

Rural Producer Group Institution Building Linking Ethiopian Coffee Producers to International Markets: An Organizational Capacity and Value Chain Approach

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Since Ethiopia is the birthplace of Arabica coffee and filled with exemplary coffees, it is no surprise that that cooperatives in the Ethiopian coffee sector are market leaders in response to the fast growing specialty coffee sector worldwide. ACDI/VOCA's Agricultural Cooperatives in Ethiopia (ACE) project, with funding from USAID, has played a central role in strengthening the cooperative coffee value chain for specialty coffee exports.

Ethiopia's annual coffee production is approximately 280,000 metric tons (MT). Even with nearly half of this total being consumed domestically, exports for the most recent year were 146,500 MT, one third of which was washed. Small-scale farmers with 1-2 hectares of land produce most of this coffee through a mixed farming system where food crops and the cash crop of coffee grow together. The income of most of these farmers is less than a \$1.00 per day and per capita annual income of Ethiopia makes it one of the ten poorest countries in the world. The specialty coffee market is an avenue for Ethiopian farmers to increase their incomes and improve the quality of their lives.

Since its start in 1999, through 2006, the ACE program has restructured and strengthened over 775 primary cooperatives, representing more than 750,000 members, in the Oromia, Amhara, Tigray and Southern Nations regions of Ethiopia. These cooperatives now operate as open, private, democratic associations providing marketing and input supply services to their members. Of the total assisted by ACE, close to 180,000 are small-scale coffee producers who have come together in 154 cooperatives federated into the four Coffee Unions of Ethiopia: Sidama, Yirgecheffe, Oromia and the Kafa Unions.

For small-scale farmer business development in Ethiopia, the focus is on enhancing the competitiveness of the coffee sectors and clusters of smallholder farmers. Using a value or market chain approach, the ACDI/VOCA program has developed a value or market chain approach that integrates the very small-scale rural coffee producers into growing international coffee markets. The comprehensive approach ensures that small-scale coffee producers access the business services to enter and thrive in these growing coffee markets.

In creating an Ethiopian Cooperative Coffee value chain to turn their comparative Advantage into market competitiveness the value chain approach is an apt construct for the ACE project, it alone however is not enough. The other prime factor in achieving the success of the cooperative coffee sector growth is the substantial and significant institutional development and capacity building completed under ACE to help build a special set of private sector businesses: cooperatives. The market was the focus but institution building of the producer groups to access the market was crucial. The heavy emphasis and close link of the institutional development to real market opportunities and demand was central in building capacity and institutions necessary to the success of the coffee value chain approach. Similarly, the success of the institutional building interventions rests on the expanded sales from the value chain approach.

The coffee cooperative unions were established and strengthened to buy, consolidate and market internationally small holder supplied coffee. In the supply chain model they are the lead firms in the local value chain and since the cooperatives own the unions, the process of building union capacities was an important facet of vertically linking cooperatives and exporters—the unions—in the value chain. Most of the cooperative members have processing or washing stations for coffee. The close collaboration between the unions and their member cooperative washing stations was integral to improving coffee

processing to meet international quality and taste standards. This linkage strengthens the value chain to achieve quality production, efficient operations, market synergy and cupping consistency. It is also important to note that horizontal learning by member cooperatives in the same union is strong. Finally, the cooperatives work directly with the farmers, forming a local vertical linkage.

The unions and member cooperatives also work along the vertical chain to establish international market linkages and sales into higher-value, generally specialty, coffee markets around the world. The unions are the lead entities in this work but cooperatives play a strong supporting role as the sources of the coffee. International buyers nearly always visit the actual coffee growing areas and seek relationships with growers.

The four unions are strengthening their members' bargaining position in the international marketplace and returning a higher share of market price to producers and allowing farmers to achieve economies of scale and to take control of their economic future. Results to date have been impressive. From an export base of 126 MT valued at about \$265,000 sold five years ago, the coffee unions have more than doubled their international sales annually such that 12,800 MT were exported in the production year ending in June 2005 worth a total of \$31.9 million. Equally impressive is the fact that the cooperatives are returning substantial dividends over the initial market prices to farmers coming from union and coop profits. In 2004, the coffee unions returned \$1.63 million to the pockets of small-scale farmers and the trend is strongly upward.

The overall success of the unions depends on the quality of the products provided by the member cooperatives. Horizontal linkages at the cooperative level have resulted in improve quality and operational efficiency. The focus on quality improvements at the processing and farmer level was strongly reinforced by the shared of goals and learning by the sister cooperatives in the unions. Shared farmer and cooperative learning in areas such as cupping, fermentation, water use conservation and other processing requirements were common. In business capacity building, ACDI/VOCA found that experience sharing and learning across the training and technical assistance provided to cooperatives staff and board members was common (e.g. in accounting, internal controls, warehouse management, staff management). Finally, cooperatives collaborated in trucking, warehouse sharing and other logistic requirements and shared market information.

At the union level there are important horizontal linkages as well. In addition to sharing market information and contacts, solutions to shipping and logistic problems have often come with the assistance of a sister unions. All four have operated together for the international coffee competition and auction. Sidama Union helped both Yirgacheffe and Kafa in their start-up periods to export containers of their coffee.

Building supporting markets is an important link in creating a viable value chain. In Ethiopia, a constraint at both the cooperative and union level has been a lack of financing. In the early years of ACE, the constraint was most severe for short-term crop financing for cooperatives to purchase cherries from the farmers. Working with USAID, ACDI/VOCA acted to link a private bank that was given a U.S. government loan guarantee through USAID for short-term crop financing. This intermediation helped both the banks and cooperatives raise their understanding of the loan relationship and requirements. For the crop year ending in 2005, the total loan guarantee was more than \$1.3 million. This facilitation and learning has helped both the unions and cooperatives expand their borrowing from other banks, and lending from other banks has grown to be significantly greater than the guarantee from USAID.

It is in cooperative and union business improvements that the value-chain and institutional strengthening models most intersect. Much of institutional and capacity building by ACE falls in the area of firm-level upgrading to strengthen the value chain. Firm-level upgrading has occurred at the farmer, cooperative and

union levels. Though interventions have been somewhat more comprehensive and extensive than what would be recommended under a traditional value-chain approach, direct support in the form of institution and capacity building and even institution creating was necessary with the unions. Institution building in the form training and technical assistance to improve quality, processing and marketing by farmers, cooperatives and unions was highly successful.

The starting point for the growth of the cooperative coffee sector was the policy decision on the part of the government to end the requirement for cooperative sector coffee to be sold through the national auction. This has allowed the cooperatives to market directly to international buyers and create a marketing chain to respond to their coffee buying needs. The cooperative experience in international markets has demonstrated the importance of quality production, traced to origin with substantial buyer monitoring and even involvement with coffee growers. The government now understands the need for change to grow the coffee export market. There is no doubt that the success of the cooperatives in coffee exports plus the pull of the international specialty coffee markets themselves are creating an evolution of internal marketing reforms in the Ethiopian coffee sector. These factors, the most important of which may be the cooperative coffee success, are contributing to the recognition that the time to officially reform the system is now.

ACE's interventions in the Ethiopian cooperative coffee sector have had a significant positive impact on small-scale coffee producers and the coffee value chain as a whole. Producers have improved the quality of their coffee, gained access to higher value coffee markets and earned substantially more income from their coffee production. The new coffee export value chain channel has been opened for smallholder rural producers.

The starting and leveraging points for Ethiopian coffee sector development is the market. A comprehensive value-chain approach to global marketing is an excellent framework to direct business development and market linkages. Linking coffee producers to international markets in an economy such as Ethiopia's where many of the requisites to successful participation in global markets are so weak requires institutional and capacity building carefully provided to support value chain expansion. Building the institutions and capacity of the cooperative sector in the case of smallholder exports of specialty coffee was essential to opening a new coffee export channel. The success of the program rests on a combined value chain and institution building program that includes a comprehensive market development assistance program and a broad-based institutional and capacity building assistance for the producer groups the cooperatives and unions.