

A Value-Chain Approach to Coffee Production: Linking Ethiopian Coffee Producers to International Markets

By Jim Dempsey & Ruth Campbell

Ethiopia—the birthplace of Arabica coffee—grows a wide variety of highly differentiated, exemplary coffees, most of which are shade-grown without chemical inputs by small-scale farmers. ACDI/VOCA's Agricultural Cooperatives in Ethiopia (ACE) project, with funding from USAID, has enabled smallholder cooperatives to capitalize on these strengths and become market leaders in the fast-growing specialty coffee sector.

Ranking eighth in the world and first in Africa, Ethiopia's annual coffee production is approximately 280,000 metric tons (MT), almost half of which is consumed domestically, often in the culturally rich traditional coffee ceremony. Most coffee is produced by smallholder farmers with 1-2 hectares of land, earning less than a dollar per day. With prices of approximately \$1.20 to \$1.50 per pound for washed coffee, the specialty market is an avenue for Ethiopian farmers to significantly increase their incomes and improve the quality of their lives.

Increasing farmer incomes through the development of smallholder cooperatives linked to markets is the primary objective of ACE. Since its inception in 1999, the project has transformed over 775 primary cooperatives in the Oromia, Amhara, Tigray and Southern Nations regions from largely dysfunctional organizations into open, private, democratic associations supplying inputs and marketing services to their more than 750,000 members. Of the total farmers assisted by ACE, close to 180,000 are small-scale coffee producers, members of 154 cooperatives federated into four coffee unions: Sidama*, Yirgacheffe, Oromia and Kafa.



Taking a Value-chain Approach

At the start of the ACE project, the challenges to the coffee industry seemed overwhelming: poor processing resulted in low and inconsistent coffee quality; export sales were regulated through a national auction which mixed coffees from different locations into a single lot and prohibited cupping prior to sales; loan funds for marketing and for investments in production and processing were unavailable; coffee cooperatives were institutionally and technically weak; and a lack of understanding of international market demand resulted in a concentration on quantity rather than quality.

A breakthrough occurred in 2001, however, when the government of Ethiopia removed the requirement for cooperatives to sell all coffee through the national auction, opening the way for direct export sales. ACDI/VOCA recognized the importance of this policy change, as well as the inability of the coffee cooperatives to take advantage of the reform, and developed and applied a value-chain approach (see text box at left) to address the constraints at each level of the industry. Within this overall approach, a particular emphasis was placed on strengthening the cooperation between small-scale producers, as well as establishing secondary

Value-chain Approach

A value chain is a supply chain consisting of the input suppliers, producers, processors and buyers that bring a product from its conception to its end use. A value-chain approach to development seeks to address the major constraints at each level of the supply chain, rather than concentrating on just one group (e.g., producers) or on one geographical location. Constraints often include a lack of technical, business or financial support services, a difficult regulatory framework, poor public infrastructure (roads, telecommunications, electricity, etc.), a lack of information about or weak connections to end markets, and/or inadequate coordination between firms. Taking a value-chain approach is often essential to successful economic development since micro and small enterprises and smallholder farmers will only benefit over the long term if the industry as a whole is competitive.

*Sidamo refers the coffee produced in the Sidama region of Ethiopia.

cooperatives or “unions” to achieve the economies of scale needed to reach international markets. In summary, the goal of ACE’s coffee component was a competitive Ethiopian coffee industry that maximized returns to smallholder producers.

Turning Comparative Advantage into Market Competitiveness

Ethiopia’s range of coffee varieties and unique flavors, its long and deep cultural appreciation of good-quality coffee, and its traditional organic, shade-grown and bird-friendly production by small-scale farmers provide Ethiopia with a comparative advantage in the international specialty coffee market. But to achieve global competitiveness, the industry required improvements in three areas: efficiency, product differentiation and response to specialized market demand.

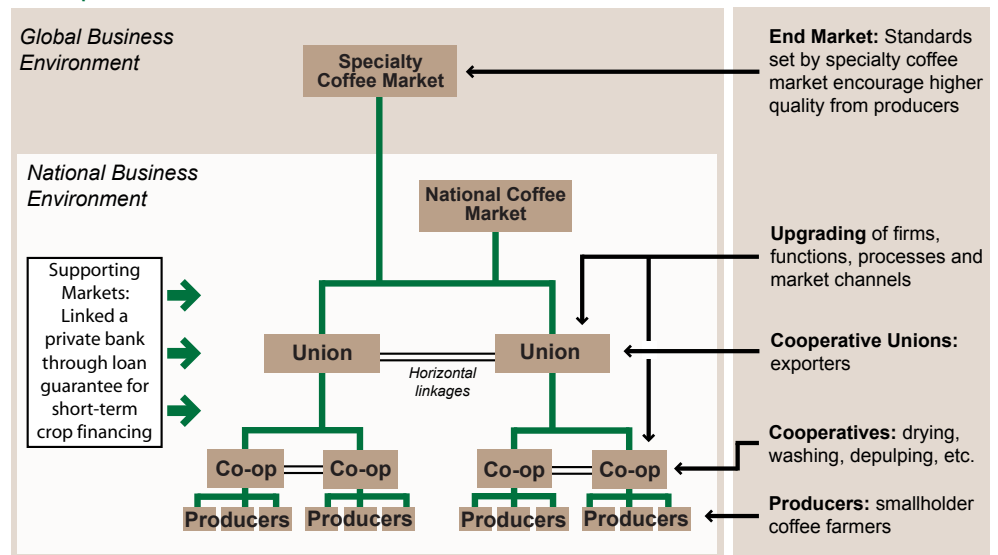
Efficiency

Ethiopia is a relatively low-cost producer of coffee. Prior to ACDI/VOCA’s involvement in the sector, Ethiopian smallholder coffee passed through multiple intermediaries before being exported. Furthermore, the rigid procedures of the national auction system—through which most exporters must still purchase their coffee—create marketing inefficiency, thereby undermining all of the advantages of low-cost production. By facilitating direct exports of smallholder specialty coffee through the establishment of unions for economies of scale, facilitation of marketing linkages through union participation in the Specialty Coffee Association of America’s annual exhibitions, and technical assistance in production, processing and export procedures, ACDI/VOCA helped develop a new, highly efficient market channel. Direct exports of specialty coffee by small-scale producers’ unions have increased from \$0.25 million in 2001 to \$31.9 million in 2005.

Product Differentiation

Improving from year to year the quality and consistency of taste of coffee defined by its regional origin, such as Sidamo and Yirgacheffe, resulted in price increases of \$0.15-0.20 per pound, which promises a large return to farmers. ACE also promotes careful sun drying on raised drying beds, which can produce extremely flavorful, highly rated coffee. In the Ethiopian Cooperative Coffee Competition supported by ACDI/VOCA in 2005, the highest-rated coffee was a sun-dried coffee, Jimma 5, which received a \$0.20 per pound premium. A recent coffee that was featured as a Starbucks Black Apron Exclusive™ was a sun-dried coffee from Ethiopia’s Ferro Cooperative. This coffee sold in Starbucks retail shops in the U.S. at close to \$25 per pound.

Ethiopian Coffee Value Chain



Specialized Market Demand

Many coffee cooperatives have invested in certification programs—24 are registered Fair Trade, and over 70 are certified organic—in order to obtain additional price premiums. For example, during the depths of the coffee crisis from 2001 through late 2003, the Fair Trade certification—guaranteeing a minimum floor price in return for assurances that profits will be used to benefit the producers’ communities—almost doubled the value of smallholder coffee. Similarly, organic certification generally adds approximately 10 percent to the price received by farmers. Several cooperatives are selling to Starbucks Coffee Company and have conformed to their Coffee and Farmer Equity (C.A.F.E.) Practices verification program. Other smallholder coffee is marketed as “relationship coffee,” which is based on developing the consumer’s understanding of the producers’ culture, living conditions, economic situation and so on in order to develop a sense of connection between producer and consumer.

Interventions throughout the Value Chain

The value-chain framework developed by ACDI/VOCA (under the Accelerated Microenterprise Advancement Project—Business Development Services Indefinite Quantity Contract) addresses constraints and exploits opportunities in five areas: 1) the business enabling environment, 2) the end markets, 3) supporting markets, including finance, 4) firm-level upgrading and 5) interfirm cooperation.

Business Enabling Environment

The cooperative experience in international markets has demonstrated the importance of quality production traced to origin with substantial buyer monitoring and even involvement with coffee growers. The government now understands the need for change to grow the coffee export market. The success of the cooperatives in coffee exports since 2001, plus the pull of the growth in size and

profitability of the international specialty coffee market are together creating the momentum for further marketing reforms.

End Markets

By conducting end-market analyses and proactively seeking out international specialty coffee buyers, the four coffee unions are strengthening their members' bargaining position in the international marketplace, returning a higher share of market price to producers and allowing farmers to achieve economies of scale and to take control of their economic future. Consequently, union exports have grown from 126 MT five years ago to 12,800 MT in 2005.

Supporting Markets

A constraint at both the cooperative and union levels has been the lack of financing. With USAID support, ACIDI/VOCA attracted a private bank into a U.S. government loan guarantee mechanism, which in its first year made \$680,000 available in local currency to unions for the purchase of product from member cooperatives for later sale. Repayment rates have remained constant at 100 percent, and the program has since been expanded to include a second bank and cover medium-term loans for equipment and infrastructure investments with a new ceiling of \$18 million.

Firm-level Upgrading

Through technical assistance from staff, consultants and volunteers—including several highly successful assignments under Coffee Corps, a program managed by the Coffee Quality Institute—the ACE project helped union and cooperative managers improve washing operations and technology. The project has trained farmers on post-harvest handling, upgraded the skills of washing station managers and trained cooperatives in contract and delivery agreements and requirements, and is currently facilitating the introduction of new washing technology that uses only a small fraction of the water required in the present systems.

Emphasis on Interfirm Cooperation

The main focus of the ACE coffee component is on strengthening the cooperation among smallholder producers through the development of coffee cooperatives and unions. The coffee unions were established to buy, consolidate and internationally market coffee supplied by smallholders through their cooperatives. The coopera-

tives buy, wash and consolidate members' coffee. Since the unions are owned by the cooperatives, these two sets of institutions form an efficient, vertically integrated operation. As a result, profits are returned to the small-scale farmers: in 2004, the coffee unions paid out \$1.63 million in dividends to cooperative members, and the trend is strongly upward.



Coffee from the Ferro Cooperative fetched a high price from Starbucks as a Black Apron Exclusive™, which came with an additional \$15,000 award for the cooperative.

Linkages between cooperatives have resulted in improved coffee quality and operational efficiency. Cooperatives collaborate in contracting for transportation and warehousing services and share market information. They learn from each other and jointly access technical assistance in such areas as cupping, fermentation, water conservation and other processing activities. Important horizontal linkages also exist at the union level. In addition to sharing market information and contacts, solutions to shipping and logistical problems have often come through the assistance of other coffee unions. Sidama Union helped both Yirgacheffe and Kafa in their start-up periods to export containers of their coffee. All four unions have collaborated to make the internationally judged cooperative coffee competition and internet coffee auctions a success. Through such cooperation, the unions are making Ethiopian coffee more competitive in the world market, to the benefit of their members.

Conclusions

ACIDI/VOCA's interventions in the Ethiopian cooperative coffee sector have had a significant positive impact on small-scale coffee producers and the coffee value chain as a whole. Producers have improved the quality of their coffees, gained access to higher-value markets and earned substantially more income from their production. The new coffee export channel is wide open for smallholder cooperative producers.

In adopting a value-chain approach, ACIDI/VOCA combined a comprehensive market development program with sustained institutional and capacity-building assistance for the coffee cooperatives and unions. This mix of facilitation of market development by private-sector stakeholders with direct technical assistance provision to cooperatives and unions was necessary to ensure the sustainability of the value chain on the one hand, and the complete integration of smallholders into this value chain on the other.

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