

**Nicaragua Cup of Excellence:
Assessment of impact and opportunity**

ALLIANCE FOR COFFEE EXCELLENCE



Report Background

The attached Executive Summary is an overview of a report created in October 2006 to measure the impact of the Cup of Excellence program in Nicaragua over its first 5 years. The report is based on interviews of more than 75 stakeholders in the Nicaragua Cup of Excellence – including buyers, farmers, exporters, and donors – and analysis of a broad set of data relevant to the program and the specialty coffee industry [See Exhibits 7-8 for list of interviewees]. The Alliance for Coffee Excellence (ACE), the Asociación de Cafes Especiales de Nicaragua (ACEN), and McKinsey & Company prepared this report in partnership. To assure an outside perspective, McKinsey led the collection of information and the development of conclusions. McKinsey provided this assistance on a pro bono basis. For the full report, interested parties should contact ACE.

EXECUTIVE SUMMARY

Over the last five years, Nicaragua has made impressive advances into the specialty coffee market. As a percent of total coffee exports, gourmet coffee grew from approximately 2% in 2001 to 15% in 2005.¹ While many factors contributed to this progress, the Cup of Excellence program (COE) undoubtedly played an important role:

- ¶ First, **the COE has been a motivator for quality improvements** in the country. Producers who participate in the COE spend a significant amount of time thinking about quality and exchanging ideas about quality improvements with other producers. The COE has played a large part in building this focus. Every year, cooperatives and exporters cup approximately 1,500 samples for potential inclusion in the COE and offer farmers feedback on how to improve the coffee. In addition, winners are repeatedly participating in the COE as an opportunity to pursue continuous quality improvement. Not surprisingly, buyers confirmed that the quality of specialty coffee coming out of Nicaragua has significantly improved in the past five years.
- ¶ Second, **the COE has greatly improved the reputation of Nicaraguan specialty coffee.** Eighty-five percent of buyers who either bought or cupped in the COE told us that their opinion of Nicaraguan specialty coffee had improved over the past five years [*Exhibit 1*], leading to increased coffee purchases from Nicaragua [*Exhibit 2*]. In addition, the interest that the COE has generated in Nicaraguan coffees has helped buyers discern the characteristics of coffee from different regions within Nicaragua. Many of the farmers we interviewed say that their region's improved reputation has been an important outcome of the COE.
- ¶ Finally, **the COE has helped to strengthen and deepen the market for specialty coffee in Nicaragua.** The competition creates incentives for buyers and sellers to meet and collaborate to increase the quality of Nicaraguan supply and the level of demand for Nicaragua as an origin. Producers are motivated to participate in the competition because of the quality improvement they gain through the process, the potential to win, and the possibility of building long-term relationships with buyers. The buyers participate for the educational value of the international jury cupping and for the opportunity to bring their customers coffees certified at the highest quality level in the world.

¹ CETREX

As a result of these contributions, **the COE has delivered a strong return on investment to Nicaragua.** The largest quantifiable benefit is the increase in the amount of coffee exported at premium prices. Based only on quantities volunteered to us by buyers and exporters interviewed, we estimate that Nicaragua now exports 35,000 more quintals per year because of specialty buyers brought to Nicaragua by the COE. We estimate that **these additional sales translate to approximately \$1.1 million of incremental profit** that is shared between Nicaraguan producers, cooperatives, and exporters each year [*Exhibit 3*].² Because this estimate includes only incremental exports volunteered to us during interviews, it likely significantly understates the actual benefits from increased sales.

In addition to incremental exports, **the COE also paid an average of \$229,000 per year in premiums directly to winning farmers** [*Exhibit 4*].³ With these premiums, winning farmers have invested in their farms, paid off their debt, and generally improved the lives of their families. Compare these benefits to the cost of the program – \$143,000 per year on average – and it is clear that the return to Nicaragua has been high [*Exhibit 5*]. Indeed, we estimate that **each Nicaragua COE has created benefits approximately nine times greater than the cost of the event** [*Exhibit 6*].

While the COE has generated impressive returns for Nicaragua, there are **opportunities to make the program even more sustainable and effective.** Specifically, we identified three key areas for improvement:

- 1) Most urgently, **due to poor financial planning and a changing funding landscape, the immediate future of the Nicaraguan program is uncertain.** In 2007, the Nicaragua COE stands to lose up to three quarters of the government and NGO funding on which it has depended in past years. ACE has an opportunity to help prevent such loss through development of standard accounting and planning procedures and through more stringent controls on the spending of COE auction proceeds for non-COE items.
- 2) The **direct impact of the COE program remains narrow.** Only 25 to 30 winning farmers receive direct financial benefits each year. And for those farmers who do win, the benefits are short-lived. Almost none are able to form long-term relationships with buyers or to procure price premiums beyond their winning lot. ACE could expand the

² \$1.1 million estimate is based on the assumption that a quintal of coffee exported at specialty prices is worth on average about \$30 more to the producer and exporter than a quintal exported at conventional prices. This order of magnitude assumption was drawn from interviews with Nicaraguan exporters and producers and validated by review of 2003 TechnoServe/McKinsey research into costs of coffee production.

³ Note that all estimates of Nicaragua COE program benefits and costs include only program years 2003 to 2006. The 2002 contest was excluded as budget data was unavailable.

program's relevance by bringing the benefits of the auction to more farmers and by helping farmers to convert a winning coffee into a lasting business relationship.

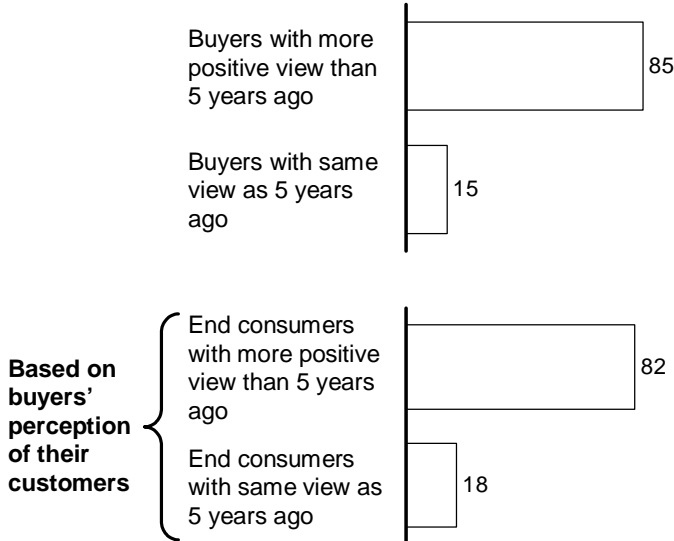
- 3) **ACE needs to increase the number of bidders and their willingness to pay.** Doing so would allow the COE to offer larger premiums to winning producers, move the program closer to self-sustainability, and permit continued expansion to new countries. Low recognition of the COE brand in consuming countries is one important piece of ACE's inability to rapidly grow the bidding base. To build brand recognition, COE needs to undertake a more aggressive strategy to market and sell the program in consuming countries.

Of these three issues, financial control is the most pressing. However, action on all three within the next one to two years is critical for continued COE program success in Nicaragua. The final section of the memo suggests next steps for further investigation and development of a plan of action to address these three issues.

Exhibit 1

THE COE HAS IMPROVED PARTICIPANTS' PERCEPTION OF NICARAGUAN COFFEE AND HAS BUILT NICARAGUA'S REPUTATION WITH CONSUMERS

Survey of "Cup of Excellence" buyers
Percent



"Through my introduction to the coffees in COE, we sell Nicaraguan coffee to our customers direct. We highlight Nicaraguan coffee in our stores . . . without visiting and seeing Nicaragua this would not have happened."

– Leah Warren,
San Francisco Coffee

"My customers would never have tried Nicaraguan without COE."

– Jeff Taylor,
PTs Coffee

"Customers' perceptions have improved because of the high quality COE Nicaraguan coffee they purchased or tried as a result of my COE purchase"

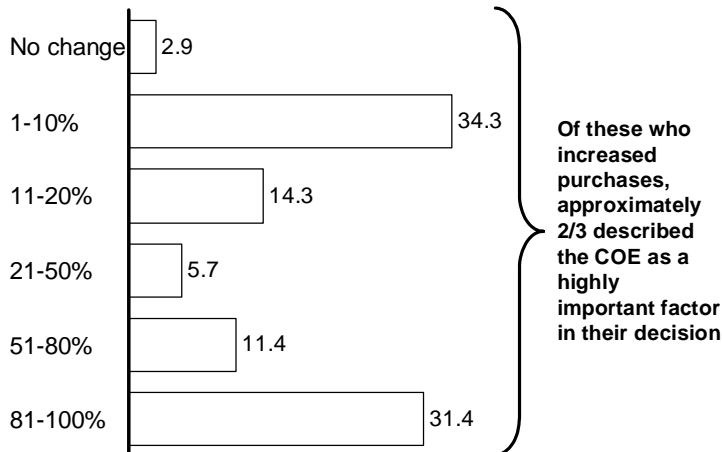
– Bill Swoope,
Coffee Tree Roasters

Exhibit 2

COE BUYERS ARE PURCHASING MORE NICARAGUAN AND THE COE HAS PLAYED A DECISIVE ROLE

Survey of "Cup of Excellence" buyers
Percent

By how much has the volume of coffee that you purchase from Nicaragua increased over the last 5 years?



Of these who increased purchases, approximately 2/3 described the COE as a highly important factor in their decision

"Prior to Cup of Excellence, I didn't buy Nicaraguan coffee. Cup of Excellence has given me access to high-quality Nicaraguan coffee."

– Matt Govoni,
Breaking New Grounds

"I did not buy Nicaraguan coffee before the 2005 COE auction. I plan to continue to buy from Nicaragua."

– Vincent Iatesta,
Caffe Pronto

Exhibit 3

Benefit from incremental exports

COE HAS BROUGHT NEW SPECIALTY EXPORT CUSTOMERS TO NICARAGUA WHICH HAS TRANSLATED TO SUBSTANTIAL BENEFIT FOR PRODUCERS AND EXPORTERS

Sample of buyers introduced to Nicaragua by COE

| Buyer | Annual purchase (quintals) |
|---|----------------------------|
| Nordquist | 15,000 |
| Boyd's | 7,500 |
| Bewley's | 3,500 |
| Solberg & Hansen | 750 |
| Justus | 375 |
| Mercanta | 375 |
| Wataru | 375 |
| Toa | 150 |
| Café Time | 90 |
| San Francisco Coffee | 30 |
| Sample total | 28,145 |
| Estimate of coffee from buyers not in sample | ~7,000 |
| Estimate of total incremental exports due to COE | 35,000 |

Quantification of benefits

- Assuming that every incremental quintal of specialty export creates a profit pool for farmers and exporters of roughly \$30,* then the total incremental exports accrued over the past five years is \$1.1 mm; an annual incremental value of \$210,000

* Estimate based on interviews with producers and exporters

Source: Interviews

Exhibit 4

Premiums to winners

PREMIUMS* GENERATED BY CUP OF EXCELLENCE

\$ Thousands

| | 2003 | 2004 | 2005 | 2006 | Total |
|---------------------------------|------|------|------|------|------------|
| Total premium paid to winners | 188 | 337 | 216 | 173 | 914 |
| Average premium paid to winners | 5.1 | 11.6 | 6.2 | 6.9 | 7.3 |
| # of coffees auctioned | 37 | 29 | 35 | 25 | 126 |
| Max premium paid to winner | 35.2 | 47.9 | 24.8 | 20.1 | |
| Max premium paid to winner | 1.8 | 4.2 | 1.7 | 3.4 | |

* Premium represents difference between the COE net winning bid (\$/lb) and the average net price (\$/lb) for all Nicaraguan coffee exported during that harvest season

Source: Nicaragua Cup of Excellence, CETREX, CSCE

Exhibit 5

Cost of program

ANNUAL PROGRAM COSTS

\$ Thousands

Average annual cost \$143,000

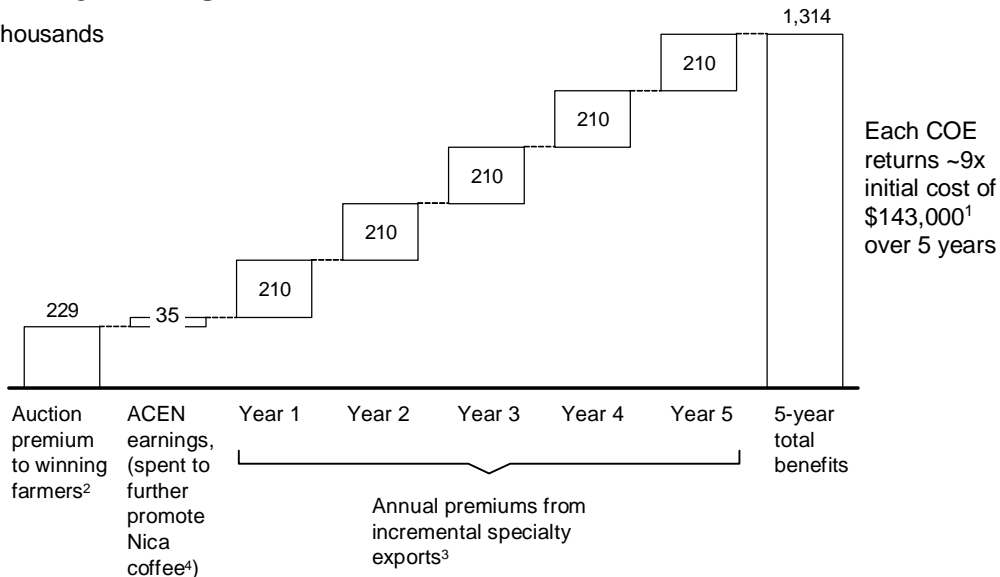
| | Year | | | | Total |
|---|------------|------------|------------|------------|------------|
| | 2003 | 2004 | 2005 | 2006 | |
| Expenses paid by international donors and with in-kind donations | | | | | |
| ACE | 54 | 56 | 48 | 56 | 213 |
| Hotel, meals, and conference rooms | 25 | 20 | 12 | 24 | 80 |
| National manager | 21 | 36 | – | – | 57 |
| Shipping of samples | 10 | 10 | 13 | 14 | 47 |
| Auction/awards ceremonies | 7 | 7 | 11 | 5 | 30 |
| Auditing | 7 | 4 | 5 | 8 | 23 |
| Press and publicity | – | 2 | 6 | 3 | 10 |
| Miscellaneous | 2 | 1 | – | 7 | 9 |
| Promotion to producers | 4 | – | 4 | – | 8 |
| Total | 129 | 136 | 98 | 115 | 479 |
| Expenses paid by ACEN | 17 | 24 | 34 | 16 | 90 |
| Grand total expenses | 146 | 160 | 132 | 130 | 569 |

* Equal to auction proceeds to ACEN less grand total expenses paid by ACEN
 Source: Nicaragua COE records and interviews

Exhibit 6

EACH EVENT RETURNS APPROXIMATELY NINE TIMES COST OVER 5 YEARS

\$ Thousands



¹ See Appendix Exhibit 5

² See Appendix Exhibit 6

³ See Appendix Exhibit 7

⁴ See Appendix Exhibit 8

Source: COE data, team analysis

Exhibit 7

NICARAGUA INTERVIEWS

Winners

- Daniel Canales (1st-2004)
- Norman Canales (12th-2005)
- Gonzalo Castillo (33rd-2003)
- David Ariel Lovo Gutierrez (3rd-2003, 13th-2006)
- Luis Joaquin Lovo Gutierrez (3rd-2003, 13th-2006)
- Flora del Socorro Montenegro (18th-2002, 4th-2004, 22nd-2005)
- Julio Solorzano (5th-2002)
- Mario Torres (8th-2006, 5th-2005)

Participants

- Victor Altamirano
- Guadalupe Castillo
- Jadirra Chaverria Altamirano
- Reynerio Lanzas
- Reynaldo Lopez
- Pastor Lovo
- Justo Pastor Montesinos
- Juan Ramon Dia
- Teofilo Rodriguez
- Gustavo Adolfo Talavera Herrera

Non-Participants

- Norman Antonio Ortez Detran
- Javier Castillo
- Maxima Talavera

Exporters/Co-op leaders

- Erick Baca Salazar (BENCAFE)
- Gonzalo Castillo (Atlantic)
- Javier Castillo (SOPPEXCA)
- Reynaldo Lopez (PRODECOOP)
- Tecnico Soppexca

Exhibit 8

BUYER INTERVIEWS

| In-person interviews | |
|--|--|
| Mike Ebert Geoff Watts | Coffee Masters Intelligentsia |
| Phone interviews | |
| Beth Ann Casperson Paul O'Toole Mike Riley Soren Sylvest | Equal Exchange Bewley's Betty's and Taylor's Estate Coffee |
| On-line survey respondents | |
| Morten Aarnæs Phil Anacker Masahisa Asano Jennifer Babcock Phil Beattie Lindsey Bolger Aleco Chigounis Dick de kock Yuzuru FUJII Matt Govoni Andreas Hertzberg Giles Hilton Pao-Lin Hsu Stephen Hurst Vincent Iatesta Yuko Itoi Glenn Junkert Norman Killmon Andrew Knight Stephen Leighton John Mahoney Scott Merle Kenkichi Nishio Tim Owen Michael Perz Mike Piccolo Vincent Schlueter Bill Swoope Jeff Taylor Ron Vaccarello Leah Warren Eijiy Yamada Lay Yong Tan | Kaffebrenneriet Flying Goat Coffee Toa Coffee Zoka Coffee Roaster & Tea Company Dillanos Coffee Roasters Green Mountain Coffee Roasters Groundwork Coffee The Coffee Company Asahi Coffee Breaking New Grounds Solberg & Hansen AS Whittard of Chelsea Orsir Coffee Company Mercanta The Coffee Hunters Caffe Pronto Time's Club Hunter Bay Coffee Roasters The Roasterie Andronica's Coffee Has Bean Coffee Atomic Café Batdorf & Bronson Wataru & Co Sweet Maria's Coffee Timothy's World Coffee 49th Parallel Roasters Inc. Schlüter & Maack Coffee Tree Roasters PTs Coffee Crescent Moon Coffee & Tea San Francisco Coffee Yamada Coffee Just Us! Coffee Roasters Co-op Limited |