

“Challenges and Opportunities in the Current Coffee Market”, Global Coffee Forum, ICO
Milan, 30 September 2015
Speech by Jean-Marc Duvoisin, CEO of Nestlé Nespresso SA

How Shared Value creates a sustainable future for coffee

Ladies and gentlemen, good morning.

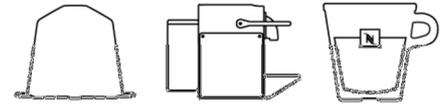
There are many opportunities in the coffee market. We at Nespresso believe that these opportunities have a very human face. The one of coffee farmers. We feel quite strongly about how we can proactively and positively find solutions to the challenges in the market today – those which affect us as a business, as well as the farmers who grow the coffee. Today I'm happy to have the opportunity to share some of my thoughts and my experiences with you.

Right now, there is a Colombian coffee farmer struggling to balance his books. He is faced with fluctuating production costs, and buyers who behave in an unpredictable way, buy at spot price, and change origins of coffee supplies when prices are lower someplace else. Creating a reliable cash flow is difficult. Maybe day-to-day his children aren't starving, but he can't effectively plan his business one year to the next, let alone think about retirement savings or passing the farm on to his children. Many of these children are today leaving for the city, seeing no future in coffee farming.

What can we do? What business approach can we take to improve that farmer's situation? What can we do to ensure coffee farming remains attractive to them, so we can ensure consistent supplies far into the future? It is a pretty stark reality, but one that everyone of us in this room needs to recognize: if farmers are not sustainable, we cannot be sustainable ourselves as a business.

At Nespresso, we are deeply committed to finding ways to safeguard farmers' welfare, the customer's cup of coffee, and our company's future. And we strongly believe that the approach of Creating Shared Value is a key part of the answer. Creating Shared Value means creating long-term positive value for shareholders, and for society. It means ensuring that our business activities preserve the environment for future generations, while pursuing economic and social prosperity for all actors. This is far more than a traditional CSR approach that to some extent pits profit against social or environmental goals. CSV is the pursuit of social and economic progress for all stakeholders in our value chain and it is embedded firmly throughout all parts of our business.

We developed our unique AAA Sustainable Quality™ Program based on these principles of Creating Shared Value, to source the highest quality coffee in the world while also improving environmental sustainability and farmer welfare. We believe that the only way to continue to deliver quality and consistency to customers is to protect the supply of our coffees. And our experience has shown us that the best way to do this is to build a more



sustainable and equitable outcome for farmers. So our AAA Program is an integral part of our business strategy.

But, why does this work? We are working with farmers to better manage their farms, their businesses and their lands. When we do this, we see a direct correlation to greater volumes of higher quality crops that meet the specific quality and aroma requirements for our Nespresso Grand Cru coffees. This not only delivers a better in-cup result for Nespresso customers, but it delivers greater income, security and stability for farmers. At the end of last year, over 80% of our coffee was sourced sustainably through our AAA Program.

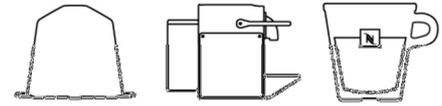
One particular business necessity has driven a lot of what our AAA Program is about. We estimate that only 1-2% of the worldwide coffee crop meets our needs in terms of quality and aroma profiles. These coffees come from specific terroirs and so, year after year we find ourselves going back to the same places and the same farmers to directly purchase our coffee. The origins of our Grands Crus are not interchangeable, so we cannot buy on the commodity market. So the opportunity for the Colombian farmer I was mentioning earlier is clear: a stable long-term buyer for a high quality supply. Since 2003, over 63'000 farmers have seen this opportunity.

AAA farmers receive on-the-ground training and support via dedicated agronomists, which helps them benefit from best practices to improve quality, sustainability and productivity. So they are growing more of the high quality beans for us to buy. We are paying a premium of 30-40% above the standard market price, or 10-15% above the market price for similar quality coffees, an aspect that is obviously valued by farmers. But interestingly, a study from INCAE Business School in Costa Rica has shown that premiums are not the key driver to income increase, it is productivity. This is why we also heavily invest in technical assistance via over 300 dedicated agronomists in producing countries. Tomas, a farmer in Costa Rica, has told us that thanks to our agronomist's support and advice, he managed to increase the yield of his farm from around thirty to forty bags of coffee beans per hectare.

An external study done by CRECE, a research institute in Colombia has shown the concrete positive impact that our AAA Program has had over three years on farming communities. Creating Shared Value works. In terms of income, the study showed that the net income of AAA farmers was 46% higher than of non-AAA farmers. But I don't only want to focus on short term income gains of farmers.

The study also measured a variety of social factors – like working practices and living conditions; economic factors – such as productivity and production costs; and environmental factors – including soil and water conservation and handling of agro chemicals. The study shows that farms taking part in our AAA Program had 22.6% better social conditions, 52% better environmental conditions and 41% better economic conditions than non-AAA farms. And coming back to the point I made earlier on stability, the study showed that proportion of AAA farmers' overall production sold to Nespresso was increasing. Stability for us from a supply perspective and stable, long term market for farmers and their crop.

In the end, this demonstrates that the creating shared value approach we are pursuing



directly contributes to soften the impacts of price volatility for a more stable future for farmers.

Through the AAA Program, we also want to foster an entrepreneurial spirit amongst farmers, to run their farms as a business and spot opportunities for themselves to improve their end income. I was impressed when I met Fabio, a young Colombian coffee farmers two years ago when he told me that:

“With the AAA Program he started to have a long term vision. He had learned to have the ability to be an entrepreneur. He had learned to run his farm as a small business instead of a farm.”

We also put in place together with Root Capital accounting trainings in Guatemala to help farmers monitor costs and revenues, reduce costs and improve productivity.

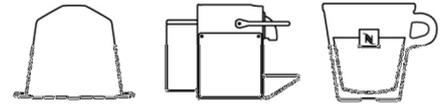
It's probably obvious that we're very proud of our approach, and although we can as a global player create substantial positive impact for farmers, for business and for the market, we are only one player. The industry has a collective responsibility to seek to create shared value wherever they can. How can global companies like ours use the agricultural markets to provide stability to farmers, and create a sustainable future for coffee and those who grow it? That is where we think the biggest opportunity lies. I strongly believe that embedding the principles of Creating Shared Value into our business model is continually proving itself to be an effective way of ensuring a stable future income for coffee farmers, and ensuring our supply.

We share the ICO's view that one of the biggest challenges of our time is mitigating the negative impacts of price volatility through business models which protect the farmer and our supply. Price volatility in the global coffee market is the single most defining characteristic since the 'coffee crisis' of 1989. This is when the International Coffee Agreement which regulated quotas and pricing collapsed and the free market took over. Fluctuations in the price of coffee pose a persistent challenge to businesses interests like ours, but also to the stability of farmer's incomes. After the crisis, some farmers became extremely vulnerable to the free market volatility, experiencing massive drops in income, abandoning their land or clearing it for more profitable crops, or engaging in illegal activity. Price volatility remains one of the biggest challenges to this day of this industry.

The factors which drive price volatility are complex and many will not be news to you. What is particularly worrying are certain market forces at work. Evidence suggests that futures speculation has amplified short term volatility¹. Traders respond to these market behaviours in complex ways, diversifying their portfolios and giving further false signals to the market contributing to a fluctuating price of coffee². Speculation and its effects have swamped real market forces so much so that certain studies have estimated as much as 60-70% of

¹ United Nations Food and Agricultural Organisation (FAO) (2010). Price Volatility in Agricultural Markets, Economic and Social Perspectives Policy Brief 12

² United Nations Conference on Trade and Development (UNCTAD) (2011) : Price Formation in Financialised Commodity Markets: the Role of Information



commodity price fluctuations are due to deliberate speculation activities³. This is over and above other factors which contribute to price volatility such as devalued currencies – as we've recently seen in Brazil, the biggest supplier of Arabica coffee – and unpredictable weather caused by climate change, which can disrupt supply and in turn prices.

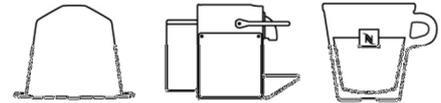
For farmers, a volatile market for buyers means uncertainty in their earnings as sellers. In addition to being dependent on the market's rules, farmers also are also dependent on external factors that exacerbate an already uncertain income. The price of fertilizer and labour and other production costs and an aging population where farmers find it increasingly difficult to draw their children into an industry with an uncertain future and unstable income prospects, for example. Trying to grapple with the challenges of price volatility and the affect that has on their lives is a very real challenge for 25 million smallholder farmers who produce the world's coffee.

So how can we make this market more stable – more predictable? Smallholders are major contributors to the global coffee economy. Global beverage companies can be a major partner, not hesitant leaders, in this re-arrangement. We have the ability to enable what one commentator calls a "global course correction" to position smallholder farmers as a crucial stakeholder partner in the value chain, not a nameless source of cheap short-term crops, with no human face. As I said earlier, for business to be sustainable, farmers have to be sustainable, and that means, amongst others, lessening the negative effects of price volatility. Nespresso not only believes but has shown that this is possible through an approach which creates shared value. Our long-term approach with the AAA Program puts the farmer at the centre. Not only does it allow to improve the quality and increase the volume of coffee, but it also values the farmer's work and his crop, which protects him better against the volatility of prices.

I often wonder "How do we create a less volatile future for coffee?", "How can agricultural markets be used to positively and permanently transform smallholder farming and create a sustainable future for coffee?" I see three key points that could help.

Number 1: commit to the long-term. Companies can unfortunately lose interest in coffee farmers when coffee is available cheaper elsewhere. Farmers never know from one year to the next who will come to buy their coffee and in which quantity. They can't plan and, in the case of a buyer not coming back, this results in a devastating loss of income. The Nespresso business model deliberately builds long-term relationships with farmers to buy directly from them. And even when prices go up, we stay with those farmers. This allows us not only a consistent supply, but it allows us to work with farmers in creative ways to create tailor-made aroma profiles. If they know we are going to be there year after year, they are more willing to work with us to create new and novel offerings. A few years ago, we worked with farmers in Santander, Colombia, to create a late harvest coffee. This meant that the farmers needed to understand what we were setting out to do and needed to trust us that we would be there for them, whether or not the novel approach worked.

³ Filimonov, V (TH Zurich) / Bicchetti, D (UNCTAD) / Maystre, N (UNCTAD) / Sornette, D (ETH Zurich) (2013): Quantification of the High Level of Endogeneity and of Structural Regime Shifts in Commodity Markets



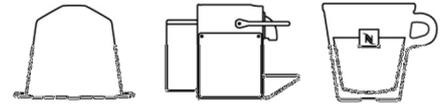
Number 2: empower whole communities, for the future. Look for and create innovative models which bring about stability for whole farming communities. Because without a stable community and a viable future for those in the community, the farmers on their own will not be able to survive. By looking at the bigger picture, we can make sure that coffee production remains an attractive prospect for existing farmers as well as for the next generation should they choose to follow in their footsteps. I am extremely proud of the steps we have taken in this regard. Last year we launched a pilot retirement savings plan for farmers like Fabio in Caldas, Colombia, who I mentioned a little while ago. The approach is part of a groundbreaking public-private partnership with the Colombian Ministry of Labour, Fairtrade International and others. The initiative leverages the national retirement scheme, Beneficios Económicos Periódicos (BEPS), developed by the Colombian Ministry of Labour to reach Colombian workers whose income does not allow them to contribute to a pension in their old age. Through premiums that we pay and government funds, farmers can start planning for their retirement. This finally makes the idea of retirement a possibility for farmers, and provides an incentive for his children to take over the farm and stay in coffee farming. Leonel, farmer in Caldas Colombia saw this new scheme as providing him peace of mind to continue coffee production.

Number 3: invest in quality. To uphold the Nespresso vision, to offer the best coffee at home, we are more than a little bit fussy about quality. Investing in quality benefits more than just our bottom line. Investing in quality benefits the entire value chain. The customer gets great coffee, the farmer gets a better price for his higher grade crop, and our business thrives. It also has the effect of beginning to 'de-commoditise' the coffee market. This makes sense today as consumers are becoming more discerning about what they drink and where their coffee comes from.

Our investment in increasing the quality of the coffee our farmers grow also has an important residual effect on the market, which sees an increased supply of higher quality beans from the farmers selling surplus to the open market. The independent study I referred to earlier about the impacts of our AAA Program also showed that 66% of AAA farmers' coffee was sold to Nespresso and the rest was sold into the broader coffee market. This means that our investment in quality and sustainability as part of our AAA Program benefits the wider coffee market.

Gourmet coffee is estimated to represent about 10-20% of the global coffee crop, depending on sources. If we look at the market, only 20% of coffee was purchased at a premium in 2014, representing around USD 350 million. A substantial figure, but I strongly believe that there is still plenty of room for our industry to improve and invest more in farmers.

We've chosen to pursue sustainable quality coffee at a higher price. We have also chosen to decouple premiums paid to the farmers from the commodity market, 'de-commoditising' coffee. We deliberately do not correlate the premiums we pay farmers to the market price, so those premiums remain stable over time and lessen the effects of volatility on farmers' incomes. Ensuring that farmers run stable and sustainable businesses is the only way we can deliver on our brand promise to customers as the company grows. It is a self-fulfilling model made possible only through creating shared value.



For Nespresso, Creating Shared Value is a mindset, a holistic approach. But I am convinced it is also an opportunity for the entire sector, in many diverse contexts.

Some will say it's easy for us to talk about Colombia, and tell you that story, because it's a great example of how creating shared value works. But the reality is that there are many other shared value stories yet to be written, other farmers who face challenges that we can try and tackle at our level.

Since 2011, we have been working in South Sudan with our partner TechnoServe, with the aim of reviving high-quality coffee production in the country. There is a wealth of challenges there, including lack of infrastructure. We have to start with the basics. But our engagement and commitment in the country is starting to yield the first promising results: the first wet mills, the first cooperatives, new agronomy skills, new processes, new income directly benefitting farmers, new GDP for the country. With our partners we are proud to have exported the first coffee from this country in 30 years. The first non-oil export from the country. There is much still to be done, but through our willingness to bring a unique Robusta to our consumers we are unlocking potential opportunities for hundreds of farmers in the country. A farmer in South Sudan named Joseph has recently told us: "We now have hope. We farmers want to do something really great, to uplift this nation."

Ladies and gentlemen, we don't have all the answers, but we believe that creating shared value is part of the solution to some of the global challenges faced by the coffee industry today, and in particular to mitigating the negative effects of price volatility for farmers. I strongly believe we have a role to play to build a reliable income and a sustainable business future for farmers like Leonel and Fabio in Colombia and Joseph in South Sudan and their families.