Photo courtesy of Costa Oro International

VALUING OUR MID-CHAIN PARTNERS

How Cost Pressures Impact Importers and Logistics Providers in the U.S.

BY ANDI TRINDLE MERSCH

The coffee supply chain is long and complex. Many hands and hearts are involved in coffee's long journey from a farmer's tree to a consumer's cup. Even in the most "direct" transactions, truckers, ocean freight carriers, customs brokers, dockworkers and others must be involved. Yet "middlemen" often are disparaged in our industry. With compassionate and well-placed intentions toward protecting and sustaining producers, many have proposed eliminating these middle players, implying they are, at best, extraneous and, at worst, serve only to create income for themselves at the expense of income to producers.

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At one point, many compassionate participants in direct trade, relationship buying and selling, and other variations of the traditional supply chain had a penchant for devaluing and even dismissing anyone between the farmer and the roaster. Fortunately, with time and experience, the pendulum is swinging back, and many now acknowledge that these in-between participants—importers and third-party warehouses among them—are at least necessary. Some even acknowledge their value and will pay for it appropriately. Nonetheless, a steady pressure remains on these middle players to keep their overall fees tight, and this price compression has been compounded by considerable operational cost increases in the past 15 to 20 years.

Green coffee warehouse Costa Oro International makes a delivery to Water Avenue Coffee. Both companies are based in Portland, Oregon.
Photo courtesy of Costa Oro International

Some might find it impertinent to even open this dialogue, given that farmers and other partners at origin also have experienced cost increases while remaining fiscally undervalued and disadvantaged. However, sustainability of our origin-side partners relies on sustainability throughout the supply chain. As Carl Walker, president of Houston-based Walker Coffee Trading, says, "We need everybody to do well or we're going to have a problem."

This article, with its selective focus on two segments of the supply chain in a single market, is not intended to portray the challenges of middle players throughout the entire seed-to-cup

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chain. Rather, it is intended only to provoke a more comprehensive discussion of financial sustainability throughout our industry.

Downstream Cost Pressures

Industry demands and global business requirements have changed considerably over the past 15 to 20-plus years, often leading to increased operational costs. Within the specialty coffee industry, successful movements such as transparent trade, microlots and sustainability initiatives have driven substantial cost increases. Simultaneously, changes and volatility in the broader business landscape—such as increased government regulations, wage and rent increases, and commodity pricing—have done the same.

Throughout the supply chain, from origin all the way through to the barista, many people are impacted by these industry-specific and non-industry-specific cost drivers. Certainly, the U.S.-based importers and third-party warehouses (also referred to as third-party logistics providers, or 3PLs) spotlighted in this article report noticeable financial impacts from these and other changes that have emerged in recent decades.

Cost Impacts of Specialty Coffee Movements

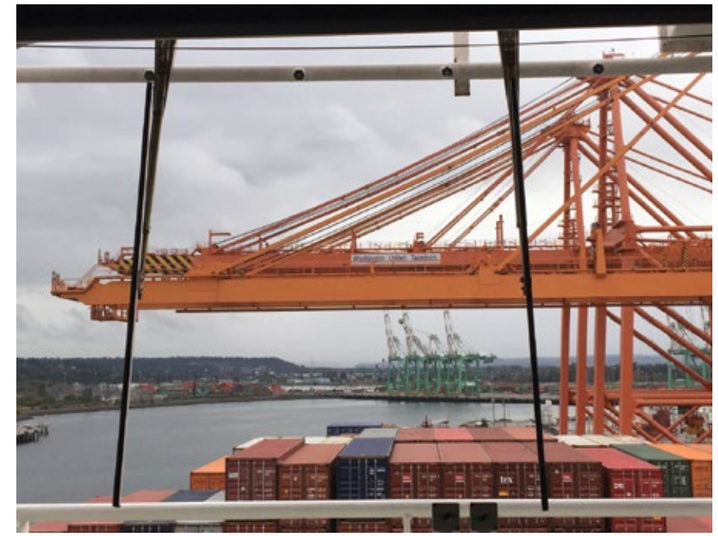
Veteran U.S.-based importers such as Walker; Alan Nietlisbach, senior vice president of Olam Specialty Coffee, based in Healdsburg, California; and Guy Burdett, president of Houston-based InterAmerican Coffee, agree that the greater appreciation for top-quality coffee that has driven microlot and transparent business models, along with a generally more educated customer base, have made a positive impact throughout the supply chain.

"It is great to see the prices that these coffees sell for, and to see farmers better compensated overall," says Burdett.

Similarly, sustainability initiatives, including third-party certifications, often motivate and successfully drive better fiscal consideration for farmers and origin-side partners.

At the same time, Nietlisbach, Burdett and Walker all note a number of cost implications that stem directly from these industry movements. A generally more engaged and knowledgeable customer base, along with microlots, transparent and direct business


Seasonal or otherwise fluctuating storage needs put financial pressure on warehouse owners, as they have to maintain adequate space throughout the year. | *Photo courtesy of East Bay Logistics*


A shipment of green coffee docks at the Port of Tacoma in Washington.
Photo courtesy of Costa Oro International

models, and certification-specific activities all drive an "increase in overhead for more personnel time," says Walker, as well as higher per-pound transactional costs in many cases.

"The game hasn't changed exactly," says Nietlisbach, "but the scope of the game has expanded."

Without hesitation, Nietlisbach, Walker and Burdett all say they enjoy working with a more knowledgeable and quality-driven customer base. This vastly expanded level of buyer knowledge also has helped roasters understand "that there is value to the in-between players in providing services and protection," Walker adds.

However, as Nietlisbach says, "Basic relationship building is now more costly."

Walker notes that more time is required "to collect and distribute the detailed information that roasters now want to see," such as cupping notes, photos, descriptive summaries and more. Additionally, today versus 20 years ago, more roasting operations employ well-trained cuppers to evaluate multiple options for each lot purchased—whether that lot is one or 300 bags—and these cuppers all are matching coffees to their companies' own unique preferences.

Good importers, seeking to add value for these sophisticated buyers, now spend additional time cupping specifically to calibrate with individual buyers. Beyond time devoted to calibration cupping, each sample has a noticeable cost. Beginning with a $20 to $25 charge on average to draw any sample from a 3PL, there are also courier charges, labeling and packaging supply expenses, and staff time to pack and distribute samples. In a microlot scenario, with a single buyer purchasing a five-bag lot and requiring an arrival sample, an importer would need to add 3 to 4 cents per pound just to cover the cost of the sample draw; other shipping expenses and staff time would add more than that.

From the warehousing perspective, Joe Paris of Paris Brothers in Kansas City, Missouri, mentions higher costs for maintaining climate controlled warehousing, which in his climate is essential for preserving the integrity of the exceptionally high-quality coffees that are the norm for many roasters these days.

In addition to higher costs related to meeting contemporary buyers' expanded expectations, transactional costs generally have increased on an average per-pound basis with the noticeable shift into transparent purchasing practices, and certified

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and microlot coffees. Associated costs of certification programs such as Fair Trade USA, Fairtrade International, Rainforest Alliance and the USDA's National Organic Program (NOP) hit both importers and 3PLs. Importers generally can charge roasters transparently for fees paid to certification agencies, but these programs also require significantly more staff time for reporting and managing audits, Walker notes. These processing costs are now simply part of the cost of doing business for specialty coffee importers and 3PLs. The trend toward in-house sustainability initiatives, whereby roasters develop their own transparently minded sourcing criteria and require suppliers along the entire supply chain to collect and track data—something my own company, Philz Coffee, has implemented—often consume even more staff time that may or may not be accounted for adequately in margins.

Similarly, microlots in particular—which, for the purpose of this article we will define as a lot of less than 50 bags—have much higher transactional costs and require more staff time for processing than more traditional full-lot loads. While a celebration of quality at the highest level is a boon to the industry in many ways (think better pricing for producers, and consumers willing to pay more for it), processing these small lots requires "complex transactions," says Burdett, "and there is an increased workload that results."

Consider what it takes to include five to even 20 or more separate purchases in a single container, versus one purchase for the same approximately 40,000 pounds total. Each lot generally requires a separate contract, often with separate terms, separate sellers, and sometimes even separate bills of lading. Burdett asserts that these increased transaction costs can be minimized to just a few cents per pound with a well-thought-out business structure; however, "if you buy quantities of less than 10 bags from a single farmer," he says, "you can start adding 10 cents to 20 cents per pound or more."

Additionally, costs are only minimized to this level if there is other coffee available to consolidate and fill a container. If not, costs will increase significantly.

According to Walker, "Importing from FOB seaport to in-store USA warehouse ranges from 7 to 15 cents per pound in the vast majority of cases," based on a full container load. (The range reflects variances in shipping distances from different origins.)

To look at one example, a container from Central America to the West Coast of the United States might cost $2,600 for ocean freight, customs, insurance, inland logistics and inbound warehousing fees, which equates to 7 cents per pound if shipping a common full-box load of roughly 38,000 pounds (250 69-kilogram bags). The same total costs exist even if one is shipping half as much coffee, which then equates to 14 cents per pound. In the worst-case scenario, small lots might end up being air freighted at a whopping $1 to $2 per pound.

As with certification fees, importers (and warehouses, too) generally can charge transparently for the additional transactional costs of processing microlots. However, the staff time required for paperwork typically is simply rolled into the cost of doing business. Additionally, in order to keep the per-pound billable cost down by avoiding shipping less-than-full container loads, importers sometimes spend an inordinate amount of time scouring for other roasters and producers to consolidate their small lots and, of course, more small lots and different sellers and buyers equals more paperwork. Furthermore, microlot and other high-value coffees can bring additional risk to importers as roasters may be more likely to reject these coffees for even minor (and typical) quality degradation that occurs between origin-side processing and domestic arrival.

Despite the bottom-line impact of small-lot management, all of the downstream supply chain players interviewed for this article support the movement unreservedly, and consider it their job to deliver these services to their buyers.

As Janet Colley Morse, vice president of Dupuy Storage & Forwarding in New Orleans, says, "Handling small amounts of coffee is more demanding on us, but it is a growing part of the coffee business, and we value being a part of that growth."

Fortunately, while transparent business practices—which have grown alongside microlots and certifications—likewise demand liberal time for data collection and management, transparency also has "forced dialogue," Nietlisbach notes, providing a forum for importers and roasters to "talk openly about services provided and margins wanted."

Third-party logistics providers such as Dupuy and East Bay Logistics, based in Hayward, California, also generally find transparency requirements helpful as a means of engaging their customers in important dialogue around costs and margins. However, as Arianna Hartstrom, founder of Costa Oro International, based in Portland, Oregon, mentions, "Green coffee warehousing is highly competitive and standardized. Increases in billing rates are infrequent and must be presented to our partners with ample notice." Importers face a similar highly competitive and standardized pricing landscape.

Adding to importer cost pressures in a highly competitive field is a recent industry trend of larger global roasters seeking vastly extended payment terms—from a norm of 15 to 30 days post-release to upward of 120 days in some cases. Part of an importer's traditional value lies in providing financing for roasters, as most small to midsize roasters don't have cash flow to pay for green beans often more than 60 days before arrival into their plant for roasting and distribution.

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Warehouses experience cost pressures as rents rise and viable space for warehousing becomes increasingly scarce in many cities. | *Photo courtesy of Costa Oro International*

Burdett reports that since importers pay for coffee when it is put on a boat, given transit times and time in a domestic warehouse, they "often finance coffee for 60, 90 or even 120 days prior to releasing to a roaster. Then payment terms extended to the roaster following release add another 30 or 60 days, so it is not uncommon for us to finance coffee for 180 days on a normal transaction."

Importers are prepared (and financed) for this kind of cash outlay and recognize it as part of their continued value, but the extension into 210 or more days on large-value invoices creates extraordinary risk. Walker points out the risk can be mitigated through a credit insurance policy, but this adds to expenses.

Cost Pressures From the Greater Business Landscape

In addition to cost-driving industry movements—of which we have covered only a few of many—the broader business landscape of recent decades also has driven a number of cost increases throughout the supply chain. Wages, rent, food safety considerations and port procedures all impact the market in the United States in particular.

The monumental Food Safety Modernization Act (FSMA), administered by the U.S. Food and Drug Administration (FDA), and a general drive from consumers, roasters and the government toward food safety and rigorous quality control programs generate new and increasing costs.

According to John Visbal, president of East Bay Logistics, "Paperwork is really the big issue here." As with microlot- and certification-related time expenditures, these types of cost-of-doing-business expenses often are hidden and harder to explain adequately to customers.

Furthermore, many warehouses, including Continental Terminals, headquartered in Jersey City, New Jersey, have undertaken at least minor if not substantive facility upgrades to

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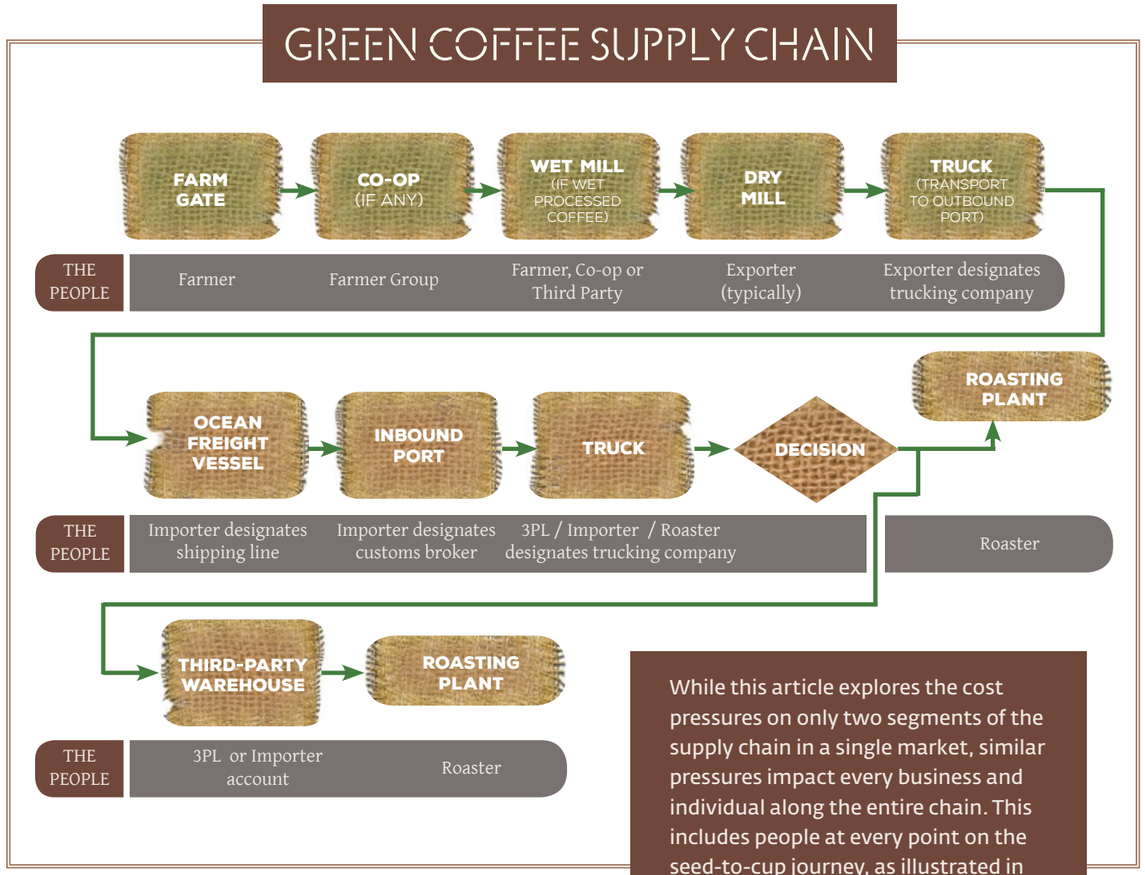
A warehouse worker pulls a sample of green coffee at Costa Oro International. | *Photo courtesy of Costa Oro International*



While this article explores the cost pressures on only two segments of the supply chain in a single market, similar pressures impact every business and individual along the entire chain. This includes people at every point on the seed-to-cup journey, as illustrated in this simplified flow chart.

meet compliance standards for product exposure issues—upgrades such as modifying overhead lighting fixtures, increasing pest-control management and other food-safety-related best practices and requirements.

Paris says he doesn't mind the investment in better storage conditions and sees it as part of the critical value 3PLs provide to the supply chain, but he and others do note that they ultimately have to find a way to cover these costs for long-term sustainability. Colley-Morse optimistically believes that "keeping our facilities and services up to date and in compliance will actually help us become more valuable to our customers and, thus, more profitable in the end."

While noticeable, the costs of compliance with food safety regulations and certification programs are relatively manageable, especially in comparison to far bigger concerns over increasing labor and rent costs. Visbal and Paris both cite wage increases among their top two growing costs, and all the importers interviewed mention rising labor rates as a concern. For Paris, labor costs have risen steadily over the years as his company maintains a commitment to its long-term employees. With warehouses located in California, Visbal navigates an extraordinarily high cost of living and additionally reports that "trained labor is tight, and there's a corresponding upward pressure on wages."

Visbal also struggles with balancing his labor needs efficiently between off-peak and peak storage seasons. There is a dramatic shift in roaster and importer off-site storage needs dictated by seasonal fluctuations, he notes, and importer and roaster forecasting that might help 3PLs plan for these fluctuations often is inaccurate.

This shifting and frequently unpredictable need for external storage not only inhibits a 3PL's ability to control labor costs, it also intensifies the already significant problem of space and rent costs. As a general rule, 3PLs "must go long on space and anticipate needs of roasters," Visbal says, noting that there is especially high pressure in the California real estate market.

"The amount of available space for [warehousing] is going away as developers want high-income-generating use of their space," he adds, "so cost for the limited space remaining for warehousing has become very high."

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Increasing labor costs are a major concern for importers and third-party logistics providers. With warehouses in California, East Bay Logistics President John Visbal notes that "trained labor is tight, and there's a corresponding upward pressure on wages."
Photos courtesy of East Bay Logistics

Hartstrom echoes this challenge, saying, "Over the last decade, costs have increased due to unpredictability in the demand for coffee storage, leading to shorter-term warehouse space commitments, which inevitably leads to higher costs."

Fortunately, like importers, most of the 3PLs interviewed believe the increasingly transparent specialty coffee business model generally allows them to share concerns over rising rent and labor expenditures in order to justify what Colley-Morse deems as "sometimes necessary rate increases to cover our increasing costs."

Other increasing expenses—such as higher costs for processing increasingly common payments by credit card, inefficiencies at port terminals that result in demurrage charges, and higher trucking costs due to extended wait times, for example—remain relatively hidden, and many clients don't recognize that they exist.

Embracing Transparency

As a first step toward ensuring that the intricate and lengthy specialty coffee supply chain remains sustainable, we need to look closely at the roles and challenges of players both upstream and downstream from wherever each of us falls in the chain. Of course, as noted in the chart on page 64, there are many more players with many more challenges and contributions than touched upon in this article. The practice of transparency may have grown in our industry predominantly to support growers, but it's a model that benefits us all.

As Visbal says, "If you talk to someone transparently, it can work." While some customers continue to push back on pricing, he notes, "most customers do listen and accommodate and will adjust."

Walker echoes this sentiment, adding, "What is necessary is trust, relationship and great communication. This can be established with an importer. We don't bite—or most of us, at least!"

ANDI TRINDLE MERSCH *has a varied background within her career in the specialty coffee industry, which began behind the espresso bar in 1989 and, since then, includes cupping, training, consulting, green coffee trading, roast quality control, sales, writing and marketing. Mersch currently serves as director of coffee at Philz Coffee in San Francisco. She was elected to the Roasters Guild Executive Council for a two-year term in March 2015, and she continues to volunteer with the Specialty Coffee Association of America (SCAA) developing coffee business curriculum. She is a past board member of the SCAA and the International Women's Coffee Alliance.*