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2nd Consultative Forum on Coffee Sector Finance
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Summary report on the 2nd Consultative Forum on Coffee Sector Finance

Background

1. The 2nd Consultative Forum on Coffee Sector Finance ('the Forum') took place during the 108th Session of the International Coffee Council. The Forum's topic was:

> The role that producer associations, governments and other entities (e.g. the private sector, non-profit organizations or public-private partnerships) play, or could play, in making risk management and financing tools more accessible, and more workable, for small- and medium-sized growers.

2. The Forum's organizing body, the Core Group[1], selected the topic based on one of the central themes that emerged from the 1st Consultative Forum, which was chaired by Mr Michael Wheeler of Papua New Guinea (see Summary Report, CF-1/11): the important role that intermediaries can play in furthering small- and medium-scale growers' understanding of and access to risk management and finance tools. The problem statement developed by the Core Group is contained in document ED-2129/12.

[1] *The terms of reference for the Core Group of the Consultative Forum are contained in document ICC-107-18.*

SUMMARY REPORT ON THE
2nd CONSULTATIVE FORUM ON COFFEE SECTOR FINANCE

1. The Forum began with remarks from the Executive Director. He welcomed the participants to the Forum and provided a brief summary of the 1st Forum, which addressed the critical issue of the volatility of green coffee prices. The Executive Director helped to introduce the topic of the Forum: the role that producer associations, governments and other entities play, or could play, in making risk management and financing tools more accessible, and more workable, for small- and medium-sized coffee growers. This was an extremely important issue since, despite the existence of viable risk management tools, small and medium producers often found it difficult to gain access to these tools. The Executive Director commended the Core Group for organizing the event and selecting the topic for this Forum and noted that the invited speakers seemed to be very well qualified to spark a stimulating discussion of this topic. In particular, he congratulated and thanked Amy Karpel, the Chair of the Core Group who would also be chairing the Forum, for her tireless work and diligence in the preparation of this Forum.

2. The Chair further welcomed the panellists and observed that the Forum provided an excellent opportunity for different participants in the coffee sector to come together in order to share their experiences, explore new ideas, and identify synergies in dealing with the issues related to coffee sector finance and the mitigation of risk for small- and medium-sized coffee growers. She invited the experts to make short presentations on risk management and access to financing, and encouraged an active and robust exchange of views and discussion among all those present. She thanked the Core Group for its contribution to the preparation of this event, the panellists for coming to the Forum and sharing their expertise, and Banco do Brasil and the Conselho Nacional do Café for their generous sponsorship of the Forum.

Presentations

Jawaid Akhtar, Chairman, Coffee Board of India

3. The Coffee Board of India is the nodal agency for the overall development of the country's coffee sector since 1942. The role of the Coffee Board in making risk management and financing tools accessible to small- and medium-sized coffee growers is particularly significant since 99% of the 266,869 holdings in the Indian coffee sector are smallholdings below 10 ha. After liberalization of coffee marketing in 1996, the role of the Coffee Board was redefined as facilitator for the overall development of the sector. The Board provides research and development and transfer of technology; dissemination of information, including market information; promotion of Indian coffee in domestic and overseas

markets; incentives for developing activities aimed at improvements in productivity and quality, risk mitigation, value addition, etc.; and welfare measures for the children of workers and small growers. Risk management and financial tools available to coffee growers include: i) a rainfall insurance scheme for coffee which provides mitigation against irregular rainfall patterns during critical stages of the crop cycle; ii) a price stabilization fund to provide financial relief to very small growers (owning up to 4 ha) when prices fall below a specified level. (The annual price spectrum band used for this purpose is based on a 7-year moving average of international prices); iii) a personal accident insurance scheme applicable to small growers and workers for which the Government provides a 50% subsidy on premiums paid by growers; iv) interest subvention and refinancing schemes operated by the Coffee Board, the Central Bank, the National Bank of Agriculture and Rural Development. State and provincial governments also provide various interest subvention schemes for loans of different categories. The Board develops the schemes mentioned at i) and ii) above as well as its own interest subvention scheme, in consultation with the implementing agencies (wherever applicable) and acts as a link between growers/growers associations and the government/implementing agencies. Information is widely disseminated through the Board's website and through radio, TV, newspapers , magazines, pamphlets, etc. There are very few growers' cooperatives in India but growers' associations help to disseminate information among their members.

Ernesto Fernández Arias, Undersecretary of Agriculture, Ministry of Agriculture (SAGARPA), Mexico

4. The coffee sector is highly concentrated in Mexico, where financial intermediaries were forbidden for many years and there is no mercantile exchange for coffee. Because the concentration of the industry also helps concentrate risks, the Mexican Government established a programme to help stakeholders manage risks more effectively with the help of financial intermediaries. Over time, this has evolved from simple forward contracts to more sophisticated risk management tools marketed through financial institutions. The current system is based on the use of put options, using an '85-50' modality. The scheme is designed to alleviate one of the most common impediments to greater utilization of put options as a risk management tool – the concern among potential purchasers that the cost of purchasing the option would be wasted if the put is never exercised. Under the Mexican Governments' programme, therefore, producers who purchase put options can recover up to 85% of the premium from the Ministry of Agriculture if the option expires without being exercised. Other stakeholders in the supply chain can recover 50% of the premium if the option expires without being exercised. Neutral arbitration is used to resolve issues related to quality and contract enforcement. The programme helps to manage risks and provides transparency in price, quantity and supply.

Xinia Chaves, Vice Minister of Agriculture and Livestock, Costa Rica

5 The Coffee Institute of Costa Rica (ICAFE) regulates the framework under Law No. 2762 that promotes fair relations in the coffee sector among producers, mills, roasters and exporters, which is based on over 40 years of experience in the regulation of the Costa Rican coffee sector. ICAFE operates a programme that helps to mitigate risk throughout the marketing year, by providing for the monitoring, registration and verification of coffee marketing at all phases. All coffee is manually harvested and most small producers are funded through mills registered and monitored by ICAFE. Producers receive a partial payment when the coffee cherry is delivered to the mill, which must officially register the total coffee received. This advance payment, which is a key feature of the equitable model, helps producers to finance their husbandry and harvesting costs. Mills must report to ICAFE all green coffee sales, which must be in line with prevailing international prices and differentials. Contracts for transactions are registered at ICAFE and mills are required to make quarterly adjustment payments according to sales. Final payment prices are published in the Costa Rican press and mills must pay the balance due to producers (after deduction for expenses and profits, which are fixed by law at 9%) within eight days. Currency hedges are used as protection against exchange rate variations. The equitable coffee marketing model operated by Costa Rica ensures that producers receive 80% of the price of each bag sold, a final payment system that is unique in the coffee growing world.

Edilson Alcântara, Director, Coffee Department, Ministry of Agriculture, Livestock and Food Supply, Brazil

6. The Coffee Economy Defence Fund (FUNCAFÉ) is used for a variety of purposes, including the provision of: finance for husbandry, harvesting and stocks to growers; finance for purchases of coffee by the local industry and trade; working capital for the Brazilian soluble industry; resources for the rehabilitation of damaged coffee farms; and options contracts and other exchange-based instruments. New risk management mechanisms were introduced in 1994 based on payments to coffee growers or cooperatives on the basis of future sales: the CPR (Rural Product Note) and the Warehouse Certificate (CDA/WA). The CPR enables coffee growers to make a forward sale of part of their crop, receiving cash or loans and assuming an obligation to deliver a specified amount of coffee at a future date and specified place. The instrument can be traded on commodity exchanges and hedged. Selling the crop in advance assures the marketing of production at a fair price and reduces dependence on subsidised credit. The Warehouse Certificate (CDA/WA) can function as a guarantee for loans and forward sales. All transactions are operated within an electronic system. The Fund also operates various options contracts in futures markets as hedging mechanisms to mitigate risk. Since coffee farmers tend to be traditionalist in outlook, the

Fund is seeking to change grower attitudes by using appropriate language to disseminate information on balancing prices and the way the market operates, promoting improvements in marketing, instilling a future-oriented vision, and encouraging producers to become more entrepreneurial. The new Brazilian model for agriculture envisages greater security for stakeholders, forward leaps in quality and productivity, and the consolidation of partnerships.

Matt Horsbrugh, Head of Trading, Twin Trading Company

7. Twin Trading's involvement with building risk management capacity for smallholders (defined as those farming lots of between 1 and 10 ha) evolved from the price volatility of the late 1990s. Twin has conducted over 200 training workshops in price risk management in Latin American and African countries, with funding provided by various stakeholders including roasters, coffee traders and finance organizations seeking to reduce risk on loans, and social finance lenders. Twin's objective is to strengthen smallholder producer organizations' ability to manage market risk by holding participatory workshops with practical classes, presentations and team exercises to foster better understanding of terminology and tools. The training workshops have a duration of two to five days and are designed to be adapted to each season, seeking to assess the strategy employed and apply the lessons learned to the new crop. In addition to developing information bulletins in selected countries, Twin has also established an Internet platform to provide an online tool that allows users to access information on the workshops and receive market analyses. The challenges facing the Twin Price Risk Management Programme include: lack of management capacity among smallholder producer organizations; problems with obtaining finance; the need to develop the use of traditional hedging tools such as futures and options; developing an understanding of market movements and differential movements in prices; and the lack of access to currency risk management tools. Twin believes that since the 2-day workshops are too concentrated, it would be useful to hold special workshops on managing pre-harvest, harvest and post-harvest sales. Risk management training provides smallholders with opportunities to improve business efficiency and to supply assurance to traders and roasters, as well as to lenders. One of the lessons Twin has learned is that risk management support needs to be ongoing since it encourages producer organizations to access international markets directly and gain a better understanding of the market, which in turn helps assure that traders will have access to sustainable certified coffee.

Marc Sadler, Team Leader, Agricultural Finance and Risk Management Unit (AFRMU), Agriculture and Rural Development Department, World Bank

8. The Agricultural Risk Management Team (ARMT), which is part of the World Bank's AFRMU, focuses on assisting clients in identifying and managing agricultural risks. Clients

include: governments (at macro level); banks, insurers, farmer associations and exporters (at meso level); and traders, cooperatives and farmers (at micro level). ARMT funding comes from the Swiss Secretariat for Economic Affairs and the Dutch Government. The development of an appropriate risk strategy is dependent on risk identification, assessment and prioritization to ensure that the risk-mitigation strategy focuses on the most significant risks facing the organization. ARMT has assisted in developing a risk management strategy based on supply chain risk assessments for the coffee sectors of Haiti, Cameroon, Vietnam and Uganda. Assessments identified, quantified and prioritized key risks facing the sectors and stakeholders in order to develop a comprehensive risk management strategy involving assigning and layering risk to ensure that levels of risk are managed effectively by the most suitable stakeholders. Farmers and cooperatives, for example, can reduce risk by improving agronomic practices, ensuring greater water-use efficiency and irrigation, introducing improved varieties, and forecasting, while cooperatives can transfer risk by arranging insurance provision. Governments can intervene in the case of catastrophic events that generate substantial losses for the entire supply chain. ARMT aims to collaborate with the ICO to undertake an exercise to examine coffee sector risk and access to finance. The goal of the exercise would be to gain a better understanding of how unmanaged risks restrict finance and how improved risk management releases finance. Collectively, the Consultative Forum has the knowledge required to distil more information for ICO countries. The World Bank and the ICO could draw up a typology of risk to provide assistance for producers and Governments.

Discussions and issues

9. The presentations were followed by an exchange of views among panel members and discussions with all participants on the issues raised. Additional issues raised by ICO Member delegations included: the need for an institutional and legal frameworks and effective public policies that can facilitate small farmers’ access to finance and risk management tools; the importance of training for farmers about the benefits of existing programme so as to encourage wider participation; the importance of transparency throughout the supply chain, including education for lenders about risks in the coffee sector to instil confidence in them to lend in the sector; the need to balance programmes aimed at mitigating price risks versus developing the coffee sector as a whole; concerns about marked growth of speculation in futures markets, making it more difficult for all but the largest actors to effectively use these markets to hedge; and strategies to build upon and adapt elements of successful finance and risk management programmes in new contexts, bearing in mind the highly idiosyncratic nature of risk management and financing tools. The main points raised are summarized below:

- **The role of an institutional and legal frameworks**

10. Governmental institutions such as the Coffee Board of India, the Ministry of Agriculture of Mexico (SAGARPA), the Coffee Institute of Costa Rica (ICAFE) and the Coffee Fund of Brazil (FUNCAFÉ), provide valuable assistance to small- and medium-scale coffee growers in the form of finance and risk management tools, including through: administering insurance schemes covering weather risks and damage caused by pests and diseases; guaranteeing funds to provide small and medium farmers with greater access to credit for risk mitigation; and funding systems developed through various institutional frameworks, whether through a 'coffee fund' approach providing assistance throughout the supply chain, or as contingency measures. The Coffee Board of India, SAGARPA, ICAFE and FUNCAFE highlight that well designed government institutions and legal frameworks are instrumental to the development and implementation of effective public policies aimed at addressing growers' finance and risk management needs, whether in highly regulated or liberalized marketing environments. Institutions and legal frameworks can also create enabling environments that encourage the creation and introduction of innovative products and methods to facilitate growers' understanding of, and access to, finance and risk management tools. Further consideration should be given to identifying successful elements of existing institutional and legal frameworks that could be expanded upon or replicated in other contexts to address growers' finance and risk management needs.

11. Further thought could also be given as to whether participation in government-sponsored finance and risk management programmes should be voluntary or compulsory and what incentives might be used to encourage participation. In addition, consideration could be given to whether coffee funding should be aimed at short-term protection or medium- to long-term development. A related issue is how to achieve a balance between solutions aimed at ensuring food security and income generation at the household level and those aimed at addressing finance and risk management challenges at the commercial level.

- **Importance of effective communication and education regarding finance and risk management**

12. There is a need for countries to invest in ways to effectively communicate with farmers about finance and risk management. For example, information about put and call options, which are complex financial operations, should be couched in terms familiar and understandable to non-experts. Education about the benefits of existing finance and risk management programmes is needed to help to achieve wider participation in those programmes, since producers are more likely to voluntarily participate in these programmes once they understand the benefits involved. Financial literacy training for nearly all

participants in the coffee sector would also be beneficial. For example, as farmers gain a better understanding of their costs of production and how prices are constructed, they will be better positioned to recognize the optimal price for their coffee and how available prices relate to their profit margins. It was noted that changing the 'culture' of coffee growers, who may be reluctant to participate in existing finance and risk management programmes or adopt new approaches, begins with effective communication and education.

- **Identification of beneficiaries**

13. Since they constitute the base of the supply chain, growers are a natural beneficiary of risk management programmes. Growers, however, do not operate in a vacuum and the involvement of other stakeholders, such as industry, trade, suppliers of inputs, and financial institutions, is necessary to find solutions to finance and risk management challenges. A related issue concerns the goals of risk management programmes. Those that are geared to social protection must have a different structure than those that seek to foster commercial development. The institutions implementing these programmes must have a clear vision on where they stand in this regard.

- **Transparency across the supply chain**

14. Transparency was highlighted as a critical factor in making finance and risk management tools more accessible and more workable for small- and medium-sized producers. It was noted that it becomes easier to devise innovative win-win solutions as different actors throughout the supply chain gain a better understanding of the respective roles of, and risks faced by, other actors in the supply chain. For example, as lenders better understand the coffee sector and risks involved, they will gain greater confidence in their ability to manage risks and invest in the sector. There are ongoing efforts to train lenders about the coffee sector, and expansion of these programmes could be effective in encouraging lenders to make additional financing available for small- and medium-sized coffee producers. Additionally, it was highlighted that risks faced by actors at the end of the supply chain decrease when risks faced by those at the start of the supply chain – i.e., coffee growers – decrease. This creates the potential for win-win solutions, such that as growers are better able to manage risk and gain access to finance coffee traders and roasters are better able to manage the risks they face. It was noted that a detailed understanding of the respective roles and risks faced by various actors in the supply chain may be unnecessary; what is important, however, is a basic appreciation of the various roles and risks of different actors. Opportunities for producers and exporters to communicate and work together to resolve conflicts were noted as important and could be facilitated by appropriate government institutions and frameworks.

- **Time frame and lessons learned**

15. It was highlighted that the finance and risk management programmes implemented by Brazil, Mexico, India and Costa Rica were the result of a long-term process of development. They reflect years of work and a number of improvements to address challenges encountered in the programmes' implementation. There are also other programmes lead by governments as well as non-governmental institutions and organizations that are making a positive difference in producers' ability to manage risk and access finance. These programmes provide building blocks to devise solutions for coffee growers for which finance and risk management tools remain unavailable or underutilized. The key will be to identify successful elements of existing programmes and adapt them in ways that can address the needs of those growers. It was emphasized that risk is highly idiosyncratic and that adapting successful elements of an existing programme for use in another context must bear this fact in mind and begin with an evaluation of the particular risks in a particular market. There is no model solution that could work across all countries; but individual countries need a model or plan based on the reality in their country and institutions to implement that plan. Further consideration should be given to identifying first steps that countries with limited risk management and finance strategies might take to develop and implement more effective programmes for their coffee growers, and to the role governments can play in creating enabling environments to encourage non-government institutions to contribute to finance and risk management solutions for small- and medium-sized coffee growers.

- **Other issues**

16. It was raised that the increased involvement of non-commercial players and speculators in the coffee market continues to pose challenges for managing risk associated with coffee price volatility. Risk management problems were included in the G-20 agenda under the Mexican Presidency and would be on the G-8 agenda under the United States Presidency.

Chairperson Summary

17. The Chairperson said that this Forum represented a significant step forward in the evolving process of consultations on topics related to finance and risk management. Key issues to be explored in greater depth include:

- ways in which to develop a typology of best practices in this field for adaptation and use in different legal and institutional frameworks, particularly for countries that are in the early stages of developing finance and risk management programmes for their coffee sectors;

- the interaction between institutional actors, such as cooperatives and growers associations, with overall government policy;
- forms of stimulating grower participation in risk management and financing schemes, for example through improving growers' financial literacy and understanding of programme benefits as well as through incentive schemes;
- the need for transparency and understanding of respective roles and risks throughout the supply chain in order to promote cooperation and win-win solutions among different actors in the supply chain; and
- the role governments can play in creating enabling environments to encourage innovation solutions to address growers finance and risk management needs.

18. Finally, it was noted that no common model exists that can be applied across the board in all producing countries, but that valuable lessons can be learned from the experiences of others.

Thanks

19. The Chairperson thanked the invited speakers for their valuable contributions, the Secretariat for its assistance in the preparation of the event and the sponsors for making the Forum possible.