

REPORT TO THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009

REPORT ON
HAWAII-GROWN COFFEE LABELING AND INSPECTION, AND
ECONOMIC IMPACT OF POTENTIAL CHANGES TO MINIMUM CONTENT
REQUIREMENTS

In response to Senate Concurrent Resolution (SCR) 102, 2007 Legislature

Prepared by:

THE STATE OF HAWAII
DEPARTMENT OF AGRICULTURE

February 2009

Section I

Background

A. Senate Concurrent Resolution (SCR) 102

For several years, coffee farmers in the Kona district of the island of Hawaii have been concerned about the percentage of Kona produced coffee in packages labeled with the Kona name. They believe that consumers may become confused when the Kona name is used as part of the label and lead them to believe that they are paying for Kona coffee when in fact there is only 10% or less Kona beans in the package. For this and other reasons, the Hawaii State Legislature passed Senate Concurrent Resolution (SCR) 102 (Appendix A).

In 2007, the Hawaii State Legislature requested through SCR 102 that the Hawaii Department of Agriculture (HDOA) study labeling requirements relating to the use of Hawaii-grown coffee names and study the effectiveness of the Hawaii Administrative Rules relating to inspection certification, and audit requirements for Hawaii-grown coffee.

SCR 102 also requested the HDOA to conduct an economic analysis of the probable impact upon the Kona coffee industry, and each segment of the coffee industry in other parts of the state, of increasing the minimum content of the Kona coffee blend requirement from 10% to 50%. No funding was appropriated for the study and economic analysis, consequently severely limiting the HDOA to carry out the full scope of the legislation. This report summarizes the activities and findings which resulted from HDOA's efforts using its own limited resources.

B. Hawaii Coffee Industry

Coffee ranks fourth by value among Hawaii's diversified agriculture crops at \$31,875,000 in 2007. Its value comprises 6.9% of diversified agriculture production. Statewide, 830 farms totaling 7,800 acres are planted in coffee. Coffee farms are concentrated on the Big Island with 790 of the 830 farms (95.2%) and 3,800 acres planted in coffee while the remaining 40 farms and 4,000 acres are located in Kauai, Maui and Honolulu counties.

The USDA, National Agricultural Statistical Services Hawaii field office reports that Hawaii county production of 3.9 million pounds in the 2007/2008 season was down by 3% from the previous season (4.0 million pounds). Production from the other coffee producing areas of the state increased to 3.6 million pounds from 3.4 million pounds.

Hawaii county coffee growers received an average price of \$6.50 per parchment equivalent pound in the 2007/2008 season, 2% above the price received for the 2006/2007 season. Kauai, Honolulu, and Maui county coffee growers received an average price of \$1.81 per parchment equivalent pound in the 2007/2008 season, down from the \$1.83 received in the previous season.

Section II

Process and Findings

A. Industry Collaboration

During 2007-2008, the HDOA held a series of meetings to seek input from the various coffee associations and industry groups including, the Hawaii Coffee Association, Kona Coffee Council, Kona Coffee Farmers Association, Ka'u coffee farmers, Maui Coffee Association and Kauai Coffee Company.

Regardless of their position on minimum blend requirements, it was made clear during these meetings that all industry groups, associations, companies and individual farmers are genuinely interested in supporting, developing, and protecting Hawaii's coffee and agricultural industry. This being said, there are major differences of opinion within the industry on the best way to support, develop, and protect the industry that should be addressed through dialogue and engagement rather than through actions that further divide the industry and damage Hawaii's brand.

B. Industry Position on Blends

Based on information gathered during these collaborative meetings the Kona Coffee Farmers Association ideally prefers a 100% Kona content. The Kona Coffee Council, Hawaii Coffee Association, Maui Coffee Association, and Kauai Coffee Company advocate completing an economic impact study before modifying the current minimum blend requirement of 10% Hawaii-grown coffee.

The majority of Hawaii coffee companies who produce and sell blends of Hawaii-grown roasted or instant coffee sell 10% blends, while some produce and sell 30% blends of Hawaii-grown coffee.

C. Industry Position on Green Coffee Inspection

Mandatory Certification

The Commodities Branch, within the HDOA's Quality Assurance Division, is responsible for the inspection and certification of Hawaii-grown green coffee beans, as described in Chapter 147, Hawaii Revised Statutes (HRS) and Chapter 4-143, Hawaii Administrative Rules (HAR).

Act 345 (SLH 1997) established mandatory certification of all green coffee beans produced in the state and shipped outside the area of their geographic origin to any point within the state or outside the state. However, this requirement does not apply to green coffee distributed within the geographic region of production, or roasted and distributed within or outside the geographic region of production.

Under the current law, §486-120.6, HRS, all Hawaii-grown roasted coffee must meet the minimum grade standard requirements under the rules adopted under Chapter 147, HRS. Concerns were raised by one coffee association that the quality of the "uncertified" Hawaii-

grown green coffee roasted within the geographic region of production may not meet the minimum quality requirements. The association proposed that the department require that all Hawaii-grown green coffee be certified to ensure that roasted coffee meet the minimum quality requirements.

Four coffee organizations were in favor of mandatory certification, provided that a certification fee schedule be developed to make green coffee certification affordable to vertically integrated small coffee farmers who produce, roast and distribute their own coffee. One organization feels that "just in time" roasting/shipment upon receipt of a retail order is a common business practice of small farmers and mandatory certification would severely impact this practice. This organization believes that the inspection and certification process does not add value and detracts from freshness and product quality. There is only one coffee company on Kauai. All of the green coffee being marketed by the company is certified by the HDOA.

Kona is estimated to have 400,000 pounds of uncertified green coffee being roasted within the region. Maui County (Maui and Molokai) is estimated to have 350,000 pounds of uncertified green coffee. Requiring all Hawaii-grown green coffee to be certified could potentially increase the current inspection workload by 50%, especially in the Kona region with its large number of small coffee farmers. This additional workload is expected to extend the certification turn-around time from 2 to 3 days to 2 weeks or more. This delay would have a detrimental effect on Hawaii's coffee industry, due to the limited storage space, and potential delay of shipments.

Additional resources, such as two positions in Kona, one position in Maui, purchase of coffee grading equipment for the Maui office, and increased office space in Kona would be needed by HDOA to conduct certification of all Hawaii-grown green coffee in a timely manner. Based on the general economic climate and forecasted budget cuts, it appears highly unlikely that the HDOA will be capable of conducting certification of all green coffee beans in the near future.

Repeal of Parchment Coffee Grade Standards

Section 4-143-5, HAR pertains to the standards for grades of parchment coffee. These grade standards are no longer being used by the industry. In order to determine the grade of parchment coffee, it must be first peeled to determine the color and quality of the green coffee as required within the grade standards. All of the coffee organizations were in favor of a proposal to repeal the parchment grade standards.

In 2009, HDOA will initiate the repeal of the parchment grade standards through amendment to Chapter 4-143, HAR.

Certification Exemption on Shipments Packed In Less Than Wholesale Quantities

Section 4-143-2 (b)(1), HAR, exempts certification of green coffee packed in less than wholesale quantities (10 pounds) and labeled for sample distribution. There have been instances in which several packages of "sample" shipments of green coffee were packed in a shipping container. The present language in the HAR has been found to be vague and the department intends to tighten up the language of this exemption to limit a sample shipment to only 10 pounds of green coffee. All of the organizations appeared to be in favor of this proposal. The department will be seeking to amend Section 4-143-2 (b)(1), HAR, in 2009.

Optional Size Requirement within the Grade Standards

Minimum green coffee bean size is included in the grade standards for Extra Fancy, Fancy, and No. 1 grades. It was suggested to the HDOA that the minimum size requirement be eliminated from these grade standards and green coffee bean size made optional, provided that there is a uniformity of size requirement. The department received mixed responses from members of the coffee organizations, many stating that it could create confusion with their customers. The department will conduct further discussions with the industry members on how to best address the grading of the smaller coffee bean varieties.

Require the Exact Grade Be Marked On All Hawaii-Grown Green Coffee Being Offered For Sale, or Transported Within Or Outside Of the Geographic Region of Production

The current Hawaii Administrative Rules only require the exact grade be conspicuously marked on green coffee sold, offered for sale, exposed for sale or transported outside of the geographic region of production. Presently, green coffee failing to meet the labeled grade can legally be sold and transported "as is" to another company within the same geographic region. The HDOA feels that the existing language should be strengthened to prohibit mislabeled product being distributed within the geographic region. In 2009, the HDOA will be seeking a rule amendment to tighten up the language to require the exact grade be marked on all green coffee being offered for sale, or transported within or outside of the geographic region of production.

D. Industry Position on Labeling

The Measurement Standards Branch within HDOA's Quality Assurance Division is responsible for the enforcement of Chapter 486, Hawaii Revised Statutes (HRS) pertaining to the labeling of Hawaii-grown coffee. Presently, the statute requires the declaration of the Hawaii geographic origin(s) of the coffee if the package contains 10% or more by weight of Hawaii-grown coffee, and sold locally in the state. Chapter §486-120.6 does not prohibit or restrict the use of trade names or brand names that contain Hawaii-origin coffee names, e.g. "Kona", if the packages contain ten per cent or more coffee by weight from that geographic origin".

The statute describes how an identity statement must be part of the labeling and must include a declaration of the percentage content of Hawaii-grown coffee, and the font size that is required based on the size of the primary display panel.

In its present form §486-120.6 prohibits the use of a Hawaii "geographic origin in labeling or advertising, including in conjunction with a coffee style or in any other manner, if the roasted or instant coffee contains less than 10% coffee by weight from that geographic origin".

Some members of the coffee industry claim the statute and its labeling requirements cause consumers to become confused because the trade name or brand name found on the primary display panel may include a Hawaii geographic origin name and lead consumers to believe that the coffee package contains, e.g., 100% "Kona" or 100% "Maui" coffee, not the 10% minimum Hawaii-grown coffee, blended with other coffees, as disclosed in the smaller, less prominently positioned identity statement.

SCR 102 asks the question: Is there a need for Federal labeling laws to address misrepresentation of origin? Federal legislation already exists that prohibits false or misleading labeling and advertising of consumer commodities. Unfortunately, two of the three federal

protections against misrepresentation can only be pursued by the agencies themselves. In instances when HDOA has made its concerns over coffee misrepresentation known to the federal agencies, the reaction has been that it is considered a low priority issue as it affects only one state in the nation. For example, The Federal Food, Drug, and Cosmetic Act addresses false or misleading geographical origins, and is enforced by the Food and Drug Administration but does not give a private right of action. Under the Federal Trade Commission Act, enforced by the Federal Trade Commission (FTC), false geographic origins can constitute an unlawful, unfair method of competition. Only the FTC can initiate action in the event that false geographic origins are alleged. The Lanham Act does give a private right of action to persons damaged by the use of a false or misleading representation of fact (including false designation of origin). However, pursuing a private right of action can be a complicated and costly process for Hawaii's primarily small businesses. In addressing the problem at a state-to-state level, it is very difficult for Hawaii to compel other states to devote resources to address the issue of misrepresentation of a coffee's origin by a company within the other states' jurisdiction. HDOA has had some limited success in working with its counterparts in other states on an informal basis to address the problem of the misuse of the Hawaii "brand" through education. We will continue this approach as we work with the Hawaii coffee industry, legislators, and congressional delegation to arrive at a reasonable and enforceable solution.

HDOA has conducted a preliminary review of an existing California law that was created to protect the quality and reputation of Napa Valley wine. HDOA believes that there are features of the California law that can be used to amend §486-120.6 to regulate the use of Hawaii geographic origins in both Trade and Brand names. However, restricting the use of registered Trade and Brand names that contain "Kona" or other Hawaii-grown coffee names to those packages containing only 100% Kona Coffee or 100% Hawaii-grown coffee may negatively impact some coffee companies that use Trade or Brand names on packages containing only 10% Kona or Hawaii-grown coffee. Since only one Hawaii coffee group was interested in amending §486-120.6 in this manner; more discussion is required.

Another course of action which HDOA will pursue in 2009 is to include Trade and Brand names in §486-1's definition of "label," recognizing that this definition will affect the entire chapter. A thorough review of §486 will need to be completed to determine if there are any potential conflicts with this definition amendment. A formal request was made to the deputy attorney general assigned to HDOA's Quality Assurance Division and the deputy attorney general is currently conducting the review.

E. Economic Analysis of Minimum Content Requirements

SCR 102 requests that a thorough economic analysis be conducted of the probable impact of increasing the minimum content requirement to 50% upon each segment of the Kona coffee industry and each segment of the coffee industry in other parts of the state. No economic analysis was conducted for the reasons previously stated. In the interim report, it was reported that the Hawaii Coffee Association was given an estimate of \$200,000 to conduct the economic analysis by the University of Hawaii, College of Tropical Agriculture. Subsequently, upon asking for a copy of the proposal, HDOA learned that the estimate was a verbal estimate only.

We have attached a copy of a proposal prepared in January 2007 by the Kona County Farm Bureau as an example of a methodology and another estimate of cost to conduct the economic analysis if funds become available in the future (Appendix B).

The researchers proposed to collect various types of Hawaii coffee background, production and market data and to conduct a number of coffee buyer and seller surveys. As such, the proposal is considered "descriptive" in nature. The proposal did not address a number of critical survey research requirements including sampling strategies and sample size, how to deal with non-respondents to the survey, construction and pilot testing of the survey questionnaire and items. Additionally, while some research questions were outlined, no research hypotheses were posed nor were data analysis methods outlined or proposed.

While the attached proposal lays the groundwork for what might later become a solid effort to analyze Hawaii's coffee situation, the proposal cost estimate would likely be higher if a more solid research strategy were proposed or even if the identified shortcomings of the attached proposal were addressed to satisfy research standards.

The Kona County Farm Bureau (KCFB) proposal was developed by a consortium of universities from outside of the State of Hawaii working in limited partnership with the UH College of Tropical Agriculture and Human Resources. The KCFB had decided not to ask Hawaii based researchers for proposals due to potential study biases that might arise stemming from intimate researcher knowledge of Hawaii's coffee production relationships.

Section III

Recommendations

1. When economic conditions allow, an economic analysis should be funded to determine the most economically advantageous blending policy that also protects the consumers from fraudulent practices.
2. When economic conditions allow, consider funding for staff and operating expenses to enable HDOA to conduct mandatory certification of all green coffee, which will also necessitate amendment of Chapter 147.
3. HDOA will undertake revision of Chapter 4-143 Hawaii Administrative Rules.
4. Upon completion of review and receipt of recommendations from the Department of the Attorney General, HDOA will, if appropriate, redefine "label" to include Trade and Brand names.
5. The industry should refrain from negative actions which harm any segment of the Hawaii coffee industry which is operating legally.
6. The industry and HDOA will continue to identify and discuss laws similar to the Napa Valley wine law for possible adoption in Hawaii.
7. The industry will work with HDOA to find common ground and to protect the Hawaii brand.

SENATE CONCURRENT RESOLUTION

REQUESTING THE DEPARTMENT OF AGRICULTURE TO STUDY LABELING REQUIREMENTS RELATING TO THE USE OF HAWAII-GROWN COFFEE NAMES AND STUDY THE EFFECTIVENESS OF THE ADMINISTRATIVE RULES RELATING TO INSPECTION, CERTIFICATION, AND AUDIT REQUIREMENTS FOR HAWAII-GROWN COFFEE.

1 WHEREAS, specialty agricultural crops, such as coffee,
2 tropical fruit, macadamia nuts, chocolate, and vanilla,
3 constitute one of the fastest expanding areas of agricultural
4 production for the state; and

5
6 WHEREAS, coffee requires a specific combination of sun,
7 soil, and water, and is successfully grown in only a limited
8 number of locations around the world; and

9
10 WHEREAS, the Kona weather pattern of bright, sunny
11 mornings, humid rainy afternoons, and mild nights create
12 favorable coffee growing conditions; and

13
14 WHEREAS, the care, skill, and cultivation practices of Kona
15 coffee farmers, most of whom operate small family-owned farms,
16 have built a reputation for quality among coffee consumers; and

17
18 WHEREAS, the Kona coffee name only applies to coffee beans
19 grown in North and South Kona, thus, coffee that is grown
20 elsewhere in Hawaii cannot be called "Kona coffee"; and

21
22 WHEREAS, under section 486-120.6, Hawaii Revised Statutes
23 (HRS), the Kona coffee name is permitted to be used on a package
24 of blended coffee that contains at least ten percent coffee by
25 weight from Kona; and

26
27 WHEREAS, the origin and percentage of the other coffees
28 contained in the package of blended coffee is not required to be
29 listed on the package label or advertisement; and



1 WHEREAS, as a result, a package of blended coffee could be
2 labeled as "Kona coffee" even though it only contains ten per
3 cent of real Kona coffee and ninety per cent of coffee grown in
4 foreign countries; and

5
6 WHEREAS, there is disagreement among Kona coffee growers
7 and processors concerning the minimum percentage of Kona coffee
8 beans that should be contained in a blend of Kona beans and
9 other coffee beans, many from out of the country, labeled as
10 "Kona coffee blend" or similar terms; and

11
12 WHEREAS, a number of Kona coffee growers and processors
13 feel that this percentage should be 75 percent at minimum; and

14
15 WHEREAS, other Kona coffee growers and processors are
16 concerned about the impact that a 75 percent requirement may
17 have on the overall price and market for Kona coffee as an
18 industry; and

19
20 WHEREAS, many small growers market their coffee as "100
21 percent Kona" on the Internet; and

22
23 WHEREAS, larger growers and processors are concerned about
24 "shelf space" in retail facilities that smaller growers and
25 processors are not concerned with; and

26
27 WHEREAS, existing labeling requirements for Kona coffee
28 causes consumer fraud and confusion and degrades the "Kona
29 coffee" name; and

30
31 WHEREAS, furthermore, coffee roasters on the mainland are
32 not bound by any labeling requirements relating to the use of
33 Kona coffee or the "Kona coffee" name, which adds to consumer
34 confusion; and

35
36 WHEREAS, in the December 2004, issue of *Consumer Reports*, a
37 writer confused Kona coffee blends with Kona coffee, and
38 mistakenly rated Kona coffee as "second rate" without
39 differentiating between pure and blended Kona coffees; and

40
41 WHEREAS, in 2005, United States Congressman Ed Case
42 introduced H.R. No. 3535 to amend the Agricultural Marketing Act
43 of 1946 to require country of origin labeling for macadamia
44 nuts; and



1
2 WHEREAS, similar legislation efforts for Hawaii-grown
3 coffee, whether on the national or state level, could establish
4 better truth-in-labeling standards for Hawaii-grown coffee and
5 lessen coffee consumer confusion; and
6

7 WHEREAS, furthermore, the high quality standards of Hawaii-
8 grown coffee beans are due to laws and administrative rules
9 enacted for the purposes of ensuring superior grade and quality;
10 and
11

12 WHEREAS, under section 147-7, HRS, all Hawaii-grown green
13 coffee beans (coffee beans that are milled and ready for
14 roasting) need to be inspected and certified by the Department
15 of Agriculture (DOA) for grade and origin unless otherwise
16 specified by rules adopted by the DOA; and
17

18 WHEREAS, title 4, chapter 143, Hawaii Administrative Rules
19 (HAR), establishes standards for coffee, including labeling
20 requirements, grade standards, inspection requirements, and a
21 coffee quality verification program; and
22

23 WHEREAS, under section 4-143-2, HAR, the inspection and
24 certification of green coffee for origin, grade, or both, are
25 required by the DOA, except for a few exceptions; and
26

27 WHEREAS, under section 4-143-10, HAR, dry millers may
28 participate in a coffee quality verification program, which is a
29 self-certification program that authorizes dry millers to
30 certify green coffee and issue a coffee quality verification
31 program certificate; and
32

33 WHEREAS, the DOA must follow a coffee quality verification
34 program audit scheme consisting of three levels of audits
35 depending on production output for dry millers participating in
36 this self-certification program; and
37

38 WHEREAS, the audit scheme ensures that a consistent level
39 of quality is maintained for all green coffee beans grown in
40 Hawaii because poor quality coffee degrades the "Kona coffee" or
41 "Hawaii Seal of Quality" names; and



1 WHEREAS, the inspection and certification requirements
2 under section 147-7, HRS, and title 4, chapter 143, HAR, apply
3 to green coffee beans, and not roasted coffee beans; and
4

5 WHEREAS, roasted coffee beans are considered processed
6 foods under part IV, chapter 147, HRS; and
7

8 WHEREAS, although roasted coffee beans must also be
9 inspected for grade or origin, it does not follow the same
10 inspection and certification processes as green coffee beans;
11 and
12

13 WHEREAS, further studies need to be performed on current
14 administrative rules relating to the certification, inspection,
15 and audit requirements for green coffee beans, and whether a
16 uniform inspection and certification process should be required
17 for all coffee beans grown in Hawaii, whether green or roasted,
18 to ensure a better and higher quality of all Hawaii-grown
19 coffee; now, therefore,
20

21 BE IT RESOLVED by the Senate of the Twenty-fourth
22 Legislature of the State of Hawaii, Regular Session of 2007, the
23 House of Representatives concurring, that the DOA is requested
24 to:
25

- 26 (1) Study existing labeling requirements relating to the
27 use of the "Kona coffee" or other Hawaii-grown coffee
28 names; and
29
30 (2) Study the effectiveness of current administrative
31 rules relating to the inspection, certification, and
32 audit requirements for all Hawaii-grown coffee beans;
33 and
34

35 BE IT FURTHER RESOLVED that the DOA is requested to:
36

- 37 (1) Examine existing labeling requirements relating to the
38 use of the "Kona coffee" or other Hawaii-grown coffee
39 names;
40
41 (2) Identify problems with the existing labeling
42 requirements for Hawaii-grown coffee;



- 1 (3) Develop stricter labeling requirements under state law
- 2 and department rules for the use of the "Kona coffee"
- 3 and other Hawaii-grown coffee names;
- 4
- 5 (4) Perform a thorough economic analysis of the probable
- 6 impact of increasing the minimum content requirement
- 7 to 50 percent upon each segment of the Kona coffee
- 8 industry, and each segment of the coffee industry in
- 9 other parts of the state, such as Ka'u and on islands
- 10 other than the island of Hawaii;
- 11
- 12 (5) Determine the fiscal impact that stricter labeling
- 13 requirements or a uniform national labeling
- 14 requirement standard will have on farmers of small
- 15 coffee bean farms in Hawaii;
- 16
- 17 (6) Develop ideas for a uniform national labeling standard
- 18 and requirements for coffee roasters to abide by for
- 19 the use of the "Kona coffee" or other Hawaii-grown
- 20 coffee names; and
- 21
- 22 (7) Seek input from and collaborate with Hawaii's
- 23 Congressional delegation, the United States Department
- 24 of Agriculture, and the Federal Food and Drug
- 25 Administration on establishing and enforcing a uniform
- 26 national labeling standard for the use of the "Kona
- 27 coffee" or other Hawaii-grown coffee names;

28 and

29
30 BE IT FURTHER RESOLVED that the DOA is requested to:

- 31
- 32 (1) Examine the effectiveness of current administrative
- 33 rules relating to the inspection, certification, and
- 34 audit requirements of green coffee beans grown in
- 35 Hawaii and current statutes relating to the inspection
- 36 of roasted Hawaii-grown coffee beans;
- 37
- 38 (2) Seek input from and collaborate with coffee
- 39 associations and coffee growers statewide on current
- 40 statutes and administrative rules relating to the
- 41 grade and quality assurance of Hawaii-grown coffee
- 42 beans;



- 1 (3) Identify any problems with current statutes or
- 2 administrative rules relating to the grade and quality
- 3 assurance of Hawaii-grown coffee beans;
- 4
- 5 (4) Determine the feasibility of establishing and
- 6 implementing uniform inspection and certification
- 7 requirements for Hawaii-grown coffee beans, whether
- 8 green or roasted, to ensure a better grade and higher
- 9 quality commodity; and
- 10
- 11 (5) Determine the fiscal impact that a uniform inspection
- 12 and certification scheme for all Hawaii-grown coffee
- 13 beans will have on growers of small coffee bean farms;

14 and

15

16 BE IT FURTHER RESOLVED that the DOA is requested to submit

17 a written report to the Legislature of its findings and

18 recommendations, including any proposed legislation, no later

19 than 20 days prior to the convening of the 2009 Regular Session;

20 and

21

22 BE IT FURTHER RESOLVED that certified copies of this

23 Concurrent Resolution be transmitted to the Chairperson of the

24 Board of Agriculture; Dean of the College of Tropical

25 Agriculture and Human Resources, University of Hawaii; President

26 of the Hawaii Farm Bureau Federation; President of the Hawaii

27 Coffee Association; President of the Kona Coffee Council;

28 President of the Kona Coffee Farmers Association; and any other

29 statewide coffee organizations.





KONA COUNTY FARM BUREAU
P.O. Box 2341 • Kealahou, Hawaii 96750
Phone: 324-6011 • Fax: 322-9633

January 31, 2007

Research Grant Proposal

I. Proposal Title: Hawaii-grown Coffee Market Study

II. Proposal summary:

The coffee plant was first brought to the District of Kona, on the island of Hawaii in the nineteenth century by Reverend Samuel Ruggles, although it was not until much later in that century that it became a consistent and worthwhile crop. Over the years, the number of acres in coffee production, and the value of the harvest and processing as well, has continued to increase in Hawaii. There has also been an increase in the number of larger companies engaged in coffee growing, processing and marketing although the century-old tradition of small family coffee farms still continues to thrive. The challenge will be to insure that coffee farmers and processing are sustainable and can withstand the structural changes occurring in the global coffee markets.

Hawaii-grown coffee is currently marketed in primarily two forms:

1. 100% Hawaii-grown coffee

Pure Hawaii-grown coffee is sold in Hawaii and around the world at prices ranging from \$18.00 per pound up to above \$45.00 per pound.

2. Hawaii-blend coffee

Most Hawaii coffee blends contain 10% Hawaii coffee. The current Hawaii state law requires that coffee labeled as a Hawaii geographic region origin coffee (e.g. "Kona Coffee") contains a minimum of 10% of the coffee being grown in the named/identified region. Typically, the remaining 90% of the blend is comprised of lower-priced coffee from various other countries, usually in South and Central America.

In Hawaii, coffee is grown on the Islands of Kauai, Maui, Molokai, Oahu and Hawaii. The largest proportion and highest value of the state's coffee production comes from the Kona coffee belt on the west side of Hawaii Island. State coffee production for the 2005/06 season was valued at \$37.3 million; \$28.2 million of the value was from Kona coffee. For the 2005/06 season, 630 coffee farms were reported in the Kona districts on 3,450 acres (2,950 acres of this were in production), producing 4.2 million pounds of green bean, according to the National Agriculture Statistics Service, Hawaii Department of Agriculture (<http://www.nass.usda.gov/hi/speccrop/coffee.pdf>)

Hawaii coffee, especially Kona coffee, has developed a reputation as a premier specialty coffee. This is very positive because the market for gourmet specialty coffees is growing and is expected to grow more in the foreseeable future. A differentiated marketing strategy has enabled producers to distinguish their products by distinct origin, defined processes, or exceptional characteristics. As a result, although about 8% of roasted coffee sold around the world is "specialty coffee", it represents over 30% in value of coffee retail sales.

The concept of specialty coffee is important. In contrast, the Hawaii macadamia nut industry has failed to distinguish Hawaii-grown macadamia nuts as a unique product, and as a consequence producers are price takers and the price they receive is determined in the international macadamia nut market.

There have not been any scientifically conducted studies of the market potential (i.e., market size, willingness to pay, comparison with commodity coffee prices) of Hawaii-grown coffee as a specialty product since 1989 (Final Report: Markets and Marketing Issues of the Kona Coffee Industry for Hawaii Dept of Ag.). This is extremely critical since the structural changes in demand at both the consumer level and at the industry level has led many coffee producing countries and regions with little information on which to base critical decisions in repositioning or maintaining their current market status. The stakeholders of the Hawaii coffee industry need reliable and valid information in order to retain their status within the competitive global coffee market. This lack of information has contributed to a significant difference of opinion regarding the future market and revenue potential associated with 100% Hawaii-grown coffee compared to blends. Also as a result, the coffee industry in Hawaii continues to make investment decisions and establish policies (e.g., proportion of Hawaii-grown coffee in blends) based on a combination of anecdotal information, personal perceptions, and/or studies completed for other coffee growing regions. The absence of scientifically gathered and analyzed market information has proved to be very divisive among coffee farmers, processors and marketers.

Farmers involved in various types of direct sales believe that there is significant upside potential associated with marketing and retailing Hawaii-grown as a 100% product; compared to selling it as a 10% blend. However, farmers who sell their cherry only on the wholesale market question whether the market for 100% Hawaii-grown specialty coffee is sufficient to increase farm-gate prices and the demand in coffee cherry. Some farmers believe that there is already too much coffee being produced while others are of the opinion that production could be doubled and demand still would not be satisfied. The problem is that neither side has the information to substantiate their perspectives and to even participate or generate a debate about the future of the Hawaii coffee industry.

There is also growing disagreement relating to the current law pertaining to coffee blends. There are some people in Hawaii's coffee industry who feel that allowing Hawaii geographic regions to be used on coffee products containing only 10% Hawaii coffee is misleading the consumer and may be detracting from the Hawaii-grown brand's position in the market (in terms of reducing the brand equity and value of the 100% Hawaii coffee blend). They further argue that increasing the required percentage of Hawaii grown coffee will enhance the quality of the product and provide opportunity to increase amount of acres of coffee in production without lowering the price to the farmer. These proponents cite examples of other states requiring higher proportion of locally grown product in order to insure a high quality product and positive perceptions of the product. For example, California state law requires wines labeled with a California appellation designation contain not less than 75% grapes grown in that region.

Farmers and processors on the other side of the issue believe that eliminating blends or significantly increasing the required proportion of locally grown coffee in blends will increase the cost of coffee to the degree that it will reduce demand and depress prices. They argue that this will drive some farmers out of business. They are of the opinion that the current high prices and demand is a temporary aberration and that the current (10%) blend law will be needed to maintain prices should the demand for coffee fall in the future. Blenders cite the high demand for 10% Hawaii blends and the large number of customers served at lower price points. They are skeptical that there is sufficient demand for higher price Hawaii grown specialty coffee. Although the cyclical nature of global coffee markets does not help in forecasting future demand, having the ability to determine which markets, value added processing, and/or new products that Hawaii farmers can utilize in making decisions will allow them to base information on facts, rather than fiction.

An industry which provides so much revenue and employment and contributes to the positive image of the state and its agricultural products should have access to scientifically conducted research to guide investment and marketing decisions. As previously stated, there have been no recent studies that provide information on the size, characteristics or behaviors of this market.

This study will be conducted in collaboration with the Kona County Farm Bureau, Kona Coffee Council, Hawaii Coffee Association and the University of Hawaii College of Tropical Agriculture and Human Resources. It will be conducted by faculty from Michigan State University and Bishops University (Sherbrooke, Canada)

III. Research Methods

The research would involve both primary and secondary data collection and analysis. The project will involve four related components.

- A. The first step will be to compile and analyze information concerning the supply and sales of coffee around the world including specialty coffees grown in different countries. The analysis will include the relative prices over time. Due to the fact that the market for Hawaii coffee has faced two major crashes over the past 20 years, the ability to understand the factors that are driving the business climate as it relates to Hawaii coffee producers will be extremely valuable.
- B. Next, we will gather and report current information relating to production (e.g., pounds, number of growers), revenue, and the direct and wholesale markets for Hawaii-grown coffees, especially Kona coffee. Information will include
 1. The production of coffee in each region of Hawaii (Kona, Maui, Molokai, Oahu, Kauai)
 2. The estimated revenues from wholesale and direct sale of Hawaii-grown and Kona Coffee
 3. Total pounds of Kona Coffee sold as 100% product, both pre-packaged and bulk products.
 4. Total pounds of Hawaii-grown coffee sold as part of blended (with other Hawaii-grown coffee) product. Total pounds of this blended product sold.
 5. Total pounds of Kona coffee sold as part of blended (with non-Hawaii coffee) product Total pounds of this blended product sold.
 6. Average retail price and price range of 100% Hawaii-grown coffee, excluding Kona Coffee.
 7. Average retail price and price range for a pound of 100% Kona coffee in Hawaii and on the mainland.
 8. Average price of blended Hawaii-grown Coffees.
 9. Average price of blended Kona Coffee.
 10. Information on demand, supply and price for specialty coffees around the world.

C. The Current Market for Coffee with an Emphasis on Specialty Coffees

This step in the research will collect and analyze secondary information (e.g., industry reports, market and preference studies) relating to the current market and market trends for specialty coffees around the world with special emphasis on North America. Information will be obtained on market potential for specialty coffees, demand from main distributors, regional distributors, and local wholesalers. Additional information will analyze the impact of developing value added processes on revenues for Hawaii farmers (i.e. new products, organic, free market). This will include both price trends and amounts and types of coffees purchased. Information will also include market characteristics of coffee consumers, coffee preferences, buying behaviors, and willingness to pay for specialty coffee products.

D. Survey of Coffee Buyers and Sellers of Specialty Coffee and Especially Kona Coffee

This component of the research will include secondary data and interviews of specialty coffee buyers and sellers in the US and Canada to determine amounts and types of specialty coffee purchased, their opinions concerning market trends and future demand for specialty coffees. Information will be collected on their current perceptions of Kona coffee, their ability to purchase the amounts of Kona coffee that they would like to purchase and any barriers to purchasing Kona coffee. This element of the research will gather additional data in regards to their perceptions of the relative quality of Kona

coffee as it relates to competitors or substitute products. An important component will be to obtain their observations on the potential impacts of coffee blends on the sale of 100% Kona Coffee.

E. Characteristics, Preferences and Behaviors of Purchasers of Blended and 100% Kona Coffee.

Identify and conduct surveys of persons who purchase Kona coffee blends and 100% Kona coffee on trips to Hawaii and at home on the mainland. Depending on costs, and availability of sampling frames, these surveys will be conducted in airports, specialty shops, hotels, restaurants, and through the internet. Both end consumers and retail outlets will be interviewed. The survey of blend buyers will focus on (a) reasons for purchasing the blends rather than 100%, (b) perceptions of flavor and quality, (c) comparisons with other coffees they normally purchase, (d) price points consumers willing to pay for specialty coffee, and (e) interest/intentions of buying 100% Kona coffee.

The survey of 100% Kona coffee buyers will focus on: (a) their specialty coffee preferences, (b) how much and what types of specialty coffees they purchase, (c) how and where they purchase specialty coffees, (d) prices they pay for these coffees, (e) price points consumers willing to pay for specialty coffee (f) when they first purchased/tried Kona coffee, and (g) their assessment of Kona coffee relative to other specialty coffees.

IV. Expected Outcome

The Expected Outcome of this long-overdue project is to provide an up-to-date, well-researched, objective market study on the economic potential of the Hawaii-grown specialty coffee industry. The objective would be addressed through studying:

- Impacts upon the local Coffee Industry of increasing/decreasing supply, of Hawaii-grown coffee
- Impacts upon the Hawaii Coffee Industry of increasing/decreasing prices
- Impacts upon the Hawaii Coffee Industry of changing Hawaii's blend laws serving to increase the minimum amount of Hawaii-grown coffee required to be included in coffee bearing Hawaii-origin identification
- The retail and production potential of Hawaii-grown coffee as a high-priced specialty product

The results of this study would assist all aspects of the Hawaii coffee industry, including farmers, processors, wholesalers, retailers, policy makers, and investors by providing increased information regarding the true potential of the Hawaii-grown coffee industry and enable fact-based decisions to be made for the future of the industry. This will aid Hawaii coffee producers by providing a better understanding of their global competitive position relative to other coffee growing regions and/or countries.

This would provide objective data for the industry.

V. Impact if Not Funded

The Hawaii coffee industry will be hampered by a lack of current scientifically gathered market and marketing data on which to base decisions and policy establishment to sustain the Hawaii coffee industry.

VI. Objectives

The purpose of this research will be to provide current information to assess various (Hawaii grown) coffee markets, product alternatives and policies. The research will provide answers to the following questions;

1. What is the market potential (in Hawaii, on the mainland, and internationally) for Hawaii-grown coffee?
2. What is the market potential (i.e., pounds, prices) of 100% Hawaii-grown coffee?

3. How much Hawaii-grown coffee could be produced without reducing the price and/or revenues to coffee farmers?
4. What is the current impact (e.g., perceptions of quality, brand identification, price elasticity) of 10% origin blends marketed as Hawaii coffee?
5. What would the likely impact (e.g., pounds of coffee demanded, price of coffee, number of processors, perceptions of product quality) of changing the current law to require a minimum of 25% Hawaii-grown Coffee as part of blended products?
6. What would the likely impact (e.g., pounds of coffee demanded, price of coffee, number of processors, perceptions of product quality) of changing the current law to require a minimum of 50% Hawaii-grown Coffee as part of blended products?
7. What would the likely impact (e.g., pounds of coffee demanded, price of coffee, number of processors, perceptions of product quality) of changing the current law to require a minimum of 75% Hawaii-grown Coffee as part of blended products?

VII. Benefits / Values of the survey/analysis:

This research would provide a number of benefits including reducing uncertainty and barriers associated with marketing and policy decisions related to Hawaii-grown coffee. Coffee farmers, processors and retailers would be in a better position to (1) evaluate increasing the acreage in coffee production, (2) assess the sales and revenue potential of direct sales and wholesale markets, (3) analyze the impacts of increasing the minimum blend requirement, (4) determine the potential impacts associated with increasing production of Hawaii specialty coffees, (5) evaluate the return on investment for coffee-processing equipment, such as coffee pulpers and roasters. The report will provide information regarding alternative marketing channels including wholesale, direct sales and Web-based marketing. Legislators would have more objective information to evaluate the likely impact of proposed coffee related policies and regulations. Within the shifting nature of the global specialty coffee market, results of this objective study regarding Hawaii's coffee industry will provide us with the knowledge to *increase* our competitive edge within the market and to *expand* the viability of Hawaii's agriculture.

VIII. Timeline:

| COMPONENT | MONTH STARTED | MONTH COMPLETED |
|---|---------------|-----------------|
| 1. Identify and compile list of stakeholders, farmers, processors, and distributors of Hawaii Coffee | 1 | 3 |
| 2. Identify and compile list of suppliers and distributors of coffee globally | 1 | 3 |
| 3. Develop data collection instruments and/or processes to obtain information from parties identified in Components 1 and 2 | 1 | 3 |
| 4. Commence data collection from parties identified in Components 1 and 2 | 2 | 3 |
| 5. Complete a thorough review of secondary information of global coffee markets (with focus on North American Specialty Coffee markets) | 2 | 3 |
| 6. Analyze and summarize data obtained in components 4 and 5 | 3 | 4 |
| 7. Using the results obtained in Component 6, develop data | 4 | 5 |

| | | |
|--|----|----|
| collection instruments for coffee buyers and specialty coffee sellers in the U.S. and Canada | | |
| 8. Begin identifying and developing a sampling framework of consumers of 100% and 10% Hawaii Coffee | 4 | 6 |
| 9. Finalize sampling framework and data collection instruments for both parties identified in Components 7 and 8 | 6 | 8 |
| 10. Pilot test both data collection instruments | 8 | 9 |
| 11. Data collection of coffee sellers | 9 | 10 |
| 12. Data collection of coffee consumers | 9 | 10 |
| 13. Analyze data | 10 | 11 |
| 14. Present report and develop action plans for stakeholders | 11 | 12 |
| 15. Project Conclusion Report | 12 | 12 |

IX. Budget (Line items specific to request for HFBF funding. You may use the Federal Standard Form 424A)
 personnel, fringe benefits, travel, equipment, supplies, contractual, construction, other, total direct and indirect charges.

| RESEARCH COMPONENTS | ESTIMATED COSTS |
|--|-----------------|
| Component 1 | |
| - Secondary Data Collection and list development | \$4,000.00 |
| - Report Development | \$500.00 |
| Component 2 | |
| - Secondary Data Collection and list development | \$4,000.00 |
| - Report Development | \$500.00 |
| Component 3 | |
| - Development of web-based survey instruments | |
| - Data Collection | \$8,000.00 |
| Component 4 | |
| - Data Collection | \$5,000.00 |
| Component 5 | |
| - Secondary data collection on Global Coffee Markets | \$7,000.00 |
| Component 7 | |
| - Data analysis (information obtained in Component 4) | \$4,000.00 |
| - Development of web-based survey and intercept survey | \$13,000.00 |
| Component 8 and 9 | |
| - List obtainment and development | \$7,000.00 |

| | |
|---|--------------------|
| Component 10, 11, and 12 | |
| - Pilot testing survey instruments | \$3,000.00 |
| - Data Collection | \$20,000.00 |
| Component 13 and 14 | |
| - Data analysis | \$8,000.00 |
| - Report Development (web and paper) | \$2,000.00 |
| - Dissemination of Reports to Stakeholders | \$500.00 |
| Travel | |
| - 2 Trips (3 People Per trip) Airfare, Per Diem | \$12,000.00 |
| Supplies | \$500.00 |
| Telecommunication Costs | \$1,000.00 |
| TOTAL | \$88,000.00 |

X. **Special Conditions (List any special contract conditions)**