

# **Roaster Decision-Making for Coffee Certification: Specialty Coffee Roasters in the North Carolina Triangle Region**



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**Roaster Decision-Making for Coffee Certification:  
Specialty Coffee Roasters in the North Carolina  
Triangle Region**

**By**

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## **Abstract**

In recent years the use of standards and certifications has gained attention among a wide array of groups indirectly and directly related to trade. Standards and certifications for commodities, such as coffee, have emerged at a time that coincides with policy supporting free trade. The debate over free trade and its impacts on stakeholders involved in commodity trading has led to the rise of advocacy groups supporting ethical trade. These groups often use standards and certifications as a means to support and encourage ethical trade. While certifications in coffee such as Fair Trade, Organic and Shade Grown/Bird Friendly have grown in recent years, little is known about why coffee roasters opt for certifications. This paper focuses on roasters, the key intermediary in coffee production that makes the decision about whether or not to purchase certified coffee. Using a value chain framework, the paper analyses why and in what conditions roasters decide to become certified. Specialty Coffee Roasters in the triangle region located in North Carolina were interviewed to provide primary data in regards to their decision-making. While there were many reasons that influenced roaster decision making, the most surprising finding was that the supporters of the ethical trade movement, of which a significant amount are students and activists, were not the consumers purchasing certified coffee.

## **Chapter 1: Introduction**

The recent proliferation of standards has emerged at the same time as “free trade” policy. The debate over free trade and its impacts on stakeholders involved in commodity trading has led to the rise of advocacy groups supporting ethical trade, and often times that is reflected in the role of standards and certifications. The use of standard as a tool to convey information has flourished in recent years and there are many signs that it will continue to grow. Furthermore, the use of certifications, which is a third party guarantee of standards, is also emerging as an important tool to provide consumers with reliable information regarding product production and characteristics.

While certification and chain driven labeling practices in commodities such as coffee have grown tremendously in the past 10 years, surprisingly little is known about why firms - especially roasters, the key intermediary buyers of coffee - opt for certified coffee or join these new supply chains.

In the coffee supply chain roasters are the decision-makers that decide whether or not to purchase certified coffee. This decision-making is important because the livelihood of coffee farmers is dependent upon roasters opting to purchase the beans they produce. Since certification is presumed to improve coffee farmer's work conditions, growing certified beans (opposed to non-certified beans) is often viewed as a favorable livelihood for farmers. However, since certification appears to add to roaster's costs of monitoring and production, the question arises, why do some roasters join and not others? How do these supply chain changes impact coffee farmers? Secondary data is unable to explain the variables at play that influence why roasters decide to buy certified coffee.

Currently, a great deal of the information regarding coffee certifications is centered on the nature of certifications and to what extent they can improve social and environmental conditions. Existing literature tends to focus on one of two stakeholders in the coffee supply chain, namely coffee farmers or multinationals. By gathering first-hand information from roasters, I will fill a gap in our understanding of how certified coffee chains actually work and how they differ from non-certified coffee chains. I will then list reasons as to why and why not roasters are diverging from the non-certified coffee supply chain in favor of the new certified supply chain. Thus, the purpose of this paper is to gather primary data from coffee roasters and analyze why they adopt or do not adopt certified coffee.

An understanding of roasters decision-making is critical for analyzing the role certifications have in local economic development for farmers. Explanations of how roasters market their products, choose what percent of certified coffee to purchase, and their views on the certification process, among other things, will give clues about roaster

decision-making. Since roasters control the quantity of certified coffee beans that are purchased, they create the demand for certified coffee beans. With greater demand, more farmers can participate in growing certified beans. Thus, expanding the market for certified coffee beans has the capacity to promote local economic development for coffee farmers. But why is this important?

Coffee farmers generally live on the brink of poverty or in poverty. They are in a weak position to negotiate coffee bean prices, which results in coffee farmers selling their beans at very low prices. Most farmers rely solely on beans for income, and therefore; are unable to climb out of poverty. Certifications for coffee can help break the poverty cycle through paying fair wages and encouraging sustainable farming.



## **1.1 Contextualizing Coffee**

Coffee is the second largest traded commodity in the world, second only to oil. It is grown in tropical and sub-tropical countries, and employs over 25 million people worldwide (Fitter & Kaplinsky, 2001). Small farmers produce approximately 50% of the world's coffee supply (Waridel, 2002). Small farms are defined as not being dependent on permanent hired labor and managing their farm with their families labor force.

### **1.11 Challenges Faced by Small Farmers**

Traditionally, small farmers grew a variety of crops that they could consume and that provided daily sustenance. However, the trend of subsistence farming is waning. Many governments in developing countries are now encouraging farmers to shift toward monocultures, the production of a single crop on a farm, in order to increase exports and thereby decrease their country's debt. A common result is that farmers are forced to purchase food in the market, but are too poor to afford it. Thus, due to desperation for money small farmers sell their harvest to middlemen and become price takers. They are unable to bypass the middlemen because they do not produce harvests large enough to export them directly. Furthermore, many small farmers do not have access to credit or loan institutions and also lack access to information on trading prices.

Another obstacle for farmers is the expansion of the number of countries exporting coffee. Structural adjustment programs administered by the International Monetary Fund (IMF) and World Bank have encouraged developing countries to increase their exports, namely coffee. This change, along with the breakdown of the International Coffee Agreement in 1989, which predetermined supply levels through export quotas, has led to an oversupply of coffee. Furthermore, the inflexibility of growing coffee to meet sudden

demand changes and stockpiling coffee in developed countries has contributed to the supply problems. The oversupply of coffee on the market has driven bean prices down to prices comparable to 30 years ago.

The International Coffee Organization (ICO) estimates in crop year 2003/2004 101.5 million bags of coffee will be produced. In 2002/2003 119.74 million bags were produced. The drop in production can be attributed to the four-year coffee crisis where prices dropped over 50 percent. The annual ICO indicator price for a pound of coffee in 1997 was 133.91 cents and dropped to 51.91 cents in 2003. A summary of the annual ICO indicator prices is given in Table 3 (“International Coffee,” 2004). The price is the amount importers or secondary market makers pay for green beans.

Table 1: ICO Composite Annual Indicator Prices (US cents/lb)

<b>Year</b>	<b>US cents/lb</b>
<b>1997</b>	<b>133.91</b>
<b>1998</b>	<b>108.95</b>
<b>1999</b>	<b>85.72</b>
<b>2000</b>	<b>64.25</b>
<b>2001</b>	<b>45.6</b>
<b>2002</b>	<b>47.74</b>
<b>2003</b>	<b>51.91</b>
<b>January 2004</b>	<b>58.69</b>

The drop in coffee production (a decrease of 15.23 %) may be correlated to the low indicator prices. However, even with the increase from 2002 to 2003 the indicator price still remains extremely low. The income of coffee farmers is related to these indicator prices established by the markets of the New York and London stock exchanges.

In January 2004, the price was \$0.5869/lb of coffee. This value is the total amount received by the stakeholders involved in coffee production before it reaches the country of consumption. Possible stakeholders could include coffee farmers, processors, estate

owners, middlemen (coyotes), distributors, brokers and exporters. Dividing \$0.5869 among these stakeholders leaves little for each of them, especially those who have invested in capital and/or extensive labor into the production process. These international changes enforce a structure that suppresses the ability of farmers to climb out of poverty. Thus, their bargaining position has been on the decline.

### **1.12 Differentiating Coffee Can Help Small Farmers**

The question then becomes, how can farmers escape the poverty trap? The fact that coffee is a classic commodity means that it will inevitably produce variable and low prices. Commodities are marked by two characteristics; they are homogenous and have low barriers to entry. These characteristics result in high competition on the global market and thereby lower market prices.

While there is no definite or single answer, economic theory suggests that differentiating generic products can secure higher prices in the marketplace. Some scholars have begun to explore this concept in the context of coffee and have suggested that a method of decommoifying coffee is to create barriers to entry by “upgrading” (Fitter & Kaplinksy, 2001). Barriers to entry increase with higher end products because they involve more knowledge and time to produce. The extra steps in production impede entry of new competitors. It follows then, that if segments of the coffee market can be differentiated, or upgraded, the prices garnered will increase.

## **1.2 Differentiating Coffee in the Specialty Coffee Market**

### **1.21 The Specialty Coffee Market**

The specialty coffee market has been successful in differentiating their coffee from lower grade coffee. The Specialty Coffee Association of America defines specialty coffee as being drawn from, “special geographic microclimates (that) produce beans with unique flavor profiles.” Specialty coffee emphasizes bean quality and distinct flavors. The specialty coffee market has grown remarkably in the past few years. In fact, in 2001 specialty coffee accounted for 17 percent of total green coffee imports by volume into the US, while its sales represented approximately 40 percent of the 18.5 billion U.S coffee market.

More recently, incorporating sustainability concepts into the specialty coffee market has further differentiated the market from lower grade coffee and within the specialty coffee market. Sustainability concepts incorporate economic, environmental and social criteria. Sustainability concepts are described in detail in section 5.1.

Differentiating coffee through sustainable practices can lead to higher prices for beans on the global market, but will the distribution of gains be equitable among the stakeholders? Wages must reach the farmers in order for them to escape the poverty trap. A value chain analysis can provide insight about the aforementioned questions. A detailed description of value chain analysis is given in section 4.2.

### **1.22 What are standards and how do they relate to certification?**

Standards can be classified into one of three types: mandatory, private and voluntary. Mandatory standards are regulations set by governments. Private standards are created by individual enterprises. Voluntary standards, which will be the focus of this

document, may be developed by NGOs, and “arise from a formal coordinated process in which key participants in a market or sector seek consensus” (Ponte, 2002, p. 9). Over the past two decades businesses, government, and trade groups have increasingly adopted standards such as ISO 9000, a quality assurance standard, and Hazard Analysis and Critical Control Point, a food safety management standard (Nadvi & Waltring, 2001). The use of standards is on the rise. While there is no single reason for the rise in standards, some may be:

- Improvement of image
- Economic incentives
- Improvement of the quality of good being produced
- Anticipated fast change of government regulations
- Pressure from external sources
- Care for the community
- Better management and organization

While the reasons may vary, the trend of using standards is growing. The coffee standards discussed in this document are voluntary, not mandatory, which means governments, industry or any other group cannot require them. Certifications are typically given by a third party that verifies a product has been produced in accordance with a set of standards. The certified product is then eligible to use labels that display the certification, which informs consumers about the standards that were used to produce the product. Coffee certifications will be described in depth in section 5.2.

### **1.3 Methodology and Conceptual Framework**

#### **1.31 Methodology**

The scope of the study is the specialty coffee market located in the North Carolina triangle region. Most of the coffee in the specialty market is sold in coffee shops, coffee bars, gourmet food stores, natural food stores, high-end hotels and restaurants. With the growth in the specialty market a slim margin of supermarkets are also beginning to stock specialty coffee beans.

The study uses primary and secondary resources. The primary data consists of personal interviews with roasters. The roasters were chosen because of their geographic location. All of the specialty roasters with headquarters in the triangle region (Raleigh, Durham, Chapel Hill) were interviewed with the exception of three. Since there is not a national coffee roasting company that is headquartered in the triangle, a multinational coffee roaster was chosen that sold both certified and non-certified coffee with coffee shops in the triangle region. The interviews were conducted in the roasters facilities, which were typically a warehouse or an office attached to a warehouse. The names of the roasters are not listed to provide anonymity. Please contact the author if you have any questions regarding the roasters.

Secondary data from periodicals, books and websites were also used. The literature review consisted of information regarding the history and current state of the coffee trade, governments and companies that are involved, the formation of coffee standards, political and commentary articles on how and if standards work, and technical reports from international agencies on value chains and certifications.

### **1.32 What is a Value Chain?**

Global value chains are a relatively new method in which local economic development and organizational structures in production networks can be analyzed. The introduction of global value chains has been especially useful in helping contextualize the changes in supply chains resulting from standards. They “highlight the relative value of those activities that are required to bring a product or service from conception through different phases of production (involving a combination of physical transformations and the input of various producer services)” (Gereffi, et al., 2001 p. 3). The value chain framework is a way to analyze global supply chains and express information regarding stakeholder relationships. It describes how the production steps connect to one another. It can also be used to analyze the control and governance as well as the distribution of equities in supply chains. Value chains are distinct from supply chains because they go beyond simply identifying stakeholders and explain how chains are organized and managed.

The introduction of global value chains has been especially useful in helping contextualize the changes in supply chains resulting from standards. There are numerous ways in which a value chain analysis is useful including (McCormick & Schmitz, 2002):

1. Understanding problems of market access
2. Acquiring production capability
3. Understanding the distribution of gains along the chain
4. Finding leverage points for policy and organizing initiatives
5. Identifying funnels for technical assistance.

Coffee production is considered a global value chain, which means that by the time a coffee bean has been picked, roasted and sold it has traveled to more than one country, typically two. Each step of the coffee bean in the supply chain adds value to the bean.

Although coffee bean production can be regional or a sub-national value chain, which means the beans are picked, roasted and sold within the same county, this type of chain will not be included in this paper. Generally, regional and sub-national value chains receive the left over coffee, or the coffee that is not of high quality (i.e. producing countries receive the lowest grade coffee and export the best). Since the specialty coffee roasters do not purchase low quality beans, they do not participate in regional or sub-national value chains.

### **1.33 Limitations of Research**

Although nearly all of the roasters in the triangle region were included in this study, it is still a modest sample size. Therefore, the information in this document may reflect the decision-making and preferences of specialty roasters in this region and may not be representative of specialty roasters in other geographical areas. Due to time and financial constraints, the research only focuses on roasters, as opposed to all of the stakeholders involved in the value chain.



## **Chapter 2: Coffee Farmers and Coffee Certifications**

### **2.1 Coffee Farmers are at the Bottom of the Value Chain, Decisions Made by Roasters**

#### **Affect their Livelihoods**

Coffee farmers' weak bargaining power and inability to influence market prices has created poor living conditions. To make ends meet, some coffee farmers are migrating to urban areas in hope of finding better wages. More often than not, families end up living in squatter settlements, finding unstable employment in the informal sector, which arguably is a more precarious position than rural poverty.

Worldwide, the “real” (includes inflation) price of coffee has fallen. In 2002 it was “25 percent of its level in 1960 meaning that the money that farmers make from coffee can only buy one-quarter of what it could 40 years ago. This is probably the lowest real price farmers have been paid for coffee in 100 years” (Raworth & Wilson, 2002 p. 6).

Coffee value chains are buyer driven. In the specialty coffee market the buyers are the roasters or the secondary market makers. The buyers make requests either to importers or to cooperatives/estates/farmers regarding how many beans they wish to purchase, what quality of bean and by what date. The farmer who can best meet the needs of the buyers will have the greatest opportunity for selling their beans.

Low bean prices on the global market have been devastating to coffee farmers. Many farmers have been forced to sell their beans for below the cost of production. The result is beans are sold for a price that is lower than the price farmers invested in growing them. Value chains reveal that value added at a certain point in the chain is not always indicative of the money and time invested at that point. For example, in 1992 coffee export-producing countries captured 33% of the bean value. Ten years later, they only

captured 10% (Regssa & Aredo, 2002). While export countries are capturing significantly less proceeds and contributing significant labor and capital, import countries are realizing the highest profits ever. The value farmers are adding to coffee is not being passed down to them in the production chain. Growing sustainable coffee may help farmers combat the low prices and their weak bargaining position.

## 2.2 Sustainable Coffee Criteria and its Impact on Farmers

The concept of sustainability has been used in many ways. There is no precise definition, although the National Campaign for Sustainable Agriculture defines it as “farming that is economically viable, environmentally sound, socially just, and humane.” (“Specialty Coffee,” 2004, p. 9). The Sustainable Agriculture Network uses nine criteria to categorize sustainable coffee farming. Table 2 lists the criteria headings and the main objectives for each heading.

Table 2. Sustainable Agriculture Network Generic Coffee Standards (“Generic Standards,” 2002).

<b>Standard</b>	<b>Objective</b>
<b>Ecosystem Conservation:</b>	<ul style="list-style-type: none"> <li>▪ Conserve ecosystems on or near the farm</li> <li>▪ Protect forest and reforest where possible</li> <li>▪ Prevent and control fires</li> </ul>
<b>Wildlife Conservation</b>	<ul style="list-style-type: none"> <li>▪ Protect and enrich habitat</li> <li>▪ Protection strategies for biodiversity and endangered species</li> <li>▪ Proper location of farms</li> </ul>
<b>Fair Treatment and Good Conditions for Workers</b>	<ul style="list-style-type: none"> <li>▪ Employment policies should improve the standard of living for workers and their families</li> <li>▪ Conditions for contracting labor</li> <li>▪ Freedom to organize, freedom to opinion</li> <li>▪ Occupational health and safety</li> <li>▪ Housing and basic services</li> </ul>
<b>Community Relations</b>	<ul style="list-style-type: none"> <li>▪ Consult communities during the planning and development stages</li> <li>▪ Respect for community resources</li> <li>▪ Community development of neighboring farms takes</li> </ul>

	<p>priority for employment and training</p> <ul style="list-style-type: none"> <li>▪ Possession and use of land</li> <li>▪ Shared resources and responsibility</li> <li>▪ Environmental education</li> </ul>
<b>Integrated Crop Management</b>	<ul style="list-style-type: none"> <li>▪ Integrated pest management</li> <li>▪ Permitted and prohibited agrochemicals</li> <li>▪ Transport of agrochemicals</li> <li>▪ Storage of agrochemicals</li> <li>▪ Application of agrochemicals</li> </ul>
<b>Complete, Integrated Management of Wastes</b>	<ul style="list-style-type: none"> <li>▪ Reduction of waste</li> <li>▪ Reuse of waste and water</li> <li>▪ Recycle waster</li> <li>▪ Appearance of farm must be clean</li> <li>▪ Final disposition of waste must minimize human and environmental health risks</li> </ul>
<b>Conservation of Water Sources</b>	<ul style="list-style-type: none"> <li>▪ Protect waterways</li> <li>▪ Rational use of water</li> <li>▪ Contamination in bodies of water</li> <li>▪ Treatment of residual water</li> </ul>
<b>Soil Conservation</b>	<ul style="list-style-type: none"> <li>▪ New farms must be located on land suitable for proposed crops</li> <li>▪ Erosion control</li> <li>▪ Soil management</li> </ul>
<b>Planning and Monitoring</b>	<ul style="list-style-type: none"> <li>▪ A plan with objectives, goals, responsibilities and social and environmental impact evaluations</li> <li>▪ Monitoring of social and environmental impacts and a tracking system to distinguish certified coffee</li> </ul>

Certifications are available that promote sustainability via setting standards. To advertise that a product is certified each certification has a unique label. The labels signal to consumers that a product has met certain standards. (Greenburg, 2001).

Of the entire North American market, certified sustainable coffee comprises only 11.2 million pounds, or approximately 2 percent of the specialty coffee market.<sup>1</sup>

Conversely, coffee certifications are well known in Europe and comprise a much larger part of their coffee trade. In fact, in 2001, fair trade products were sold in over 2,300

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<sup>1</sup> The figures for this value were calculated using coffee that was certified by a third party. The statistics do not account for the coffee labeled organic, shade grown or fair trade that have not been independently certified.

supermarkets in Europe (Marie-Krier, 2001). Globally, certified coffee is predicted to represent less than 1 percent of sales. While the percentage is low, the number of pounds of coffee it represents is significant. It is estimated that 1 percent is equal to 36 million pounds of coffee (Giovannucci, 2001, p.25). Furthermore, the market share is continually growing. The rise in public awareness of coffee certifications has pressured multi-national coffee roasters to sell fair trade and/or organic certified coffee. The growth of certified coffee is a trend that has great potential to create sustainable livelihoods for coffee farmers worldwide. While coffee certifications may not be a solution for all coffee growers, it is a valuable asset to many farmers.

The most widely recognized certifications for coffee are Organic, Fair Trade, Bird-friendly/Shade Grown (Smithsonian) and ECO-O.K. It is important to know the differences in criteria between the types of certifications in order to understand their impact on farmers.

### **2.3 Types of Coffee Certifications**

*2.3.1 Organic* certification ensures that the coffee tree has grown without the use of synthetic pesticides, herbicides and fungicides and any other chemosynthetic external input. Emphasis is placed on restoring and enhancing soil fertility through environmentally friendly methods. By regulating the chemicals used in organic farming coffee beans and the natural environment are exposed to fewer chemicals, creating a system that works with the ecosystem to reduce disease and increase yields. The International Federation of Organic Agriculture Movements sets the standards for organic agriculture. It is an international organization that leads, unites and assists the organic movement (<http://www.ifoam.org/>). In North Carolina, the most widely used certifier is the Organic Crop Improvement Association (OCIA). OCIA is a nonprofit organization that provides accredited organic

certification (<http://www.ocia.org/members/index.asp>). The main tenants for organic coffee certification are:

1. “The coffee has to be grown without the use of synthetic agro-chemicals for three years prior to certification.
2. Farmers and processors must keep detailed records of methods and materials used in coffee production.
3. A third party certifier annually inspects all methods and materials.
4. All farmers and handlers are required to maintain organic plans detailing management practices” (Ponte, 2002, p.22).

Organic certification is focused on environmental criteria, and does not guarantee farmers an equitable income. The prices organic farmers are paid are based on the market. In general, organic farmers receive higher prices for organic beans, but there are no criteria to ensure that this is always true. However, organic certifications limitations on the use of non-farm inputs can reduce health problems to farmers and their families, saving money that may otherwise be spent on healthcare. Furthermore, the reduction in the costs of chemical inputs is another savings for organic farmers. Another major benefit of organic farming is the positive impact on the natural environment. An explanation of how organic farming impacts the natural environment is beyond the scope of this paper, however, these benefits are eventually realized by the coffee farmer through a myriad of ways such as: healthier soils, crops, greater biodiversity, greater natural resistance to disease and pests and higher quality beans with exceptional flavor.

2.32 *Fair trade* certification verifies that coffee beans have met social and environmental criteria. The certification guarantees a fair price to producers, and requires them to invest part of their proceeds in economic, environmental and social development.

TransFair USA is the third party certifier in the USA, while TransFair Canada and Fair Trade certify in Canada and Europe respectively. There are nineteen fair trade certifiers globally. The fair trade movement was initiated in the late 1940s, possibly by the Mennonite Central Committee, who now operates Ten Thousand Villages. Fair trade was originally referred to as alternative trade. Initially it was developed with the hope of opening markets to disadvantaged producers. Today, it has evolved into a comprehensive manner of trading based on socio-economic and environmental practices.

The Max Haavelar Foundation developed the first fair trade certification for coffee. Based in the Netherlands, the foundation received certification in 1988 and by 2002 ninety percent of European consumers were familiar with the label (Waridel, 2002).

The Fairtrade Labeling Organization International (FLO) creates the fair trade standards. The minimum standards required for small farmers organizations are listed below (“Fairtrade Labeling,” 2003). The complete set of standards is provided at <http://www.fairtrade.net>.

Table 3. Generic Standards for Small Coffee Farmers

Standard	Standard Subheading
Social Development	<i>Fair trade adds development potential:</i> Fair trade should make a difference in development for certified producers.
	<i>Members are small producers</i> and depend on their family for labor.

	<i>Democracy, Participation and Transparency:</i> The organization must have a democratic structure and transparent administration. Members elect the board of directors. All members participate in decision-making. All members will decide on what projects to undertake and how to spend/allocate the proceeds
	<i>Non-Discrimination:</i> There must be no discrimination.
Economic Development	<i>Fair trade Premium:</i> The fair trade premium must be used transparent.
	<i>Export ability:</i> Farmers must have all necessary access to bring a quality product to the market.
	<i>Economic Strengthening of the Organization</i>
Environmental Development	<i>Environment protection:</i> Producers must protect the natural environment. They must use Integrated Crop Management and devise a protection plan that is permanently adopted. The use of excessive external inputs will be gradually replaced by organic inputs.
Standards on Labor Conditions	<i>Forced Labor and Child Labor:</i> Forced or bonded labor must not occur. Children may only work if their education is not jeopardized.
	<i>Freedom of Association and Collective Bargaining</i>
	<i>Conditions of Employment:</i> Wages must be in line or exceed national laws on minimum wages.
	<i>Occupational Health &amp; Safety</i>
The Trade Standards for Coffee	<i>Product Description:</i> Both the Arabica and Robusta coffee species apply.
	<i>Procure a Long Term and Stable relationship:</i> The buyers and sellers will sign contractual agreements for a minimum of one growing season.
	<i>International Customary Conditions:</i> International customary conditions apply.

	<i>Pricing and Premium:</i> The minimum price for beans is shown below in Table 4. Non-washed prices are not shown. Prices are given in US\$ per pound, FOB port of origin.
	<i>Pre-financing/Credit:</i> If requested by the farmers, a line of credit up to 60% of the contract must be made available by the importer.
	<i>Dispute Settlement</i>

Table 4. Fair Trade Pricing (see *pricing and premium* subheading above)

	Fair Trade Certified		Fair Trade and Organic Certified	
	Central America, Mexico, Africa, Asia	South America, Caribbean Area	Central America, Mexico, Africa	South America, Caribbean Area
<b>Washed Arabica</b>	1.26	1.24	1.41	<b>1.39</b>
<b>Washed Robusta</b>	1.10	1.10	1.25	<b>1.25</b>

In sum, Fair trade certification is focused on social criteria. All coffee farmers must be paid \$1.26 for Arabica beans (\$1.10 for Robusta beans) and have agreements with buyers for no less than one full harvest cycle. The terms of the agreement are decided and written in a letter of intent before the harvest cycle. This system allows the farmer to plan ahead and have a reliable source of income. Although fair trade criteria emphasize the importance of sustainable development it does not require beans to be organically produced. Therefore not all fair trade beans are certified organic.



2.33 *Shade Grown or Bird-Friendly (Smithsonian)* certification verifies that beans have been grown under a shade canopy, which also provide habitat for migratory birds. The shade is planted and managed, and is distinct from growing coffee under existing canopies. The beans must also be certified organic. The certification was established by the Smithsonian Migratory Bird Center in Washington D.C. For every pound of beans, \$0.25 is given to the Smithsonian Migratory Bird research and conservation programs. All Bird-Friendly certified coffee originates from Latin America. The certification is inclusive of all stages of coffee production, from farmer to retailer. To ensure compliance with Bird-Friendly criteria, inspections are performed yearly. The following criteria are tenants of the certification (“Norms of Production,” 2002).

1. “Environmental Sustainability, with the aim of protecting and/or improving ecological indicators of environmental health.
2. Coffee’s cultivation within an agroforestry setting.
3. Protecting structural as well as species biodiversity, in order to guarantee shelter and food for birds, especially migratory ones.
4. That any land transformed or incorporated for coffee production not be part of any protected zone or natural reserve.
5. Guaranteeing that agronomic practices relating to the production process must leave intact specific ecosystems and contribute to the conservation and sustainable use of natural resources.
6. Permitting cultural practices involving the use of epiphytes for ceremonial or festive purposes.

7. Keeping documentation describing the unit and demonstrating the management of the plantation and shade.”

2.34 *ECO-O.K.* The Conservation Agriculture Network is a coalition of non-profits in Latin and North America that certify the ECO-O.K. label. The Rainforest Alliance, an international non-profit organization, certifies farms with the ECO-O.K. seal. Certification is based on a performance based evaluation of coffee farms that focuses on environmental and social criteria. Considerations for the label include minimal use of toxic inputs, humane and fair treatment of farmers, water conservation and biological diversity.

## **Chapter 3: Analysis of Coffee Roaster Decision-Making**

### **3.1 Who are Roasters?**

Roasters purchase “green beans” (the color of coffee beans before they have been exposed to heat) from importers, estates, cooperatives or secondary market makers. Before the roaster purchases green beans they have already completed an extensive preparation process for export. First a berry grows on a coffee tree and after it is hand picked it is de-pulped, which gives two beans per berry. Next, the beans ferment for several days, are washed and then dried outside. After drying the skin of the bean, a delicate, thin layer, is removed by machines. The beans are graded by shape, color and density and made ready for export in 132 lb (60kg) bags.

The green beans can remain fresh for long periods of time, allowing roasters to purchase green beans far in advance of the roasting process. However, once beans have been roasted they lose their freshness quickly. Roasters own expensive machinery that controls the humidity, temperature and roasting time of beans. The green beans are exposed to high temperatures, which induce a chemical transformation. The beans change from green to a myriad of brown shades, are cooled, and are finally ready for consumption. The roasting process significantly affects the quality of the bean. By changing the temperature or length of time a bean is in the roaster the flavor of the bean changes dramatically. Roastmasters are continually checking the appearance of the beans as they roast to ensure optimal bean flavor and quality.

Roasters are also involved in “cupping” coffee. Cupping is how roasters determine the flavor profiles of coffee. Roasters are able to ensure consistent flavor profiles from one batch to another through cupping. They also use cupping to create and sample coffee

blends (a combination of single origin coffees mixed together to create a unique flavor profile).

Cupping coffee can also be done before roasters purchase the green beans. Roasters often receive samples of beans in the mail from estates and brokers. If the roaster is interested in the bean, they may pursue a relationship with them.

Roasted beans are then packaged, labeled with the roaster's brand name and distributed for retail sales. Most specialty roasters distribute to the retail destination within four days of roasting, and some are able to distribute the beans within 24 hours.

Although most specialty coffee roasters do not view multinational coffee roasters as direct competitors, they are influential on coffee prices. In 2001, Philip Morris, Nestle and Sara Lee owned forty-five percent of the world's coffee market (not just specialty coffee) (Dow Jones, 2001). By making use of economies of scale, these roasters are able to streamline costs and greatly influence coffee prices. Other large roasters include Proctor and Gamble, Cara, Starbucks, Diedrich, AFC, Van Houtte and Tetley (Waridel, (2002).

The specialty coffee market has differentiated themselves from these multinationals by providing higher quality coffee. Furthermore, certifications have provided another means of differentiating the specialty coffee market. However, multinationals have recently begun selling certified coffee. Of the companies that do, most have chosen to certify one line of coffee, which accounts for a very small percentage of their overall sales.

### **3.2 Interviews with Coffee Roasters**

I interviewed six out of nine specialty roasters in the triangle region. For analysis purposes I have divided the roasters into three groups. The first are roasters who are roasters and retailers. More specifically, they roast beans and own coffee shops where they

brew and sell coffee locally. The second are wholesalers who roast beans and then distribute the beans to retailers locally, regionally or nationally. The third group is a coffee chain that is vertically integrated and is a national chain. They are importers, brokers, roasters, distributors and retailers. Table 4 lists the roasters as they will be referred to in this paper and their certifications. Roaster B in Group 1 will be used as the standards comparison for this paper since it does not have any certifications. The company names of the roasters have not been used to ensure anonymity. Please contact the author for any specific questions related to the roasters.

Table 5. Roaster Groups and Certifications

	<b>Group 1</b>	<b>Group 2</b>	<b>Group 3</b>
	Roasters/Retailers	Roaster/Wholesale	Vertical Integration
<b>Roaster A</b>	Organic		
<b>Roaster B</b>	No certifications		
<b>Roaster C</b>		Organic, Fair Trade, Bird Friendly	
<b>Roaster D</b>		Organic, Fair Trade, Bird Friendly	
<b>Roaster E</b>		Organic, Fair Trade	
<b>Roaster F</b>			Organic, Fair Trade

The roasters exhibited quite varied patterns of certification. Of the six roasters, only one certified 100% of their coffee, namely Roaster E. All the other roasters (except Roaster B) certified just one or two lines of beans, while the vast majority of their beans were non-certified. The median percent for certified organic, fair trade and bird-friendly coffee was 13.5, 5 and .05 respectively. This means that over 80% of the beans produced by the specialty coffee market do not have any certification. Furthermore, it displays the very small percentage of coffee that has the Shade Grown or Bird-Friendly Smithsonian certificate. The number of full-time employees ranged from 9-14 (excluding national chain). With the exception of one roaster all of them started in the early to mid- 90s.

### **3.3 Coffee Value Chains**

A “map” of a value chain visually depicts how stakeholders are organized across the production process of a commodity. Since relationships among stakeholders can be quite different (e.g., collaborative, hierarchical, arms length relationships) these differences can be expressed quickly through the use of lines. The number of lines connecting stakeholders will represent their relationship. For purposes of this paper I will use between one and four lines in the diagram to depict relationships among stakeholders. The significance of the lines are as follows:

- One: The market determines the production of goods, which is referred to as “*arms length*” transactions. The stakeholders involved do not depend on one another. Either side of the relationship could be substituted for a different stakeholder. Informational flows are limited.
- Two: The production of goods is a *balanced network* among stakeholders. Both stakeholders benefit from the relationship and there is information flows in both directions.
- Three: One lead firm has a *directed network* and controls the production of goods. One stakeholder offers more benefits than the other stakeholder. The lead firm knows more of the non-lead firm’s capability than the non-lead firms knows of the lead firm’s capabilities.
- Four: A *hierarchy* exists with one or two stakeholders controlling the entire chain. The chain may be made up of subsidiaries of the controlling firm or the controlling firm may have ownership connections to the stakeholders involved.

Often there is vertical integration of several chain stages within the controlling firm.

A value chain was been created for each roaster. The table below shows the group number and the roaster that relates to each figure. Since several of the roasters participate in more than one value chain (e.g. they have non-certified coffee, fair trade certified and organic certified) they will be listed multiple times.

Table 6. Roasters and Related Value Chains

		Figure 1	Figure 2	Figure 3	Figure 4	Figure 5	Figure 6
<b>Group 1 Roaster/ Retailer</b>	<b>Roaster A</b>	<b>X</b>	<b>X</b>				
	<b>Roaster B</b>	<b>X</b>					
<b>Group 2 Roaster/ Wholesaler</b>	<b>Roaster C</b>			<b>X</b>	<b>X</b>	<b>X</b>	
	<b>Roaster D</b>			<b>X</b>	<b>X</b>	<b>X</b>	
	<b>Roaster E</b>				<b>X</b>	<b>X</b>	
<b>Group 3 National Chain</b>	<b>Roaster F</b>						<b>X</b>

The following value chains (shown in the Figures below) are generalizations of roasters. Certainly not all roaster transactions fit into the chains depicted in the figures. The value chains were created based on interviews with roasters and information obtained through a literature review.

Following is the value chain for Group 1 (Roaster A, B) with no certifications. For Group 1, the Non-certified Roaster/Retailer value chain, nearly all of the relationships are arms length, which means that both stakeholders require the other for business purposes, but that either of them could substitute a different stakeholder. The most notable point about this figure is the relationship between the small farmer and the local middleman. There are three lines, which indicate one lead firm has a directed network and

controls the production of goods. In contextual terms this means the small farmer offers more benefits than the other local middleman. Since the local middlemen know more about the small farmer's capabilities and limitations than vice versa the local middlemen have greater control in the relationship. In this value chain stakeholders are unable to benefit from information flows with other stakeholders due to the limited nature of their transactions. Thus, this value chain does not allow stakeholders to meet their highest potential or their highest earnings.



**Figure 1.**

**Non-certified Roaster/Retailer**

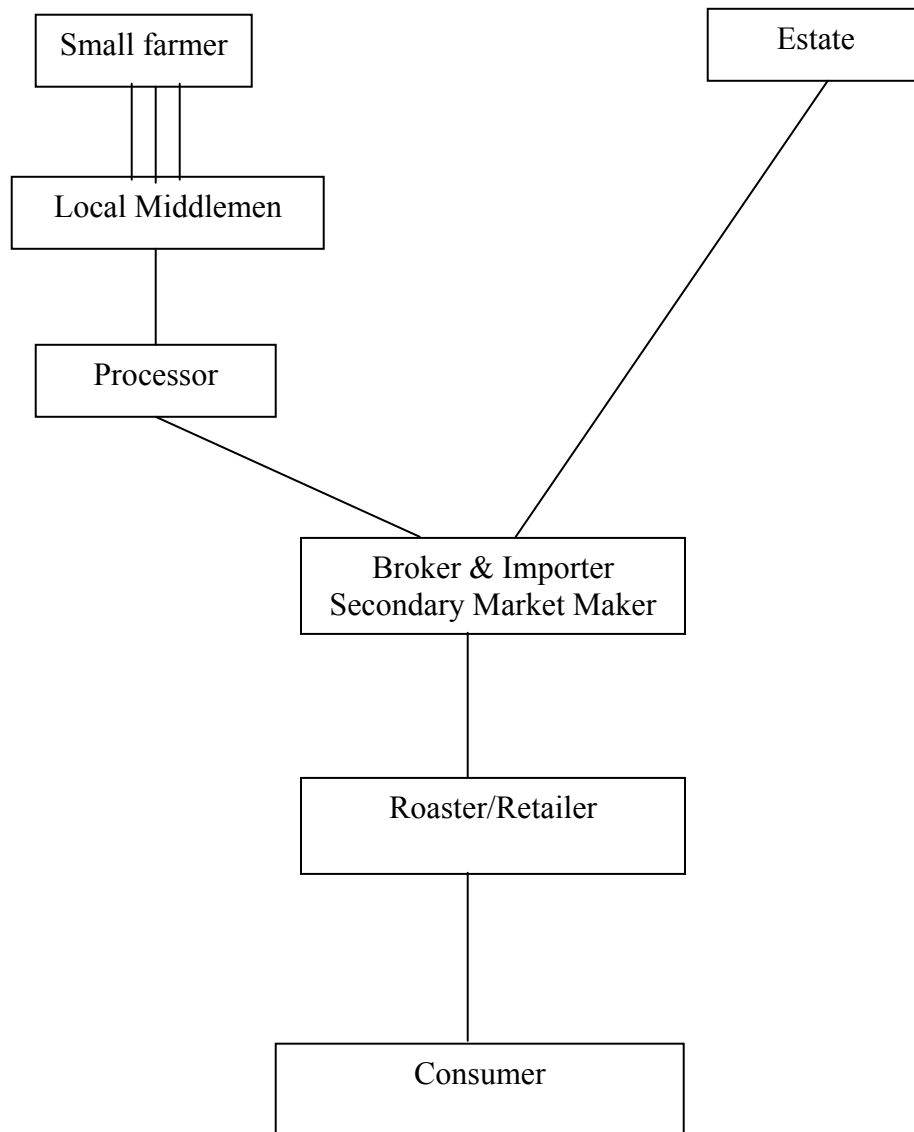


Figure 2 displays Certified Organic Roaster/Retailers. Only Roaster B is a roaster/retailer with organic coffee. This value chain has all arm's length relationships. The important depiction in this value chain is that the certifier has a relationship with multiple stakeholders. This may result in greater information flows due to the larger exposure to stakeholders, although there is no guarantee. One positive change from the non-certified roaster/retailer is that coffee farmers (who are typically cooperatives and estates for organic coffee) are no longer involved in a directed network. This means that they may be better off because they are not working with stakeholders that have extensive knowledge about and control over them.

**Figure 2.**

**Certified Organic Roaster/Retailer**

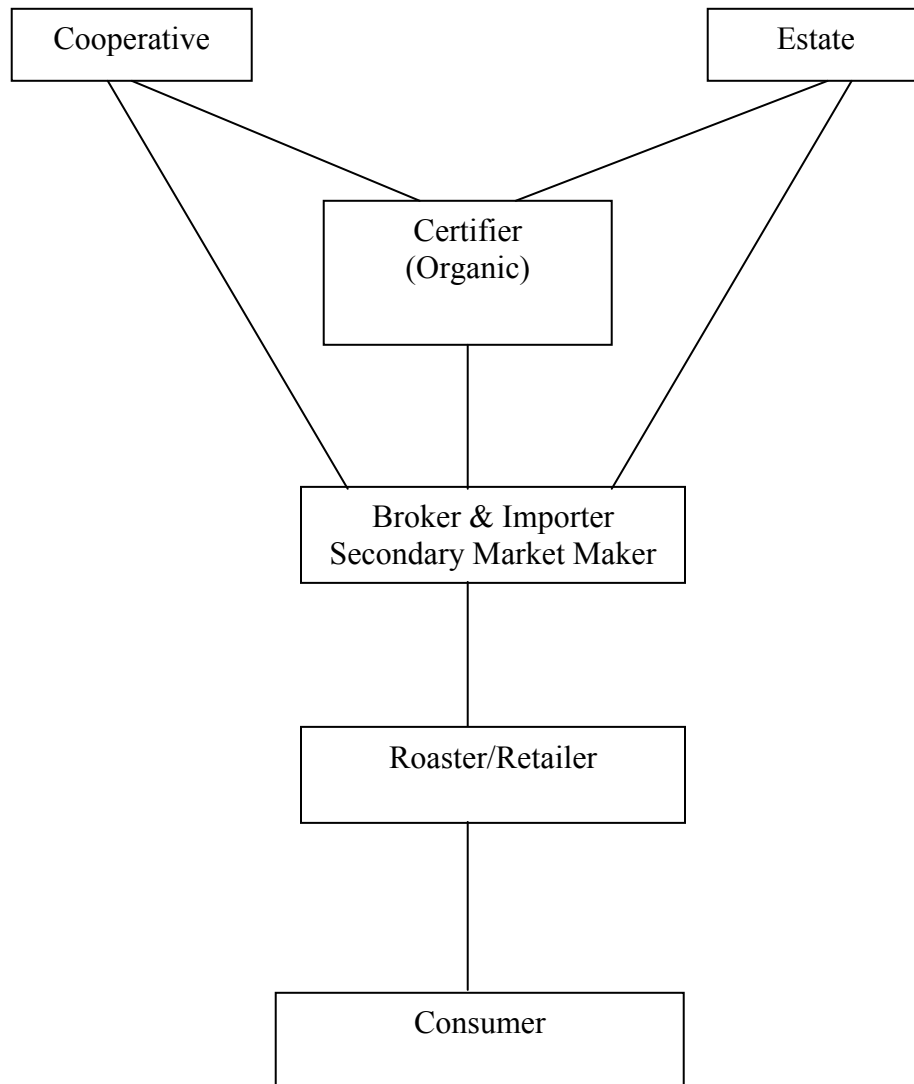


Figure 3 displays non-certified roaster/wholesalers. Roaster C and D fall into this category. Similar to Figure 1, this value chain also has a directed network between the small farmer and the local middlemen. The relationship between the roaster/wholesaler and retailers is typically a balanced network. In balanced networks both stakeholders benefit from the relationship and there is information flows in both directions. In the case here the roaster has constant communication regarding the retailer's desires as does the retailer. These relationships tend to be stable because each side is meeting the needs of the other.

**Figure 3.**

**Non-certified Roaster/Wholesaler**

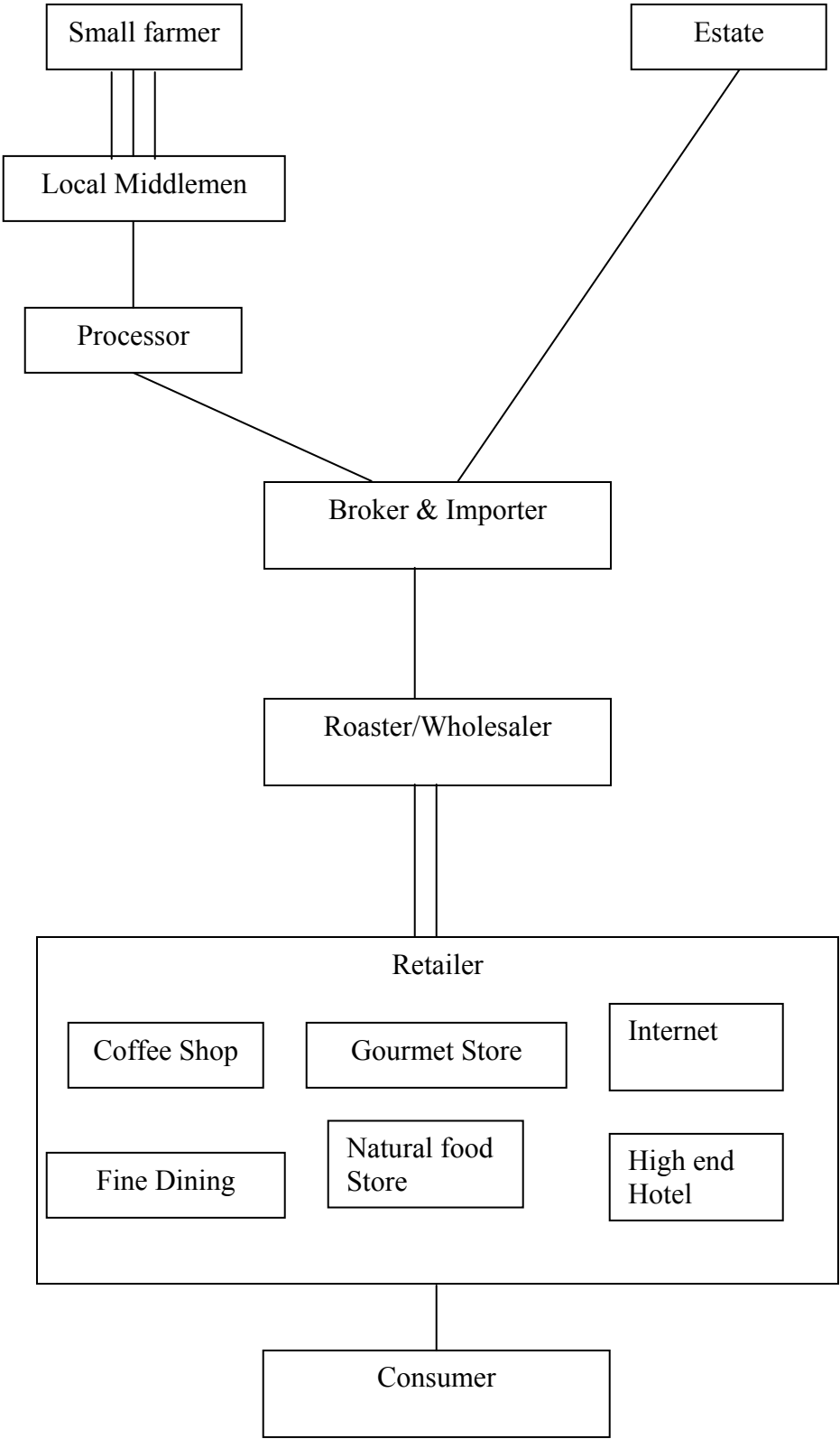


Figure 4 is the fair trade certified roaster/wholesaler value chain. All of the roaster/wholesalers interviewed fit into this category. The relationship among nearly all of the stakeholders is balanced. Even the cooperative/processor can have a balanced relationship. This is atypical, since in non-certified models there is inevitably an importer, exporter or broker that serves as a middleman. The fair trade certification ensures these balanced networks through its criteria. For example, farmers must be paid \$1.26 per pound of coffee, even if the market prices are less than half of that. This ensures that an equitable amount – or at least a decent amount- of earnings is distributed to the farmers. Furthermore, the removal of the middlemen and sometimes the importer, between the small farmer and roaster means that there are less stakeholders partaking in the profit margin. The Fairtrade Labeling Organization (FLO) conveys information between the stakeholders by setting standard criteria. This enables the stakeholders to be confident of the quality of the product they receive.

**Figure 4.**

**Fair Trade Certified Roaster/ Wholesaler**

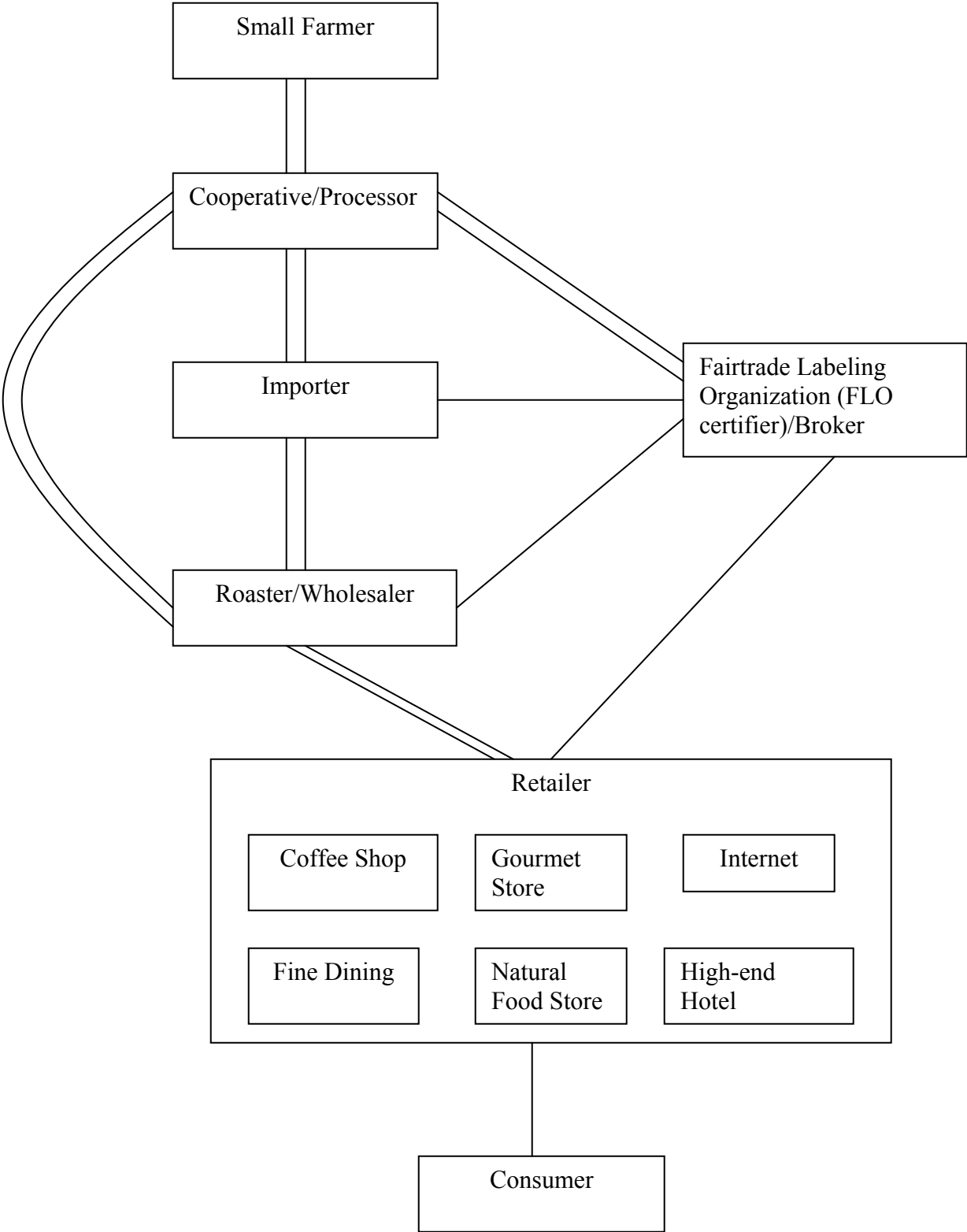


Figure 5 depicts the value chain for organic certified roaster/wholesalers. Roasters C, D and E fit into this chain. This value chain has diverse types of relationships. The main difference between this value chain and the roaster/retailer value chain (Figure 2) is that cooperatives and estates occasionally bypass the broker/importers. Furthermore, the roaster has a balanced network with the retailers.



**Figure 5.**

**Organic Certified Roaster/ Wholesaler**

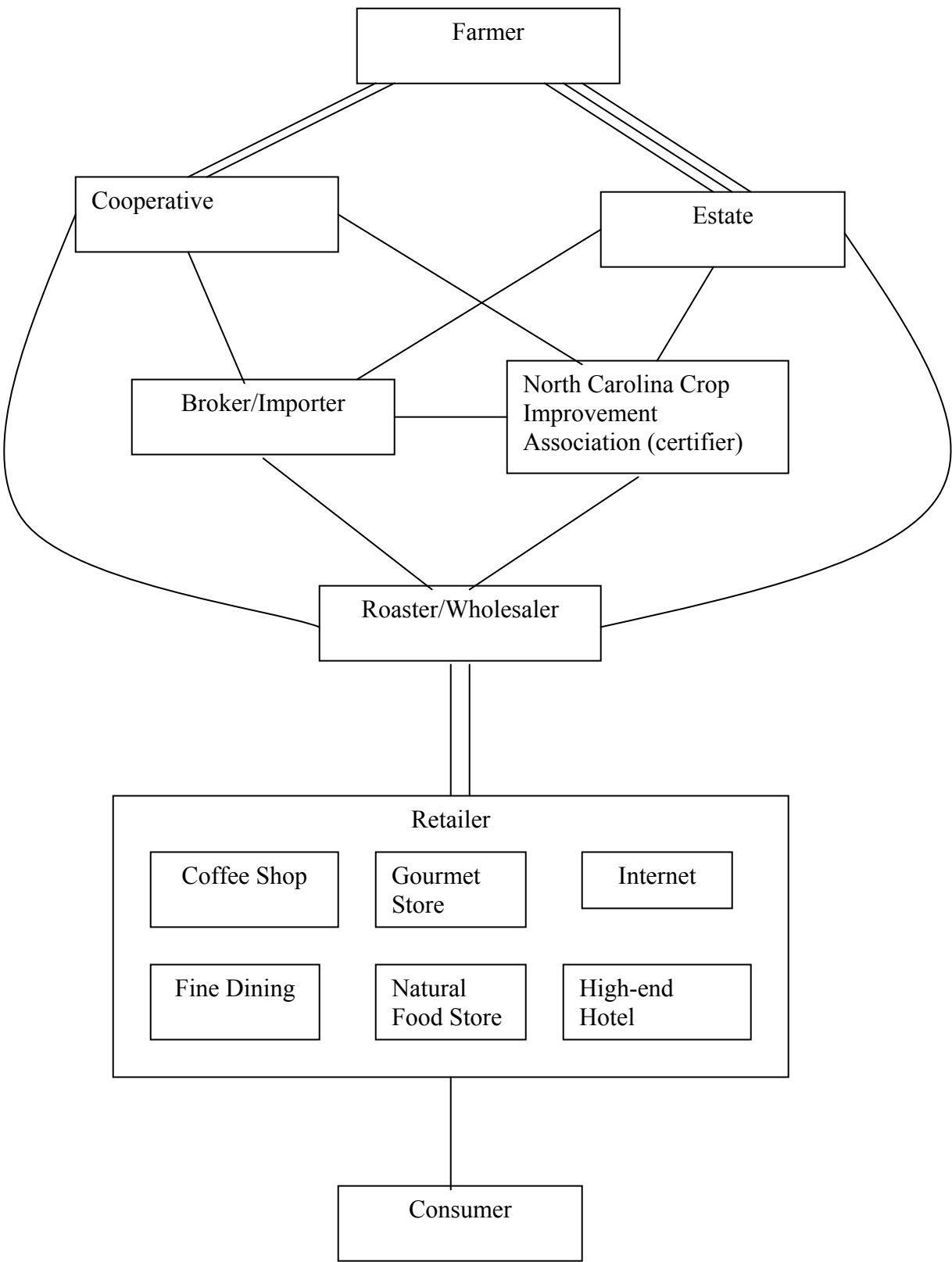
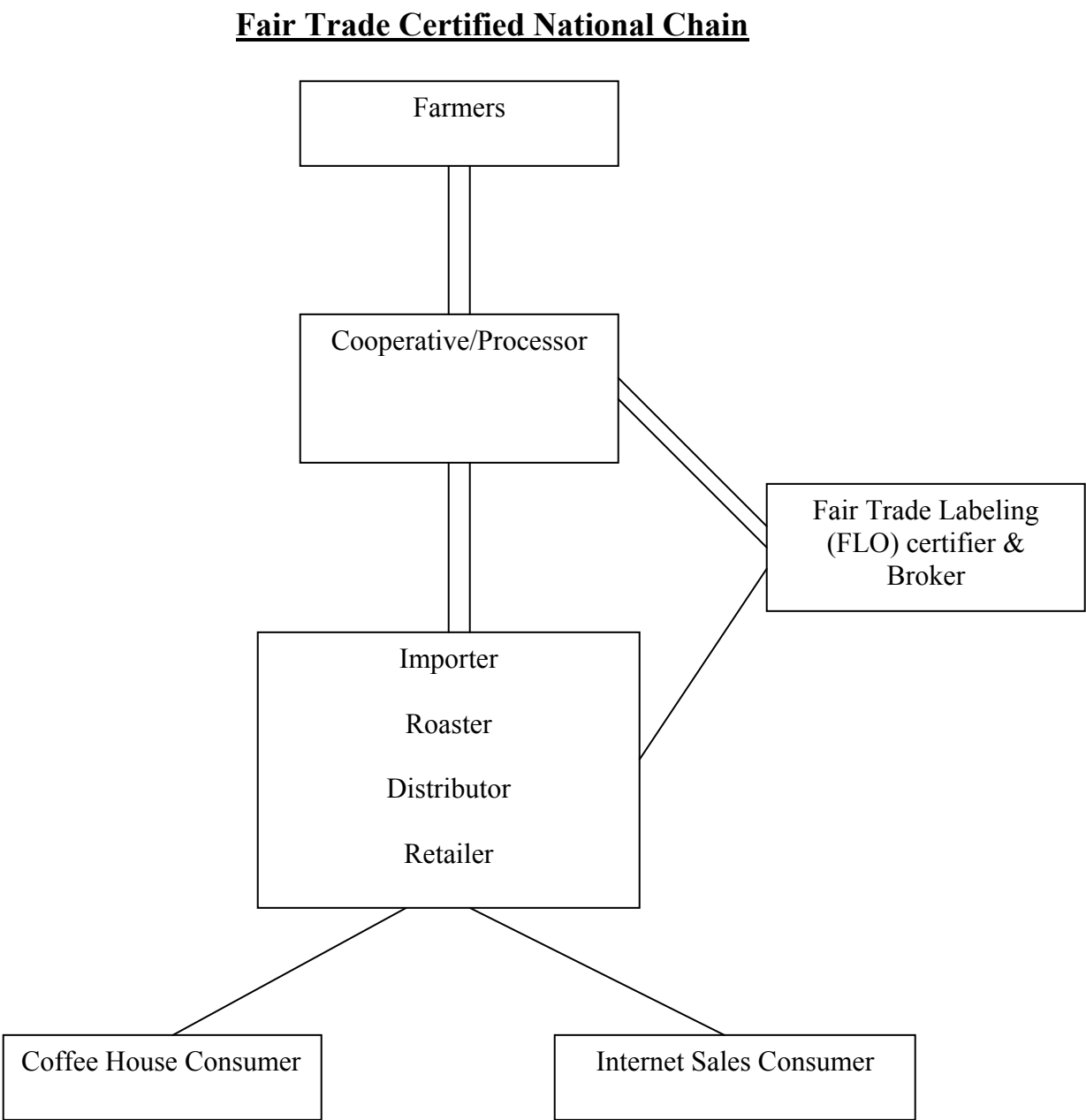


Figure 6 is the Fairtrade certified national chain. This value chain diverges greatly from all the others. The most notable aspect of the value chain is the vertical integration of the importer, roaster, distributor and retailer. The other relationships tend to be balanced, signifying that the chain is fairly equitable among stakeholders. As mentioned before, the balanced chain is due, in part, to the fair trade criteria.

**Figure 6.**



### **3.4 Profile of Roasters**

Roasters A and B operate on a local scale with coffee shops in Orange County, NC. They have a small market which is limited to the consumers who enter their coffee shops. Neither sells much coffee wholesale, and both sell the majority of their coffee brewed (as opposed to coffee beans). Roaster A's primary consumers are middle class community members while Roaster B's consumers are nearly all students from the University of North Carolina and some professors. Roaster A sells approximately 80% non-certified coffee and 20% organic certified coffee while Roaster B does not sell any certified coffee.

Roaster C, D and E are wholesalers whose headquarters are in Raleigh. They distribute coffee beans to multiple states. In fact, one of the roasters distributes to approximately 40 states. Roaster C certifies approximately 13 % fair trade, 13% organic, and 2% shade grown/bird friendly. Specific information about Roaster D's certification percentages was not attained, although it may approximate those of Roaster C. As of January, 2004, Roaster E certified 100% of their coffee fair trade and organic. They do not have a shade grown/bird friendly certification because they are at odds with some of the criteria.

Roaster F, the national chain, is located in 9 states and is soon to have international locations. It is quite large, with approximately 3,500 employees. Roaster F sells one line of coffee that is certified fair trade and organic. Approximately 5% of their coffee is certified organic and fair trade.

### **3.5 Conclusions about Roaster Decision-Making regarding certifications**

As we saw, Roaster A chose the organic certification because the master roaster enjoyed the flavor profiles of the organic coffee. The roaster wanted to label it organic

because the coffee had always been labeled as such in the coffee shop. Since labeling something organic without receiving the certification is illegal, the roaster had to obtain the certification. Roaster A's primary concern when purchasing beans is their quality. Similar to most roasters, the roaster really enjoys the complexity of coffee tones (flavors) and therefore, often selects beans based on personal preference.

The size of the submarket a roaster caters to is significant. Group 1 (roasters and retailers) was less interested in certifications than Group 2 or 3. The value chain for Group 1 reveals that the market they cater to is far more focused than Group 2 or 3. Their beans are primarily sold in their coffee shops. Therefore, their business is dependent on meeting the demands of a select population – the consumers who come into their coffee shop.

Another factor that plays into decision-making may be, in part, the quantity of beans a roaster roasts. Roasters in Group 1, the retailers/roasters, did get certified (except organic) while Group 2, roasters/wholesalers, have a selection of certifications. The roasters/retailers roasted considerably less quantities of beans than the wholesalers. Their time and energy was spread between their roles as roaster and retailer. Roaster B commented that there was not enough time to research certifications. The amount of beans that passes through roaster/retailers hands is not significant enough to put forth the time required for certification.

In addition to time, certification requires money. As noted before, organic and fair trade criteria require that the tools used to contain and move the beans must be different from those of the non-certified beans. There can be no mixing of the two. Naturally, more space and capital is required if the two must be separated. Furthermore, detailed documentation is a requirement of certified coffee. While this may be a small burden for a

roaster/retailer, it becomes significant when it is accompanied by yearly fees and bi-annual auditing. Yearly fees for organic certification amount to approximately \$500. Barriers of space, capital, finances and time are important factors in small business roaster/retail decision-making.

Yet another driving force behind roasters decision to become certified is to gain a market edge on competitors. The specialty coffee market is expanding, which has resulted in a rise of specialty coffee roasters. With the increase in communication flows from the Internet, retailers have a wider selection of wholesalers to choose from. Wholesalers differentiate their roasted beans from competitors by offering certified coffee beans. The wholesalers are also able to provide a “story” from where the beans came from. The story of the beans may describe the farmers, where they live, their family, and what new opportunities they now have due to the certification, among other things. Providing a “story” is a powerful way for retailers to market and sell coffee.

An additional factor figuring into decision-making among roasters is whether or not the bulk of their sales come from brewed coffee. Group 1(roaster/retailer) reported that they do not sell brewed *certified* coffee- and if they do, it is in small quantities. Since the roasters sell brewed coffee for the same price – whether it is the non-certified breakfast blend, Columbian or certified fair trade etc., purchasing certified coffee that is usually more expensive than non-certified coffee reduces their profit margins. Group 2 does not experience the same profit margin problem because they do not sell brewed coffee. Since they are not retailers, they do not need to conform the beans to one set price. Their flexibility in pricing allows them to purchase certified beans and then sell it at a profit margin comparable to non-certified beans. Therefore, roasters who are also retailers are

less inclined to buy certified coffee than roasters who are just wholesalers, because it affects their profit margin.

Yet one more influence on roaster-decision making is the demographic group of their submarket. This is perhaps the most significant finding of the research.

The value chain for Group 2 shows that the wholesaler's customers (the retailers) tend to be middle/high income institutions or businesses in middle/high class regions. For example, the wholesalers' sell to high-end hotels, gourmet food stores, fine dining restaurants and they all offer Internet sales. It cannot be overlooked that the specialty coffee industry inherently caters to middle-high income consumers, but what should be noted is that the wholesalers who supply retailers are consistently offering a selection of certified coffee. Two of the roaster/wholesalers interviews offer organic, fair trade and shade grown/bird-friendly, while the third offers organic and fair trade. It appears that the submarkets the wholesalers are supplying have a direct effect on the demand for certified coffee. However, what is puzzling it that the roasters in Group 2 reported that consumer preference for certified coffee was not the primary factor for purchasing it. So why are middle-upper income regions offering certified coffee and why are the corresponding demographic groups purchasing it?

A closer look at Roaster B provides some insight. Roaster B caters to a large student population. Students have been a strong force in gathering momentum for ethical trade. "Ethical trade is one dimension of corporate social responsibility, bringing social issues into the mainstream of commercial supply chain management through the use codes of conduct" (Barrientos & Blowfield, 2001, p. 9). Student groups have formed all over the nation to promote ethical trade in products ranging from t-shirts to coffee. Since Group B

serves primarily students it is extremely surprising that they do not have any certifications. Roaster B reported that students would occasionally request certified coffee and the roaster has purchased it in the past. However, once the certified coffee is available, another puzzling situation results-there is no follow through-the student population does not purchase it.

Therefore, the activists and students who are part of the force behind the certified coffee movement are not the demographic group purchasing it. A possible reason why students purchase limited amounts of certified coffee may be the cost. Although both the coffee shops sell brewed coffee for the same price, selling beans by the pound is priced according to the bean's value. Certified coffee is generally sold at higher prices per pound than non-certified coffee. Student's limited purchasing power may prevent them from buying certified coffee, even though they advocate for it. Still, this begs the important question, why are some roasters/wholesalers/retailers offering certified coffee if the major demographic groups demanding it are not purchasing it? Answering this question is beyond the scope of this paper and would be an excellent area for further study.

Interestingly, the coffee shops at the University of Madison-Wisconsin do not conform to the research gathered in the triangle region. Madison's coffee shops sell certified coffee in large quantities to students. The discrepancy between coffee shops frequented by students suggests the importance of conducting research on a submarket level. Ethical trade cannot be conformed to fit into classical economic theory of demand and supply. Researching submarkets that reveal unique variables is critical for a comprehensive understanding of ethical trade market transactions.



## **Conclusion**

I began this paper with the question: why do some roasters join the new supply chains and not others? The answer is due to a complex set of factors that are determined by the market. It is clear that roasters do not sell certified coffee because they are altruistic. In fact, improvements in the quality of life of farmers and positive effects on the natural environment were rarely cited as reasons to purchase certified beans. Except for one roaster, none of the roasters knew the details of any of the certifications. Most knew the main tenants, but nothing more. A few roasters referred to their coffee as being shade grown or fair trade, even though they did not have the certifications.

My research shows that roaster-decision making to choose certified beans is based on multiple factors, but seven factors stand out as the most important. These seven factors are the quality of beans, consumer demand for certified beans or the lack of it, marketing strategies, the quantity of beans roasted and manner in which coffee is sold (beans or brewed), whether or not the roaster is a retailer or wholesaler, and the submarket demographics.

The quality of the beans is the number one reason why roasters decide to purchase a certain type of bean, despite if it is certified or not. Consumer demand is not a major driver for roasters to become certified, especially among coffee shops. Roaster/wholesalers commonly offer a selection of certified coffee. The opening of their market to national competition through faster and more efficient information flows forces them to differentiate themselves from their competitors. Since certified coffee is a niche market it is an important marketing strategy. The large quantity of coffee beans that moves through roaster/wholesalers is another factor that helps them reduce certification barriers. Selling

beans by the pound and not by the cup allows them to change the price of the beans based on the bean value. Small roasters are at a disadvantage to large roasters because they often lack the space, capital, finances and time to comply with the strict certification standards.

Submarket demographics have a strong effect on roaster-decision making. While students and activists are fueling the ethical trade movement, they are not the consumers purchasing the products – at least in the case of coffee. Upper to middle class regions are more likely to provide certified coffee even though the consumers that frequent these areas are not demanding certified coffee.

One hypothesis is that the pressure from students to participate in ethical trade has influenced roaster/wholesaler decision-making. Since the role of the roaster/wholesaler is to provide retailers with a selection of coffee that will meet the demands of their consumers, their decision-making may be made in response to general consumer demand, which is greatly influenced by the voices of the ethical trade movement. Therefore, even though the retailer's submarkets are middle-upper income institutions/consumers, which are not driving the certified coffee movement, their deep pockets allow them to receive the benefits. However, further research is needed to examine the correlation between the incomes of demographic groups who purchase certified coffee versus demographic groups that do not purchase certified coffee.

The need for more research regarding coffee certifications will add to the growing knowledge regarding standards. Research on certifications can provide useful insight into the impacts of standards. With the recent trend of opening the global market to “free trade” with new policy measures, the role of standards and their impact on trade is becoming increasingly important to understand.

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#### Useful links:

Fair Trade Resource Network (FTRN), [www.fairtraderesource.org](http://www.fairtraderesource.org)

US Fair Trade Certifying Agency, Transfair, [www.transfairusa.org](http://www.transfairusa.org)

United States Department of Agriculture (USDA), <http://www.usda.gov/Agriculture>