



The Multiple Dimensions of Risk in Coffee

**Annual Conference
Forum on Agricultural Risk Management in
Development**

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**José Sette
Executive Director a.i.**

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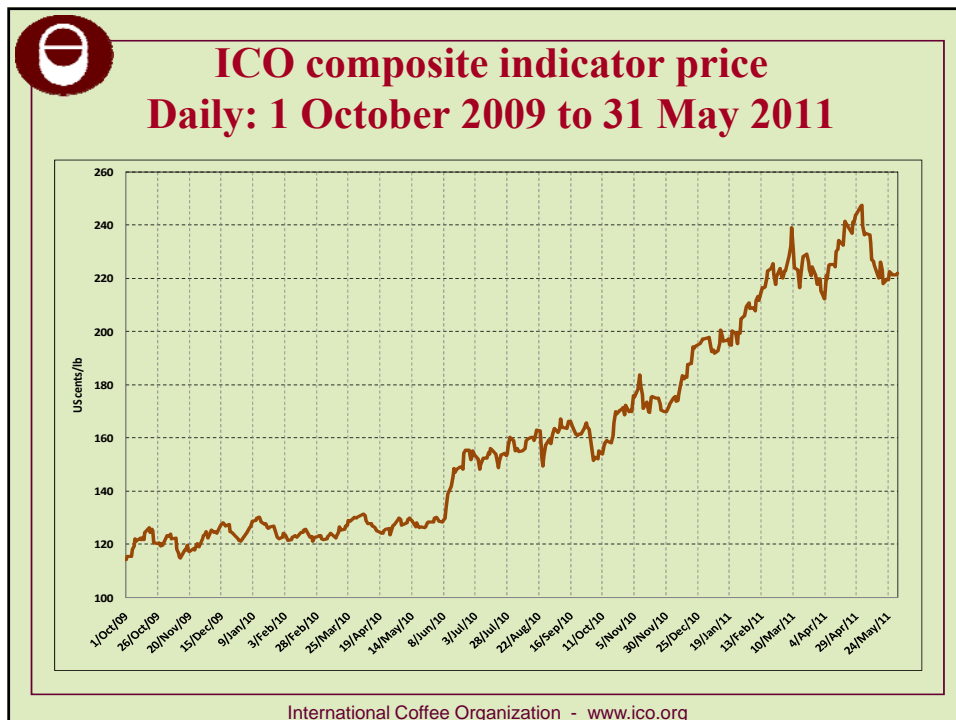
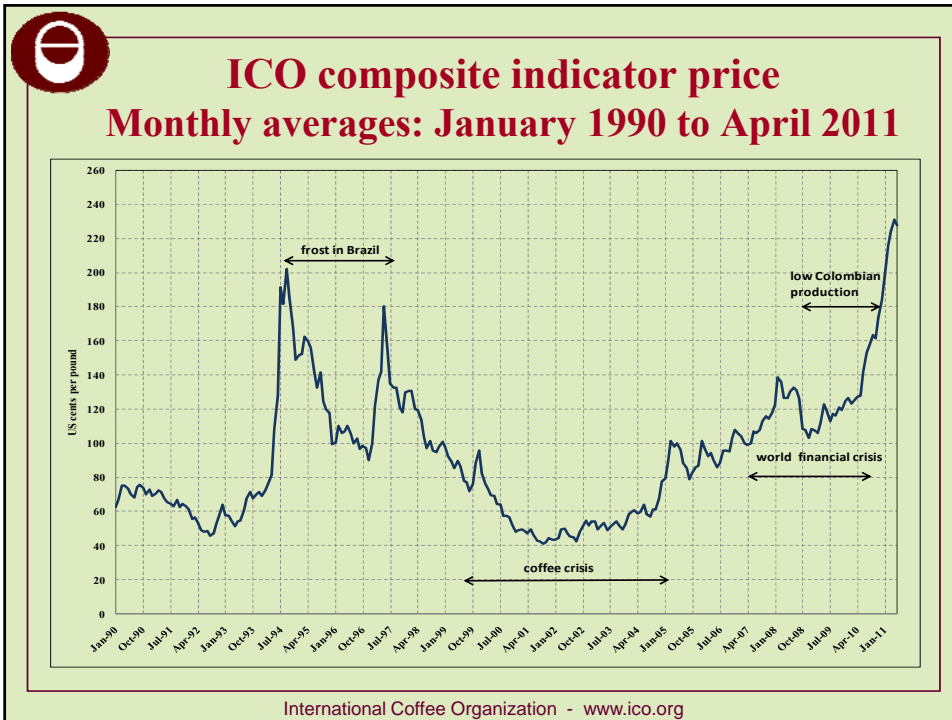
SUMMARY

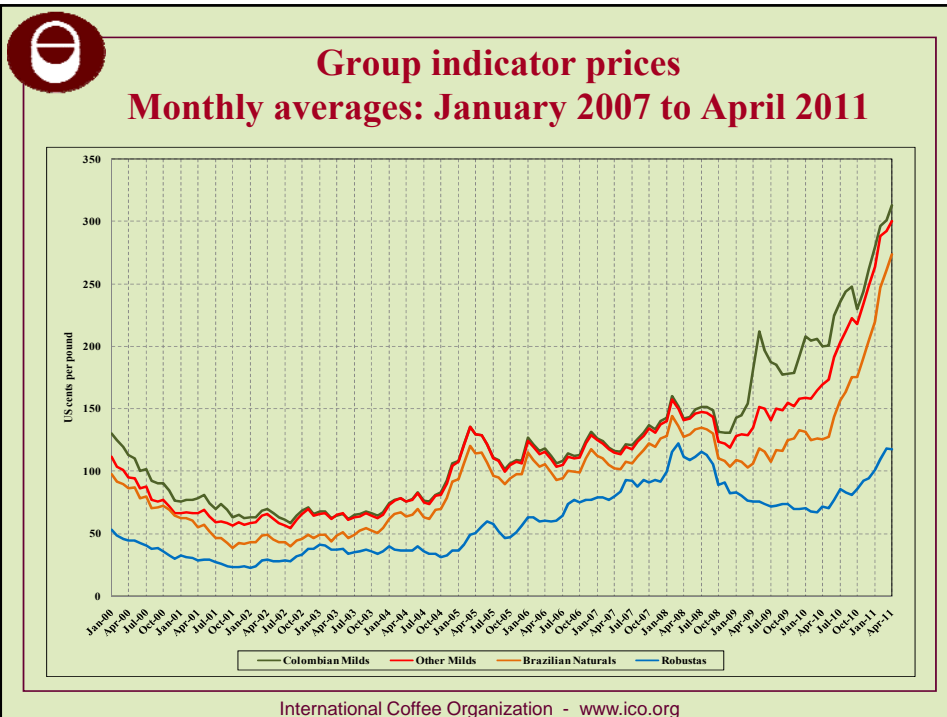
1. Types of risk

- Physical and security risk
- Quality / value risk
- Performance (counterpart) risk
- Price / market risk

2. The role of International Commodity Bodies

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- ## Physical and Security Risk
- ▶ Physical loss or damage, theft and fraud
 - ❖ On plantation
 - ❖ During transportation
 - ▶ Instruments
 - ❖ Insurance
 - ❖ Physical security: armed guards, convoys, satellite tracking
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Quality / Value Risk

- Goods do not match description
- Instruments
 - ❖ Minimum quality standards (ICO Resolution 429 – voluntary application)
 - ❖ ISO 9001
 - ❖ Standard contracts (European Coffee Contract & Green Coffee Assoc. of NY)

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Quality / Value Risk

- European Coffee Contract
 - ❖ Mechanisms for dispute resolution
 - ❖ ‘Even if the price is expressed "Free on Board port of shipment", the contract is in fact to be considered as an ill-defined Cost & Freight contract, the freight being for account of the buyers.’
 - ❖ Oligopsonistic structure

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Performance (counterpart) Risk

- Risk that one of the parties to the transaction does not fulfill its obligations (default)
- Instruments:
 - ❖ Limit exposure to any one client/supplier
 - ❖ Establish list of approved trading partners
 - ❖ Establish strong administrative processes
 - ❖ Monitor behaviour of trading partners

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Price or Market Risk

- Market risk
- Currency risk
- Basis (differential) risk

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Market Risk

- Price of market as a whole rises or falls to the detriment of owner, depending on type of transaction
- Instruments:
 - ❖ Price-to-be-fixed (PTBF) contracts
 - ❖ Margin calls – liquidity trap
 - ✓ Volume limits
 - ✓ Financial limits

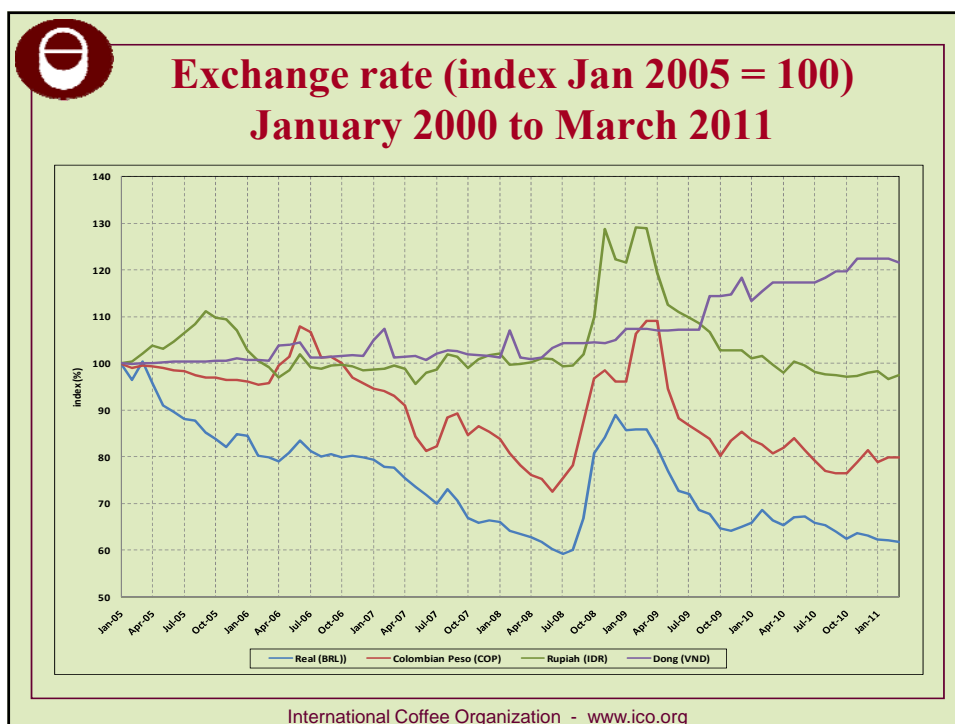
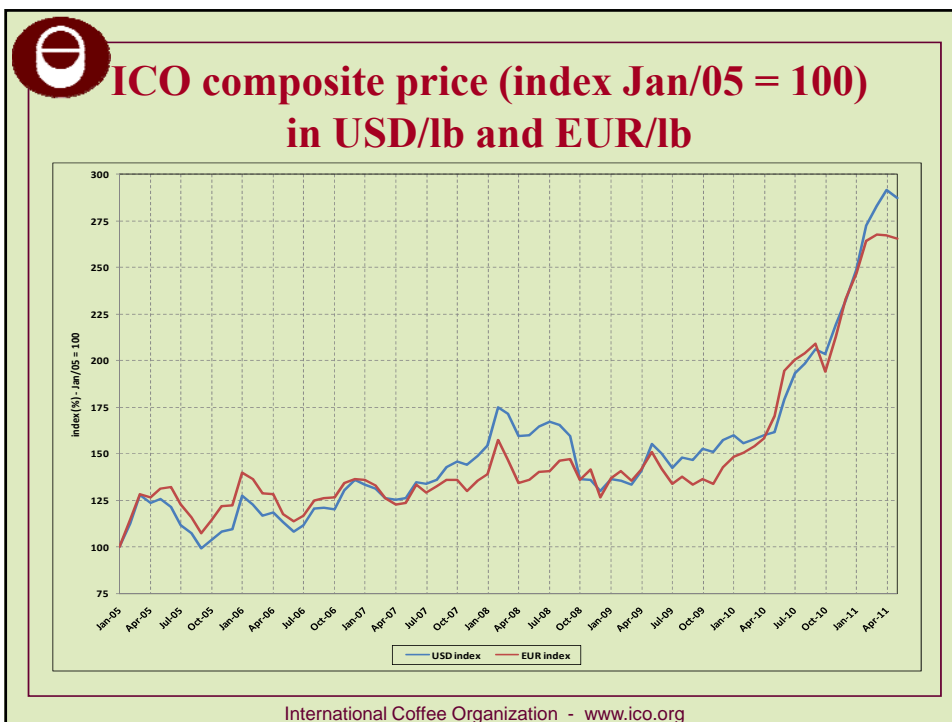
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Currency Risk

- Adverse movements in local currency vs US dollar
- Instruments:
 - ❖ Currency futures contracts
 - ❖ Forward contracts

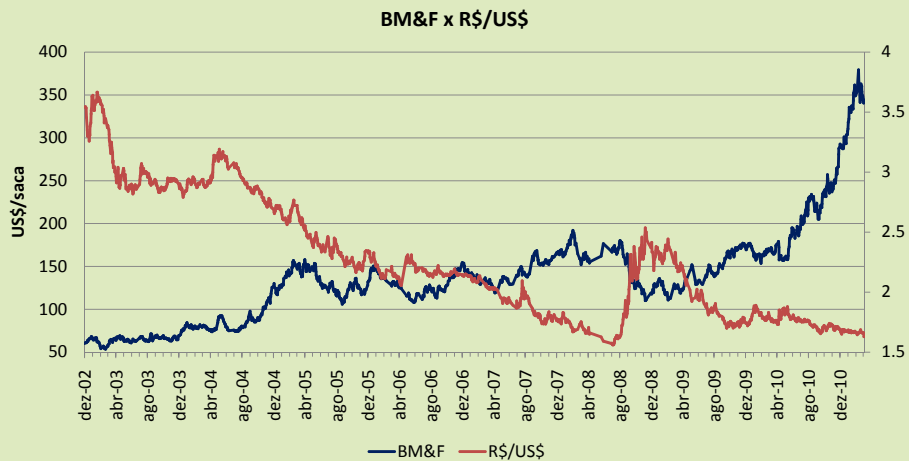
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Bolsa e taxa de câmbio

Atualizado: 23/05/2011



Source: Pharos Commodity Risk Mgt.

Correlação no período: -76,38%

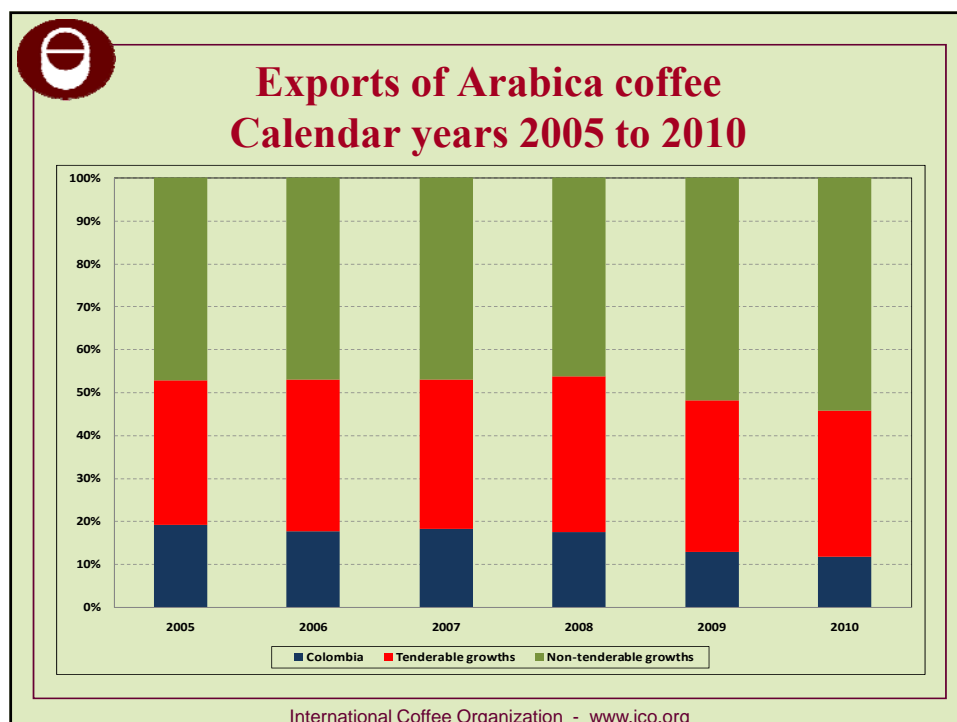
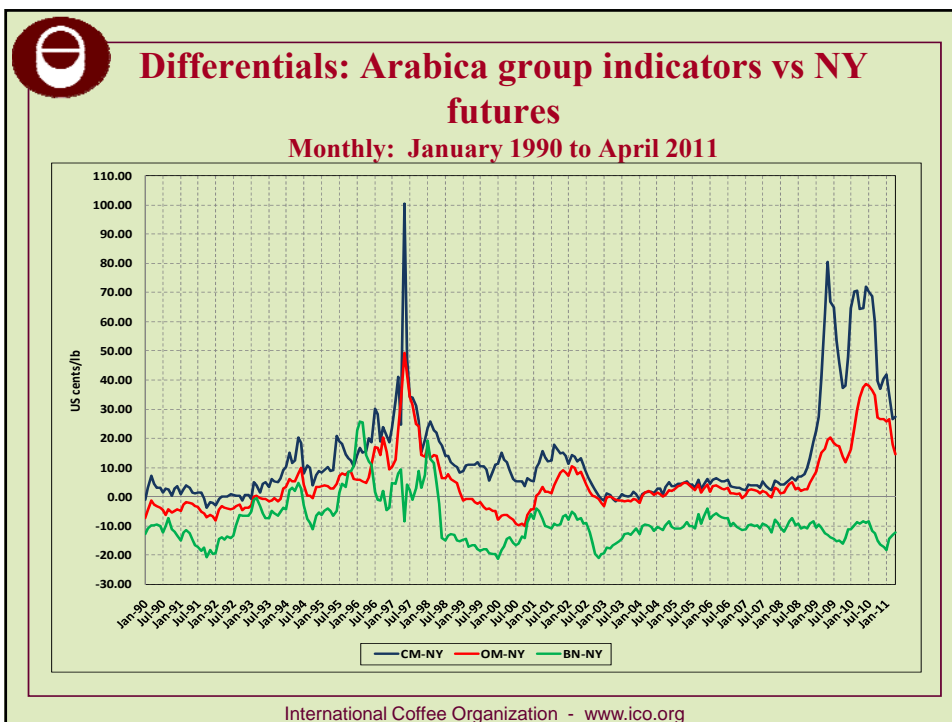
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Basis (Differential) Risk

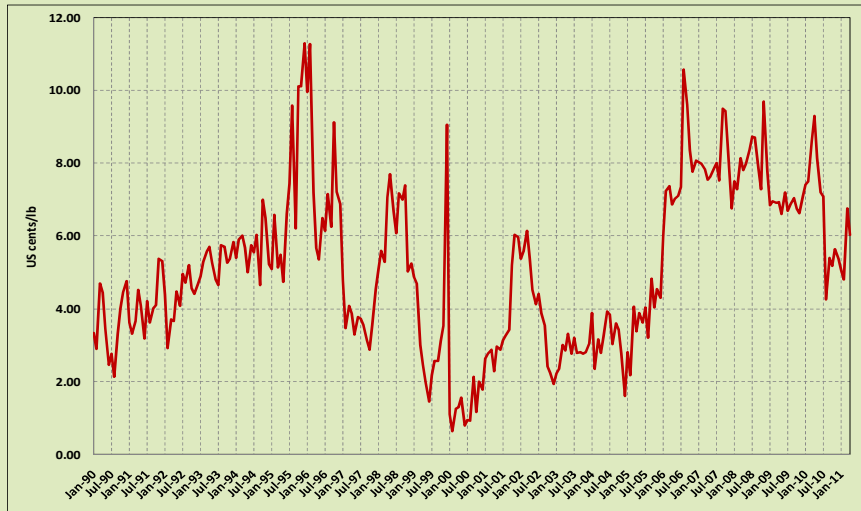
- ▶ Changes in relations of the price of a specific quality of coffee to that of market as a whole
- ▶ Instruments:
 - ❖ ???????

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Differential: Robusta indicator and London futures Monthly: January 1990 to April 2011



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Risk in a context of high price / high volatility

Type of risk	Change
Physical / security	↑
Quality	Unch or ↑
Performance (counterpart)	↑
Market	↑
Currency	Unch
Basis (differential)	↑

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THE ROLE OF ICBs

1. Risk management tools for smallholders
2. Coping strategies
 - Diversification
 - Promotion & market development
3. Market transparency

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Risk management

Instruments for managing commodity risks include:

- Stabilization programs
- Marketing strategies involving the timing of sales and purchases
- Long-term contracts with fixed prices
- Forward contracts
- Futures or options to hedge prices through commodity exchanges

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Risk management in exporting countries

In order to successfully run risk management programmes in exporting countries in a way that contributes to reducing rural poverty, the work needs to be carried out in several stages:

- Strengthening institutional framework
- Training
- Development of domestic marketing (e.g. warehouse receipt system)
- Improving access to agricultural credit

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Risk management in exporting countries

Relevant projects:

- CFC/ICO/21FA: Coffee price risk management in Eastern and Southern Africa
- CFC/ICO/24FT: Study of the potential for commodity exchanges and other forms of market places in COMESA countries
- CFC/ICO/16: Strengthening the commercial, financial, management and business capacity of small coffee producers/exporters
- CFC/ICO/03FA: Coffee market development and trade promotion in Eastern and Southern Africa
- CFC/ICO/20: Pilot short- and medium-term finance to small-scale coffee farmers in Kenya
- CFC/ICO/20FT: Workshop on structured short- and medium-term finance to small-scale farmers in Africa

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Coping strategies

► Crop diversification (food crops)

- ❖ CFC/ICO/47: Raising income security of smallholder coffee farmers in Malawi and Tanzania through sustainable commodity diversification
- ❖ CFC/ICO/32: Diversification of production in marginal areas in the State of Veracruz, Mexico
- ❖ CFC/ICO/31: Reconversion of small coffee farms into self-sustainable agricultural family units in Ecuador

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Coping strategies

Promotion & Market Development: differentiation

- CFC/ICO/39: Enhancing the potential of gourmet coffee production in Central American countries
- CFC/ICO/42: Developing the potential of Gourmet Robusta coffee in Gabon and Togo
- CFC/ICO/45: Building capacity in coffee certification and verification for specialty coffee farmers in EAFCA countries
- CFC/ICO/01: Development of gourmet coffee potential
- CFC/ICO/05: Robusta quality and marketing improvement by optimal use of coffee terroirs

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Coping strategies

- ▶ Promotion & Market Development: internal consumption



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World coffee consumption Evolution 2000 – 2010 (in thousand bags)

	2000	2010*	Growth rate (%)
Traditional markets	63 367	70 837	+1.1
Producing countries	26 385	40 280	+4.3
Emerging markets	15 750	22 883	+3.8
World total	105 502	134 000	+2.4

*Estimated

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World coffee consumption: Producing countries Evolution 2000 – 2010

(in thousand 60-kg bags)

	2000	2010*	Growth rate (%)
Total	26 385	40 283	+4.3
Brazil	13 075	18 945	+3.8
Indonesia	1 664	3 333	+7.2
Ethiopia	1 938	3 253	+5.3
Mexico	1 189	2 239	+6.5
India	938	1 400	+4.1
Others	7 581	11 113	+3.9

*Estimated

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Market Transparency

- ICO Indicator Prices (daily)
- Monthly Trade Statistics (monthly)
- Green and Processed Coffee Trade Statistics (quarterly)
- Coffee Statistics (annual)

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Market Transparency

- Monthly Market Report
- Economic Studies
 - ❖ Volatility
 - ❖ Global value chain
 - ❖ Fertilizer prices
 - ❖ Consumption in selected countries
 - ❖ Obstacles to consumption
 - ❖ Organic coffee
 - ❖ Other

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Market Transparency

- Coffee: An Exporter's Guide
(collaboration with ITC/UNCTAD)
 - ❖ Book
 - ❖ Website: www.thecoffeeguide.org



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