



Fairtrade Foundation

Review of UK supply chain, returns to producers, and retail margin issues

The Fairtrade system is about trading as directly as possible with producer organisations and ensuring that all participants comply with Fairtrade standards. These standards guarantee fair and sustainable terms of trade for producers in developing countries. Our partner, Fairtrade Labelling Organisations International (FLO), audits the price and/or premium paid to Fairtrade producers, while the Fairtrade Foundation audits the commercial activities related to the purchase and sale of Fairtrade products in the UK. Fairtrade licensees pay a fee of 1.8% of net wholesale value which pays for this work and for the Fairtrade Foundation's work in promoting Fairtrade in the UK.

Question: How much do farmers receive from the retail price of a product sold on Fairtrade terms compared to the same product sold on conventional terms?

Response: We are frequently asked this sort of question. While such comparisons would be a simple way to demonstrate the impact of Fairtrade from the consumer's perspective, they don't actually address the real inequities in typical conventional market arrangements. For producers, the value of Fairtrade is not about the relationship of their selling price to that of the finished product, but to their costs of production and the conventional market price. We are also concerned that there are many complex and variable factors to take into account in comparing different elements of the final price paid by consumers which can be misleading.

For example, the price received by a cocoa or coffee producer selling to the conventional market depends on many factors including:

- fluctuating international market prices - the producer 'cut' from a chocolate bar will vary according to the international price of cocoa at the time of sale and the percentage cocoa content of the bar
- whether the producer is an independent smallholder or a plantation employee
- whether the smallholder/co-operative/plantation carries out processing or other value-added operations
- whether a smallholder sells directly to a local buyer or is a member of a co-operative
- whether the co-operative sells to local traders or to auction, or exports the product on behalf of its members
- local trading conditions - these can vary greatly within a country let alone within different continents e.g. whether the industry has been liberalised or is state-regulated
- the varying costs of production from country to country
- the varying plantation labour standards and wage agreements from country to country

Once the primary product is sold to a registered Fairtrade importer, the costs are similar to those for a conventional product - transport and export costs; shipping and insurance; import licences and taxes; ripening or processing; packing; warehousing and distribution; marketing and promotion; retailer overheads. It should be understood that the Fairtrade Foundation has no control or influence over commercial costs or margins. And because the major costs of the finished product are incurred after the producer has sold the commodity, the return to the producer will inevitably make up a relatively small percentage of the retail price.

As in conventional markets, there are a number of different supply chains within Fairtrade. For example, a large well-organised secondary level co-operative, such as Coocafe in Costa Rica, organises the transport, processing and exportation of coffee produced by its nine member co-ops that represent 3,500 small-scale coffee farmers. A UK buyer purchases coffee directly from the co-op on behalf of its partner coffee company. The buyer contracts out the roasting, packing, etc., before the finished product is delivered to the coffee company's warehouse. Distribution is arranged to a variety of retail outlets including major supermarket chains. The coffee company's main role is marketing and new product development.

In another model, a small co-op, such as Aprocapi in Colombia, pays for processing and export services. A registered Fairtrade exporter then supplies the coffee to registered importers in Europe who in turn sell on Fairtrade terms to small, independent licensed roasters who market their product to outlets such as the catering trade or health food shops. The importer also fulfils orders for finished product from small coffee marketing companies. As it is not commercially viable for a small coffee company or retail outlet to directly import small shipments of coffee, this process allows those companies to participate in Fairtrade.

Once the product is in the UK, Fairtrade companies employ efficient services that have been honed over the years by commercial trade, and to which there is no cost-effective alternative.

As long as the Fairtrade standards are met, the way the finished product is traded is the responsibility of the trading partners, i.e. the Fairtrade-licensed company and the supermarkets or other retail outlets. They decide at what price it will be sold to the consumer and the Fairtrade Foundation has no control or responsibility over this. Supermarkets and their suppliers negotiate the retail price of each product, a process that incorporates the revenue/profit targets for each square foot of shelf space, and supermarkets obviously have the upper hand in this process. No commercial company will be involved in Fairtrade unless it is a fully commercially viable proposition for them - our role is to ensure that it is also a fully commercially viable proposition for the producers.

One element, however, that can increase the price of Fairtrade products is the retail margin that supermarkets take. They always work on a percentage margin of the retail price, so the higher the initial price the greater the retail margin in monetary terms even though the percentage is the same. Therefore the monetary margin taken on a Fairtrade product would be higher than on a comparable conventional product if the RRP of the Fairtrade product were higher.

Supermarkets argue that this doesn't necessarily mean higher profits. Rather that it covers the higher costs incurred in retailing smaller volume products compared to high volume products. Supermarkets and major brands employ significant economies of scale in sourcing and marketing their products. They are purchased in large volumes at low prices, and own brand products have little or no marketing costs. Because own brand, 'value' and major brands have a fast throughput they more easily meet the revenue targets per square foot of shelf space and can be sold at lower prices. Many companies that market Fairtrade products are tiny in comparison to their mainstream competitors and have much less power in the market place. They generally have much higher unit costs because they don't have the economies of scale of the major companies, and this may have a bearing on the recommended retail price. Fairtrade products are unlikely to be able to compete on price with own brand, 'value' or major brand products and should therefore be compared on price with equivalent conventional products.

Fairtrade products do not necessarily cost more than their conventional equivalent. A recent price survey showed that in many product categories, for example coffee and chocolate, both cheaper and more expensive comparable conventional products flank Fairtrade products on supermarket shelves.

Undoubtedly, some Fairtrade products are more expensive. This is because of the inherently unfair structure of conventional trade in the product. Bananas are one example. Fairtrade bagged bananas are sourced on sustainable terms from small-scale producers struggling with a global

trading environment that is forcing many of them out of business. They have no chance of competing on price with loose bananas sourced from low-wage, high chemical use plantations that are currently being used as cannon fodder in a supermarket price war.

The most important element of Fairtrade for producer organisations is the knowledge that they have secure, long-term trading relations and will receive a guaranteed minimum price no matter how low the international price falls. This is far more relevant to the producers than, for example, the amount received as a percentage of the retail price. The minimum price is designed to cover production costs and provide a sustainable livelihood for the farmer and family. It gives producers a degree of financial stability and the confidence to plan production and invest in the necessary agricultural inputs to ensure the quality of their crop. This goes hand-in-hand with the availability of pre-finance, particularly for single-harvest crops, long-term trading relationships, and access to markets through a buyer they can trust.

The Fairtrade price includes a premium to be used for social, business or environmental development, cash payments to farmers, or in any other way agreed by the organisation's members or by the workforce in the case of plantations. The producer support and development programmes co-ordinated by FLO are another important element of the Fairtrade scheme, though as yet their scope is limited by a lack of resources. The programmes offer technical and business training which strengthen producer organisations and enable them to compete more effectively and efficiently in both local and export markets.

Examples of Fairtrade and international prices

For most Fairtrade products a minimum price has been set that covers the costs of sustainable production and living. There is an additional premium as described above and, where applicable, an organic premium. When the international price is higher than the Fairtrade minimum price, then the Fairtrade price comprises the international price plus Fairtrade premium.

Coffee: growers have been facing a crisis since international prices began to slump in the late 1990s. In 2001, coffee prices fell to a 30-year low of 45 cents/lb for arabica and 17 cents for robusta, all-time lows in real terms when inflation is taken into account.

Arabica coffee: the Fairtrade minimum price paid to farmers' co-operatives is 126 cents/lb, including 5 cents/lb premium. The average international price was around 65 cents/lb in 2003, 80 cents in 2004 and passed 120 cents at the start of 2005 for the first time for five years, averaging 110 cents for the year.

Robusta coffee: the Fairtrade minimum price is 106 cents/lb, including 5 cents/lb premium. The average international price was around 35 cents/lb in 2003 and 51 cents in 2005. More on the coffee market can be found on our web site at 'Resources/publications/reports/Spilling the Beans'.

Cocoa: the Fairtrade minimum price is \$1,750/tonne, including \$150/tonne premium. The international price fell to a 27-year low of \$724 in 2000 but fears of a shortage saw prices surge to a 16-year high of \$2,000 in October 2002. Prices averaged \$1,500 in 2005.

Bananas: conventional export prices for bananas vary according to country of origin and market conditions. The minimum Fairtrade price paid to farmers' organisations in Ecuador, for example, is \$7.75 a box including \$1.00 premium. Conventional prices in Ecuador during 2002/03 fluctuated between \$3.65 and \$6.64 a box. Revised Fairtrade minimum prices and premiums for bananas for each producer country came into effect on 1 November 2005 and 1 January 2006.

More on the banana market can be found on our web site at 'Resources/publications/reports/bananas: behind the price tag' and 'Resources/publications/reports/Unpeeling the Banana Trade'. Fairtrade standards for all products, including price setting and labour, social and environmental standards, are available at www.fairtrade.net.