

Success for the Specialty Coffee Industry

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Specialty Coffee in the United States of America

With an annual net worth of \$80 billion, coffee is the world's second largest trade commodity.¹ The United States of America alone imports one quarter of the world's coffee product.² Two types of coffee are marketed in the United States. Standard coffee can be found at most stores for low prices and it is not organic nor is it fair trade. However, in capitalist markets such as the United States, this product has been able to thrive at the cost of the product's quality and the industry's integrity.

The second segment of the American Coffee industry markets organic, fair trade, high quality coffee product. The 'organic' and 'fairtrade' labels have become a trendy cause for elitist consumers to follow, and they are bringing in staggering profits. These businesses boast of excellence from start to finish in their product, meaning that their crop is planted, harvested, and fermented with the utmost care, and then it is prepared and served as a delicacy. These elitist attitudes have allowed this new segment to grow rapidly since the 1990s, concentrating over 45% of its business on the west coast.³ The phenomenon has been labeled the "Third Wave Coffee" movement.

A History

The term Third Wave Coffee movement signifies the great push for reform in the industry. The seeds of the reform movement can be traced back to the 1920s, after coffee became a cultural icon of leisure in the United States. This occurred internationally because coffee farmers experimented with more efficient ways to harvest coffee, and thus the product became inexpensive to produce and consume.⁴ It was also affected by the social climate of the United

¹ Giovannucci, Daniele. *Sustainable Coffee Survey of the North American Specialty Coffee Industry*. Specialty Coffee Association of America, Coffee Association of Canada. 2001.

² Giovannucci.

³ Giovannucci.

⁴ Halevy, Alon. *The Infinite Emotions of Coffee*. United States: Macchiatone Communications. 2014. (Halevy 2011. P. 1-158).

States, during post war periods and the depression when there was a need for cheap pastimes. This period of time is now referred to as the 'First Wave' of coffee. The United States continued to increase its imports due to a sharp rise in demand of the product from the 1920s to the 1960s. Demand hit all-time highs directly after WWII and farmers scurried to meet that demand by planting far more than necessary.⁵ Due to rising demand and multiple years with long frost periods, prices for the product soared and were not met by consumers. Another contributing variable to the coffee problem was that harvesting seasons only occurred twice a year for coffee farmers. This meant that a lot of beans hit the market at one time, so the ample supply of the product from multiple vendors drove the price down substantially.⁶ Seven studies done measuring the fall in costs of agricultural products revealed a decline of 50% to 86%, with coffee as the biggest price decline.⁷

The product came in second only to petroleum in terms of demand in the global market. Additionally, the product was being consumed by countries that did not produce it, which made it more economically valuable. Farmers wanted to meet that demand and increase their profits by producing more for a lower cost. Eventually, competition drove the prices dangerously low and profits failed to cover even the price of planting. Many countries put tariffs on the product in order to lower production and stabilize the price, but the United States refrained and therefore significantly drove the market price down. Beginning in the late 1940s, the market suffered from severe overproduction. President Kennedy intervened in 1962 by enacting the International Coffee Agreement in order to support the development of Latin America.⁸ Under the International Coffee Agreement, farmers would be able to pay for the clearing, planting, and harvesting of their coffee trees. Prior to the agreement, all the profits that farmers made were lost when they had to compensate for the high costs of the farming process. Under the agreement, farmers would finally be able to cover the expenses of the initial farming process, and then be able to profit off the fruit of their labor. This would be achieved by limiting the amount of supplied product in relation to the amount of demand. The agreement was constructed in hopes that it would achieve financial equilibrium between the consumption and

⁵ Bilder, Richard B. *The International Coffee Agreement: A Case History In Negotiation*. L.B. 956 Harvard Law School. 2014. Office of the Legal Adviser, United States Department of State. Member of the U.S. Delegation and Chairman of the Legal and Drafting Group, United Nations Coffee Conference.

⁶ Bilder.

⁷ Osorio, Nestor. *Lessons From the World Coffee Crisis: A Serious Problem For Sustainable Development*. International Coffee Organization. London. April, 2004.

⁸ Halevy.

production of the coffee commodity. The agreement's primary goal was to stabilize the price of coffee beans, which had suffered from chronic instability.⁹ As coffee came in first in regards to agricultural value in world trade, economists and farmers hoped that the success of this agreement would be a model for other agricultural industries such as tea and fruit.¹⁰ Though the agreement had some success, it was quickly side swiped by big business in the 1970s.

The 'Second Wave' of coffee came with the end of the 1960s, when companies like Starbucks and Peet's Coffee brought high quality Arabica beans to the country.¹¹ After these companies learned how to mass produce coffee, they quickly became two of the nation's largest corporations. Though mass production enabled them to thrive economically, their means of trade became less fair and their production quality began to erode. The focus shifted from the product to the potential revenue the product could generate.

As these companies became more successful by selling a cheaper product, demand for their low cost services increased and the government felt pressure to enable their expansion by withdrawing from the ICA (International Coffee Agreement).¹² However, when The United States pulled out of the agreement in 1989, the industry plunged into chaos. In 1989 the leading world coffee producer, Brazil, was selling coffee at \$3.05 per pound.¹³ When Vietnam saw that the United States had halted their participation in the ICA, the Vietnamese Government began using their World Bank loans to invest in mass coffee production for a cheaper selling price in order capture United States attention.¹⁴ This strategy worked and was soon followed by Guatemala, India, Uganda, and Ethiopia. Due to the sudden competition for a slot in the United States' vast consumer market, countries continued lowering their prices. Within a decade, a pound of coffee went from \$3.05 in market value, to a mere .41 cents.¹⁵ The production and consumption of coffee became a major human rights and environmental crisis between 1989 and 1995.

⁹ Bilder.

¹⁰ Bilder.

¹¹ Giovannucci.

¹² Bilder.

¹³ Brown, Keith R. *Buying into Fair Trade: Culture, Morality, and Consumption*. New York University Press. 2014. (Brown 2014 P. 1-188)

¹⁴ Brown.

¹⁵ Halevy.

Facets of the Crisis

Depressed coffee costs led to a wide range of problems. In regards to economics, the lowered prices lead to the abandonment of farms, loss of jobs, low fiscal revenue, and the domino-effect on various economic sectors.¹⁶ In November of 2003, the Deputy Secretary General of the United Nations claimed that, “the decline in prices for commodities such as coffee, which now receives roughly a third of the prices that prevailed in the mid-1990s, contributes to increased poverty and makes it more difficult to reach the millennium development goals.”¹⁷

Socially, it contributed to emigration from the country, influx of people from the countryside to the cities, overpopulated cities, decreased standard of living, increased debt, and increased poverty levels.¹⁸ On the environmental level, many Shade plantations were foreclosed and then used as a source of timber.¹⁹ The destruction of these plantations has contributed to various environmental issues, the most important being the lack of oxygen provided by trees.

Though the coffee industry is flourishing on the consumers’ end of the deal, it is not sustainable from the producers end. The damage that cheap coffee has done on the economies, social structures, and environments of developing countries has been a major detriment to these countries as a whole, as this main branch of agriculture affects many other economic sectors. However, demand for cheap coffee continues to grow, especially as developed nations push promotions that are intended to enlarge coffee orders and increase sales. To this day, many buyers continue to exploit these farmers by purchasing coffee at low prices in order to facilitate its mass consumption.

As a response to the deterioration of the coffee industry’s integrity, the ‘Third Wave’ coffee movement was born in the 1990s. Little is reported as to where the first Third Wave shop was, but over 45% of the movement is now concentrated on the North American west coast and researchers assume that is where it originated. This movement focuses on quality, fair trade, and sustainable production methods. The specialty coffee industry in 2014 emphasizes the culture surrounding the product rather than its value as a trade commodity. Third wave coffee is an example of American elitist consumerism, in which excellence in all stages of production is highly valued. Not only is the quality of the product expected to be above and beyond popular

¹⁶ Osorio.

¹⁷ Osorio.

¹⁸ Osorio.

¹⁹ Osorio.

standards in order to maintain relative taste reputation, but the quality of the production process is now a factor of coffee's perceived value.

The Third Wave Model

The Third Wave coffee segment only represents 17% of the country's coffee industry.²⁰ However, it generates 40% of the industry's revenue.²¹ This statistic challenges the notion that businesses will always perform better when they decide to compromise production quality in order to be more efficient. When surveyed by the Specialty Coffee Association of America, a target group of 2098 roasters, retailers, wholesalers, distributors, and importers involved in the organic and fairtrade coffee market were asked to describe their production processes and their business tactics. The results are further detailed in the *Sustainable Coffee Survey of the North American Specialty Coffee Industry*.²²

Survey Results

Wage Rates and Trade Methods

This segment of the industry understands the value of building strong work relationships. They demonstrate this by being involved at the plantations and paying higher wages to their workers. This is an investment that they are unwilling to compromise.

The results of the survey revealed that Third Wave coffee businesses frequently choose direct trade to conduct business transactions.²³ This is a process in which the farms that produce the beans are paid directly for their work, rather than passing money down a long line of packaging companies and distributors. In other methods of payment, money is usually lost among the various people involved in the buying and distributing processes, and farmers end up getting a much lower amount of money than they deserve for their work. In addition to paying directly to farmers, many Third Wave business owners pay farm workers four times the average fair trade wage of \$1.20 per pound.²⁴ This increased rate is given to the workers under the condition that a part of the money is invested back into the farms soil, trees and maintenance in order to

²⁰ Giovannucci.

²¹ Giovannucci.

²² Giovannucci.

²³ Giovannucci.

²⁴ Fairtrade International. "*Minimum Price and Premium Information*." Last modified January 2014. <www.fairtrade.net> Accessed April 2014.

ensure that the farms will maintain their rates of production without compromising their long term sustainability.²⁵ This is enabling many workers to maintain their farms, increase their general standard of living, and stimulate the economy of their local communities. This higher wage rate is also intended to increase the general 'happiness' of workers, so that they do not feel pressured to cut corners during production in order to be competitive. Third Wave business owners want all of their employees, including those at the farm, to cherish the product from start to finish.

In addition to paying a higher wage rate to the farmers, many business owners are personally involved in the harvesting and fermentation processes on the farm. These roasters and retailers spend months at a time on plantations alongside the farmers experimenting with the fermentation processes in order to differentiate flavors and consistencies of roasts. These individuals do this not only to enhance their relationship with the farmers, but they feel a deep attachment to the product and want to be involved in the whole process. These individuals view coffee as a delicacy and they will go to great lengths to make sure that their product is the best, the most novel, the most complex that they can offer. Similarities can be drawn with the Japanese people's treatment of sushi, in which chefs are often personally acquainted with the fishermen that they buy from, in order to ensure the consistency of the product and the excellence of the entire process. These elitist business owners are so passionate about their work that they feel an obligation to be well educated and involved in the holistic journey of their product.

How Coffee Grows

Coffee beans begin as cherry-like tree fruit. They are roasted and sold, or they are roasted and ground into a water-soluble product for sale. Three major types of coffee crop exist. The first type is called *Brazils*, which as the name suggests, are only grown in Brazil.²⁶ The second type are called *Milds*, and they are mostly located in the rest of the Latin American region.²⁷ The final type are called *Robustas*, and they come from the African region.²⁸ *Robustas* are known to be the darkest roast. Some roasts are exposed to more light or more shade than others. This

²⁵ Talbot, John M. *Grounds for Agreement: The Political Economy of the Coffee Commodity Chain*. Rowman & Littlefield Publishers, Inc. 2004. (Talbot 2004. P. 1-218)

²⁶ Bilder.

²⁷ Bilder.

²⁸ Bilder.

affects the length of time it takes to grow the crop organically and the inevitable consistency and flavor of each.

Coffee tree crops have a particularly lengthy gestation period. The period that lasts between planting and eventual fruit bearing is usually about 3 to 5 years.²⁹ After trees begin to bear fruit, they can continue for almost 40 years, though trees usually only remain healthy for about 25-30 years.³⁰

The cost of Organic

Many people are familiar with the term 'organic' and connect a positive connotation to it, but few people understand what that term actually means. When it comes to coffee production, most standard coffee is produced by aligning many coffee trees closely together so that as much product as possible will be yielded. This ruins soil fertility and air quality because coffee plants are supposed to be grown beneath shade.³¹ The shade trees allow the plant to photosynthesize, whereas they are hardly able to when subjected to direct sunlight.³² Standard coffee farmers are able to get a high yield from coffee plants grown without shade by using sun tolerant genetically altered coffee plants and agrochemical inputs.³³ Growing coffee beneath shade additionally facilitates the proper air circulation necessary for the plant, in addition to replenishing the soil's fertility levels.³⁴ This method is known as the Shade or Passive Organic method of growth.

Standard coffee growing methods not only deprive the coffee plant of necessary shade, but they subject the plant to high amounts of chemical fertilizers and inputs that increase the plants yield but damage the plant and the soil.³⁵ Some farmers refrain from using chemical fertilizers to increase the plant's long term sustainability. Allowing the soil to replenish itself through a normal process is known as the Natural method.

The purest form of the term Organic would entail a method that implements the Shade method and the Natural method in addition to using naturally occurring seeds. The cost of Organic

²⁹ Bilder.

³⁰ Bilder.

³¹ Martinez-Torres, Maria Elena. *Organic Coffee: Sustainable Development by Mayan Farmers*. Center for International Studies, Ohio University. Ohio, USA. 2006.

³² Martinez-Torres

³³ Martinez-Torres

³⁴ Martinez-Torres

³⁵ Martinez-Torres

coffee is not only expensive because it produces a smaller yield, but the cost of becoming certified Organic is high. Importers pay almost \$0.24 more per pound of Organic coffee, and the process of obtaining official Organic certification takes approximately 3 years.³⁶ This is an investment that reaps financial reward in the long run, but it takes many years before investors will start to break even and eventually make profit.

The various investments of Third Wave coffee groups are beneficial for environmental conservation causes and international business in the global market. In addition to being beneficial in these ways, the investments have also been financially successful. Researchers wanted to know how these businesses are able to make any profit at all while they are spending far more than the median coffee business in North America. Those surveyed claim that they are able to make up for their investment expenditures by implementing high price premiums at the sales counter.³⁷ These premiums cost only about .75 cents to \$1.00 more than the average Starbucks drink, but the premiums are high enough that they generate significant revenue.³⁸ Overtime, the premiums have built up enough that they are able to cover the Organic and Fair-Trade costs as well as the high costs of the in store necessities. Costs are not only high during cultivation and packaging, but the over the counter demands of the Third Wave culture comes at a great price.

The Third Wave Attitude

Pyramid for Producer's Needs

Researchers asked why Third Wave owners insist on maintaining their high cost culture. A surprising find of the Sustainable Coffee Survey of America was that the Third Wave coffee “pyramid for producer’s needs” placed the greatest importance on product quality when making purchases.³⁹ Their second, third, and fourth considerations pertained to the diversity of the product and its long term sustainability. Their last consideration when making purchase decisions was customer demand.⁴⁰ This demonstrated that there is an artistic attitude about the culture that has very little to do with the desire to make a profit. Many parallels have been drawn

³⁶ Weber, Jermeij G. *How Much More Do Growers Receive For Fair Trade-Organic Coffee?* United States Department of Agriculture. 2011. P 677.

³⁷ Giovannucci

³⁸ Halevy.

³⁹ Giovannucci.

⁴⁰ Giovannucci.

with the wine industry, which collects thousands of dollars per bottle depending on the quality of the brand. Third Wave participants are quickly becoming just as fervent about their product. Thousands of dollars go into certain Third Wave shops in major cities in California, such as Handsome in LA, which only has four items on its menu: espresso, espresso with milk, brewed coffee, and iced coffee. Their menu does offer decaffeinated alternatives nor does it offer sweet drinks, to which many North American are accustomed. These peculiar coffee standards have little to do with popular trends among customers, and very much to do with the personal interests and experimentations of Third Wave owners. Lack of attention to customer demand is often considered risky and impractical to profit increase, but has proven to work for those interviewed in the survey.

Elitism as a Business Strategy

Researchers were perplexed by this result and inquired further into the business mechanisms of the Third Wave coffee movement by asking how standards are created. The majority responded that the network of roasters and retailers set standards among themselves as to what is desirable in the product.⁴¹ They then project their ideals of what is fashionable and what is not onto their clientele. This successful projection is achieved via customer education. The group of roasters consciously ignore the demands of their customers for cheaper coffee because they believe it would compromise the quality of their product. These sellers consider their product too valuable to compromise. Many baristas and brewers treat their coffee as an art worthy of creativity, experimentation, adoration, and high selling prices. The culture of this new coffee segment is centered on the pleasure that one receives from drinking an exquisite cup of coffee rather than the monetary value of the drink. The culture gives particular attention to the psychology of guilty pleasures and they create an atmosphere and product worthy of indulgence. Because Third Wave supporters take the product so seriously, they are able to overlook the capitalist push for economic competition and choose to invest in their product as their artistic whims guide them.

Customer Education

Many customers choose to buy more expensive coffee products from Third Wave stores when they could choose to get 'more for their money' at larger corporations. Customer education and advertising is accredited as the primary method of converting standard coffee drinkers to Third Wave devotees. Many reformed coffee businesses host various classes pertaining to the

⁴¹Giovannucci.

education of their customers. At Insight Coffee in Sacramento, California, 'cupping' classes are held twice weekly in order to inform customers about the different types of roasts represented at the shop and the brew methods of the respective blends. These classes inform customers about the origin of each roast, the fermentation processes, and the result of the beans' reaction with the hot water during the brew process. Customers then taste each cup and determine which they prefer.

These educational workshops are indispensable to Third Wave businesses. Third Wave shops claim to have turned many 'sugar and espresso powder' fans into fanatics of their reformed product. They believe that after customers are informed about the farm, the bean, and the process, they will feel that they are investing in quality and sustainability rather than purchasing a mere caffeine fix.

In addition to customer education is the heavy reliance on advertising. In many Third Wave shops there are signs advertising the different roasts and the farms where they come from. Baristas tend to inform customers about their purchase and explain the differences between the options available to them. Third Wave businesses advertise their certified organic and fair trade statuses with pride and use them as a means of justifying their high price premiums.

This strategy may seem unconventional at first blush but it is proving to be successful for Third Wave coffee and other artisan products nationwide. The connection between the wine industry, foodie phenomenon, organic movement, and specialty coffee industry is undeniable. Their business approaches have allowed many artisan industries to gain financial success and popularity. The specialty coffee industry is an exemplary model for the proper implementation of these strategies.

Though the coffee industry in the United States of America was previously thought to be a saturated market, the Third Wave coffee segment has grown at a rate of 7% annually since it began in the 1990s.⁴² The strong economic trends inspired by the Third Wave coffee movement have caused economists to expect the segment to continue growing at this rate for decades.

⁴² Brown

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