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Counter Culture Coffee Pursues Coffee Perfection

- Crafting Tea Lattes
- The Growing Need to Diversify
- Advantages of Offering Coffeehouse Wi-Fi
- Special Series:
Sustainable Coffee Production Part II

C O N T E N T S

April 2018 Vol. 190/No. 4

FEATURES

- 22** Counter Culture Coffee: On a Relentless Pursuit of Coffee Perfection
By Anne-Marie Hardie ☕
- 16** We Don't Own Nature: Coffee Producers and Diversification
By Anika Rice ☕
- 33** 5 Tips for Coffeehouse Wi-Fi
By Ryan Detwiller ☕ 🌿
- 35** The Powerful Role of Intangibles in the Coffee Value Chain
By Michael Maxey ☕
- 40** Special Series: Sustainable Coffee Production Part II/Certification
By Rachel Northrop ☕
- 47** Art of the Tea Latte
By Maxwell C Pollock 🌿



22



16



33



47



35



40

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DEPARTMENTS

- 5** Editor's Letter
- 6** New & Notable 🌿
- 10** Sustaining the Chain 🌿
- 15** Calendar of Events 📅
- 51** Green Coffee Report 🌿
- 52** Company News 🚫
- 56** People News 🌿
- 58** Straight from the Cup: ☕
Carlos Ortiz, Global Manager for Volcafe's Sustainable Sourcing Strategy

🌿 Designates a tea story ☕ Designates a coffee story

The Powerful Role of Intangibles in the Coffee Value Chain

A recent study published by the World Intellectual Property Organisation (WPO) draws the attention of the coffee industry to the relationship between intangibles, value chain governance and farmer economic sustainability. The paper estimates the annual global coffee trade is valued at USD \$200 billion with most of the economic returns going to brands, retailers and supply chain operators. Most of the risk, however, is borne by 25 million small-scale farm families producing on average less than five hectares of coffee in 50 countries around the world.

The sustainability of the three billion cups of coffee (based on an average cup size of 100ml and a concentration of seven roasted grams per serving using the 2016 International Coffee Organization world green coffee consumption figures) consumed daily depends upon the ability of these farmers to weather the fluctuations of commodity prices, global warming and declining rural population. Luis Samper and his co-authors of this study provide an argument for focusing on

Below is a summary of the *Economic Research Working Group Paper No 39* from the World Intellectual Property Organization (WPO), November 2017, authored by Luis Fernando Samper, Daniele Giovannucci and Luciana Marques Vieira. The paper discusses coffee's "third wave" or "experiential" segment as a way of creating value for the small-scale producer and coffee exporting communities by promoting intangible assets.

By Michael Maxey

coffee's "third wave" or "experiential" segment as a way of creating value for the small-scale producer and coffee exporting communities by promoting intangible assets.

The paper is divided into three segments: (1) Description of coffee value chain with an explanation of how consumption and associated distribution channels at play create a structural influence in coffee pricing and value chain



Photo courtesy of Anika Rice

The sustainability of the three billion cups of coffee consumed daily depends largely on small-scale farmers and their ability to weather climate change and market fluctuations.

governance; (2) Discussion of the three coffee market segments or “waves” and the opportunity to increase intangible asset value of coffee as new roles and marketing channels emerge; and (3) Description of the current and potential role of intellectual property tools for creating value for small-scale coffee producers and coffee exporting communities in the context of a global value chain.

The Coffee Value Chain

According to the International Coffee Organization (ICO), more than 52 percent of world coffee production is consumed in the North America and Europe under trade patterns and a value chain governance structure that characterizes coffee as a commodity. This trade regime is characterized by unequal value distribution with less than 10 percent of the global annual value of coffee being retained by farmers, exporters and government agencies in exporting countries (USD \$19.2 billion retained in coffee countries versus USD \$200 billion value for the global coffee market [Based on estimates from global market intelligence firm, Euromonitor International 2017, ICO 2012, ICO 2014 and ICO 2016. Approximately 74 percent of global coffee production is exported creating an average annual export value of \$20.2 billion based on prices and volumes between 2010 and 2015]).

Illustrative of the disparity of share of value received by coffee farmers in relation to the overall market, the National Coffee Association (NCA) of the United States estimated that US sales of coffee and ancillary goods generated over \$28 billion in tax revenues for federal and local governments in the US during 2015. The NCA further reported that consumers in the US paid more in taxes for coffee than 25 million coffee farmers worldwide earned in 2015 (this includes taxes on ancillary goods). The sustainability of this economic model is being questioned by the International Coffee Organization, Specialty Coffee Association (SCA) and national coffee institutions. (Studies by the

ICO in 2016 and the SCA in 2017 on coffee profitability point to the potential of unsustainable production of high quality Arabica coffee under a commodity regime. This paper points to those studies and defines coffee market sector.)

Intangible Assets in Coffee

The market has evolved in three “waves” over the last 50 years:

1. Conventional or First Wave – Ten dominant brands accounted for USD \$26.7 billion dollars in sales in retail outlets in 2015. Nescafé is the world leader in soluble coffee with \$12.6 billion in sales in 2015.


2. Differentiated or Second Wave – This segment is closely associated with the evolution of specialty coffee shops. Within this segment are chain coffee shops and independent coffeehouses (73,000 brand shops versus 38,500 independent shops). Two key intangibles in this segment are: (a) know-how and ability to learn and detect consumer trends, and (b) capacity to brand and communicate different ways to make their brands attractive. Specialty coffee is growing as a percentage of total value of retail coffee sales in coffeehouses versus restaurants. The specialty market is growing and the use of Voluntary Sustainability Standards (VSS) that focus on economic, social and environmental aspects of coffee production has only provided a modest price premium.

3. Experiential Third Wave Segment – Based on growing desire of certain consumers to have an in-depth knowledge of coffee with a focus on product-oriented experience rather than an ambiance-oriented experience. Experiential coffeehouses provide a sense of the local by focusing on single origin coffees of superior qualities that are served with deep knowledge – specific farm origin, coffee variety, post harvesting process, altitude at which the coffee was grown, etc – providing the consumer with detailed knowledge ▶

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An Indicative Distribution of Value Creation and Distribution in Different Coffee Segments (2014)

		Commercial coffees		SCAA 2014		Tim Wendelboe Transparency Report 2014 (d)	
		US\$/lb 453	Index	US\$/lb 453 g	Index	US\$/lb	Index
Producer-Exporter	Producer FarmGate	1,25	a 86	na		4,11	80
	Exporter	na		na		0,45	
	Dry milling	na		na		0,4	
	Packaging	na		na		0,11	
	Coop Services	na		na		0,07	
Importer	Green FOB	1,45	b 100	2,89	100	5,14	100
	Logistic costs and importer margin			0,24			
	Green coffee at warehouse	na		3,13	108	6,58	128
Roaster	Weight Loss and delivery to roaster	na		3,13		na	
	Weight Loss and delivery to roaster	na		0,78		na	
	Packaging and Direct Labor	na		0,84		na	
	Other Wages Sg&A	na		1,00		na	
	Other Fixed Costs	na		2,00		na	
	Fair Trade USA fee for maintaining certification	na		0,04		na	
	Travelling to Origin	na				0,35	
	Gross Margin	na		0,71		na	
Total Roaster Sale Price		4,11	c 283	8,50	294	17,45	340

Source: SCAA, Tim Wendelboe, ICO

a Simple average from all ICO countries that submitted data

b Average exdock indicator minus 10 cts for exdock FOB conversion

c Simple average from all ICO countries that on Retail prices submitted data minus 30% on channel markup

d Producer - Exporter breakdown based on 2012 figures

of the production process.

Second Wave coffee shops focus more on blends, ambiance, beverage preparation standards and more generic information. Whereas, Third Wave coffees are roasted according to their specific origins and their flavour profiles are described in detail. Third Wave coffee shops seek to establish direct trade relationships with specific farmers or farm organizations through specialized exporters/importers that can provide specific high quality coffee needed in limited quantities. This approach represents a modification to the commodity-focused supply chain.

Intellectual Property Rights

Three differentiation platforms comprise the experiential coffee sector: transparency, quality and knowledge. Millennial consumer preferences include credibility attributes for products that satisfy emotional and educational content as well as provide a narrative for quality, direct trade, grower relationships and the higher costs that go into to producing this coffee.

Coffee quality is being codified largely by the work of the SCA through training (Q graders), the Cup of Excellence, strong links to the barista movement, and activities in producing countries to increase knowledge of coffee quality attributes. A focus on quality throughout the value chain brings the farmer, coffee shop owner and consumer closer together in understanding the value of

carefully produced and origin identified coffee. Education and knowledge bring a craft orientation to this sector as beverage preparation and coffee origin form part of an artisanal experience.

These three areas – transparency, quality and knowledge – require significant changes of the role different value chain actors play. The focus on origin, knowledge and quality requires a more relational value chain focus. The tendency is for a blurring of the lines of traditional actors with importers and roasters running experiential farms, growers getting into the business of retailing third wave coffee or baristas venturing into coffee growing.

In summary, the experiential segment’s focus on origin, farmers’ contributions to the final product and overall experience and joint farmer and barista intangibles has made possible a significant change in coffee value chain governance for Third Wave coffees. The relational governance associated with these operations favours farmer, importer and roaster partnerships, which if scaled up, will provide the basis for a new industry dynamic. ■

To read the entire *Economic Research Working Group Paper No 39* November 2017, authored by Luis Fernando Samper, Daniele Giovannucci and Luciana Marques Vieira, visit the White Paper section of www.teaandcoffee.net.