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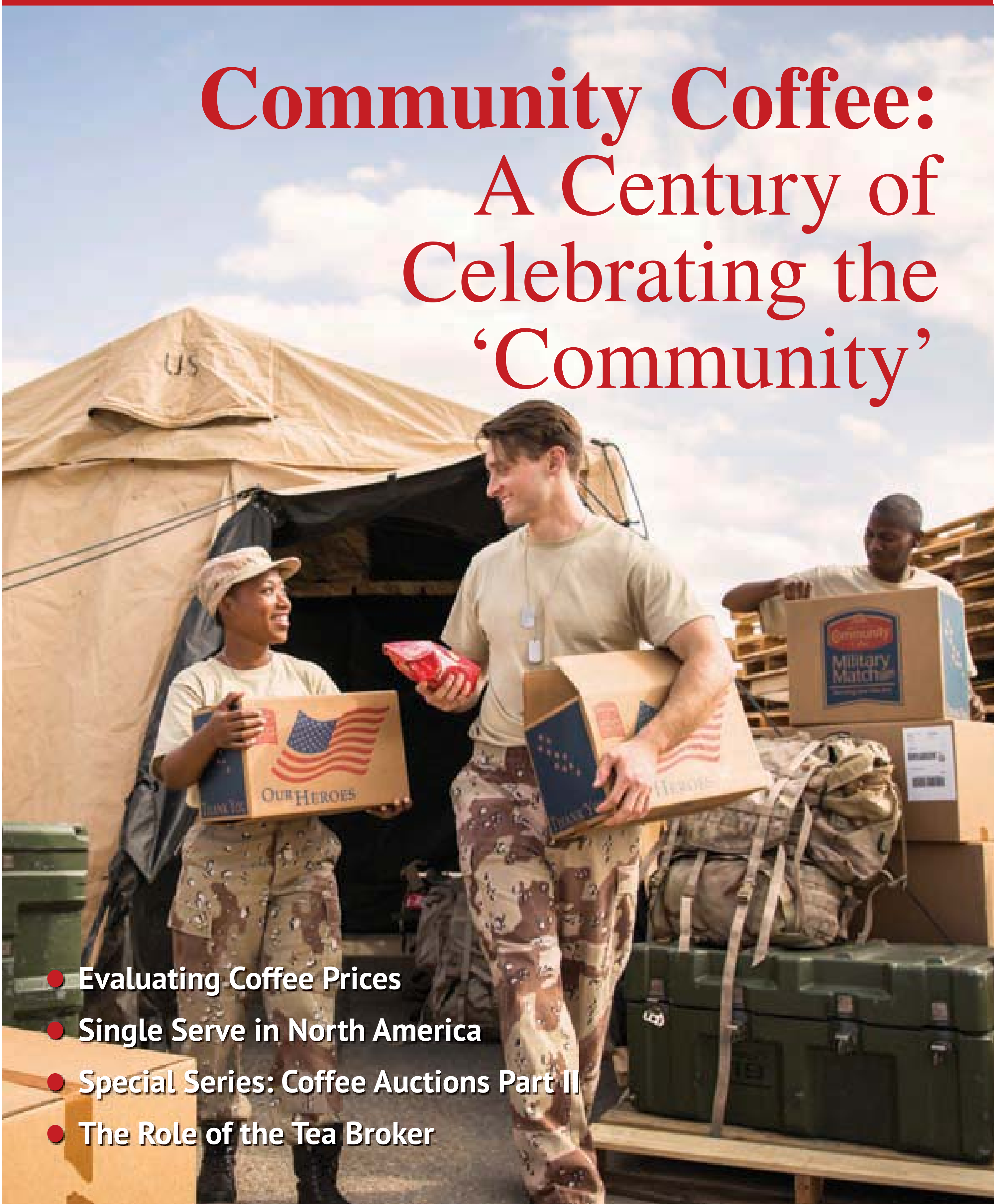
Community Coffee: A Century of Celebrating the 'Community'



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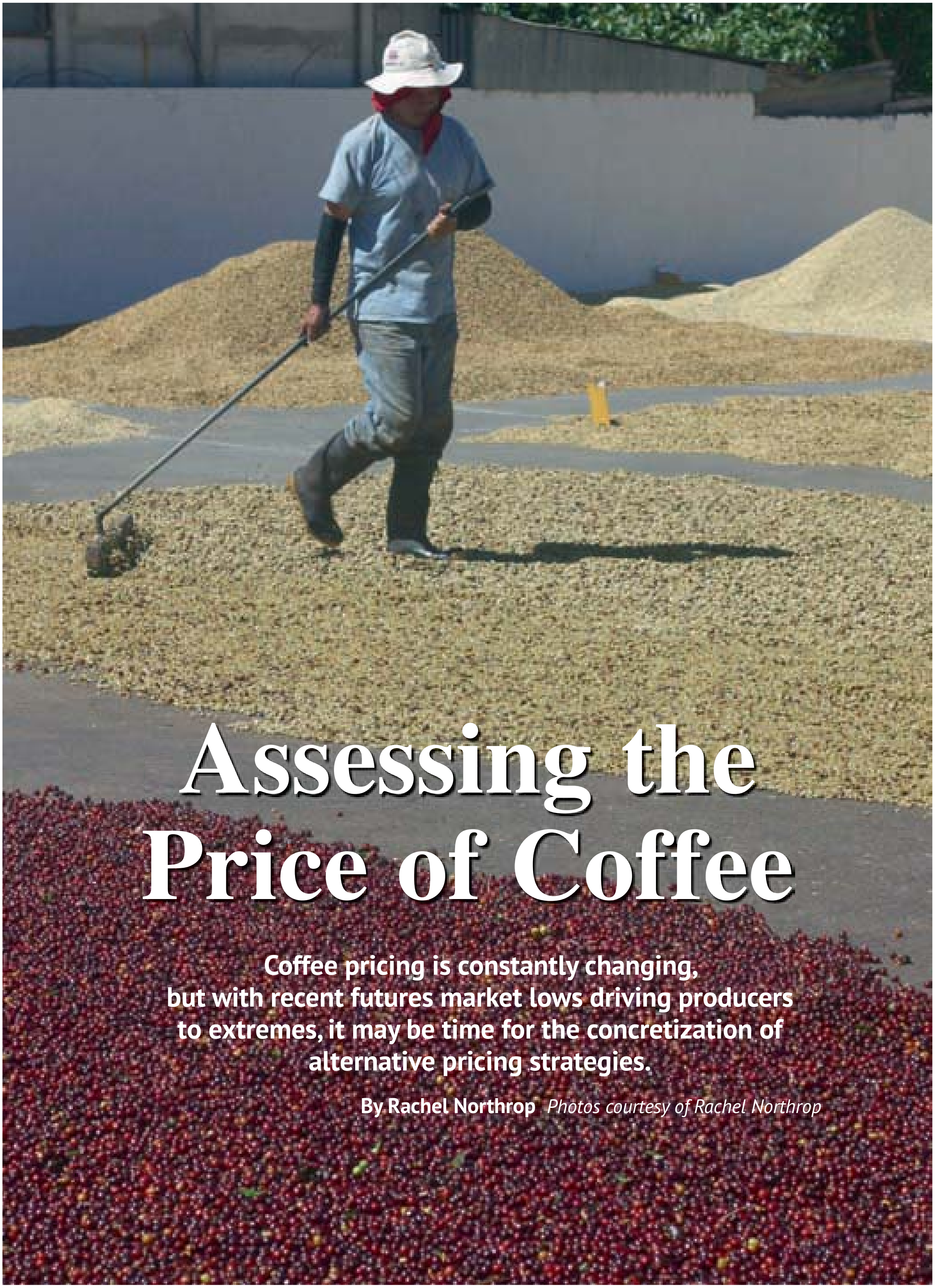

Assessing the Price of Coffee

Coffee pricing is constantly changing, but with recent futures market lows driving producers to extremes, it may be time for the concretization of alternative pricing strategies.

By Rachel Northrop *Photos courtesy of Rachel Northrop*

In 2018, the term "coffee price" was often paired with the descriptor "crisis." The Arabica futures trading price of coffee, commonly referred to as the C market, spent significant periods trading below USD $1.00/lb in August-September and December of last year, a threshold that drew close attention to how coffee is valued, how that value is priced, and how these cash amounts impact various supply chain stakeholders.

Focus on Producer Livelihoods

In October, the Colombian Coffee Growers Federation (FNC) based in Bogotá, circulated a letter drafted and signed by the leaders of seven coffee-producer groups around the globe. The letter, fruition in part of ideas incubated at the first World Coffee Producer Forum held in Medellin, Colombia, in July of 2017, identified coffee prices as "behaving in a way that is every day more and more damaging to farmers," and called for "serious discussion and joint actions between the industry and producers to find ways to guarantee economic sustainability of coffee growers by increasing their income."

But in late October and November 2018, C market prices rallied to above $1.20/lb, effectively edging the concerns of producers out of the industry's larger consciousness. The most visible serious discussion and joint action has been the Specialty Coffee Association's (SCA) December announcement of the Coffee Price Crisis Response Initiative, an effort led by the Santa Ana, California and Essex, England-based association's former executive director Ric Rhinehart that, to date, has been focused on researching the crisis' legacy and discussing, via webinars with members, possible future models for farmer profitability.

"The past year is a stark reminder of the disconnection between world market price and local costs of production," Sara Morrocchi, of Vuna Origin Consulting in Amsterdam told *Tea & Coffee Trade Journal*. "Whether world market prices are driven by laws of supply and demand or by investors' speculation through managed money, or a combination of the two, these prices no longer reflect the true cost of a pound of green beans."

Participating in Price Discovery

Dean Kallivrousis, an account manager with Lausanne, Switzerland-based green coffee company Ally Coffee's US Specialty Division, heard many questions from industry freshmen regarding reports of coffee's sinking C market price. "I had clients coming to me asking things like, 'How can we help? What can we do? How do we support a more sustainable supply chain?" Kallivrousis reported.

Many of today's emerging roasting businesses launched as craft artisans and are now looking to scale – today's industry freshmen who moved laterally into coffee and might not have been mentored by those with experience in the industry. Therefore, this new generation of roasters seeks context for business practices that are often viewed as standard to the trade, such as using the C market as a benchmark price for contracts and as a tool for hedging. Their collective question is valid: how did a tool for the coffee trade – a globally visible futures market price – become detrimental to the supply chain's first stakeholders?

While new research such as that being undertaken by the SCA's working groups, will provide guidance on which joint actions to take to respond to producers' collective call for assuming co-responsibility for prices that do not sustain production, Kallivrousis also found that research from previous decades showed how coffee prices progressed to a state of crisis. "I found *The Latte Revolution? Winners and Losers in the Restructuring of the Global Coffee Marketing Chain* by Stefano Ponte particularly helpful in understanding how we got here," he said. Writing in 2001 for the Centre for Development Research in Copenhagen, Ponte wanted to unpack the consequences of the dismantling of the International Coffee Agreement (ICA) a decade earlier in 1989, to see if the resulting price instability of the coffee futures market was locking smallholders into a position primed for loss.

"Coffee industry operators may have contributed to increased volatility," wrote Ponte. "Large roasting corporations in the mid 1990s started carrying out 'supplier managed inventory' systems. This has allowed roasters to out-source supply and quality risk to trading houses."

Working with the C Market

Supplier-managed inventory is made possible by supply surplus, particularly of trader-held stocks. In the climate of oversupply, deregulation, and dropping prices described by Ponte in 2001, producers sought the added value of specialization and differentiation through certifications, which is still a practice used today by producer groups looking to ▷

Monthly averages of the International Coffee Organisation's composite indicator from December 2017 through December 2018.

	ICO Composite	Colombian Milds	Other Milds	Brazilian Naturals	Robustas	New York*	London*
Monthly averages							
Dec-17	114.00	141.62	137.42	121.47	87.59	125.25	78.30
Jan-18	115.60	143.77	138.81	123.67	88.65	127.65	78.90
Feb-18	114.19	141.50	136.28	120.83	89.24	123.82	80.38
Mar-18	112.99	139.45	135.03	119.80	88.18	121.66	79.86
Apr-18	112.56	139.29	134.34	118.76	88.31	120.17	79.36
May-18	113.34	140.26	135.61	119.57	88.74	122.50	79.85
Jun-18	110.44	138.55	134.03	115.10	86.07	120.19	77.40
Jul-18	107.20	133.92	130.60	110.54	84.42	114.06	75.56
Aug-18	102.41	129.99	125.21	104.46	80.74	108.12	71.94
Sep-18	98.17	125.74	121.18	99.87	76.70	102.83	68.03
Oct-18	111.21	140.83	137.34	115.59	85.32	119.73	77.16
Nov-18	109.59	139.27	137.11	113.27	83.52	117.06	75.23
Dec-18	100.61	127.86	127.10	102.10	77.57	105.79	69.59
% change between Nov-18 and Dec-18							
	-8.2%	-8.2%	-7.3%	-9.9%	-7.1%	-9.6%	-7.5%
Volatility (%)							
Dec-18	6.9%	7.3%	8.1%	9.5%	4.6%	10.4%	5.3%
Nov-18	7.2%	7.8%	8.0%	9.2%	5.8%	10.7%	6.5%
Variation between Nov-18 and Dec-18							
	-1.6	-1.7	-1.9	-1.7	-1.0	-1.9	-1.4

* Average price for 2nd and 3rd positions

Source: International Coffee Organisation

assure that their members earn premiums above low C market prices.

"Within our commercial strategy, we are working hard on traceability and origin, which is why we have implemented certifications that can help our producers earn better prices," said Luis Fernando Madrigal, general manager of Coopedota, RL in Santa Maria de Dota, Costa Rica. Madrigal cites the Rainforest Alliance as well as internal programs for rewarding producers who deliver the highest quality cherries to the coop as increasing the price paid to individuals and farming families.

Morrocchi's Vuna Consulting has been involved in several price risk management programs aimed at equipping producer organizations with the necessary know-how and tools to navigate and make best use of hedging instruments available to make do with futures market prices. "The futures market undeniably plays a fundamental role in providing coffee market actors with instruments such as futures and options," said Morrocchi.

These instruments serve to protect against volatile changes in price. Morrocchi explained that companies that have access to these instruments are better equipped to navigate price rollercoasters and adjust their procurement and marketing plans accordingly. "It allows them to remain competitive, while at the same time containing potential losses." It takes time and resources to set up an adequate price risk management program: "it is not a quick fix for a low coffee price season," she said. This year's prices are a reminder that price risk management is a necessary component of any coffee production strategy.

One notable program Vuna was involved in is the Price Risk Management Program for Latin American Cooperatives funded by the InterAmerican Bank and executed by OikoCredit, with the support of other industry stakeholders such as FairTrade USA and Keurig Green Mountain. The objective was to weave price risk management practices into all areas of a producer organization – including procurement, sales, and finance – and to involve members from all layers of an organization, from accountants to export managers and the board of directors.

In the past, similar programs focused on training general managers on the specifics of the functions and mechanics of futures markets. Morrocchi noted that today, the Price Risk Management program is about learning how each component of commercial activity can mitigate price risk exposure, such as restructuring or fine-tuning physical strategies. "The idea is to have the physical and hedging strategies working in tandem."

There is a current scarcity of credit instruments to cover the costs of these tools for producer organizations because "there aren't many banks or social lenders today who can easily finance an organization's hedging strategy. It is not surprising that only a handful of smallholder producer organizations are successfully running a complete price risk management program with their own funds."

A Return to Quotas?

With C market volatility too drastic to be affordably hedged by producers, many have begun to question the validity of reinstating physical coffee quotas.

Senior economist Christoph Saenger with the International Coffee Organisation (ICO) in London said that the ICO's Indicator Prices, still published daily, relate to the past system of regulation. "The origins of the Indicator Price date back to the pre-1989 period of price stabilization," he explained. The Indicator Price was used to manage the export quota system. "A corridor with a ceiling and floor price was determined collectively by ICO Members with idea that if coffee prices remain within this band, they would be remunerative for producers and acceptable for consumers. If the Indicator Price rose above the ceiling, indicating a deficit in the market, quotas were relaxed and vice versa."

Janine Grabs, PhD candidate in Political Science at the University of Münster, Germany and contributing researcher to the SCA's Coffee Price Crisis Response Initiative, wrote in the report *"Can We Tame the C Market?"* that "to lift coffee prices to a level that covers production costs for non-industrialized farmers, it is likely necessary to address the fundamentals – that is, better balance supply and demand through supply management initiatives such as output quotas."

Ponte, writing just a decade after the collapse of the ICA, cited reasons why quotas did not solve all pricing problems. "Export quotas were allocated to traders on a political basis. Growers received a low share of the coffee export prices. Marketing arrangements were sometimes inefficient, therefore, coffee did not move fast enough through the chain."

Working Outside the C Market

While some serious discussions centre around the feasibility of quotas, others question what the coffee trade would look – if it could exist at all – without basing price negotiations on a

Pricing signboard in Colombia, May 2018.

volatile futures market. At Coopedota, Madrigal noted that in addition to certifications, "we have incorporated fixed price negotiations with clients for several years."

According to Grabs, one thing remains certain: "if the C market is not fulfilling the functions for which it was created – to assist price discovery and allow for price stabilization through hedging – we need to create new instruments that do."

Today, Ponte's 2001 prediction on the effects of supplier managed inventory and increasing volatility in both futures and spot cash market prices reads as prophetic. "Minor producers may become increasingly marginalized in the future […] without necessarily increasing the bargaining power of major producers."

Whether significant volumes of coffee shall be traded with fixed price contracts divorced from the C market remains to be seen, but with so many producers in desperation and so many roasters and traders asking what can be done, this might be the decade in which the coffee industry creates the new pricing instruments necessary to sustain everyone.

Rachel Northrop has been covering coffee for *T&CTJ* since 2012, while she lived in Latin America's coffee lands writing *When Coffee Speaks*. She was based in Brooklyn, NY but has recently relocated to Miami, FL. She may be reached at northrop.rachel@gmail.com.