

E. Executive Summary

Introduction

Organic, eco-friendly, and fair trade coffees — collectively referred to in this report as sustainable coffees — fill a market niche that is not only rewarded with a premium price but can also provide other superior benefits that help producers improve their sustainability. These benefits are very much sought-after in producing countries because they can offer coffee producers distinct environmental and social advantages as well as a considerable direct economic impact measurable in millions of dollars.

Of course, these types of coffees do not necessarily guarantee sustainability nor are they the only path to coffee growing sustainability. While other types of coffee may also contribute positively to sustainable development, these three general types possess intrinsic qualities that most closely fulfill the balanced social, environmental, and economic requirements necessary for sustainability. They are also among the few that permit reasonable verification of their claims. For these reasons the use of the term ‘sustainable coffee’ is a useful shorthand description and is not intended to imply that other non-certified coffees are necessarily unsustainable.

As the coffee industry experiences some of the lowest green bean prices of the past hundred years (in real terms), sustainable and other differentiated coffees, are among the few receiving a more substantial remuneration and showing significant growth. Since very little is known about the market characteristics and trends for these coffees, this report concisely conveys the result of extensive research that was conducted over the course of 11 months from early 2002 through January of 2003.

This study specifically assessed the characteristics, quantities, and tendencies of trade for each of the sustainable coffees in the most important consumer markets in Europe and in Japan. The research

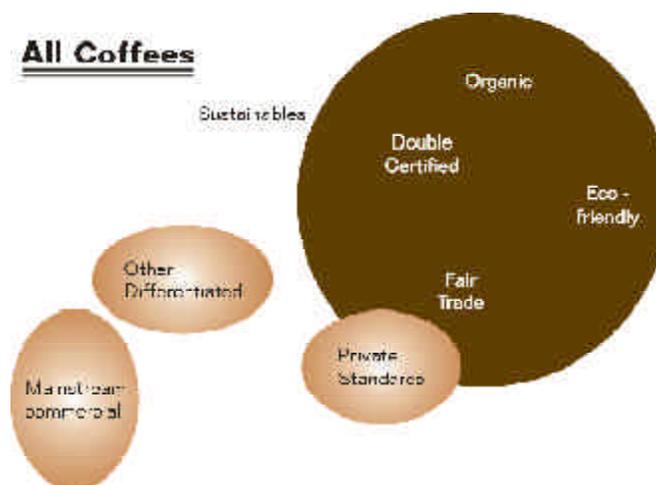
primarily covers: Belgium, Denmark, Finland, France, Germany, Italy, Japan, The Netherlands, Norway, Sweden, Switzerland, and the UK. It complements an earlier study of the U.S. and Canadian markets. The research team conducted interviews and discussions with buyers, traders, agents, trade associations, certifiers, and government entities, focusing particularly on those responsible for the trade in sustainable coffees, and also reviewed existing studies and reports on these markets as well as national and international databases.

What are sustainable coffees?

Sustainability is a dynamic continuum and can best be perceived as an ongoing process rather than a static achievement. Sustainability has been defined in several ways and this report uses the term in the generally accepted form of the international development community, stating that in order to achieve sustainability long-term

environmental, social, and economic needs must be met in an integrated manner without compromising the ability of future generations **to meet their own needs**. Another useful definition states that “a sustainable producer shall meet long term environmental and social goals while being able to compete effectively with other market participants and achieve prices that cover his production costs and allow him to earn an acceptable business margin”². Unfortunately, the coffee commodity market is driven exclusively by economic factors and, like all commodity markets, does not recognize, much less internalize into its prices, the very real environmental and social costs of production. The entire coffee industry benefits from some excellent initiatives currently working to both define and operationalize sustainable coffee standards. While it is at the forefront of other commodities in this regard, the mainstream industry still has a long way to go. Organic, eco-friendly, and fair trade are arguably the best attempts toward sustainable production practices

Figure E.1 A Characterization of Coffees



- 1 From the Brundtland Report (1987) as confirmed at the Rio Summit (1992) and the Johannesburg World Summit on Sustainable Development (2002)
- 2 Adapted from personal communication with Michael Opitz April 25, 2003.

that meet a number of the vital environmental, social, and economic needs of nearly a million coffee producers. They will not however necessarily resolve all of the current problems of nearly 25 million other producers and of the global coffee industry, many of which are rooted in large-scale structural and market deficiencies (Lewin & Giovannucci 2003).

Sustainability is an issue far broader than the types of coffee that are identified as ‘sustainable’ per se and that are measured in this report. There are in fact a number of new initiatives that are distinct from the well-known organic, fair trade, and eco-friendly coffees that can also contribute to long-term sustainability in the coffee sector. Many of these can be characterized as corporate-driven endeavors that define sustainability somewhere between conventional practices and an improved level of sustainability companies feel they can reasonably achieve and pay for. The better of these initiatives incorporate independent third party verification and are very useful to producers while some others are little more than public relations gambits.

The marketing of coffees as sustainable is a relatively new idea for the coffee industry. For less than two decades they have been typically available in very small quantities from a handful of countries. In the past, these coffees were inconsistent in both their quality and their availability. Sales growth occurred almost exclusively within a relatively small core market of specialty retailers, social organizations, and cause-conscious consumers. In the last few years this has begun to change dramatically and these coffees are now at a crossroads with many opportunities in new, high-volume distribution channels.

The business for these coffees has recently grown quite robust at all levels of the supply chain. Sustainable coffees now involve 32 producer countries, many hundreds of producer organizations, dozens of specialized traders, more than 20 consuming countries, hundreds of

roasters, hundreds of brand-owners, and thousands of retailers. In some countries between 10 and 20 percent of households are regular buyers of these coffees.

Higher quality is the recipe for sustainability according to some who argue that a sustainable coffee culture can best be achieved through farmers that grow and sell high-quality products. Adequate quality is certainly an important component of a farmer’s ability to be competitive and minimum quality standards are a baseline necessity. However, many quality-oriented arguments tend to miss one or more critical points. In the absence of quality regulations, the market does not always reward superior quality and often bulks together the production of many growers into common lots where individual differentiation is lost. Commodity markets may require a minimum quality but similarly do not reward superior quality. Even when superior quality coffees are rewarded, this economic benefit is not necessarily translated into improved social or environmental benefits that are the other two pillars of sustainability. So while a quality output is important, it is equally important to consider the process of production and trading relationships in order to improve sustainability.

The importance of sustainable coffee

Fair trade, organic, and eco-friendly coffees occupy a market niche that is still small in volume — on average less than 2% of consumption in the more developed markets — but offers attractive benefits not only for about ¾ million farm households, but also for the entire industry in terms of increased sales from these coffees and greater profits all along the supply chain. Total global sales for 2002 — calculating conservative estimates of both certified and non-certified coffees that paid producers a premium and were sold with claims of sustainable production practices (i.e. ethical, eco-friendly,



Utz Kapeh) — were in excess of 1.1 million bags of coffee. With average sales growth many times greater than conventional coffees, these are among the fastest-growing market segments because they appear to be attuned with emerging consumer demands, increasing corporate responsibility, and heightened risk management along agricultural supply chains.

For coffee growers in many countries, coffee provides their sole source of cash income and so even modest premiums earned from differentiating their production can make an appreciable difference. At today's (early 2003) prices a producer that can sell double certified (organic and fair trade) coffee would double his income above the benchmark market price. Although many farmers producing certified coffees may earn somewhat less than double, they desperately need these price premiums and the opportunity to establish more direct personal contacts with importers and roasters. There are nevertheless, other features that can also be of great value to coffee producers. For many, their participation in these markets has provided important social and environmental benefits that contribute to local sustainability and stability.

Besides a direct economic benefit to many coffee growers, sustainable coffees provide additional intended benefits or positive externalities at the producer level in the field that go beyond a market advantage. These can include:

1. Improved natural resource management and biodiversity conservation
2. Crop resilience to weather & climactic risk
3. On-farm diversification and fewer external input costs reduce financial exposure
4. Community or organizational development and increased use of rural labor
5. Fewer health risks due to misuse of agrochemicals

Certain standards in particular offer further benefits like traceability and process management that can help prepare smaller producers to better compete in modern agricultural trade.

European and Japanese markets overview

Size & market share

The share of sustainable coffees in each of the 11 most important European coffee markets (2001 data by volume) ranges from a low of 0.3 percent to 3.4 percent. The overall average between the countries was approximately 1.6 percent while the weighted average was 1.1 percent. Preliminary 2002 data indicates that market share for sustainable coffees has grown further in most countries. Their 2002 market share in Japan is approximately 1.2 percent. Sustainable coffees have the highest market share in Switzerland and Denmark and are also strong in Sweden. In certain market segments they have a much larger share. For example, looking at just the roast and ground segment and not the instant coffee segment in the UK, would show that sustainable coffees have about a 10 percent share. Of course, roast and ground only represents a minor percentage of the total UK market.

Estimating total value rather than volume brings the market shares of sustainable coffees higher still, since sustainable coffees are on average more expensive than conventional coffees. The estimated value share of sustainable coffees in these European markets ranges from approximately 0.4 percent to approximately 5 percent. Individual segments could be considerably higher.

The 11 major European consumers combined to use more than 15.4 million kilograms of certified fair trade and approximately 11.2 million kilograms of certified organic coffees in 2001. Of these, 5.3 million kilograms were double

certified as both fair trade and organic indicating a net total of more than 21 million kilograms sold in 2001 (355,000 bags of green coffee). Japan added a total of only about 1.6 million kilograms in 2001 - an unusually low year. For 2002 the joint certified total in these 12 markets is estimated to have been about 27.7 million kilograms or 460,000 bags.

The European sustainable coffee markets are dominated by fair trade and organic, the former of which is the larger. Eco-friendly and shade-grown or bird-friendly certifications have just begun to reach Europe. In Japan, like North America, organic coffees are the dominant type and there is a considerably stronger interest in eco-friendly coffees that are demonstrating rapid growth.

Germany is Europe's largest market for sustainable coffees followed by the Netherlands³ and the UK. Some nations like Finland and Norway have shown less interest to date and their markets, like those of Spain, Portugal, Austria, and Greece are relatively quite small. Japan is one of the world's biggest coffee consumers and although its sustainable markets are still small they also include eco-friendly varieties along with the more typical organic and fair trade.

Distribution channels and formats

Distribution channels in all of the markets for sustainable coffees have expanded enormously in recent years. This is all being facilitated by an increasing number of traders, including some of the largest global players, who are getting increasingly involved in these coffees. The expansion has been particularly evident at the retail level where supermarkets and high-volume multiple store chains have joined the specialty retailers in this business. The mainstream retail

channels that are beginning to provide these coffees with much broader exposure to a greater range of consumers are far from being fully developed. Most of the mainstream retailers are recent entrants to this field and many only carry a nominal stock or selection of these coffees. With a few notable exceptions, promotional efforts for these coffees have been modest with very few firms willing to make strong commitments to promotional investments.

Many of the specialty retailers including coffee shops, fair trade stores, health food stores, and independent grocers have consequently seen their market share of sustainable coffee eroded as supermarkets expand their participation. There is a dramatic difference from country to country in the institutional or out of home channels for sustainable coffees and, judging by the success of countries like Austria and the Netherlands, many may have a considerable untapped potential in this area. These include restaurants, cafes, offices, government, healthcare organizations, and even vending machines.

Sustainable coffees are sold in a variety of different formats ranging from gourmet and single origin, to espresso, to mainstream or mass-market blends, and even soluble or instant coffees. Consequently, the market requires an increasing range of different coffee types and qualities and not just high-quality, high-grown, mild arabicas.

Certification issues

Although organic, eco-friendly, and fair trade coffees are distinct, it appears that the market often does not perceive them as such. There is growing evidence that consumers closely associate these coffees that have each accumulated a measure of both credibility and

³ The Netherlands' considerable import volumes are in part due to their position as a popular port of entry and they re-export a considerable portion of these coffees.



goodwill and do not always make clear distinctions between their unique characteristics. A number of retailers speculate that consumers would prefer to not have to choose between organic and fair trade and an increasing number of major retailers want to have coffees with both certifications. Indeed, approximately 44 percent of fair trade coffee production is now also certified as organic. This is dramatically up from 1 percent in 1996. Some retailers, and even some roasters, are already exploring such combined characteristics under their own private labels.

Not all of the production that is certified sustainable is necessarily sold by producers at a premium and, of the coffee that is shipped as certified organic, eco-friendly, and or fair trade, not all makes it into the consumer market as such. A portion, for various reasons, is sold as conventional coffee.

Producer countries

Firms indicate that an increasing number of countries now supply these coffees. The great majority come from Latin America where two countries stand out as the dominant providers: Mexico and Peru. All of the Central American producers are increasing their participation as are the Latin American giants, Colombia and especially Brazil. Uganda, Ethiopia, and Tanzania lead the way in Africa while India, Indonesia, Papua New Guinea, and East Timor are the major Asian suppliers.

Trends in European and Japanese markets

Organic foods are achieving unprecedented global popularity and with half of sales occurring

in Europe, organic coffees there are also likely to benefit.

Eco-friendly coffees are closely associated with organic principles and are likely to also benefit from increased consumer consciousness of health and environmental issues. Organics appear to gain from a fundamental perception that they are healthier for the consumer.

Fair trade also benefits from the increasing awareness among consumers and buyers of how their purchasing power, when directed toward ethical trade, can impact both labor standards in developing countries and corporate social responsibility. Overall fair trade product sales⁴ have enjoyed steady volume growth of nearly 20 percent per year on average from 1999 through 2002. Fair trade coffee has also grown overall but at a slower average overall pace and with considerable disparities between countries.

There is a concern that in some of the more mature markets fair trade coffee may have hit a glass ceiling, unable to grow beyond its affinity with a more socially conscious but relatively limited market. New access to more promotion and distribution in mainstream channels like supermarkets could rapidly change this but has not yet materialized.

Average sales growth for sustainable coffees in recent years has easily been 5 times greater than that of conventional coffees in most of these markets. There are dramatic differences in growth between the different European countries and particularly between organic and fair trade that are not visible in the overall average growth of about 10 percent per year over the last three years. Firms involved with sustainable coffee generally predict modest growth in the near term and much more positive growth for 2004-2005. Double certified coffees in particular are expected to

⁴ primarily coffee, tea, bananas, cocoa, sugar, honey, and orange juice

show the highest rates of growth. By 2004 the major European sustainable coffee markets are conservatively expected to grow by about 55 to 65 percent from their 1999 level. Although projections for growth continue to be positive overall, they are not homogenous across European countries. In Japan the recent interest in eco-friendly coffees on the part of some of the major roasters and large retailers could rapidly increase the availability of such coffees.

Over the last three years Sweden and Italy experienced the greatest growth overall with sustainable coffees and were surpassed only by France's 175 percent increase during this period. Switzerland, after several years of very strong growth, is the only country where sales actually declined, albeit slightly, in more than one year of the last three. In fair trade coffees Germany and the Netherlands represent the greatest volume consumption but are stagnant whereas France, Norway, and Sweden posted the greatest rate of growth over the last three years even though the all three countries started from a relatively small base. The greatest growth for organic coffees occurred in Italy, Sweden, and the UK. Germany, Sweden and Denmark were the top three volume consumers of organic coffee in 2001. Eco-friendly coffees are beginning to make their appearance in Germany and the UK but have developed no track record in Europe.

Prices and premiums

Retailers until recently had very little competition for these products and could afford to keep prices relatively high especially since some believed that lower prices might simply serve to substitute these for their existing business in parallel conventional coffees. This is clearly changing as more retailers and more brands offer these coffees and competition heats up. A small but increasing number of European retailers that carry these products are bringing their retail prices much closer to the level of conventional coffees.

However, in most stores and most markets the difference is still considerable.

Organic green bean premiums show a considerable scale of variance but the mean range is approximately US\$0.15 to US\$0.30 per lb. While most of the industry feels that these premiums are justified, nearly half predicts that, as supply competition heats up over the next few years, these are likely to erode. Eco-friendly coffees typically range from US\$ 0.10 to US\$ 0.60 per pound although it is difficult to disaggregate certification premiums from quality premiums. For fair trade, most participating buyers pay at least the official FLO minimum prices while very few pay slightly more and some pay much less by operating outside of the FLO certification and registration system. With current market prices for arabica coffees, the FLO price translates to a fair trade premium of approximately US\$.66 per lb above the "C" market rate for similar coffees produced in the conventional manner. Most, but not all, fair trade coffees are arabica.

Since some of the more popular origins for sustainable coffees like Mexico and Peru typically sell their conventional coffees at a discounted differential to the "C" price, actual sustainable coffee premiums, since these are often based on the "C", are therefore even higher than similar quality conventional coffees. However, the markets for such coffees are still relatively small, premiums are negotiable, and such margins may not remain at their current level.

Perceptions

Overall the industry is cautious but optimistic about the future. It recognizes that these sustainable coffees are not only important for the health of the coffee industry but also that these are no longer inconsequential niches. Some speculate that over the course of the next decade



such coffees will become a strong rather than a marginal segment in the industry. As such, they could eventually become more of a competitive standard rather than a competitive differentiator. There are of course different definitions of sustainability and it is not yet clear which of the concepts will turn into mainstream standards and which will remain confined to niches. In either case, it appears clear that organic, eco-friendly, and fair trade coffees are here to stay.

While the cause-related aspects of fair trade or organic are important differentiators in the marketplace, another aspect is just as important for farmer sustainability: consistency. The industry claims that sound trade relationships are always developed as a result of consistency in both the quality of the coffee and the business practices of the farmer or cooperative. These two types of consistency are perhaps the most valuable supplier characteristics that emerged from trade interviews and discussions. The highest quality is not always necessary, unless it is for the gourmet market, since average coffees are often needed as fillers in blends to keep cost low⁵. While some buyers might bear a lower quality coffee, they have a very low tolerance for the increased risks of having an inconsistent supplier. There is some anecdotal evidence that sustainable production practices improve consistency, risk management, and overall quality; however, further research would be necessary to confirm this

A strong majority of the roasters and importers involved with the sustainable coffee industry feel that the premiums paid for sustainable coffees in general are reasonable and justified. Some respondents felt that fair trade prices are too high considering today's low market prices. A number of the firms who balked at fair trade prices claimed to do so because they were not convinced that a significant portion of the benefits actually reached the producers.

Confusion about certification dampens the market

Confusion about certification schemes is more prevalent in some of the countries surveyed than in others but the industry overall has a limited understanding. There is general concurrence among the industry everywhere that certifications and labels are confusing to consumers. The survey respondents who found the certifications confusing considered that there are a large number of terms and labels like organic, ecological, biological, fair trade, ethical, sustainable, and responsible that overlap and cause uncertainty. So even if people are familiar with the existence of these labels, they often may not know what they stand for. One could expect that a consequence of this confusion is a reduced willingness to pay for these coffees.

Organic labeling guidelines and the new government seals in countries like Germany and Japan will undoubtedly help consumers to more readily identify and develop a trust in certified organic products. Despite the introduction of regulations, inefficiencies between different government bureaucracies and the lack of unified standards concerning organic certification among different certifiers still cause confusion and inefficiencies in the coffee trade making it a source of conflict that comes up repeatedly in the industry surveys. Fair trade guidelines are not mandated by any law and there is increasing evidence of coffees using 'fair' or 'ethical' verbiage to sell products that are not FLO certified or otherwise independently verified.

Alternative certifications positive but potentially risky

There are a number of alternatives to the formal systems of sustainable coffees that this research is primarily concerned with. In many European

⁵ caution in regard to the quality is warranted in view of evidence from the ICO indicating that the use of lower quality coffees may be associated with declining consumption trends

countries and in Japan, solidarity groups lend support to coffee growers through the marketing of their products within a network of socially conscious consumers such as civic and religious groups.

Some coffee companies' social responsibility has led them to independently develop their own private guidelines for sustainability that many perceive as positive and welcome signs. There is however a considerable risk of causing confusion when companies offer coffees labeled with their own independent guidelines in the open market. There is a likelihood, particularly at the corporate level, of free riding on the reputation and the moral position of, for example, registered fair trade participants when such coffees represent themselves as 'fair' or 'ethical' but do not offer similar price levels or benefits to farmers and often do not engage third party verification of their practices.

Challenges

Many would agree that the coffee industry is faced with a number of challenges and that overproduction is at the top of the list. It appears that the cycles of imbalance in supply and demand are inherent in current market structures and there are no easy or short-term solutions to this problem (Lewin & Giovannucci 2003). The consequences, of course, bear hardest on the producers but the resulting instability is ultimately also damaging to the rest of the industry.

a) The development of market-oriented approaches to foster the different kinds of sustainable coffees is a relevant and critical challenge for the future sustainability of both coffee producers and the industry. At the same time, it is important for producers and policymakers to know that sustainable coffees are neither a quick fix panacea nor the answer to all the world's coffee problems.

b) These coffees are truly at a crossroads. In most European countries, consistent availability and improved quality have recently enabled much broader distribution especially to demanding multiple store operations like supermarkets. As mainstream retailers take over more of the business, consumers necessarily lose the personal attention of specialized retailers that, in most cases, introduced them to sustainable coffees. It will therefore become increasingly important to substitute this with branding, promotion, and advertising strategies. Without strong promotion and branding efforts, it will be difficult for any sustainable coffees to fulfill the promise of high sales growth in their new distribution channels where they compete with heavily advertised, low-priced brands. This represents a paradigm shift away from the traditional methods of marketing these coffees and while several roasters and wholesalers are beginning to build sustainable coffee brands, very few large European or Japanese retailers have done the same.

c) The credibility of sustainable coffees is built on trust and trust is assured by independent certification. As more firms adopt their own "sustainable" sourcing criteria for these coffees, it will be critical that they clarify or improve existing standards and certification systems rather than dilute these by adopting many varying different standards of their own. Accredited third-party verification is essential in order to ensure compliance with claims and to reduce the considerable risk of losing public confidence that all market participants face.

d) Many sustainable coffees do not have strong brand recognition and the different certifications or labels can be confusing especially to a potential new consumer. Even many roasters and some coffee buyers are



unfamiliar with the characteristics or reliability of such coffees leading some to reject them. Further education about the scope and the diverse benefits of sustainable coffees could pay substantial dividends if it is directed toward both consumers and the mainstream coffee industry.

e) Finally, the primary drivers for most sustainable coffees are premiums, but these

may well be ephemeral. Clearly, sustainability cannot be built on these alone. It is important that both farmers and policymakers understand the greater long-term value of sustainable practices and facilitate their adoption, not just as part of a competitive market strategy, but also as part of a sound rural strategy to reduce risks and improve livelihoods for both farmers and laborers.