

Cup of Excellence in Brazil and Honduras: An Impact Assessment

January 2015



PROJECT BACKGROUND

The Cup of Excellence (COE) program was born in Brazil in 1999 as a way to promote specialty coffee produced in Brazil. The program has grown since then, having held 100 successful specialty coffee auctions across 11 countries. On the milestone occasion of the 100th COE contest and auction this report was created to measure the impact of the program in Brazil and Honduras.

Executive Summary

Cup of Excellence (COE) was created in 1999 with the goal of promoting Brazilian specialty coffee. Its success there led to expansion throughout Latin America and Africa, including to Honduras in 2004. This study aims to identify and describe the impact COE has had after 15 years and 100 contests. COE has had a far-reaching impact far beyond the participants and helped the two countries studied in this document, Brazil and Honduras, develop specialty coffee industries. COE has created immense value for these countries: US\$137 million¹ in Brazil and \$25 million in Honduras in total benefit through direct auction sales, increased direct trade, and a boosted specialty trade.

The global specialty coffee industry has grown at an estimated 5-10% annually since COE began. Finer coffees usually command higher prices throughout the supply chain, and producing them is an income opportunity for origin countries. Coffee production is diffuse and information about quality is hard to obtain, making it hard to identify new specialty supply. Countries like Brazil and Honduras had reputations as commercial producers to overcome. COE has helped solve these challenges, enabling new specialty regions to emerge and thrive. In addition, it has served as the catalyst for specialty production in many regions and the vanguard in creating standards around specialty coffee.

Brazil and Honduras serve as test cases for COE's impact given their poor reputation for quality when COE was introduced. This report considers the time period from 1999 to 2014 in Brazil (excluding the 2014 Early Harvest competition in November, 2014 unless otherwise noted), and from 2004 to 2014 in Honduras. We used in-depth interviews with over 100 producers, cooperatives, exporters and other specialty market agents in each country and with specialty roasters and buyers worldwide to gather information. An online survey of buyers was used to collect additional data, and reached 25 unique respondents. The multiple perspectives captured allowed us to construct a comprehensive synthesis of the data and corroborate data points. This information was complemented by data from COE auctions, ICO, national coffee organizations, and other statistical sources.

The impact from the program has been profound, beginning with the auction sales themselves. COE has created \$8 million in auction sales in Brazil since 1999 and nearly \$4.4 million in Honduras since 2004. Considering the prices these coffees would likely have received otherwise, this portion of the total benefit represents nearly \$6 million in incremental value for farmers in Brazil and over \$3 million in Honduras.

The premiums paid by COE are several times higher than prevailing specialty and direct trade prices. These high premiums encourage producers to enter a beneficial cycle of improved quality, greater recognition for specialty coffee, and greater demand. COE farmers produce additional specialty coffee beyond what goes to auction and other producers are motivated by the contest to enter specialty coffee. This creates a multiplier effect that boosts the broader specialty trade: we estimate that for every farmer who participates in COE, 2-4 others have entered

specialty production. The indirect benefits from COE are estimated to be more than \$100 million for Brazil and \$22 million for Honduras (and are included in the total benefit cited above).

For individual producers, the access to specialty markets that COE provides mean significantly higher incomes. In Brazil, specialty producers have profit margins 50% greater than conventional producers in similar areas; in Honduras, producers who sell direct trade coffee have margins six to nine times that of conventional producers. The tens of thousands of dollars this represents for typical farms allows for investments and improvements to farms, homes, and communities.

Larger typical farm sizes in Brazil and COE's longer history in that country drive the difference in impact between Brazil and Honduras. The economic trade-offs are also more favorable in Brazil for entering specialty production: because Brazilian coffee is generally unwashed, the price gains from moving into washed specialty coffee are greater than in Honduras, which produces washed coffee. On the other hand, Honduras' small farm sizes make it practical for buyers to make direct trade deals with farmers. Honduran farmers who enter the COE auction are often able to sell most of their production direct trade, boosting their profits considerably.

COE also creates many benefits for the local and international specialty coffee trade. Local exporters and cooperatives have followed COE's example and invested in more transparent trading mechanisms to link specialty producers with buyers and reward higher quality with higher prices. COE offers a platform for sourcing the finest specialty coffees from each COE country COE and allows buyers from around the world to identify new suppliers and develop their supply chains. The competition helps develop cupping skills among buyers and at origin and creates a consensus around the meaning of specialty coffee. It promotes an international specialty coffee community among participants.

These results have been achieved with a relatively small cumulative direct cost of producing the program in each country: approximately \$2 million in Brazil and \$1 million in Honduras. This modest philanthropic investment has yielded an incredible return both for producers and the trade. Various opportunities exist to expand on this impact and to bring the benefits of specialty coffee and COE to new producers.

Introduction: Cup of Excellence

COE began in 1999 with its first auction in Brazil

The Cup of Excellence (COE) concept² was launched in Brazil in 1999. It was conceived with the specific goal of increasing the sales of high-quality coffees and promoting Brazil as a specialty coffee origin.³

COE was preceded by other efforts⁴ to promote specialty coffee⁵ and attract buyers. COE built on these efforts and introduced something new: a competitive process to identify the best coffees followed, by an exclusive, limited-volume auction to reward the best coffees with the highest prices.

COE has succeeded in achieving this purpose and expanded in the past 15 years

COE is widely viewed as a success story. Since 1999, COE has convened 100 competitions globally, auctioned over 2,500 lots of coffee, and generated direct auction sales of over \$40 million for farmers worldwide.⁶

COE has grown from its origins as a Brazilian competition. Brazil now convenes two contests per year and the COE platform has been taken to new origins with the goal of promoting specialty coffee. It is now present in other parts of Latin America and, more recently, in Africa. In 2001, Guatemala became the second origin to host a COE competition. In 2004, Honduras hosted its first COE, continuing uninterrupted to the present.⁷

COE now represents the top 0.002% of coffee production and attracts extraordinary premiums

While COE has expanded, it has retained its exclusivity. Only the very best lots reach the auction. The vetting process has grown more rigorous and comprehensive to identify the best coffees out of a larger pool of submissions. The lots at COE are the top ~600 bags of a country's production, and sell for prices multiple times the prevailing market rates (see Figure 1). In 2013/14, COE coffees represented the top 0.002% of global coffee production.⁸

COE has had far-reaching impact beyond premiums for winning farms

COE has also catalyzed the growth of the specialty coffee industry in participating countries. It has promoted direct trade and new relationships between buyers and producers and helped open new markets, particularly in East Asia.

Through its auctions, COE helped establish a new paradigm for coffee trading in which price (value) and cup quality are transparently linked for all market actors. It set an expectation that such transparency would be replicated in specialty channels outside the auction. This, in turn, has encouraged producers, cooperatives, exporters, and others to invest in

quality. And, through higher quality and higher prices, COE has helped many coffee farmers to build strong farm businesses and improve their quality of life.

This study looks at COE’s impact in two distinct origins, Brazil and Honduras

This study focuses on two countries that have been involved in COE for more than a decade: Brazil and Honduras. These origins are different from one another in industry structure, farmer profile, and scale, but similar in that they have both historically been viewed as “commodity” producers. They serve as example cases to understand the benefits of COE. Their experiences are instructive to other origins and demonstrate the value of continuing and expanding the COE platform in the future.

Figure 1

COE auction lots earn significant price premiums

	 Brazil	 Honduras		
	Volume (bags)	Differential (¢ per lb)	Volume (bags)	Differential (¢ per lb)
Conventional	43 million <i>(incl. robusta)</i>	-10 to -25	4 million	0 to +10
Specialty*	4 million	+20 to +40	500,000	+10 to +20
COE Auction Lots**	900	+500 to +700	300	+800 to +1000

*Prices are for general specialty trade (before any additional premiums for certification) and not direct trade. Direct trade prices range from \$3-4 per pound for both origins

** COE volumes based on average of last two years; prices based on range from last two years

Note: differentials are calculated above the average “C” price.

Source: Exporter interviews, COE, BSCA, IHCAFE

Context: The Commercial and Specialty Markets in Brazil and Honduras

Brazil and Honduras have reputations as a “commodity” producers

Historically, Brazil and Honduras were overlooked by specialty buyers in preference to countries with a long-standing reputation for quality, such as Colombia or Kenya.

Brazil had a challenging reputation to overcome. Many perceived it as a country of large, highly technified farms producing interchangeable lots of “commodity” grade coffee. Indeed, the majority of Brazil’s coffee is traded at a negative differential to the benchmark Arabica price (see again Figure 1). These coffees are exported with flavor categories such as “strictly soft” (clean and balanced) and “rio” (strong, medicinal taste)⁹ and comprise a primary blending ingredient in the world’s mainstream coffee brands. The sheer scale of Brazil’s industry, and its efficiency in serving the commodity segment, contributed to a perception that Brazil is only viable as a commercial producer, not as a differentiated one.

Honduras not only had similar reputational challenges, but also an internal market that hindered the discovery of quality. Honduras is the largest coffee producer in Central America, with more than five million bags of production,¹⁰ but typically exports coffee at a price discount to neighboring origins such as Costa Rica and Guatemala.¹¹ Unlike Costa Rica and Guatemala, which trade in cherry or dry parchment, the internal Honduran coffee sector trades primarily in wet parchment.¹² Exporters rely heavily on small-scale intermediaries to source coffees from farmers. While intermediaries offer efficiency, they often lack mechanisms or incentives to differentiate quality. Wet parchment must be fully dried before it can be cupped and thus it is difficult to offer differential pricing to farmers. Furthermore, the practice of transporting and storing coffee while wet can lead to over-fermentation, mold, or flavor taints.¹³

Nonetheless, the specialty market has grown rapidly in both countries

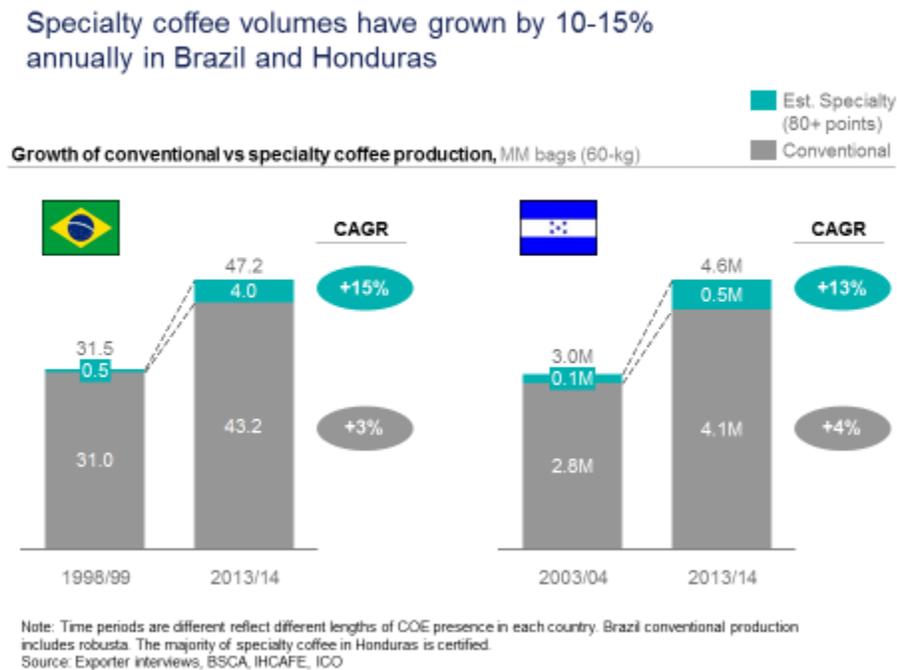
Globally, specialty coffee demand has risen in the range of 5-10% year over year since the 1990s. This growth has been driven by the rise of large brands like Starbucks, Nespresso and Illy, as well as by smaller, gourmet brands featuring “single origin” coffees.

Both Brazil and Honduras have seen faster specialty market growth than the global average. We estimate Brazil’s growth at ~15% year over year since 1999 (see Figure 2).¹⁴ Brazilian experts estimate specialty coffee now comprises 8-9% of national production or about four million bags.¹⁵

In Honduras, the market for “differentiated” coffees has grown from almost 50,000 bags in 2005 (the first year these records were kept) to

over one million bags today¹⁶ – a growth rate of over 40%. However, this figure is heavily weighted by certified coffees and likely fails to capture a higher starting point of coffees that had specialty cup characteristics. Using cup quality as the defining characteristic of specialty, Honduran experts estimate a base of around 150,000 bags in 2004 and current exports of 500,000 bags as of 2014, or a ~13% average annual growth rate (see again Figure 2).¹⁷

Figure 2



Several factors have contributed to the rapid development in Brazil and Honduras

It is important to recognize that Brazil and Honduras entered the specialty market from lower starting points than countries like Costa Rica or Kenya. In those countries, a higher proportion of the base production is likely to be specialty due to higher altitudes and predominant processing methods (i.e., washed rather than natural).¹⁸

Events in the global coffee market also contributed to specialty growth in Brazil and Honduras. For example, from 2008-2011, when Colombia’s production dipped significantly, many specialty buyers turned to Brazil to make up for lost production.¹⁹ As volumes have also decreased in other Central American countries (including Costa Rica and El Salvador), buyers have similarly turned to Honduras to help fill that volume.

Finally, Brazil and Honduras have made specific efforts to grow their specialty coffee sales. In Brazil, the efforts of the BSCA are notable in promoting Brazilian specialty coffee. In Honduras, work from the Honduran Coffee Institute (IHCAFE) and the Honduran government, bilateral donors, and NGOs has improved coffee infrastructure in the country and trained farmers on best practices. In both countries, exporters, cooperatives, and other farmer groups have invested in specialty production, processing, and marketing.

COE played a key role in accelerating this growth

Alongside these broader industry trends, COE had a substantial contribution to the growth of the specialty coffee industry in both countries. According to a Brazilian exporter interviewed for this study, “The growth of quality volume and quality itself is due to COE.”²⁰ COE is well known throughout Honduras as well, and experts there credit the program with boosting Honduras’ reputation for specialty coffee and helping develop the industry.

A Beneficial Cycle: COE Premiums as a Catalyst

COE buyers have paid millions of dollars in auction premiums since 1999

From 1999 to 2014, more than 400 lots of coffee have been auctioned in Brazil.²¹ These coffees have attracted 269 different buyers to participate in the auctions and generated more than \$8 million in gross sales.²² Subtracting what these coffees would have likely received in other specialty markets, this represents an incremental \$6 million in premiums to farmers.²³ Over 200 producers and producer groups have been represented at the auction and received premiums for their coffee.²⁴

In Honduras, COE has generated auction sales of \$4.4 million.²⁵ Adjusting for baseline specialty prices, COE has helped farmers earn an incremental \$3.4 million in premiums.²⁶ Over 170 producers and family groups have sold over 300 lots at the auction.²⁷

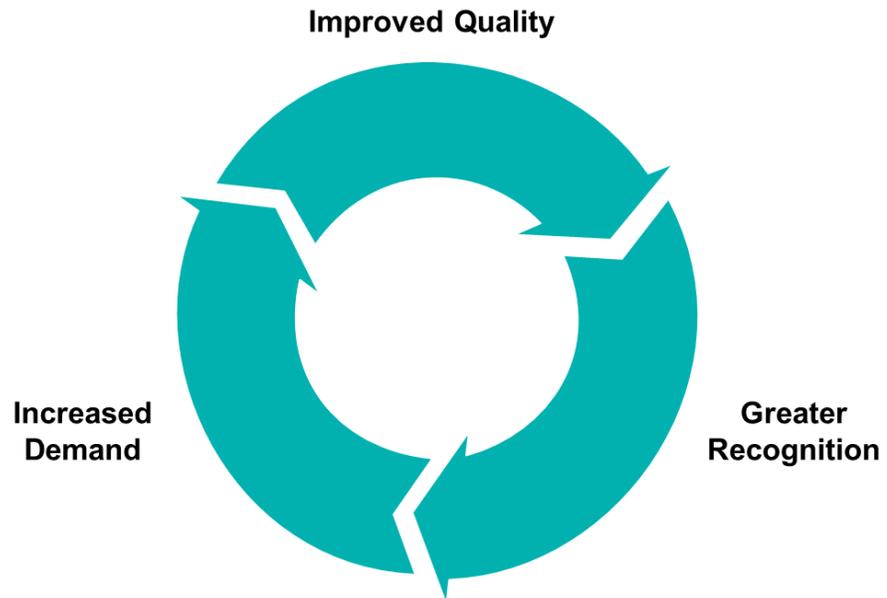
Premiums catalyze a beneficial cycle of improving quality, promoting greater recognition, and increasing demand

The financial incentive provided by COE triggers a beneficial cycle of improvement and growth, which have an important spillover effect in the broader specialty coffee sector.

Farmers who participate in the COE program seek to repeat their success. New farmers are also attracted to participate. Farmers are driven to utilize better farming and processing practices, and to invest in better infrastructure. There is also an attitudinal shift to afford greater attention

to detail and differentiation. This increased focus and participation results in increasing supplies of specialty coffee for the country and for COE.

Greater recognition for quality coffees in Brazil and Honduras and the increased availability of specialty coffees attracts buyers. Increased demand and competition can lead to higher premiums. The price discovery function provided by the auction sets a new benchmark for contract transparency, which is replicated in negotiations between producers and buyers outside the auction. As differentials for COE and other specialty coffees have increased, it has encouraged more production and continued participation from producers. These factors constitute a beneficial cycle, which is further elaborated on in the next sections.



A Beneficial Cycle: Improved Quality

COE participants have invested in improving quality in three ways

The incentive of a higher price for higher quality coffee encourages producers to invest in quality. Producers cite three principal areas of additional investment: (1) Improved post-harvest practices; (2) Improved processing infrastructure; (3) Greater care and differentiation within the farm.

(1) Improved post-harvest practices

Compared with a traditional farm selling into conventional markets, a specialty farm has to invest considerably greater time and effort in all stages of preparation.

In Brazil, these changes include same-day processing of cherry, more rigorous cherry separation, more frequent turning of coffee drying on patios, resting (conditioning) coffee for up to 30 days before the final dry-milling, and better overall cleaning and maintenance of equipment. In Honduras, the emphasis is on careful cherry selection at harvesting and increased drying of coffee after wet milling. These changes are summarized in Figures 3 and 4 on the following pages.²⁸

Figure 3

Brazil specialty farms: additional post-harvesting steps

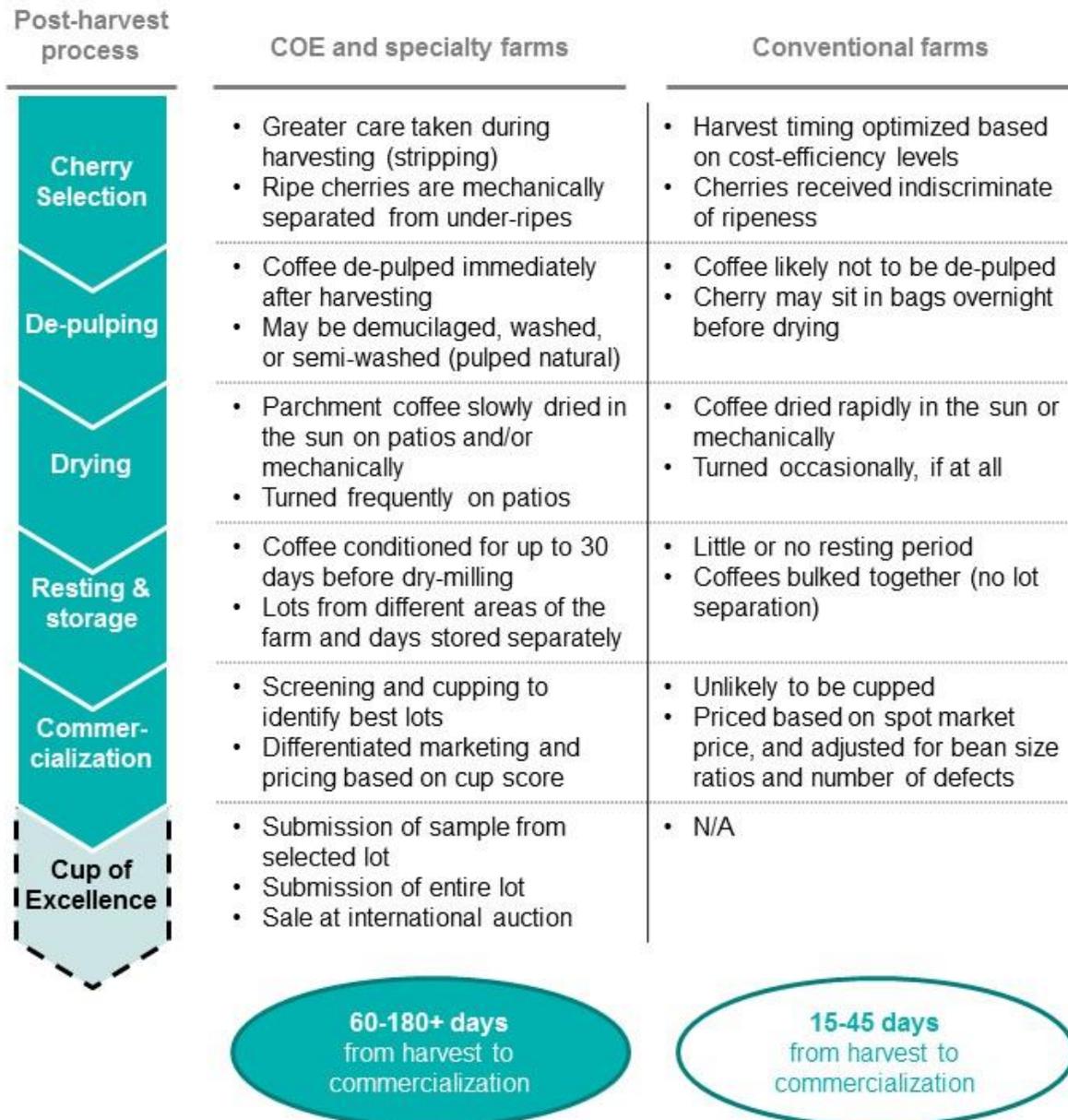


Figure 4

Honduras specialty farms: additional post-harvesting steps



Post-harvest process	COE and specialty farms	Conventional farms
Cherry Selection	<ul style="list-style-type: none"> Cherries selectively harvested based on ripeness Collectors are paid more to pick cherries carefully 	<ul style="list-style-type: none"> Cherries picked with little or no differentiation based on ripeness
De-pulping	<ul style="list-style-type: none"> Coffee de-pulped same day as harvested on clean equipment Beans sorted by size Coffee washed w/ fresh water 	<ul style="list-style-type: none"> Cherry may sit in bags overnight before de-pulping Same water used for many coffee washings
Drying	<ul style="list-style-type: none"> Coffee dried in patios or solar dryers 	<ul style="list-style-type: none"> Coffee typically sold wet, not dried
Resting & storage	<ul style="list-style-type: none"> Coffee rested for 15-30 days after drying Lots stored carefully away from moisture 	<ul style="list-style-type: none"> No resting period – coffee sold as quickly as possible No separation of coffees by lots
Commercialization	<ul style="list-style-type: none"> Screening and cupping to identify best lots Hand-sorted to zero defects 	<ul style="list-style-type: none"> No tasting of coffees sold May be differentiated based on bean size or number of defects
Cup of Excellence	<ul style="list-style-type: none"> Submission of sample from selected lot Submission of entire lot Sale at international auction 	<ul style="list-style-type: none"> N/A
	<div style="border: 2px solid teal; border-radius: 50%; padding: 10px; width: fit-content; margin: 0 auto;"> <p>60-180+ days from harvest to commercialization</p> </div>	<div style="border: 2px solid teal; border-radius: 50%; padding: 10px; width: fit-content; margin: 0 auto;"> <p>1-15 days from harvest to commercialization</p> </div>

(2) Improved processing infrastructure

COE winners (i.e., auction finalists) invest in post-harvest processing infrastructure. In Brazil, a recent first-time auction winner described using the winnings to help improve his de-pulper.²⁹ Another farmer who achieved repeated success made multi-year investments: building a new drying patio and adding conditioning bins to store coffee.³⁰ These investments vary considerably by producer, but a typical investment for a medium sized farm (~30-100Ha) is an estimated \$60,000-\$70,000.³¹ When amortized over 10 years, this represents an added cost of ~\$6,000-7,000 per farm per year, or approximately 3-4 cents per pound (see Figure 5 on the following page)³². The return on this investment is discussed later in this report.

In Honduras, on-farm drying has been less common historically.³³ Thus, the key investment farmers make to produce specialty coffee is in suspended drying beds or drying patios. The former are covered by plastic tarps, which accelerates the drying and keeps the coffee safe from rain. A suspended drying bed measuring 10 x 2 meters and capable of drying around 1,500 pounds of parchment at a time costs approximately \$300-400.³⁴ IHCAFE and other organizations offer financing for this type of dryer, typically with 1-3 year terms.³⁵ Amortized over three years, this drying investment costs 3-5 cents per pound for a typical farm.

(3) Greater care and differentiation within the farm

COE participants change the way they run their farms to better identify, separate, and differentiate their coffees. Parcels of land within the farm that have varieties or microclimates likely to produce fine coffee are specially demarcated. Producers then track, process, and store lots from these parcels separately. In Honduras, farmers recognize that coffees from later in the harvest are often better, and separate these. The best lots are identified and submitted to COE, and others are separated for direct trade or specialty sales.

A higher quality threshold has been set for COE entrants

The growing supply of higher quality coffee has enabled COE to become more selective in what it deems eligible for entry into the context. As shown in Figure 6, the threshold cup score for entry has risen from an 80 in 1999 to an 85 without reducing the volume offered at the auctions.³⁶

The increase in quality is supported by buyer feedback

Industry participants agree that COE has helped increase the quality of coffees available in the market. In the buyer survey for Brazil, 80% of respondents agreed or completely agreed that COE had encouraged greater production of specialty coffee.³⁷ In Honduras, buyers describe the dramatic increase in their perception of Honduran coffee, noting that most of the top roasters bought no Honduran coffee 8-10 years ago.³⁸

Figure 5

In Brazil, farmers must make numerous investment to produce specialty coffee

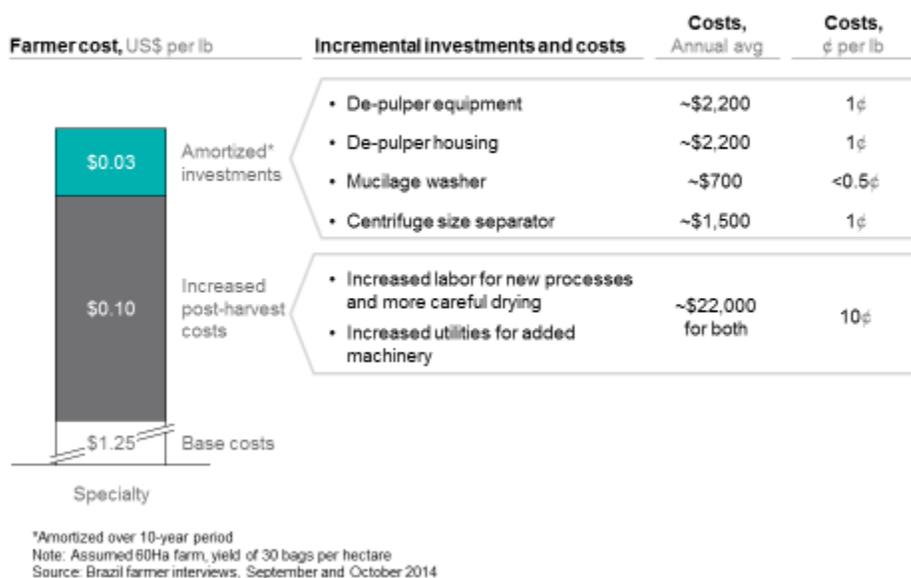
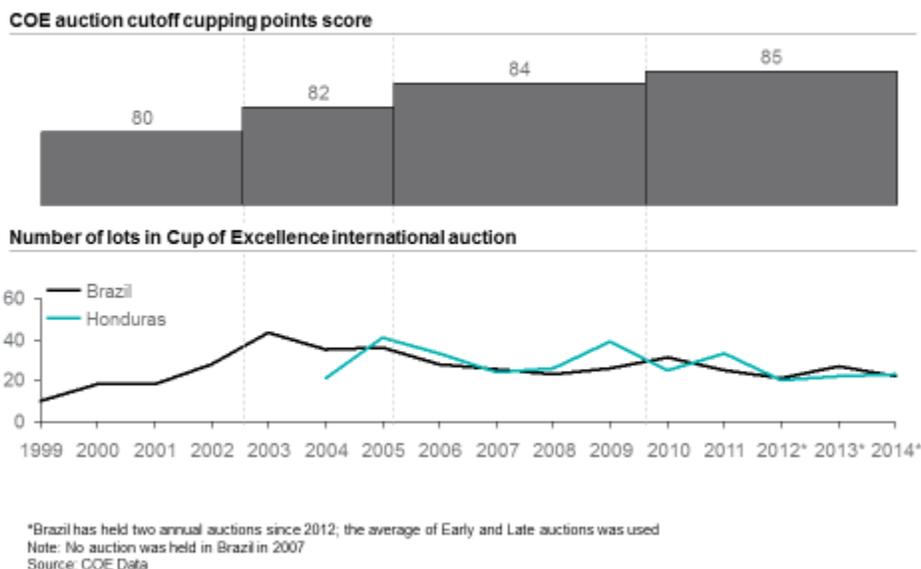


Figure 6

COE has been able to raise the quality threshold for entering the auction, without reducing the number of entrants



A Beneficial Cycle: Greater Recognition

Perceptions of Brazilian and Honduran coffee quality have changed

COE has helped raise the profile of both origins as specialty producers. Among respondents in a buyer survey, 60% agreed or completely agreed that COE had improved their perception of Brazilian coffee; 100% felt this had occurred for Honduras as well.³⁹ Prior to COE, the highest quality description for Honduran coffee was SHG (“strictly high grown”).⁴⁰ Many Honduran coffees are now traded well above the benchmark Honduran SHG price on the basis of quality, unique cup attributes, and relationship.⁴¹

COE has helped put new regions on the map

Some areas have had sustained success in COE and this has brought additional benefits. In Brazil, Mantiqueira de Minas has produced 54% of all winning farms since 1999 and as many as 70% of them in some years.⁴² As one producer described it, “COE put this small town on the map.”⁴³ The region was not well-known as a source for high-quality coffee, but is now viewed as Brazil’s primary source for specialty coffee. It is seeking to protect its enhanced reputation by pursuing a certified “Indication of Origin”.⁴⁴ Along with Mantiqueira de Minas, other areas such as Montanhas do Espírito Santo and Chapada Diamantina in the state of Bahia have emerged as regions with high-quality coffee in large part as a result of their success at COE. These regions emerged in addition to existing areas that were known for their quality.

This is seen in Honduras as well. Marcala was the primary quality region for the country in the past, but the Santa Barbara mountain in the department of Santa Barbara has risen to prominence thanks to COE.⁴⁵ The department of Santa Barbara has produced 40% of COE winners over 11 contests in the country.⁴⁶

Private sector investments further promoted specialty coffee

These areas’ reputations benefited by having a few pioneering farms with early wins at COE. This reputation was further enhanced through investments made by the local private sector. These actors created transparent frameworks for linking buyers with producers, and price with quality, modeled on the experience demonstrated by COE.

As a prime example, Carmo Coffees, in the Mantiquiera de Minas region of Brazil, established a comprehensive direct trade business, where farmers are able to meet and negotiate with buyers.⁴⁷ It works closely with producers to teach best practices for specialty production and to match them with specialty buyers. COCARIVE, a cooperative in the

same area, began an export business to link farmers with specialty buyers and provides training and information sharing among farmers.⁴⁸

In Honduras, exporters such as Beneficio Santa Rosa (in Copan) and Beneficio San Vicente (in Santa Barbara) have developed processes to handle specialty coffee and link producers to buyers.⁴⁹ In partnership with NGOs and other agencies, they seek to reward the production of quality coffee in new areas, and bring new producers into the specialty coffee supply chain. In addition, they organize cuppings and farm visits for buyers. IHCAFE also provides guidance to producers on best practices, offers loans for drying infrastructure, and invests in market promotion.⁵⁰

In many cases in both Brazil and Honduras, these investments were initially driven by the desire to service COE clients, but have since expanded to service the broader specialty (and direct trade) segments of the market. For instance, COE's exacting standards for shipment and delivery pioneered to the use of vacuum-sealed bags for green coffee export, and companies like Bourbon Specialty in Brazil are continuing to implement and develop this technology.

COE has inspired other in-country specialty coffee contests

Although COE remains the most prestigious competition in Brazil, it has inspired other specialty competitions at the local level. In Carmo de Minas alone, over 20 specialty coffee contests convened in 2013.⁵¹ These events offer new channels for producers to receive recognition. They also encourage a higher degree of self-selection among farms that submit coffee to COE.

IHCAFE, in Honduras, has created regional coffee fairs to promote specialty coffee and COE.⁵² The regional fairs serve to identify and screen farmers with potential for specialty production. Farmers bring samples of their coffee and the best coffees in each region are recognized. Farmers are then encouraged to prepare a lot for COE. 200-300 farmers participate in each coffee fair across six different regions of Honduras.⁵³

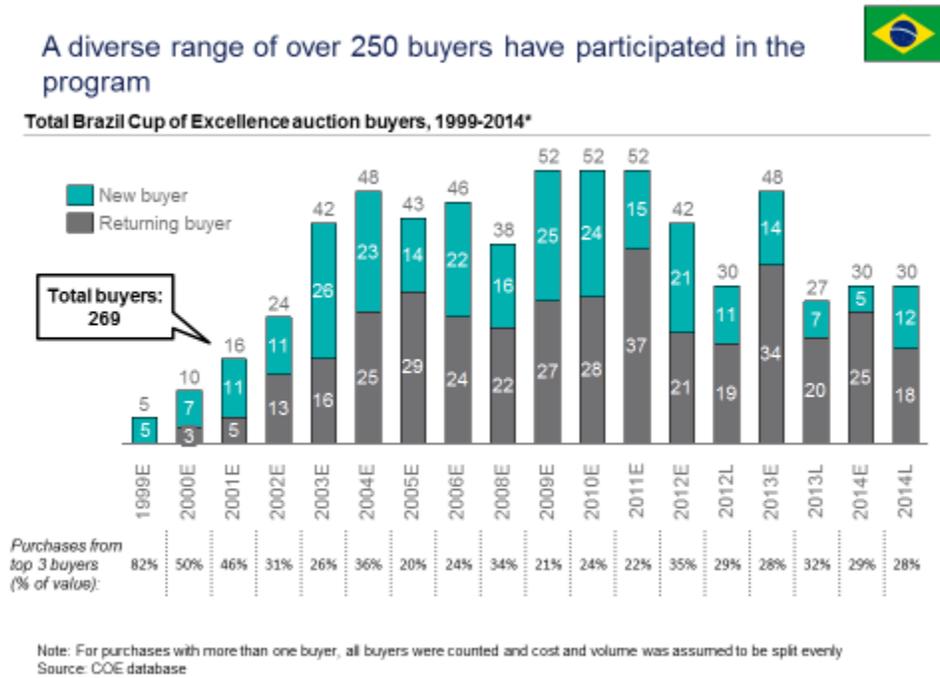
A Beneficial Cycle: Increased Demand

More buyers are participating in COE

Only five buyers from Europe and North America participated in the first COE auction in Brazil. Through the end of 2014, 269 different buyers have participated at Brazil's COE auction and 184 in Honduras's auction.⁵⁴ Currently, a mix of 30-50 new and returning buyers participate in COE in each country, including those buying through purchasing

groups or importers (see Figure 7 for the Brazil example). Asia, led by Japan, has become the leading destination for these COE lots.⁵⁵

Figure 7

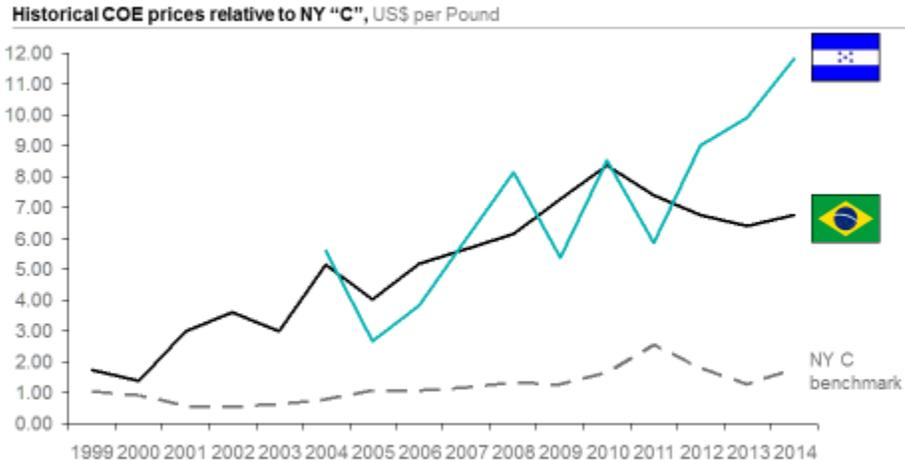


Auction differentials have widened

Increased demand and competition are best evidenced by widening differential premiums for COE coffees above the NY-C benchmark (see Figure 8 on the following page).⁵⁶ While specialty coffee premiums have risen in general, the premiums paid at COE remain substantially higher. This is true for both Brazil and Honduras – in fact, since 2012, differentials for COE in Honduras have surpassed those in Brazil.

Figure 8

COE auction differentials have grown significantly since the auction started in 1999



Note: Since 2012, Brazil has held two auctions per year. No auction was held in Brazil in 2007
Source: COE data; NY Board of Trade

Direct trade relationships have grown

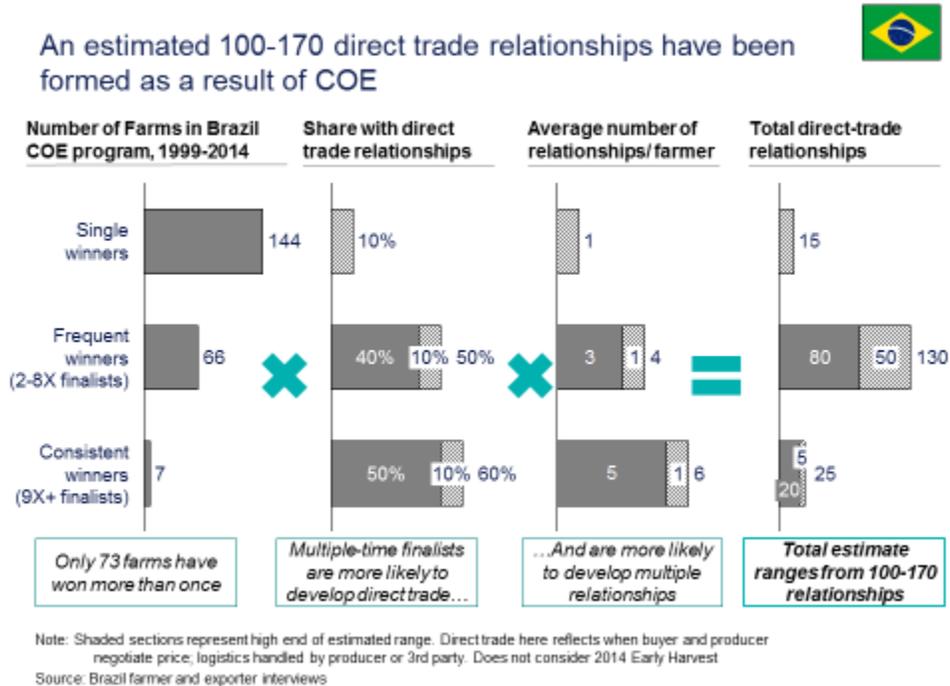
Greater demand is also seen in “direct trade” relationships that exist outside the COE auction. The term direct trade emerged in the 2000s and is generally associated with a transparent, long-term relationship that exists between the buyer (typically a roaster or specialty importer) and the farmer. Quality and prices in the direct trade niche are usually higher than in the broader specialty segment, and prices are typically negotiated as flat prices rather than floating differentials. In this analysis, we considered direct trade to be relationships where farmers and buyers negotiated price. Other companies often executed the exporting itself.

In Brazil, the producers interviewed reported nearly 30 direct trade relationships that formed as a result of COE.⁵⁷ For the broader population of COE participants, an estimated 100-170 new direct trade relationships have been formed (see Figure 9 for details; note that a single buyer may buy from many producers).

In Honduras, the prevalence of direct trade is more pronounced. Seventy percent of the COE winners interviewed were engaged in direct trade.⁵⁸ Multiple farmers report multi-year contracts or indefinite term agreements with given buyers.⁵⁹ Producers view finding a direct trade buyer as a key business goal, and many exporters and cooperatives have begun facilitating this type of sale.

Many of these relationships formed because of the introduction and exposure provided by COE.⁶⁰ In other cases, buyers purchased coffee from a COE winner in one year and continued the relationship with the producer (independent of COE performance) in future years.

Figure 9



COE has promoted broader sales of specialty coffee

COE helps promote greater production of specialty coffee and increased recognition of quality and value. This results in increased specialty trade well beyond COE auction lots and COE producers. The same producers’ associations and exporters that work with COE lots and direct trade relationships also service the broader specialty industry. Regions that develop a reputation for quality through COE are recognized broadly and are able to sell additional specialty volumes.

In Brazil, over 60% of buyers surveyed reported that COE has led them to buy more specialty coffee than they would have otherwise; among buyers of Honduran coffee surveyed, the figure is 90%.⁶¹ In both cases, over 80% of those who purchased more also reported an improved perception of the country’s coffee.⁶² As one producer put it, “The biggest benefit isn’t the one-time windfall – it’s shared. It’s contact with buyers who see that the whole region has differentiated coffee.”⁶³ In this way, COE has a significant indirect benefit on the entire specialty coffee sector.

COE has helped develop new markets in Asia and Australia

The contest has helped open markets in Asia for specialty coffee from COE origins. Japan, Korea, and Taiwan are now major specialty coffee markets. Japan’s specialty industry has grown by an estimated 15% annually since 2000; Taiwan has been growing at a similar rate.⁶⁴ In South Korea, specialty coffee has also been booming. There are 12,000 specialty coffee shops in Korea (including Starbucks), an increase of 60% since 2008.⁶⁵ COE provides buyers from these countries confidence in sourcing from new origins. In the words of one Japanese buyer, “I would have no interest in Honduras if it were not for COE.”⁶⁶

COE is credited with facilitating and accelerating the development of the specialty coffee industry in consuming countries. One buyer said that the development of this industry in Australia would have been much slower without COE.⁶⁷

Overall Impact: Effects of COE

Millions of dollars in auction premiums have been paid to producers

From 1999-2014, buyers have paid \$8 million at the Brazil COE auction.⁶⁸ This represents nearly \$6 million in premiums to farmers above and beyond what they would have earned selling the coffee at specialty prices.⁶⁹ In Honduras, buyers have spent \$4.4 million from 2004-2014, or \$3.4 million over what they would have earned at specialty prices.⁷⁰

COE winners continue selling specialty coffee

Farmers participating in COE don’t just produce high quality coffee for COE or a once-off lot submission. Changes made by farmers in terms of processing and lot differentiation are typically sustained in perpetuity. The premiums and recognition of winning COE therefore contribute to a “multiplier effect” for the farmer. For COE winners in Brazil, for every \$1 received in auction premiums, we estimate the farmer receives an incremental \$1 to 2+ in specialty premiums each year thereafter.⁷¹

COE winners also influence other farms to enter specialty and/or direct trade

There is also a spillover effect for farms that do not win COE. Other farms in successful COE areas are motivated and inspired by winners’ experiences and decide to enter specialty production. These may be farms that have upgraded their practices and tried to enter COE, but were unsuccessful, as well as farms that never entered COE but started producing specialty production after observing the success that COE participants achieved. Buyers and the local private sector are also more likely to invest their efforts in these areas with proven quality reputations.

Areas with high COE presence produce a greater share of specialty coffee than the national average

Areas with a higher number of COE auction finalists produce a larger share of specialty coffee than others. For example, Mantiqueira de Minas produces 30% specialty coffee, compared to 8-9% nationally.⁷² If one assumes that without COE, specialty production in Mantiqueira de Minas would be closer to the national average, then the incremental ~20% can be attributed directly or indirectly to COE. Such attribution is supported by feedback from local stakeholders and market participants.⁷³

This multiplier effect varies, but is highest in areas with many COE winners over time

In Mantiqueira de Minas, the region with the most COE winners in Brazil, incremental specialty volumes due to COE have risen to about 160,000 bags per year.⁷⁴ Based on average farm sizes and specialty production volumes, 20-30% of the volume increase is likely from the 95 COE winners in the area.⁷⁵ The remaining 70-80% comes from an estimated 300 to 400 other farms influenced by COE's presence.⁷⁶ These farms typically have a similar profile as COE winners (in terms of farm size and yield), but sell lower volumes of specialty. We estimate, therefore, that for every COE winner in Mantiqueira de Minas, there are 3-4 other farms selling specialty coffee as an indirect result of COE.

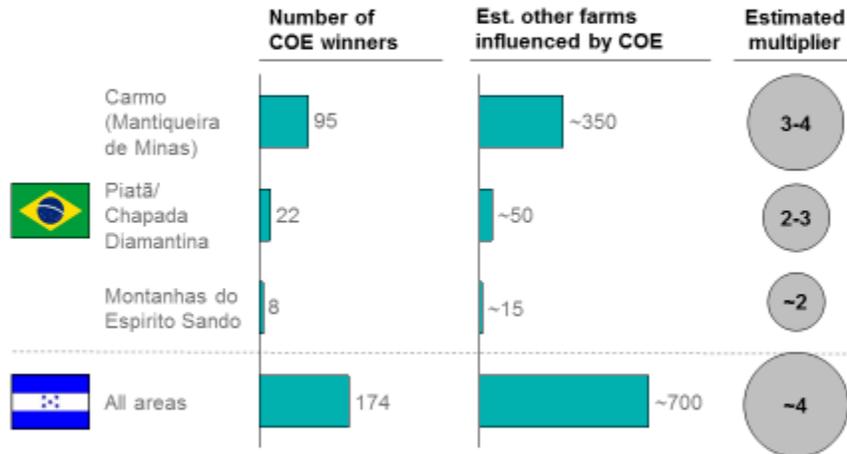
In other regions of Brazil with less concentration of COE winners the multiplier is likely between 1 and 2.5.⁷⁷ In Honduras, where farms are smaller and closer together, we estimate the multiplier effect to be 3-5 (see Figure 10 on the following page).⁷⁸

The multiplier effect grows through continued presence of COE in an area

The multiplier effect accelerates over time, as the beneficial cycle continues and greater numbers of COE winners influence additional farmers to produce specialty coffee. Eventually, specialty volumes from the spillover effect into non-COE winning farms eclipses that associated with COE farms. See Figure 11 (on the following page) for an estimate of how this multiplier effect evolved in Mantiqueira de Minas.⁷⁹

Figure 10

COE winners have a “multiplier effect” on other farms, especially in areas with repeated success



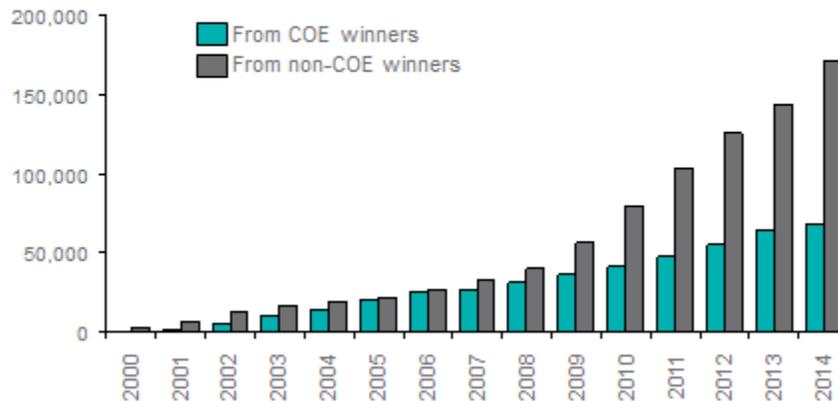
Note: Multipliers based on specialty production among COE farmers and a projection of how many additional farms would be necessary to fulfill the COE-influenced volume in each region. Does not consider 2014 Early Harvest
 Assumes farm sizes and yields of 8Ha & 17 bags/ Ha in Honduras; 80Ha & 30 bags/ Ha in Carmo; 80Ha & 30 bags/ Ha in Piatã; and 25 Ha & 20 bags/ Ha in ES.

Figure 11

The multiplier effect takes time to gather momentum



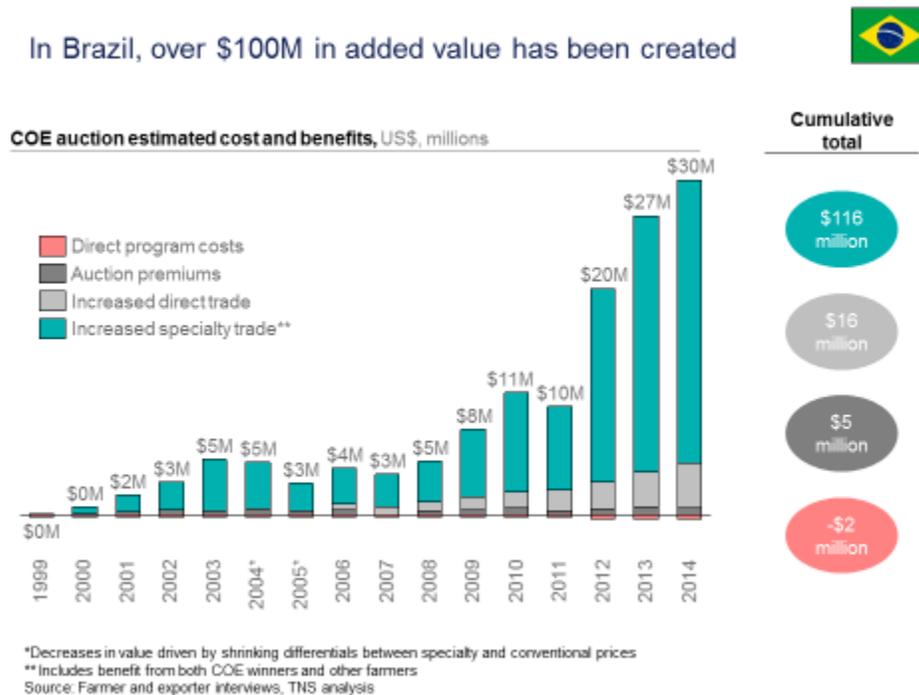
Est. volume of specialty sales, Mantiquiera de Minas, Bags



In Brazil, COE’s indirect benefit translates into increased specialty coffee sales of over \$100 million since 1999

Across all regions in Brazil, incremental specialty sales from COE-winning farms and COE-influenced farms have risen to approximately 300,000 bags (as of 2013/14).⁸⁰ Since 1999, a total of nearly 2 million bags additional specialty coffee has been sold, worth \$100-120 million in revenues,⁸¹ plus an additional 35,000-40,000 bags sold through direct trade, worth \$15-20 million in revenues⁸² (see Figure 12). Approximately 40% of this incremental production comes from Mantiquiera de Minas.⁸³

Figure 12

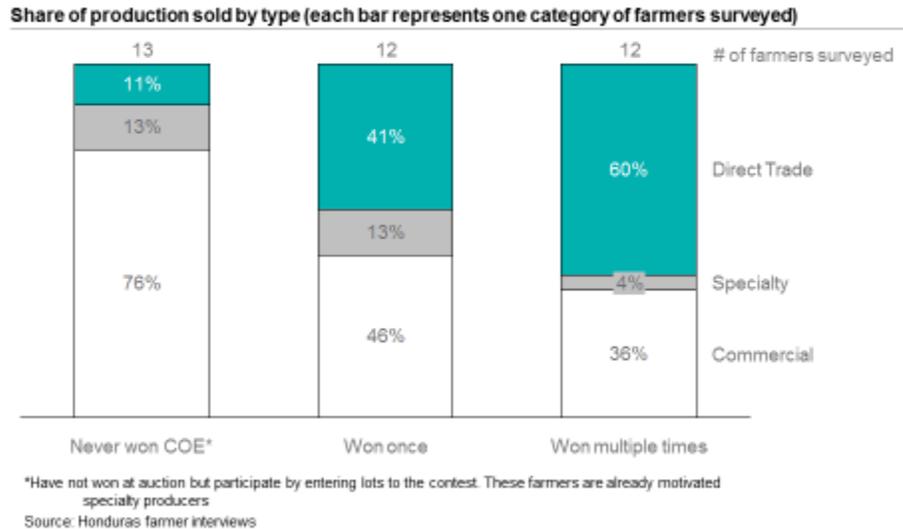


In Honduras, cumulative benefits total more than \$30 million since 2004

In Honduras, COE has had greater impact in the direct trade segment than in the broader specialty market. COE winners are typically able to sell a high share of their production as direct trade (40-60%), but report a lower share as specialty sales (5-15%).⁸⁴ (See Figure 13). Since 2004, a total of nearly 80,000 bags additional specialty coffee have been sold due to COE,⁸⁵ worth \$1-2 million in revenues,⁸⁶ as well as an additional 110,000 bags of specialty coffee via direct trade,⁸⁷ worth \$20-25 million in revenues.⁸⁸

Figure 13

In Honduras, farms with repeated success at COE now sell the majority of their coffee through direct trade



The impact of COE in Brazil and Honduras differs for several reasons

Several factors help explain why Honduras and Brazil differ in terms of the share of their coffee crops sold as direct trade versus regular specialty. First, farms are bigger in Brazil than in Honduras. The purchasing capacity of direct trade buyers is the same, however. A 50-bag direct trade purchase may be 40% of a Honduran farmer’s crop but less than 5% of a Brazilian farmer’s.⁸⁹ Honduran farmers can devote more effort on small volumes, which represent a larger share of their total production, to produce coffee that meets the highest standards demanded by direct trade buyers. For direct trade buyers, working with smaller farmers and volumes is financially more feasible and provides a more appealing marketing message. On the other hand, larger farms in Brazil produce much more coffee, increasing the magnitude of COE’s impact. Each additional farmer COE motivates to enter specialty production in Brazil produces more coffee, worth more in total, than those in Honduras.

Second, the economics of moving from commercial to specialty production are less attractive in Honduras. Farmers in both countries need to make investments to upgrade quality, but in Brazil these costs can be spread over a larger volume of coffee, due to larger farms, and a longer period of time, due to longer financing periods.⁹⁰ In addition, the premium associated with moving from a commercial coffee to a specialty coffee is greater in Brazil than in Honduras.⁹¹ This is because the starting

point in Brazil is a less-processed unwashed coffee, rather than a washed coffee. As result, a Honduran farmer’s investment per pound of coffee is greater, and the increase in specialty premiums they can achieve is smaller (see Figure 14; see COE Benefits: For Farmers section for additional detail on farmer costs and income).

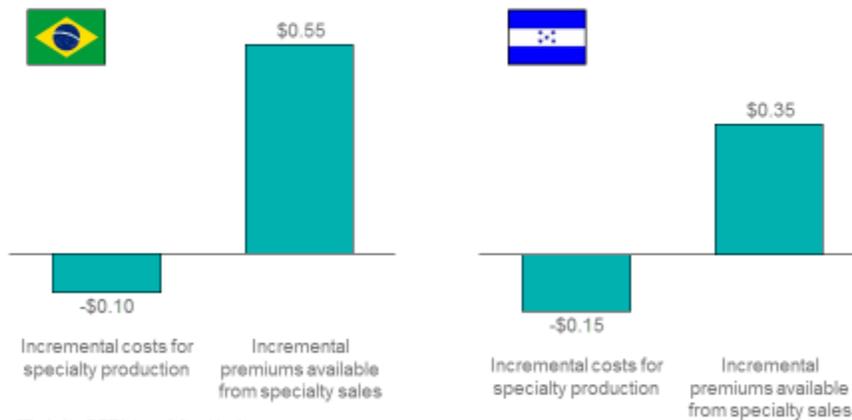
Third, unlike Brazil, a high share of Honduras’ specialty coffee is certified, particularly Fairtrade and/or organic. Although COE winners may be certified, this study did not assume COE had influence on expanding certification or demand for certified coffees.

Finally, Brazil has been evolving as a specialty origin for longer than Honduras. COE started five years earlier in Brazil; the BSCA has existed since 1992. Honduras is still improving the consistency of the coffees it delivers and building marketplace trust in its coffees.

Figure 14

The economics of shifting to specialty production appear more attractive in Brazil (though fewer farms have the altitude, growing conditions, etc. to do so)

Estimated specialty premiums and production costs (2014), US\$ per lb (green)



*Excludes COE lots and direct trade

Note: Honduran farmers are able to sell a greater share of their production as specialty (70% vs. 40% in Brazil) due to smaller farm sizes and hand-picking; this is not accounted for here. Brazil conventional production costs for mountainous, non-mechanized areas

Source: Interviews with Brazilian and Honduran exporters and farmers

Overall Impact: Return on Investment

For every \$1 spent on COE, \$1.5-3 is created in incremental auction premiums for farmers

In Figure 15, the costs of the COE program are compared to the incremental income that it generates in each country. The direct cost of each auction in Brazil is approximately \$220,000, of which \$120,000 is funded by Brazil's export agency, APEX.⁹² These annual investments of \$440,000 generate roughly \$600,000 in auction premiums for producers per year, over and above the price they would have received had the coffee been sold through normal specialty channels.⁹³ In Honduras, the direct cost of an auction is \$125,000,⁹⁴ with average incremental premiums of \$343,000.⁹⁵

Figure 15

COE has brought millions of dollars in benefits at a modest cost

	 Brazil	 Honduras
Program costs (2014)	\$440K (2 auctions per year*)	\$125K (1 auction per year)
Auction premiums (2014)	\$600K (2 auctions per year*)	\$343K (1 auction per year)
Increased sales for COE beneficiaries** (2014)	\$30M (Incl. benefits to previous winners, other farmers influenced by COE)	\$9M (Incl. benefits to previous winners, other farmers influenced by COE)
Cumulative program costs	\$2M (since 1999)	\$1M (since 2004)
Increased sales for COE beneficiaries** – cumulative total	\$137M (217 winners since 1999, multiplier of 2-4x on other farms)	\$25M (174 winners since 2004, multiplier of ~4x on other farms)

*Since 2012, Brazil has hosted two auctions per year, Early Harvest and Late Harvest

**Beneficiaries include COE winners and other farmers influenced by COE as result of prolonged presence in a given area

Note: program costs and incremental premiums refer to gross amounts, and do not reflect the share of the premiums paid to organizers to fund the program. Auction premiums are prices paid above local specialty prices, average of last two auctions used

Source: COE, IHCAFE; BSCA; Honduras and Brazil farmer and exporter interviews

Indirect benefits have “snow-balled” over time

The return on investment is even greater if the estimated value of direct trade and indirect sales benefits described in the previous sections are included. These benefits have experienced a “snowball effect,” building off the previous years’ momentum (see again Figure 12). In Brazil, we estimate the indirect benefits totaled more than \$30 million in the 2013/14 crop year (see Figure 16 on the following page) and, in Honduras, more than \$9 million for the same period.⁹⁶

Figure 16

The benefits of increased specialty and direct trade eventually exceed the benefits from COE auction premiums alone



Est. overall increase in sales revenues for COE winners and influenced farms, US\$ millions (2013/14)



Cumulatively, for every \$1 spent on COE, more than \$25 in benefits were created

Total spending on COE in Brazil has been ~\$2 million from 1999-2014.⁹⁷ As described in the previous section, we estimate a total of \$120-140 million has been created in additional value for the Brazilian coffee sector over that same period. In Honduras, ~\$1 million has been spent from 2004-2014⁹⁸ to generate a total estimated benefit of \$25 million. This represents an overall return of 25 to 70 times the direct costs for these nations.

Considerations

There are several important considerations to bear in mind when interpreting this analysis. There is no counterfactual analysis on what the specialty coffee industry of either country would look like without COE. This section is intended to provide additional information that may temper the estimates constructed above.

First, the costs and efforts of other actors in the supply chain in Brazil have not been modeled. Programs and investments made by cooperatives, farmers' groups, exporters, and motivated individuals are not accounted for. Similarly, the investments made by buyers to travel to origin, participate in COE auctions, etc. are not considered.

Second, other internal factors played some role in the development of the specialty industry in Brazil and Honduras, and globally. COE, however, was the only specific initiative considered in this economic analysis.

Third, there have been important changes in the global coffee marketplace that influence these figures. Shifts in supply and price in other specialty origins, such as Colombia, may have contributed to increased demand for coffee in Brazil and Honduras beyond what was accounted for here.

Finally, the comparison of benefits-to-costs should not be taken to represent a strict multiplier relationship – that is, an additional \$1 in spending would not necessarily result in an additional benefit of more than \$25. There may be diminishing returns to an expanded COE auction. The growth of the indirect benefits is due to COE’s continued presence in Brazil and Honduras, and not necessarily to the scale of the contest in a given year. In addition, and partially due to COE’s contributions, specialty coffee is now a powerful trend globally and within Brazil and Honduras. Other forces are now at work to sustain the momentum created by COE, and the rapid pace in which COE achieved impact in the past may be hard to repeat.

COE Benefits: For Farmers

Farmers who have participated in COE have higher incomes

COE winning farms are typically able to generate higher income from coffee than other farms. This comes not only from auction winnings, but also from longer-lasting increased specialty and direct trade sales.

In Brazil, only higher altitude farms in mountainous areas are likely to excel at specialty production. The incremental added cost of producing specialty is estimated at 10-15 cents per pound (green)⁹⁹, but results in 28 cents per pound (green) higher average sale price.¹⁰⁰ This translates into a 50% higher profit margin than commercial production. For a typical, non-mechanized farm, investments in quality yield \$290,000 in additional net income over a 10-year investment period. See Figures 17 and 18 (on pages 30 and 31, respectively) for an illustration of the overall cost-benefit comparison.

In Honduras, the altitude is more favorable for specialty production country-wide. The incremental added cost of producing specialty is estimated at 15 to 50+ cents per pound (green)¹⁰¹. The low-end estimate (15 cents) includes drying and selective harvesting costs. The higher cost estimate is driven by spending on micro-lot preparation and increased

fertilization.¹⁰² COE farmers in Honduras have had success raising their incomes through direct trade: 70% of COE finalists interviewed in Honduras reported having entered into direct trade as a result of COE.¹⁰³ The prices for coffees sold through direct trade typically range from \$3-4 per pound.¹⁰⁴ Becoming a direct trade producer raises average farm-gate prices from \$0.90 per pound to \$2.50 (See Figure 19 on following page).¹⁰⁵ For a typical farm, this translates into an additional \$15,000 per year in net profit. If a lot is sold at the COE auction, profits are even higher (see Figure 20 on page 32). It is worth noting that COE winners tend to be larger (a median of 8 Ha) than the norm in Honduras (1-2 Ha).¹⁰⁶ These farmers may be more sophisticated and have greater financial resilience than a “typical” Honduran farmer, enabling their success.

In both countries, the promotion of long-term direct trade relationships can benefit producers by being a predictable, recurring, revenue stream. This allows farmers to plan better than they would be able to in the typical fluctuating-price environment.

Figure 17

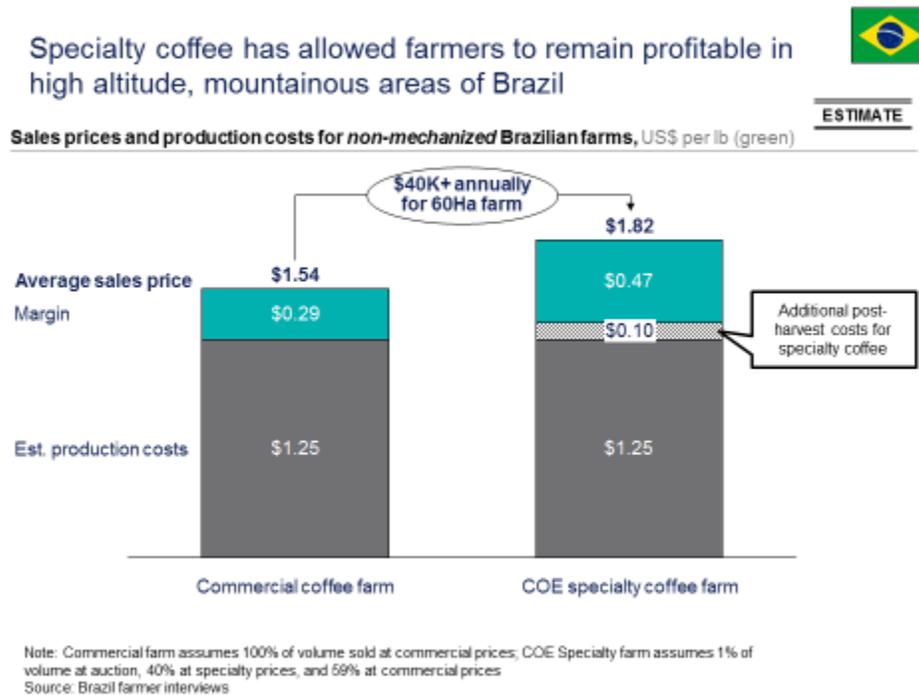
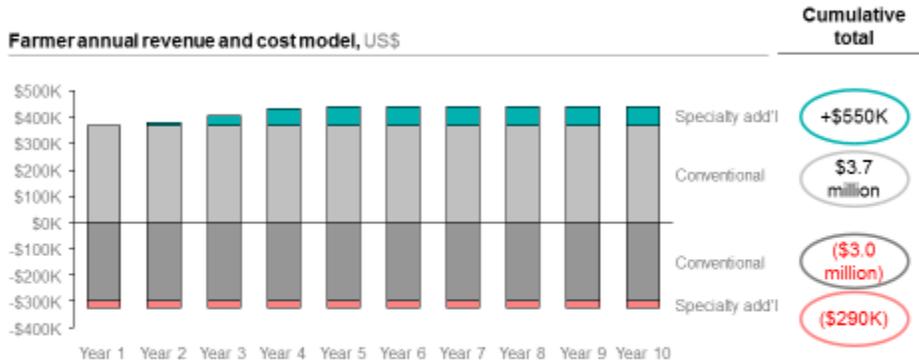


Figure 18

Over a 10 year period, a Brazilian COE farmer nets \$290,000 more than a conventional farmer



Key assumptions

- 60 Ha farm, 30 bags per hectare production
- 40% total sold specialty (including direct trade)
- 1 COE auction appearance
- 10 year amortization period for capital investments*
- Constant prices

Source: Brazil farmer interviews, TNS analysis

Figure 19

In Honduras, the price difference between direct trade and “regular” specialty is substantial



Estimated average farm gate price (2014), US\$ per lb (green)



Scenario assumptions:

	Est. Price*	Volume shares		
Conventional	\$0.90	100%	30%	30%
Specialty	\$1.25	0%	70%	10%
Direct trade	\$3.50	0%	0%	60%

*Estimated farm-gate price based on farmer interviews

Note: Based on estimated size of 8Ha per farm, yields of 1000kg/Ha

Source: Interviews with Honduran exporters and farmers

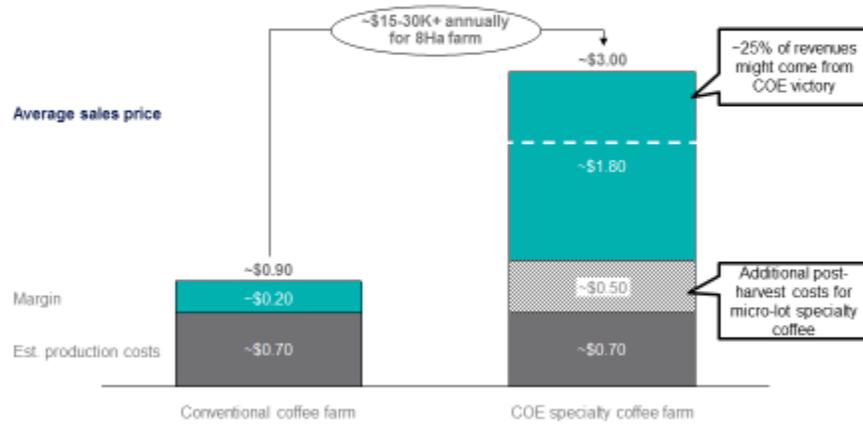
Figure 20

As Honduran COE farms typically enter direct trade, they earn much more than conventional farms



ESTIMATE

Sales prices and production costs for Honduran farms, US\$ per Pound



Note: Conventional farm assumes 100% of volume sold at commercial prices; COE Specialty farm assumes 10% of volume at auction, 55% at direct trade prices, 10% at specialty prices, and 25% at commercial prices. 8Ha farm producing 1000kg/ Ha green coffee
 Source: Honduras farmer and exporter interviews

In Brazil, higher profits enable farms to remain viable in mountainous areas

For farmers in mountainous areas of Brazil, the revenue boost provided by specialty coffee enables them to remain profitable coffee businesses. The cost of labor in Brazil is higher than other coffee origins. The Brazilian coffee industry has adapted through mechanization of coffee farms, keeping costs competitive globally. However, in Brazil’s more mountainous areas, the terrain limits the use of current mechanized technologies.¹⁰⁷ Specialty coffee provides a viable way forward.

In Honduras, increased profits can help farms avoid costly loans

Most Honduran farmers require financing during the year for inputs, labor, and other operating costs. These loans are typically offered by local coffee intermediaries or exporters at 2-3% monthly interest rates.¹⁰⁸ For a typical farmer, the incremental costs of this financing during months without coffee income can be 5-10 cents per pound.¹⁰⁹ If a farmer receives local conventional coffee prices, interest costs can eat away up to 20% of profits. Income from COE and/or direct trade allows farmers to save money from one harvest to the next to pay for inputs and avoid loans.

COE helps establish greater

COE has set an expectation among producers for a transparent correlation between price and quality. This change in perception extends beyond the

**transparency
around coffee
quality and pricing**

COE auction. Producers expect a price premium based on quality and try to differentiate their coffees accordingly: the best for COE and other contests, some (often as much as possible) for direct trade, some for specialty sales, and the remainder at commercial prices. In this way, producers are able to capture more value from their crop and better serve a heterogeneous mix of buyers and markets.

**Farmers build
additional skills
and a mindset of
“farming as a
business”**

Although the principal benefits of the COE contest for producers are financial, producers also develop additional skills that enable them to improve overall business management. These skills go beyond the improved post-harvest practices described earlier.

For instance, farmers gain business skills in marketing and branding. This is particularly true for direct trade farmers. Additionally, while awareness of coffee quality and cupping scores is generally high among COE participants, some have also started cupping coffees on their farms. As one producer mentioned, “There’s a movement of producers tasting their own coffees, and it’s stimulated by contests like COE.”¹¹⁰

In addition, to improve differentiation, producers have started tracking individual lots of their coffee and developing a more sophisticated understanding of inventory, especially in Brazil where larger farms with much greater production are common. This need for lot-level traceability to identify and sell quality demands new management skills such as detailed record-keeping for lots and plot-level cost understanding.

Overall, COE helps promote a change in attitude among producers, a shift towards greater attention to detail, care, and management practices geared toward specialty coffee production. Producers look at their farms more holistically as a business, with different cost and revenue drivers, inventory flows, and target markets.

COE Benefits: For the Trade

**COE benefits the
marketplace in
four key ways**

COE has helped develop the specialty coffee industry in Brazil and abroad beyond its impact on producers. It has benefitted the marketplace in four key ways by:

1. Providing a platform for buyers to source exceptional coffees;
 2. Facilitating the creation of long-term buying relationships;
 3. Developing cupping skills and better understanding of quality; and
 4. Fostering a community of specialty coffee professionals
-

(1) Providing a platform for sourcing exceptional coffees

COE provides a platform and a mechanism for buyers to purchase specialty coffees that have been rigorously vetted. Because of the multiple rounds of cupping and the reputation of the international cuppers, buyers are assured that the coffees they buy are exceptional.

The high caliber of the selection process and the trustworthiness of its results allows buyers to access coffees that they otherwise might be inaccessible due to distance and logistical complexity. In the words of one buyer, “If we want to try an origin, we don’t have to go ourselves – we don’t have to spend the resources to go and find it, and we know the quality will be there.”¹¹¹

The presence of the COE platform also helps specialty coffee penetrate new geographies, such as East Asia, by providing a trusted source of high-quality coffees that can be accessed reliably. COE played a large role in facilitating specialty coffee purchases in these fast-growing coffee markets. Through the trips COE promotes to origin, it has also helped normalized farm visits as part of buyers’ activities and spread the concept of direct trade.

(2) Creating new buying relationships

Beyond purchases at auction, the COE program allows buyers to develop their supply chains by forming new relationships with producers. COE introduces buyers to producers and exporters who work with the highest-quality coffees, and gives them the opportunity to seek out these suppliers for additional purchases. The lots submitted to the auction represent only a portion of a farm’s production; farms have significant amounts of additional specialty coffee to sell.

The ability to discover new producers and new regions was cited as one of the primary benefits of participating in COE by 80% of buyers surveyed.¹¹² Among international auction finalists in Brazil, 46% of producers reported having formed direct trade relationships and 92% received farm visits from buyers.¹¹³ As mentioned above, 70% of COE winners in Honduras reported having direct trade relationships formed by COE. Buyers report meeting producers through COE and then expanding into buying coffee from other family members and neighbors. IHCAFE, for instance, has offered micro-lots to over 100 buyers and roasters that it met through COE.¹¹⁴

As with producers, forming direct trade buying relationships benefits buyers with its predictability. Buyers are able to forecast their costs more accurately, and their businesses benefit by having a reliable source of high-quality coffee.

(3) Developing cupping skills and understanding of quality

By exposing cuppers to exceptional coffees from around the world and to other top-rate cuppers, COE helps them develop technical cupping skills and deepen their understanding of specialty coffee. Cuppers, who are also buyers, said they appreciate the opportunity to share knowledge and experiences with each other, sharpening their skills. Newer cuppers are given an opportunity to learn from the best, to the point where participation on COE juries is incorporated into the staff training program of at least one roaster. As a specialty coffee roaster put it, “As a cupper, there has been no greater single influence on how I evaluate coffee than COE.”¹¹⁵

COE also helps buyers develop technical cupping skills and harmonize around definitions of cup quality. COE introduced new coffee attributes to the world with its cupping form, such as the quality of coffee acidity (not just the intensity), that allow buyers to better understand and describe cup attributes. In addition, COE exposes cuppers to a wide range of coffees, showing them fine examples of several coffee characteristics. In the words of a COE buyer and cupper, COE has helped buyers “rally around a shared definition, scale, and language for quality.”¹¹⁶

This impact is also strong within COE countries. In Brazil, where COE has hosted over domestic 200 cuppers at different phases of the contest,¹¹⁷ it is viewed by local cuppers as an important source of technical knowledge. The benefit to the national talent pool is well summarized in the words of one exporter and industry leader: “COE is the primary school for opinion makers in the industry in Brazil.”¹¹⁸ Participating on COE juries is an important career distinction for many in the domestic industry.¹¹⁹ In Honduras, COE is credited as spurring the formation of specialty coffee cuppers in the country. COE’s protocols provided much of the technical knowledge for the curriculum of the Honduran cupping school and inform the operations of many labs.¹²⁰ Contest experience showed cuppers how to describe different varieties and processing methods. The formation of the cupping school coincided with the start of COE in Honduras, and was motivated by the contest. Cuppers who participate in COE become core members of the local specialty coffee industry.

(4) Creating a specialty coffee community for participants from around the world

COE’s cross-border nature helps foster an international community of specialty coffee industry participants. Buyers are able to meet each other, as well as local industry participants. Different degrees of participation are possible, including buying, cupping, and working within ACE itself.

In Brazil and Honduras, cuppers (who come from the local specialty industry) also appreciate the opportunity to network with other people in

the field and internationally. This interaction is vital for the continued development of effective production, processing and marketing knowledge. It is an opportunity to “meet new people and form new relationships,” as one national phase cupper put it.¹²¹ Many national contest cuppers aspire to be jurors at the international level, both for the recognition and for the opportunity to interact with numerous buyers.

Future Opportunities

COE can be maximally effective with certain factors in place

COE has been very successful in Brazil and Honduras. As the program considers expanding, it is enlightening to consider what factors led to the high degree of impact from COE in these origins. Some of the most important ones are: (1) strong local organizations; (2) continuity; and (3) regional concentration

In addition to these factors that allow countries to take advantage of COE to the fullest, we have outlined other specific opportunities below.

(1) Strong local organizations

A critical key to COE’s success is a strong and supportive in-country partner to run the program. The BSCA and IHCAFE view COE as one of their central activities, and devote the resources and effort necessary to make COE successful.

Robust organizations are also necessary to reach farmers across entire countries. Local groups are needed who can promote COE to farmers and work with them on best quality practices throughout the year. These groups also often perform the important function of pre-screening coffee lots that are submitted to COE. This local-level support comes from a mix of national COE partners, cooperatives, brokers, and exporters.

Finally, COE is most effective where there is private-sector commercial support, either from cooperatives or exporters. COE farmers need local buyers who will pay premiums for their specialty coffee. COE should continue to work closely with cooperatives and export businesses in specialty coffee regions who are eager to commercialize specialty coffee, publicize COE, and support specialty farmers. In new origins and regions, COE should proactively identify these allies.

(2) Continuity

Continuity of COE within its origins is important for its continued impact. As seen in Figures 11 and 12 above, the effect of COE takes time to gather momentum and deepen. By establishing itself over several years in Brazil and Honduras, COE has become a well-known reference point

for specialty coffee, and a consistent demonstration of the possibilities of specialty production for producers.

Promoting continuity among buyers is also key. As we have seen, the biggest COE impact comes from trade that occurs outside the auction. Encouraging COE cuppers and buyers to meet exporters and farmers and pursue buying relationships is valuable.

(3) Regional concentration

Repeated COE success within a given region allows for reputations to form. A single winner from an area might not draw the attention of international buyers, but several winners over many years establishes the region as a quality origin, as has been the case with Mantiqueira de Minas in Brazil and Santa Barbara in Honduras. This draws specialty coffee buyers of many degrees to the region, increases demand, and boosts the specialty trade.

Additionally, COE often inspires farmers to enter specialty production after they see others' success at COE. The multiplier effect is much more powerful when the successful farmer examples are one's neighbors. In an area like Mantiqueira de Minas, a spirit of friendly competition exists among the many farmers who participate in COE. This competition helps drive further improvements to coffee quality.

It is challenging to know ahead of time which regions will produce a high number of auction finalists. However, working with regional partners to further develop specialty coffee and promote COE in areas with many COE wins helps maximize the impact from this program.

Expanding COE to more producers and areas

Stakeholders in both Brazil and Honduras recognize that the "beneficial cycle" and its resultant multiplier effects have been the greatest benefits of COE. However, these benefits have historically been concentrated in a few specific regions, i.e., Mantiqueira de Minas in Brazil and Santa Barbara in Honduras.

There may be opportunities to expand COE's outreach and encourage participation of additional producers, particularly from under-represented regions. In Brazil, regional COE auctions are a possibility. States like Bahia, Minas Gerais and São Paulo produce more coffee than entire countries.

Another possibility may be to set quotas (minimum or maximum) for the number of producers that can participate from a given state or region. This latter approach would likely produce a more geographically

balanced view of a country's best coffees, but wouldn't preclude a single region from consistently having the best scoring or highest priced coffees.

A third approach entails decentralizing aspects of the screening and vetting process to state or regional level sub-competitions. The logistical complexity and rigor that are required to run a COE auction should not be underestimated. However, if run properly, sub-competitions could feed winners to enter into the national COE competition. This would confer some prestige and recognition to producers who win for their region, while keeping the selection of COE finalists region-blind to ensure only the best coffees are represented at the international auction.

These opportunities should be considered carefully on a case-by-case basis. On the one hand, there is a desire to share the benefits of the program with a broader set of producers; on the other, there is recognition that much of the value COE creates is derived through exclusivity. As the market for super-premium coffees is not unlimited, there is a risk that expansion would yield diminishing returns. COE has delivered an incredible amount of value through its focus on finding only the best coffees, but should consider some of these ideas to broaden its base in the future.

Further differentiation and promotion of an origin's diversity of coffee

COE has already broadened the market's perceptions of the range of cup qualities that are possible. There may be opportunities to create additional value through further differentiation, not only by region but also by processing method, varietal and producer type.

As precedent, COE launched a "late harvest" contest for Brazilian naturals in 2012; as of 2014, 63 lots of coffee have been auctioned. Auction prices have been similar to those of the early harvest, demonstrating the demand from the buyer side. The fact that the late harvest auction did not cannibalize sales at the early harvest shows potential for additional differentiation.

Diversity could also be promoted by explicitly recognizing the best coffees in the competition of different categories. For instance, the best "Bourbon varietal" or the best "under 5 hectare farm" entrants could be recognized. Such recognition does not need to be financial or transferred directly through auction premiums. By awarding the best coffee of different varietals, farm size, or region, COE would encourage buyers to continue exploring the diversity of origins like Brazil and Honduras and create opportunities for new producers to achieve recognition.

Greater feedback on cupping results

Farmers have asked for greater feedback on cupping results for lots submitted. Producers who do not make the international auction currently do not receive feedback on the score or quality attributes of the coffees they submitted to judges. “We only know the yes-or-no if we make it to the next phase,” said one Brazilian participant who had made the national phase. “It would be good to know why we didn’t make it.” Data collected on processing techniques is also not shared. Greater dissemination of information already collected by the COE program would help producers improve and further spread the understanding and language of specialty coffee in the country.

Decentralized lot collection centers

Small farmers in Honduras mentioned the need to add additional collection centers for COE lots. Currently, only one warehouse in Honduras serves the all lots for the entire COE auction. High transport costs and the risks associated with transporting a value product long distances deter some farmers from participating. In Brazil, regional collection centers have reduced this burden for farmers and allowed the contest to reach more farmers.

Risk management for lots that don’t make it to auction

There may also be opportunities to mitigate a key risk faced by COE entrants: losing money on COE lots that don’t make it to the auction. Farmers who separate a lot and enter it to COE must wait several months to learn if it has been selected for the auction. During this time, they’ve had to forgo traditional sales channels in specialty or direct trade. Underlying market prices may have changed too. In Honduras, where “fading” is a major concern among buyers, the specialty and direct trade sales window is especially short; non-finalists who miss that window may have little choice but to sell their lots into commercial markets.

COE could take actions to minimize the duration of time from when lots are submitted to when they are selected for the auction. At a national level, however, this may be impractical, as different regions and altitudes have different harvest peaks.

COE could also intervene by offering a purchase guarantee, floor price, or cash advance on lots that meet a certain quality threshold. The first option, the purchase guarantee, would likely require assembling a consortium of larger specialty buyers willing to commit to a certain volume (consisting of multiple lots) at a minimum price. Producers would have the option of pre-selling their coffees into this scheme to mitigate the risk that they aren’t selected for the auction. It is unknown how many buyers might be willing to participate and under what terms.

Alternatively, COE could facilitate price-risk management services for producers and thereby offer a floor price. Less complex models could involve trading a futures contract (which would effectively lock in today's price for the coffee, regardless of when it is sold in the future) or purchasing a "put" option (which would secure a floor price for several months in the future, if the market falls, but would leave the producer with full upside potential if the market rises). A more sophisticated model would involve trading a futures contract to lock in a floor price and purchasing a "call" option that allows the farmer to still benefit if the market rallies. Traders or brokerage firms may be willing to provide this service for COE lots once they are secured in the warehouse. Banks could also provide a cash advance to producers against these secured and hedged lots.

These approaches would effectively take risks that producers currently face and transfer them to COE. This is not an insignificant undertaking. In order to make this transition, COE (or ACE) would need to ensure it has appropriate technical expertise and a viable financial model.

Establishing mechanisms for more rigorous impact tracking in the future

This report has sought to determine the scale and value of COE's impact in Brazil and Honduras. By gathering the input of a broad range of farmers, buyers, and many other market actors, it has endeavored to show the changes that COE has helped stimulate in the specialty coffee industry and the corresponding financial benefits for producers. Of course, correlation is not causality, and it is difficult to fully establish impact in the absence of a counterfactual or "pre-COE" baseline. However, as COE expands to new countries or regions, there may be merit in taking a detailed baseline of participating farmers and revisiting their progress in the future. COE could also create mechanisms for entrants to provide more information about their farms at the time of lot submission, for instance, their current share of conventional, specialty, and direct trade sales.

Growing its community and followers

This study has attempted to quantify the benefits of COE in two of its key partner countries, Brazil and Honduras. These benefits were witnessed by a broad community of beneficiaries, including farmers, past winners, local traders, and partner institutions like BSCA and IHCAFE. Buyers, international traders, and cuppers also cited important benefits of the program. However, the community has not yet expanded to include large swathes of consumers. Ultimately, growing consumer demand for the best coffees – and the willingness to pay a premium for them – must underpin the expansion of COE and the industry's broader efforts to increase quality. COE is in a unique position to help accelerate those efforts.

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- Chris Jordan, Verve
- Flori Marin, Monmouth
- Geoff Watts, Intelligentsia
- George Howell, Terroir
- Jason Long, Café Imports
- Joe Hsu, Orsir
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- Mark Dundon, Seven Seeds
- Matt Daks, Volcafe
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- Manwoo Lee, bigboyscoffee
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APPENDIX

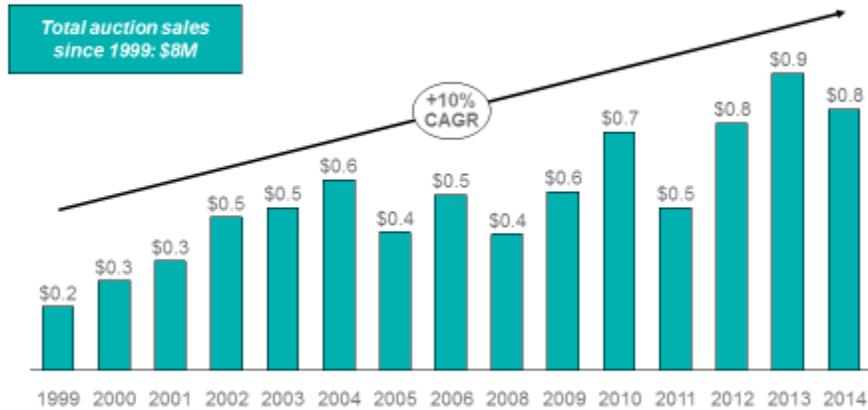
Brazil COE statistics

Appendix Figure 1

The total value paid at Brazil's Cup of Excellence auction has risen steadily since 1999



Total paid at Cup of Excellence Brazil auctions, US\$, millions



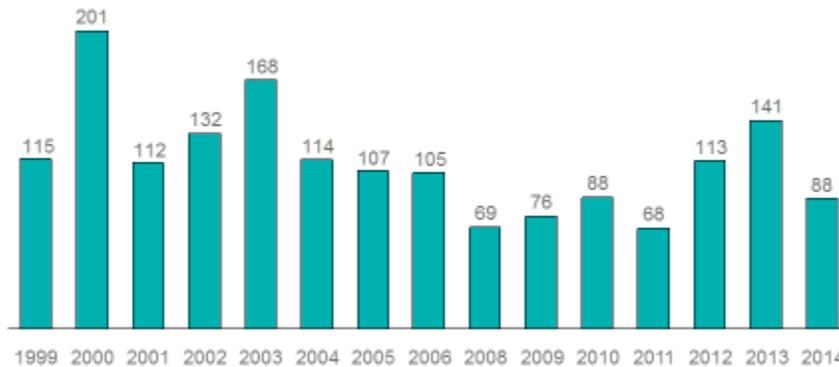
Note: Since 2012, Brazil has held two auctions per year. No auction was held in 2007
Source: COE database

Appendix Figure 2

The volume of coffee sold has decreased from its 2000 peak



Total volume at Cup of Excellence Brazil auctions, Thousands of Pounds



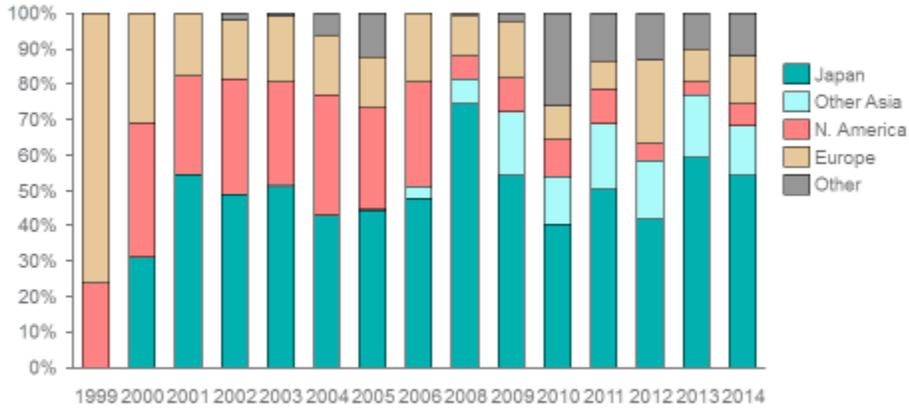
Note: Since 2012, Brazil has held two auctions per year. No auction was held in 2007
Source: COE database

Appendix Figure 3

Japan has been the largest buyer within Asia...



Total Brazil Cup of Excellence auction spend, 1999-2014*, US\$ Thousands



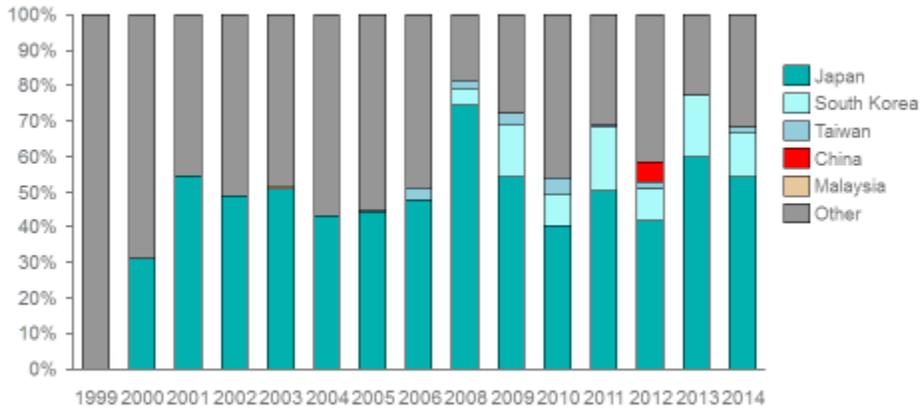
Note: For purchases with more than one buyer, cost and volume was assumed to be split evenly
Source: COE database

Appendix Figure 4

...Though South Korea is emerging as a major buyer with ~20% of purchases in recent years



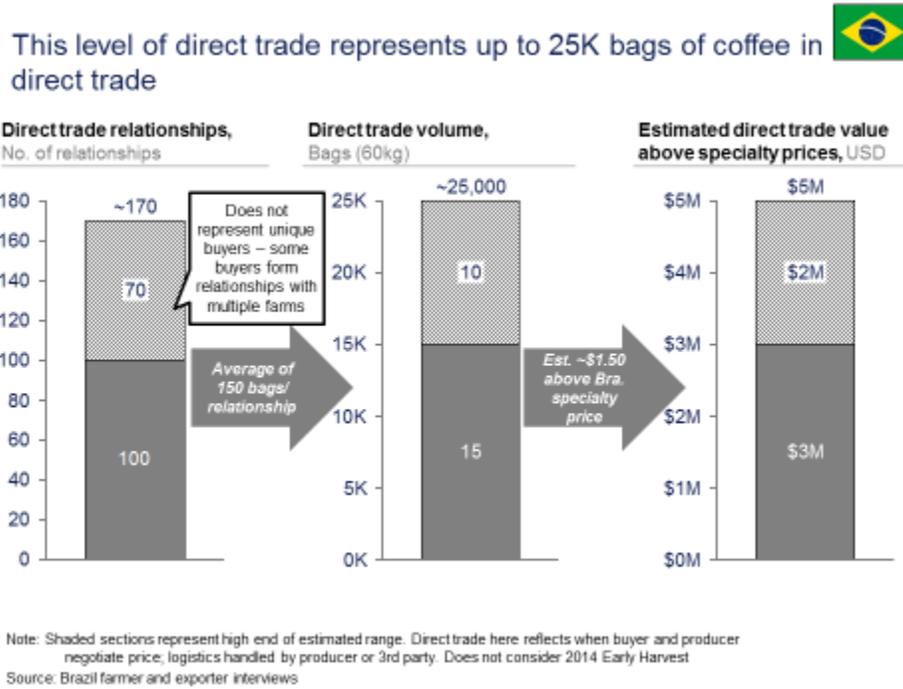
Total Brazil Cup of Excellence auction spend, 1999-2014*, US\$ Thousands



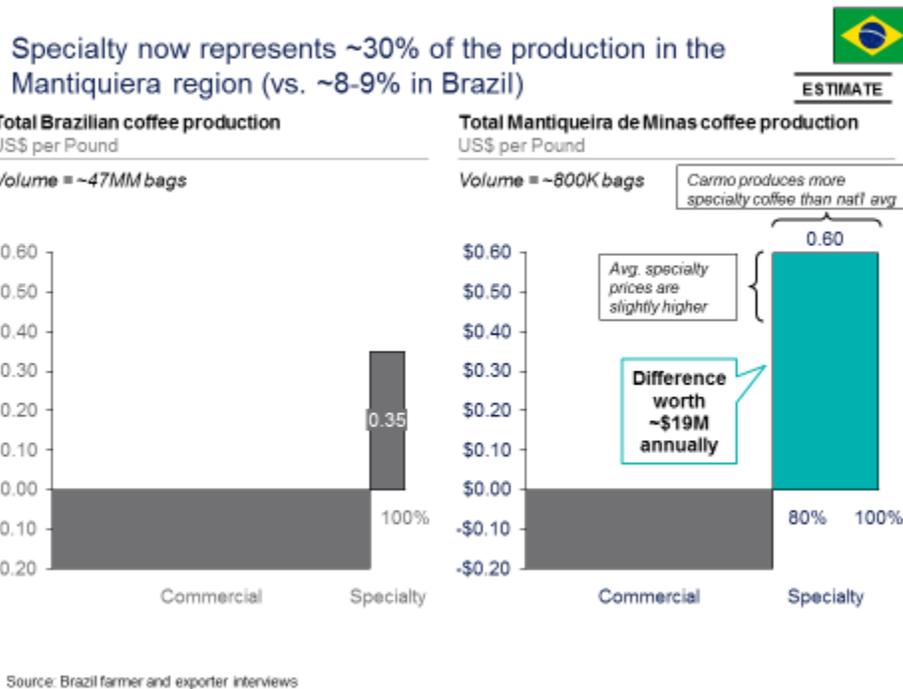
Note: For purchases with more than one buyer, cost and volume was assumed to be split evenly
Source: COE database

Brazil increased demand detail

Appendix Figure 5



Appendix Figure 6



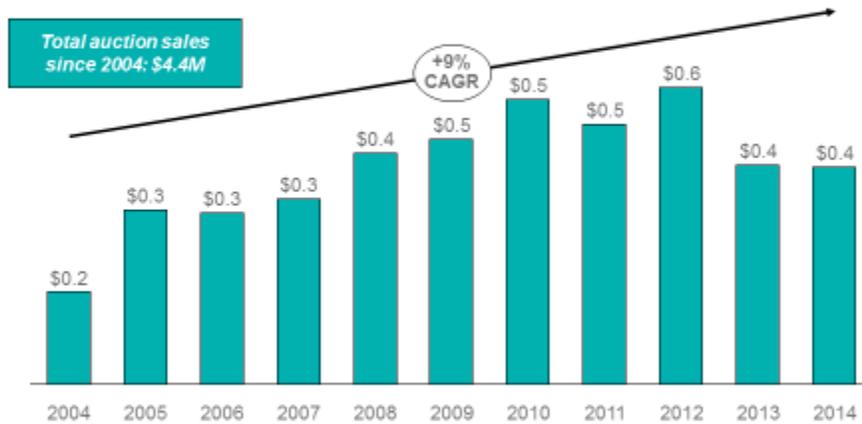
Honduras COE statistics

Appendix Figure 7

The total value paid at Honduras' Cup of Excellence auction has decreased since a peak in 2012



Total paid at Cup of Excellence Honduras auctions, US\$, millions



Source: COE database

Appendix Figure 8

The volume of coffee sold at COE Honduras has decreased steadily since 2005



Total volume at Cup of Excellence Honduras auctions, Thousands of Pounds



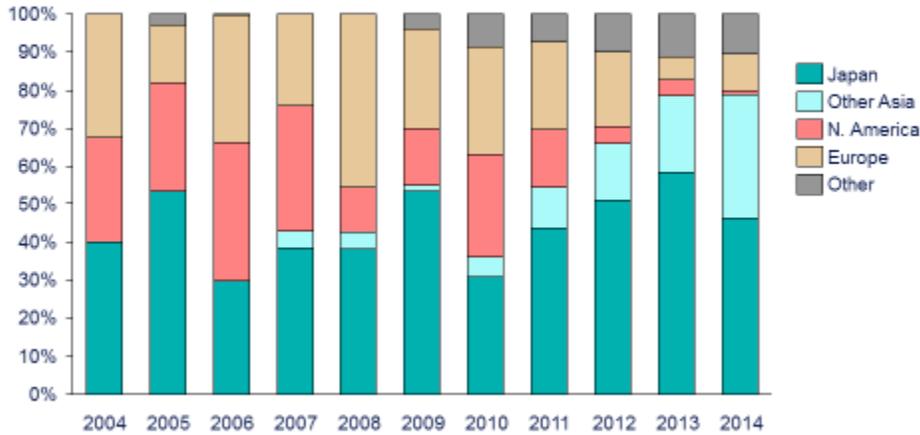
Source: COE database

Appendix Figure 9

In Honduras, Japan has been the largest buyer from Asia and overall



Total Honduras Cup of Excellence auction spend, 2004-2014, US\$ Thousands



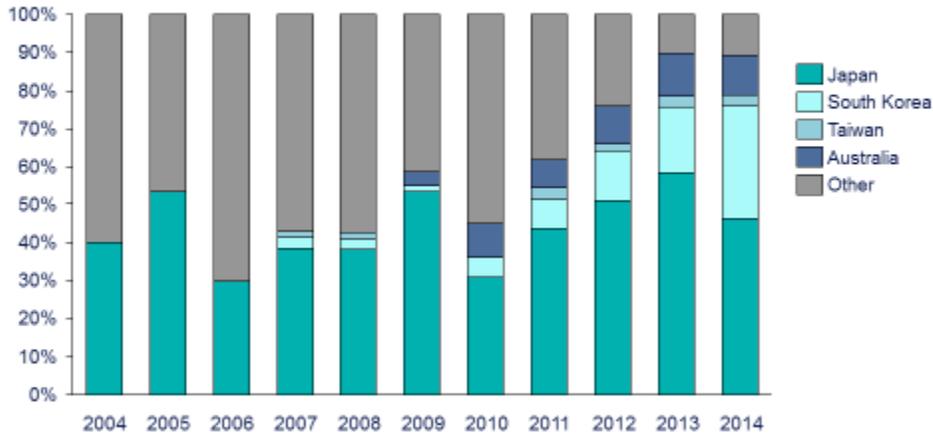
Note: For purchases with more than one buyer, cost and volume was assumed to be split evenly
Source: COE database

Appendix Figure 10

South Korea has become the second largest buyer for Honduran COE coffees in the last three years



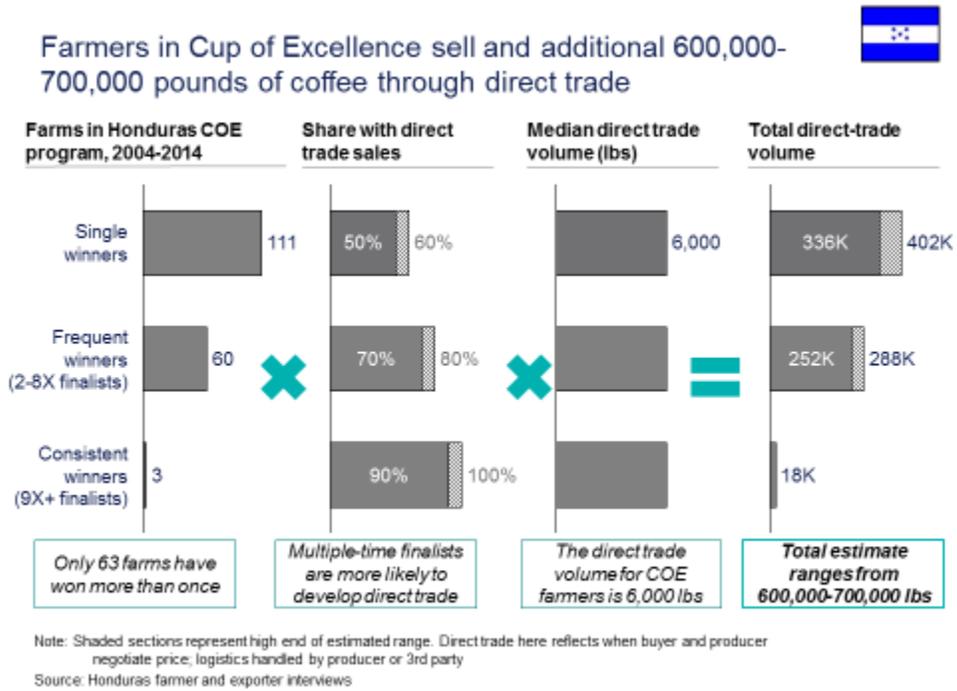
Total Honduras Cup of Excellence auction spend, 2004-2014, US\$ Thousands



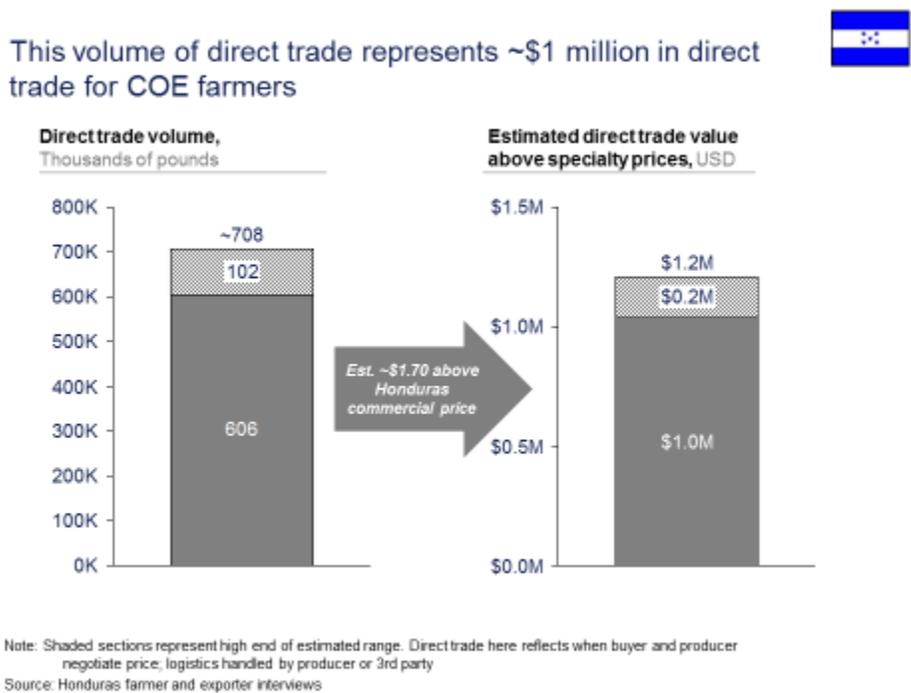
Note: For purchases with more than one buyer, cost and volume was assumed to be split evenly
Source: COE database

Honduras increased demand detail

Appendix Figure 11



Appendix Figure 12



Increased Honduras farmer costs detail

Appendix Figure 13

Farmers and exporters must invest extra time and money to produce specialty coffee



Process	COE and specialty farms	Conventional farms	Est. added costs* Cents per lb green
Harvesting	<ul style="list-style-type: none"> Greater care taken to pick only red ripe cherries Workers receive an extra ~10 lempira per gallon of cherry harvested 	<ul style="list-style-type: none"> Harvest timing optimized based on cost-effectiveness Cherries received indiscriminate of ripeness 	~10
Drying	<ul style="list-style-type: none"> Parchment coffee dried slowly in the sun on patios or drying beds Turned frequently 	<ul style="list-style-type: none"> Coffee sold as wet parchment 	~5**
Export	<ul style="list-style-type: none"> Additional samples for cupping and marketing Hand-sorting to zero defects Lower exportable yields due to fewer defects Better storage and packing Lot separation 	<ul style="list-style-type: none"> 1 cupping sample Mechanical sorting only Higher exportable yields Conventional (i.e. jute bag) packing No lot separation 	up to 40*** (for micro lot preparation)

**Total added costs:
15 to 55**

*Excludes additional financing costs

**Includes amortization of drying infrastructure (e.g., patios)

***Applies only to volume that is directly exported, not volume sold locally

Source: Interviews with Honduran exporters and farmers

ENDNOTES

- ¹ All future currencies listed are in US Dollars, denoted with “\$”
- ² COE grew out of the Gourmet Coffee Project, organized by the International Coffee Organization (ICO), the International Trade Center (ITC) (a World Trade Organization and UN Conference on Trade and Development agency), and the Common Fund for Commodities
- ³ Interviews with BSCA and Brazilian exporters
- ⁴ Such as the Illy coffee competition
- ⁵ “Specialty” in the context of this report is defined as per the Specialty Coffee Association of America (SCAA) definition of a cup score above 80 points.
- ⁶ COE database. Includes Brazil Early Harvest 2014
- ⁷ COE database, interviews with COE founding participants, September and October 2014
- ⁸ COE database and ICO
- ⁹ Brazilian copper interviews, September 2014
- ¹⁰ ICO
- ¹¹ Honduras exporter interviews; coffee trader reports
- ¹² Based on TechnoServe field experience in Central America
- ¹³ Honduras cooperative and exporter interviews, November 2014
- ¹⁴ Based on BSCA and Brazilian exporter interviews, September 2014
- ¹⁵ Ibid
- ¹⁶ IHCAFE Annual End-of-Harvest reports, 2004/05 to 2013/14
- ¹⁷ Honduran exporter interviews, November 2014
- ¹⁸ Based on TechnoServe field experience in Central America and East Africa
- ¹⁹ Buyer and exporter interviews
- ²⁰ Brazilian specialty exporter interview, September 2014. All interviews were conducted on basis of anonymity.
- ²¹ All figures in this paragraph include 2014 Brazil Early Harvest Auction.
- ²² COE database
- ²³ Local specialty prices from Brazilian exporters and farmers, and international buyer interviews
- ²⁴ COE database. Winners were grouped together (if applicable) based on family relationships, company affiliation, and location of coffee processing
- ²⁵ COE database
- ²⁶ Local specialty prices from Honduran exporter and farmer interviews, Nov 2014, and IHCAFE Annual End-of-Harvest reports
- ²⁷ COE database. Winners were grouped together (if applicable) based on family relationships and location of coffee processing
- ²⁸ Figures 3 and 4 based on extensive conversations on quality practices in Brazil and Honduras interviews, September and November 2014 (respectively)
- ²⁹ 2013 Early Harvest Winner, interviewed September 2014
- ³⁰ 9+ time auction finalist interview, September 2014.
- ³¹ Brazilian farmer interviews, September 2014. Farm sizes based on Brazilian COE farmers interviewed.
- ³² Brazilian farmer interviews, September 2014. 10 year amortization period given as typical in farmer interviews. Assumed yield of 30 bags per hectare (1800Kg/Ha) based on average yields given in farm interviews.
- ³³ Exporter and IHCAFE interviews, November 2014; TechnoServe field experience. Estimates vary, but 50-70% of parchment is sold wet by farmers in Honduras
- ³⁴ Honduras farmer interviews, November 2014. Issue of drying and drying beds was discussed at length with several farmers.
- ³⁵ IHCAFE and farmer interviews
- ³⁶ ACE, exporter interviews
- ³⁷ Brazil buyer survey conducted Sep – Oct 2014, N=18
- ³⁸ Buyer interviews, October and December 2014. For instance: “Before COE, we didn’t know Honduras had high quality coffee, we didn’t carry any coffee from there at all in 2003”

-
- ³⁹ Brazil buyer survey; Honduras buyer survey conducted Dec 2014, N=9. Two buyers responded to both surveys; total number of unique respondents = 25.
- ⁴⁰ IHCAFE and Honduran exporter interviews, November 2014
- ⁴¹ Honduran exporter interviews, November 2014
- ⁴² COE Database. Includes 2014 Brazil Early Harvest Auction
- ⁴³ Interview with multiple-time auction finalist from Carmo de Minas, September 2014
- ⁴⁴ See <http://www.mantiqueirademinas.com.br/>
- ⁴⁵ Buyer, exporter, and IHCAFE interviews
- ⁴⁶ COE database
- ⁴⁷ Exporter interview, September 2014
- ⁴⁸ Cooperative interview, September 2014
- ⁴⁹ Exporter interviews, November 2014
- ⁵⁰ IHCAFE interviews, November 2014
- ⁵¹ Brazil exporter interview, September 2014
- ⁵² IHCAFE interviews, November 2014
- ⁵³ Ibid
- ⁵⁴ COE database. Includes November 2014 Early Harvest Auction
- ⁵⁵ Ibid
- ⁵⁶ Ibid
- ⁵⁷ Brazil COE farmer interviews, September 2014
- ⁵⁸ Direct trade considered to be when farmers negotiate the sale directly with the buyer; export logistics may be handled by a third party
- ⁵⁹ Honduras COE farmer interviews, November 2014
- ⁶⁰ Brazil and Honduras farmer interviews. Farmers were asked how they met their direct trade buyers.
- ⁶¹ Brazil buyer survey, conducted Sep-Oct 2014; Honduras buyer survey, conducted Dec 2014
- ⁶² Ibid
- ⁶³ 9+ time auction finalist interview, September 2014 (different from Note 30)
- ⁶⁴ Buyer interviews, September and December 2014
- ⁶⁵ USDA Foreign Agricultural Services, GAIN Report Republic of Korea Coffee Market Brief Update, February 2013
- ⁶⁶ Buyer interview, December 2014
- ⁶⁷ Buyer interview, December 2014
- ⁶⁸ COE database; Including Nov 2014 Early Harvest auction
- ⁶⁹ Local specialty prices from local exporters and international buyer interviews
- ⁷⁰ COE database and interviews with local exporters and international coffee buyers
- ⁷¹ Model scenario with a one-time COE finalist farm in a region without other COE winners. Assumed farm sells a share of its production as specialty coffee for five years following win at constant market prices. Additional income based on premiums received above local conventional prices. Assumes COE income equal to average sale for an auction lot.
- ⁷² Brazil exporter interviews, September 2014
- ⁷³ Exporter and BSCA interviews, September-November 2014. For other regions in Brazil, a similar approach was followed.
- ⁷⁴ Mantiqueira de Minas exporter interview, September 2014. Estimated volume above what it would have been if the region produced specialty at the national average share (i.e., incremental volume due to COE)
- ⁷⁵ Volumes and specialty production from Brazilian farmer interviews, September 2014. Number of COE finalists from the area from COE database
- ⁷⁶ Number of farms influenced by COE estimated based on number of farms needed to complete volume attributed to COE in exporter interviews
- ⁷⁷ The same methodology was used: the volume of specialty coffee attributable to COE was determined and how much came from COE-winning farms vs others determined based on number of COE winners, average farm size, average yield, and share of specialty production. Lower multiplier due to less specialty coffee overall and less specialty attributable to COE.
- ⁷⁸ Honduran COE farmers were also asked directly how many additional farms now produce specialty due to their encouragement, and corroborate the 3-5X estimate

-
- ⁷⁹ Evolution of volumes from COE winners based on growth in number of new COE finalists. Evolution of volumes from non-winners based on estimated historical growth rates
- ⁸⁰ This figure combines the regions previously discussed, as well as other parts of Brazil. Estimate for other parts of Brazil are based on the number of COE winners from those areas, their average farm sizes and yields, and a conservative multiplier effect that generates additional volume.
- ⁸¹ Volume over time based on historical growth rate estimates. Prices over time based on coffee trader reports.
- ⁸² Direct trade volumes based on analysis shown in Figure 9 and Appendix Figure 5. Prices based on Brazilian farmer interviews. Volume over time based on historical growth rate estimates
- ⁸³ See volumes shown in Figure 11
- ⁸⁴ Interviews with Honduran farmers, November 2014. 37 farmers were asked to categorize their sales as conventional, specialty, or direct trade
- ⁸⁵ Estimate based on exporter estimates of specialty coffee in the country, number of COE participants (and their average size, yield, and specialty production, and estimated multiplier effect on non-COE farms
- ⁸⁶ Local specialty prices from Honduran exporter and farmer interviews, Nov 2014, and IHCAFE Annual End-of-Harvest reports
- ⁸⁷ Direct trade volumes based on exporter estimates of direct trade volume and COE attribution. Volume over time based on historical growth rate estimates.
- ⁸⁸ Prices based on Honduran farmer and exporter interviews, November 2014
- ⁸⁹ Example figures based on median farm production from Brazil and Honduras farmer interviews.
- ⁹⁰ Brazil and Honduras farmer interviews
- ⁹¹ Ibid
- ⁹² BSCA
- ⁹³ Local specialty prices from Brazilian exporters and farmers, and international buyer interviews
- ⁹⁴ IHCAFE
- ⁹⁵ Local specialty prices from Honduran exporter and farmer interviews
- ⁹⁶ Based on methodology described in Overall Impact: Effects of COE section
- ⁹⁷ BSCA
- ⁹⁸ IHCAFE
- ⁹⁹ Farmer interviews. This includes the amortization (over 10 years) for up-front investment in equipment and increased operating costs; assumes a 60Ha farm producing 30 bags/ Ha.
- ¹⁰⁰ Brazilian farmer interviews, September 2014. Modeled changes to average sale price for conventional farmer vs. specialty producing farmer. Scenarios based on typical farm sizes, yields, and share of production that is specialty; prices based on farmer and exporter interviews.
- ¹⁰¹ Farmer interviews. This includes the amortization (over 3 years) for up-front investment in equipment and increased operating costs; assumes an 8Ha farm producing 1,000 kg/ Ha.
- ¹⁰² Cost types and values based on extensive interviews with Honduran farmers and exporters, November 2014.
- ¹⁰³ Honduras farmer interviews, November 2014
- ¹⁰⁴ Honduran farmer interviews, November 2014. Corroborated by buyer interviews
- ¹⁰⁵ Honduran farmer interviews, November 2014. Modeled changes to average sale price for conventional, specialty, and direct-trade selling farmers. Scenarios based on typical farm sizes, yields, and share of production that is sold for each type; prices based on farmer and exporter interviews.
- ¹⁰⁶ COE farm sizes based on farmer interviews; Honduras overall farm sizes from IHCAFE statistics
- ¹⁰⁷ Brazilian farmer interviews, September 2014
- ¹⁰⁸ Honduran farmer and exporter interviews, November 2014
- ¹⁰⁹ Ibid. Based on interest rates described previously and farm costs (fertilization, cleanings, etc.) incurred
- ¹¹⁰ Interview with multiple-time Brazil auction finalist, September 2014
- ¹¹¹ European buyer interview, September 2014
- ¹¹² Brazil buyer survey
- ¹¹³ Brazil farmer interviews, September 2014. Direct trade considered to be when farmers negotiate the sale directly with the buyer; export logistics may be handled by a third party
- ¹¹⁴ IHCAFE interviews, November 2014
- ¹¹⁵ North American buyer/ cupper interview, August 2014.
- ¹¹⁶ Ibid

¹¹⁷ Brazil auction judge interview, September 2014

¹¹⁸ Brazilian specialty exporter interview, September 2014

¹¹⁹ Brazilian copper interviews at COE Early Harvest pre-selection phase, September 2014

¹²⁰ IHCAFE interview, November 2014

¹²¹ Brazilian copper interviews at COE Early Harvest pre-selection phase, September 2014

¹²² Mr. Tomazini was a participant at the time of the interview who has since been an auction finalist

¹²³ The survey was conducted anonymously and not all survey respondents elected to leave their name and company information