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Marketing channel and value chain of coffee producers cooperative union of Ethiopia

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ABSTRACT

Ethiopia is one of the leading producers and exporters of coffee. Ethiopia is the fifth largest exporter of coffee among the coffee producing and exporting countries. Majority of the coffee producers in Ethiopia consist of small farmers and many of them depend mainly on coffee for their livelihood. In several parts of Oromiya and SNNP regions of Ethiopia, especially in Jimma and Sidamo zones, primary cooperatives and cooperative unions have been organized exclusively for the coffee producers to market and provide service and supplies to them. Present study is undertaken to know the marketing strategies followed by the cooperative unions, especially with reference to export marketing. As these cooperatives are contributing to the foreign exchange of the country, the study gains relevance to today's economic situation of the country. The specific objectives of the study are: To study the internal and external marketing practices followed by the sample cooperative unions. To examine the type of competition that exists in export business and the strategies followed to meet such competition, and to analyse the problems faced by the cooperatives in export marketing and to offer suggestions to them. The study was conducted on two cooperative unions, which are better performing in export trade and were purposively selected. The sample Cooperative Unions are Oromia Coffee Farmers Cooperative Union and Yirgacheffe Coffee Cooperative Union. For deeper study the most successful Cooperative Union, namely Oromia Coffee Farmers Cooperative Union and two primary cooperatives affiliated to it were selected. The major findings of the study were: In their export marketing the unions have to face stiff international competition. They are able to withstand such competition and come out successfully by means of improving the quality of coffee, going for fair trade practices and by keeping better rapport with all the stakeholders involved in export trade. As fair trade coffee brings better price and dividend price, the primary cooperatives are educating the farmers to go for such practices continuously. To give value addition, numbers of processing activities are added by the unions. Some times when production is high, the unions are unable to procure the entire produces. During such seasons primaries sell coffee to the private merchants.

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Introduction

Coffee is the world's largest traded commodity after crude oil and creates jobs for 10 millions people, many of them in poor countries. Global revenues from coffee sales are around \$55 billion, compared to \$30 billion in the 1990s. Coffee is sold on the world market at commodity exchanges along with other agricultural products. The benchmark robusta beans price per ton is the standard price for coffee. The coffee futures market is popular with speculators.

The coffee market is controlled by the four big coffee roasters: Sara Lee, Nestle, Proctor & Gamble and Kraft, which is part of Philip Morris. Market share in 2002: Philip Morris (25 percent); Nestle (24 percent); Sara Lee (7 percent), Proctor & Gamble (7 percent), Tchibo (6 percent); Other (31 percent). Starbucks only accounts for 1 percent of all coffee sales.

About 10 percent of the profits from coffee sales go to growers; 10 percent to exporters, 55 percent to shippers and roasters and 25 percent to retailers. In early 1990s, people in the coffee-producing countries earned about 40 cents on every dollar spent on coffee. Now they only earn about 8 to 13 cents. The difference is attributed mainly to low coffee prices paid to farmers and the high prices paid by consumers.

In 2002, a typical small farmer sold his crop to a middleman at a price of 14 cents a kilogram. After the middleman takes the raw coffee berries to a mill and transports the beans to a major trading center or city he sells them for 26 cents a kilogram to an exporter, who transports the coffee to a port, sorts it for quality, pays taxes and delivers to an importer, who buys it for 45 cents a kilogram. He delivers it to a consuming country in Europe or North America and sells it there for 52 cents a kilo. The price includes the cost of the coffee, insurance and freight. Transportation to a roaster adds 11 cents and boosts the price to 63 cents. [Source: The Independent]

At the roasting factory, the coffee beans lose weight as they are ground and processed into brewing coffee or instant coffee. In the case of instant coffee, a kilogram of coffee that was bought for 63 cents is reduced in weight to 385 grams and sells for \$1.64. The roaster processes, packages, distributes and markets the coffee and sells it at a wholesale price to supermarkets for around \$13.40 a kilo. Consumers buy it at the retail price of \$26.40 a kilogram, or 7000 percent more than what the farmer is paid.

For a \$3.75 double cappuccino sold at a coffee specialty shop in the United States, 3.5 cents goes to coffee growers, 17.5

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cents goes to coffee millers, exporters, importers and roasters, 40 cents covers the cost of the milk, 7 cents covers the cost of the cup, \$1.35 pays the labor costs at the coffee shop, \$1.29 covers the shop rent, marketing and general administration, 18 cents goes towards the initial investment, and 25 cents is the profit earned by the shop owner.

Rising demand for coffee in China has created rising demand for coffee production world wide. Starbucks buys about 2 percent of the world's coffee.

The typical marketing channel of the coffee cooperatives and unions is very simple. The payment system of coffee cooperatives and unions is as follows:

1. A cooperative purchases coffee from farmers at the market price. The price is determined based on competition between cooperatives and private traders. The payment by the cooperative is made immediately or around one week after the farmers deliver the coffee. The timing of the payment depends on the financial status of the cooperative.

2. The coffee purchased by the cooperative is delivered to a union. The union purchases coffee from cooperatives at a price equivalent to the domestic auction price at that time. The payment is usually made immediately or after a couple of weeks following coffee delivery; the exact payment time depends on the financial status of the union. In some cases, the union might suggest that cooperatives sell their coffee to auctions instead of to unions due to reasons described below :

(1) the coffee volume has exceeded the amount the unions are able to sell;

(2) the quality of the coffee does not meet the unions' standards; and

(3) the auction price is higher than the unions' price.

3. Unions export coffee through a Fair trade route or conventional route.

4. After completing the audit of unions' finances, the amount of the dividends to be paid out to the cooperatives is decided. The dividends are calculated after deducting 30% of the net profit for the unions.

5. Whereas 30% of the net profit, including the dividends from the union, is reserved for the primary cooperatives, the remaining 70% is distributed as dividends to farmers after auditing procedures are complete. The mode of dividend distribution is based on the volume of coffee and the size of the share purchased by farmers

The financial constraints of primary cooperatives also limit the amount they purchase. Although farmers tend to be satisfied with the price offered by the cooperatives and are willing to sell more to them, cooperatives cannot buy all the volume farmers produce. Farmers sell the remaining volume to private traders.

The marketing chain

Farmers prefer to sell red cherry for wet processing because this results in higher quality coffee and fetches a better price. For red cherry, the buying season is very short, and so farmers must sell immediately. In theory, a farmer can sell dry berries at any time in the year, waiting until the price gets high in June. In practice, they often face financial difficulties and have to sell immediately, when prices are low, men, women or children take coffee to market.

Information about coffee prices on the national or international market is difficult to obtain. There is a broadcast every day on national radio, but very few farmers have a radio. Moreover, broadcasts are in Amharic a language that many people do not speak.

However, since for the past many years, some of the cooperatives have gone bankrupt or have not had the finance to

buy sufficient quantities of coffee. This meant that the traders dropped their prices even lower than would otherwise have been the case.

After processing, the private collector or co-operative bags the coffee and transports it to Addis Ababa. Here, the beans are inspected and graded by the government coffee and Tea Authority. A graded sample is then taken to the auction house where an exporter may buy it. Unlike the situation in other countries, exporters do not buy directly from farmers. Moreover, all exporters are Ethiopian; the law prohibits foreign firms from buying at the auction house. A few are agents of the big importers.

The exporter sorts, cleans, and blends the different coffees to prepare them for export; in the case wet coffee, they also have to hull the coffee. The exporter then takes the coffee beans back again to the government, where they are re-inspected and certified for export, and finally packaged in labeled bags (60kg/132lbs).

The major ten coffee importers from Ethiopia in order of size are Volcafe, Weser International, AI Kahair General, Mitsui, Nichimen, Mitsubishi, Toyota Tususho Corporation, Taloca, Toshoku, and Bernhard Rothfos. The main importers of Ethiopian coffee are located in Germany (13.61 per cent) Holland (2.10 per cent). And Poland (1.53 per cent) The UK imported only 0.06 per cent. The US and German markets are decaling, while the Japanese, Saudi, French, and UK markets are growing

Value chain in Coffee Marketing

To make Ethiopian coffee more competitive they can fall in three areas per the value chain approach.

A. Product Differentiation – What special qualities does the product have or can be made to have that increases value and ultimately sales.

B. Untapped Market Demand- Are there consumers that demand product characteristics that are a competitive advantage for sales. If product differentiation is an attempt to change supply characteristics, in this case, competitive advantage comes from identifying new or different demand characteristics.

C. Improved Efficiency – How can the same product be produced and exported at a lower cost? Rather than change demand or supply of the product, the goal is to produce the product to end markets at a lower price. For coffee produced by small holders in Ethiopia, the cooperatives and ACDI/VOCA identified significant potential comparative advantages for cooperative coffee production.

A. Product Differentiation

Improving quality and ensuring consistency for original coffee (Yirgacheffe, Sidamo, Limu, Wild Forest Coffee, etc.) Introducing High Quality Sun-dried Natural Coffee

Improving the quality and consistency of taste from year to year of origin coffee was the main objective and starting point under product differentiation. By and large, this was washed coffee coming from Sidamo and Yirgacheffe. Three things were important and became the mantra for ACE coffee - "quality, quality, quality". If these coffees were harvested at the right time and processed well, they were able to fetch prices of \$0.15-0.20 per lb over the New York Board of Trade "C" Contract daily benchmark price. Many Ethiopian washed origin coffees were receiving less than New York C-market benchmark price. As certain ACE-assisted cooperatives have recently learned, careful sun drying can produce extremely flavorful, highly rated coffee. In the Ethiopian Cooperative Coffee Competition supported by ACDI/VOCA in 2005, the best rated coffee was a sun-dried coffee that would normally be exported as bulk coffee,

Jimma 5, which typically sells at \$0.20 below the New York C benchmark price. The right technique for sun drying differentiated this coffee such that it was bought from the cooperatives at prices equal to that of the best washed coffees. A recent Starbucks top rated coffee that was featured as its "Black Apron" awardee was a sun-dried coffee coming from Ethiopia's Ferro Cooperative which is known for its washed coffee. Again a change in processing differentiates this coffee as high value. The coffee is currently selling in Starbucks retail shops in the US at over \$20/lb. Product differentiation by quality and origin offer enormous potential competitive advantage for Ethiopia.

B. Market Demand Opportunities

- Fair Trade, Organic, Utz Kapeh and other special certifications
- Starbucks quality bonus and CAFÉ Practices verification programs
- Relationship Coffee

These special coffee market opportunities can be exploited by Ethiopian cooperative producers at significant competitive advantage. International buyers pay premiums for these certifications. Certifications are an important demand opportunity to achieve higher prices as well as increased sales. It is important to note that the demand for certifications is strongest when the quality of the coffee is high. The price impacts have proved to be most significant for certifications. For example, Fair trade coffee was paying almost double the market price during the depths of the coffee crisis from 2001 through late 2003. ACIDI/VOCA educated cooperative and union leadership on the benefits and cost of certification, helped build capacity to meet and continue to meet certification requirements, and facilitated the linkages with the certification agencies. The actual cost of the certifications for organic, Fair trade and Utz Kapeh were covered by the cooperatives and unions in some cases, international buyers in others, and donors in a few instances.

C. Improved market Efficiency

The significance of the government decision to allow cooperatives to directly export is that it opened a potentially new value chain channel for coffee export. The institutions and structures of that channel were missing in some cases, but the potential for increased efficiency was enormous. This new value chain stands in stark contrast to the rigid and narrow auction system that other private sector operators in Ethiopia must use for export. Other exporters must seek out quality in the auction rather than work with producers and processors at the farm level to build quality. Traceability, which is becoming so important in organic coffee and EU regulations, is impossible or at best impractical in the present Ethiopian auction system. The rigidity of the auction and export processes including the inability of buyers to taste the coffee in advance of sales creates a highly inefficient marketing chain. Much of the advantages of Ethiopia being a low cost coffee producer are lost in the inefficiency of the auction channel of the value chain.

The interventions and facilitation by ACIDI/VOCA to help cooperative coffee become competitive are well described using the value chain framework or approach. The interventions fall into five areas of the value chain structure.

- A. Vertical linkages and cooperation,
- B. Horizontal linkages and cooperation,
- C. Supporting markets, especially financial markets,
- D. Firm level upgrading, and
- E. Improvements in the enabling environment.

However, a value chain approach alone was not enough. The other prime factor in achieving the success of the cooperative coffee sector growth is the substantial and significant institutional development and capacity building completed under ACE for cooperatives. This was goal was to help build a special set of private sector businesses, that is cooperatives. Some might describe the interventions as a throwback to earlier business development models where donors or governments selected private firms for assistance and supplied them with technical assistance and training. Looking back at the five years of the coffee sector support, building capacity and institutions was necessary to the success of the coffee value chain approach. Similarly, the success of the institutional building interventions rests on the expanded sales from the value chain approach. The key difference between the ACE case and the earlier small business development model was the heavy emphasis and close link of the institutional development to real market opportunities and demand. Before looking deeper into the conclusions and implications on lessons that we might learn from this "dual" approach to small-scale farm business development, it is important to set out the activities and interventions in the five areas listed above as well as to describe ACE cooperative institutional and capacity building. This will give us a more thorough understanding of the experience so to help draw out conclusions and lessons.

A. Vertical linkages and cooperation, The coffee cooperative unions were established and strengthened to buy, consolidate and market internationally cooperative supplied coffee. In the supply chain model they would be the lead firms in the local value chain. As of the end of 2005, cooperatives had formed four coffee unions owned and directed by the member cooperatives. Altogether there were 154 cooperatives in the four unions with just short of 180,000 farmer members. The Oromia Coffee cooperative was established in June 1999 but the other three, Sidama, Yirgacheffe and Kafa Forest Coffee Unions, were established with direct support by ACIDI/VOCA under ACE. All received capacity building assistance. A listing of the types of assistance provided is set out below. Since the cooperatives were the owners of the unions, the process of building union capacities was an important vertical linking of coop and exporters, the unions, in the value chain. Most of the cooperative members have washing stations that process coffee. The close collaboration between the unions and their member cooperative washing stations was integral to improving coffee processing to meet exporter (union) quality and taste demands. The linkage strengthened the value chain to achieve quality production, efficient operations, market synergy and cupping consistency. It is also important to note that horizontal learning by member cooperatives in the same union was strong. Finally, the cooperatives work with the farmers, the local vertical linkage, was strengthened as well because they knew what was needed for union premium sales and could communicate that to the farmers (e.g. ripe cherries, delivered quickly).

The types of institutional and capacity building support provided under ACE include:

Assisted with legal, technical and business formation of three coffee cooperative unions.

Provided start-up training and support on how to operate a union.

Trained managers, staff, and board members in cooperative principles and basic business and marketing skills.

Organized initial tours to other local unions (non-coffee) for manager, staff and board members to learn of their operations.

Shared cost of opening office – office rental, furniture, equipment, computers and training materials. Business, Technical and Marketing Capacity Building

Provided unions with advanced business skills such as accounting and auditing, warehouse controls and human resource management training.

Trained staff and members in post harvest handling and processing for improved coffee quality

Supported unions to build their coffee liquoring capacity.

B. Horizontal linkages and cooperation

At the cooperative level the cooperative structure of member ownership and self- help for the common business improvement of members greatly supported ACIDI/VOCA facilitation of horizontal linkages and cooperation. The focus on quality improvements at the processing and farmer level was strongly reinforced by the shared goals as sister members of the unions. Cooperation in trucking, warehouse sharing and other logistic requirements was strong. Market information was shared. Learning in areas such as cupping, fermentation, water use conservation and other processing requirements was common. In business capacity building, ACIDI/VOCA found that experience sharing and learning across the training and technical assistance provided to cooperatives staff and board members was common (e.g. in accounting, internal controls, warehouse management, staff management).

At the cooperatives, ACIDI/VOCA provided facilitation in a series of technical areas that cut across all of the cooperatives. The most important of these include:

Assessed the status of washed coffee processing technology used by coffee cooperatives and helped union and cooperative managers improve washing operations and technology. ACIDI/VOCA is facilitating the introduction of new washing technology, which uses only a small fraction of the water, required in the present systems.

Assessed the status of sun-dried coffee processing and have started trials to change drying from farmer to cooperative performed task.

Trained farmers on post-harvest handling and delivery of coffee cherries to the washing stations in order to improve quality of coffee marketed through primary cooperatives and unions.

Upgraded the skills of washing station managers to improve coffee processing

Introduced and trained on coffee contract and delivery agreements and requirements. At the Union level Important linkages were achieved among the four unions such that they worked in cooperation rather than competition. They shared market information and contacts. Solutions to shipping and logistic problems often came with the assistance of a sister unions. All four operated together for the international coffee competition and auction. Sidama Union helped both Yirgacheffe and Kafa in its start-up period to export containers of their coffee.

C. Supporting Markets, A constraint at both the cooperative and union level has been a lack of financing. In the early years of ACE, the constraint was most severe for short term crop financing for cooperatives to purchase cherry from the farmer. Working with USAID, ACIDI/VOCA acted to link a private bank that was given a US Government loan guarantee through USAID for short term crop financing. This intermediation helped both the banks and cooperatives raise their understanding of the loan relationship and requirements. For the crop year ending in 2005, the total USG loan guarantee enhance lending to the coffee sector was more than \$1.3 million. This facilitation

and learning helped both the unions and cooperative expand their borrowing from other banks such that lending from other banks has grown to be significantly more than the USG enhanced lending. For investments, ACIDI/VOCA is planning to cost share with the Unions investment studies to purchase warehouse facilities and dry mills. Input supply as a supporting market for coffee is minimal for small-scale producers in Ethiopia. They use no purchased fertilizer or chemical inputs. Input supply is not part of the value chain

D. Firm level upgrading

Firm level upgrading was done at the farmer, cooperative and union level. Much of what was described previously as institutional and capacity building falls in the area of firm level upgrading to strengthening the value chain. However, as noted previously, the interventions were more comprehensive and extensive than what would be recommended under a value chain approach to sector development where facilitation of market forces to strengthen firms is considered more appropriate than direct assistance. There was much direct support in the form of institution and capacity building and even institution creating with the unions. Institution building in the form training and technical assistance to improve quality, processing and marketing by farmers, cooperatives and unions was successfully completed. This fact then raises an important question addressed in lessons learned sector below about the value of combining a strong firm level capacity building program and the value chain approach

E. Improvements in the Enabling Environment

The starting point for the growth of the cooperative coffee sector was the policy decision on the part of the government to end the requirement for cooperative sector coffee to be sold through the national auction. Under ACE, ACIDI/VOCA had no funding or mandate for policy reform or improvements in the enabling environments of the many sectors in which ACE worked. Yet, within the coffee sector, there were many exchanges with government officials by cooperative leaders and ACE staff on the relative success of the coffee cooperatives compared to the private exporters, local traders and washing station owners. There has also been discussion between government officials and international buyers and roasters about the rise and changing nature of the international specialty coffee markets. The importance of quality production, traced to origin with substantial buyer monitoring and even involvement with coffee growers has been well understood by government officials. At this time at the start of 2006 for non-cooperative producers and exporters, the Ethiopian coffee value chain has a number of emerging market channels that are eroding the single way out for exports through the auction system. There is no doubt that the success of the cooperatives in coffee exports plus the market pull of the international specialty coffee markets themselves are creating the evolution and emerging channels in the coffee value chain. Coffee as the largest foreign exchange earner for the country is the focus of many in government who are dealing with the country's present foreign exchange shortages.

Conclusion

A comprehensive value chain approach to global marketing is an excellent framework to direct business development and market linkages. Equally important in understanding the potential growth of the coffee sector is that Ethiopia is one of the poorest countries in the world with literacy rates, roads per capita, manufacturing level, and overall competitive measures rated in all cases in the bottom 10 countries of the world. Additionally, both business knowledge and experience are

extremely low as a result of years of economically disruptive civil war and Marxist rule preceded by essentially a feudal system. Ethiopia's ability to enter and be competitive in international markets is limited because of these factors. Linking coffee producers to international markets in an economy such as Ethiopia's where many of the requisites to successful participation in global markets are so weak requires institutional and capacity building carefully provided to support value chain expansion. Building the institutions and capacity of the cooperative sector in the case of smallholder exports of specialty coffee was essential to opening a new coffee export channel. In Ethiopia for cooperative coffee, the combination of value chain approach and strong institutional development interventions provided the basis for a success in exchange shortages. These factors, the most important of which may be the cooperative coffee success, are contributing to the recognition that the time to officially reform the system is now.

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