BUILDING SUSTAINABILITY THROUGH COLLABORATIVE SUPPLY CHAINS

FALCON COFFEES’ BLUEPRINT FOR SMALLHOLDER AGRICULTURE

DAVID DIAZ

The optimisation of supply chains creates new opportunities for farmers, trade organisations and investors in the coffee business and is a core principle behind development investments. The company Falcon Coffees Ltd. has developed a blueprint to increase the efficiency and transparency of supply chains, opening the way for participants in the coffee trade to achieve greater commercial success. Around 30 million smallholder farmers and an additional 100 million people employed in coffee processing and distribution could now benefit from this model.
Coffee, one of the world’s most ubiquitous agricultural commodities, is grown in one in every three countries on Earth. Its production involves 30 million smallholder farmers and its processing and distribution engage an additional 100 million people. These numbers will only increase in the medium term: by 2020, production will need to expand by 11% over current levels as the proliferation of coffee-shop chains and single-serve coffee-capsule machines raises consumption across all markets. Consumption will expand most rapidly in developing countries as rising incomes alter preferences more quickly there than elsewhere. These trends are reflected by the expansion plans of US-based coffee company and coffeehouse chain Starbucks: of the 1,600 new stores that it opened in 2015, over half are in Asia. Accordingly, coffee will remain central to the livelihoods of millions of rural farming families for years to come.

Coffee's cultivation profile restricts its growth to sub-tropical or tropical climates close to the equator, where most of the world’s low-income population reside. The costs involved in collecting, processing, shipping and roasting the coffee result in its being largely consumed in countries with relatively high incomes. While in principle this suggests that the global coffee trade represents a direct transfer of income from some of the world’s wealthiest people to some of its poorest, the reality is far less heartening. Most of the world’s coffee is grown by smallholder farmers that tend to receive a small portion of the final retail price due to their weak bargaining position, lack of access to inputs or finance and inability to sell directly to higher-paying markets.

1 The Economist Intelligence Unit. World Commodity Forecast December 2015.
Farmers’ resulting poverty and disenfranchisement are the most significant threat to the industry’s long-term sustainability. As production costs rise and systemic strains from climate change, shifting demographics and gender inequality mount, farmers’ ability to produce coffee sustainably – meaning profitably – will only grow more difficult.

Coffee: Global imports and exports in 2015 and average income per capita

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Exports (million 60-kg bags)</th>
<th>Total Imports (million 60-kg bags)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>30.0 (28%)</td>
<td>45.5 (45%)</td>
</tr>
<tr>
<td>Vietnam</td>
<td>25.5 (24%)</td>
<td>24.0 (24%)</td>
</tr>
<tr>
<td>Colombia</td>
<td>11.5 (11%)</td>
<td>6.7 (7%)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6.5 (6%)</td>
<td>2.6 (3%)</td>
</tr>
<tr>
<td>Honduras</td>
<td>5.6 (5%)</td>
<td>2.5 (2%)</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>3.5 (3%)</td>
<td>2.4 (2%)</td>
</tr>
<tr>
<td>Uganda</td>
<td>3.5 (3%)</td>
<td>2.3 (2%)</td>
</tr>
<tr>
<td>India</td>
<td>3.5 (3%)</td>
<td>2.2 (2%)</td>
</tr>
<tr>
<td>Guatemala</td>
<td>2.9 (3%)</td>
<td>1.3 (1%)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106.8</strong></td>
<td><strong>101.4</strong></td>
</tr>
</tbody>
</table>

Sources: USDA Coffee World Markets and Trade, 2015; World Bank Development Indicators 2015

“Agriculture has become a strong pillar of development investments, and coffee is at its very core. Both private and institutional investors have a strong sense for the value created on coffee’s journey from grower to drinker and an equal sensitivity for its development impact.”

Christian Etzensperger, Head Corporate Development & Strategy at responsAbility Investments

**KEEP IN MIND**

Coffee is grown in developing countries and mainly consumed in wealthier nations but the global coffee trade does not result in a direct transfer of income from the wealthy to the poor.

- Smallholder farmers tend to be paid only a small portion of the final retail price for their crop.
- There is a massive income gap between coffee consumers and coffee farmers, whose poverty and disenfranchisement threaten the long-term sustainability of the industry.
CONCERNS OVER SUSTAINABILITY HAVE LED TO AN INCREASE IN THE PRODUCTION OF CERTIFIED COFFEE

In addition to posing grave social risks, the status quo raises serious environmental concerns as well. First, if farmers lack the funds needed to invest in raising their productivity, the only way that they can increase output is by farming more land. This could lead to more primary forest conversion, accelerating deforestation and loss of biodiversity through habitat destruction. Second, if farmers lack access to training and extension services, they are more likely to employ agricultural practices that may be hazardous to the environment. For instance, when farmers rely solely on agrochemicals to protect against pests and diseases, the risk of run-off into neighbouring water streams rises. There is no question that farmers can be excellent stewards of their natural environments; the challenge, however, is to stimulate the development of supply chains that enable and reward their focus on environmental sustainability. In the medium term, as natural resources come under increased pressure and shifting demographics alter consumer preferences, the demand for coffee that adheres to social and environmental sourcing criteria will grow.

By 2050, arable land available for production will more than halve ...

... and demographic shifts will cause demand for sustainably produced coffee to rise

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One challenge facing the coffee sector is the decline in the availability of arable land for production, which is expected to more than halve by 2050. At the same time, demographic shifts are driving increased demand for sustainably produced coffee.
Recognising this opportunity, several coffee companies, traders and roasters have started investing in ways to improve their sourcing practices, leading to a sharp rise in the share of coffee that carries a social or environmental certification. While it was in the single digits at the turn of the millennium, by 2013 the amount of coffee produced as certified had risen to 40%2. In addition to the five major coffee production standards – Fairtrade Labeling Organization, Organic, Rainforest Alliance, UTZ Certified and 4C Association – these certifications include private roasters’ own sets of social and environmental sustainability standards, such as Starbucks’ C.A.F.E. Practices and Nespresso’s AAA Guidelines. These certifications strengthen farmers’ commitment to sustainable practices by making their coffee more competitive in the eyes of socially- or environmentally-conscious consumers.

RISE IN PROPORTION OF CERTIFIED COFFEE IS A WELCOME—BUT INSUFFICIENT—DEVELOPMENT

Nevertheless, the rise of certified coffee will not lead to the creation of a truly sustainable market all on its own. There are at least two reasons for this: first, on the demand side, a certification is only one of many variables that influence a consumer’s choice to purchase a particular coffee. For instance, some buyers value taste or origin over certification status; unless certified coffees can compete on these fronts as well they run the risk of falling out of favour with consumers as preferences shift. The potential slack in demand for certified coffee is reflected in the following statistic: while the share of coffee produced as certified accounts for nearly 40% of the global total, the amount actually sold as certified is modest, at 15%3. In other words, while more certified coffee is being produced, consumers are not necessarily buying it. Second, certifications do not address the most important determinant of the market’s long-term prospects: the poverty of many of its growers. While certifications are right to promote adherence to social and environmental standards, they rarely lead to significant income gains for their growers. Additionally, given their high cost, these standards are unachievable for the poorest farmers, limiting their impact potential. Quite simply, if farmers cannot grow their coffee at a profit, they will either underinvest in their fields – which raises social and environmental risks – or abandon their production altogether. Failure to invest in solutions that measurably and predictably improve the quantity and quality of coffee production threatens the long-term sustainability of the global coffee market and, along with it, the livelihoods of the more than 130 million people it employs.

KEEP IN MIND

The share of coffee that carries a social or environmental certification has risen sharply from single digits at the turn of the millennium to 40% by 2013.

- However, the amount of coffee actually sold as certified is modest, at only 15%.
- Thus, a certification is one of many variables that influence a consumer’s choice.
- Therefore, unless certified coffees can compete on taste or origin as well, they run the risk of falling out of favour with consumers as preferences shift.

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2 Oxfam et al. Coffee Barometer 2014. This is likely an overestimate, however, as companies carrying more than one certification are occasionally counted multiple times.
3 Ibid.
ALREADY LOW, FARMER PROFITABILITY IS UNDER INCREASED PRESSURE

Over the last 15 years, production costs have been rising while coffee prices have been volatile, often falling below production costs. In 2012 and 2013, for instance, a combination of weak demand and abundant supply brought international coffee prices down to seven-year lows. While they recovered briefly in 2014 after a severe drought lowered output in Brazil, the world’s largest producer, prices have fallen sharply yet again. In February 2016, the ICE Coffee “C” Futures price – the world benchmark for Arabica coffee – averaged USD 116.59 per lb, which is already below the average production costs for producers in Costa Rica and Kenya and is approaching those in Colombia and Ecuador (see figure below). High price volatility and declining terms of trade will squeeze farmer margins, leading to underinvestment in their fields and, as a result, smaller and lower-quality harvests.

While costs vary widely from one country to another due to differing marketing systems, physical infrastructure, land ownership and availability of financing, the trend is broadly the same. Moreover, although coffee from these countries sells at a premium over the ICE Futures price (between 10% and 20% for Costa Rican and Colombian coffees, for instance), this premium is rarely large enough to spur investments in improving yields and quality. Furthermore, pressures on profitability will only grow in coming years as coffee trees age, becoming less productive and more vulnerable to disease.

Coffee prices and production costs for selected exporters, 2003–15 (yearly average)

Source: Data on ICE Coffee “C” Futures from The Public Ledger, and on production costs from the ICO World Coffee Trade Review (1963–2013). For production costs, data for 2014 and 2015 are calculated by applying the average rate of growth over the 2003–13 period.
In addition to problems on the production level, three larger, systemic issues threaten farmers’ operations. The first is climate change, which will reduce the terrain suitable for growing coffee and increase weather-related losses. According to a 2013 Oxfam study of Uganda, for instance, in the next 30 to 50 years, land located at or below 1,300 meters altitude will no longer be suitable for growing Arabica coffee, resulting in tens of millions of lost annual revenues. The second is a demographic shift as the children of farming families decide to abandon coffee farming due to its low and volatile returns, depleting the sector of both youth and skills. In Africa, for instance, the average coffee farmer is currently more than 60 years old. The third is gender inequality, which will undermine farmer productivity and family wellbeing across many smallholder farms. While women make up nearly half of the global agricultural labour force, they are far more restricted in their access to labour-saving technologies, services and infrastructure than men are. Coupled with the larger reproductive and social work burdens that women in rural agricultural communities tend to bear, this inequality exacerbates poverty and food insecurity for the whole farming family.

Unless coffee growers, traders and roasters come together to address the myriad and complex challenges that threaten the industry’s future, the underlying risks will continue to mount. There are plenty of reasons to remain optimistic, however. Smallholder coffee growers tend to be poor simply because they lack access to resources, not because they lack skills, ambition or ingenuity. Any business that lacks access to credit, training or extension services or stable markets, would struggle to compete in today’s international marketplace and the same is true for coffee farmers. Business models that address these structural bottlenecks have the greatest potential to alter the status quo, providing farmers with the opportunity to increase their incomes and improve their way of life. One such business model – Falcon Coffees’ Collaborative Supply Chain, is the focus of this public paper.

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### Keep in Mind

Three systemic issues threaten farmers’ operations.

- Climate change will reduce the terrain suitable for growing coffee and increase weather-related losses.
- Children of farming families are abandoning coffee farming due to its low and volatile returns, depleting the sector of both youth and skills.
- Gender inequality undermines farmer productivity and family wellbeing, as women are more restricted in their access to labour-saving technologies, services and infrastructure than men.

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Food and Agriculture Organisation (FAO), Twin Trading, responsAbility Research.


FAO. Running out of time: The reduction of women’s work burden in agricultural production, 2015.
FALCON COFFEES:
SOCIAL AND ENVIRONMENTAL IMPACT
THROUGH COMMERCIAL SUCCESS

Falcon, a coffee trader established in the United Kingdom in 2008, is powered by the desire to create social and environmental impact through commercial enterprise. What sets Falcon apart is its business model based on collaboration with other industry players, whereby the various partners bring different but complementary skill sets and resources to the supply chain. Partners include development-minded investors such as responsAbility-managed funds, non-governmental organisations, private coffee exporters, producer cooperatives and roasters. This unique business model has led Falcon to become the preferred supplier of coffees from specific origin countries and regions for Starbucks and Keurig Green Mountain, among others. The company currently sources over 70% of its coffee from Nicaragua, Ethiopia, Peru, Uganda, Rwanda and Honduras and it is actively expanding activities in other countries, such as Colombia and the Democratic Republic of the Congo (see figure at right). Its operations can be grouped under three main categories.
1. DIRECT COFFEE TRADE.
Falcon builds supply chains from farmers in the developing world to major roasters such as Starbucks, Keurig Green Mountain and Lofberg Lille for retail. Falcon develops long-term relationships with its producers and supply chain partners, establishing networks that streamline the farmer-to-roaster relationship.

![Falcon main origins for supply, 2015](image)

Source: Falcon Coffees 2016

2. LOGISTICS AND QUALITY CONTROL.
Falcon handles the logistics involved in transporting coffee from its point of origin in one of the countries listed above to a roasting company in the United States, Canada, Europe, Japan, Taiwan or Korea. In addition to arranging inland transport, sea freight and import documentation, Falcon performs all sampling and quality evaluation along the supply chain. Falcon's management team has more than 70 years of experience across all segments of the coffee value chain.

3. PRICE RISK MANAGEMENT.
Falcon provides guidance to farmers and roasters on how best to manage their price risk, protecting them from losses linked to the coffee market's volatility. This includes hedging solutions as well. Falcon holds futures accounts, offering buyers and sellers call fixations and option strategies.

Falcon's ability to “pay for, process and move coffee from anywhere, to anywhere” has allowed it to rapidly gain market share in major consuming markets including Britain. Its sales have risen from 12,800 MTs in 2010 to 23,000 MTs in 2015, an 80% increase over the period. Looking forward, its future is bright, as the recent acquisition of the majority of Falcon's shares by Westrock Coffee Company – a vertically integrated coffee supply and service provider – has given it an even stronger foundation from which to operate. Yet unlike many trading houses, Falcon is not content with simply trading coffee; driven by its social mission, the company aims to revolutionise the way in which the coffee trade functions, creating a blueprint of sustainable value chains that may be reproducible across other products and markets. In order to do so, Falcon focuses on the greatest hurdle to sustainability: farmer poverty.

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Falcon is rapidly growing its market share and has a bright future.

- With its successful business model, Falcon achieved an 80% increase in sales from 2010 to 2015.
- Falcon is striving to transform the coffee trade with its blueprint for sustainable value chains applicable across countries and commodities.

FORGING A PATH TO LONG-TERM SUSTAINABILITY INVOLVES IMPROVING COFFEE SUPPLY CHAINS

The coffee supply chain is not a direct line from tree to cup. Instead, it is a complex series of interactions involving myriad actors, each of which contributes to the final cost of coffee’s transformation from cherry to beverage. Consider the following simplified example.

1. A farmer produces the coffee.

2. An intermediary purchases the coffee, adds it to that of her neighbours, and then delivers it to a processor or collection centre.

3. The processor prepares the coffee for export by removing the cherry and mucilage, but leaving the protective layer of parchment in place (at this point it is still called “parchment” coffee). Once ready, it is sent to an exporter.

4. The exporter contacts coffee roasters and sells the coffee to the one offering the highest price. Once the contract is secured, it removes the parchment (thereby turning it into “green” coffee) and delivers it to a ship for transport. It is common for one company to act as both processor and exporter.

5. The importer unloads the green coffee at the port of entry and delivers it to a roaster for processing.

6. The roaster roasts and packages it, according to the retailer’s demands.

7. A retailer buys the coffee, brews it and then delivers it to the consumer.
“The Collaborative Supply Chain model represents a move away from a segmented form of agriculture in which many actors operate in isolation. Its integrated approach strengthens product flows, generates efficiency gains and increases value through improved price opportunities.”

— Gaëlle Bonnieux, Head Agriculture Debt Financing at responsAbility Investments.

In an efficient supply chain, the actors involved in moving coffee from a farmer to a roaster or retailer only add value to the final product, meaning there are only necessary interventions. If, in addition to efficient, the supply chain is transparent, the actors can see all costs and payments along the value chain and be certain that they are receiving payment commensurate to their contributions. Yet supply chains are rarely efficient or transparent, and this translates into lost revenue for all actors, especially those at the origin of the chain: farmers. In an interview for this case study, Matt Smith, Falcon’s Chief Operating Officer, described a classic example of a bad supply chain, which he encountered while working in the Democratic Republic of the Congo (DRC):

“When Falcon and our sister company, Rwanda Trading Company, started working in Bukavu, South Kivu, we were shocked by how poorly the supply chains operated there. The coffee passed through multiple intermediaries and collection points – sometimes even across several borders – before it was delivered to the dry mill that would process and prepare it for export. These additional intermediaries represented unnecessary costs given that they charged a fee and were not adding any value to the final product. We solved this problem in two steps: first, we removed the intermediaries and worked with Eastern Congo Initiative to organise farmers into cooperatives that they could deliver their coffee to directly. This cooperative would then send the coffee to a local miller and exporter that we work with by providing working capital and price risk management. From the many, many steps previously needed to bring the coffee to export, we were now down to three. Second, we improved accounting and transparency along the value chain so that farmers could see that they were receiving fair prices. In addition to engendering trust, this allowed us to institute a system whereby we could pay farmers a second time after having sold their coffee to the roaster, in this instance Starbucks. These measures had a huge impact on farmer income: from 2013 to 2014, household income for the 4,200 farmers we worked with more than tripled.”

To create more value for farmers, Falcon zeroes in on the many points along the value chain where there are opportunities lost or benefits to be gained. In addition to eliminating unnecessary costs and promoting transparency, Falcon and its sister companies within Westrock International provide farmers with agronomic training services, access to credit and links to stable, higher-paying markets by leveraging the skills of their various partners, in other words, by getting them to collaborate. This “collaborative” supply chain approach creates efficiency through cost rationalisation and risk reduction. It gives farmers access to credit, which allows them to produce more and better quality coffee, and it links them to stable buyers at the end of the chain, which renders their income more predictable. This raises farmer incomes and enables long-term planning horizons, both of which

KEEP IN MIND

Falcon and its sister company Rwanda Trading Company solved the problem of inefficiencies in the supply chain, with the income of 4,200 farmers tripling as a result.

- First, the companies removed intermediaries and organised the farmers into cooperatives.
- Second, accounting practices and transparency were enhanced along the value chain – enabling farmers to see that they are being paid fairly.

Inefficient supply chains are an obstacle to the success of all participants in the coffee trade – especially farmers – since they lead to a loss of revenue.
are crucial to exiting poverty. A clearer, more direct connection to consumers also allows farmers to adapt to retailers' preferences, creating opportunities for specialisation and scale. The table below details the income that farmers stuck in poor supply chains in Rwanda, Tanzania and Uganda gained by choosing to work within Falcon's collaborative approach instead.

### Average income and missed opportunities for East African farmers, 2014–15

<table>
<thead>
<tr>
<th></th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
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<tbody>
<tr>
<td><strong>Annual coffee income of average farmer</strong></td>
<td>USD 86</td>
<td>USD 543</td>
<td>USD 110</td>
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<tr>
<td><strong>Missed opportunities</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Volume</td>
<td>USD 342</td>
<td>USD 238</td>
<td>USD 220</td>
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<tr>
<td>Quality</td>
<td>USD 34</td>
<td>USD 198</td>
<td>USD 11</td>
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<tr>
<td>Transparency and efficiency</td>
<td>USD 43</td>
<td>USD 297</td>
<td>USD 44</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>USD 419</td>
<td>USD 733</td>
<td>USD 275</td>
</tr>
</tbody>
</table>

Source: Falcon Coffees 2016

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A COLLABORATIVE SUPPLY CHAIN AT WORK: WESTROCK, RWANDA TRADING COMPANY, FALCON AND RESPONSABILITY

1. **RWANDA TRADING COMPANY – A FULLY OWNED SUBSIDIARY OF WESTROCK COFFEE – CREATES ROBUST FARMER NETWORKS, BOOSTING OUTPUT AND QUALITY.**

   Rwanda Trading Company (RTC), a coffee processor and exporter located in the Gashabo District of Kigali, was founded in 2009 by Westrock Coffee (now Falcon’s majority shareholder). After revitalising an old dry mill in the district, RTC organised the farmers into groups, removed unnecessary intermediaries and provided training and extension services. Supported in part by Westrock’s strong financial standing, RTC could pay its farmers on time and at higher prices than what the intermediaries offered before them. Because of the improved prices and agronomic training and extension services, farmer output and quality rises rapidly, and RTC looks to Falcon to help it market its coffees internationally.

2. **FALCON COFFEE LINKS RTC TO STABLE, HIGH-PAYING INTERNATIONAL MARKETS AND PROVIDES PRICE RISK MANAGEMENT SUPPORT.**

   Falcon Coffee connects Rwanda Trading Company with reliable, high-paying buyers in the United States and the UK, such as Sweet Maria’s in San Francisco or Peet’s and Taylors of Harrogate in the UK. It handles logistics and after-sales quality control and provides financing and price risk management to the final buyers. In addition, Falcon ensures full transparency along the value chain, providing RTC with data on how much Sweet Maria’s paid for each lot of coffee, which RTC can then communicate to its farmers. This level of granularity and transparency allows RTC to institute a “second-payment” system to reward farmers’ investments in out-

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The effective collaboration between key participants helps to drive a sustainable supply chain.

**Facts:**
- Rwanda Trading Company was founded in 2009 by Westrock Coffee.
- In view of Westrock’s financial strength, Rwanda Trading Company is able to promptly pay its farmers higher prices.
- Falcon connects Rwanda Trading Company with reliable high-paying buyers in the US and UK markets.
- Logistics and after-sales quality control are managed by Falcon, which also provides financing and price risk management to the final buyers (and supplies Rwanda Trading Company with transparent data on sales).
According to Falcon, in a truly sustainable supply chain, four conditions are met:

1. Everyone in the supply chain is profitable.
2. Costs are understood and controlled responsibly.
3. The full value of the product is realised.
4. Profits are distributed to each party commensurate to the value it has added.

Given the tremendous challenges that coffee farmers are currently facing, meeting these conditions is no simple feat. According to Konrad Brits, Falcon’s founder and CEO, “Building and maintaining truly sustainable supply chains requires a complex response to a complex problem, and no actor, individual or business can do it alone. Sustainability is not a destination; it is a maintained state of being, like treading water. To achieve this state, companies that are motivated by both profit and impact need to collaborate and leverage their diverse skills and resources.”

For an example of what this collaborative approach actually looks like, consider Falcon, Rwanda Trading Company and responsAbility’s activities in Rwanda, described in the box below.

Put and quality. Once RTC determines how much additional profit it made from the lots sold to Sweet Maria it splits it evenly with farmers. This “second payment” system does more than raise farmer incomes. It creates an incentive structure by which farmers have a reason to invest in their crops because they trust that they will be rewarded for the gains in output and quality that they achieve. As RTC grows, Falcon leverages its network and finds new buyers to connect RTC with, promoting specialisation and scale. Moreover, given Falcon’s strong, collaborative relationships with its buyers, the supply chain helps build resilience to unforeseen price or product shocks.

3. RESPONSABILITY PROVIDES DEBT FINANCING TO BOTH FALCON AND RTC, SUPPORTING THEIR COFFEE PURCHASES AND EXTENSIONS OF CREDIT.

responsAbility-managed funds have been supporting Falcon’s purchases of coffee from processors and exporters since 2013. In 2014, on Falcon’s recommendation, they began providing debt financing to Rwanda Trading Company as well. As RTC’s strong positioning and successful procurement model are driving a rapid increase in market share, the company’s needs are too large to meet with its own funds, and those offered by local banks are too burdensome. responsAbility-managed funds fill this financing gap. Going forward RTC, like Falcon, benefits from access to a large and reliable source of financing that is ready to adapt to its evolving business needs. Given responsAbility’s wide investment scope, the potential for collaboration is vast. For instance, responsAbility funds could provide long-term fixed asset financing to RTC to build a new mill and increase its processing capacity. responsAbility, on the other hand, benefits by having access to a strong and rapidly growing exporter like RTC that has a very low procurement risk. RTC has risen to become the largest exporter of premium coffee out of Rwanda.

Result: a resilient supply chain made up of actors that collaborate to achieve social impact through commercial success. Farmers in these value chains gain access to financing solutions, higher prices, agronomic training and extension services, and stable foreign buyers. This gives them the opportunity to invest in increasing their coffee’s yields and quality, thereby raising profitability. In addition, supported by Falcon’s and RTC’s networks, farmers gain access to technologies or trainings that allow them to confront the larger, more systemic issues threatening their livelihoods, such as climate change. For instance, Falcon is currently partnering with World Coffee Research and RTC to run trials of new hybrid coffee trees (non-GMO) that can cope with the onset of climate change.
“Economic viability and development impact go hand in hand. Benefit without profit will not be sustained over time. But neither will profit without benefit. In the harsh reality of developing countries, this intuitive logic becomes more visible than elsewhere.”

Christian Etzensperger,
Head Corporate Development & Strategy at responsAbility Investments.

**KEEP IN MIND**

Reflecting its focus on sustainably produced coffee, a central tenet of Falcon’s business model is that it works exclusively with processors and exporters that engage in environmentally sustainable practices.

- A failure to use sound agricultural practices reduces land productivity and limits the farmers’ potential output and profitability.
- Rwanda Trading Company provides intensive training for farmers to promote good agricultural practices and prepare them for certification.

Falcon purchases coffee from certified organisations. For individual farms in the supply chain, certification is not mandatory. Falcon believes they should only take this step if there is a sound business case for it.

**GOOD AGRICULTURAL PRACTICES ARE CENTRAL TO TRUE SUSTAINABILITY**

Falcon only sources from processors and exporters that adhere to sound agricultural practices, considering it a central tenet of its business model. According to Matt Smith, Falcon’s Chief Operating Officer, “Growing practices that are not environmentally sustainable undermine the land’s productive capacity, limiting potential output and quality gains and undermining farmer profitability. If you want to build successful coffee value chains, then, sound agricultural practices are paramount.” For instance, Rwanda Trading Company puts farmers through an extensive training programme at the beginning of their relationship. This programme builds on a gap analysis of all major certifying bodies, ensuring it is comprehensive. According to Matt Smith, “Farmers are business people; they quickly see that good agricultural practices improve their long-term earnings prospects. And we do not cut corners. I am confident that any farmer that passes our training programme would pass any third-party certification audit as well.”

Falcon purchases coffee from organisations that are certified by third-party labels as well, although they do not make certification mandatory for farmers to be included in their supply chains. In Falcon’s view, a certification is an investment, meaning it should be done if and only if there is a sound business case for it. If not, the investment could result in revenue losses for the farmer. Yet certified coffee clearly has an important role to play in the global coffee market and Falcon is eager to work with organisations and brands that share its goals and values. According to Brooke Cantrell, Westrock Coffee’s Chief Impact Officer, “Once the four conditions of true sustainability are met, certification can play an important role: helping farmers maintain a competitive position in the coffee world.”

**COMMERCIAL AND SOCIAL IMPACT ARE COMPLEMENTARY, NOT MUTUALLY EXCLUSIVE**

Measuring whether a company is achieving its commercial goals is relatively straightforward: there is a near-universal vocabulary and set of metrics that indicate whether a company is financially viable or not. Determining whether a company is achieving its social goals, however, is by no means as simple. This is the case for at least three reasons: first, there is no consensus on what “social impact” means, resulting in a set of disparate definitions and objectives that undermine its scalability. Second, while many companies claim to pursue social impact, few set any real objectives or attempt to monitor their progress, fuelling the impression that it is more a marketing buzzword than a testable measure of performance. Third, while financial performance can be measured in cents and dollars, social performance involves myriad indicators that are painstaking to track and monitor. As a result, many companies choose to avoid tracking social performance altogether, focusing on guaranteeing financial performance instead. This is, of course, often a perfectly acceptable managerial decision.
These challenges notwithstanding, Falcon prefers to think of the “social versus financial” dilemma in a different way: if the underlying business model is truly devoted to both impact and profit, social and financial performance are complementary. In other words, by achieving social gains, commercial success is more likely to follow (and vice versa). To see why, consider the following comparison of Falcon’s collaborative supply chain to that of a typical coffee trader. Falcon leverages the resources of the actors along the chain to improve farmer output and quality and institutes a system of transparency and trust that binds the actors together. This supply chain will generate greater returns for all actors – as more and better coffee will be produced – and it is more likely to withstand external shocks – as the actors realise that it is in their commercial best interest to collaborate. The result: a resilient value chain with profitable, value-enhancing actors.

The value chain of a typical coffee trader tends to look different, however. As this trader will not collaborate with a processor that invests in its farmers, output and quality remain stagnant and volatile and therefore increasingly at risk of climate change, demographic shifts and gender inequality. This is compounded by the fact that the chain is not transparent, meaning farmers lack the incentives to commit to long-term relationships and will sell opportunistically when it is in their interest. This then leads to losses for the processor or trader, as they cannot always be sure of securing the product they need. The result: a weak value chain with financially vulnerable, opportunistic actors. To Konrad Brits, “We need our farmers to be commercially viable business partners that view farming coffee as a viable way to improve the quality of their lives, not impoverished beneficiaries of unsustainable handouts, dependent on our welfare. Therefore, working towards sustainability is not about social justice or taking the moral high ground; it is about investing in the economics of coffee because it makes good business sense. In coffee, altruism, caring for the welfare of others, is moving from philanthropy to a case for business. This is a paradigm shift that holds incredible power of opportunity for smallholder agriculture.”

TO DETERMINE WHETHER ONE IS MAKING PROGRESS OR NOT, MEASUREMENT IS KEY

Driven by the conviction that financial and social performance are complementary, Falcon has partnered with Rwanda Trading Company and other actors to develop indicators that measure its social performance. According to Brooke Cantrell, Westrock Coffee’s Chief Impact Officer, “We firmly believe that if you do not measure it, you cannot know whether you have actually done anything. These tools are challenging to build and they require a lot of testing, but they are crucial to our social and, by extension, commercial success.” In building these tools, Brooke and her team proceed as follows: first, they identify the main social barriers to achieving true sustainability; second, they determine the indicators best able to address whether progress is being made or not; third, they measure progress at multiple levels. A snapshot of this social measurement model is illustrated on the next page.
OBSTACLE 1: INCONSISTENT YIELDS, UNREALISED PROFITS AND UNSECURED FUTURE COFFEE SUPPLY

Impact indicators: farmer to exporter
- % of farmers creating farm inheritance strategies to secure a future in farming for families
- % of average household coffee income increases due to volume improvements
- % of average household coffee income increases due to quality improvements

Impact indicators: exporter to trader
- % of households for which exporter facilitates agribusiness training programmes (ATP)
- % of average return on investment for each ATP group trained, after 3rd year of investment

OBSTACLE 2: LIMITED MARKET ACCESS AND CASH FOR INVESTMENT

Impact indicators: farmer to exporter
- % of farmers that receive cash at the time of sale
- % of ATP farmers that leverage community coffee income for farm investment

Impact indicators: exporter to trader
- % of farmers connected to a direct-export buyer
- % of farmer groups for which exporter facilitates withholding or savings strategies

OBSTACLE 3: FARMER VULNERABILITY DUE TO LIMITED PRICE PROTECTION, LITTLE TO NO TRANSPARENCY AND GREATER SOCIOECONOMIC ISSUES

Impact indicators: farmer to exporter
- % of average household coffee income increases due to transparency improvements
- # of farmer collectives with equal opportunities and compensation for men and women

Impact indicators: exporter to trader
- # of collectives assisted with community-led projects
- # of women who are publicly supported by the exporter in a designated role

Source: Falcon Coffees 2016
For now, Brooke and her team use these indicators in Rwanda and Tanzania. However, Falcon has plans to expand the farmer training programmes and social performance measurements to every area it trades, beginning with Uganda this year. As different countries have different regulations, organisational structures and market fundamentals, there is no “one-size-fits-all” approach. Accordingly, Falcon will work with local partners to develop and test the model best suited to each country and region. The rationale for developing these systems across all of their origin countries is clear though, given the progress they have recorded. In Rwanda, for instance, farmer yields have increased by 155% since the programme’s launch in 2013, resulting in a 61% rise in coffee income. As Falcon continues expanding the depth and coverage of its activities, more and more farmers will have the choice to partner with them and benefit from inclusion in Collaborative Supply Chains.

Driven by the desire to improve smallholder value chains, Konrad Brits, Falcon’s founder and CEO, is not content to stop at coffee. Persuaded by the complementarity of social impact and financial enterprise made evident in Falcon’s collaborative supply chains, he finds that, “The unintended consequence of the work that companies like Falcon and responsAbility do is to participate in the building of a blueprint for sustainable smallholder agriculture, applicable across countries and commodities. If we, together, construct a model that is true to coffee, then we would have built a blueprint for addressing global food security, as the 500 million smallholder farmers that grow 70% of the world’s staple crops are marginalised in similar ways. This would be an incredible legacy. We are currently in the process of building this into a concept which we call Project Blueprint.”

**GOOD TO KNOW**

Falcon believes that social and financial performance go hand in hand. It has worked with Rwanda Trading Company and other parties to develop tools to measure the social impact of its activities.

- Tools that measure social performance are challenging to build but are crucial to the social and commercial success of Falcon’s business.
- The main purpose of the tools is to identify social barriers to sustainability and determine the best indicators of progress in order to gauge social performance.

The development of a blueprint to increase the efficiency and transparency of supply chains in the coffee trade could be replicated in other sectors. This model could address the issue of global food security by benefiting 500 million smallholder farmers who grow 70% of the world’s staple crops.

“Investors and end-clients seek financially attractive, efficient and sustainable companies that demonstrate transparently – through the measurement of outputs – how they are adding value. This is of great importance to development investments as it aligns long-term interests among all engaged stakeholders in an optimal way.”

Henry González, Head of Research & Advisory at responsAbility Investments
responsAbility’s relationship with Falcon dates back to autumn 2013. In Falcon, responsAbility saw more than a well-run business with strong growth prospects; it recognised a long-term partner that shared its ambition of creating social impact through commercial enterprise. Since then, responsAbility-managed funds have disbursed USD 13 million to Falcon, financing a portion of the company’s green coffee purchases from developing countries the world over, including Nicaragua, Ethiopia, Uganda, Peru, Honduras, Rwanda, Tanzania and El Salvador.

Then, in April 2014, responsAbility took the relationship further. Persuaded by the social and financial potential of Falcon’s Collaborative Supply Chain model, responsAbility decided to finance two of Falcon’s origin partners, Rwanda Trading Company in Rwanda and Tembo Coffee in Tanzania as well (both are also owned by Westrock Coffee Company). Like Falcon, these companies were financially sound, had strong market positioning and were growing quickly. Rwanda Trading Company is now the country’s third-largest exporter, and first in terms of specialty coffee varieties, which receive higher prices on the international market. Tembo
has also performed extremely well, growing by 166% from 2013 to 2014 in terms of sales. Falcon has introduced responsAbility to other promising coffee producers as well, such as Great Lakes in Uganda and Peralta Coffees in Nicaragua, expanding the reach and resilience of the company’s innovative investment model.

responsAbility’s size and flexible financing options provided these companies with an alternative that is difficult to find on local markets. In Tanzania, for example, local banks’ collateralisation requirements were overly restrictive, which forced Tembo to rely on its parent company for working capital requirements. This limited the amount of coffee that Tembo could purchase at the harvest period, thereby reducing the number of farmers that could participate in its collaborative supply chain. By providing flexible loans backed by sales contracts instead, RTC and Tembo were able to meet their growing harvest financing needs. Going forward, responsAbility-managed funds will remain a reliable source of financing for Falcon and its collaborative supply chain partners. Given responsAbility’s wide investment scope, the potential for collaboration is vast. For instance, its funds could provide long-term fixed asset financing to RTC to build a new mill and increase its processing capacity.

 Millions of farming families stand to benefit from inclusion in the kind of collaborative supply chains that Falcon and its partners are pioneering. The threats to sustainable food production are already too large for any single actor to take on alone, and they will only get worse with time. Accordingly, it is imperative that companies committed to social impact through financial success collaborate to tackle this generational challenge.

INVESTING ACROSS THE WORLD AND ALONG THE AGRICULTURAL VALUE CHAIN

Through its funds, responsAbility invests in actors active along the entire agricultural value chain, focusing on those that show a strong commitment to sustainable production and trade. The investments are made primarily in developing economies and emerging markets and are diversified over more than 50 agricultural commodities. The fund currently manages more than USD 170 million, which is invested in more than 110 organisations across 47 countries. This strong growth and diversification was achieved as a result of the increased presence of dedicated agriculture investment officers across different continents. Factors that contributed to this successful expansion include active portfolio management and the efficiency of responsAbility’s joint investment process. Given the dynamic growth that the global market for sustainably-produced agricultural products is experiencing, responsAbility looks forward to supporting many innovative business models like that of Falcon Coffee.

GOOD TO KNOW

- A strong commitment to sustainable production and trade is a key criterion that responsAbility considers when selecting partners in the agricultural sector.
- Investments focus on companies along the agricultural value chain in developing countries and emerging markets.
- Investments are diversified across 35 different agricultural commodities.
The answer was to partner with smaller local export companies that struggle to compete with the multinationals as they lack working capital, risk-hedging services and market access. Falcon, with partners like responsAbility, is able to bring these three elements to the partnership.

How do farmers benefit?

By joining our collaborative supply chains, farmers benefit in myriad ways. First, they gain access to agronomic training and extension services that help them improve their agricultural practices. Second, they gain access to pre-harvest and harvest finance, which allows them to invest in their farms and improve the yield and quality of their coffee and food crops. Third, they enter an efficient and fully transparent supply chain, composed of actors that only add value to the final product. As they know where the coffee is sold and what costs are attached to the export, their income increases, so they learn to trust their supply chain and commit to it for the long term. Finally, as they are connected to reliable buyers on the other side of the chain, their well-being is far more secure than before. Our goal, then, is to enable farmers to produce more and better-quality coffee and have them receive fair compensation for their product.

What inspired the Collaborative Supply Chain approach?

One of the most challenging problems in coffee-growing countries across the world is a lack of access to finance. Banking sectors in many producing countries are underdeveloped and highly risk averse, barring smallholder farmers from accessing affordable loans to manage their domestic expenses and grow their businesses. This forces them to sell their crop at its lowest value, as fruit picked off the tree rather than export-grade coffee.

Multinational coffee companies have replaced traditional finance institutions, using their capital strength to purchase coffee as close to the tree as possible. This allows them to control the quality, reduce their risk and add the greatest value. While this is not wrong and brings much needed liquidity to these markets, this system is in conflict with achieving sustainability. If poverty is the greatest hurdle to achieving sustainability in coffee, then the easiest way to increase revenue to farmers is to build a system that allows them to participate in the highest value of their crop, the value at the point of export.

Our approach, then, started with a simple question: instead of building brick-and-mortar operations everywhere we go, what can we do to achieve this goal while protecting our own margin?
If you want to build successful coffee supply chains, sound agricultural practices are paramount. There is no way around it. Accordingly, we are working to extend the agricultural training programme we pioneered in Rwanda to more of our supply chains in other origins. This programme was built on a robust gap analysis of all major certifying bodies and we are confident that it prepares our farmers to meet and exceed the requirements of any environmental audit. There is no “one-size-fits-all” approach though, and adapting this programme to different market structures takes time. For instance, in Tanzania, governmental regulations make it difficult for external actors like us to engage directly with farmers, complicating our efforts to build skills and transparency there. More generally, we believe that if given the means to grow their crops profitably, farmers will employ environmentally sound practices. As farmers are the first to suffer from the erosion of their land or the destruction of local ecosystems or communities, they are best positioned to be the caretakers of their natural environments.
Why is traceability so important?

Traceability allows every actor in the supply chain to see where value is created and how revenues are distributed. It is essential to building trust. When all actors in the supply chain feel that they are receiving fair compensation for their work, they are far more likely to commit to that supply chain for the long term. This makes their relationship more resilient, allows them to increase their incomes and creates opportunities for specialisation and scale.

For instance, consider the second-payment system in place at Rwanda Trading Company, a local processor and exporter in Rwanda, and one of our main partners. RTC makes the first payment to the producer upon receiving his or her coffee at fair market levels. Then, after the final sale price of the coffee

“Traceability allows every actor in the supply chain to see where value is created and how revenues are distributed.”
is determined, and where a premium was paid for the quality, RTC makes a second payment to the producer equal to 50% of the profits from the sale. This system creates an incentive structure by which farmers have a reason to invest in their crops because they trust that they will be rewarded for the gains in quality that they achieve. It would be impossible to do this without full traceability across the supply chain.

**What do you like about working with responsAbility?**

Well, first of all, we like working with an actor that shares our belief in the complementarity of social impact and commercial success. Unlike many actors in the industry, responsAbility does not have an identity crisis: it believes it is possible to be a successful business while also having significant social and environmental benefits. Secondly, we respect responsAbility’s extensive knowledge of the marketplace, from larger commodity or market issues to more technical aspects of the value chain. Finally, we view it as a powerful partner in our collaborative approach, given its wide investment scope. In addition to helping ensure that we have the financing we need to purchase coffee, we see that responsAbility is an excellent resource for our origin partners as well. We have already seen this with Great Lakes in Uganda, Tembo in Tanzania, Peralta in Nicaragua and Rwanda Trading Company in Rwanda, and we hope to see it in other of our origin partners as well. As Falcon and responsAbility both stand to benefit from the leveraging of our mutual skills, we hope to find ways to expand and deepen our relationship.
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