity in order to successfully fulfill this high-value differentiated coffee market offer?