

Today, farmers suffer from
depressed coffee prices

What can be done?





The basic problem:

too many beans

Due to an ongoing over-production of coffee compared to demand, coffee bean prices are at historically low levels. In 2002/2003, 111 million bags of coffee were produced, while about 109 million bags were consumed. This has added to the already large stock of coffee accumulated over the past years, resulting in a disturbing increase in poverty among some coffee farmers and their families.

Green coffee prices are cyclical, and the present phase follows a long period during which prices far exceeded production costs. When prices were high, a significant number of farmers – sometimes encouraged by third parties – decided to increase their production or simply to start growing coffee.

Simultaneously, many Brazilian farmers reduced the cost of producing coffee through modern agricultural techniques, while Vietnamese farmers invested heavily in an expanded planting programme. This resulted in an oversupply, with stocks amounting to nearly 50% of the annual worldwide consumption. It will take time to reduce these stocks.

Coffee price (US cents/lb)



International Coffee Organization's composite average coffee price 1989-2003

At the most fundamental level, two factors can positively impact the imbalance in the market: a slowdown in production and an increase in demand. Given this situation, what can be done to improve the income of coffee farmers and improve the social and economic situation of their families?

This document describes the measures which Nestlé considers to be the most important in improving the lives of coffee farmers, as well as Nestlé's contribution to their well-being.

Who determines the coffee price?

Coffee prices are based on two commodity exchanges: the LIFFE, in London, and the New York Board of Trade. Commodity futures markets are a way of managing risk by establishing a basis to determine the price of the product for producer, exporter, shipper and consumer. At inception there were, in the main, only coffee-related companies involved. Today, with the active presence of funds playing in this field, futures markets risk adding to the volatility of prices, as demonstrated by the fact that the volume traded on coffee markets exceeds the global production by a factor of ten.

Move to speciality coffees and niche markets

To obtain better prices, one strategy for coffee farmers is to engage in niche markets, such as speciality coffees or coffees labelled as organic or Fair Trade.

Speciality coffees are superior quality products made from beans that are available in limited quantities and for which the price is set according to origins and quality. This translates into higher prices for the farmers who produce these beans.

Companies such as the fast-growing *Nespresso* business, which sell these products, provide increased opportunities for farmers, given the premium prices these companies pay for the special qualities of coffee they buy.

However, while high quality and labelled coffees provide some coffee farmers with an opportunity for greater revenues, they account for a relatively small percentage of the consuming public and do not represent a solution for the broad coffee market as a whole.

Nestlé and Fair Trade

Nestlé recognises that Fair Trade is a useful way to raise consciousness about the coffee issue and for individual consumers to express their solidarity with a group of coffee farmers in the developing world.

However, if on a broad basis, coffee farmers were paid Fair Trade prices exceeding the market price the result would be to encourage those farmers to increase coffee production, further distorting the imbalance between supply and demand and, therefore, depressing prices for green coffee.

Worldwide, the Fair Trade movement accounts for less than 25 000 tonnes of green coffee.

Nestlé's direct purchasing accounts for 110 000 tonnes of green coffee per year. This system enables the farmer to retain a greater portion of the price paid by Nestlé, therefore improving his income (see page 6).



Speciality coffee brand *Nespresso* pays higher prices to the farmers according to quality





Diversification to other crops

"I grew up with coffee, and it is important for me to have my own farm"

Bongsong Kanakrut has a two-hectare farm in Sawi, Thailand where he grows coffee and tropical fruits (durian and rambutan). "I started to plant durian three years ago, when coffee prices started to decline. But it needs six years to produce. So now, I work with Nestlé to have some more money," he says. During the harvest season, he is a driver at the buying station and the rest of the year, he grows coffee for a Nestlé research project. "My job on the Nestlé project allows me to learn new cultivation techniques that I can apply on my own farm." His wife takes care of the plantation but he gives her a hand at the weekends.

Their two daughters go to the local school. He would like them to study at university. "It all depends on their capacity and the way I manage my farm. If I am successful, I will be able to pay for their studies." He hopes that, if they go to university, they study agronomy and then come back to the farm "because I like coffee growing and I know that it is a good occupation.

"With the money I make with durian, I will be able to earn a good income in the future."

For farmers who do not have the possibility to produce the quality required for speciality coffee, it is vital that they reduce their over-dependence on coffee. They need to find new sources of income in order to be less vulnerable to the inevitable fluctuations of coffee prices. These sources of income can be either alternative crops or other activities.

However, it is not a simple matter for farmers to shift to alternative crops. Farm subsidies and other trade barriers in the United States and the European Union currently impede access to major markets. They hamper attempts to sell agricultural goods on a profitable basis to Europe and North America. Nestlé has repeatedly spoken out for the elimination of these trade barriers.

"A significant reduction in tariffs on farm products and the ultimate phasing out of farm subsidies and protection of the rich countries [would offer third world farmers] real benefits"

**Peter Brabeck-Letmathe,
CEO of Nestlé, The Guardian,
08.09.2003**

Direct procurement: helping farmers to retain more of their coffee's value

Due to the fact that coffee is often grown in remote areas, the crop from these isolated regions is usually sold to middlemen who are often inefficient and may tend to take advantage of their situation. Prices can be set with exaggerated commissions, high transportation fees are charged and farmers are left with the bare minimum for their green coffee.

Though middlemen play an important role by transporting the coffee from remote cultivation areas to the traders or to the coffee mills, a shortening of the supply chain helps farmers to retain more of their produce's value.

Several mechanisms to increase the supply chain's efficiency have been developed. Among them, farmers have gathered in co-operatives to act as exporters and some large-scale farmers, particularly in Brazil, have developed privileged relationships with roasters.

At industry level, Nestlé developed a direct procurement system over 20 years ago. In coffee-producing countries where the company has a *Nescafé* factory, it has set up buying stations where farmers can sell their coffee directly to Nestlé, thus retaining for themselves a larger portion of the value of their coffee.

Retaining value: direct purchasing in Thailand

Nestlé is the world's largest direct buyer of coffee. In 2002, the company bought about 110 000 tonnes of coffee directly from farmers and cooperatives. This was a 10% increase over the previous year.

In Thailand, where direct procurement has been in place since 1991, Nestlé purchases some 34 000 tonnes of green coffee annually directly from farmers. The company has opened six buying stations in the coffee growing areas in the south of the country, reaching some 16 000 farmers.

In these buying stations, the farmers are allowed to sell their coffee at transparent conditions. In 2002/2003, the average price paid by Nestlé for coffee was THB 38.7 (about USD 0.97) while local traders typically paid around THB 17 to THB 25.

The agronomists responsible for the buying stations during the harvest season spend the remainder of their time providing free technical advice to the coffee farmers. They also provide them with free plantlets in order to help them renew their plantations with productive varieties.



Nestlé's plantlets distribution programmes allow farmers to cultivate better coffee trees



“Making compost and reducing fertilisers helps me to save money”

“I started growing coffee in 1985. In the beginning, I was selling it to the local traders and I relied on my neighbours to teach me the best way to grow coffee,” Surachet Silpsorn says.

Since 1992, at the same time as the launch of the direct procurement in the Sawi area, Nestlé has provided technical assistance to farmers. This free advice is primarily focused on better use of fertilisers, productivity increase and overall quality improvement.

“I benefit a lot from the free assistance provided by Nestlé. One of the key lessons I learned is the floating of my coffee. It is an easy technique, which allows me to identify the inferior quality cherries just after harvest. Since I built my two floating tanks, I now manage to sell my coffee at a higher price because it is of a better quality.

“Nestlé’s agronomist taught me how making compost and mixing it with the fertilisers is a good way to save money. Now that I do it, I have more money at the end of the year.”

Assist the farmers to improve the quality of their coffee

It is evident that quality improvement has a direct impact on farmers' income. Quality coffee will be bought at a higher price and will compensate for the reduced quantities of coffee produced.

Technical assistance to coffee farmers is an efficient way to help them improve their farming techniques. Based on a win-win philosophy, the free assistance provided by Nestlé Agricultural Services allows farmers to benefit from state-of-the-art training while ensuring the company that it will receive the quality it needs for its *Nescafé* factories.

Nestlé and the ICO Resolution 407

The International Coffee Organisation (ICO) recently passed a resolution aimed at eliminating low-grade quality coffees from the supply chain (ICO Resolution 407).

The Nestlé Quality Control Centres (NQCC) were created over 30 years ago to ensure that the quality of exported coffees complies with the requirements of the Nestlé market, which ordered the product.

Nestlé believes that the NQCC network in producing countries encourages and enhances a better understanding of quality and this contributes to the objectives of ICO Resolution 407.



Nestlé's technical assistance contributes to the improvement of the quality of coffee





“If the coffee we produced here were not of high quality, I wouldn’t expect Nestlé to buy it”

“My name is Florentino Asís Anastacio. I am in charge of quality control at the Limonestitla mill in Veracruz, Mexico. When the coffee is brought here by the farmers for sale, I carry out an inspection to establish its quality.”

The Limonestitla mill was built in 1997 after the coffee farmers of the region decided to establish a central place from which to trade their coffee. Their hope was that by working together as a group they could negotiate a better deal for the sale of their coffee. And they have succeeded. Whereas before they were selling piecemeal to local middlemen, they are now selling directly to Nestlé.

“First, I check the moisture content. If it is too high, the coffee must be rejected and put through the drying process once again. Then I check the concentration of defects – such as stones and bad beans – in the sample. Once again, if this is too high, the coffee must be rejected and resorted. I then roast and grind some of the coffee and prepare a sample for tasting.

“I learnt these activities with Nestlé’s assistance. I have attended two courses in Mexico City and two here in Veracruz state. Martín Vázquez, who works for Nestlé, also supports

me. If I have any questions, I can always ask him. I must admit that the first time I did this job, I was a little confused. The second time, it was a bit easier. By the third time, I knew exactly what I was doing.

“For me, like all the people in this community, coffee is very important. I consider my job to be very important – of course, if the coffee we produce here was not of high quality, I wouldn’t expect Nestlé to buy it.

“Yes, I drink coffee. In fact, the first thing I do every morning before work is have a cup!”

Helping developing countries' local economies

Too often, the developing world is solely the producer of agricultural raw materials that are directly exported to be transformed in developed countries, with the result that the added value is not retained in those developing economies.

Some companies, however, decided to locate their factories in the emerging world. In the case of Nestlé, nearly half of its employees and factories are located in developing countries. Looking more specifically at *Nescafé*, Nestlé operates 27 factories of which 11 are in coffee-producing countries. Some 55% of *Nescafé* is produced in developing countries.



55% of *Nescafé* is produced in developing countries, including in this factory in Abidjan, Côte d'Ivoire





"I have tasted over half a million cups of coffee!"

Koffi Kouame works as a coffee taster in the *Nescafé* factory in Abidjan. He is 42 years old and married with four children. He works from 7.45am to 4.30pm, with a 45-minute lunch break.

"My job mostly involves the sampling of coffee. I also sample cocoa, but I prefer coffee tasting. I taste about 120 cups of coffee each day, but I drink just two: one in the morning with my breakfast and one in the afternoon."

"Yes, I enjoy my work. It makes me proud to know that I am in some way responsible for ensuring the quality of the *Nescafé* that we produce here. I believe that I am very well qualified for the job because I have 15 years experience in this position, which means I have tasted well over half a million cups of coffee!"

The way forward: industry's efforts to improve the farmers' situation

SAI coffee working group

Co-founded by Nestlé, Unilever and Danone in 2001, the Sustainable Agriculture Initiative aims at promoting farming methods that ensure decent living conditions for the farmers, while respecting the environment and securing socially responsible labour practices. Since its creation, Nestlé has promoted this platform to companies active in the coffee sector in order to encourage viable discussion forums to jointly define sustainability guidelines agreed upon by the industry. In 2003, facing the complexity of the coffee supply chain, SAI Platform members involved in coffee decided to create the SAI coffee working group which aims to implement sustainability all along the coffee supply chain. To date, seventeen companies have joined the SAI Platform and the coffee working group, now composed of eight companies, and have defined strategic orientations for sustainable coffee cultivation.

CCCC

Initiated by the German Coffee Association (DKV) and the Gesellschaft für Technische Zusammenarbeit (GTZ) the Common Code for the Coffee Community is a multi-stakeholder platform aimed at defining a code for establishing sustainability from the coffee tree to the end product. Representatives of the industry, the civil society and the growers work together to define the way forward towards sustainable coffee production. Through DKV, Nestlé is one of the founders of CCCC and is presently an active steering committee

member. All member companies of the SAI coffee group actively participate in this initiative.

Increase consumption to help reduce stocks

As stated on page 3, the basic problem with coffee prices is that supply exceeds demand, and roasters can play a significant role in increasing coffee consumption.

Collaborative efforts and individual marketing campaigns are necessary to promote consumption around the world. To evaluate the positive impact of promotion, it is interesting to observe that over the past decade, total coffee consumption increased by 17%. Over the same period, driven by *Nescafé*, soluble coffee consumption increased by 35% and Nestlé alone increased its soluble sales by 40%.

Under the auspices of the ICO, the most important roasters have recently committed to the Positively Coffee Initiative. This project is aimed at promoting coffee consumption by giving a positive image of coffee to consumers.

Over the past twenty years consumers have listened to many negative messages concerning coffee and caffeine intake. However, new scientific data from worldwide research centres are providing us with another perspective. This initiative aims at sharing balanced and consistent information about the positive aspects of drinking coffee.



Over the past decade, Nestlé increased its *Nescafé* sales by 40%



"My objective is that the coffee farmers earn a decent living in the long term"

Patrick Leheup is an agronomist working for Nestlé. He spends a great amount of his time on coffee plantations around the world, providing advice to the farmers. He is also a member of the SAI coffee and CCCC steering committees. For him, working on the sustainability of the coffee farmers is not a matter of charity, but of responsibility. "For a company like Nestlé, it is vital that the coffee farmers receive fair prices. Otherwise they will have no incentive to produce the quality of coffee that we need for *Nescafé*."

Nestlé:

our contribution

Nestlé has been contributing to the farmers' well-being for many years. Over the past year, this contribution has been strengthened, both independently and in partnership with the industry. Here are some examples of Nestlé's initiatives:

Direct procurement

Over the past year, Nestlé has increased its direct procurement from 100 000 tonnes to 110 000 tonnes, which represents 14% of the company's green coffee purchases.

Sustainable Agriculture Initiative's coffee group

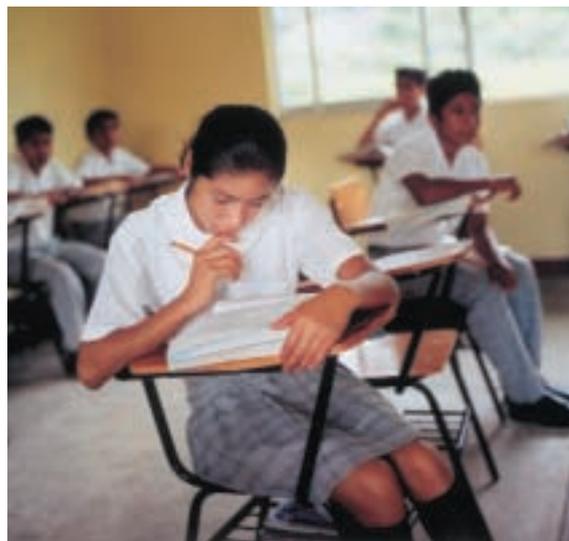
An industry working group has been set up by Nestlé, aimed at developing a sustainable approach in coffee cultivation. Eight companies involved in coffee are already members of this group.

Common Code for the Coffee Community (CCCC)

GTZ/DKV initiative is aimed at developing and implementing guidelines for the coffee sector. Nestlé is a member of the steering committee.

Coffee programmes on FM radio stations in southern Thailand

As of June 2003, a weekly programme dedicated to coffee farmers which, until then, had been broadcasted on two radio stations is now also aired on Chumphon meteorological radio station, thus allowing Nestlé to reach all 14 000 farmers who supply coffee to the company.



Technical assistance in Vietnam

Nestlé hired an agronomist to provide technical assistance for the Dong Nai province in Vietnam.

Diversification and education in Mexico

Nestlé supports the Tezonapa Project in the Veracruz Province of Mexico aimed at helping farmers to improve the quality of their coffee and to increase productivity. To that effect, seedlings have been given free of charge to the coffee farmers. Diversification of their sources of income is promoted through fish farming and tropical wood production. A junior high school is also being financially supported by Nestlé (construction, equipment and teaching personnel).

School children in the Tezonapa region of Mexico

Sustainable coffee in the Philippines

Nestlé Philippines committed to provide CARE Philippines with technical assistance for its AWESOME project in Mt. Malindang Range National Park. This project focuses strongly on intercropping and diversification.

Pilot farm in the Philippines

A coffee-based sustainable farming system is being demonstrated and used in a privately owned pilot farm in the Sultan Kudarat Province. Diversification is one of the main objectives of this project, with crops such as peanuts, vegetables, root crops, pineapples and highland bananas.

Farm sustainability in Indonesia

Since 2000, Nestlé has been conducting a campaign aimed at improving farms' sustainability and land optimisation. Strong emphasis has been placed on diversification.

Côte d'Ivoire

Two buying stations located in the most dangerous areas of the recent armed conflict became inaccessible and it was necessary to set up a new station in a very short period of time. It was possible to increase the volume purchased which reached 30 000 tonnes (increase of 10% compared to 2002).

Support to Ethiopia's coffee sector

Nestlé has committed to the Jimma agricultural research centre by assisting them to increase their scientific capacity in the coffee sector. Nestlé will also support the Goma coffee technology training centre.

Advocacy for change

Called upon by the United Nations General Assembly and under the auspices of the UNCTAD, the Eminent Persons Group, composed of 15 people including Peter Brabeck-Letmathe, CEO of Nestlé, signed an appeal for, among other things, more liberalised exchanges between the developing and developed countries.

Positively Coffee Project

Nestlé strongly supports this ICO initiative aimed at increasing consumption by projecting a positive image of coffee among the public.

FAO Mould Prevention

Nestlé supports this project aimed at improving coffee quality.

ISO coffee committee

Nestlé actively participates in a standardisation project aimed at assessing the quality of the coffee.

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Cleaning coffee beans in front of the Nestlé buying station, Gagnoa, Côte d'Ivoire

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Good Food, Good Life