The Green Coffee Purchasing Policies of Italian Roasters:

Case Findings

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Vedete quanto poco ci vuole a rendere felice un uomo:
una tazzina di caffè presa tranquillamente

See how easy it can be to make a man happy: a
nice cup of coffee does it all

- Edoardo De Filippo (*These Ghosts*, Act II)

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Summary

This study is aimed at understanding the determinants of roasters' purchasing policies and how roasters' competitive strategies affect their purchasing policies. The study provides specific insights into, and comparison between, Italian coffee roasters. The research methodology is qualitative and ethnographic, and it utilises multiple cases, thus reflecting the exploratory approach to theory-building. Interpretation is made first through individual case analysis in order to identify important themes, clusters, and patterns in the research data, and secondly through cross-case analysis. By integrating different perspectives, the nature of the purchasing polices is analyzed. Coffee transactions are shown to be surrounded by extreme uncertainty. This influences the choice of the purchasing channels, which also derives from the firm's competitive strategy. Asset specificity, which underlies different levels of vertical integration, is likewise revealed to be dependent on the competitive strategy chosen. The social dimensions of the transaction are shown to be central to explaining control and coordination in trader-roaster relations and even more in the exporter-roaster interface. A process model that links uncertainty, relation with supplier, vertical integration and the effect of competitive strategy is proposed. Finally, recommendations for different stakeholders, including policy makers, are provided.

Key words: New Institutional Economics, Coffee, Relational Contracting, Network, Purchasing strategies, Italy

JLE Classification: L14

1. INTRODUCTION

Great changes have occurred in the balance of power of the coffee supply chain. Specifically, roasters have increased their influence on the other actors and particularly on international traders as a result of oversupply, market concentration, increased flexibility in blending and, largely, through the implementation of supplier-managed inventory[1] systems (Ponte, 2002).

This paper analyzes which are the determinants of roasters' purchasing policies and how roasters' competitive strategies affect their purchasing polices. Due to financial and time constrains only cases in the Italian market will be analyzed.

[1] It is the mirror image of just-in-time management systems, whereby the roaster delegates to international traders the procurement and stocking of green coffee from different sources, to match a supply schedule.

2. CONCEPTUAL FRAMEWORK

The nature of the relations between two parties involved in a transaction (for instance, the roaster and its suppliers) can be analyzed from very different, and contrasting, theoretical perspectives.

2.1. NEW INSTITUTIONAL ECONOMICS

The traditional transaction cost approach can be very useful, as it is an interdisciplinary undertaking of New Institutional Economics (NIE) that joins economics with aspects of organization theory and overlaps widely with contract law (Williamson, 1979). Williamson's analysis (1985) starts from behavioural assumptions of human nature with reference to limited rationality and opportunism. The first recognizes limits on cognitive competence. The second "refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse" (Williamson, 1985: p47). Opportunism is permitted by asymmetry of information, whereby one party has information and the other party does not. In addition, according to Williamson (1985), three dimensions influence the rational economic reasons for organizing transactions in a specific way: frequency, uncertainty, and asset specificity. While the first two concepts are quite obvious, the third one deserves some clarification. Asset specificity refers to the degree to which an asset can be redeployed to alternative uses and by alternative users without sacrificing its productive value (Williamson, 1991). Six main distinctions in asset specificity have been made: 1) physical asset specificity, such as specialized equipment that is required to produce a component; 2) site specificity, as successive stations are located very close to each other so as to economize on inventory and transportation expenses; 3) human-asset specificity that arises through training and learning by doing; 4) brand name capital; 5) dedicated assets, which are discrete investments in general purpose plants that are made at the behest of a specific customer; and 6) temporal specificity, which is similar to technological non-separability and can be thought of as a type of site specificity in which timely responsiveness by on-site human assets is essential (Masten et al, 1991 cited by Williamson, 1991). Asset specificity, especially in the first five forms, is important because it "creates bilateral dependency and poses added contracting hazards" (Williamson, 1991: p282).

The degree of uncertainty, frequency and asset specificity influence the organizational form that is most likely to take place: spot market, vertical integration and hybrid forms. The spot market becomes less attractive as the degree of uncertainty surrounding a transaction increases, as the frequency of transaction rises, and as greater investments are made in specific assets. When the risks associated with uncertainty, asset specificity and frequency become too high, transactions are absorbed within the firm and vertical integration takes place. Between spot market and vertical integration are a range of bilateral contracts and hybrid forms that arise to cope with different levels of uncertainty, frequency and asset specificity (Williamson, 1985).

In the end, the different kinds of contracts that Williamson explains have the purpose of reducing the cost of transacting, which, according to North (1990: p27), “consist of the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements. These measurement and enforcement costs are the source of social, political and economic institutions”. In a world of perfect enforcement there would be a neutral third party that, impartially, evaluates disputes and awards compensation to the party injured as a result of contract violation. In this world opportunism would never pay, but such a world has not yet come, as the cost of measurement very often makes it difficult to determine whether a contract has been breached and by whom (North, 1987).

2.2. RELATIONAL CONTRACTING AND NETWORK STRUCTURES

A growing number of empirical studies of a variety of hybrid arrangements, however, has challenged the cost-based view implicit in the transaction cost approach whereby cost-minimization is the dominant control mechanism of hybrid organizational forms. Alternative exchange arrangements have taken different names. Macaulay (1963) talks about relational contracting to explain why non-contractual practices are so common. The author emphasizes that firms draw on different policies to protect themselves from opportunism and default. Consequently, contracts and contract law are often unnecessary because there are many effective non-legal sanctions: buyers can withhold part of their payments until sellers have performed to their satisfaction and sellers hope for repeat orders and one gets few of these from unhappy customers. Preservation of reputation is clearly essential. Not only do the parties in a given exchange want to deal which each other again, they also want to deal with other business units in the future, and the way one behaves in a particular transaction, or series of transactions, will colour one’s general business reputation. Blacklisting can be formal or informal, and sellers who do not satisfy their customers become the subject of discussion in gossip exchanged among the sector’s practitioners. Personal relationships across the boundaries of organizations very often are found to play an essential role. In addition, the buyer’s technical staff may work with the seller’s technical staff to solve problems jointly. Powell (1987) stresses that non-market non-bureaucratic organizational arrangements are highly significant characteristics of the organizational landscape and that hybrid forms represent a modern version of a century-old mean of allocating good and services. Thus, transactions occur neither by administrative fiat nor by discrete exchange but through networks of individuals engaged in reciprocal, preferential, mutually supportive actions. Trust, reputation, tacit complicity, and a "relative absence of calculative quid pro quo behaviour" (Ibid: p. 82) are the driving forces of this system of exchange. Of course, hybrid arrangements of this kind have drawbacks, because, like most forms of social organizations in which there are enduring patterns of repeated trading, they deny opportunities to newcomers. Obviously, restricting access, either intentionally or more subtly through such organizational barriers as unwritten rules or informal codes of conduct, shapes the nature of competition.

The same author defines "networks" in terms of descriptive characteristics and critical components that are distinct from hierarchies and markets in their heavy reliance on collaboration, complementary interdependence, a reputation and relationship basis for communication, and an informal climate oriented towards mutual gain. According to Powell (1990), the firms most likely to engage in network arrangements will be those needing to exchange difficult-to-codify knowledge-intensive skills that are best transferred through processes of collaboration and information sharing. Larson (1992), in order to explain the driving forces of exchange in networks, refers to concepts like trust, concern for preserving reputation, prior personal knowledge of top managers, routine collaboration and communication. Thus, social relations and economic exchange are inextricably intertwined to govern behaviour in networks of this kind. The same author stresses that in a formal organization market prices are replaced by administrative coordination and control mechanisms such as employee incentives and transfer pricing. The intricacies of these administrative challenges make it difficult to structure internal transactions equitably and efficiently. A network structure avoids these problems while institutionalizing cooperation and information sharing, both of which are considered benefits of vertical integrated exchange. In addition, Larson (1992) points out that the use of a network exchange structure presents critical leveraging opportunities to gain resources and competitive advantages without incurring the capital investments of vertical integration. Consequently, these network exchange structures can be interpreted as flexible alternatives to integration, providing many of the strategic benefits of vertical integration while avoiding the bureaucratic inefficiencies and capital investments of integrated units.

2.3. THE PROPOSED CONCEPTUAL FRAMEWORK

NIE and relational/network contracting are not irreconcilable approaches.

The proposed framework cannot ignore analysis of the institutional environment, defined as the fundamental set of rules, both informal and formal, that govern production, exchange and distribution within a society—in short, the “rules of the game” (North, 1990: p3).

The nature of spot markets and vertical integration is revealed by looking at three key dimensions of transacting: asset specificity, frequency and uncertainty. However, what NIE defines as hybrid arrangements needs a wider perspective, in order to allow for their social essence. The relational-contracting and network-structure approach is thought to offer a better interpretation of hybrid arrangements and will consequently be proposed as part of the conceptual framework of these coordination mechanisms.

3. MARKET OVERVIEW

3.1 THE INTERNATIONAL COFFEE MARKET

Coffee is an international traded commodity that has always had a special importance both for producing and consuming countries. In world trade, coffee is the second leading commodity, after petroleum. The worldwide coffee market spans some 71 countries, of which 51 are significant producers and 20 are key consumers (World Bank, 2002). Over 90 per cent of global production takes place in developing countries, while consumption takes place mainly in developed countries. Production-consumption patterns are not generally distorted by protectionism.[2] The economies of many low-income countries are highly dependent on trade in coffee; consequently producing-country governments have often treated coffee as a strategic commodity. They directly or indirectly controlled domestic market and quality control operations until market liberalization took place in the ‘80s and ‘90s (Daviron and Ponte, 2005).

Coffee has been characterized by a long-term decline in price. Given the importance of this product for the livelihoods of about 25 million farmers around the world, Oxfam calls this price decline a “coffee crisis” (Gresser and Tickell, 2002). However, recent years have been characterized by a strong increase in price (ICO, 2005). In addition, lower coffee prices have been accompanied by a higher level of price volatility. From 1982 to 1990 the nominal monthly variability of prices reported by ICO was 14.8%. This indicator almost doubled to 37% in the 1990-7 period, and then further increased to 43% in the 1998–2000 period (Daviron and Ponte, 2005). The reasons for the price volatility must be found in the low price elasticity of demand and supply (McClumpha, 1998) and the volatility of coffee futures markets (Crow, 1997). Coffee futures represent coffee that will become available at some point in the future. Traders in the futures markets are primarily interested in risk management (i.e. hedging) or speculation, rather than the physical exchange of actual coffee.[3] The volatility of a futures price is generally triggered by changes in demand and supply, but is magnified by speculative activity. Investment funds are extremely active in commodity markets. Because they operate on the basis of trend following, “trigger signals” tend to cause larger movement in and out of the market than if the market were operated by the coffee industry alone (Ibid).

Important changes have occurred in international coffee trade during recent years. The end of the International Coffee Agreement (ICA) in 1989 has done away with the International Coffee

[2] Even if green coffee importation is not generally taxed, countries that import coffee impose tariffs on roasted and instant coffees, in order to protect their own industries (Renard, 1999)

[3] Although delivery of physical coffee can take place under the terms of the futures contract, few contracts actually lead to delivery. Instead purchases are usually matched by offsetting sales and vice versa, and no physical delivery takes place. (ITC & UNCTAD/WTO, 2002).

Organization's ability to set a price band[4] (Ponte, 2002). Vietnam has appeared as a new actor in the international market: in 1989 it produced around 1 million 60kg bags of coffee, whereas in 2005 it reached 11 million bags (ICO, 2005), becoming the second largest producer in the world. Roasters have started to adopt "supplier-managed inventory"[5] strategies, reducing working stock[6] through the outsourcing of stock management. Consequently, the roaster holds a minimum quantity of stock linked to projected sales of roasted coffee and adjusted to actual sales. A proportion of the stock (and its ownership) has moved from roasters to traders. In this way, the stocks that are immediately available on the market (mobilizable stocks) have increased. The result has been that, previous to 1997, the quantity of world stocks included an important quantity of stocks owned by roasters (i.e. non-mobilizable stocks). By the early 2000s, a bigger part of world stocks had become mobilizable with the result that, when stock levels are compared with the international prices, the impact of stocks on prices appears stronger than before (Daviron and Ponte, 2005).

In the end, the high level of concentration of the international market must be stressed, as five roasters[7] buy almost half of all coffee beans each years (Gresser and Tickell, 2002).

3.2. THE ITALIAN COFFEE MARKET

Coffee is the warm beverage that is more consumed by the Italians, not only for its charm, taste and smell but also because it has an importance of ritual nature that marks the pace of the day (Maggiordomo, 2003).

Italy is the forth coffee importer in the world in terms of volume and it is the second in Europe. In 2005 Italy imported more than 7,300,000 60kg bags (ICO, 2005). A good part of the imported coffee is re-exported. In 2004 Italy exported 5.089 tonnes of green coffee[8] and 72.697 tonnes of roasted coffee (European Coffee Federation, 2005). Export of roasted coffee has increased significantly, exceeding 1.4 million bags green equivalent. Thanks to this growth, Italian coffee-

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[4] Under the ICA regulatory system (1962–89), a price band for coffee was set and export quotas were allocated to each producer. When the indicator price calculated by the International Coffee Organization rose over the set price, quotas were relaxed; when it fell below the set price, quotas were tightened. If an extremely high price emerged (as in 1975–77) quotas were abandoned until prices fell down within the band (Ponte, 2002). For more information about the collapse of the ICA see Ponte (2002), Bates (1997), and Gresser and Tickell, (2002).

[5] SMI is the mirror image of just-in-time management systems.

[6] For other possible interpretations of the application of SMI by roasters and of the conditions for implementing successful management of SMI see Lodder (1997) and Ponte (2002).

[7] These are: Kraft Jacobs-Suchard, the food sector of the gigantic Philip Morris corporation; Nestlé, known in the coffee world for its Nescafé brand, which is number one in instant coffee; the Douwe Egberts group, that is the European coffee sector of the Sara Lee multiproduct brand; Folger Coffee, a branch of Procter & Gamble; Tchibo, the giant German roaster.

8 Coffee can be traded in three different forms: green, soluble and roasted. Green Coffee is the coffee that, through post-harvest operations, has lost exocarp, mesocarp and endocarp. Green Coffee is the row material to produce roasted coffee. All over the world green coffee accounts for almost 80% of gross imports, while roasted and soluble coffee account for 7.4% and 13.7% respectively (ICO, 2005)

roasting firms have strengthened their position in the group of major coffee exporters, consolidating the second place among the European countries (Ibid).

The so-called "sustainable coffees"[9] account only for 0.3% of the Italian market (Giovannucci, and Koeckoek, 2003).

According to the Databank coffee market report (2005),[10] in Italy 60% of all coffee is consumed at home with the traditional stove-top maker. However, home consumption corresponds only to 29% of total value of sales. About 35% of the coffee that is consumed out of home is taken in bars and restaurants. The remaining 5% is consumed through vending machines.

Concerning the home consumption market (HCM), coffee is commercialized mainly through hypermarkets and supermarkets, which sell 75% of volume. The remaining 25% is distributed through superettes, hard-discount stores and traditional retailers.

At present in Italy there are 600 roasters (Databank, 2006), whereas in 2002 there were around 750 roasting firms (Databank, 2002). Clearly, the market is undergoing a period of restructuring characterized by a decrease of fragmentation.

The HCM is highly concentrated since four roasters control 75% of sales. Lavazza alone controls 46% of the total HCM (Databank, 2006).

Advertising of main brands is considered a key factor in the HCM. Promotional sales are very common tools to sustain selling. Competition for shelf space and need for visibility have provoked an increase in the number of different blends that are offered in supermarkets by the major roasters. The bigger firms offer many blends in order to take more space and cut out small roasters (Maggiordomo, 2003). Because the flavour identified by the consumer is the result of blending different kinds of coffee from different places, the product's identity is more closely associated with the brand name than with its geographical origin (Renard, 1999). Blending is also used to manage the natural variability of coffee. By manipulating the blend composition roasters can obtain the same homogeneous product without being overly dependent on any one origin. In fact, a critical quality factor for bigger roaster is homogeneity: each product needs to taste the same in time and space. Blending is the most important operation for a roaster, the one in which specific know-how is mobilized (Daviron and Ponte, 2005).

Generally, consumers do not have the capacity to distinguish the subtle differences between one blend and another, because in the home market coffee is consumed through the traditional stove-top maker, which does not transfer the quality characteristics of coffee. The result is that brand reputation is used as a proxy for variance in quality (Ibid).

The other main market is the bar coffee market.

[9] In the case of the Italian market they are represented only by the Fair Trade and Organic label.
[10] Databank is a consulting firm that does market studies on behalf of private companies

In Italy there are 88,820 coffee bars (Bargiornale, 2002). Coffee bars are often family owned, rarely franchised and rely on a core group of customers visiting the establishment daily. The bars are viewed as places of social interaction and conviviality (Bargionale, 2006). Rather than provision of ambience (as in US bar chains), the "Italian bars' *modus vivendi* is in-person services[11] based on repeated interactions with clients that have elements of affective service provision. These services are also based on the facilitation of implicit and explicit exchange between consumers" (Daviron and Ponte, 2005: p147).

The bar market (which also includes restaurants and hotels and generally is abbreviated as Ho.Re.Ca) is extremely fragmented. As mentioned, in Italy there are 600 roasting firms, but compared to the HCM, where the first eight competitors control 80% of the market, in the Ho.Re.Ca market the first eight firms control 32.2%[12] of the market. The remaining 67.8% is fragmented among a large group composed by small and medium-small roasters. The leading roaster is Illycaffè, which controls only 7% of the sales (Databank, 2006).

Branding, promotion and advertising, which represent very important factors in the HCM are not considered of great importance in the Ho.Re.Ca. market. The result is that the big firms do not have particular strategic advantages compared with the medium and small ones (Tedeschi, 1998). This can explain the great fragmentation of the Ho.Re.Ca market. The lack of advertising means is coherent with a study reported by ICO (2000) stating that over 75% of consumers coming out of a bar were not able to remember what brand of coffee the bar sold in spite of the great amount of coffee-brand signals that are present in bars.

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[11] Drawing on the work of Hardt (1999) the authors, with "in-person services", refer to interpersonal relations. Two types of interpersonal relation can be distinguished: 1) the relation between the consumer and the person delivering the service 2) the relation between consumers. In addition, regarding the first interaction, among the different sorts of labour involved in service production, *affective labour* must be distinguished. This labour is immaterial, even if it is affective and corporal, since its products are intangible: a feeling of well-being, ease, satisfaction, excitement and even a sense of connectedness or community.

[12] In value.

4. METHODOLOGY

This project did non begin as a research of purchasing policies, but was the result of a study designed to quantify the variation of the participation of farmers' exporting organizations in the Italian coffee market according to the variation of the green coffee market price. This original study needed the purchase prices from traders and roasters, but the first attempts to get these data made it clear that firms were extremely sensitive to purchase prices, and that the purchase prices would have not been made available. However, during this inquiry into purchase prices, three qualitative pilot studies, of two different firms and of a dealer, were made in order to understand what the general purchase procedures were.

From the analysis of these first cases and of the literature review undertaken, three elements arose: a qualitative approach was needed to get information from firms and the price analysis would have to be abandoned; firm's competitive strategy has a role in the purchase policy; the determinants of the purchase polices are complex, dynamic and characterized by the interlacing of economic exchange and social relations. This is why the appropriate methodology was believed to be qualitative, ethnographic, and inductive case studies, reflecting the exploratory approach to building theories. A multi-case approach was chosen to provide increased reliability through repetition (Yin, 1994).

The limits of qualitative research involving a small set of cases are known: it is not possible to generalize to a larger population. What can be done using case studies is theoretical generalization (Thomas, 1998).

The value of the research lies in its capacity to provide insight through rich detail, to produce a grounded model, and to generate hypotheses for further testing (Larson, 1992).

The cases have been selected through purposeful sampling, using the "maximum variation" criterion, among those indicated by Patton (1990), as the one most appropriate to the exploratory approach of this multi-case study. As already mentioned, initially two roasters and one dealer were interviewed. The representatives of these firms, as experts, were asked to suggest other roasters that they thought could enrich the study because of their different purchasing policies and company strategies.

Eight different roasters were selected. The quantity could appear quite small, but considering the number of variables that emerge in qualitative interviews and the time necessary to analyze each case and to compare it with others, they are not. In addition, as Patton (1990; p185) stresses, "the validity, meaningfulness and insights generated from qualitative inquiry have more to do with the information-richness of the cases selected and the observational/analytical capabilities of the researcher than with sample size".

Individual face-to-face semi structured interviews (SSI) with different representatives of the selected firms were conducted. Once the firm had been approached and the general purpose of the research explained, information was requested about the people in charge of green coffee purchase and of marketing strategies. Obviously in the smaller firms these functions were covered by the same person. As suggested by Perry (1998), disguise was offered for the interviewee's name and organization in order to develop trust. None of the interviewees accepted to remain anonymous, however, during the interviews some individuals asked not to reveal their name and the name of the organization for which they worked in connection with specific topics of discussion. Consequently, for some cases reported in this paper, instead of the exact name of the organization or of the person that has been interviewed, a general descriptor (e.g. a roaster) has been used.

Guidelines for the questions of the SSI were developed. Interview respondents were invited to express their perception of the firms' strategy and the chosen purchasing polices. Concerning the firm' strategies, Porter's framework (1980) on "generic competitive strategies"[13] was used for question development and the consequent interpretation.

In order to be sure that the relevant arguments arose in the interview, probe questions were prepared. These concerned marketing objectives, marketing positioning and market targeting. In addition, specific questions about the firm's size and volume of production were inserted in the SSI.

Concerning the questions about the coffee purchase the following topics were addressed in the SSI: general purchase channels, criteria to select suppliers, relation with suppliers and investments in suppliers.

Interviews were recorded and transcribed. On average each interview lasted an hour and half. Follow-up questions were explored through a combination of face-to-face interviews and telephone conversations. All the interviews were held between May and August 2006.

As Yin (1994) stresses, interviews can be subject to problems of bias and poor and inaccurate articulation. Therefore, in order to test for convergence, interview evidence must be triangulated with multiple data sources. When it was possible more persons in the same firm were interviewed. Since the research deals with purchasing policies, a dealer and a broker from whom some of the

[13] According to Porter, to achieve a competitive advantage, management is faced with a choice between one of three strategies, which he calls generic competitive strategies: cost-leadership strategy, whereby the firm offers its product at the lowest prices; differentiation strategy, whereby the firm differentiates its products or services from those of competitors on the basis of different attributes that buyers value; focus strategy, whereby the firm concentrates on a particular segment and applies either a cost-leadership or a differentiation strategy. However, as Garcia Martinez and Pool (2004) emphasize, in real business, firms can pursue both the differentiation and the cost-leadership strategy, or even other strategies.

selected roasters buy coffee were interviewed. In addition, annual reports, press releases, web sites, product descriptions, and other public sources of information about the firms also were reviewed.

The details of the interviews are reported in Appendix

Among the limits of this research, the impossibility to interview exporters in producing countries must be stressed.

Finally, the cases were analyzed individually (i.e. within case analysis) before an analysis across two, then three, four, etc. cases was carried out.

5. THE DETERMINANTS OF PURCHASING POLICES

The Italian roasters that make up the case studies of this research purchase green coffee through different forms. Three main channels were identified: direct importation from exporters in producing countries, purchase from brokers, and purchase from dealers. The last two channels deserve some clarification. The brokers sell coffee contracts. They offer the roasters a wide variety of coffee that, at the moment of the purchase from the roaster, can be in any part of the world, still to be harvested, on ships or in custom warehouses. The price is set by the broker and it can be opened or closed. In the first case what is set is the differential above the future contract traded on the New York or London futures market;[14] consequently the roaster will pay the sum of these two prices. In the second case the price is closed[15] and is generally the sum of the current future contract plus the same differential. Buying through brokers implies that the roaster acquires the contract in a first moment. Subsequently, when the roaster has completed all the necessary formalities to clear the coffee and has arranged for shipment, it can come into possession the coffee. The dealers can buy coffee directly from exporters in producing countries or from brokers. The dealer does not sell a simple contract, it sells the physical good and delivers it to the roaster's address. Consequently the dealer takes upon itself all the formalities for clearing the coffee at customs. In addition, the dealer controls the quality and eliminates the damaged beans and impurities.

5.1. UNCERTAINTY

The first consideration to be made, which underlies the choice both of the purchase channel and of the specific commercial partner, is that uncertainty surrounds many aspects of green coffee transactions.

Along the coffee supply chain from producer to roaster the asymmetries of information are many. First of all the farmer does not taste the coffee he produces and even if he does, he lacks the tasting skills necessary to evaluate his product. However, if the contract between the exporter and the buyer is signed when the coffee is still to be harvested, the farmer is the only one that has some information about his product. At the moment a contract between the exporter and the buyer is signed, even if the buyer has received a 300gr. sample (representing no less than 19 tonnes), the exporter is the only one having full information about his product. Only when the lot has arrived at the destination port the buyer can have full information about the product he has already bought. Occasions for opportunism are many: the exporter could cheat the farmer by stating that after having tasted the coffee he realized that fermentation processes had begun and consequently, the

[14] There are two markets for coffee futures: one in London for Robuta coffee and one in New York for Arabica coffee.
[15] The value does not change with the variation of the future value.

coffee had been damaged; the farmer could state that the coffee had been pulped immediately after the harvest[16] when this was not the case, hoping that this will not be found out; the exporter could sell a product to an international buyer that he knows is not the one the buyer wants, as the contract is signed when the coffee is still in the producing country; once the coffee has arrived at the port of destination the buyer could claim that the coffee is not the agreed one (even if it is) in order to obtain a price reduction or to reject it if during the shipment the buyer has found another seller that can provide him the same quality of coffee for a lower price. This kind of uncertainty is typical of any product that is traded internationally, but coffee has some additional characteristics that increase the level of uncertainty surrounding it: while physical defects are quite easy to detect, its complete and actual characteristics can be evaluated only by tasting it, but this requires special equipment, special skills and a common language to communicate. A coffee dealer described this problem as follows:

You can't image how difficult is for us to explain by e-mail or by phone what is wrong in the coffee we tasted in a way that the exporter really understands it. In addition, we taste coffee with the espresso machine, but very often they [exporters] don't have it since its maintenance is too complicated, so they taste it the Brazilian way[17] and the result is often different (Sandalj, 2006).

An important element that increases the uncertainty surrounding international coffee transaction from producing countries to importing countries is the absence of effective and efficient arbitration. The contract used to regulate coffee transaction by roasters, dealers or brokers in Europe is a standard contract in which the arbitration board must be indicated. If the arbitration board indicated is in Italy it may be possible to enforce its decisions if both the parties are European (as, for example, in the case of a transaction between a European trader and roaster); but enforcement is much more difficult or impossible if one of the parties is under the jurisdiction of a producing country in Latin America, Africa or Asia. In addition, concerning the quality of the coffee, what can easily be claimed in an arbitration board are the physical defects, while the organoleptic ones are much more difficult to demonstrate. In the end, the arbitration process is considered too long and not effective in guaranteeing adequate compensation. A dealer described his experience with arbitration in this way:

[16] Mild Arabica coffee needs to be pulped (i.e. separation of the exocarp from the mesocarp) immediately after the harvest, otherwise fermentation processes that damage the organoleptic characteristics begin.
[17] Tasting coffee pouring 100 parts (by weight) of boiling water on 7 parts of coffee powder.

About 7 or 8 years ago we used arbitration quite a lot to solve disputes, but we decided to stop because it was a process of months and months and we could obtain only a 2 or 3% discount, when what really interested us was getting rid of the defective coffee. Moreover, if the supplier compensated us as the arbitration had determined, it was okay, but if it didn't there was absolutely no way to enforce the verdict for exporters located at the other end of world…. We don't have this kind of problems with European suppliers. They want to maintain their reputation and problems are solved in a friendly way (Sandalj, 2006).

Uncertainty about the other party's behaviour is further complicated by the presence of coffee futures markets. These markets are used as reference points to set the price at a specific moment but the actual coffee delivery must occur at a second moment set in the contract of purchase. If, between the moment of price setting and the moment of delivery, the price indicated by the futures market rises, the exporter may be tempted to breach the contract and not deliver the coffee. Conversely, if the price indicated by the futures market decreases after the parties have signed the contract and the coffee has not been paid for, the buyer may be tempted not to buy it.

The director of the coffee buying department of Lavazza explains how this possibility influences the choice of the supplier:

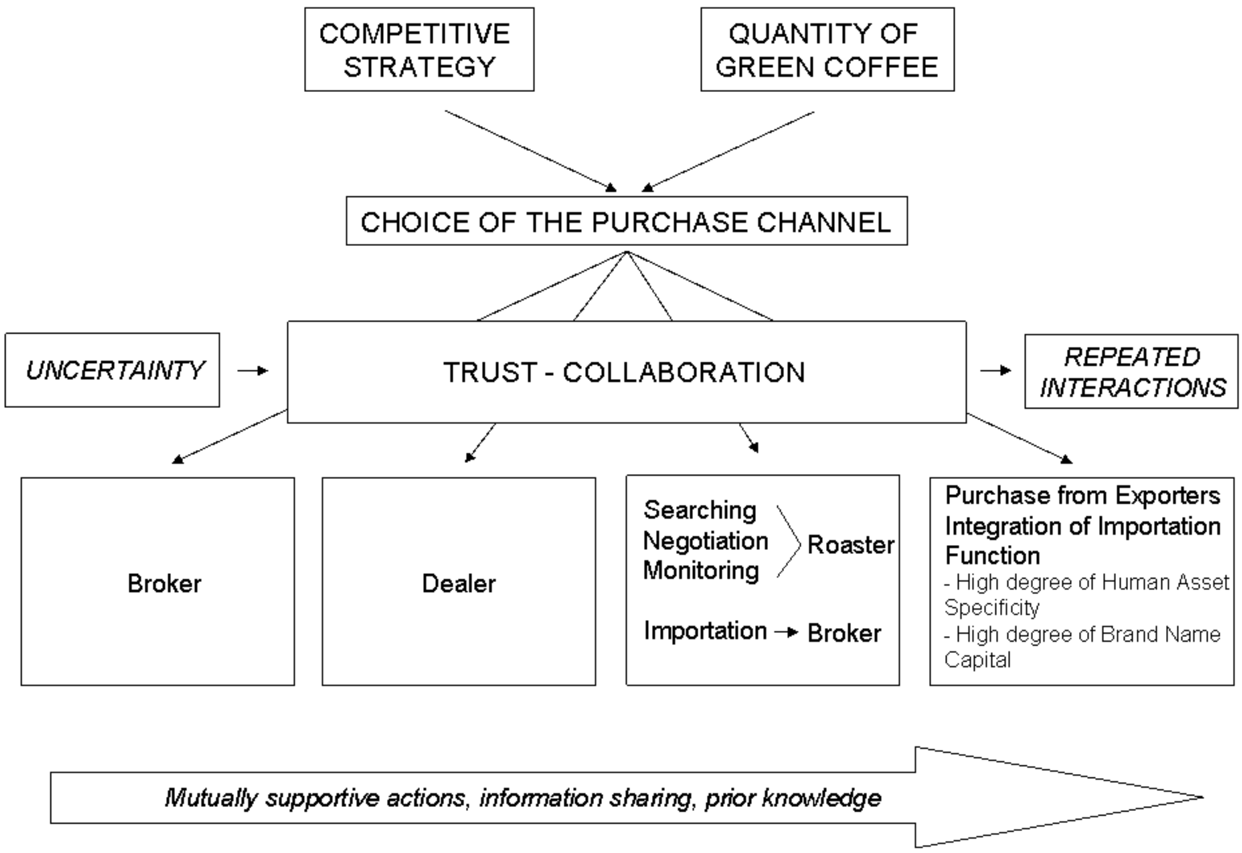
We sign long contracts, I mean 7-8-9 months, only with suppliers we have known a long time and in whom we have complete trust. We want to be sure that once a contract is signed the supplier gives us what we set at the price we set even if New York [futures market for Arabica] rises (Cerutti, 2006).

The uncertainty created by the use of the futures market as a reference point for price determination, is increased if in the producing country an auction system is in force, as the director of the coffee buying office of Illycaffè explains:

There are moments at which the price set by the auctions is completely unrelated to the price of New York [futures market for Arabica] but Ethiopian coffee hasn't the name [i.e. good quality reputation] of Kenyan coffee, so buyers continue to expect to set prices in relation to the level of New York, but exporters may have paid a much higher price set by the auction. So, what generally happens is that Ethiopian exporters breach contracts claiming that they don't have coffee anymore. They stock the coffee and wait for a rise in New York….In Ethiopia we buy always from the same *exporter in whom we have complete trust...*(Colussi, 2006).

From the discussion just reported three elements arose: the relationship with suppliers, the integration of the importation function, and the firm's competitive strategy. Figure 1, summarizing the discussion reported below, graphically shows the links among these three elements and uncertainty.

Figure 1



5.2. RELATIONSHIP WITH SUPPLIER

Small and medium roasters do not generally have a green coffee buying office and rely on the work of brokers or traders to cope with the aforementioned uncertainties. These traders take the inherent risks of the international coffee transactions on behalf of the roasters. In the case a roaster is not satisfied with the coffee that has been purchased, friendly solutions can easily be found and litigated disputes almost never arise. This could be due to the enforceability of the arbitration's provisions among European parties. So, the companies effect settlement themselves. But this does not seem to be the main reason. Traders are not so numerous in Europe and reputation is considered very important. They easily accept to settle the buyer's claims through monetary compensation or by recalling the delivered coffee, for the risk of not doing so is the loss of reputation.

Trust and collaboration between the roaster and supplier is considered essential. This is well explained in the words of a roaster:

The traders that supply us are serious people, we know them, we trust them. They are the same that supplied my father years ago when he was in charge of the firm. They collaborate with us. If we order some coffee and then we realize that we don't need it in the period we set it, we talk and we solve the problem....If we have some problem with the coffee they sold us they immediately solve it….As far as I remember only once it happened that we blacklisted a trader; this was due to quality reasons (Dini, 2006).

The same consideration about the necessity to build up a relationship based on trust and collaboration are even more important if the buyer-supplier interface is that of the roaster-exporter. In this case the development of mutually preferential supportive actions is considered a source of competitive advantage. This is well explained in the words of Lavazza's purchases director:

With some of our suppliers we have a relation based on real friendship. I know that I can phone them and ask for an unforeseen and rapid shipment if we need it. If they tell me that they can't do it, it's because there is absolutely no way they can do it, otherwise they would do it….If they ask me to train here their new staff to learn how to taste coffee and which kind of coffee we look for, we are happy to do it. On the contrary, sometimes we ask them to let our new staff stay with them in order to learn what kind of coffee they have and how they prepare it (Cerutti, 2006).

Information sharing with exporters is considered essential for those that import directly, as the same roaster explains:

If I talk half an hour on the phone with one of our suppliers in Brazil, for five minutes we talk about the coffee purchase, and for the rest of the conversation we talk about the on-going harvest, the influence of climate, possible plagues in the country, and if the official forecasts are reliable or not. Confirmation or denial of government forecasts about the incoming harvest by somebody that we trust is essential for us. If official forecasts state that the harvest will be around 30 million bags, and this is confirmed by our suppliers, we start to buy whatever coffee we find, but if our suppliers *tell us that the forecasts are not reliable because the information has not been properly collected, we are much more confident* (Cerutti, 2006).

Prior knowledge of the personnel working in the exporting company has been indicated as a determinant factor for the roaster to decide to import directly from the exporter without a trader's intermediation. Two small and medium roasters import coffee directly from Brazil, and in both cases the prior knowledge of the top management or simply of the exporters' agent has been the key element to start a long relation based on trust and collaboration.

The phrases reported above show another characteristic that has been found in almost all the cases of this research: the relation between the roaster and the supplier is generally a very long one. The traders on which the roaster relies almost never change. Again, this is probably due to the intrinsic uncertainty that surrounds coffee transactions, so that once a roaster develops good commercial experiences with a trader, it will be reluctant to try new business parties. Obviously, this phenomenon reduces the possibility that new traders enter into the market and diminishes competition.

In the end, in the case a dispute cannot be solved, blacklisting is the foregone result both for the roaster-trader and for the roaster-exporter relation.

5.3. VERTICAL INTEGRATION

Among the cases in this study, two roasters have vertically integrated the importation function: Lavazza and Illycaffè. However, as will be explained below, other firms have devised hybrid arrangements between direct importation and complete reliance on traders. Lavazza and Illycaffè are among the biggest roasters in Italy.[18] Direct importation seems an option only for the biggest firms; this is consistent with economic theory (Williamson, 1985), but it is only part of the story. For roasters, a critical element that has often emerged during the interviews is the necessity to offer a final product whose quality is constant in time but that is made with a raw material whose quality presents a high degree of variability in time and space. The two above-mentioned roasters have invested considerable resources with their suppliers in order to be sure that the supplier is able to provide them green coffee with the desired characteristics. The personnel of the buying offices of the two companies very often visit their suppliers in producing countries. Such visits can be planned as formal training events or informal meetings during which the exporter's personnel learn what kind of coffee the roaster wants, how to distinguish it from the rest of their coffee, and which

[18] Lavazza is a company with 1938 employees and 867 million euros of revenue; it is the sixth roaster in the world and it imports around 2.2 million green coffee bags yearly (Torello, 2006). Illycaffè has about 700 employees (of which 400 in Italy), 227 million euros of revenue and imports around 283,000 bags of green coffee yearly (Presotto, 2006).

organoleptic and physical attributes it must have. At the same time, the personnel of the two parties develop a common language to communicate about the characteristics of the coffee they wish to trade. Both roasters have reported that when new personnel is employed in their company (or among their suppliers) very often the new staff is hosted for a certain period in the supplier's firm (or the roaster's) to learn cupping techniques and the characteristics of the coffee the exporters have (or the attributes of the coffee the roaster seeks). These visits, training, learning by doing, represent investments in specific assets (human asset specificity). In addition, a high degree of bilateral dependency develops between the parties.

However, the two companies do not behave in the same way concerning coffee purchases. About 15-20% of the coffee Lavazza buys comes from brokers, whereas Illycaffè imports all the coffee it roasts without intermediation. In addition, the companies present a different level of investments in their suppliers' capacities and different levels of vertical integration. Underlying such diversities are the firms' different competitive strategies.

5.4. THE EFFECT OF THE COMPETITIVE STRATEGIES

Among the firms under analysis, no one has adopted a cost-leadership strategy, whereas many of the strategies undertaken can probably be identified as differentiation strategies.

The ways the roasters of this study try to differentiate their offers are different, and generally the component of service provision to the customers in addition to sales of coffee is considered very important. Excluding Illycaffè and Caffè Piansa, all the firms of this research supply financial services, offering bank warranty or direct financing through their own financial branch. Very often, these financial services are offered to bar owners when they set up a new bar or renovate an existing one. By contract, the bar owner has to buy at least an agreed amount of coffee for a number of years. Obviously this system limits competition enormously, because the bar owner is bound for years to a specific roaster. Competition on coffee quality can be completely absent, as a roaster described:

The great problem of this sector is financing. We offer financing because we don't have alternatives. Because we charge the same market interest rate as banks, we incur losses, but at least this permits us to stay on the market. Our competitors very often don't offer financial services, they simply buy customers by giving them non-repayable grants. And when they have bound the bar owner for years, the quality of the product becomes completely irrelevant (Dalla Ragione, 2006).

Other kinds of services that roasters offer to bar owners in order to differentiate themselves from their competitors are: technical assistance for the installation and maintenance of coffee machines, high frequency and regularity of visits and deliveries to bars in order to guarantee freshness of the product and restocking in small amount, provision of coffee machines under different contractual forms (free loan, rental, sales, etc.), training for *barista* (*espresso* coffee bartender), technical assistance for bar refurbishing, and design of business plans. The actual range of services provided varies from firm to firm, but the higher the effort on services provision, the less interested the roaster seems to be in controlling the origin and the core product of its coffee supply. The two roasters that present the highest range of services provided rely completely on brokers to buy coffee. Another roaster, which besides offering a wide range of services, focuses its differentiation strategy on huge financing and on the provision of a certified system that guarantees the quality of the preparation process[19] of coffee from the roasting activity to the final preparation in the bar, relies completely on brokers as well. For all three roasters, if a consignment is not up the expected quality, a new price is set with the brokers through compensation mechanisms, but the coffee is not rejected. These roasters do not require pre-shipment samples, because they rely on the average quality the brokers can provide them. They make purchase decisions according to the best prices offered by a few trusted brokers for specific qualities of coffee defined by standardized descriptors that define the ingredients of their blends. However, these standard descriptors do not reveal much information about the quality. For instance, the most expensive quality of Colombian coffee that brokers supply is identified with the name of “Colombia Supremo”, however, this definition indicates only the dimension of the coffee beans, it does not give information about the origin or the organoleptic characteristics of the coffee. Considering that in Colombia there are three different cordilleras, it is not difficult to imagine that the quality of the coffee of the country is extremely varied, independently of the dimensions of the beans.

The length of the green coffee supply contract is directly affected by the uncertainty that characterizes coffee transactions: the longer the contract, the riskier the transaction, for many natural and economic events could occur after the signing of the contract. The longest contract that was usually signed by the roasters of this research was 18 months. This 18-month contract was used by a roaster that did not chose a differentiation strategy for the quality of its core product, but for the kind of customer services it provided. The purpose of such a “long” contract was to get coffee for an extended period with the current price when this was thought to be profitable.

[19] INEI (Istituto Nazionale Espresso Italiano) certifies the downstream part of the roaster’s supply chain. It guarantees the quality of the product to the end-consumers certifying the quality of the coffee blend, the training of the *barista*, and the correct working of the coffee machines that are used in cafés. It does not cover any aspect of the quality of green coffee nor does it certify the origin of the blend or the quality of its individual ingredients.

Uncertainty surrounding coffee transactions is much greater for the roaster that has chosen a differentiation focus strategy for quality of core product matched by appropriate branding, like Illycaffè. In order to be consistent with the differentiation focus strategy, the firm produces only one blend. The director of its marketing department sums up the company's intended position for its product with one short, clear sentence:

We want to offer the best coffee in world (Presotto, 2006).

The same person explains the success of the firm's strategy positioning for quality and branding in the Ho.Re.Ca market as follows:

According to our research, the people that chose a bar on the basis of the coffee brand are Illy customers. 17% of the bar customers chose the bar by looking for Illy coffee. The others chose the bar for proximity and on the basis of other criteria.

In order to obtain the coffee with the required quality characteristics, Illycaffè directly imports all of the coffee it purchases, pays prices that are much higher than the market prices, and invests in suppliers and makes use of only short contracts for prompt delivery, as the natural variability of coffee production in time does not ensure a consistent quality. Illycaffè's personnel continuously visits suppliers in order to instruct them not only in the quality control measures and tasting techniques that the exporters must perform in order to separate the coffee with the best physical and organoleptic characteristics from the rest of the coffee, but also in cultivation methods and post-harvest operations. Obviously, these kinds of investment create a strong bilateral dependency, but the development of reciprocal trust and transparency is part of the strategy. The exporters' personnel are often invited to training courses organised by Illycaffè in Italy. Suppliers are chosen not only for their commercial reliability and their capacity to provide a quality product, but also for their willingness and capacity to transfer part of the premium price paid by the roaster to their farmers. Illycaffè's personnel devise mechanisms with the exporters' personnel to ensure the transfer of the premium. This may be a matter of corporate social responsibility and business ethics, but the company considers the farmers their partners in their strategy and wants to reward the farmers' effort in order to be sure that the production of quality coffee starts in the field and not in the exporter's quality-control lab.

As for the great majority of the Italian roasters, also for Illycaffè, Brazilian coffee is a main ingredient of the blend. Illycaffè has consequently made specific investments in order to get huge amounts of high-quality coffee from Brazil: a permanent training centre has been set up; each year competition is organized among the farmers in order to reward the best qualities of coffee produced, and recently the traditional sole exporter that has always supplied Illycaffè has been vertically integrated. Again, the high degree of asset specificity (human asset and brand name capital) underlies vertical integration. In the end, it is useful to stress how such investments, which arrive directly to influence the farmers' behaviour, reduce the uncertainty surrounding the production and commercialization of quality coffee enormously.

This kind of investment can be carried out by Illycaffè, which is a big company with 227 million euros of turnover, but small and medium roasters that want to differentiate themselves for the quality of the core product must find different devises. Certain subjects have developed hybrid arrangements between the complete reliance on traders and direct importation. Two roasters in this research have joined with other roasters to develop a certified system of coffee purchase called CSC.[20] The certification guarantees that the product is of high quality[21] and that the coffee comes directly from the farmer that exports it.

These roasters visit the farmers in order to find the coffee with the characteristic they want and to identify farmers that are willing to invest in the quality production processes indicated by roasters. The farmers are rewarded by a quality premium decided jointly according to the cost of the process required. In addition, the farmers are periodically invited to Italy. The underlying necessity to devise mechanisms to cope with uncertainty due to asymmetric information and opportunism is clear in the words of the president of the CSC group of roasters:

Our farmers know that they can't be at fault with us because we know each other very well and they know that we are able to recognize coffee (Moschini, 2006).

However, even if the roaster invests in the search for the estate of origin and in the development of a relation based on trust and personal knowledge of the farmer in order to differentiate itself for the quality of its products, given the dimension of the roasters, the transaction costs associated with the direct importation of coffee are still considered too expensive. Consequently, importation is delegated to a broker that is a member of the certification system.

The cases just discussed show that the quantity of coffee purchased and firm's competitive strategy are critical variables in deciding the importation channel. The case of Caffè Piansa corroborates this hypothesis. Caffè Piansa is a small roaster that buys about 1,000 bags of green

[20] CSC stands for Caffè Speciali Certificati. The costs of the certification are completely covered by the roasters.
[21] It must be approved by a technical committee made up of professional coffee tasters

coffee per year and that employs only five persons. This firm sells only on the Ho.Re.Ca market, does not provide any kind of service to its customers in addition to the sale of roasted coffee, and focuses its differentiation strategy only on the quality of the core product. It is certainly a firm that does not have the resources to invest in the search for specialty coffee at the origin, but given the chosen strategy, its manager is aware that the search for high quality coffee must be conducted by somebody, as the firm cannot rely on the coffee of average quality defined by the standardized descriptors that brokers provide. Besides, brokers require minimum amounts of coffee to be purchased that are often too big for Caffè Piansa. The solution is to rely on a coffee dealer specialized in high quality coffee. The dealer covers the costs of searching for coffee with the desired quality attributes on behalf of its customer (the roaster), it identifies at the origin the coffee for the roaster, takes the risks concerned with the international transaction of the coffee, develops the trusting relation that has been indicated as essential for this business with the exporters, clears the imported material through customs, carries out the quality controls in its lab, and delivers the amount of product required by the roaster directly to the roaster's plant. In the course of time the dependency relation that develops between the importing roaster and the exporter arises again with the intermediation of the traders, as a dealer explains:

In the course of time a relation of dependency arises between the exporter and the roaster, as the roaster always presents great resistance to changing the ingredients of its blend. This is why the exporter increases its bargaining power with us, fetching higher prices (Sandalj, 2006).

The same relation based on reciprocal trust, sharing of information, and collaboration arises in the roaster-dealer interface, as the following words indicate:

We have a very long and trusting relationship with Sandalj [the dealer]. He always provides products of constant quality and if for some reason he has a product that is not of great quality, he is the first one to advise us not to buy it. If we don't like the coffee he has sold us, he takes it back immediately, without any resistance. Sometimes, if he has a new coffee he sends me a sample, asking me for advise even if he knows that I will never buy it because I always buy the same coffee from him (Staderini, 2006).

Before concluding, it is worth noting the effect of the targeted market and brand positioning.

All the roasters of this research have targeted at least the Ho.Re.Ca market. Three cases have targeted the HCM also. Lavazza, whose purchasing policy has already been explained and whose sales are generated mainly in the HCM, targets all consumer segments; consequently it offers a very wide variety of blends and packs with different prices. Illycaffè, which generates 48% of it value in Italy through the HCM,[22] which intends *to offer the best coffee in the world*, and which matches the quality attributes of its products with appropriate branding, produces only one blend positioned in the highest price range. Dinicaffè is a medium-small roaster that employs 13 people, is part of the CSC certification system described above, and consequently aims to position its coffee in the high quality range; it produces mainly for the Ho.Re.Ca market, though it tried, unsuccessfully, to target the HCM via supermarkets. One of the main reasons that forced it to abandon the supermarket channel was that the catered supermarket had started to sell Dinicaffè's products below cost, to promote it or perhaps as "loss leaders".[23] The result was that bar owners, who traditionally constituted the main segment to which the roaster catered, complained that in this way their coffee would have been considered a low-cost and low-quality coffee. This was not a problem for Illycaffè, which through its branding position did not risk a low-quality perception among consumers, and it was not a problem for Lavazza, which does not position itself as a high-quality product like the other two roasters. Dinicaffè, which does not have the resources for the brand positioning of Illycaffè, in order to use the supermarket channel would have had to change its quality positioning and consequently its expensive green coffee purchase policy through by the CSC system.

[22] 30% of Illycaffè's sales in the home consumption market are generated abroad.

[23] "Loss leaders" are products that are deliberately sold at a loss. Since they are products that are bought regularly, customers tend to remember their prices and are able to compare them across different supermarkets. Conversely, consumers are less able to remember the price of products that are bought less frequently. They are therefore likely to base their choice of supermarkets on the price of few products that are bought frequently, whose price can easily be remembered. Supermarkets are willing to take a loss on a few products in order to attract more consumers, because they know that when customers come they buy goods other than loss leaders. The supermarkets can, in this way, recoup the losses taken on loss leaders through the margins on other products.

6. CONCLUSIONS

The coffee market is characterized by strong uncertainty. Small and medium roasters rely on different kinds of traders in order to cope with the risks of coffee transactions. The larger roasters among the case studies of this research import directly. However, the size of firms is not the only variable in the choice of the purchase channel. The competitive strategy chosen is also a critical factor. The greater the focus on quality, the greater the need to control the coffee production process from the first steps of the supply chain. Thus, firms that have chosen a differentiation strategy based on the quality of the core product invest in their suppliers.

The smallest roasters of this research, having chosen a quality differentiation strategy, rely on dealers. These traders are able to provide the roaster quality coffee, and where purchasing practices are concerned, they behave like the roaster that imports directly and positions itself for the quality of its products. The same dependency relation that develops between the importing roaster and the exporter arises again with the intermediation of the dealer.

The medium roasters that aim to differentiate themselves for the quality of their products develop hybrid arrangements between direct importation and trader's intermediation: they cover the searching costs, they make investments in order to develop a trusting relationship with the farmers, but they rely on brokers' intermediation for the actual purchase.

If service provision is the main differentiation strategy, roasters tend to rely completely on traders for coffee purchase and the willingness to use longer supply contracts increases.

Concerning relations between the roaster and the supplier, many of the descriptions that have been provided show characteristics like those of Macaulay's (1963) relational contracting and Powell's (1987, 1990) hybrid arrangements and networks. In fact, the parties are often engaged in reciprocal, preferential, mutually supportive actions; they share information and develop a relation based on trust and collaboration. Business reputation is of course considered very important. These features are essential for the roasters that import directly. However, they are also important for the trader-roaster relation. The reasons for the development of such coordination mechanisms probably have to do with the uncertainty that surrounds coffee transactions. Obviously, the repeated patterns that characterize the roaster-trader relation foreclose opportunities for new comers and reduce competition. However, this aspect is probably less important in the case of direct importation, as this activity is much more risky than purchase with traders' intermediation and importing roasters need to have a wide range of actual and potential exporters in case some of them fail to provide the expected quality and quantity.

Transaction cost economics is useful in understating the rationale for vertical integration of the importation function for the two importing firms. Asset specificity of investments in human capital and brand name capital proves critical. In addition, the degree of investment in these specific assets turns out to be dependent on the firm's marketing strategy. The Illycaffè case shows that *offering the best coffee in the world* implies huge control of purchases through the integration of the importation function, and for the country from where the most important coffee is bought, the integration of the exporting house in the producing country.

New Institutional Economics is also useful to highlight the importance of the institutional environment (i.e. the North's rules of the game) in shaping the uncertainty and the transaction costs of green coffee commercialization. In the international coffee trade, the Italian party and the exporter in the producing country cannot rely on efficient and effective arbitration: this is too slow in emitting verdicts and the sentences are not enforceable.

6.1. RECOMMENDATIONS FOR FIRMS

The firm that decides to make the quality of its core product its differentiation strategy should not rely on brokers' supply. If vertical integration of the importation function is not a feasible option because of its high cost compared to the firm's size, hybrid arrangements can be devised to delegate the importation function to brokers and to control the choice of coffee at the origin. Besides, although purchasing from dealers implies renouncing complete control of coffee at origin, this avenue can represent an alternative to the meaningless descriptors of brokers.

The purchase of coffee at the origin is expensive and requires investments in suppliers to develop effective coordination mechanisms. Such a choice must be made consciously as part of the overall company strategy.

Finally, firms that target both the Ho.Re.Ca and the HCM and that position their products in the highest quality range, investing in expensive purchasing polices, should have a consistent brand positioning. Otherwise retailers could reduce the product price, provoking a low quality perception among supermarket customers. This affects the Ho.Re.Ca market, as bar owners who have chosen to buy high-quality coffee do not want their coffee be perceived as a low-quality one.

6.2. RECOMMENDATIONS FOR POLICY MAKERS

The importance of fast and neutral arbitration, whose resolutions are enforceable, has been stressed. Effective arbitration would reduce the uncertainty of coffee transactions and would consequently favour the purchase of coffee directly from exporters. In this way, exporters could differentiate their offers much more, reaching well beyond what brokers are doing through standardized descriptors. The better coffees would be easier to identify and buyers could pay a higher price for them, facilitating the transfer of a quality premium along the supply chain towards the producing countries. Longer contracts could be used, to the benefit of exporters and farmers, who could decide more easily how much to invest in production and post-harvest processes once they knew the price they would receive. Farmers would benefit to the extent that exporters distinguish among (and pay), farmers for the most valuable coffees on the international market, and to the extent that exporting houses are controlled by farmers.

Among the strategies that roasters adopt to attract customers in the Ho.Re.Ca market, the importance of financing has been highlighted. However, the possibility that Italian law gives roasters to finance coffee-bar owners, reduces competition for quality among roasters. The real winners are the bar owners, who have easy credit access; losers are the roasters, who are forced to offer finance in order to stay on the market; consumers, as the quality of the coffee becomes a secondary aspect in bar owners' choice of roaster; and green coffee suppliers, as the material content of coffee sales in the Ho.Re.Ca market is dramatically reduced by competition for finance. Ponte (2002) had drawn on the "Latte Revolution" concept expressed by Fitter and Kaplinsky (2001) to explain how the coffee content of consumption experiences is very low. In the case of the Italian market it would be more proper to talk about the "Financing Revolution". The abandonment of this practice would be beneficial for the sector because it would increase competition for the material content of coffee supply in the Ho.Re.Ca market.

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APPENDIX I

SEMI-STRUCTURED INTERVIEW

The following questions were used during the interview. They were used as a guide to gather information and generate discussion. Not all questions were proposed, as some of them are not applicable to all the firms.

The first set of questions were posed to the person in charge of the firm's marketing strategies, the second set were posed to the person in charge of coffee purchases (in some cases they coincided).

In order to facilitate the development of the conversation, the most direct questions about firm's size, turnover, volume of purchase were posed at the end of the interview.

FIRM NAME
Name of respondent
Function of respondent

MARKETING OBJECTIVES AND MARKETING POSITIONING

1. What are your marketing strategies and objectives?
2. How do you differentiate from competitors?
3. How many blends do you produce for the Ho.Re.Ca market?
4. How many blends do you produce for the home consumption market?
5. Which kind of services do you offer to your customers?
6. How do you consider your service provision, compared to that of your competitors?
7. Do you provide financial services to your customers?
8. What kind of financial services do you offer (direct financing, bank warranty)?
9. Which distribution channels do you use in Italy?
10. And abroad?
11. Compared to competitors, in which price range do you position your products in Ho.Re.Ca?
12. Compared to competitors, in which price range do you position your products in the home consumption market?
13. At what price do you sell your leading product?
14. For vending?
15. How would you consider the quality positioning of your coffee?
16. How would you consider your brand positioning compared to that of your competitors?
17. How do you promote your products?

MARKET TARGETING

1. Which percentage of your sales is generated in Italy?
2. Which percentage of your sales in Italy is generated in the Ho.Re.Ca market?
3. Which percentage of your sales in Italy is generated in the home consumption market?
4. What is the percentage of your sales in Italy that comes from vending?
5. Of your sales abroad, what is the percentage that is generated in the Ho.Re.Ca market?
6. Of your sales abroad, what is the percentage that is generated in the home consumption market?
7. Of your sales abroad, what is the percentage that comes from vending?

FIRM SIZE

1. Is it possible to know last year's turnover?
2. How many employees does your firm have?

Name of respondent

Function of respondent
GENERAL PURCHASE CHANNELS
1. What are the channels you buy coffee through?
2. What percentage of the coffee you buy is imported directly, without traders' intermediation?
3. What percentage of the coffee you buy is bought from brokers?
4. What percentage of the coffee you buy is bought from dealers?
5. Why do you directly import coffee, without intermediation?
6. Why do you buy coffee from dealers/brokers instead of importing it directly?

CRITERIA TO SELECT SUPPLIERS
1. What are the criteria on which you select your exporters?
2. What are the criteria on which you select your traders?
3. What are the main reasons why you no longer buy from a supplier?
4. If the coffee you receive is not the agreed one, how do you manage it?

RELATION AND INVESTMENTS
1. How would you describe your relationship with your exporters?
2. How would you describe your relationship with your traders?
3. To what extent do you and your traders share information?
4. To what extent do you and your exporters share information?
5. Do you think that the relation you have with your supplier is a source of competitive advantage for your company? Why?
6. Does the relation you have with your suppliers represent an investment for you? Why?
7. What are the costs of these investments?
8. What are the benefits?
9. Exchange and training with your suppliers?
10. Do you use trade fairs to start new business relations with suppliers?

PRICE AND CONTRACT
1. What kind of contract do you use?
2. Do you use long term contract? Why?
3. How long is the longest contract that you use?
4. How is the price determined?

VOLUME OF PURCHASE
1. How many green coffee bags did you buy last year?

APPENDIX II

SUMMARY OF THE INTERVIEWS

ORGANIZATION NAME	ORGANIZATION TYPE	INTERVIEWEE'S POSITION	DATEOF THE INTERVIEW
Illycaffe'	Roaster	Assistant to Buying Office Director	31/5/2006
Illycaffe'	Roaster	Honorary president	31/5/2006
Caffe' River	Roaster	Managing Director	22/6/2006
Illycaffe'	Roaster	Director od the buying office	5/7/2006
Illycaffe'	Roaster	Director of the Marketing office	5/7/2006
Sandalj Trading Company	Dealer	President	6/7/2006
Caffe' Piansa	Roaster	President	7/7/2006
Arcaffe'	Roaster	President	12/7/2006
Dini Caffe'	Roaster	Managing Director	13/7/2006
Caffe' River	Roaster	Managing Director	20/7/2006
Arcaffe'	Roaster	President	21/7/2006
Jolly Caffe'	Roaster	Quality manager	25/7/2006
Jolly Caffe'	Roaster	Sales director	25/7/2006
Casa del Caffe´ Vergnano	Roaster	President	26/7/2006
Casa del Caffe´ Vergnano	Roaster	Managing Director	26/7/2006
Sandalj Trading Company	Dealer	President	1/8/2006
Lavazza	Roaster	Director of the buying office	8/8/2006
Lavazza	Roaster	Director of the marketing office	8/8/2006