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Labour  
Organization

# Case Study

## **Good Procurement Practices and SMEs in Supply Chains:**

Nespresso AAA Sustainable Quality Program

Impact of Procurement Practices in an SME in Colombia



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## Introduction

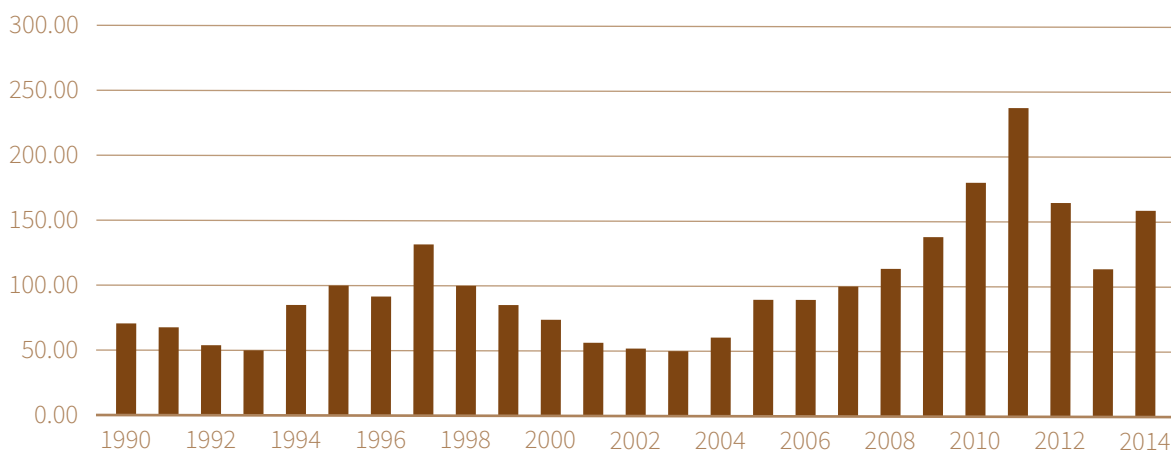
The global coffee market has experienced unprecedented growth but in a complex and volatile global market, capturing the economic gains in producing countries remains largely elusive. Yet, as large buyers seek to secure sustainable supply and suppliers higher incomes, investment in value-added production is one way to “create shared value”<sup>1</sup> for both buyer and seller. This study identifies procurement practices carried out by Nespresso, as an individual large buyer, and how ‘good procurement practices’ associated with its AAA Sustainable Quality™ Program contributed to economic and social upgrading of selected suppliers (intermediaries) and some 30,000 producers (farmers) in Colombia.

In assessing good practice and upgrading potential, the study draws on a Value-Chain analysis framework. Whereas this study includes input from the MNE buyer and a Colombian SME supplier, direct farm level verification of impacts for producers in the supply chain was outside the scope of this study. However, a recent assessment of the AAA Program by researchers in Colombia through farmer surveys is included in this case study.

## The coffee market

Colombia is the third largest coffee producer among nearly 50 coffee producing countries. Last year these countries produced 146.8 million 60 kilogram bags of coffee<sup>2</sup> (ICO, 2015) providing a source of income for some 20 to 25 million farmers (SSI, 2014). 80 per cent of global production was exported (SSI, 2014), earning exporters, including re-exporters (mostly in developed countries), \$31.8 billion<sup>3</sup>. Colombia alone accounted for \$2.7 billion of those export earnings (ITC, 2015). Global production and consumption have grown more than 50 per cent since 1990 and are forecast to continue to grow at 5 per cent per year with premium market coffee expected to grow at twice that rate (Eurofound, in Globe and Mail, 2015). However, overall volume growth does not often translate into income growth at the producer level. The coffee market, as with many other commodities, suffers from considerable instability and volatile price fluctuations, primarily attributed to market forces (supply), speculation and climatic uncertainty (ICO, 2014; SSI, 2014). As shown in figure 1, producer prices are volatile and as demonstrated in Figure 2, they are largely disconnected from consumer prices.

**Prices paid to growers in Colombia**  
US cents per pound (1990 - 2014)



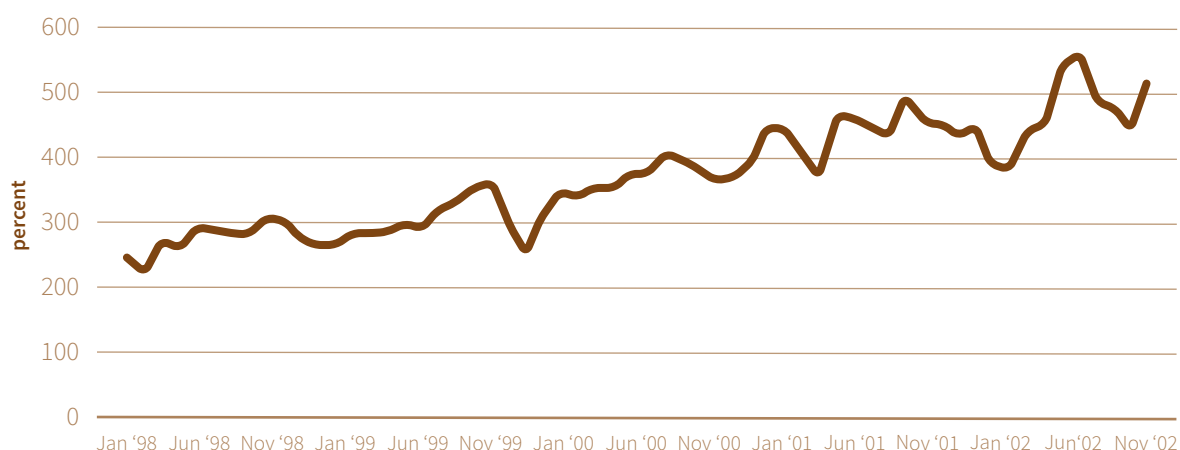
**Figure 1: Prices paid to growers in Colombia, 1990 to 2014**

Source: ICO, 2015

1 Porter and Kramer (2011) argue that companies create value by creating societal value: by reconceiving products and markets, redefining productivity in the value chain, and by building supportive industry clusters in the company's locations. Porter and Kramer build their case with a number of corporate examples, including the successful procurement practices initiated by Nestlé Nespresso through its development of clusters in coffee producing communities.

2 146.8 million bags in 2013-14; 141.7 million estimated for 2015 (ICO, 2015).

3 The top three producers, Brazil, Vietnam, and Colombia received 36 per cent.



**Figure 2: Price spread between US retail price and Colombia producer price during “Coffee Crisis”, 1998 to 2002<sup>4</sup>**

Source: FOA, 2004

More than 563,000 Colombian families, predominantly small-scale farmers, grow premium-quality coffee beans across nearly 2.2 million acres of Colombian highlands (FNC, 2015). Coffee is Colombia’s fifth largest export sector, (ITC, 2015), and the largest source of rural employment (FNC, 2013). Given its unique growing environment at high-altitude and atomized farm structure (95 %, family owned and under 2 hectares)<sup>5</sup>, the potential importance of product upgrading for producers in this country makes Colombia of particular interest for this study.

Issues concerning working conditions in the coffee sector include the existence of Child Labour, and violation of workers’ right to associate and to benefit from good Occupational safety and health (OSH) standards. Of all child labor found in agriculture globally<sup>6</sup>, the majority (68.4 per cent) are found on family farms (ILO, 2013). Colombia was not identified as a major source of forced labor; however, child labor is reported as prevalent in the sector, and the country has had a poor record on Freedom of Association, including the unresolved deaths of trade unionists (USDOL, 2015).

Due to heightened awareness surrounding rural poverty and conditions of production, coffee is reported to have the highest presence of sustainability standards among commodity sectors (SSI, 2014, Hamman et al, 2014)<sup>7</sup>. Brand owners (and not consumers) are credited for creating the market for sustainable coffee, as in the early days it enabled brands to differentiate themselves. Over time, the increased adoption of standards by companies moved the practice from CSR reputational benefit to a license to operate issue (Ingenbleek and Reinders, 2013). Campaigns by NGOs were also prominent in raising concerns about the plight of farmers (SSI, 2014). By 2012, certified sustainable coffee production accounted for 40 per cent of global production (up from only 15 per cent in 2008), rapidly outpacing the overall growth in global coffee production (SSI, 2014), and by 2012 accounted for 23 per cent of total Colombian production (FNC, 2013).

<sup>4</sup> Between 1965 and 1989 the market was regulated by the International Coffee Agreement, in an attempt to reduce volatility and to provide farmers with more predictable income. Since the collapse of this agreement in 1989, the market since 1990 has experienced two periods of exceptionally low prices for producers. The most severe price decline between 1999 and 2004, known as “the coffee crisis,” had severe economic consequences for coffee exporting countries.(ICO, 2014)

<sup>5</sup> Nespresso, 2015.

<sup>6</sup> Worldwide, 98 million (or 59 per cent) of all child labor is found in agriculture (ILO, 2013)

<sup>7</sup> Today, the most active voluntary standards in the coffee sector are: AAA (Nespresso), 4C Association, C .A.F.E. Practices (Starbucks), Fairtrade, Organic, Rainforest Alliance, and UTZ Certified (SSI, 2014).



## Case Study: Nespresso and Expocafé Colombia

### Nespresso

Founded in 1986, the Nestlé Nespresso Company is a wholly-owned company of the Nestlé Group, focused on delivery of high-quality espresso coffee in the “portioned coffee segment”, i.e. individual coffee portions dispensed via aluminium “pods”. Overall, the Nestlé Group is the global coffee market leader in value (23 per cent market share) and until recently in volume (12 per cent)<sup>8</sup>. In terms of quality, only between one and two per cent of the world’s coffees are reported by the company to meet its stringent requirements and specific taste and aroma profiles. For Nespresso, internal changes and a dramatic acceleration in annual business growth<sup>9</sup> from 2000 onwards, led the company to realize that, given the very specialized profile of the coffee beans sourced, a closer relationship with producers would have to be established to guarantee quality coffee supply (Barone, 2015). More coffee beans of interest would need to be identified, and secured, and farming practices upgraded to increase the productivity of the highly sought varieties (ibid).

### The AAA Sustainable Quality™ Program

Originally derived from the AA standard associated with high quality coffee found in Kenya and other high quality regions, the three A’s signify three pillars in the Nespresso AAA Sustainable Quality™ Program (‘Program’). Launched in 2003, the Program involves “building a long-term relationship with farmers” based on the three A’s: (1) quality (focus on cultivation practices to attain taste and aroma profiles); (2) sustainability (environmental and social responsibility, including biodiversity, water management, farm worker rights and working conditions, developed in conjunction with Rainforest Alliance and SAN Standards for Sustainable Agriculture); and (3) productivity (improving net income through increased productivity and reduced cost). Each of these pillars is supported by field technical assistance, and followed up with measurement or certification, with compliant farmers rewarded with different levels of transparent premiums on purchase price, 30 – 40 per cent above market (and 10-15 per cent above comparable quality).<sup>10</sup>

### Colombian SME: Expocafé S.A.


Established in 1985, Expocafé S.A. is a limited-liability private company founded by all Colombian coffee growers’ cooperatives in order to gain direct access to international buyers, gain scale, consolidate marketing, management and technical costs, manage risk, and overcome perceptions of informality that can limit cooperatives access to global markets (Ardila, 2015). Originally a green (unroasted) coffee exporter, today Expocafé positions itself in the quality, value-added sector, which requires extra services to both buyers and producers. The company, generating some \$200-250 million in coffee exports, currently employs some 35 to 40 direct employees and 97 in total.

Expocafé distinguishes itself for its early, exclusive role in the overall development and launch of Nespresso’s AAA Sustainable Quality™ Program in Colombia. The company began supplying coffee to Nespresso in 2002, in a run-up to the AAA Program. The early 2000’s, were “bleak years” for coffee producers as real producer prices were at their lowest levels and the impact on countries like Colombia, highly dependent on coffee exports was devastating to farmer incomes (FAO, 2004). Quality also suffered as prices dipped below production costs. The opportunity to participate in an initiative that would help farmers increase their competitiveness and incomes was key for the company.

8 Source: Euromonitor International, September 2014. Passport: Nestle S.A. in Hot Drinks (World). The competitive landscape is highly concentrated, and is becoming more so, following recent mergers and acquisitions under JAB Holdings.

9 Estimated 30 per cent per year (Barone, 2015)

10 Suppliers are obligated to offer farmer competitive prices, at least 80 per cent of Nespresso’s FOB purchase price, and “must always target the highest coffee prices paid in the region and be known for doing so” (Nespresso, 2015, p.6).



The AAA Program rolled out sequentially, with the first aim to achieve Nespresso's quality standard. Nespresso was already acquiring from Expocafé a particularly distinctive variety of coffee grown by farmers in Caldas, and spent a further year researching exact flavours and aromas it wanted for its brand. Once the taste profile had been identified and refined, the growing conditions under which this taste could be achieved needed to be defined. For the first time, product quality would be measured by taste rather than appearance of the bean. Building this level of capability, requiring a process and production upgrade among coffee growers in Expocafé's territory, would take several years during which the company had exclusivity in its agreement with Nespresso. Farmers who met the product requirements were eligible for the AAA premium prices paid by Nespresso.

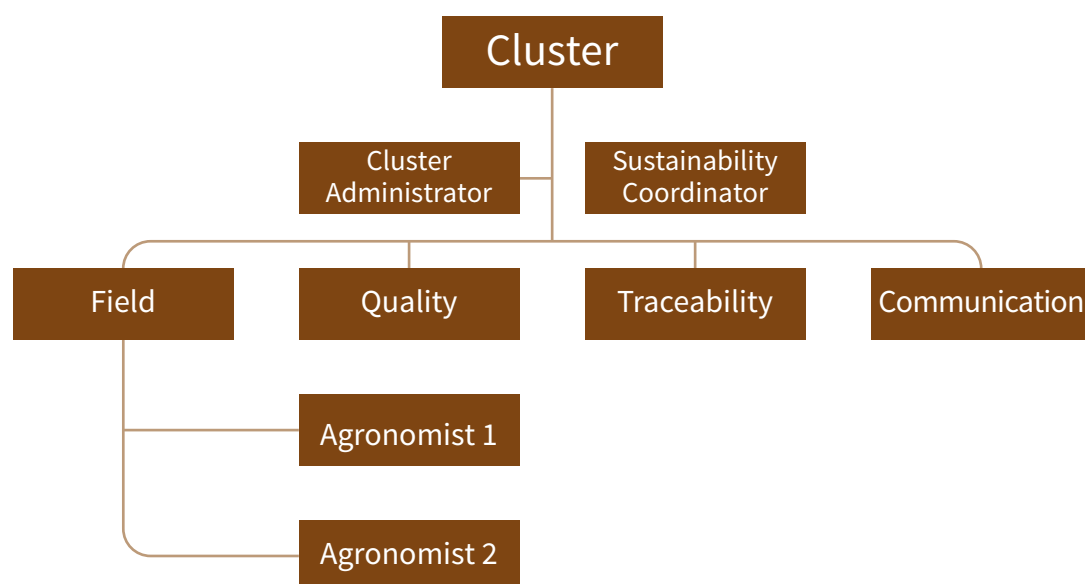
To ensure quality from field to cup, establishing product traceability was a critical requirement of the AAA program. With Nespresso's support, Expocafé would invest significantly in the next few years to develop advanced procedures and systems to manage traceability in its "chain of custody". While supply chain traceability would become a criterion for all buyers, and is a food safety requirement increasingly required in trade agreements, Nestle Nespresso would set the highest standards among buyers in their expectations and active auditing of these systems (Ardila, 2015; Barone, 2015).

With traceability methods established by 2006, social and environmental sustainability was added to the quality dimension of the AAA Program. Rainforest Alliance, an NGO whose standard focuses on protection of ecosystems and compliance with social standards, and the producer cooperatives were brought into the design of the program. Under the program, agronomists and project managers were made available to the Expocafé cluster to provide technical guidance on environmentally sustainable production methods, as well as, to help farmers to achieve and maintain the quality taste. Farms are visited annually to assess the farm against the AAA criteria, to develop an action plan and training plan, and are subsequently assessed under SAN methods (Standards for Sustainable Agriculture). Expocafé deploys and manages the field technicians and agronomists, and Nespresso covers the costs of their employment.

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 proprietary tool for measuring and reporting farmer incomes. It provides for individual, yet comparable, farmer income statements including farm size and yield, portion of harvest sold as AAA, total price received, 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.

While by 2006 Nespresso had expanded the number of its intermediary suppliers in Colombia from one to four to meet its fast growing demand and to diversify its risk, it did so via a unique channel strategy for the sector. Each of the four suppliers has regional exclusivity for a specific cluster. In this way, the success of each of the suppliers would be directly linked to its investment in the program and the success of its farmers. In Colombia, this would lead to the enrolment and active participation of almost 30,000 farmers in the AAA Program (7,000 of these through Expocafé).

Each of the four exporters employs program staff financially supported by Nespresso to administer the AAA Program in its cluster of farmers. The program staffing requirement for each exporter<sup>11</sup> is shown here:



**Figure 3: Cluster organizational chart, adapted from Nespresso AAA Shared Commitment (p. 56)**

Whereas the AAA Program is focused on standards at the farm level, Nespresso and the company’s intermediary partners are engaged in community based, multi-stakeholder, “out of farm” projects to support larger social and environmental issues. For example an aging farm population and the urban migration of youth is a major social concern threatening long-term sustainability of supply from small-scale farms (some 95% of the production). Nespresso and its multi-stakeholder partners are currently working 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 1000 farmers. Under this scheme, coffee premiums are applied directly to a saving plan for the farmers.

## Impact of AAA Sustainable Quality <sup>TM</sup> Program

### *SME Perspective: Expocafé*

Juan Carlos Ardila, Expocafé’s representative in Europe reported that the Nespresso’s procurement program under AAA had been extremely beneficial for Expocafé, as well as, for farmers. The engagement with Nespresso had led the company to move from its role as a pure commodity exporter (prior to 2002), to a value-added services company, with a diverse staff of internationally qualified technical professionals.

Through its partnership, Expocafé 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 – a skill not exclusively required by the coffee industry, but increasingly for all agricultural products destined for export.

Expocafé, in partnership with other organizations, also provides employment for a share of the 300<sup>12</sup> agronomists and field technicians worldwide that are financed under the AAA Program by Nespresso and that support farmers in achieving a variety of sustainability certifications, and to connect buyers to certified sources.

11 Expocafé employs 57 contractors, including 35 agronomists to support AAA Program requirements for 7000 farmers in its cluster.

12 Estimated number: cited as 300-330 in interviews. Nespresso website states 300. (Of these, some 35 agronomists and field technicians are active in Colombian Program).



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.

### ***MNE Perspective: On Colombian market***

Paulo Barone, Green Coffee Sustainability Operations Manager at Nestle Nespresso has overseen the AAA Program's progress in Colombia for the past decade. He has identified key success factors that have led to positive impacts for farmers and Nespresso: (1) Mutual trust and loyalty: To have continuity of supply and return on investment, both parties need to be in for the long-term. In early days, farmers were sceptical about Nespresso's intentions and commitments. However, year after year, the company continued with its initiative on how "learning would lead to earning", and matched its commitment with high service levels and information transparency, earning a high level of farmer loyalty and trust. (2) Presence in the field: Its commitments have been backed with active and visible presence in the field, working with farmers. Given the impact of weather, global price fluctuations, and currency risks, the assistance of more than 300 experts have helped farmers "work smarter", the one area under their control. Furthermore, equipment acquisition and certification support is substantial, and (3) Price: The commitment to pay 30-40 per cent over market is a substantial incentive and has helped to "de-commoditize" the product, and provide farmers an opportunity to earn more for better quality.

Barone also observes that farmers are today much more empowered than they were a decade ago, and that some of the power imbalances between farmers, intermediaries and buyers are better addressed. Today they are connected to the latest tools and information, and can exchange expert advice with agronomists on computer tablets. There is a pride in new skills attained in the accreditation processes, and the transparent reporting of prices and margins has strengthened farmer knowledge of their worth, and with it their negotiating capacity.

Initially, getting all stakeholders on board was a challenge for Nespresso. In an industry where commodity traders make money buying low and selling high, the notion of economic traceability was not easily embraced by all. But with time, the value of distinguishing a higher quality product at a differentiated cost, can award all in the chain (if not at the margin spans intermediaries preferred to control in the past).

In spite of gains brought by the program, buyers and producers recognize the precarious environment in which farmers operate; weather, fluctuating global price floors for coffee, and fluctuating currencies can rapidly wipe out gains made through hard labour and improved farming practices. For Nespresso, climate change is an area where multi-stakeholder participation is sought to tackle larger infrastructure issues, drought and pest resistant crops, and water management, issues which require potentially large-scale joint initiatives.

In terms of returns to Nespresso for its efforts, the program has ensured good supply as intended, and the company has developed a reliable chain of producers to draw from. Reputational benefits for Nespresso have been high as well. Nespresso is seen not only as a reliable partner to farmers, but also for governments, multi-lateral agencies, and NGOs. Because of Nespresso's end-to-end engagement and access to the coffee value chain, the company has been called on to participate in a number of multi-stakeholder development projects (e.g. World Bank, IFC, IDH, USAID, and individual country governments).

### ***External Factors***

There are innumerable external factors in the coffee market that influence outcomes at the level of the farmer – with prices fundamentally driven by supply and demand in a globalized market.<sup>13</sup> Monitoring and addressing the

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<sup>13</sup> For example, factors seen to contribute to the coffee crisis of the early 2000s included the emergence of Viet Nam as a major producer and exporter, the depreciation of the Brazilian real, "under-consumption", exploitation of market power by roasters and retailers, technological change in roasting, domestic market liberalization and the abolition of parastatal marketing agencies, dismantling of the coffee agreement – but ultimately, were boiled down to an oversupply at the global level (Hallam, 2003).

impact of these factors at a national and local level relies on the vigilance of diverse stakeholders.

In Colombia, national, regional, and departmental governments, as well as, the National Federation of Coffee Producers of Colombia (FNC)<sup>14</sup> and cooperatives themselves, have played a contributing role to environmental and social upgrading over the past decades. Rejuvenation of the tree stock by these stakeholders has played a role in productivity, and FNC's role as the country's buyer of last resort for all Colombian coffee supply has also helped support a local price floor. Competitors, including Starbucks, have similar programs, and other exporters focused on Fair Trade, Organic, and other private label certifications have undertaken various initiatives as well. Foreign aid has also been invested in farmer initiatives and peace-building initiatives in coffee growing areas (FNC, 2013).

Civil society has also had a role in maintaining pressure on stakeholders, including buyers, to undertake and maintain action to reduce poverty among farmers<sup>15</sup>. For example, following the collapse of prices in 2011, Dignidad Cafetera's (a farmer activist group), launched a Paro Cívico Cafetero Nacional (National Civic Coffee Strike) lasting 11 days from February 25, 2013 and involving more than 150 thousand coffee farmers, and was reported to have led to a government subsidy program, La Protección al Ingreso al Cafetero (Cafetero Income Protection, PIC) to make up for shortfalls between the selling prices of coffee beans and the costs of production (Houghton, 2015).

## **Lessons Learned – AAA Sustainable Quality™ Program example of 'Good Practice'**

Value chain diagnostics (UNIDO, 2011) and results from a multi-year impact assessment<sup>16</sup> 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)<sup>17</sup> are applied in the analysis of this case to evaluate the potential effectiveness of process, product and social upgrading. In doing so, this case study has started by examining the governance approach of Nespresso procurement practices for its AAA program, and the parameters it has set for its supply chain.

In terms of governance, the relationship between Nespresso and its AAA suppliers in Colombia in the context of the AAA Program can be categorized as “quasi-hierarchal” (Gereffi et al, 2005), based on indicators of highly specified product requirements, price setting structure, market dependence, and level of supplier competition<sup>18</sup>. In spite of the general coffee market dynamic that primarily leaves growers as price-takers, the Nespresso Program is identified as a good procurement practice for coffee growers as it provides for differentiated pricing based on added value, including a significant investment in process upgrading - that is seen as a positive contributor to social and environmental upgrading.

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14 The FNC was founded in 1927 to protect Colombian farmers from volatility in the market and is today one of the world's largest NGOs.

15 For example, in 2000, sustainable coffee accounted for less than 1 per cent of the market. Thereafter, media campaigns by Oxfam and others were seen to help raise awareness for the plight of farmers during the coffee crisis (SSI, 2014).

16 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.

17 COSA method here refers to an internationally-recognized sustainability assessment methodology established with the Committee on Sustainability Assessment (COSA, 2013). With core funding by the Swiss Government (State Secretariat for Economic Affairs – SECO) and The Ford Foundation, and project funding from diverse range of United Nations and other development agencies, private foundations, and producer groups (including the National Federation of Coffee Producers of Colombia, FNC), “COSA” is a collaborative grouping of dozens of organizations and hundreds of experts joined together in the development of the “COSA” system to provide tools for gather, compare and share information, including indicators, technologies, and analysis methodologies to measure the growing list of sustainability labels. Its ground-breaking research into 12 coffee and cocoa producing countries has helped to advance tools and a common framework for measuring impacts of the numerous initiatives and “eco labels” in the sector. The assessments use a mixed-method approach to capture and assess diverse conditions in the field, the main component consisting of two surveys: one administered to farmers and another conducted with cooperatives or community level organizations that interact with farmers, as well as, data collection from key stakeholders before and after the survey (COSA, p 18. 2013). The CRECE study uses the COSA methodology.

18 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.

In early years, parameters set by Nespresso were focused on product quality and Nespresso's target of achieving the quality, taste and aroma profile defined by its target consumers. However, as environmental and social concerns gained importance, a focus on process upgrading was added to the program to include supply chain parameters for environmental and social sustainability.

In analysing the Nespresso AAA Sustainable Quality Program™ procurement practices, the following areas feature as positive indicators of good practice:

- **Procurement Program Scale:** The program has been implemented for more than 12 years, reaches some 30,000 farmers in Colombia and accounts for more than 84 per cent of coffee purchased by Nespresso<sup>19</sup> (100 per cent of purchases from Expocafé), indicating that it is an integral part of the company's procurement strategy. Though originating in Latin America, the program has been replicated in Africa and Asia, and is operational in eleven countries<sup>20</sup>. Nespresso currently funds the Program in intervals of at least five years. However, Expocafé anticipates that the procurement practices will continue in some form as long as quality product is in demand.
- **Quality assurance and economic transparency through traceability:** The Program demonstrates 100 per cent product and economic traceability by Nespresso between supplier (intermediary) and producer. Terms clearly dictate 80 per cent as the minimum value of the total transaction to go to the producer, and this is audited by Nespresso. Traceability files are transmitted every four months to Nespresso, but are available real time (within 15 minutes of request) as needed. Economic transparency is a major breakthrough for farmer empowerment in a market that has been controlled for generations by a hand full of mostly private global trading companies, who profit on their ability to buy low and sell high. Measured at the level of the local SME exporter, the traceability systems established for Nespresso are now a major operating asset potentially transferable for trading of other commodities in the future if necessary. The economic traceability requirement is also a barrier to entry for competitors unwilling to be transparent on margins.
- **Pricing:** While the price floor is established by international markets and the capacity for FNC to serve as buyer of last resort, Nespresso's explicit communication that it will pay the highest price in the market (and that it wants to be known for this) should help provide some upward pressure on prices, benefiting farmers overall. In addition, Nespresso's AAA express target to be 30 to 40 per cent above market and at least 10 to 15 per cent above others for the same quality of product represents a direct investment in participating farmers. The generous price premium above others cannot mitigate the global market base price, reduced yields nor higher production costs, but represents an advantage against the alternative of lower or no premium. The CRECE study findings showed 41 per cent higher economic outcomes for the AAA Program participants over the control group<sup>21</sup>: Among the components of economic variables were: yield and net income from production, and included the level of knowledge that the producer has on the market and the access to it, technical use of the inputs, perception of the economic situation of the farm, diseases and pests and percentage of coffee sold as low quality (Ochoa et al, 2013).
- **Provision of training:** In addition to higher prices paid for coffee, the primary investment by Nespresso and its suppliers is in the provision of training to assist farmers in meeting AAA requirements. The INCAE

19 Nestlé Nespresso's most recently published a self-assessment of the AAA Sustainable Quality™ Program carried out for the period 2009-2013. The report establishes the company had sourced 84 per cent of its coffee from AAA Program farmers (up from 47 per cent in 2009), including 30 per cent with Rainforest Alliance certification. The number of participating farmers increased from 26,500 to 62,000 (63,000 by 2015); production from 130,000 to 290,000 hectares, and hired 240 (330 in 2015) agronomists, up from 100 in 2009. It reported that 79.8 per cent were meeting all the AAA criteria, with farmer satisfaction rates of 82.5 per cent and 90 per cent loyalty to the AAA Program were reported. Specific to Colombia, a two-year crop management pilot to increase productivity in the Caldas region in Colombia had resulted in a six to 30 per cent productivity gain over previous years, resulting in higher incomes (Nestlé Nespresso, 2013).

20 Brazil, Colombia, Mexico, Costa Rica, Guatemala, India, Nicaragua, Kenya, Peru, Indonesia, and Ethiopia.

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

study concluded that while farmers focused on sales price as the main driver of profitability, it found the real driver is productivity or yield. This outcome led Nespresso to modify the AAA Program to place more emphasis on technical assistance relating to productivity, as well as, tools to help farmers understand and calculate income. Each farm (and for Expocafé that represents 7000 farmers) must be visited annually, and inspected in accordance with the TASQ™ method<sup>22</sup>. Cluster administrators prepare and submit an annual action plan to be budgeted and agreed with Nespresso's local AAA Program managers, targeting the specific needs of farmers within the cluster (or sub-cluster). A minimum of 65 per cent of program investment, fully refundable, is to be directed towards the time of agronomists or field technicians for implementing the AAA program<sup>23</sup>.

- **Pro-active monitoring and verification of compliance with labour standards, including child labour:** Nestlé's stringent Supplier Code strongly endorses ILO core labour standards, and includes provisions on working time and rest days, wages and benefits, and substantive pro-active requirements on safety and health. The AAA Program's training, follow-up and monitoring of these provisions indicates progress on these indicators, particularly child labour, with no incidences identified on the AAA farms in the past decade. These findings are consistent with overall findings of the independent COSA study of 12 countries which found that certified<sup>24</sup> farmers received more training and practiced valuable avoidance of some negative practices such as child labour (COSA, 2013). Moreover, the CRECE study findings showed higher improved outcomes on social variables for the AAA Program participants over the control group: 22.6 per cent better social conditions, than among non-AAA farms in the control group<sup>25</sup>. Among the components of social indicators to be rated higher among AAA participants were: possession of household assets, number of protective gear items worn by workers, living conditions of the workers, perception of the household's quality of life, and perception of relationships with the employees (Ochoa et al, 2014).
- **Supportive Supplier Management:** Often sustainable procurement practices are criticized for the administrative costs and burdens they place on the SME supplier. In this case, the program is comprehensive in accounting for the costs incurred in implementing the program, and these costs are subsequently negotiated within the purchase price agreed between Nespresso and the SME supplier. To support cash flow requirements, a portion of agreed project implementation costs are paid in advance. A high level engagement by Nespresso management, agronomists and technical experts has been seen to provide significant support to the SME's in their ability to carry out the programs as envisioned by Nespresso. The initiative is also sensitive to duplicating supplier burdens associated with the proliferation of standards by partnering with the Rainforest Alliance as the basis for AAA certification (and helping farmers attain and pay for their accreditation for Rainforest Alliance as well).

## Conclusions – Potential role for ILO

The research and interviews have identified good procurement practices carried out by Nespresso, an individual large buyer, and how the buyer's investment in process and product upgrading at the supplier and farm level is reported to have contributed to social (economic and environmental) upgrading. The company has observed important metrics in the design of the AAA Program. For start, different stakeholders including the SME were involved in the participative planning of the initiative. At the core of the program is the investment in local capacity building of its intermediary supplier, Expocafé (and its shareholders), as well as, in the capacity of local farmers in select clusters whose products are capable of meeting the buyer's standards. A spill-over effect is created by this program as well, in that the practices applied are not just applicable to the buyer's product, but potentially, for supplying other buyers or in the production of other agricultural products, should the farmers

22 See the AAA Shared Commitment Version 1.0, Reference Document 3: The TASQ™ Cycle and Tools for details on the seven step process. Available at [www.nestle-nespresso.com/.../Nespresso%20AAA%20Shared%20Commitment](http://www.nestle-nespresso.com/.../Nespresso%20AAA%20Shared%20Commitment)

23 Nespresso will begin reporting this data, referred to as Real Farmer Income™ in 2016.

24 Certification was not exclusive to the AAA Program, but to any of the leading standards.

25 52.1 per cent better environmental conditions were also reported.



diversify. The practice has demonstrated its capacity to be implemented at large scale and in multiple markets.

The COSA-designed CRECE study, conducted over a three year period, indicates that better outcomes could be attributed to the AAA Program participants than non-participating control groups. When considering the investment that Nespresso has chosen to make by launching and maintaining the AAA Sustainable Quality Program™ it may be very meaningful to consider its existence in comparison to the counterfactual. It is difficult to envision a scenario where it is preferable to not earn a 30-40 per cent premium, particularly when there are no out of pocket expenses. It is also true, that more data over a longer period is needed to provide strong evidence that the AAA Program and price premiums (and similar initiatives) are truly leading to sustained social, economic and environmental upgrading. Endemic structural issues need to be taken into account in considering the future of small holder farming in Colombia: Whether it is sustainable over time against low-cost, large scale producing regions and countries may be beyond the scope of any company initiative.

Companies such as Nespresso and Starbucks, and others such as Fair Trade buyers who are engaged at this level of the market with their producers are demonstrating leadership in an otherwise troubling industry narrative. The AAA Program refers to product upgrading within limitations– many factors of production remain outside the farmers’ control –and, the program does not address the mass market of coffee shipped from Colombia (and other countries). While 40 per cent of all coffee now estimated to be grown under certified sustainable conditions, only 15 per cent is actually sold at premium prices or as sustainable (SSI, 2014). The level of public interest in sustainability remains relatively low and the standard set by the AAA Program should read as a challenge to the industry to do better. Unfortunately, for those concerned with conditions in the coffee market, recent mergers and acquisitions should raise alarm, including the news that a private equity holding company is racing to “control” the coffee market<sup>26</sup>. Further consolidation of buyers generally works against producers. There are numerous global brands and the bulk of procurement is not engaged in comparable practices to those assessed in this study<sup>27</sup>. Not all quality can afford a premium. However, helping consumers and policy-makers distinguish what constitutes good practice may be a starting point.

## Role for the ILO

There are immediate opportunities to contribute to the efforts of companies and other stakeholders engaged in good procurement practices in the coffee sector. ILO has a possible role to play in contributing where it has specialized knowledge, as an advisor to business, policy-makers, and civil society organizations:

- Social protection for farmers – providing information on what frameworks can best be applied to assist aging farmers to retire and transition farms to next generation.
- Youth employment – identifying the terms and working conditions that will attract younger workers to consider farming, and assist policy makers in implementation.
- Working conditions – assisting companies and NGOs in providing proven methodologies for training SMEs in areas such as Occupational Safety and Health, Child Labour, Maternity protection, Working time and other standards.
- COSA identified the need for more training on gender-inclusion and bringing more women into leadership roles in agriculture – ILO has specialized knowledge in this area.

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<sup>26</sup> See JAB’s acquisition of Keurig Green Mountain Inc. <http://www.bloomberg.com/news/articles/2015-12-07/jab-trio-creates-global-coffee-empire-for-billionaire-backers>

<sup>27</sup> Data for leading brands sourced at: <http://www.coffeehabitat.com/2012/01/market-share-update-2012/> [31 January 2015]. For example, Nespresso’s parent company, Nestlé, the world’s single largest buyer is reported to buy only 0.2 per cent of its coffee beans from certified sustainable sources, by comparison to Nespresso’s 84 per cent.



- Trade and employment – assisting host governments in identifying appropriate policies that support job creation and good working conditions in bi-lateral or multi-lateral trade agreements.
- Measuring impact – providing guidance on meaningful social metrics for measuring the success of sustainability standards (public or private).

## Methodology Statement

A case study methodology is adopted in this study to illustrate how the procurement practices of large companies from small and medium enterprises (SMEs) can support the development and growth of these enterprises (SMEs) by improving their market access and increasing their added value. The case was selected for its capacity to meet a significant number of the criteria sought by the ILO, including that the practice is intended for mainstream application (and not a pet project), and on the basis that the practice has been positive in areas of key interest (SME growth, job creation and working conditions). In this case, the researchers had knowledge of region and industry, and access to key informants at the level of the MNE and SME deemed critical to addressing the research terms of reference.

Data collection was conducted between October and December 2015 using multiple methods:

- Archival analysis of external reports in the public domain (literature review, company and stakeholder websites).
- Triangulation of company published data with external data, where possible. While there are numerous references to Nespresso's program, there is only one independent evaluation of the impact of the procurement practice available, and while dependent in part on access to company data, its methodology has been validated by a credible body.
- Semi-structured open-ended interviews with responsible executives at Expocafé (SME); December 4, December 15; and, with Nespresso (MNE), December 21.

This study presents background on the coffee industry in Colombia and a descriptive account on the introduction of the AAA Program into Colombia, its strengths and challenges in implementation, as well as, measured and perceived impacts on SMEs and small holder farmers. It is intended to provide useful insights and is not intended as a critique or endorsement of any of the companies or actors involved.

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