Assessing Social Return: (C)
Pachamama Coffee Co-op

Pachamama Coffee Co-op was founded in 2001 with a view to bring fair trade and organic opportunities to small-scale coffee farmers who were being impoverished by the economics of low margin coffee production. A number of fair trade initiatives were already in operation, improving prices for small-scale producers groups in return for guaranteed supply.

Pachamama's founder, Nicola Brown, was looking to take this concept one stage further by using sophisticated internet technology to remove some stages within the supply chain and the Co-ops distribution system. With a fair trade ethos that centred upon profit sharing with producer groups, Pachamama's vision included community development and the promotion of environmentally friendly practices.

Brown was convinced of the financial robustness of the Pachamama proposition in its own right and was committed to achieving the Co-op's vision of wider social impact. How should he communicate the value of the business to the socially oriented investor that he was seeking?

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The Pachamama Coffee Co-operative was set up in 2001 as a not for profit co-operative based in Davis, California. Its owners would be a large number of small-scale coffee farmers from around the world, represented by a smaller number of producer groups. Pachamama expected to have 10 producer group members representing over 10,000 small-scale coffee farmers in the developing world at start-up.

The Co-op had been established to market its members' organic coffee directly to a carefully targeted segment of end consumers and select wholesale customers. One of Pachamama's primary distribution channels would be an e-commerce enabled Web site. In 2000, total North American retails sales of sustainable coffees (defined as either organic, shade-grown or fair trade) were roughly $152 million. Worldwide sales of 'fair trade' coffee were over $300 million in 2001, mostly in Europe.

The average market price for green coffee during 2001 was less than $0.50 per pound. This price did not allow most small-scale coffee farmers to recover their costs of production and many were being forced into debt or were abandoning farming altogether. While the market price for green coffee was at an all-time low, retail prices of roasted speciality coffees were largely unchanged and commanded over $10.00 in the US market.

Various "fair-trade" initiatives looked to disinter mediate local agents and exporters, through purchase of coffee direct from producers at an agreed price (**see Exhibit 2**). Pachamama looked to take these initiatives one stage further by using innovative web-based ordering systems to disinter mediate importers, roasters, distributors and retailers, thus capture greater margins on behalf of small-scale coffee farmers (**see Exhibit 3**). Pachamama would pay $1.71 per pound for its coffee, well above the normal fair trade rate, reflecting its ability to cut out some distributor margin. Its prices promised to be competitive to consumers and Pachamama believed that it would not end up cannibalising existing fair trade initiatives due to the growth of the fair trade market generally, and the Co-op's focus on specific wholesale and retail buyer profiles for market entry.

Initially, Pachamama would look to target sales to the wholesale market in the form of university cafes. After five years, it was forecast that 30 cafes would be ordering 1,000 lbs of coffee per month at $7.03 per lb. Pachamama's web site would also enable it to target the end user market, with consumers ordering directly from the site and having their orders shipped to them. The retail market was projected to account for a smaller but increasing proportion of revenue (22.7% during Year 5) with consumers forecast to pay $14.58 per lb (including delivery).

In addition to paying a fair trade price for its members' green coffee, all of Pachamama's profits would belong to the small-scale coffee farmers who owned and controlled the Co-Op. Pachamama's articles required that after retaining a reasonable amount of net earnings as reserves, allocating 1-5% of earnings to an educational fund, and paying any preferred stock dividend, all earnings would be assigned in the form of patronage refunds and or retains to members. In this way, Pachamama members strove to increase the income levels of thousands of small-scale farmers, which were estimated at $600 a year.

Community Development

These profits would also help fund social investments undertaken by Pachamama producer group-members in their own communities, i.e. the formation of micro finance programs, the construction of health centres and funding for educational scholarships. In addition, the distribution of net earnings to members would provide significant incentives for small-scale coffee farmers to transition from conventional to organic production in order to join the Co-op.

Among other things, Pachamama's approach would have a positive impact on the environment and support the conservation of small-scale coffee farms for future generations. The bulk of the social value created would come from this combination of raising the income of individuals, encouraging the funding of social projects in their communities and stimulating environmentally positive production.

Costs of capital

Pachamama expected to receive capital from investors based in the developed world as well as from producer groups in the developing world. From the way the Co-op was structured, it was assumed that no long-term debt would be carried. The costs of capital of the producer groups were likely to be higher than that obtained from investors in the developed world (25.6% compared to 17.8% respectively). However, the proportion of capital derived from producer groups was likely to increase steadily (see **Exhibit 2**).

At this point, he had letters of intent from two producer groups, representing a member commitment of $5,000. These funds would be transferred once $50,000 of external financing was committed. To date, Nicolas and his team had committed the start-up capital required to develop the business plan 3 and enable the web site.

Human Capital Development

Pachamama's policy of paying out dividends to members was a key factor in developing human capital. This increase in income would contribute to helping small-scale farmers to cover their costs of production, feed their families and keep their children in school.

One of Pachamama's primary objectives was to increase the understanding of coffee consumers in the developed world of the realities experienced by the small-scale producers of their coffee. This heightened level of understanding was expected to contribute to additional community development via increased sales.

While consumers were usually unaware of how any particular purchase might benefit small-scale coffee farmers, most consumers prepared to pay a fair trade premium for their coffee did have a notion that small-scale farmers could benefit within a co-operative. Market research among speciality coffee consumers revealed that 50% of respondents would pay $1.00 or more per pound of fair trade coffee. Pachamama assumed that the other 50% would not be prepared to pay any sort of premium, therefore estimated that fair trade coffee would be able to command a $0.50 premium on average.

To a certain extent, the level of fair trade premium in the marketplace was an indication of the value that coffee consumers placed on supporting the community of small-scale coffee farmers.

Environmental value

The other main area where Pachamama hoped to create social value was in encouraging positive environmental practices. 100% of Pachamama coffee would be organic. Switching costs to organic production were very high, often prohibitive for farmers without additional resources at their disposal. The price premium charged would be a financial incentive for small-scale farmers to continue and expand their production of organic coffee. It was also an incentive for producers of conventional coffee to transition to organic production and ideally, a transition fund would be created to support farmers switching from conventional to organic production. Finally, a portion of the returns from organic production received by Pachamama's members would be used to run workshops on organic production for members and potential co-op members.

A number of producer organisations had been able to extract a premium for organic coffee over the non-organic "fair trade price". On average this premium was 12% over the regular producer sale price although the amount of this premium that was passed along by members of the coffee value chain to end consumers might be variable. Moreover, how much of it that could be attributable to consumers' wishes to impact the environment in a positive way was unclear. Datamonitor identified the key factors driving the purchase of organic agricultural products as being:

- Concern for the environment
- General health and well-being awareness
- Fear of genetically modified food and other food scares
- Government support (i.e. subsidies)
- Retailer support (i.e. promotions)

While the overall coffee market in the US remained flat, consumers were increasingly choosing to purchase value-added coffees, which was increasing the overall value of the market. According to the Speciality Coffee Association of America: 'Future growth for the U.S. coffee industry will be directly related to how effective the speciality coffee segment becomes in educating consumers about the value added nature of the coffee beans and beverages now available'.

Pachamama Coffee Co-op was seeking $300,000 for start-up in a market that had clear growth potential for producers and their investors. As Nicolas prepared his pitch for the socially oriented investor circuit, he deliberated on the many factors that could be calculated: environmental, organic, human capital and community development. Which ones to exclude? Which to highlight and promote?

Exhibits

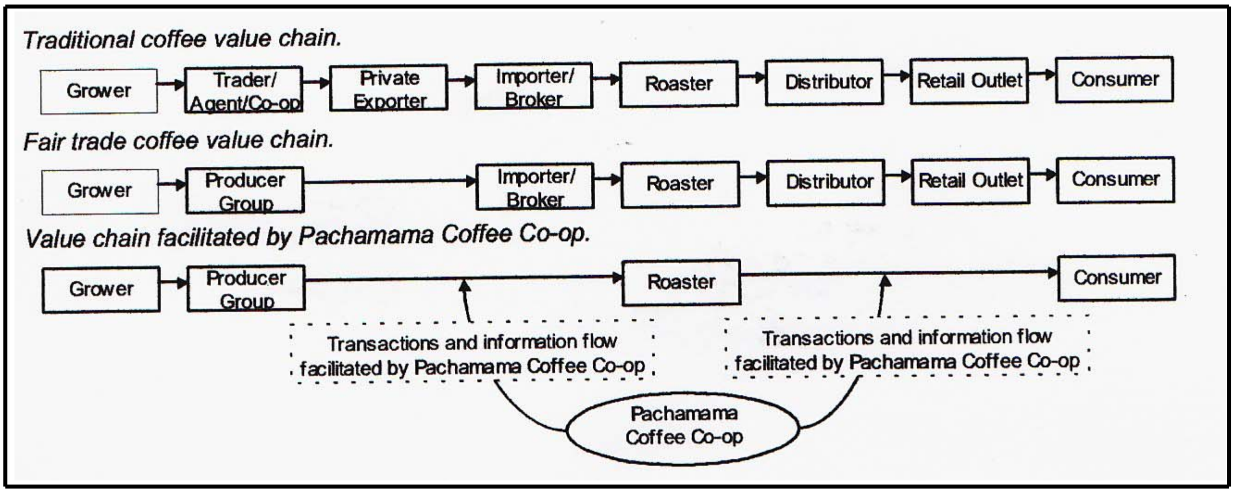
1. Start-Up Requirements

Website & production technology	$36,000
Personnel	$ 87,500
Marketing, Promotion & Operating	$50,290
Start-up SG&A expense	**$173, 790**
Start-up inventory	$ 47,219
Additional cash reserves required	$ 76,991
Total start-up funding	**$300,000**

2. Minimum fair trade coffee prices

Type of coffee	**Regular**		**Certified organic**	
	Central America, Mexico, Africa	South America, Caribbean Area	Central America, Mexico, Africa	South America, Caribbean Area
Washed arabica	$1.26	$1.24	$1.41	$1.39

3. Value chain facilitated by Pachamama Co-op



4. Revenue Mix - Retail sales as % of total

Yr 1 (after launch)	**Yr 2**	**Yr 3**	**Yr 4**	**Yr 5**
17.4%	**12.7%**	**12.9%**	**14.6%**	**19.4%**

5. Income Statement (pro forma)

$	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Revenues					
Sales	364,799	885,601	1,560,569	2,441,258	3,275,502
COGS	207,775	498,337	861,104	1,343,338	1,797,228
Gross profit	157,024	387,264	699,464	1,097,919	1,478,274
Expenses					
SG & A	264,283	495,857	549,742	726,402	970,168
Depreciation	-	-	-	-	-
Operating profit	(107,259)	(108,592)	149,722	371,517	508,106
Member dividends	-	-	88,673	279,277	396,368
Tax	-	-	20,757	31,362	37,991
Net income	(107,259)	(108,592)	40,292	60,878	73,747
Sales volume (lbs)	53,098	128,464	219,626	330,273	418,672

6. Proportion of capital investment in Pachamama projects

	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Proportion of investment from “developed world”	87.8%	85.7%	81.8%	80.0%	60.8%
Proportion of investment from Producer groups	12.2%	14.3%	18.2%	20.0%	39.2%