

# Proposal for USAID Global Coffee Strategy

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Coffee is grown in more than 80 countries on 11 million hectares. It is second to oil as the most valuable item of international trade, and provides employment to over twenty million people in some of the poorest countries in the world. The United States consumes 20% of world coffee production. According to the International Coffee Organization (ICO), in 1997, the U.S. coffee market was worth an estimated US\$ 9.6 billion; up 12% on the previous year, and up 80% on the 1990 market. An increasing share of the U.S. market is in specialty coffee<sup>1</sup> which was once a minor part of the market but has now garnered almost 30 percent of total coffee market sales and is projected to make up 50 percent of U.S. coffee sales by the Year 2000. With this change, there are new opportunities to sell high quality coffee. Coffee consumers while increasingly sophisticated in their desire for unique quality coffee are also concerned about social and environmental issues as witnessed by an increasing number of retail coffee companies (including Starbucks) promoting “alternative” coffee.<sup>2</sup>

**Opportunity:** USAID, through a global program partnered with key individual USAID Missions, could play a pivotal role in helping small farmer organizations identify and market “alternative” coffee resources to U.S., European and Asia coffee markets. While this is a small segment of the overall coffee market, it may offer significant returns to small farmers meeting the criteria for high quality, old variety arabica coffee that delivers an excellent cup quality and also provides important secondary environmental and social benefits. Market research and input from industry experts indicate that the typical gourmet coffee consumer ranks quality as the highest priority in buying a particular coffee. There are, however, secondary concerns about the impact of coffee production and processing methods on biodiversity (migratory bird populations for example have declined by 30 percent in new variety, sun produced coffee in Latin America). Native shade trees, a primary requirement for alternative coffee, are usually found in old variety arabica coffee (typica and bourbon varieties). This old growth or heirloom coffee also has a cup quality recognized by many as being clearly superior to modern coffee varieties.

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<sup>1</sup> **Specialty Coffee** - ICO’s “Coffee International File” classifies specialty coffee as retail coffee types ranging from single origin coffees, roasted by comparatively small firms (although Starbucks breaks that mold with 1,200 retail outlets and over \$1.3 billion in sales in 1998) to premium coffees sold in supermarkets. Specialty coffee is sold in upscale coffee shops and delicatessens either as single origin, blended, flavored and organic types. Premium coffees are sold through mass market outlets by the three principal coffee retailers in the U.S.: Kraft Foods Inc. (Philip Morris Group), Nestle, and Procter & Gamble.

<sup>2</sup> **Alternative Coffee** – Coffees that claim to be one or more of the following: bird-friendly, environmentally friendly, fair-traded, socially responsible, or organic. Bird-friendly Coffee is defined as coffees grown under conditions that favors the natural environment (biodiversity in particular). Tree shade is emphasized by “bird friendly” and these coffees may be grown under integrated pest management which use commercial pesticides and fertilizers in limited amounts. Fair traded coffee is marketed in such a way that the small coffee producer receives a higher price than he/she otherwise would. This may be achieved by the elimination of middlemen, “coyotes”, obtaining a higher farm gate price for the farmer, or by both. Organic coffee is grown on land free of all but a very few, specified commercial additives over the past three years, then processed and roasted in a chemical free environment.

What had been a weakness, lower yielding old variety coffee, can be a major advantage if identified, processed correctly, isolated and marketed as a unique tasting coffee<sup>3</sup> with important secondary environmental and social benefits.

After an extensive review, it was determined that there is no system in place to verify alternative coffee sources. Starbucks is working with Conservation International in Mexico to source coffee it markets as shade or bird friendly. Other companies use information from field visits and contacts in source countries as verification that their product is providing benefits identified with alternative coffee. Recent articles in The Atlantic Monthly, The New York Times and The Wall Street Journal stress the important potential of alternative coffee in addressing social and environmental issues. But a global, recognized system to actually verify alternative coffees is not in place. There is an opportunity for USAID working through the NGO community to put this system in place, and provide significant value to old growth, shade grown, small farmer produced coffee varieties. This system would help farmers verify production systems through satellite imagery of GPS demarcated fields, link those farmers via Internet with U.S., European and Asian consumers, and promote joint ventures between USAID supported farmer groups, source country coffee exporters, and private specialty coffee companies. Also, this same verification system could serve to measure carbon sequestration programs, habitat preservation on a large scale, and promote community to community North-South links at a grass roots level (a school or a church could “adopt” and interact daily with a campesino community via an Internet link).

The literature indicates that a large segment of the American public is concerned about social and environmental issues. Over 1,000 Lutheran churches are buying “fair trade” coffee for their congregations. Birdwatchers now number over 54 million in the U.S. and they are concerned about the 30% decline in some neotropical migratory bird species over the last 15 years (a decline that many associate with a change from old shade coffee varieties to semi-dwarf hybrids produced in sun). Over 80% of primary U.S. coffee drinker age group (45 to 65 yrs) gave a donation to charity in 1997 averaging over \$1,100 with 29% earmarked for social and environmental causes. Surveys and national events (the Seattle WTO protests for corporate responsibility) indicate that doing good is not only spiritually but financially rewarding. USAID has an opportunity to 1) help small farmers increase the value of a critical commodity, 2) empower ordinary citizens, through their purchases, to know they are making a difference, and 3) help coffee sector corporations quantify the positive social and economic impact of their purchasing and marketing decisions.

The issue and the opportunity is how to give value to our farmers and their products, then use that value to leverage in-country and offshore investment in joint venture enterprises to market this unique product. An additional opportunity is to bring the American consumer and USAID's ultimate client down to village level to see and hear issues and understand the difference their choices as a consumer make which in many cases impact

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<sup>3</sup> **Hybrids vs Heirlooms** – Kevin Knox in “Coffee Basics”, John Wiley & Sons, 1996, p. 4 states that ---“As is the case with many domesticated agricultural products today, the issue of growing heirloom varieties versus modern varieties is a great concern to the specialty coffee industry. Older versions of the arabica plant are preferred by many specialty coffee buyers for their superior and distinctive taste qualities. Specialty coffee buyers concerned about flavor and the future existence of fine coffee encourage growers to continue cultivating heirloom plants. They are also willing to pay the higher price that support growers in doing so.”

directly in their lives. This strategy is one part of a series of actions under consideration in USAID/Peru to ensure sustainability of our Alternative Development Program.<sup>4</sup>

**Proposal:** USAID/W via an NGO will establish a global program linked through buy-ins with key coffee source countries (USAID/Ethiopia at a technical level has indicated interest in the program and contacts are being made with other USAID Mission technical offices) to:

1. Establish a verification system to identify and isolate unique coffee types meeting established minimum criteria for alternative coffee. Rigid quality standards for green coffee would be the foundation of the program. Coffee meeting this standard would then be classified on the basis of type, production system and social benefit to the community. This is a complicated area and would require close consultation with the coffee industry but initial contacts with major specialty coffee retailers, the SCAA Environmental Committee, Smithsonian Migratory Bird Program, TransFair USA (a small farmer "fair trade" organization), and the Songbird Foundation indicate there is interest and a willingness to participate in developing a set of standards. The verification system would involve demarcating source country production areas with portable Global Positioning System (GPS) equipment (e.g., Magellan GPS Satellite Navigator), verifying demarcated areas for amount and type of tree shade with three meter resolution unclassified satellite imagery, and establishing an in-country audit trail to authenticate coffee origin according to classification. How coffee would be classified raises issues as well but a suggestion by Danny O'Keefe, Director of the Songbird Foundation, sounds practical: O'Keefe recommended a gold, silver and bronze standard in which a certified organic, shade coffee produced under fair trade guidelines would be gold; 2 of those criteria would be silver; and one would be bronze.
2. Establish an "information platform" via the Internet that would provide source country producer information linked to the verification system and also provide for direct communication between source country farmers and U.S., European and Asian consumers. This link would also provide a format for "relationship marketing" with target country consumers via monthly electronic newsletters, special country reports, opportunities to help, etc. The objective is to create a customer database owned by the USAID small farmers which would have value for coffee wholesalers and retailers in target country. The end result of the verification system would be a code for each bag of coffee sold by a retailer that would allow a consumer to enter a restricted website at the USAID financed Internet site which would yield specific information on where the coffee was produced, who produced, what type of shade was at the farm site and what bird species this habitat supported, organic certification information, fair trade information, etc. Latest technology would be used to provide streaming video

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<sup>4</sup> USAID/Peru is implementing a \$194 million Alternative Development Program (ADP) aimed at sustaining illicit coca reduction by providing the social and economic base for a legal society in Peru's high jungle area. Since many Peruvian farmers in the coca zone are also coffee farmers (we are currently working with over 7,000 small farmers producing 16,000 hectares of coffee --- about 30% would meet the quality and other criteria for alternative coffee). ADP, which began in 1995, is currently programmed to end in 2003. USAID/Peru is defining and initiating the implementation of an "exit strategy" that focuses on making critical aspects of the program self sustaining. We understand that this is largely a market driven process that will require Peruvian and offshore investment, and our efforts are aimed at increasing the marketability of our small farmers and their products.

interviews of farmer, still and motion images of farm site, shade trees, bird species (also include audio files of specific bird calls), and satellite imagery with a full interpretation and longitude/latitude coordinates from GPS. There will also be an Internet link with the farmer community or group of communities and a system to encourage consumer direct contact with farmers and their families.

3. Initiate a publicity campaign to inform consumers of the issues related to alternative coffee, explain the verification system and how it works, solicit consumer involvement in the program by their contacting an Internet site and/or a 1-800 telemarketing number. An important aspect of this program to coffee retailers will be the customer potential developed by the interactive way the program is operated with consumers. The marketing emphasis will be on “wallet share” as opposed to market share<sup>5</sup>. If the program is successful it will develop a database of consumers with a strong preference to purchase a product that carries the program label, verification code and with access to the interactive platform for understanding the importance of their purchase. Overall market potential could be very high. Initial discussions with green coffee exporters in Peru have been enthusiastically received and it appears a joint venture enterprise can be established between exporters and our farmers.
4. Promote linkages between small farmers, green coffee exporters and specialty coffee markets to encourage private sector investment in the program. In fact, the program will only be successful if the private sector perceives a value in the system and its potential to increase their profits. This promotion could follow the lead of USAID’s successful Global Technology Network (GTN) which is bringing U.S. companies together with developing country market opportunities. This would also be the part of the program that would promote the social benefit and recognition that could accrue to companies involved in the program. This component would be tied into the publicity campaign and do similar publicity initiatives like CARE uses in promoting their association with Starbucks (Starbucks is CARE’s largest corporate sponsor). The virtual relationship that the Internet linkage between consumers and small farmers and their communities will give the program a draw for Internet based companies to become involved (re CISCO Corporation with UNESCO and their World Aid site featuring U2 and other celebrities).

#### Next Steps:

This proposal will be shared with USAID, industry and NGO representatives for their input and recommendations. If there is sufficient interest and support for a global program, a meeting could be called to draft a detailed program description. Design of the program should be a joint effort with equal participation from USAID/W, USAID Missions, the specialty coffee industry, and concerned NGOs. USAID/Peru will proceed in developing this program in conjunction with local private sector investment and be ready to support a larger initiative. On a global scale this is a rare opportunity to for USAID to move international assistance, citizen involvement and sustainable development a quantum leap forward.

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<sup>5</sup> **Wallet Share** – Having a loyal, committed customer base is critical to retail sales and is highly prized. For example, with only 10,000 consumers drinking the equivalent of 20 grams of coffee per day at current specialty coffee price levels of \$9.50 per pound, that would amount to 440 pounds of coffee sales per day at \$4,100, in a year sales would be \$1.5 million. Reaching only one percent of current specialty coffee consumers would mean sales of over \$25 million annually and the potential if quality can be maintained.

# Background

Coffee (family Rubiaceae, genus *Coffea*) is native to East Africa and Arabia but has been introduced around the globe and is currently exported by at least 43 countries. It is estimated that approximately 11 million hectares are in coffee cultivation around the world. Although there are twenty species within the genus *Coffea*, only two are important to world coffee commerce: 1) *Coffea arabica* (known as “arabica”) the original coffee which originated in Ethiopia over one thousand years ago, it makes up 70 percent of world coffee trade, is grown at higher altitudes, has good cup quality and demands a higher price in coffee market; and 2) *Coffea canephora* var. *robusta* (known as “robusta”) originated in the lowland forests of West Africa and entered commercial trade in last 40 years, it makes up 30 percent of world trade, grows at lower altitudes, is a hardy plant with high production and high caffeine content but has poor cup quality. The International Coffee Organization Indicator Price data (1995 – 1998) indicate an average arabica price of US\$1.78 per pound compared to US\$0.83 per pound for robusta.

Generally speaking, Central and South America grown arabica coffee, and West Africa and Southeast Asia grow robusta. One exception is Brazil, which grows both coffee varieties and is projected to produce over 22 million 60 kg bags of arabica and 4 million bags of robusta in 1999. The United Nations Food and Agriculture Organization (FAO) estimates that in the 1990s there were 11 million hectares of coffee cultivation with 2 million hectares in North and Central America, 4.2 million in South America, 3.4 million in Africa, and 1.4 million in Asia.

From the two major types of coffee, robusta and arabica, there are many varieties. The oldest varieties of arabica are “typica” and “bourbon”; both require shade cover to produce effectively. Beginning in the mid-1970s, a successful push to “technify” or “modernize” the coffee sector in much of northern Latin America emerged. The force behind this move came from a fungal disease known as coffee leaf rust (*Hemileia vastatrix*), also known by its Spanish name, *la roya* (“the rust”), spreading throughout the region. The devastating potential of the rust was known from historical records in India and Sri Lanka (formerly Ceylon), where the disease halted coffee production within two decades in the second half of the 19th century. The wind-borne spores finally made a New World landfall in 1970 on the East Coast of Brazil, an event that triggered panic throughout the coffee industry in the Americas. A major effort was made to replace old growth, typica and bourbon coffee with resistant semi-dwarf hybrid arabica varieties (Caturra, Catuai, Colombia and Catimor) which produced higher yields but required production in full sunlight and increased use of fertilizer and pesticides. Recent studies indicate that 40 percent of Latin American coffee has converted to the new semi-dwarf, arabica varieties and sun cultivation (this includes 60 percent of Colombia’s coffee crop, 40 percent of Costa Rica’s crop and 35 percent of the crop in Honduras). This change from shade produced old varieties to sun produced semi-dwarf hybrids has been associated with a drastic reduction in some migratory bird species.

Aside from a negative environmental impact, some experts question the cup quality of these new varieties preferring the old growth types (typica and bourbon) for their cupping characteristics. Blind cuppings indicate that production area, age of the plantation, and post harvest processing and handling are key factors in determining final cup characteristics of a particular variety. However, old growth arabica varieties of typica and

bourbon tend to be the most sought out by the specialty coffee trade for their cup characteristics<sup>6</sup>

Trading Classifications

The International Coffee Organization (ICO) was established in 1963 to administer the International Coffee Agreement (ICA) providing for coffee production and consumption quotas aimed at stabilizing world coffee prices. The ICA was in effect until 1989 and the ICO continues as a coffee monitoring/information sharing entity for the world coffee industry. Part of ICO reporting and monitoring involves tracking the trade of various coffee types.

ICO tracking of world market trade is classified into four types, three Arabica groups --- Colombian Milds; Other Milds; and Brazilian and Other Milds; and one Robusta group. The following table provides a summary of coffee producing countries included in each category and the overall market share of each type.

Type	Primary Producers	1997 Export Market Share
Colombian Milds	Colombia, Kenya and Tanzania	16%
Other Milds	Costa Rica, El Salvador, Guatemala, Mexico, Honduras, India, Jamaica, Cuba, Burundi, Zambia, Rwanda, Nicaragua, Venezuela, Haiti, Malawi, Peru, Zimbabwe, Panama, Papua New Guinea, Ecuador and Dominican Republic	31%
Brazilian & Other Arabicas	Bolivia, Brazil, Ethiopia and Paraguay	25%
Robustas	Angola, Brazil, Ghana, Guinea, Indonesian, Liberia, Nigeria, Benin, Cameroon, Ivory Coast, Gabon, Togo, Madagascar, Philippines, Sierra Leone and Vietnam	28%

Regarding the different types of coffee in the U.S. market, the Colombian Milds and Other Milds have traditionally commanded the highest premiums based on quality (although this depends in large part on country of origin within the classification). The Brazilian and

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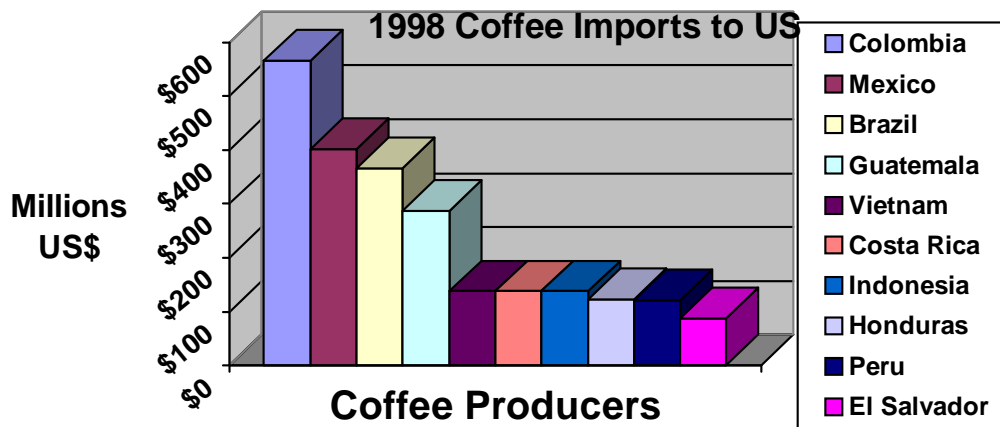
<sup>6</sup> An example of this desire for the old growth varieties is found in Mark Pendergrast’s 1999 book on the history of coffee, “Uncommon Grounds” in which he described the impact of new varieties p.295, “Agronomists made the situation worse with heavily producing hybrids. Their beans did not taste quite as good, but few noticed or cared.”: And on p. 296, “(with the introduction of Caturra, Catuai and new varieties) ... one after the other, the fine coffees carefully grown and harvested on the upper hills of America, Africa and Asia have become scarce.”

Other Milds are generally used in mass produced “ground/roast” coffee segment for blending. Generic “super market” coffee is typically a blend of 1/3 good arabica, 1/3 medium quality arabica, and 1/3 robusta. The “instant coffee” segment is comprised primarily of processed robusta and lower quality arabica. The “whole bean” and “specialty” segments use higher quality arabica (Columbia and Other Milds coffees). According to prominent industry representatives, there is a growing shortage of exceptional quality coffee.

Coffee Exports to U.S. Market

In 1997, the U.S. imported 20.6 million bags of coffee, up 11% on 1995/96. The U.S. sources most of its coffee from Latin America. In 1996, Mexico was the number one supplier with a 20% share of the import, followed by Colombia (16%), Brazil (12%), Guatemala (9%) and Indonesian and Vietnam (each at 6%). Together, the top six source countries made up some the gross import total of the U.S. Strongest import growth over the 1991-96 review period was recorded by Mexico (+29%), Guatemala and Indonesia (+122%). The following graph shows the top ten coffee source countries for the U.S. in 1998<sup>7</sup>.

In the U.S., there is a clear preference for Arabica coffees with over 80 percent of all coffee imported being Arabica and 68 percent of coffee imports are classified as



Colombian Milds and Other Milds, both classes of higher quality coffee.

Peru exports to the U.S. averaged approximately 500,000 60 kg bags per year to the U.S. since 1991. A recent purchase of arabica coffee of the variety typica by Seattle Best Coffee Company as a specialty coffee signaled U.S. coffee sector interest in high quality, old variety coffee. Kenneth Davids ([www.coffeereview.com](http://www.coffeereview.com)), a coffee expert who hosts a blind cupping panel, recently that, “the finest old arabicas have been growing in particular microclimates for years ... a botanical variety interacts with growing conditions to affect the taste. The challenge is to find the right variety for a given set of growing conditions.”

<sup>7</sup> Top ten countries providing coffee to the United States were: 1) Colombia with exports of green coffee to the U.S. valued at US\$566 million, 2) Mexico at US\$401 million; 3) Brazil at US\$367 million; 4) Guatemala at US\$287 million; 5) Vietnam at US\$138 million; 6) Costa Rica at US\$138; 7) Indonesia at US\$138 million; 8) Honduras at US\$123 million; 9) Peru at US\$121 million; and El Salvador at US\$88 million.

## United States Coffee Market

The United States of America is two and one half times as large as Western Europe. It is comprised of fifty states with a land area of over 9 million square kilometers, a population of 272 million citizens and a powerful, diverse and technologically advanced economy with a per capita Gross Domestic Product of US\$31,500. Over the last fifty years, sustained U.S. economic growth spurred a 200 percent rise in American real income. In the last decade, the U.S. experienced the longest peacetime economic expansion in its history with personal income going from US\$4.796 trillion in 1990 to US\$6.027 trillion in 1998. During the same period, disposable personal income rose from US\$16,689 to US\$22,301, and median family income went from \$35,353 to \$44,568. Disposable income is at the highest level in a generation while unemployment and inflation both remain low (4.5% unemployment and 2.5% inflation). The U.S. is an affluent society with high discretionary income and high consumption levels.

In the roast and ground market, regular ground coffee will continue to lose share to the specialty/gourmet sector. By the year 2002, whole bean coffees are also expected to have doubled their share of the market. Higher value-added decaffeinated coffee products could also potentially increase share of ready-to-drink sales in the market, though this will depend on company marketing strategies and other factors. Ground coffee commanded a 43% share of the U.S. coffee market by value. In 1997, specialty coffee held a 27% share and whole beans a 7% share. The specialty market accounted for about 37% of coffee sales in the U.S. By the year 2000, this share is expected to reach around 50%. The specialty sector will continue to drive coffee sales in the U.S. The chains (egg. Starbucks, Second Cup, Barnie's etc.) account for roughly 70% of total specialty retail sales.

### Market Segments

According to the International Coffee Organization industry report, "Coffee International File, 1998 – 2002", the U.S. coffee market is divided into five principal segments: 1) roast and ground; 2) whole beans; 3) specialty/gourmet; 4) instant; and 5) ready-to-drink. Total market value in 1997 stood at US\$9.6 billion.

Roast and Ground - The roast and ground segment is the traditional mainstay of the U.S. coffee sector characterized as mass marketed, canned blend of arabica and robusta coffee. In 1997, roast and ground coffee was worth an estimated US\$4.2 billion with regular ground accounting for 73 percent of the segment and decaffeinated making up the remaining 27 percent. Four companies control this segment: Proctor & Gamble (Folgers, Millstone); Phillip Morris (Maxwell House, Chase & Sanborn); Chock Full O'Nuts; and Nestle (Hill Brothers). Trend is for decreasing growth, as specialty coffee becomes stronger player in market.

Whole Bean - The 1997 whole bean category had an estimated value of US\$679 million, up 13 percent from 1996, and 202 percent higher than 1990. The growth of whole bean coffee in recent years has been largely at the expense of instant and is believed to be a reflection of maturing U.S. consumer taste. The relative strength of the economy is enabling consumers to indulge in affordable luxuries including upscale varieties of staple consumer products. The expansion of new retail formats throughout the U.S., in particular the franchise coffee shops (Starbucks, Seattle's Best, Deidrich, etc.) helped spark consumer demand for a wider diversity and higher quality coffee. In supermarkets



this has translated into high growth of whole bean coffee sales, as well as higher priced varieties of roast and ground brands. In 1997, supermarket sales of whole bean coffee were US\$234 million. Competition in the supermarket sector is now intensifying. This segment should continue growing as mass marketing/supermarket sales intensifies.

Specialty/Gourmet - Specialty coffee has been part of a larger cultural trend that includes such developments as microbrewer beer, specialty breads, single malt scotches, and organic vegetables. In each case, a consumer product has been recast as something more authentic, more traditional, diverse, flavorful, and healthful than the mass-produced product it supplants. In each case, the "specialty" product is hyped as the original, traditional item that had been debased by mass production and corporatism. Trends analyst Faith Popcorn describes the appeal of these products as deriving from their role as "small indulgences". A three dollar (specialty coffee drink) is a quick and cheap vacation; a break from the hectic modern lifestyle. What's more, it's one that almost everyone can afford and is small enough to not be overtly indulgent or decadent. "In a consumer culture," writes Popcorn, "the motive has never been need, but want." The aging of "baby boomers" will change market demographics for U.S. retailers. Part of this change will be an increase in the number of affluent consumers, 45 to 65 year olds, interested in a higher quality of life and a group which has historically consumed more coffee.

A 1996 SVP Fine Market research report estimates that in 1996, the retail dollar volume for all coffee products sold through all channels of distribution totaled over \$8.6 billion. Of that, supermarkets accounted for 58% of total retail sales, or almost \$5.0 billion. Within the total market, SVP estimates canned ground coffee was the leading segment, with over \$2.6 billion in retail sales through all channels. The second-largest segment of the coffee market was specialty coffee, with total retail sales of just over \$2.2 billion. In 1997, the ICO reported that the specialty coffee market was worth US\$2.6 billion, and had grown by 216 percent since 1990. It currently accounts for 22 percent of all coffee volume and 27 percent of coffee value in the U.S. market. When instant specialties are included, market share climbs to around 37 percent. Flavored coffee is estimated to make up 40 percent of this segment. In the late 1980s, the estate/prestige coffee became popular in the U.S., and demand for "alternative coffees" such as organic, Fair Trade, etc. also began to grow. Growing mail order business for high value coffee noted in this segment with Philip Morris' Gevalia with a major portion of an estimated US\$300 million business (Starbucks is also increasing efforts in mail order and as well as a number of other companies --- Thanksgiving Coffee, Equal Exchange, Green Mountain Roasters, Bernie's, Seattle's Best, etc). To varying degrees, specialty coffee continues to drive coffee sales with most growth occurring in non-traditional channels. Specialty is rising star segment of market and is expected to continue overall growth in both total coffee volume and market value.

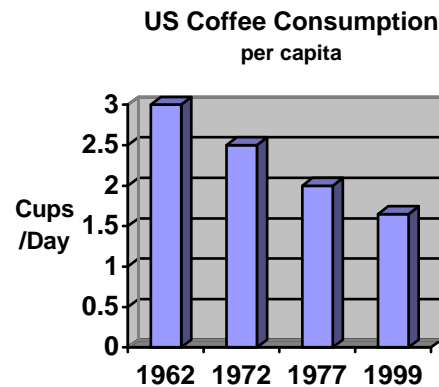
Instant - The U.S. regular instant coffee was worth US\$1.87 billion in 1997. Regular instant coffee made up 81 percent of this total while decaffeinated was 19 percent. Overall market share of instant coffee has dropped from 29 percent of total coffee market in 1990 to just under 20 percent in 1997. Expect a continuing declining share of market for instant coffee.

Ready-to-Drink – This is the fastest growing segment of the coffee market increasing from sales of US\$19 million in 1990 to US\$298 million in 1997. These are primarily canned or bottled coffee drinks in a variety of flavors. Nestle, Starbucks, Cornucopia

Beverages and others are involved in this market. This segment is expected to continue growing at a strong pace (Starbucks sales of Frappuccino drink now being made through Wal-Mart is a good indication of market exposure of ready-to-drink products).

### Coffee Consumption

The United States is the largest coffee-consuming nation in the world, drinking roughly one fifth of the 100 million 60 kg bags of coffee produced each year. Coffee is produced in the U.S. in Hawaii and Puerto Rico but production is limited to less than 100,000 bags or 0.1 percent of world production. Over 75 percent of all coffee consumed in the U.S. is consumed at home. In 1996, the equivalent of 450 million cups of coffee were consumed in the U.S. making coffee, at US\$3.4 billion, the most valuable food import. According to the International Coffee Organization, total sales of coffee in the U.S. exceeded US\$9.5 billion in 1997. Even though coffee continues to be a significant part of U.S. retail market, overall coffee consumption is down more than fifty percent from its peak year in 1962-1963, when the U.S. consumed more than half of all world production.



Coffee consumption as tracked by the National Coffee Association Coffee Drinking Trends annual survey has been found to be relatively inelastic. That is, price and/or other factors tend to have little impact on consumption, and changes in the market are very small. Significant market changes take a long time. Per capita consumption of coffee has declined by 50 percent over the last 30 years or so, and the NCA believes the decline has reached bottom and predicts coffee consumption, spurred by specialty coffee sales, will show an increase over the next five years.

The most important coffee drinkers in the United States are the 50 – 69 age bracket which according to a coffee consumption survey by the U.S. National Coffee Association, (NCA) in 1999, consumed 2.4 cups per day followed by 30 – 49 year olds at 1.7 cups per day. The International Coffee Organization recently stated that the greying of North America has implications for the types of coffee produced and marketed citing that specialty and gourmet products may be regarded as holding particular attraction for older consumers. Daily coffee consumption per drinker in the US was up 16.6% in 1999 on the year, according to the NCA survey. Consumption went from 3.0 cups per day in 1998 to 3.5 cups for the nation's 113 million daily coffee drinkers. Young adults were the fastest growing segment of coffee drinkers in the U.S., with 23% of 18-24 year olds consuming 4.6 cups of coffee on a daily basis. "This is good news for everybody, consumers and producers," said one coffee roaster, "industry should care for the quality of the coffee it sells and producers, the quality and care of their orchards because I think this only shows what is going on with consumption at a global level and consumers are demanding more and higher quality." The widening of the U.S. coffee market was highlighted in the 1998 NCA survey indicating that there are now 21 million daily gourmet coffee drinkers compared to 4.5 million daily consumers in 1993. By 1998, retail specialty coffee beverage sales in the U.S. at some 15,000 cafes, kiosks, and carts --- had passed \$3 billion in sales. This new industry is consuming 5 percent of the world's coffee output and

diverting some fine coffees from European markets that were more accustomed to high quality beans.

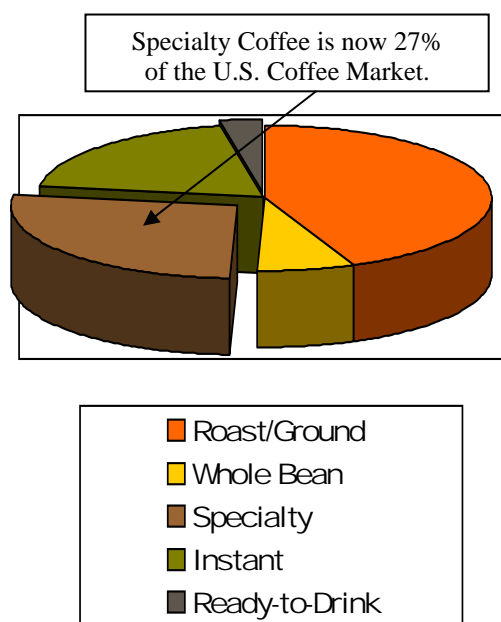
The Coffee International File, 1998 – 2002, drafted by the International Coffee Organization cited the growing importance of specialty coffee. Some comments from the report were the following:

- While overall coffee consumption was stagnant over the last 9 years, the specialty coffee segment grew by over 70 percent. Ready-to-drink coffee, specialty/gourmet ground coffee, and whole beans were the most dynamic sectors of the market. Niche segments currently showing strong growth include espresso, flavored coffees, and instant cappuccinos.
- Although specialty coffee is not expected to become the staple beverage among the majority of users, growth in the U.S. coffee market over the next five years will continue to be driven by this thriving sector --- in particular by the gourmet or single origin/estate coffee segment.

### Current Situation

Despite a long-term trend towards more dining out, consumption of coffee has not increased at eating-places over the past 40 years. increasingly, coffee is being consumed at home (75 percent of coffee consumption takes place in the home) and in the morning (54 percent of coffee drinkers surveyed indicated primary consumption was in the morning) instead of late in the day when people are more likely to dine out. Consumption in the roast and ground sector has been increasing at the expense of instant in 1997, the proportion of the U.S. population consuming regular coffee stood at 41 percent, up from 37 percent in 1988, while the percent drinking instant coffee stood at just 9 percent, down from 15 percent in 1988 and 24 percent in 1982.

The coffee culture in the U.S. has traditionally centered on mass produced roast coffee but since 1990 a major change in the coffee sector has occurred with the advent of specialty coffee. The specialty industry has tapped into an unrequited desire for diversity and quality among affluent coffee drinkers, and has stopped the slide in overall coffee consumption. In 1998 there was an increase in coffee consumption, the first time in a third of a century, with a total of 177 million Americans drinking coffee, 113 million of which call themselves



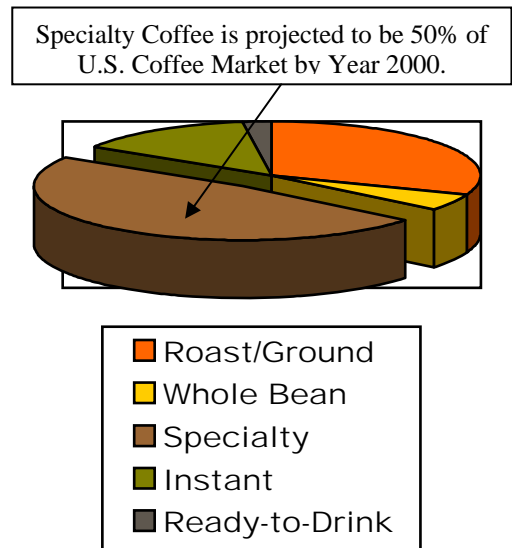
daily coffee drinkers, up from 105 million in 1991. Out of these 113 million daily coffee drinkers, over 20 million identified themselves as specialty coffee drinkers.

The Coffee International File, 1998 – 2002, drafted by the International Coffee Organization cited the growing importance of specialty coffee. Stating that while overall coffee consumption was stagnant over the last 9 years, the traditionally smaller segments --- ready-to-drink coffee, specialty/gourmet ground coffee, and whole beans --- were the most dynamic sectors of the market. Niche segments currently showing strong growth include espresso, flavored coffees, and instant cappuccinos.

According to Specialty Coffee Association of America (SCAA), in April 1999, there were approximately 15,000 active specialty coffee retailers here in the U.S. currently. About 50% would qualify in the general category as a "coffeehouse"; others would be more accurately categorized as coffee retail stores, kiosks, espresso bars or carts. A good definition of a coffeehouse, is a unit that does a significant amount of coffee beverage business (at least 30% of sales) and has seating for customers. The average revenues for coffeehouses in the U.S. is about \$350,000. Sales mix is about 15% whole bean (for consumption off premise), 50% beverages, 30% food, and 10% "other". More and more consumers understand coffee quality and are increasingly demanding a better coffee for home and out of home consumption.

Market Trends

The U.S. market is changing. The aging of "baby boomers" will change market demographics for U.S. retailers --- from 1990 to 2010, the 45 year old age group will increase by 225 percent. These consumers will help fuel the continuing cultural phenomena of increased specialty coffee consumption in the U.S., which has more than doubled since 1990, and now accounts for 27 percent of total coffee sales. Within the next few years, sales of specialty coffee in the U.S. are expected to reach over US\$4 billion, or around 50 percent of total U.S. coffee sales. One result of this market change has been an increase in quality by the large roasters. Overall coffee quality is improving and according to a recent book on the coffee industry, "Uncommon Grounds" by Mark Pendergrast, "... it is becoming increasingly difficult to find reliable sources, since the supply of true 'specialty' coffee ---- about ten percent of the world's Arabica production at best --- is getting tight." U.S. market for mass produced coffee is static to declining but specialty coffee segment continues to grow. Direct mail specialty coffee is currently valued at US\$300 million and growing. Projected demand for specialty coffee including mail order whole bean and ground coffee should continue to be strong.



Within the increasing demand for high quality coffee, there is a small but growing focus on how coffee is grown and marketed, and the impact that production and marketing practices have on small coffee farmers, natural resources in fragile tropical areas, and global environmental issues. A recent survey ("Essential Data on Civic America" in The Public Perspective, Vol. 7, #4, June/July 1996, The Roper Center) of U.S. consumers indicates that between 1987 – 1993, 73 percent of American households contributed to charity. Over 23 percent of contributions went to charities involved with environmental and public/social activities, and the age groups providing the most contributions per household (avg. of \$1,100), 45 to 74 year olds, is the same population group that consumes the most coffee in the U.S. and meets other critical criteria for gourmet product consumers. This age group is becoming especially important in terms of coffee consumption, high- income level, and tendency to support social and environmental causes. This group with its higher disposable income also tends to travel more, engage more in leisure activities, and contribute to causes that concern them.

A marketing trend is emerging to provide coffee that is produced in such a way that it helps protect U.S. migratory birds. Up to 10 billion birds summer in the temperate forests of North America --- various species of swallows, swifts, warblers, vireos, orioles, raptors, thrushes, and hummingbirds are neotropical migrants. During 1978 – 1987, the U.S. Fish and Wildlife Service's Breeding Bird Survey found a decline in neotropical migrants from one to three percent annually. Loss of shade cover in coffee producing areas could be a factor contributing to this decline.

### Mail Order Coffee

In the U.S. there were 2,000 coffee roasters in operation in 1998, although only three roasted more than one million 60 kilogram bags and the largest 4 percent of roasters accounted for more than 80 percent of all coffee roasted. Coffee at the large roasters is ground and packaged, usually in vacuum packed bricks or cans. For small scale (specialty) coffee roasters, the goal is maximum freshness achieved by roasting small quantities for sale and consumption within a short period of time. Most roast coffee (64 percent in 1998) in the U.S. is sold in supermarkets as mass produced canned coffee, and amounts to over US\$6,000 million in retail sales. Specialty coffee roasters distribute their coffee to retail outlets, restaurants, and by mail order with a total retail sales value of over US\$2,500 million. Whole bean coffee sales amounted to US\$679 million and ready-to-drink coffee had sales of US\$300 million. In the specialty coffee category, mail order coffee accounts for about four percent of coffee consumption in U.S. homes (approximately 50 million pounds of roasted coffee) with a value in excess of US\$300 million. Prospects are good for a continued increase in the sale of specialty coffee including via direct mail as indicated by recent launch of Starbucks direct marketing of mail order coffee.

### Target Consumer Characteristics

Alternative coffee program will target consumers who: 1) fit primary demographic for specialty coffee drinkers (college educated, urban dwelling and between 35 and 65 years of age), 2) are concerned about social issues and have donated to a community development or environmental charity within the last six months, 3) regularly purchase products by mail, and 4) are interested in exotic lands (they will have either traveled overseas or in some other way shown interest).

## Age & Income

The wealthiest segment of the U.S. population, those above 45 years of age, also consume the most coffee. From 1990 to 2010, the 45 and above age bracket is projected to grow by 225 percent. Since 1997, 10,000 Americans turn 50 every day or some 3.6 million people per year according to the Census Bureau. This market segment enjoys a higher relative

income with the 45 to 54 year group achieving a 3.3 percent increase in median household income from 1980 to 1995. During the same period, the 55 to 64 year old bracket has a 5.2 percent increase in income while the 65 and up segment's

income rose by 17.4 percent. By 2008, these older population segments will overtake the younger set, altering the landscape of consumer spending in the 21<sup>st</sup> century. While marketers have traditionally focused their efforts on younger married couples, considered by many the bedrock of consumer demand in the United States (the "mass market"), that market is changing. By 2002, 45 to 54 year olds will be the biggest aggregate spenders in health care, transportation and entertainment. And their spending will be nearly equal to the 35 to 44 year old households in food and apparel. This older segment may not spend in total as much on food as active parents do, for example, but they spend more per capita and they are prime consumers of gourmet foods and high quality fresh foods.

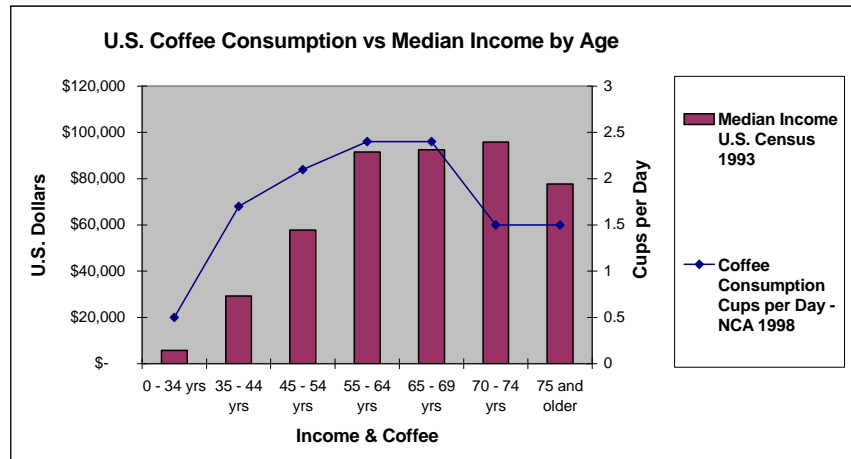
A recent International Coffee Organization paper states that consumption of specialty coffee in U.S. is predominantly an East and West Coast phenomenon, with consumers tending to be well educated, in a higher income bracket, and perceive themselves to be more sophisticated and cosmopolitan. Quality and taste appear to be the two main selling points for specialty coffee.

## Social & Environmental Aspects

An important secondary consideration in the marketing of alternative coffee is the impact coffee production and marketing systems have on social and environmental issues important to these consumers. In the marketing campaign and publicity/promotion activities, an emphasis will be on the quality and also the way this coffee is produced, by whom and the impact it has on social and environmental issues.

The message to be provided is the following:

*Alternative Coffee is produced by over 2,000 peasant farmers in Peru's high jungle areas where some of the last major expanses of the old arabica coffee varieties are still grown --- the original typica and bourbon varieties introduced in Latin America over*



150 years ago. These heirloom coffee varieties provide an outstanding and unique coffee drinking experience and they also provide a important social benefit by helping these peasant turn away from coca leaf production (visit <http://www.AlternativeCoffee> or call 1-800-GO-BIRDS) for information on how you can help in the fight against drugs). Since these production areas are already home to some of the highest level biodiversity on the planet, your purchase of this coffee also ensures the continued production of old growth coffee under a canopy of a tropical rainforest provides a critical home to migratory birds and other wildlife.

This same message will be included in the direct mail material sent to potential customers --- the mailing list for this direct mail campaign will be made up of consumers that contact alternative coffee program through its Internet site and 1-800 number.

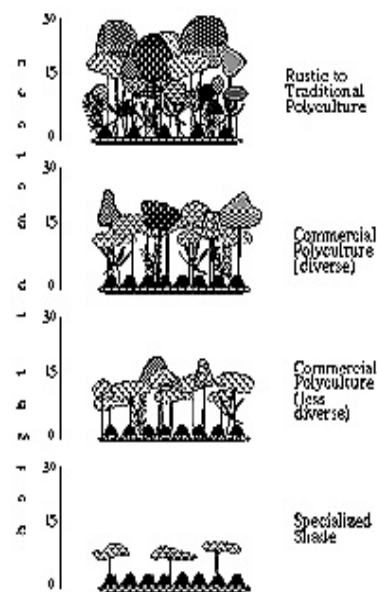
Environmental Aspect - There is a growing concern that converting large areas of coffee from traditional shade production to full sun production has contributed to the 30 percent decrease in numbers of neotropical migratory birds (the Baltimore Oriole is one example). Some coffee companies are marketing their coffee as "bird friendly" because of the way it was grown (under "diverse commercial polyculture" tree canopy as classified by the Smithsonian Institute Migratory Bird Program).

All of this has been accompanied by substantial publicity in the U.S. national media. For example this year the New York Times stated in an editorial that "...buying organic, shade-tree, bird friendly coffee is an everyday act of mindful consumerism that can actually make a difference for both biodiversity and poor peasant farmers..."(Editorial: The New York Times (July 5, 1999 page A15). And an Atlantic Monthly article earlier this year stated:

*"As traditionally grown, under a canopy of shade trees and amid other vegetation, coffee is an environment-friendly crop. The shade trees fix nitrogen in the soil, fostering the growth of the coffee bushes, and their fallen leaves provide nutrients, further reducing the need for chemical fertilizers. The mixture of vegetation prevents erosion and protects the coffee from harsh weather. In contrast to corn and cattle, which almost always require clear-cutting, coffee can be grown in relative harmony with the rain forest.*

*Recently, however, many coffee farmers in northern Latin America have reduced or eliminated shade to grow new high-yielding coffee plants*

Shade gradient gestalt for shade coffee verification  
(epiphytes and parasitic plants not shown)



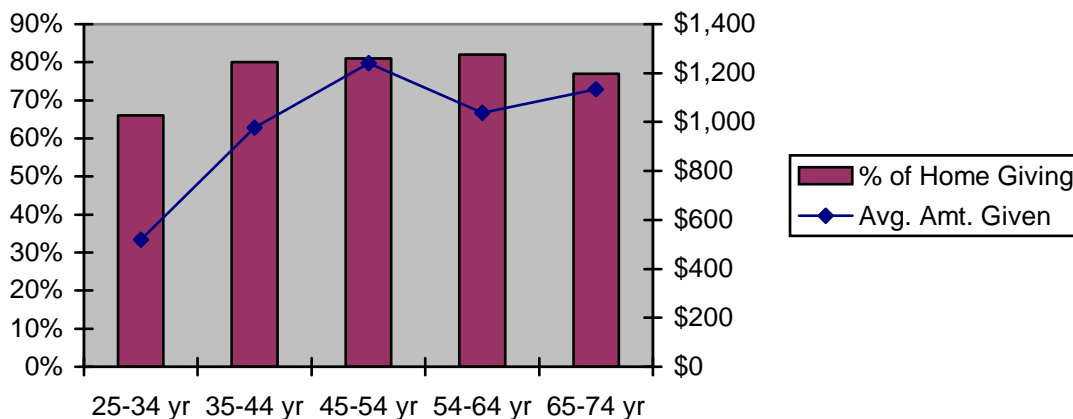
Prepared by SMBC; based on Moguel and Toledo, 1995

*under direct sun. Fear of a disease known as coffee leaf rust sparked an early round of conversions, most of which took place in the 1970s. To prevent the spread of the disease, coffee farmers "technified," replacing older, shade-loving coffee varieties, such as typica and bourbon, with new varieties, packed in tight hedgerows, that can survive open sun -- but only with chemical inputs."*

Consumers are concerned about this change and the potential impact it can have on migratory bird populations. In order to understand the magnitude of this concern, one must look at the statistics for bird watching in the United States. Of the 54 million Americans who consider themselves birdwatchers, 24 million actually traveled in 1991 to observe birds. In the process, they spent US\$2.5 billion. The demographics for serious bird watchers --- well educated, well heeled and interested in conservation --- resemble those for specialty coffee consumers.

Charitable Giving – One of the key aspects of the promotion campaign is the impact Café Peru can have in protecting the environment, promoting Third World economic development, and providing farmers in Peru an alternative to illicit coca production. The objective of promotion activities will be to attract perspective customers to the Café Peru website where they can register for an electronic newsletter, get more information on how Café Peru is produced, how it benefits peasant farmers, and contributes to solving environmental, poverty and drug related problems.

The social benefit of Café Peru may attract consumers who are already inclined to contribute to altruistic activities. As can be seen from the graph, more than 80 percent of the 35 to 64 year old age group give to charity each year with our consumer target group, 45 to 54 year olds, contributing the most per household at US\$1,200. The highest contributors to charities are also the higher median income households which also consume the most coffee --- age, median income, coffee consumption and charitable giving are all attributes of our target group.



It's important to note that between 1987 – 1993, approximately 73 percent of American households gave to charity. The average contribution per household was US\$1,105, and percent of income given was 2.2 percent. In 1996, 49 percent of charitable contributions were made for health, environment, and social benefit programs. Americans are clearly



willing to support charitable activities and the benefit provided by alternative coffee may be an important secondary benefit.

The alternative coffee message to consumers will be:

*"It may be a simple thing to consume a particular type of coffee that one enjoys, and that aspect is very important, but this special ritual can have an impact on a poor farmer in a distant land and the drug problem on the corner in your neighborhood.*

*Alternative coffee. Allowing you to reach beyond your great cup of coffee and help in the fight against drugs. You can make a difference! Alternative coffee can show you how!"*

### Product Marketing Strategy

Alternative coffee will take advantage of increasing demand for specialty coffee in U.S. market. Primary marketing objective is to provide a unique, high quality old variety, roasted Arabica coffee direct to U.S. consumers. The product consists of old growth typica and/or bourbon type coffee grown in Peru's high elevation microclimates and provides not a unique flavor but also directly contributes to biodiversity conservation, improves economic conditions for Peruvian coffee farmers, and conserves critical Amazon basin rainforest.

The primary benefits this product provides are the following:

- Cup Quality - A unique cup quality found in old growth, heirloom Arabica coffee grown at high elevation in the jungle areas of Peru's Amazon Basin. The taste, aroma, body and acidity of this coffee will be a key selling point. Approximately 2,000 hectares (20 percent of current production area) of small farmer produced Arabica coffee will be carefully selected with primary emphasis on the cupping quality of the coffee produced in each microclimate. The goal is to produce only Typica and Bourbon varieties of Arabica coffee. Initial indications are that Peru has the highest concentration of high grown Typica coffee of any country in the world. Confirmation through actual production site selection will be done and a final marketing strategy agreed upon based on coffee varieties available. At a minimum, the marketing strategy will stick with old growth coffee types and promote Old Growth™ coffee.
- Social Impact - This coffee will be produced under conditions that provide a fair return and an equity share for small farmers participating in the business. It will preserve forest habitat for migratory birds and other species. More forest habitat will mean less greenhouse gas emissions and potentially less global warming. Production and processing will be done in a manner that conserves natural resources, minimizes waterway pollution and is sustainable over the long term. A verifiable system will be put into place and monitored by a third party that will "certify" that production conditions meet specific social impact indicators as defined by the Smithsonian Institute Migratory Bird Program, Eco-OK, TransFair and others. Exact procedures and costs of this program have to worked out but an independent body using an auditable trail of actions (much as is done in organic coffee production) will

spot check the system to ensure the creditability of claims made regarding production systems, impacts on local environment, and benefits provided to farmers.

- Unique Experience – A story will go out with every sale of this coffee that describes how it was produced, where, under what conditions. The consumer will be able via a code provided inside each bag of coffee to go to an Internet site and type in their code which shows a series of maps each showing in greater detail where the coffee was produced in Peru. There will be GPS (geographic positioning system) coordinates tagging the coffee production area so that a consumer could request coffee from a specific microclimate or by specific farmers. The consumer can get specific information on types of tree shade used in farmer's production plot, bird species, other biodiversity. Audio files can be included that would allow a consumer to hear bird calls of the species found in and around the farm site. The consumer will hear the farmer and his family speak (with English subtitles) about what they are doing and the impact it is having on their lives via digital video downloads at the website. For the first time, a consumer and a farmer can have a virtual relationship. We will be able to take our campesino farmer, his rains forest, birds and unique biodiversity directly to the consumer's living room.