Analysis of the Common Code for the Coffee Community

The goal of this paper is to objectively analyse the proposal set forward by the Common Code for the Coffee Community (4Cs).

As an organization that is involved in the international discussion on sustainability in the coffee business, we have not participated in the building up of the 4Cs at any instance. We have followed the discussion and analysed the papers that were made available to the public, 4Cs internal documents such as the Rules of Participation, used the content of discussions we have held with a large number of people who have participated in the process of the 4Cs and set the information received into the wider, international and practical concept of the coffee market business.
We have therefore to anticipate that there may be some information which is unknown to us, but we believe to have enough information to be able to undertake this analysis from a strategic point of view.

The Common Code is not a finished process, it is still under discussion. We are conscious that some items that we will bring up in this analysis are being addressed in the current discussion. Nevertheless, we included these items to emphasize that they indeed need to be discussed.

The coffee business has a large number of stakeholders, physical and business processes and interests. As a consequence, a common code for the coffee community must respond to this complexity to a certain extent. With the purpose to keep the overview and in view that many detail aspects of the code have yet to be defined, we have conducted this analysis from a broad approach; leaving a detailed analysis for a future moment of time.

We undertake this analysis in an attempt to support the international effort to bring 'true' sustainability in the coffee sector. We hope that it will contribute to finding the correct path to the benefit of everybody in the coffee business.

Table of contents

Background

Coffee is grown in more than 50 countries worldwide, by its largest majority in developing countries and consumed everywhere in the world. Though world market prices have many times been very volatile, the long depressed price levels between 2000 and 2004 have brought many producers in a difficult economic situation with the relative impact on social and environmental aspects. Furthermore, due to budgetary restrictions attention to quality of production was kept at a minimum in numerous production units which in turn has had a further negative impact on the net income of producers.

On the coffee political level, sustainability has been mentioned as an option to lessen the impact of the price baisse for some time now. For instance, Mr Walter Zwald of the Worldwide Sustainable Coffee Fund brought forward the proposal of a fund already in 2000. This concern was taken up little by little by many participants along the coffee supply chain and resulted in a larger initiative lead originally by the Deutsche Kaffeeverband and the German Government, mainly its developing aid dependency, the GTZ. They succeeded in binding in the largest industrial companies active in the coffee business along with a number of NGOs and some producer organizations. The result of this cooperation was the Common Code, publicly announced in September 2004.

Overview

The initiative to the Common Code parts from the desire to bring increased sustainability into the coffee business. This desire has been expressed by many participants in the coffee business and as such the Common Code takes up this need.

The attempt to bring a strong, solid code into the coffee business and to complement the fair-trade movement was supported by many. The nature of the coffee business can be characterized as complex, although it is basically one product, there are countless forms of consumption, preparation, production and ways to commercialise it; the composition of the group of people sitting down at a round table to discuss a common code must, as a result of the business characteristics, be complex. As a consequence the diverse nature and background of the participants was contained in the 4Cs discussions. Finding a consensus that can be implemented in this complex business and can count on the support of a large majority of the participants in the coffee business can be stated as an extremely challenging enterprise. Such a challenge brings along also the opportunity for success and for failure.

As a whole, the Common Code as presented to the public and available on the website, together with all the subsequent publications and comments, tries to address most of the complex facets of the coffee business, but it misses yet the convincing logics that usually carry a worldwide initiative that enters into the books of history. It seems like an engine for a car that has been built outside of its chassis and does now not fit into the designed space, no matter how we turn and twist it. So let's look at this engine; let's analyse each component and always put it into the context of the entire engine and the chassis with its own aerodynamic and physical properties. After all the car should eventually drive along the roads and it should do it with safety, economically and for a long time.

Practicality

a. Self assessment

Under the 4Cs scheme, producers and or exporters (the Common Code Unit) can register for participation in the 4Cs. The main prerequisite is a self-assessment. Whether there are, and with what frequency, random inspections from third party institutes is an open point that is still being discussed. Nevertheless this is not relevant for this analysis. Full inspection of all coffees produced by future 4Cs Units is impossible, so self-assessment will have to be practiced to some extent, at least.

We take it as a fact that most people are fundamentally well intentioned. Many partners in the coffee business work towards an increased sustainability and therefore we can assume that self-assessment will genuinely be accomplished with fair intentions. However, as the past has shown us, when there are dilemmas, divergences or uncomfortable situations, people have always found ways to not respect laws, even if control was in place. The problem with self assessment is that the looser the control, the easier it is to not respect the laws.

The participants at 4Cs must have considered these facts when building the codes and must have done everything to prevent abuse. Nevertheless, a global system like the 4Cs cannot build on self reliance: business practices will finish in not respecting a considerable number of rules. Therefore, the only possible forms to enforce regulations are through the market (economic implication) or national legislation. Market regulation is not contemplated in the Common Code; legal enforcement is not within the competence of the private sector or any foreign institution.

As to legislation with regard to environmental and social standards there are international conventions that regulate them on legal bases. Most of the coffee producing countries have signed these conventions and are doing their best to implement it. The regulation therefore exists and has been approved, what still may be open is the final implementation of them. As a consequence, the question can be raised whether instead of introducing new regulations and additional control mechanisms, rather the collaboration for the implementation of the existing national and international treaties and laws should be supported by the coffee business community.

Let's turn to the above argument that the market could be used as a mean to enforce implementation of the rules. We know from the laws of the market, that only what is being valued by the customers will be honoured. The price honoured of a specific coffee offered is always determined by the market in respect to origin, preparation, selection, altitude, characteristics of cup and reliability of exporter. With these items functioning as the main aspect to determine market value, producers will naturally attempt to produce the best product/service to obtain the highest profit. Almost everybody involved in sustainable production assures that the sustainable production system leads to reduced cost and the prospect of higher income. The producer, who is knowledgeable about this fact, will do everything to imitate these results; most of the items of the code matrix are part of the actions required for increased sustainability. Therefore the market can be used to tell exactly who has applied sustainability in all aspects and who has not.

We conclude this thought with an open question: Instead of imposing the code through self assessment and verification, may the use of the market forces – apart from being neutral – not have a deeper rooted and longer-lasting effect as a vehicle for verification?

b. Verification

As mentioned above, whether verification will be implemented and to what extent remains open. From an empirical point of view, the implementation of new rules generally require verification if they are meant to be followed.

On the other hand, cost for verification can be enormous if it is to be done properly. Reduced verification may be an option, but if it is below a certain limit, it does not have any effect at all.

Following this logic, verification must be applied. However, verification itself does not create any added value to the product coffee, so its cost should be included in the value added by the practice of the code itself.

Based on experience of international verification systems, establishing the code or requirements is the easy part. Implementing the code in the business practice represents a much higher challenge. Nevertheless, the most difficult and expensive part is the verification and the maintenance of the verification system over years.

Considering this input, it seems critical that the extent of verification needed and its cost are assessed before implementation and put into relation to the benefit such a system can have.

c. Minimum Unit of one container

The Common Code mentions under auditable units "the smallest unit …is where … volume composes at least one container." The reasons for setting such a level are obvious to all: registering all participants at smaller volumes would exceed the administrative capacity by large and verification for compliance at smaller volumes is simply not practicable.

The code matrix includes a larger amount of principles that include also, or aim only at, the production of coffee, for instance social dimension 5b, 5c, 5e; environmental dimension 1a, 1b, 2a, 3a, 3b, 3c, 4a, 4b, 5, 6a, 6b; economic dimensions 2.

A 4Cs unit that composes a container unit will have to assure that the principles are respected for all the coffee in a given container. As we know, in most cases there are coffees from different farmers in one container. This puts the 4Cs unit, most likely the exporter, in a very difficult position for a variety of reasons:

a. He cannot himself verify and/or assure that the principles have been respected by all the farmers that constitute a given 4Cs container. This task goes beyond his capacity.

b. When he is certain only for a given number of bags in a single a container that they have been produced under 4Cs criteria, what does he do when he has to certify it for the complete container? Most likely, he either
   1. refuses to sell such a container because he cannot assure that all the coffee is 4Cs coffee, or
   2. he tries to fill it with some other coffee of which he can assume that it has been produced under 4Cs principles, but cannot guarantee it, or
   3. he asks his supplier of 4Cs coffee to provide more 4Cs coffee who in turn will, in absence of any verified 4Cs coffee, procure coffee that is most likely to fulfil the 4Cs criteria.

c. What are the legal risks that a 4Cs unit assumes when including coffee of which it does have no proof that it was produced under 4Cs criteria?

We take it for granted, that all participants in the coffee supply chain agree that a code should only be implemented if it can also successfully withstand rigorous tests. On the eve of this testing, the theoretic foundations of Common Code should be able to answer, with certain security, the question: Can coffee that has not been produced as 4Cs coffee be detected as such along the supply chain and be prevented from being sold as such? Many of the readers may recall the experiment from a well-known environmental activist group. Related to 4Cs, this would involve marking non 4Cs coffee with red paint and packing it in export bags. This particular coffee would appear at a roaster as 4Cs coffee; hence it was declared 4Cs coffee though it was not. For those who have learnt the lesson, we ask ourselves: "Can 4Cs coffee pass this test?"

Further, coffee can be shipped in bulk and the future may see an increasing number of bulk shipments. Would the exporter have to segregate 4Cs coffee from non 4Cs coffee and put them in separate hatches? It is very difficult to imagine how 4Cs coffee can be handled with bulk shipments.

d. Blending coffees at origin

Many buyers and roasters have specific quality requirements (acidity, body, flavour, size of bean) which are satisfied by blending at origin from many different plantations/farmers within the same origin.

Under the 4Cs scheme, the mill will have to assure that all its suppliers fulfil the 4Cs criteria. If some of them do not fulfil the criteria, it could not use their coffees which results in a disadvantage to the roaster who can not come up with his customers' expectations.

This type of situation has to be avoided if we want to restrain from loosing further consumers.

e. Buying process of 4Cs coffee

It is planned that 4Cs coffee should be purchased at a premium by the roasting industry. While this is seen as the critical factor to offset the additional investment, there is a number of concerns:

a. Time of purchase

Generally, a roaster purchases its needs of green coffee well ahead of the supply as a result of its marketing and production planning. It could not afford to have its production plant stopped because of a lack of supply of green beans. When buying 4Cs coffee, the trader/exporter compromises to supply 4Cs coffee as per contractual terms, including grade/provenience/time. Let's assume at a differential of +2 and an additional US cents 2/lb for being 4Cs coffee: That is a total of +4.

At the time of the contractual agreement however, the coffee cherries have most likely not yet even started to flourish. As the time for coverage in the origins comes closer the trader/exporter starts to secure its needs at the cooperatives and farmers. He will try to cover the coffee at the best price. For example, the market differential has now increased from 2 to 3 cents. Will the trader/exporter purchase at +4 (+3 of the market and 1 for 4Cs coffee) to break even or will he honestly cover at +5 (+3 of market plus 2 for 4Cs coffee)?

It is obvious that the trader/exporter has the intention to cover the short sale physically at a lower differential than he sold at. In the case where the differential has developed against him, he will try to reduce the premium for the 4Cs coffee in order to compensate their negative market evolution.

Based on this fact, the premium for 4Cs coffee should not be passed on to the exporter through the regular market negotiation.

b. Low offer of 4Cs coffee

It may turn out that several traders/exporters have short sales in their book to purchase 4Cs coffee in excess to the grade/provenience/time of the 4Cs coffee available. What does a trader/exporter do at this time to honour its commitment with the roaster? It is absolutely clear that the trader/exporter cannot dishonour its obligations. So it has to 'invent' this 4Cs coffee somehow/somewhere.

c. Price premium for 4Cs coffee

There have been indications that 4Cs coffee should collect a premium compared to same coffee quality that is not 4Cs coffee. For obvious reasons, the premium cannot be fixed in advance or in general. The premium will hence to be determined by the market forces. Due to the public attention to the first containers of 4Cs coffee, there will be increased conscious on the premium and participants will want to honour this special occasion. But what will happen over time? Realistically, public attention on trading of 4Cs coffee will diminish, or even vanish, and it will become every day business. Over time, the roasters will naturally focus on their own profit and loss and keep cost for raw material at the low end. This is the law of the market force and there is nothing negative about it. But, will the producers/exporters that have incurred and constantly incur extra costs for producing 4Cs coffee be compensated in view that the roasters can purchase the same coffee quality from a non 4Cs supplier?

The logics of the 4Cs base on the assumption that offer and demand of 4Cs coffees will drive the premium for 4Cs coffee. First, the consumer market does not demand 4Cs coffee at all. Secondly, over time offer for 4Cs coffees may increase considerably and driving down the premium. There is a potential that the premium will be traded below the investment and maintenance cost of the producers. This should not be the goal of the 4Cs. What does it do to prevent such situation?

A premium may work over a short time period, but sustainability looks into the far future – 5, 10, 20 years from now – and the solution implemented today will have to be valid in the far future, too.

Under an oversupply situation, the exporter/cooperative does no more have a strong position to demand the 4Cs premium, because he has to sell under depressed market condition. In other words, the 4Cs exporter is in a competitive disadvantage for its higher priced 4Cs coffees compared to 'regular' coffee. What structure does assure the producers that the premium will be paid under any market condition?

Just like reasoning a) above (time of purchase) determining the premium via the market does not seem appropriate.

d. Transparency in passing on the premium

The premium for 4Cs coffee is paid from the roaster to the trader, from the trader to the exporter, the exporter to the farmer association and from the farmer association to the farmer itself. More often than not, there are even further layers involved. It is questionable whether the entire premium paid for 4Cs coffee arrives at the farmer or at least the farmer association. Trade and exporters may claim, and probably rightfully, that they have additional work and expenses due to 4Cs coffee and that they should also be compensated for it. The premium will shrink therefore with each layer it passes through. What will arrive at the end of the payment chain?

<u>f. Increasing quantity</u>

There is an intention to increase the volumes of 4Cs coffee over time. Roasters cannot compromise themselves to this principle because they do not yet know what their purchase tactics will be in the future, nor can they know whether the coffees they need will be available in increasing quantities under 4Cs scheme as trade handles sometimes one or two years ahead of the effective shipment months.

It has been argued that this commitment by the roaster to purchase 4Cs coffee in increasing quantities will create a need for them to invest in capacity building (sustainable projects). This strategic intention however bears enormous risks for the coffee producers, their organizations and the countries as explained under capacity building below. In brief, it is a form to bind the coffee farmers to large multinational companies who will not and cannot act in a sustainable interest of the coffee farmers. Large trading and roasting firms have a natural interest in purchasing coffee based on their needs, but cannot and are unable to commit themselves to support the long-term development of the producers: the financial dimension involved exceeds their capacity and sooner or later there will be a political divergence between the a multinational and a local producer. Producers may not agree with the political decisions of a multinational company, hence they may be presented with the situation to either accept the dictation or to loose the business. View this problem from an other point of view, sustainable development is mostly about developing the responsibility (and the capacity) of the producers to subsist in the market on their own which can only be built on their freedom to take strategic decisions for their business.

The Rules of Participation foresee that "The Code contains a voluntary commitment by buying participants to purchase 4Cs green coffee in increasing amounts over time." This statement contains a direct contradiction. A commitment is generally made in order to execute it.

However, the addition of the word ‘voluntary’ turns the ‘commitment’ into an intention. If the buying participants cannot increase the purchase of 4Cs green coffee over time, then there is no binding obligation to do so. What happens however then to the producers who have invested in the making 4Cs coffee available on the market? Is there investment simply gone?

Producing and purchasing 4Cs coffee constitutes an enormous risk for both the producers and the roasters since market behaviour cannot be anticipated.

g. Decision to participate in 4Cs

A producer organisation or exporter is a business person like anybody else. For deciding to participate in the 4Cs they will evaluate investment cost vs. additional revenue. In the absence of hard facts for the cost and revenue they will estimate them on the best of the information available. For estimating the revenue they will also have to take into consideration the degree of certainty that their estimate becomes true. From the current proposal for the Common Code this degree of certainty is very low. What would make a producer assure that he will get rewarded for his investment?

h. Acceptance of added value

Fair-trade coffees respond to a need by the consumer market where consumers are prepared to pay a premium for a number of surrounding characteristics of coffee production and processing – such as socially just, fair business practices and environmental concerns.

Sustainable practices in the main stream market (such as 4Cs) do have the handicap – compared to the fair-trade market – that there is no natural market that demands and will pay for these principles; those who demand it in the mainstream market is a mixture of public opinion, governmental attitude and the industries’ own corporate governance. In human history it has always been the case, that whoever demands something has to pay for it. Let us briefly examine the potential acceptance of added value and the disposition to compensate for it by the three groups mentioned:

a. Public opinion
   - Apart from the consumers who favour fair-trade products, there are a number of people who wish to see good business practices extended to the main stream market. These are people who are loyal to their traditional brand of coffee, activists, people who sympathize with activists and journalists.

   - Public opinion also embraces the regular and irregular consumers. Increasing sustainability in the coffee business may have an effect on the image towards coffee and the attitude towards coffee products in any form and eventually lead to increased consumption. To achieve and to multiply this effect, PR campaigns will be required, which are not foreseen (allowed?) in 4Cs. The increased sustainability must also be made public; to the contrary the premium will soon disappear.

- PR campaigns will only show effect where the public opinion is susceptible, i.e. in Western Europe, USA/Canada and, to a lesser degree, in highly developed Asian countries. How much value are these people prepared to invest in seeing their desires for sustainable coffee production come true? It is certainly not offensive to state that for the first group the aggregate value does not represent a significant share of the cost the implementation of the 4Cs may require. For the second group, there may be a more significant effect mostly through increased consumption of coffee. To measure the impact of this effect and to put it against the investment required for the implementation of the code and the relative PR campaign, further data should be gathered.

b. Governmental attitude

Mainly through the public opinion of fair trading practices and environmental concerns, most governments of developed countries support measurements heading towards increased sustainability. Through the concept of public-private partnership, models of financing are possible and it can be assumed that governmental funding will be available also in the long run. Governments however clearly express that they do support new initiatives for sustainable business practices, but these practices have to become self-sustaining once they are mature. Therefore, no government could justify supporting practices that do not have the prospect of reaching maturity within a given time frame. Governmental support for a given concept is hence limited in time.

There is massive support for development aid, mainly led by the G8 countries. Some of this financial support may be to the benefit of coffee projects. Also here, criteria for obtaining this support will be that the scheme applied to the project can convince that it is self-sustaining in the long run.

In brief, governments will support the initial stakeholder process and capacity building, but the operations of any sustainable initiative must be self supporting.

c. Industries' corporate governance

Taken the entire coffee business, from tree to cup, there is a certain concern to increase sustainability in its own business practices; for the industry it is to improve the public image.

As opposed to the value the consumer market is willing to pay or the governments are ready to subsidize for increased sustainability, determining the added value for the coffee business community for having a "sustainable code" can only be assessed very approximately and is not available to this date. It must therefore be based on intuitive appreciation for the time being.

It is the exporters, traders and roasters who have to quantify the value added of the Common Code for them and put it against their investment into it. From an intuitive point of view, we anticipate that if the premium for 4Cs green coffee will be determined by the equation of cost vs. benefit of the Common Code for the roasting industry, it most likely will not match the extra cost the producers and exporters have by participating in the 4Cs scheme as currently proposed.

i. Serving the terminal market

When a trader, roaster and or exporter wants to cover his Terminal (NYBOT + LIFFEE) short position with physical coffee and has different 4C coffee qualities in his position – for which he paid a premium – does he get the premium from the terminal market? If by a tender of 4C coffee quality the premium paid would be lost then it would be a severe restriction to 4C coffee in relation to the marketing possibilities of 4C coffee.

In conclusion, it is recommendable to determine more precisely the value added by the Common Code in order to be able to put it against the cost. Even if these figures may be extremely rough, they could provide some indications that will help guiding the Common Code towards a higher probability of accurately evaluating its economic feasibility. Also refer to the item Testing below.

The Code

The code matrix bases on the principle of a traffic light. This system, being globally comprehensive, allows for tolerance (yellow) where some elements still need improvement and gives a clear sign where the tolerance ends (red) at the same time. It also includes the mention of the desirable practice (green), hence it works with the widely accepted principle of continuous improvement.

The code itself consists of three dimensions (social, environmental and economic), each of which is broken down into between five and seven categories which consist of between one and 5 principles. There is a total of 30 principles.
The principles can be consulted under http://www.sustainable-coffee.net/download/4Cs-drafts/common-code-en.pdf

a. Content of the principles

In the discussions with many people in the coffee business none of the principles encountered opposition as such. It can therefore be concluded that each principle counts on a wide support when examined independently. These original 30 principles can also be regarded as a minimum consensus on which can be built further up.

b. Analysis of existing principles

The 4Cs stand for Common Code for the Coffee Community. The Coffee Community can be split into 4 to 6 sections, depending on the interpretation. For the purpose of this analysis we take 5 sections, namely:

1. Coffee production and processing
2. Coffee export
3. International coffee trade
4. Coffee roasting and soluble production
5. Distribution and points of sales (retailers, catering)

There is no clear distinction along the supply chain of these sections and some processes are strongly interconnected with those of another section.

1. Social dimension

   The 13 social dimensions can be applied to all sections along the coffee supply chain. Nevertheless, items 5b and 5c (working hours and wages) are referred in the code to coffee exporters and coffee production only. It is not clear why these items are not applicable for trade, industry and distribution.

   Although these principles are all fundamental, many coffee producers have questioned whether the principles will bring them the desired social development. Coffee farmers, and in particular small holders – who should ultimately benefit most from the sustainability initiatives, look at the economic and social development of their region. The social dimensions proposed in the code matrix are accompanying measurements, but do not foster the socio-economic development per se. It is the availability of resources that will have the population of an area develop further, economically and socially. Resources will be obtained through their own labor – embedded in socially just business practices – as soon as their labor results in more revenue than cost. Furthermore, each country and each region has the right and the obligation to develop socially through their own political debate. Outside advisors can support the creation of opinions by sharing their own experience – but should not intervene with binding rules.

   To support the social dimension in coffee producing areas, the international coffee community can support the local efforts by providing resources (community centers, education, opportunities for opinion forming etc) and advise at the creation of local policies (possibly specific to coffee matters) in order to prevent people in coffee producing areas to repeat errors that have been committed elsewhere.

Each coffee producing area, or specific community / corporation, should therefore be able to decide whether to adopt the recommended principles in the 4Cs code matrix. It should not be a condition for selling coffee in the 4Cs market, which is a main stream market after all. This connection can be regarded as discriminatory or intruding.

2. Environmental dimension
   10 out of the 11 principles under environmental dimension apply to coffee producers and exporters (as per the code matrix).
   From empirical evidence, these measurements may even help to reduce costs and potentially increase efficiency and quality. Many coffee farmers have taken measurements in the past that go in this direction and others have practiced them for ever.

   Since most of the environmental pollution is taking place in developed countries, the question is raised what measurements the coffee trade, industry and distribution should undertake to contribute to the environmental dimension. Specifically, category 6 (Energy) of the environmental dimension, can be easily applied along the entire supply chain, from the manufacturing point to the delivery point to their clients. There are many techniques for the use of renewable energy and reduction of use of energy proper to each section of the supply chain. The thought of a given imbalance between the two ends of the supply chain becomes hence apparent.

   If trade, industry and distribution already have their own standards for dealing with energy, the elementary key points should be included in 4Cs and should be subject to the self assessment / verification scheme of the Common Code.

3. Economic Dimension
   Economic dimensions include 6 principles that are equally distributed among the sectors of the entire supply chain.
   Categories 1, 2 and 4 (Market information, Market access and Commerce) refer to business practices that are already present. Improvements in these categories are possible and desirable, but the criteria for red, yellow and green are relatively vague – mainly due to the fact that their implementation is very complex and no blueprint solution is available. The measurements that will be taken based on these principles remain hence very open and so does the potential impact.
   Specifically, on item 4 (Commerce), it seems that the open market that has been practiced since 1989 is perfectly implemented: Quality of the product is recognized and traded based on supply and demand.

   How verification of these principles could be executed needs also to be defined with further precision.

Item 3 (Quality) will be discussed separately below.

c. Quality

Quality among others is one of the most relevant aspects that can create added value. The market (consumer or trade) is willing to pay 'a little more' for coffees that have a higher quality. Besides given basic aspects such as type of coffee, origin and climate, higher grade of quality comprises:

a. Have less defects
b. Are ripe beans (cropping methods)
c. Have gone through a proper post-harvest process
d. Consistency of the coffees sold (an exporter or area will achieve higher price if the buyer knows what he can expect)
e. Reliance of service (comply with contractual agreements such as delivery time frame, sampling, documentation, product quality)
f. Quantity consistency (long term stability of quantity of specific qualities supplied to the market)

Achieving best quality starts mainly from the consciousness that quality is remunerated adequately and from the knowledge how to produce higher quality. To this effect, extensive training in agricultural practices, post harvesting processes, and agricultural and business management as well as cupping is required.
Given the fact that focus on quality has allowed many coffee producers or co-operative to achieve better results, the factor quality has been assigned relatively little importance in the code matrix.

The detail indicators for quality requirements in the 4Cs matrix are currently being developed. Further analysis is pending.

d. Missing principles

As already mentioned the 4Cs is a code for the entire coffee community. It indicates: "… establishes a new basis for competition with regard to the quality of the product …". Extended over the entire coffee community, the code matrix does not explain how this 'new competition' is being addressed at the consumer side. It would appear logical that if focus on quality production is given in the initial stages of coffee production and post-harvesting processes, the efforts for increased quality should be extended to include the quality in serving coffees since this has been the major reason for reduced coffee consumption.
It may be that some quality aspects are already put in place for most of the trade, industry and distributors; nevertheless they should be included in the code matrix and undergo the same self-assessment and verification process as all other principles. After all, the Common Code is for the entire coffee community.

e. Creation of value

The final goal of sustainable coffee production means that every component along the supply chain can contribute their stake to the value creation of the final product in such a manner that its benefit is financing the relative expenses. In such a context, no outside support would be needed. On the way to this final goal, temporary support however is required.

This thought means that each production and processing business unit should strive for creation of value; and the sustainability initiatives should support them accordingly temporarily until that item becomes self-sustaining.

The social dimension creates added value in the sense that based on a better social ground work, workers have more capacity to focus on the labor itself and will show less absenteeism. Environmental dimension creates value in the sense that its activities have the world population increase the security and the probability of conserving the earth's resources balanced. Under the economic dimension the creation of value can be identified through measurements in quality (see previous point). Further possible measurements that create value, such as improved management practices, diversification, and commercial use of by-products have not been identified. Many sources of successful coffee farming however show that these measurements can make a difference in becoming self-sustaining.

With the creation of value being the key factor that drives sustainability (since it will lead to social and environmental sustainability if practiced adequately), we recommend to revisit this aspect in the code matrix.

f. Future coffee crisis

Coffee is a commodity that is subject to strong price fluctuations. The future may see again extended periods of depressed prices. The Common Code does not respond at all to:

a. What measurements can be taken to lessen the impact of a future coffee crisis on the coffee farmers and their organizations?
b. What actions are taken to allow farmers and organizations to respond swiftly and effectively to such a crisis?

Whereas education will have a long-term effect to prevent crisis and respond to them, most other principles aim mainly at periods of stable markets and growing business. Under prevention for crisis would be the strengthening of the local economy through alternative products and by products that are unrelated to the coffee market. This would also allow

coffee farmers to find more quickly an alternative income when the revenue from coffee does not cover the living cost anymore.
This goes in line with the conclusion of point e) above (creation of value).

In conclusion, the 4Cs code matrix represents a solid basis that should be expanded to the entire supply chain in the coffee business and contain more specific indications. This should be done even before the start of the testing phase so as to include the additional items in the testing phase.

Testing the Code

Projects under the Common Code have been categorized into two types: associated projects and pilot projects. Under associated projects fall activities supported in the coffee sector that have an effect on sustainability, but they do not test the code per se. Pilot projects are the actual projects that test the Common Code for its economic, social and environmental impact and measure its results.

The 4Cs have defined a two year window to test the code through the so-called pilot projects.
First pilot projects have been discussed, but their start has been delayed in view of necessary discussions and further definition of legal aspects. This, at least, is the information as it has been perceived by the public.

Testing the Common Code will require applying the principles and the framework as proposed in order to draw reliable conclusions about the code. Pilot projects shall only include the capacity building, which rely exclusively on the code matrix. Other capacity building such as programmes to increase customer service and cupping among many others must not be included, since this would falsify the results. Pilot projects are deemed to test the Common Code, so they can test only the criteria that apply to the Common Code.

Specifically, following items should be included in the test phase:

1. Different types of farms should include
    a. small-holders, medium sized and large farms,
    b. farms with good access to transport and farms with remote access,
    c. a representative distribution among producing countries,
    d. farms with rather good sustainable practices and farms with worst practices
2. Each test must include pre-assessment on each item in order to compare to post-assessment.
3. It will be very critical that the pilot projects can isolate the effects of the application of the code from any other variation that occur during the time of testing. To this effect it will be imperative that for each 4Cs stakeholder tested there is one control unit with the characteristics as close as possible to the 4Cs stakeholder being tested.

No project must be run for this control unit so that the comparison of the two will constitute a reliable result as to the impact of the application of the Common Code.

4. Testing will need to asses the additional expenses to comply with 4Cs criteria for several different types of farming units.
5. Tests on the ability of 4Cs Unit to compose a container unit with 4Cs coffee only.
6. Test the rigidness of control; i.e. can non-4Cs coffee be infiltrated in 4Cs system?
7. Thorough testing will be needed on verification methods, the intensity required and the relative costs.
8. Level of value that the market is willing to compensate for 4Cs coffee compared to regular main stream coffee.
9. Identification of perceived value added by the consumers expressed in monetary terms.
10. Precise definition of additional administrative burden with relative costs.
11. Testing will need to include accurate assessment of the cost for the overhead structure of the Common Code, including the legal matters, internal statistics and those run by independent third-party, organization of verification process and the general administration.

In order to guarantee transparency of the results, the testing should be either executed or supervised by an independent third-party organization.

There has been no official publication on how exactly the testing phase will be rolled out. Prior to the start, such conceptual work has to be published.

Real sustainable needs in coffee business

a. Process of assessing the needs

When putting together the code matrix of 4Cs and identifying what the coffee business needs to become more sustainable, a multi-stakeholder approach was chosen. Representatives from coffee industry and trade, from coffee production, from civil society and extraordinary members were invited to participate. The participants all agreed out of their own will and with the best intentions.
However, almost none of the participants had been elected officially from what constitutes the group she or he represented. Within the process of defining the code, a positive attitude towards the work achieved resided within the group of representatives. This was possible because all participants had come along a common path and developed the ideas jointly. When the code was presented to the extended group of stakeholders in the coffee business, many did not comprehend the outcome because they completely missed the process of constructing it. Therefore a clash of opinions was inevitable. Had the code been built over a longer period of time, allowing the representatives to obtain the approval from whoever they

represented, the divergence of opinion would have been less. No doubt, this would have involved additional, considerable resources which were not available at that time. Furthermore, building a code within a group that is quite close in itself bears the risk of excluding the opposing forces and those that are inside get carried away by the dynamics of the group itself. This group dynamics can still be perceived from those who stand behind the 4Cs, because they are fully convinced of the positive results. But since the result of a worldwide initiative on sustainability concerns an extremely wide range of people, it must be regarded as critical to the success of such an initiative that a larger number of people are included in carrying on this process – including the strong opposition.
This constitutes one of the elemental aspects that lead the concept of the 4Cs into such a broad non-acceptance.

b. Coffee wide sector needs

The difficulties in sustainable coffee production and processing stem largely from the volatility of the market and the reduced ability to cope with it.
In particular the extended period of depressed prices made it extremely difficult for many producers to invest, to react to any sort of happenings and to assure continuing education of their skills.
It can be regarded as "highly unfortunate" the coincidence that a substantial increase in production at the end of last century met with a reduced demand at the beginning of this century. These two occurrences resulted in a strong oversupply in the market.
The main reason for reduced demand is certainly the lower level of quality in traditional consuming countries such as Germany.
Is the solution now to add requirements to coffee production? It cannot be the intention of the 4Cs to drive small-holders out of the market that cannot fulfil the requirements – as some critics have suggested. What other steps would then the 4Cs concept do to correct the long-term market imbalance? As identified throughout this analysis the relationship of the 4Cs concept with the coffee market, and indirectly with the value added, is not obvious.

As with a patient who has suffered a heavy accident and for who time is an important factor in recovering, so will time help to correct market imbalances in the coffee sector. But there are methods of helping the patient reduce the time to recovery, for instance through physical therapy. Simplified to fit this comparison, applying physical therapy to the coffee business will help to accelerate the recovery. Since there were two reasons that lead to the market imbalance, both of the two reasons should be looked at under the concept of the physical therapy.

The reduction in demand of coffee consumption can be met through stimulation of the market. Promotion of new markets and in producing countries has been under discussion at the ICO. The 4Cs do not address this fact at all. A worldwide initiative for sustainability however should address this point; at least it should define how it believes to bridge this gap and may propose measurements of collaboration with the ICO. On the other hand, the

Worldwide Sustainable Coffee Fund has proposed a series of measurements for marketing which may be attractive to the 4Cs.

On the other hand, the increase in production cannot be 'corrected' by cutting part of the production. But part of the production can be diverted from mainstream market, i.e. into higher quality gourmet coffees (relying on the market stimulation mentioned above) or the process of identifying alternative uses can be supported. As a further alternative, support for coffee farmers in non-ideal locations for coffee growing to divert to alternative crops can serve as a stimulation to limit oversupply (A programme in this sense is currently running in Mexico).

In essence, it seems relevant that the two causes of the decreased sustainability, reduction in demand and increase in supply, are worked on to correct the problem. Adding requirements to coffee production such as under the Common Code does not seem relate to the causes of the problem at all.

c. Determining needs of sustainability

Sustainable coffee production can only be achieved if the people who produce, process, export and manage these processes know their business and succeed in achieving an economic benefit.

Behind each business there is a creative thought and a CEO that carries the philosophy of the business. Every coffee farm can be regarded as a business and the farmer is his own CEO. The farmer CEO therefore must stand fully behind his business philosophy and be able to apply his vision for being successful. This relation may seem exaggerated, but it constitutes where the coffee business should strive at. To allow the farmer CEO to develop his philosophy, business practices and experiences and become (more) profitable, there is no other way than having him go along this path on his own feet. There is no sense of providing him with a perfect tool; he has to go through the process of discovery himself so that he can stand behind it completely convinced. What he needs is the opportunity to learn and to define his own way of doing business.

This same concept applies to the coffee business in the coffee producing countries. Each country needs to define itself where it believes coffee production and processing should go to. The coffee market and the consuming countries can collaborate in the opinion building and the execution of the decisions taken, but should not interfere in the decision taking process. This applies to the definition of sustainability for the coffee business in each producing country.

<u>Value Creation</u>

The argument of value creation has been mentioned earlier under Practicality where the added value of the Common Code for the public opinion, governments and the coffee business' corporate governance was discussed. The present chapter looks into the creation of value for coffee production and processing.

Under 'Real sustainable needs in coffee business' we identified that the cause of the reduced sustainability originates in the extended period of reduced market prices. Apart from the efforts to balance offer and demand in coffee, the creation of added value for coffee producers and processors can be a form to increase sustainability.

The retention of added value in coffee producing countries can be achieved by a number of practices:

a. Include additional processes that increase the value of the product
b. Improve the physical and physiological characteristics of the product for which the customers are willing to pay a higher price
c. Increase and/or improve the service to the customer
d. Forward integration
e. Eliminate unnecessary cost factors
f. Improved collaboration with other stakeholders in the coffee business in terms of marketing efforts

The Common Code addresses mainly item e) under its social and environmental dimension. We believe that there may be further considerations to be added under item e) mostly in terms of improved business practices, such as use of synergies, elimination of duplication of work processes, streamlined communication, and improved co-ordination among different stake holders.

Item b) is touched under the quality aspect in the Common Code, but as shown under paragraph quality above, this needs further definition. Item f) is also being touched by the Common Code, but does not focus on marketing and the creation of value for the end consumer.

Items a), c) and d) are not treated under the Common Code. It may be questionable whether all these items should be addressed in a Common Code, however these items lead to increased value retention in the producing countries and, therefore, to increased sustainability.

Producing countries, and in particular the businesses involved along the supply chain in the producing countries, may have a strong interest that these items be treated under a global sustainable initiative. One may add, that trade and roasters may also have an interest as they potentially can also harvest from an effort of added value in the practices mentioned, in particular b), c) and f).

It is clear that many of the above items cannot be addressed in great detail in a code, but the disposition to work on them should be contained.

Small holders

The entities in the coffee supply chain who have suffered most from the long-term low price levels and who show the highest need to increase sustainability are the smallholders. They are the ones who generally have low access to financing and almost no resources for investing in their production capacity.

The Common Code addresses the need of the small holders under social dimension, category 6 “capacity and skill development”. Most of the other social dimensions apply to workers who generally are employed temporarily during the harvesting periods. The small holders, i.e. the owners of small plantations of only one or a few hectares are not concerned by the social dimensions except for capacity and skill developments.

It may be assumed that the benefits of increased sustainability achieved at the 4Cs Units are passed on along to producer associations and to the smallholders. This assumption does not seem to be a strong enough evidence in view that one of the goals of 4Cs is to allow small holders to become more sustainable and a more secure participant in the free market. In any instance does the 4Cs address specifically how the small holders will benefit from the Common Code.

Furthermore, the 4Cs include several aspects that may limit the small holders even further and eventually drive them out of the business. For instance, if they are not lucky enough to be part of a sustainable project, they would have to finance the investment themselves or be excluded from a possible premium. Further, the premium risks not to be passed on to the small holders or at least not in the size to cover their investment. Then, some items of the 4Cs code matrix are more burdensome to the small holders than that they may support them whilst excluding measurements that could be beneficial to them.

At this point we simply would like to raise the question whether those who most need support will be able to take their stake of the cake under the Common Code? Wouldn’t there be a mechanism that is more geared towards them?

Capacity building

(Sustainable projects in coffee producing countries)

Along the 4Cs process producers have manifested their preoccupation that participating in 4Cs will cause investments to be made for which no financing was available. The rules of participation of the Common Code include therefore that "participants strive to contribute to capacity building …, but decide about the nature, scale and amount of their contribution to capacity building activities on a voluntary basis."

Whilst it is clear that participants cannot compromise in any form, extension or type of capacity building, this formulation is, again, extremely vague and may inclusively lead to undesirable business practices.

a. Conflict of interest

The fact that the same purchasing participants (the trade and industry) will be the drivers for the projects in producing areas is an evidential conflict of interest. On one hand they are interested in obtaining the coffee at the most favourable condition (as per the laws of the market) and on the other hand they have to act in the most sincere long-term interest of the coffee producers. This twist of interest is impossible, even when having the best intentions.

When assigning projects to producers, the purchasing agents will – naturally – seek to secure supply of the coffees in advance and the producers would have to commit selling it in advance to a specific party. This limits the producer to act freely when he is ready for selling and provides an advantage to the purchasing participant. In this sense, the industry is likely to draw much benefit out of the investment – and they are not even to be blamed, because they act according to the rules set up by 4Cs.

Not only the danger comes from the fact that the trade and industry will have to bear a double hat, also producers will try to position themselves to be assigned projects. First of all, this will favour those producers who have already a rather strong relationship with the purchasing participants and disfavouring those who most likely need the project assistance most. Secondly, this practice supports corruption in the fight for getting the assistance – and hence again disfavouring the weakest.

b. Inclusion of all stakeholders in capacity building

Capacity building will be extended to 4Cs stakeholders. Stakeholders that are very remote from a 4Cs Unit or rely on a weak organizational structure may not have sufficient means to make themselves noted on time or strongly enough to receive capacity building. The Common Code does not foresee measurements on how to assure that the stakeholders that in fact need most capacity building are considered for capacity building.

Part of the commitment form traders and roasters is the financing and coordination of sustainable projects. If a small or medium sized trader or roaster wants to participate in the 4Cs he most likely will not have the capacity to drive projects in the origin on his own. Since the 4Cs is open to all participants in the coffee business, the 4Cs should include a solution how small and medium sized firms can participate in the sustainable projects to fulfil their commitment.

c. Coordination of capacity building

The fact that each purchasing participants of 4Cs will be deciding on the place, nature and scale of the capacity building bears a strong potential danger of uncoordinated measurements that lead to

a. waste of resources through duplication or unnecessary projects
b. bad investments due to the missing long-term focus
c. non support of critical elements along the supply chain
d. investments that are not in the interest of the producing country, the region/state or the 4Cs stakeholder itself
e. Globally the administrative cost increases due to the fact that the different actors do not and cannot co-ordinate their efforts

d. Transparency

The proposal that the purchasing participants are the investors in the sustainable projects will undeniable exclude transparency from what is being achieved and who contributed to it.
The only way of achieving transparency would be if for every project it would be stated clearly how much each financing partner invested into the project and yearly reports would be published on the status and what exactly has been achieved.

We therefore strongly recommend that capacity building is reported and co-ordinated with the national (coffee) authorities and must be executed by an independent institution and not by a party with interest in buying and selling coffee.

Attitude

As mentioned above, the work out of the Common Code, the management thereof and the discussions within the steering committee have been held within a relatively closed circle of people. This has created a good group dynamics, but has excluded others.

There is a general feeling of exclusion from many stakeholders in the coffee business. This has been manifested ever since the ICO Meetings in September 2004. Instead of trying to reduce this feeling by having additional stakeholders included in an even somewhat broader, open discussion on the Common Code, the general communication from 4Cs officials has been of the style to assure that the Common Code is beneficial to all and that it will move forward. Even if the intention was to be convincing on those who had reserves, the effect was the opposite, namely that it was perceived that no questions are allowed on the Common Code.

In addition, 4Cs officials have insisted that the Common Code was a dynamic process and that adjustments were being made. For people interested in seeing the developments and even those who could have contributed to the discussion in the Common Code with a creative input, did at no point have access to what exactly was being discussed. Apart from the official announcement in September 04, no further details have been released as to where the Common Code is moving until today, 10 months later (The several presentations held in the meantime did not reveal any breaking news). Further, no official communication has been made about the status of the phase II, the testing phase, even within 6 months after its official start. To add one more point, the official website is very much out of date (no further press statements have been added after September 2004, the Progress of the project's latest info states that it has started on January 1, 2003 and "will conclude on December 31, 2004"). In brief, Transparency of the Common Code is very low.

Isolated observations

1. The item that can bring added value to coffee production is quality. The determination of what quality is under the 4Cs concept has yet to be defined. The option to refer to ISO norms or to ICO resolution 420 is being discussed. This seems again a vague approach that does not add value over what the market compensates already today. The problem with ISO guidelines for coffee production is that they are standard procedures, whereas coffee production, blending and cupping has been and always will be a personal judgement on the taste and it is generally identified on the tongue and not by numbers.

2. The Common Code states that it is "a market-based and open initiative to promote and encourage sustainability in the green coffee chain". It has insisted numerous times that participation is voluntary. In its proposed form it includes a higher compensation of the coffees sold and a higher profitability of the producers and exporters. This increased profitability makes it for most of the producers and producer organization in the mainstream market a must to participate, because if being excluded, their work results in lower profitability.
   The risk of exclusion is in certain contradiction to the argument of being voluntary.

3. The social and environmental dimensions of the code matrix include some of the factors that can lead to reduced cost. If one could expect that the economic dimension would focus on the how to add more value to coffee production and processing, one will search for it in vain.

The economic criteria in the code matrix are altogether extremely vague and the categories of market information, market access and commerce are already today common practice. If not all coffee farmers have permanent access to latest price developments then it is a question of installations and not of imposing a rule indicating their right. If access to financing is limited, then it is a question of practical solutions to it (long term reliability, cost for interests is comprised in export price etc) and not of imposing the right of access to financing. Furthermore, how would verification apply to access of financing? If a coffee farmer does not have access to financing, is he excluded from 4Cs?

4. The Rules of Participation (which include the commitment the industry would give to participate in 4Cs) state very clearly that they are voluntary. It has been informed that they cannot be binding because of the anti-trust laws. This fact raises the question of the equality in the deal. Producers will have to invest in order to be able to participate under 4Cs programme, but the purchasing participants do not have to enter any binding commitment. If the rules of participation cannot include any firm commitment, wouldn't there be any other form of expressing their firm commitment?

Final conclusion

The Common Code tries to respond to a concern in the coffee business. Its principles are unchallenged; the code matrix may once become a workable frame, but much more work needs to be invested. The question of how to apply the matrix raises a number of strong incongruence and not executable concepts. The main questions are how to marry the code with every day's business, whether the code addresses the real needs, whether it can be efficient and whether it makes economically sense.

Based on the view of the enormous importance of the unsolved questions, we suggest that:

1. The 4Cs define further the code matrix and the detail indicators and what sustainable coffee business means for the entire supply chain, even until reaching the consumer. This includes basically
    a. Defining the code matrix with more detail.
    b. Extending the content of the dimensions into trading, roasting and distribution.

    This definition should find the approval of the majority of the business stakeholders and the governments concerned.

2. After completion of step 1, a discussion should follow as how to assure the distribution of the revenue of the added value a stakeholder produces (and to no disadvantage to any 4Cs stakeholder) and how it could be put into practice.

3. For the time being, that is until step 1 and 2 have not been concluded and a broader political and practical bases has been established, the concept of 4Cs should abstain from any effort to implement the code, namely from:
    a. Capacity building
    b. Verification process
    c. Purchasing / Trading of 4Cs coffee
    d. Testing

Meggen, July 10th, 2005