

# **WORLD COFFEE CONFERENCE**

**May 18, 2001 London**

## **Session three: Major Supply and Demand Trends**

### **Presentation by Michael R. Neumann**

Chairman Dr. Jorge Cardenas – it is an immense pleasure to be joining in this great effort of the International Coffee Organisation and of yourself here and now. Thank you for the opportunity.

Your Excellencies,  
Ladies and Gentlemen,

The first two sessions of this conference handled macro topics. Congratulations to the speakers for their enlightening insight into the global political and economic framework within which our coffee industry operates.

The subject of this session – major coffee supply and demand trends – brings us much closer to the real world of coffee and its present and future predicaments and challenges:

I want to use this opportunity to thank and congratulate the conference chairman for putting together such an extraordinary group of the most competent entrepreneurs and managers to handle this challenging theme together with me this afternoon. Before our coffee break at about 4 p.m. we will have the privilege to listen to

Mr. Jorge Esteve of Esteve S.A., Santos  
who will explain to us the case of „Coffee in Brazil, history and a 3 year outlook“

followed by  
Mr. Doug Burns of Kraft Foods International, Brentford  
with his views on the „Growth in the global coffee industry“

Mr. Gordon Gillett of Nestle S.A., Vevey  
on „Growing the World’s Coffee Consumption – Nescafe a Global Brand  
Opening Up New and Increasing Coffee Demand“

and  
Mr. Robert Nelson of the National Coffee Association of America  
analysing „Consumption and demand trends in the U.S.“

Mr. Helmut Ahlfeld of F. O. Licht, Germany  
has prepared a paper on „Coffee – the next 5 years“.  
Unfortunately Mr. Ahlfeld has fallen ill and I am grateful to  
Mr. Donald Spence for delivering his friends statement to us this afternoon.

Before I open the floor to our first speaker, here are a couple of observations to approximate our present status in the world-wide coffee industry: A German merchant proverb tells us that 'a business is truly good only when it is good for all its parties'. By this measure the coffee business is bad today because the producing side finds itself in a severe state of crisis. What can we do to alleviate this situation, to cope and by which means can we begin to avoid the next bout of crisis in a few years time.

This present harsh period is quite unique, not comparable to former cycles.

Sure, the years 1994 to 97 with their good prices typically triggered some pro-cyclical additional production. But this effect would barely have been enough to satisfy growing world demand. No, the real causes of our troubles today are much more structural: The 90's, globalisation, the opening of markets world-wide after the end of the Soviet Union and the fall of the Berlin wall.

In Vietnam this phenomenon was called Doimoi and for coffee it worked better than any fertilizer. And some illguided council of international donor organisations significantly added to the problematic. One seriously wonders why nobody ever asked during all these years, where and by whom all these additional volumes of coffee were going to be consumed?

I find that there is little reason today to make Vietnam the culprit while our own representatives strongly gave the advice that this was a good policy to follow.

And then there is the Brazilian case: the re-creation of an entire coffee economy in the last 10 years on account of favourable macro conditions: the victory over inflation in the early 90's, the introduction of free market play in coffee, state of the art production methods and sophisticated management and administration know-how in the country side: These factors generated not only significant additional production but – more important – serious gains in productivity.

So between these two countries – Vietnam and Brazil – the world coffee market now enjoys an additional production capability of 20 million bags p.a. With all the differences of the 2 cases, what they have in common – in my view - is that both of them most likely are one time events.

Consumption in the world cannot absorb these quantities ad hoc. And this is so even though, after years of growth between 1 and 1.5 mio bags per year, consumer offtake is likely to increase by 2 mio bags plus during 2001. Four years like that and the slack in supply and demand would be gone – granted at static conditions and for sure the coffee world will not be static, if only because no producer respectively producing country can survive several years of price levels below the cost of production.

So what are the answers to these pressing problems? I am sure that my colleagues will shed some light on these difficult areas. Towards the end of this part of our session I will make a few proposals of my own. Thank you for your attention.

Jorge, you have the floor:

After these excellent presentations and before turning this complex of subjects over to our round table, I would like to present for your consideration three practical proposals for the future strategic management of the coffee market.

We all realise how much the world has changed in the last ten years. We cannot remain in a post-ICO mode. The role formerly played by consumer country governments has in many ways been taken over by some major global corporations and a small number of globally dedicated green coffee houses. Some donor organisations and numerous NGO's complete this scenario. On the other hand the communication revolution is increasingly creating consumer awareness. In consequence the commitment to conditions in producing countries on the part of major market participants has grown exponentially.

The old thinking by which producers and consumers are almost opponents has no chance today. Granted, occasionally there may be conflicting views between the quarterly P+L and sustainable midterm goals – sometimes a cultural question - but with today's food crisis in Europe, the subject of genetic modification in cereals among so many other aspects, no CEO worth his salt would risk disregarding aspects of social and ecological sustainability when defining a raw material policy.

All companies – private and public – will be measured by this new benchmark: ‚responsible business‘. And before anything else this will mean remunerative prices for the productive modern farm base as well as for the average cost producer. I should mention though that political trigger prices which will protect the highest cost producers in high cost countries will be counterproductive.

This new scenario offers a host of possibilities for fruitful cooperation between producers and branded product companies respectively major green coffee service groups. Private public partnerships are very modern. They should be tried in organisation of the world coffee market, in order to correct cyclical imbalances of supply and demand – up to the point of joint stock programs.

My 2<sup>nd</sup> proposal has to do with production and market tenors. We are all aware that to produce a coffee bean will take on average 4 years from the point of the investment decision. And still I would guess that more than 75 % of all coffee will be marketed for three months deliveries and less. Selling possibilities in excess of one year are practically nil. There is something profoundly wrong here. National regulations in producing countries often subject the farmer to the worst kind of speculation possible: that of putting his money and effort into producing a crop without the slightest idea what his produce will be worth when harvested. I advocate that we need to design contract farming patterns which give security to the farmers by making volume and price arrangements for up to 5 and 7 years. The price should be based on production cost plus a risk premium and a reasonable profit. Such marketing would allow every type of cooperation between the producer and the final user on quality and other aspects from farming methods to mill investments and logistics.

Producer country governments and donor organisations would be called upon to create regulations and warranties to promote such long-term marketing and permit smallholder producers to come into the system. I am encouraged by the fact that a project under study by the Worldbank clearly moves in this direction.

Incidentally I would venture that the notorious coffee market volatility would be significantly reduced once a certain percentage of world trade would be covered by such long-term marketing. We would help the producer to become much more rational and reduce the speculative element which today's mechanisms force on him.

My third and last proposal would largely follow the same objective. We live in the age of knowledge and information. The entire world is communicated online. Every aspect of most economic contexts is analysed many times over and the information often is available on a click of a mouse. But this information age and that analytical capability has generally not arrived on the coffee farm.

A farmer large or small in so many countries usually takes his investment decision in some way emotionally – anyway without any degree of objective analysis. Often he stakes his entire livelihood on such a decision.

I propose that we need to establish a world-wide, internet-based database on coffee. On the production side simple empiric information on a large scale should be made available: How many coffee trees were planted world-wide this year, last year and the year before? Of which variety are the new plantings? Will they be irrigated or not? Which countries will have on or off years in their producing farm bases. A study on production cost per country on unified criteria etc. etc. Strangely enough I think that consumption probably will not require the same attention. Unless we should have cycles of exorbitant prices a slow and constant growth of world offtake can be assumed.

The study I propose must be guaranteed to be neutral and objective. The job to produce such an ongoing database should be entrusted to a first class university with particular qualifications for this job. In so far as funding goes, again I happen to think that there should be a private public partnership foundation. I know of 1 or 2 big corporations in coffee which have shown strong interest to get involved in such a project the same as I know of at least 1 important donor organisation with a keen interest.

The dissemination of such information should be available at a nominal price to farmers world-wide, to farm management companies and cooperatives, to banks, the coffee trade and the roasting and soluble industry along with government organisations in all coffee producing countries.

The results would be manifold. It would make the supply side of coffee that much more predictable. This would help millions of farmers to take more rational investment decisions. The information would certainly help the banks and assist governments to set the right rules. Eventually it will to some extent level production cycles of coffee and even create a juster and more equitable farm business to the benefit of the entire coffee economy world-wide.

Thank you for your attention.