

## **Investor Brief: Fair Trade Coffee**

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### **The coffee crisis**

According to the Food and Agriculture Organization of the United Nations (FAO), coffee is the world's fourth most valuable agricultural commodity.<sup>1</sup> About 70 percent of the world's coffee is produced in small family farms in Latin America, Asia and Africa, where 25 million people depend on the coffee industry for their livelihoods.<sup>2</sup>

While the coffee industry has brought huge profits to roasters and retailers, producers are receiving an ever-diminishing share of the profits that often does not cover the cost of production. According to the Institute for Food and Development Policy, the price paid for a single cup of coffee in the U.S. exceeds half the daily income of many small-scale coffee farmers.<sup>3</sup> Other estimates find that, on average, growers receive less than 1 percent of what a Northern consumer pays for a cup of coffee in a restaurant or coffee shop, and roughly 6 percent of the retail price of coffee purchased in a grocery store.<sup>4</sup> This situation, commonly known as the "coffee crisis," presents a range of risks to companies and investors in the coffee retailing industry, including reputational and market access risks and risks to the long-term quality and stability of their coffee supply.

Two key factors have contributed to the coffee crisis. First, due to oversupply in producing countries, international coffee prices fell sharply in the 1990s and have only marginally recovered since 2001, when they reached their lowest levels in over a century.<sup>5</sup> According to Oxfam, the coffee crisis has deeply affected coffee farmers, forcing them to cut down on essential expenses such as school fees for their children or food, to lose their farms, or to migrate to cities in the hope of a better future.<sup>6</sup>

The second factor is the consolidation of a handful of multinational corporations (traders and roasters) which control the coffee market and have been able to pick and choose among vulnerable producers in developing countries. These companies, including Kraft, Nestlé, Procter & Gamble, Sara Lee, Tchibo and large coffee retailers such as Starbucks, have made considerable profits even in the midst of the coffee crisis. In 2001, for instance, Nestlé reported a rise in profits of over 20 percent, with the beverages sector performing strongly, while Starbucks, the world's largest coffee retailer and one of the biggest specialty coffee buyers in the world, reported a 41 percent profit increase in the first quarter of 2001.<sup>7</sup>

In 2005, Oxfam reported that even though international coffee prices have begun to recover, a few extra cents does not signal the end of the coffee crisis. Oxfam also noted that "small-scale farmers and farm workers remain extremely vulnerable to the coffee market's swings and the disproportionate market power of local buyers, international traders, and multinational coffee companies."<sup>8</sup>

### **The FLO Fair Trade system and coffee**

Fair Trade offers an alternative to conventional trade in order to ensure that producers in developing countries get a fair price for their products. This is accomplished through a set of trading, social and environmental standards whose implementation by producers or buyers (as applicable) is certified by an independent body. The standards are established by Fairtrade Labelling Organizations International (FLO), a non-profit, multi-stakeholder organization based in Germany.

Under the FLO Fair Trade rules, coffee is produced by co-operatives or associations of small farmers that are democratic and accountable to their members. Producers must comply with various social and environmental requirements, including the prohibition of child labour, compliance with the standards of the International Labour Organization conventions, limited use of pesticides, and prohibition of use of certain types of toxic agrochemicals and of genetically modified organisms.<sup>9</sup>

Certified buyers must give farmers a minimum guaranteed price that reflects the cost of sustainable production, so producers are not at the mercy of the market (market prices apply if they surpass the Fair Trade minimum price). Buyers must also pay farmers a premium price meant for investment in community development projects such as schools, hospitals and infrastructure for improved coffee production and quality. The use of the premium is determined by farmers themselves, through a democratic process. Just as important, buyers must sign contracts with producers and give them up to 60% pre-payments of the contract value if so requested by producers.<sup>10</sup>

### **Fair Trade coffee market growth and responses by investors**

Although the international market for Fair Trade products still represents a minor share of global trade, it is growing rapidly, with coffee at the forefront of the growth curve. Between 2003 and 2008, average annual sales of Fair Trade coffee grew 35% in the U.S. and 32.9% in Canada. In 2008, despite the economic recession, Fair Trade certified coffee sales grew more than 30% in the United States and 23% in Canada. (TransFair Canada; TransFair USA).

In response to the risks that the coffee crisis presents to companies dependent on coffee and to growing consumer demand for Fair Trade coffee, investors in Canada and the U.S. have started to ask their companies to introduce or increase their sales of Fair Trade certified coffee products. In April 2003, a coalition of U.S. shareholders filed a shareholder proposal at Procter & Gamble to ask the company to start marketing Fair Trade coffee. The resolution and a grassroots campaign by Global Exchange, Oxfam America and others prompted the company later that year to announce that it would start selling Fair Trade certified coffee products.<sup>11</sup>

In 2004, another group of U.S. shareholders filed a resolution at Kraft Foods Inc. to request a Board report reviewing the company's policies related to the effects of the steep decline in coffee prices. Investors claimed that the coffee crisis presented risks to the stability and quality of Kraft's coffee supply and the long-term sustainability and profitability of its coffee business, given the inability of farmers affected by the crisis to meet their basic needs, or to reinvest funds into maintaining or improving coffee quality.<sup>12</sup>

In Canada, The Ethical Funds Company filed a shareholder proposal at Metro in 2005 to request a Board report on the company's plans to meet the growing market demand for Fair Trade coffee.<sup>13</sup> More recently, SHARE and Bâtirente initiated dialogues with Tim Hortons to address risks associated with the company's coffee supply.

### **What SHARE is doing**

Tim Hortons is a Canadian cultural icon that dominates the carry-out coffee market in Canada. In 2009, SHARE initiated a dialogue with the company on behalf of our client Meritas Mutual Funds. Our dialogue with Tim Hortons has two key purposes. First, we are requesting additional information regarding Tim Hortons' Sustainable Coffee Program, a goodwill project that aims to provide financial assistance, technical training, education and social services to a number of coffee-producing communities in Guatemala, Colombia and Brazil. Second, we are

discussing steps available to Tim Hortons to adopt a forward-looking approach to coffee sourcing in order to mitigate long-term risks and seize new opportunities associated with its coffee supply. The proposed steps recognize the significance of the Fair Trade coffee market growth and the opportunities that Fair Trade presents for Tim Hortons' coffee supply management processes.

SHARE, August 2009

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## NOTES

- <sup>1</sup> In Mark Pendergrast, "Coffee second only to oil?" *Tea & Coffee Trade Journal* (April 2009), [http://www.entrepreneur.com/tradejournals/article/198849799\\_1.html](http://www.entrepreneur.com/tradejournals/article/198849799_1.html)
- <sup>2</sup> See International Coffee Organization, "International Coffee Agreement 2007," <http://www.ico.org/ica2007.asp>.
- <sup>3</sup> See Institute for Food and Development Policy, "Organic Coffee Crisis?" (2007), by Eric Holt et al, [http://www.foodfirst.org/files/pdf/backgrounders/35644\\_FoodFirst\\_Backgrounder1.pdf](http://www.foodfirst.org/files/pdf/backgrounders/35644_FoodFirst_Backgrounder1.pdf).
- <sup>4</sup> See "Depressed Coffee Prices Yield Suffering in Poor Countries," by Paul Jeffrey, *National Catholic Reporter* (7 February 2003), <http://www.globalpolicy.org/globaliz/econ/2003/0207coff.htm>.
- <sup>5</sup> See Christopher Bacon, "Confronting the Coffee Crisis: Can Fair Trade, Organic, and Specialty Coffees Reduce Small-Scale Farmer Vulnerability in Northern Nicaragua?" (2005) 33:3 *World Development* at 497–511; and Holt et al, *supra* note 3.
- <sup>6</sup> See Oxfam International, "Bitter Coffee: How the Poor are Paying for the Slump in Coffee Prices," <http://www.globalexchange.org/campaigns/fairtrade/coffee/OxfamPriceReport.pdf>
- <sup>7</sup> See *ibid.* and Holt et al, *supra* note 3.
- <sup>8</sup> See Oxfam America, "The Coffee Crisis Continues: Situation Assessment and Policy Recommendations for Reducing Poverty in the Coffee Sector" (April 2005), <http://www.oxfamamerica.org/publications/the-coffee-crisis-continues>
- <sup>9</sup> See FLO International, "Generic Fairtrade Standards for small farmers' organizations" (17 Dec. 2007), [http://www.fairtrade.net/fileadmin/user\\_upload/content/Generic\\_Fairtrade\\_Standard\\_SF\\_Dec\\_2007\\_EN.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/Generic_Fairtrade_Standard_SF_Dec_2007_EN.pdf).
- <sup>10</sup> See FLO International, "Fairtrade Standards for Coffee for Small Producers' Organizations" (16 Feb. 2009), [http://www.fairtrade.net/fileadmin/user\\_upload/content/02-09\\_Coffee\\_SPO\\_EN.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/02-09_Coffee_SPO_EN.pdf).
- <sup>11</sup> See "Advocacy Groups and Shareholders Persuade Procter & Gamble," Global Exchange Press release (15 September 2003), <http://globalexchange.org/update/press/1043.html>.
- <sup>12</sup> The text of these shareholder proposals can be found through the Interfaith Center on Corporate Responsibility (ICCR) shareholder resolutions database, <http://www.iccr.org/>.
- <sup>13</sup> See SHARE, Shareholder Proposals database, <http://www.share.ca/shareholderdb>.