Intangibles: new keys to economic sustainability

Can the global coffee and chocolate industries address their single biggest challenge with a new business model and achieve sustainable production systems that provide growers with a decent livelihood?

Small farmers often earn only a small percentage of the price paid by consumers (photo: World Agroforestry Centre)

In the following article, two experts remind us that commoditization of coffee and cocoa dims the ability of many to see the potential 'blue ocean' strategies[1] that are already blossoming in certain origins.

Daniele Giovannucci* and Luis Fernando Samper,** both leading authorities in the field, propose that change is already happening and that it is likely to be scalable.

Their recent paper, co-authored with Brazilian scholar Luciana Marques Vieira, was first featured by the World Intellectual Property Organization[2] in its 2017 publication.

The use of intellectual property (IP) that is both tangible and intangible has unquestionably proven to be valuable for the industry as a differentiating characteristic that has value.

Unique varietals, diverse approaches to primary processing, unique micro-climates, and geographical indications of origin all provide consumer value and narratives that benefit every member of the supply chain. It even creates value for mass-market conventional commodities by improving the overall perception of the product. Most of the early lessons have been best developed in coffee (and also wine and other beverages that are not covered yet by *C&CI*) so the focus here is on coffee.

Much will depend on how well market-oriented brands can see the value of investing in the origins as a clear way to escalate the potential benefits for everyone in the industry, from farmers to consumers.

Lessons from the past

To consider where we can go in the future, it is worth understanding the lessons of the past. It can be easy to forget how different the industry was just 30 years ago when few predicted today's increasingly differentiated coffee world. So, what led to such a significant growth both in volume and value since then?

The first wave of conventional coffees was challenged by a second wave or 'differentiated' segment in the 1980s consisting of new players that leveraged beverage quality attributes in out-of-home venues such as specialty coffee shops, and focused on selling blends or preparations to consumers.

The intangibles that generated the most value were associated with economies of scale related to know-how and access to large distribution outlets and mass advertising, in the case of conventional brands. They were associated with brand experience and beverage preparation techniques in out-of-home venues selling at higher price-points for second wave brands.

Coffee producer intangibles were mostly irrelevant for consumers in blend-focused segments that highlighted the expertise of coffee roasters in designing their own Arabica blends from the 'lush growing areas of Central and South America.'

Not even the arrival of voluntary sustainability standards (VSS) significantly changed the market driven governance of the value chain, as these new actors focused on developing consumer loyalty to their seals rather than to the farmers or regions of provenance. As a result, farmer equity and ability to develop specific demand for their coffees was obscured and exacerbated the imbalance of income distribution among value chain actors.

Quality revolution

The so called 'quality revolution' and the accompanying 'latte revolution' that took off in the early 1990s helped to popularize a new set of global brands and made the beverage newly appealing to younger generation and to a global audience. As a result of coffee's new image in global media and American movies, younger generations in emerging markets such as Eastern Europe and in coffee producing countries saw coffee as an easy way to enhance status.

This positive high-end image has also strongly attracted the millennial generation with new and more complex service offerings. The so-called third wave (or experiential segment) is now playing the key role of providing new trends, innovation, and interest that helps pull the overall industry's growth. These brands, focusing on direct trade and single origin coffees, have taken on the role of providing industry visibility and new levels of attraction to younger generations and to more sophisticated segments.

It is difficult to avoid the comparison with the wine industry that, in the 1980s, began evolving from mostly commodity grape providers to highly differentiated and much more lucrative market segments based on varietals and more specific origins. Micro-breweries are now recreating the beer industry in creatively differentiated ways and the same is happening in many other products including specialty coffee and chocolate products.

There are fundamentally two reasons for this evolution in possibilities:

- Consumers are able (and willing) to take on a lot more information that distinguishes products by their own specific preferences (ranging from ethical to aromatic).
- Technology and logistics now cost-effectively permit a considerably greater range of remarkable differentiation plus traceability and the capacity to selectively market each product in diverse segments, even within mass markets.

Second wave brands (a differentiated segment) that focused on high quality blends and sustainability distinctions such as standards or certifications are also diversifying their product portfolio to the point that even Starbucks' version of a third wave offering, Starbucks Reserve, is now a main source of news and developments for this successful global brand.

Even first wave or conventional coffee brands primarily sold in grocery stores are adapting to the challenge of origin specific coffees and an expanded product portfolio that complements their more generic 'breakfast or house blends.'

The importance of authenticity

In a world saturated by hyperbole and stale stories created by marketing departments, authenticity is increasingly esteemed. However, this virtuous cycle of high quality, high visibility and industry growth, depends considerably on interesting coffees. Such supply, in particular of high quality Arabica coffees, is highly vulnerable and subject to significant risks.

When the coffee leaf rust (roya) pandemic hit Colombia, Peru and Central America a few years ago, the specialty coffee industry suddenly realized that coffees that were considered 'sustainable' according to different VSS specifications were not immune.

Growing coffee is a riskier proposition nowadays thanks to climate change and climate variability, declining share of price to producers, higher costs of production and greater market requirements. COSA data from a number of countries shows the high average age of coffee growers. The industry is scrambling to find and motivate a new generation of coffee growers.

Analysing a complex industry

The UN's World Intellectual Property Organization (WIPO) was well aware of coffee's global importance when they approached us to reflect on the potential role of intangibles in agriculture value chains. Their challenge to review the role of value chain governance for the different segments was certainly a novel way of analysing a complex industry that could open new opportunities to sort out the economic sustainability puzzle. An understanding of how the industry generates and then distributes value among value chain actors served as a basis to reveal the key areas that help control or unlock value. We understood that the any successful solution would not seek to wrestle some value at one end to bolster the other end of the chain. A sustainable solution would add value to the entire chain and for the consumer as well.

As in many commodity value chains, powerful brands and processors, often based in consuming countries, keep most of the industry value for coffee. For producing countries the total export value is now less than 10 per cent of our estimated US$200 billion annual industry value.

Many small farmers earn a far smaller percentage of the price paid by consumers. The difference can be accounted for partly in the asymmetry of power evident in a market driven value chain governance and partly by the ability to create and market intangible value associated with brands or retail experience at the consumer end of the value chain. Nevertheless, our collective experience in dozens of countries suggests that the value appropriation among industry actors can vary significantly depending on the ability of farmers and their associations to develop their own intangibles.

This corresponds well with coffee's third wave or 'experiential' segment – where the human connection with the producer or origin play more significant roles – and offers an opportunity to creatively alter a 'dependence pathway' typical of North-South trade.

Shorter value chain

These new formats, mostly led by independent baristas and coffee shop operators, focus on direct trade with coffee producers and new beverage preparations. This focus is leading to a shortened value chain, often featuring co-operation that creates conditions for product innovation, and increased roles for science, flavour, and origin as product differentiators.

This specialized segment creates new excitement about coffee as a sophisticated product and sells at higher prices by creating intangible values for both the brands and for origins or farmers. It is also particularly relevant to younger consumers. Although still small in volume, independent third wave brands and cafes have been able to create a highly visible new trend


Supply of high quality coffees is increasingly vulnerable to risks from climate change

and are expanding their footprint in many countries, altering consumer expectations and influencing the whole industry.

This new business model is likely to be scalable. Digital generations' demand for more information about the origin and character of what they consume and the increased ability to get reliable content can feed the roots of this revolution. It is an elegant solution: considerable new value that is not subject to the vagaries of commodity markets; incentives for longer-term relationships; increasing the viability of many origins and putting more sustainability options in their hands; origin names and characteristics can increasingly be protected legally.

Of course it is not for everyone. This certainly does not eliminate the commoditized market where producers have a limited set of options or the unsavoury option of a race to the bottom competing against each other on basic factors such as price.

But such new relational value chains where both farmers and retailers depend on one another to create additional value may be harbingers for a much more personalized beverage experience in the future. Scaling up this model may both increase overall value and shift more of that value to producers. It may be one of the best solutions to the significant challenges the coffee industry is currently facing. ■ C&CI

1 Refers to the theory of INSEAD's bestselling business Professors Kim and Mauborgne who, after studying more than 150 creations in over 30 industries, proposed how rather than competing in the same grind, creative managers can see entirely new business models that "Create Uncontested Market Space and Make Competition Irrelevant".

2 The UN body that coordinates at a supranational level the global issues related to IP.

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