

Nespresso's AAA Program

High Quality Coffee Sourcing in Colombia



This case study focuses on the procurement practices of Nespresso, a company specialized in the delivery of high-quality coffee, and its relationship with Expocafé, a Colombian coffee exporter.¹

Background

Colombia is the third largest coffee producer among nearly 50 coffee producing countries in the world. In 2015 these countries produced 146.8 million 60-kilogram bags of coffee providing a source of income for some 20 to 25 million farmers and exporting 80% of the global production (State of Sustainability Initiatives, 2014), earning exporters, including re-exporters (mostly in developed countries), \$31.8 billion. It is a growing market, with global production and consumption increasing by 50% since 1990. This growth, however, does not translate into income growth at the farmer level, as producer prices are volatile, and disconnected from consumer prices.

A major actor in this market, the Nestlé Nespresso Company (Nespresso) was founded in 1986 and is owned by the Nestlé group. It is specialized in the delivery of individual coffee portions in aluminum capsules. Overall,

¹ This paper is adapted by Carlo Maria Delù for the ILO from McFalls, R., and Kemanian, V., 2016, Good Procurement Practices and SMEs in Supply Chains: Nespresso AAA Sustainable Quality Program and Impact of SME Procurement Practices in Colombia, as part of the ongoing research by the International Labour Office's SME Unit on the impact of MNE's procurement practices on developing countries' SMEs. In addition to the case study authors, we would like to thank Paulo Barone and the concerned companies for their collaboration in the data collection phase. Reference to names of firms, their practices, and commercial products and processes does not imply their endorsement by the International Labour Office, and any failure to mention a particular firm, practice, commercial product or process is not a sign of disapproval.

the Nestlé group is a leader in this market, with a 23% market share in terms of value. It sources part of the coffee in Colombia, where it has relationships with four main exporters. Being positioned in the premium market segment, Nespresso continuously looks for sources of high quality coffee estimating that only 1 to 2% of the global production complies with the company's standards, which can lead to bottlenecks in the supply chain if there is an increase in demand. This became clear in the 2000s, when demand for Nespresso capsules increased radically, prompting the company to start a closer relationship with producers in order to guarantee the supply of quality coffee.² Thus, the AAA Sustainable Quality TM Program was born. The program takes its name from the Kenyan coffee classification system, where the AA grade identifies the highest quality coffee. In the case of Nespresso, a third A is added so that the acronym represents the three pillars of the Sustainable Quality Program: quality, sustainability, and productivity.

The exporter in Colombia: Expocafé

One of Nespresso's main partners in Colombia is Expocafé, a private company that was founded in 1985 by Colombian coffee growers' cooperatives to gain access to international buyers, consolidate costs, and manage risks (Ardila, 2015). Originally, the company exported unroasted coffee, but they report that the engagement with Nespresso has helped them become a value-added services company, with a diverse staff of internationally technical professionals. Expocafé acts as an intermediary between Nespresso and 7,000 smallholder farmers (see map) and generates between 200 and 250 million \$US in sales, all while directly employing 35 - 40 people.

Thanks to the partnership with Nespresso, Expocafé has developed a complex, proprietary, and state-of-the art information system for economic and product traceability from farm to cup, and a capability to respond within 15 minutes for any questions related to its supply chain. According to Expocafé, the premiums paid by Nespresso make it highly desirable for farmers to be accredited as AAA suppliers, and there is significant demand by farmers to participate in the program as the higher standards of living for those participating are evident.

Strategy

The Program was launched in 2003 and saw the involvement of Expocafé (see below) in Colombia from the outset. At first, the aim of the program was to train farmers to achieve Nespresso's quality standards. The buyer started out by defining the exact flavours and aromas it wanted for its brand, and subsequently by defining the growing conditions needed to achieve that taste profile. In order to meet those conditions, a *process and production* upgrade was required on the part of farmers working with Expocafé: as farmers started meeting the quality requirements, they became eligible for the price premiums paid by Nespresso under the AAA program. To ensure quality, Nespresso introduced the requirement of product traceability from producer to consumer, and Expocafé developed advanced procedures and systems to gather the information and make it available to the buyer.

Since the inception of the AAA program, Nespresso involved Rainforest Alliance, an NGO specialised on the promotion of environmental and social standards, as well as producer cooperatives in the design of this new phase of the program. Social and environmental sustainability were integrated to the quality consideration, which is intrinsic to the Nespresso business model. Agronomists and project managers were made available to Expocafé farmers, to provide technical guidance on environmentally sustainable production methods, as well as to help farmers achieve and maintain the coffee quality and taste profile. Farms are visited annually by the agronomists to assess the farm against the AAA criteria, to develop an action plan and training plan, and are subsequently assessed using the *Standards for Sustainable Agriculture* system developed by the Sustainable Agriculture Network, an association of NGOs that works for the conservation of biodiversity and rural development. As show in the map, Expocafé deploys and manages the field technicians and agronomists, and Nespresso covers the costs of their employment.

² Barone, P. 2015. Interviewed by Ricarda McFalls on December 21, 2015.

Nespresso also increased its focus on measuring farmer income as the program evolved. With the help of INCAE, a prominent business school in the region, the company developed metrics of Real Farmer Income™, a tool for measuring and reporting farmer incomes. It provides for individual, yet comparable, farmer income statements including farm size and yield, the portion of harvest sold as AAA, the total price received, the premium received, and production costs. Economic traceability became an added requirement for suppliers, enabling Nespresso to trace the source of all products and the exact amount paid to farmers via the supplier in a transparent way. Expocafé highlights the traceability of funds as a key differentiator for the AAA program and Nespresso, and a barrier to entry for companies unwilling to disclose margins.

The program, then, covers various dimensions of the relationship between the buyer (Nespresso), the intermediary (Expocafé), and producers (the farmers), as shown in the map, and is in fact based on three pillars:

- *Quality*: it focuses on cultivation practices to attain the specific taste and aroma profiles required by Nespresso.
- *Sustainability*: attention is given to environmental and social responsibility, including biodiversity, water management, farm worker rights and working conditions, developed in conjunction with Rainforest Alliance and Sustainable Agriculture Network (SAN) the Standards for Sustainable Agriculture.
- *Productivity*: it works towards improving net income through increased productivity and reduced costs.



Each of these pillars is supported by a team of agronomists, managed by Expocafé and funded by Nespresso. In addition to provide field technical assistance, these specialists teams follow up with measurement or certification, with compliant farmers rewarded with different levels of transparent premiums on purchase price.

More recently, Nespresso and the company's intermediary partners are now also engaged in community based, multi-stakeholder, "out of farm" projects to support larger social and environmental issues. They work to find solutions for inter-generational succession planning, minimum salaries, and social security. In conjunction with the Colombian government, an initial pilot plan is underway in Colombia with 1,000 farmers. Under this scheme, coffee premiums are applied directly to a saving plan for the farmers.

Good Practices


Value chain diagnostics (UNIDO, 2011) and results from a multi-year impact assessment³ commissioned by Nespresso on the Nespresso AAA Sustainable Quality™ Program by the Centre for Regional Coffee and Entrepreneurial Research (CRECE) in Colombia (Ochoa, G. et al, 2014), combined with conclusions from an independent 12-country COSA study (COSA, 2013)⁴ have been looked at for this case study⁵.

The Nespresso AAA program is considered a good procurement practice because it differentiates the price paid to farmers based on the quality of the product, and includes significant investments in product and process

³ Between 2008 and 2010, INCAE Business School, in partnership with Nespresso studied 600 participating farmers in five countries, including Colombia to understand the different factors that affect farmers' net income. A second study was conducted by the Centre for Regional Coffee and Entrepreneurial Research (CRECE) in Manizales, Colombia.

⁴ COSA method here refers to an internationally-recognized sustainability assessment methodology established with the Committee on Sustainability Assessment (see: <https://thecosa.org>). The CRECE study uses the COSA methodology.

⁵ See indicators in UNIDO, Diagnostics for Industrial Value Chain Development, An Integrated Tool, 2011, p 55, based on Humphrey and Schmitz, 2000; Gereffi et al, 2005 and Bazan and Navas-Aleman 2004.



upgrading, that are seen as a positive contributor to social and environmental upgrading. Indicators of good practice included:

- *Procurement program scale:* The program accounts for 84% of the coffee purchased by Nespresso, and is being implemented in eleven countries across Latin America, Africa, and Asia, indicating that it is an integral part of the company's procurement strategy.
- *Quality assurance and economic transparency through traceability:* Under the program, Expocafé is required to provide traceability information on both the chain of custody of the product and the prices paid to the producer. Moreover, the terms of the contract clearly dictate that at least 80% of the total value of the transaction has to go to the coffee producer. Although Nespresso operates through a first tier supplier, these terms ensure that the procurement practice has a real impact on the smallholder coffee producers, which are relegated to lower tiers in the value chain.
- *Pricing:* Under the program, Nespresso pays a premium for the high quality coffee it buys: the program's target is to pay from 30 to 40% above the market price, or at least 10-15% above the price paid for coffee of comparable quality. Although impact studies for the program remain limited, a multi-year impact assessment by the Centre for Regional Coffee and Entrepreneurial Research (CRECE) showed 41% higher economic outcomes for AAA Program participants over a control group⁶.
- *Provision of training:* In order to help farmers reach the AAA quality and sustainability requirements, Nespresso invests in the provision of training, through visits from agronomists or field technicians, hired by Expocafé.
- *Pro-active monitoring and verification of compliance with labour standards, including child labour:* Nestlé's stringent Supplier Code strongly endorses International Labour Office core labour standards, and includes provisions on working time and rest days, wages and benefits, and substantive pro-active requirements on safety and health.
- *Supportive supplier management:* Nespresso takes into account the costs incurred by Expocafé for the implementation of the programme when negotiating the coffee purchase price, and also pays in advance part of the implementation costs to support cash flow requirements. To avoid duplicating the burden on suppliers, Nespresso partnered with an existing environmental accreditation body (Rainforest Alliance) and integrated their certification system in its program.

Conclusion

Based on these elements, the AAA program can be seen as an integral part of Nespresso's core business and strategic planning. It is tied to a large share of the coffee the company buys, and was put in place to address a business risk to ensure that quality supply is available to meet a strong increase in demand as first encountered in the early 2000s. Moreover, Nespresso and its AAA program cover the "trinity" of good prices, stable orders, and use of standards, to which it adds a fundamental training dimension.

⁶ Sample composed of 1222 target and 563 conventional farmers randomly selected from AAA Program Clusters with 95% of confidence and errors of 7% or less. (Ochoa, G. et al, 2013).

