

oikos Sustainability Case Writing Competition 2005

2nd Prize

The Fair Trade Story

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The Fair Trade Story

Part (A): The Discovery of Charity Trade

The Discovery of Charity Trade

In the late 1950s Leslie Kirkley, the then director of Oxfam, was visiting Hong Kong where Oxfam was funding development projects to help Chinese refugees from the mainland. The Oxford Committee for Famine Relief (Oxfam) had been founded in 1942 to raise funds for the International Red Cross to help fight famine in Nazi-occupied Greece. After World War II Oxfam grew into one of Britain's foremost famine and disaster relief organizations (see Exhibit A1). Oxfam generated revenues by asking for cash and in-kind donations such as old clothes. The latter were sold through an extensive network of shops staffed by volunteers. These sales generated the income to support its aid projects.

Standing in the chaos of a Hong Kong refugee camp Kirkley was enveloped by the noise of playing children and the smells from the camp's kitchen, where rows of woks balanced on makeshift fireplaces. Suddenly he saw a group of Chinese producing small handicraft such as pincushions and an idea struck him. For a moment the camp's bustle receded. Could this be an opening for a different kind of development aid? Caught by a sudden madness Kirkley emptied his suitcase, filled it up with pincushions. Back in England he began to sell them through Oxfam's stores (Wills, 2002, interview). Soon Oxfam began systematically to import and market handicrafts from the South through its extensive network of shops (Oxfam, 2002).

Although the concept was new to Oxfam fair trade was invented much earlier (Wills, 2002, interview). *In the U.S.* the Mennonites began selling goods from poor regions through their church network in the 1940s. Over time this operation grew in size and is today operating under the name of Ten Thousand Villages (2002). Yet, although fair trade was invented in the U.S. it has been most successful in Europe.

The first occurrences of fair trade were little more than extensions of traditional charity. Goods came from people with whom the charities were already involved anyway through other development projects (Tallontire, 2001b). The traded goods from the developing world (often handicraft of no particular value) had the same function as a ribbon that the donor could pin to the lapel. They were signalling that a donation had been given, but often they had only a small functional value. In reality this activity was charity masquerading as trade. Tallontire (2001b) calls this early form of fair trade goodwill trade. According to its main actors it might be more precise to talk of charity trade.

While fair trade started to take roots in the UK, other European countries were going in similar directions. In the Netherlands the development organisation Steun Onderontwikkelde Streken (SOS) had been established in 1959 as a charity (Fairtrade, 2002), while in Germany the development movement "Aktion Dritte Welt Handel" had been founded in 1970 as an outgrowth of several Christian youth groups (NRW Kirchenarchiv, 2002).

Fair trade in coffee started as early as the 1970s. With the invention of freeze-dried granulate coffee the older version of powdered coffee gradually fell out favour. In response to this an

UK aid scheme decided to donate the old machinery for making powdered coffee to a group of coffee-producing smallholders in Tanzania. The resulting product, called Africafé, was probably the first fair trade coffee in the world, which even today can still be found in some World shops (Wills, 2002, interview).

Development through Trade or Trade Development?

Recent decades have seen an unprecedented increase in world trade, linking consumers in developed countries ever closer to producers in developing countries. Proponents of globalisation point to the trickle-down of prosperity from the so-called First World to the Third World. And indeed globalisation has brought wealth (through industrialisation) to many people in the Asian Tiger nations. However, regions such as Africa and Latin America have been less fortunate. They are relying strongly on cash crops (i.e. agricultural produce that is destined for export on the world-market rather than to be consumed locally) as their main source of income. As more and more developing countries have encouraged their farmers to switch from subsistence farming to the production of cash crops, production has soared and prices have fallen to rock-bottom levels. The people affected worst by this trend are so-called *smallholders*.

"[Smallholders are] farmers who've got a few hectares or a very small plot of land where they'll grow tea or coffee etc. Throughout Latin America and Africa there are many smallholders. They own a small plot of land and the family members often work on the land. It's usually quite difficult to get a good income." (Wills, 2002, interview)

Seeds, fertiliser and pesticides are typically bought against credit, leaving the smallholders no capital to invest in order to improve efficiency. Squeezed by low world-market prices on the one hand and big estates employing dozens of workers on the other hand, most smallholders are only barely able to make a living. A year of bad crops can bring them to the brink of poverty.

Fair trade has grown out of the development movement as a tool to help these disenfranchised producers by providing minimum prices, training, and long-term financing. In sharp difference from other developmental programmes (which are mostly financed by governmental donors and usually run on a large scale), fair trade is financed via the consumers in the developed world. Fair trade products are sold at a price premium to finance the fair trade process. It is important to stress that fair trade is not intended as a charitable donation or a mere minimum standard to protect workers, but as a continuous improvement process (Bretman, 2002, interview). Fair trade can thus be located somewhere between "development through trade and trade development" (Tallontire, 2001a).

Penny Newman of Cafédirect proposes the following distinction:

"Fair Trade is a trading partnership, based on dialogue, transparency and respect, that seeks greater equity in international trade. It contributes to sustainable development by offering better trading conditions to, and securing the rights of, marginalized producers. Fair Trade organisations (backed by consumers) are engaged actively in supporting producers, awareness raising and in campaigning for changes in the rules and practice of conventional international trade." (Newman, 2002a)

How Fair Trade Works

The constitutive attributes of fair trade are usually:

- Fair trade has a strong developmental motivation, wanting to help disenfranchised and self-employed *smallholders* to develop capabilities for accessing lucrative markets at prices that allow them a sustainable livelihood.
- Its primary instrument is the manipulation of *trading relationships* through minimum prices, premiums, pre-financing, and training.
- Fair trade is usually conducted by *alternative trading organisations* (ATOs), which have often been founded particularly for the purpose of fair trade.

The operational details differ from one ATO to another. However, most fair trade schemes include the following elements (see for example Littrell and Dickson, 1999; Mayoux, 2001; Tallontire, 2001a):

- A *minimum price*, which will always be paid even if the world market price falls below this point.
- A *price premium* of a given percentage, which is paid when the world market price rises beyond the minimum price.
- *Pre-financing* of 60% of the total order to allow smallholders to buy raw materials.
- *Training* in quality control and marketing know-how to build the capacity to also trade on the world market independently of fair trade.
- ATOs trade rarely with the smallholders individually. Instead they work with *co-operatives*, which have been formed by several smallholders. It is usually the co-operative that decides how the fair trade premium is used (i.e. to buy a van for all members or to build joint storage facilities).

The Development of Fair Trade in Britain

Upon Kirkley's return it became clear that his luggage was ill suited for sustaining an emerging trade in pincushions. So in 1964 Oxfam formalized Kirkley's efforts and began to import and market handicrafts from the South through its extensive network of shops (Oxfam, 2002). This "Bridge Programme" later became the Oxfam Fair-Trade Company.

As fair trade matured in the 1970s, it began to expand beyond the charity movement and to become a force of its own. An important new appeal was solidarity between consumers and producers rather than pure charity. International politics also entered the field as, for example, in the case of coffee sourced from Nicaragua or the Frontline African States. Trade with these countries was more a political statement than development aid. In this phase, which is usually referred to as solidarity trade (Tallontire, 2001b) or alternative trade (Wills, 2002, interview), two important developments happened:

Firstly, so called *alternative trade organisations* (ATO) emerged that were dedicated only to fair trade. For the charities fair trade had always been just one minority activity among many. The ATOs on the other hand were solely dedicated to promoting fair trade, and could thus devote more attention towards the development of this new approach. While still selling

through the traditional distribution channels (such as charities and church groups), ATOs started to build their own distribution network through specialised World Shops (also called "Third World Shops" or "One World Shops"). The Oxfam Fair-Trade Company was one of the earliest ATOs.

A second change was what might be called the "*discovery of the producer*" as a partner and not the recipient of donations. This changed the focus of fair trade from charitable towards developmental work. As a consequence ATOs had to build up new capabilities. For example, to engage with producers in long-term relationships, they had to better understand their needs and the different contextual situations of producers in various regions. Furthermore, they started to look at benefits beyond the immediate income from the traded goods, such as training and other support programmes, which would help producers to trade on the world market.

Over time ATOs grew in stature and size as they imposed themselves as the missing link between producers and consumers. In Britain three ATOs emerged alongside Oxfam. These are Traidcraft, Equal Exchange, and Twin.

- **Traidcraft** was founded in 1979 as a fair trade mail-order service (Traidcraft, 2002). It grew out of the Tearfund, an ecumenical Christian relief and development fund. Traidcraft's first catalogue was published in July 1979. From the beginning Traidcraft relied heavily on sales from voluntary reps and church groups, who also helped to raise awareness about the need for fair trade. In the beginning it was selling handicraft, moving into food products in 1982 and into clothing in 1987.
- The roots of **Equal Exchange** go back to 1979 as well (Equal Exchange, 2002b). In this year three voluntary workers returned to Edinburgh after working on aid projects in various parts of Africa. Along with a sister organisation in London, Campaign Co-op, they started buying instant coffee from Bukoba on Lake Victoria in Tanzania, launching Campaign Coffee Scotland (CCS). In 1990, structural changes separated a new trading co-operative from the educational charity. Campaign Coffee Scotland thus became Equal Exchange Trading. Today the Equal Exchange distributes fair trade products through a wide network of wholesalers who in turn supply independent whole food shops, delicatessens and organic food specialists.
- The third organisation, **Twin**, was founded in 1985 when the Greater London Council decided to set up a dedicated developing agency (White, 2002, interview). Its primary goal was to support technology and know-how transfer between the UK and developing countries. However, very soon Twin realised that the most important knowledge they could transfer concerned the capability to trade efficiently in the world markets. And it felt also that fair trade was the best instrument to reach this goal. Thus, towards the end of the 1980s, **Twin Trading Ltd** started to trade jam, honey and nuts with producer groups in Africa and Latin America.

While the three ATOs emerged in the UK, a similar process happened in other countries. The Dutch SOS, for example, shifted its focus more towards fair trade and eventually changed its name to SOS Wereldhandel (and later even to Fair Trade Organisatie and Fair Trade Assistance) (Fairtrade, 2002). In Germany the Gesellschaft zur Förderung der Partnerschaft mit der Dritten Welt mbH (gepa) was founded in 1975, growing out of the Aktion Dritte Welt Handel (Gepa, 2002). Contact between ATOs in the different countries became more frequent as they started to source from the same producer co-operatives and often also from each other. Nonetheless, until the late 1980s such contacts remained largely serendipitous.

The Social Impact of Fair Trade

Does fair trade actually reach its developmental goals? Social-impact assessments have only just begun to analyse the real impact that fair trade has. The following overview will discuss evidence from an overview study by Mayoux (2001) compiling social-impact assessments on several fair trade products ranging from coffee, via bananas, to nuts and cocoa.

Social Impacts

Fair trade departed from the assumption that markets were far from the neo-classic ideal of perfect competition. Instead market mechanisms were believed to unfairly exclude some producers – such as smallholders in the developing world – from full and fair market participation (Mayoux, 2001). The reasons why these producers were deemed to be disadvantaged were multiple. Many smallholders, for example, had no possibility to obtain production skills, market savvy, and access to financing, which would have allowed them to compete on the world market. More importantly, existing power relationships (a multitude of small and local producers facing few multinational buyers) disfavoured producers. Market data supported these arguments:

"20 years ago the world coffee market was worth \$30 billion, of which the producers received \$12 billion (40%). Now it is worth \$50 billion of which producer receive only \$8 billion (16%). The main reason for this deepening inequality has been the decline in primary coffee prices. In the past year world coffee prices fell to their lowest point for 30 years. Throughout 2000/2001 they never exceeded the Fairtrade minimum. This has left many coffee farmers in destitution, while the profits of the major brands continue to expand." (Twin Trading, 2001: 2)

There were three ways through which fair trade purported to generate positive social impacts (Barr, 2002, interview):

- Firstly, through minimum prices and premiums fair trade interventions **increased the income** of the concerned smallholders. Twin Trading reported that in 2000/2001 purchasing prices were on average 2 to 3 times the level of those on the world market, paying out £1.24 million in price premium support (Twin Trading, 2001: 1).

"The producers decide collectively how the premium [...] should be used. [...] It is either distributed as an extra payment to farmers or used collectively as investments in their business or community. [In Peru] they decided collectively that they wanted a truck. [...] Before the truck, they were carrying the sacks of coffee on their backs to the collection point, which took about eight hours. [...] In Africa they repaired a bridge and built a maternity near the tea factory." (Newman, 2002b)

- Secondly, fair trade provided **pre-financing** through low interest loans, which helped smallholders to fund farm-level purchasing. In 2000/2001 Twin reported loans of £1.5 million (Twin Trading, 2001: 1). These loans covered about 60% of every contract thus providing working capital to the smallholders to buy plants, fertiliser, and other necessary equipment, thereby keeping them out of debt (Newman, 2002b).
- Thirdly, by educating smallholders fair trade contributed to their **empowerment**. Towards this end Twin earmarked 10% of its gross profit for developing tailor-made business programs to help producers build and grow their competencies and their communities (Newman, 2002b). The producer support activities of Oxfam, Twin Trading or Traidcraft provided organisational, technical, and market support to

smallholder producer organizations with the motivation to strengthen their trading and management capabilities (Newman, 2002a, interview).

The actual social benefits of fair trade were *difficult to quantify*. However, practical experience seemed to suggest that although the financial per capita benefits from fair trade were often quite low (Bretman, 2002, interview), inclusion in a fair trade programme could mean the difference between mere survival and the beginning of a development process that might eventually lead to the production of higher quality products particularly when world market prices dropped (Tallontire, 2001a: 7).

Ecological Impacts

In their review of the social benefits of environmentally-driven trade Robins et al. (1997) pointed out that *organic products* were not automatically benefiting smallholder producers in the south. Nor was it necessarily the other way around (Equal Exchange, 2002a). Yet, although its primary concern was the improvement of social conditions among smallholders, fair trade nonetheless often increased the eco-efficiency of coffee production.

With organic certification the poor background of many smallholders came in as an asset: "[In Peru our producers] are totally organic. [...] They've never had the money for fertilisers so *they've been growing organic coffee all their lives*" (Newman, 2002b). This lucky coincidence led to a situation in which Twin Trading bought a quarter of its coffee from organic sources (Twin Trading, 2001: 3). However, there were limits as to how far fair trade could become organic. "The organic certification is expensive. It usually takes two to three years before you can get certified as well. And what happens to the farm during that time?" (Newman, 2002b)

From the consumer perspective, though, there was an increasing *pressure towards convergence* of labels and systems that would make shopping easier. "The people who are concerned about [fair trade] tend to be concerned about the environment too" (Bretman, 2002, interview).

Oxfam's Council of Management

Upon Kirkley's return the Oxfam Council of Management called a meeting. Imagine you are one of the council's members and called upon to evaluate Kirkley's most recent initiative. The agenda contains two items.

Firstly, you have to assess whether Oxfam as an organization should engage in fair trade.

- Should Oxfam embrace this new type of activity more systematically?
- How should the non-profit make this decision? What criteria are to be considered?
- Provided Oxfam decides to go ahead, how should the organization do so? How will this change the non-profit?

Secondly, you have to analyze the actual social impact of fair trade.

- How do you evaluate the social impacts of fair trade?
- How does this compare to competing mechanisms to fight poverty?
- What are the risks of fair trade that Oxfam should look out for?

Exhibits

Exhibit A1

Oxfam International's Mission Statement

Oxfam International is an international group of independent non-governmental organizations dedicated to fighting poverty and related injustice around the world. The Oxfams work together internationally to achieve greater impact by their collective efforts.

Oxfams believe that:

1. Poverty and powerlessness are avoidable and can be eliminated by human action and political will.
2. Basic human needs and rights can be met. These include the rights to a sustainable livelihood, and the rights and capacities to participate in societies and make positive changes to people's lives.
3. Inequalities can be significantly reduced both between rich and poor nations and within nations.
4. Peace and substantial arms reduction are essential conditions for development.

Oxfams understand that:

5. Poverty is a state of powerlessness in which people are unable to exercise their basic human rights or control virtually any aspect of their lives. Poverty manifests itself in the inadequacy of material goods and lack of access to basic services and opportunities leading to a condition of insecurity.
6. All poverty is almost always rooted in human action or inaction. It can be made worse by natural calamities, and human violence, oppression and environmental destruction. It is maintained by entrenched inequalities and institutional and economic mechanisms.

The Oxfam approach is that:

7. Our programs will:
 - address the structural causes of poverty and related injustice
 - work primarily through local accountable organizations, seeking to strengthen their empowerment
 - help people directly where local capacity is insufficient or inappropriate for Oxfam's purposes
 - assist the development of structures which directly benefit people facing the realities of poverty and injustice and which are accountable to them.
8. In all our actions our ultimate goal is to enable people to exercise their rights and manage their own lives.

9. For people to be able to exercise their rights:
 - opportunities must be created so people can participate in governing all aspects of their lives, and
 - they must have the genuine capacity to organize and take advantage of those opportunities.
10. Gender inequalities and other diversity issues will be addressed in our actions and programs.
11. In the economic arena, we will seek:
 - to enable people to meet their needs by creating opportunities within markets, while protecting themselves against the excesses of unregulated market forces
 - to strengthen institutions intervening in the market in the interests of the poor.
12. Preventing and reversing damage to the environment is essential to achieving sustainable livelihoods.
13. Action against violence must include:
 - coming to the aid of victims
 - strengthening people's capacity to peacefully resolve conflicts
 - demanding a determined response from the international community where the situation warrants it.
14. In working together the Oxfams believe that:
15. Oxfam International offers a unique potential to achieve greater impact on the causes of poverty and powerlessness by combining the diverse experiences of Oxfams and their partners.
16. The name "Oxfam" will stand for a clear and consistent approach. We can achieve this through closer co-operation in our communications, advocacy, education and public campaigns; fund-raising; emergency, development programs and fair trading.

Oxfam International's purpose is to:

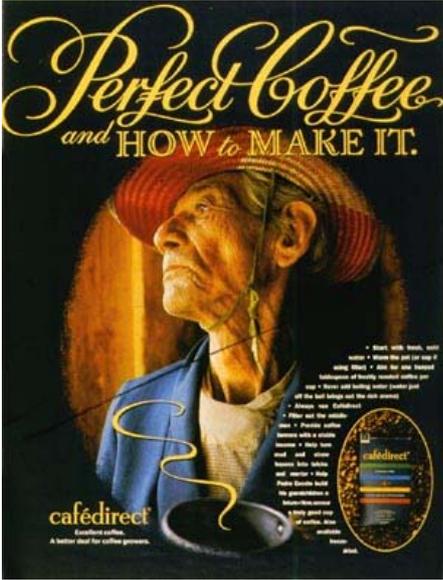
17. Further the Oxfams' common goals
18. Promote, assist and co-ordinate collaboration among the Oxfams where this will result in a greater impact of the sum total of their joint efforts
19. Protect the Oxfam name and enhance its standing.

Source: Adopted by the Oxfam Board, Ottawa, September 1996

Online: www.oxfam.org/eng/about_strat_mission.htm (Oxfam, 1996)

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The Fair Trade Story (B)

The Foundation of Cafédirect

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The Discovery of the Consumer

Alternative trade organizations (ATOs) emerged in the 1960s/70s. By providing minimum prices, prefinancing, and trade support they enabled poor producers in the Third World to participate in the world market and make a living rather than relying on charitable donations. In the UK Oxfam (which had introduced fair trade to the UK) was joined in 1979 by Traidcraft and Equal Exchange. In 1985 the Greater London Council initiated Twin. The organizations sold products from the developing world either through their own distribution channels or through a network of so called "World Shops". Clients were usually concerned citizens for whom the charity aspect of fair trade prevailed over product quality.

During the 1980s fair trade grew steadily. However, as the turn of the decade neared it became apparent that *all was not well*. ATOs found it difficult to attract new customers, while old clients were switching back to traditional products. As a result sales remained flat or even began to decrease. At Traidcraft poor mail-order sales and increased market competition led to a trading loss, which in 1991 eventually triggered a major business review and 20 redundancies (Traidcraft, 2002). Other ATOs and World shops also ran into financial difficulty.

"The producer focus of earlier periods was associated with the neglect of the consumer. As profits dropped and some ATOs faced bankruptcy, many began to look towards consumer needs and to balance these with the needs of producers. Consumer marketing, product development and product quality all became important concerns of ATOs, marking increased commercial awareness." (Tallontire, 2001: 3)

Most interestingly the initial pressure to change did not come from the ATO's themselves but rather from the producers in the developing countries. "What we need to understand, is that *it was the producers' idea*," explains Penny Newman (2002, interview). Coffee producers suffered huge price drops when in 1989 the international coffee agreement collapsed. The idea of establishing coffee export quotas on a worldwide basis had been adopted in 1962, when the first International Coffee Agreement (ICA) was negotiated by the United Nations (Shoppingplace, 2002). The agreement was renegotiated in 1968, 1976, and in 1983. However, world coffee prices plunged when participating nations failed to sign a new pact in 1989.

"The [collapse] of the international coffee agreement [...] sent the whole market into a free-fall. [...] The producers wanted two things. They said: 'First we want a minimum or fair-trade price and secondly we want people to understand what happened and what low prices mean for us.' [...] It was they who said: 'Why can't we put a mainstream brand in the marketplace?' [...] So with this idea from the producers [the four ATOs] sat together and came up with Cafédirect. Each [of the four founding organisations] had to be convinced that this was the way to go. The investment to put the brand into the marketplace was quite something for these organisations." (Newman, 2002, interview)

Prompted by producers, the four leading ATOs in the UK, Oxfam, Traidcraft, Equal Exchange, and Twin Trading, came together in late 1989 to discuss options for how to increase growth in the fair-trade market and thus to better help producers. The solidarity appeal of fair trade had reached a small group of committed customers, but it had failed to build a sustainable mass market.

Carol Wills (Wills, 2002, interview), who worked at Oxfam at that time, recalled the difficulties that had to be overcome:

"It was a very hard job to persuade the Oxfam trading board, [and] to get them to invest. [...] We were all beginners at producing the sort of business plans you now have. [The] board was full of dedicated people, [but] not many with real trading experience. They found it very hard to believe that the consortium would produce a coffee that would compete in the mainstream market." (Wills, 2002, interview)

The ATOs realised that *they had to achieve two goals*:

- Rather than having each ATO peddle its own coffee, they needed to develop a branded fair-trade coffee that would be available across the four organisations.
- Furthermore, they hoped that such a move would allow them to target the mainstream distribution channels such as supermarkets, catering, and coffee bars.

The Birth of Cafédirect

After having whipped their UK partners into action three fair-trade co-operatives in Mexico, Peru and Costa Rica each lent Cafédirect a container of coffee and agreed to take payment once the finished product was sold in the UK. The first packets of Cafédirect Medium Roast & Ground Coffee emerged in World shops in the summer of 1991 (White, 2002, interview). After a campaign by fair-trade activists, Cafédirect reached its first trial distribution in some UK supermarkets in 1992 (Cafédirect, 2002b). However, it took until 1992 before the company was officially founded, with each of the four ATOs contributing £25,000.

The distribution of roles was clear from the beginning. Twin Trading, the youngest of the four partners, would house Cafédirect and would take care of supply chain management and producer support (Wills, 2002, interview). The three others would also help Cafédirect through its contacts with producers on the ground. Yet more importantly they provided their campaigning skills and opened their whole activist network to Cafédirect. By being offered in Oxfam's over 600 shops and Traidcraft's mail-order catalogue, Cafédirect was able to reach out to a large part of its potential customers. Furthermore, the founders helped Cafédirect with its advertising campaign (see Exhibit B2).

Rather than having to build up a new infrastructure, Cafédirect could draw on the experience of its four founders thus leapfrogging years of painful build-up (Barr, 2002, interview). In 1993, Cafédirect gained national distribution in the Co-op and other supermarkets, a first for a fair-trade product (Hudghton, 2002, interview). Extending its product range, Cafédirect introduced in 1994 Medium Roast, Freeze Dried Instant coffee, the first fair-trade instant coffee. Given that in the UK about 80% of the coffee drunk was instant, this move opened up access to the mainstream market.

Emergence of a Fair Trade Labelling System

The increasing importance of consumers (epitomized through the foundation of Cafédirect) required changes in the way fair trade worked. In the early days of fair-trade the very reputation of the ATOs had been guarantee enough for their customers. However, as both products and distribution channels multiplied, consumers were increasingly sceptical: Did fair-trade premiums actually reach the producers? Furthermore, consumers faced an increasing range of fair-trade products that each applied its own mix of fair-trade criteria – ranging from very strict standards to products that could at best be qualified as "fair-trade lite".

"There are hundreds if not thousands of very small fair-trade initiatives, just based on people wanting to do something to help producers in developing countries. I think one of the main challenges we're facing is to develop a more coherent philosophy as to how these things fit together." (Bretman, 2002, interview)

One step in that direction was the introduction of *an independent verification and labelling system* to guarantee that only such products were sold as fair-trade that met certified standards. In 1988, the Dutch ATOs were the first to found an organisation dedicated to fair-trade labelling. They named it *Max Havelaar* after a 19th century book about a Dutch plantation owner who adopted a responsible approach towards his Javanese workers (Roozen and Van Der Hoff, 2002). The newly founded organisation was not involved in trading itself. Instead it maintained a fair-trade register of producers that were accredited fair-trade suppliers. Importers and retailers could obtain a label – the fairtrade mark – if they bought from these producers while observing conditions that were audited by Max Havelaar.

The concept was so convincing that soon other countries followed suit. TransFair, the German labelling organisation, was launched by gepa in 1992. In the same year the *Fairtrade Foundation* was launched by the same four partners that had founded Cafédirect. They intended both organizations to be complementary. However, Cafédirect felt that it did not need the fair-trade mark, which came with a 2% license fee on all sales with the mark.

"By the time the mark was launched, Cafédirect products were already on sale. [...] They didn't feel they needed the mark. They had the backing of four national organisations that had a fair-trade reputation. They had a distinct brand identity. They said: 'The fair-trade mark [isn't] for us.' [Yet] we felt we needed their support. We wanted a clear message to consumers and not [have to] say [that] some products carry the mark and some don't. Then Cafédirect said: 'You want us to put the mark on for solidarity, to help you, rather than us.' That sort of rooted the problems. It illustrates the lack of coherence in the trade movement. The same people who were setting us up were setting up Cafédirect. [However] there was no coherent strategy for doing that." (Bretman, 2002, interview)

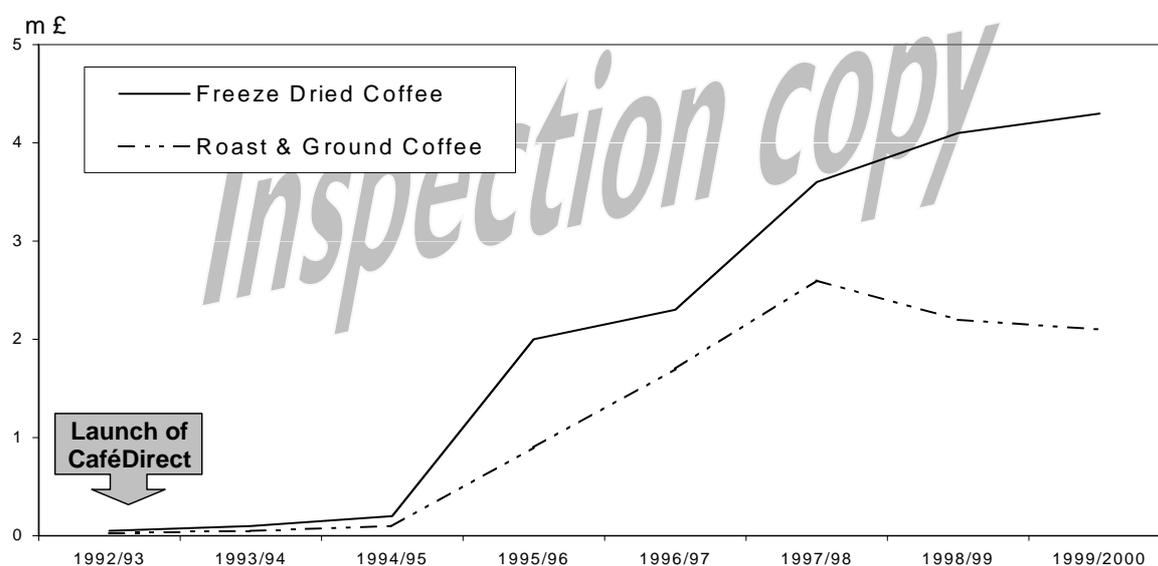
Cafédirect felt unhappy since its own fair trade criteria (what they called the "gold standard") went beyond what the Fairtrade Foundation was prescribing as minimum standards for fair trade labelling.

Reviving the Cafédirect Brand

Cafédirect's expansion was by no means easy. Its most important growth (increasing turnover by more than a factor of 10) happened between 1994 and 1997 (see Figure 1 below). By 1998, Cafédirect had reached a size at which it made sense to move out of Twin Trading's offices into their own space. Furthermore, Ian Lepper, Cafédirect's first managing director, decided to leave Cafédirect. Unsurprisingly this led to a lot of *organisational stress*.

After Lepper left Cafédirect went through some turbulent stages. The partnership between the four founding ATOs was being stretched. Sales-wise Cafédirect was still doing well with freeze-dried coffee, while Roast & Ground had dropped off. Overall sales in 1998 increased by only 8% (see Exhibit B3). Furthermore, the underlying direction of the charity spin-off was unclear as the interests of business partners, producer groups, grassroots supporters and founders diverged.

Figure 1:
Sales Growth at Cafédirect



Source: Data provided by Cafédirect (2000; 2002b)

In a radical move the Cafédirect board decided to hire an outside managing director with extensive business experience in the area of fast-moving consumer goods (FMCG) rather than a pure fair-trade specialist. The new MD, Penny Newman had worked at Schwarzkopf, Faberge, a Capital Venture Group and most recently the Body Shop. With growth rates finally levelling off, she faced the challenge to lead Cafédirect into a new management phase. When starting in August 1998, Newman realized that although Cafédirect was more market-savvy than other ATOs, it remained at its heart development-centered.

"Our mission statement is to be the leading brand which strengthens the influence, income, and security of producer partners in the south and links them to consumers. When I joined, its focus was on the developmental aspect. We have added the element of becoming a leading brand, which now gives us more commercial purpose. We also recognise [that] we can't do it without the consumer." (Newman, 2002, interview)

Lawrence Watson a freelance consultant to the fair trade movement pin-pointed a key problem: "Fair-trade activists are passionate about 'fair' but very ambivalent about 'trade'" (2002, interview). This fuelled a *constant tension* between the aspiration for commercial success and unease with the trade-offs that growth brought along. When Penny Newman came to Cafédirect, she consciously continued and even accelerated the organisation's shift from charity spin-off to ethical business venture, by pushing for more customer focus.

"I've led a culture that's much more business focussed. [...] People were shocked I was using [...] words such as 'sales'. The word 'customer' [also] was too commercial. They asked if we were forgetting the producer in this. [...] I sat in my first meeting [on fair-trade] and talked about customers and there was a deadly hush. I couldn't believe it. [...] I was talking about supply chains, about consumers, and you could see people thinking this is too commercial. This isn't the language of fair-trade." (Newman, 2002, interview)

Ian Bretman, deputy director of the Fairtrade Foundation and responsible for business development, has had similar experiences.

"For us, the key objective is [...] to get fair-trade products into supermarkets. And that means approaching companies like Starbucks. [But many activists say] you can't work with Starbucks. We're even accused of undermining what campaigners are doing. They claim a sort of greenwash, saying we give outfits the label of fair-trade for a little bit of activity. [...]" (Bretman, 2002, interview)

Driven by customer focus Penny Newman's vision was to reposition Cafédirect as a high quality coffee brand. However, this was not a self-evident strategy. The early years of Cafédirect had been plagued by inconsistency in quality. "Some batches tasted very good and others tasted very poor. That generated a lot of negative reaction in the UK to Cafédirect in the first years." (Hudghton, 2002, interview). Still Newman was positive that the organization could grow into the role.

The grudging recognition that customers were also important for the success of fair-trade notwithstanding, most ATOs in the late 1990s saw themselves still primarily as development organizations. Their strategy was to make buying fair-trade products *less difficult and less unattractive* for customers (i.e. by offering more choice and using traditional distribution and communication channels). However, their consumer appeal largely remained the same: "When people buy [fair-trade] products, there's a very heavy element of altruism. There has to be, with the message that we've got. This isn't about what this product does for you, it's about what somebody else gets out of it" (Bretman, 2002, interview). Sipping on a hot cup of Cafédirect coffee Penny Newman mused whether she could turn this appeal on its head.

Meet The Management Team

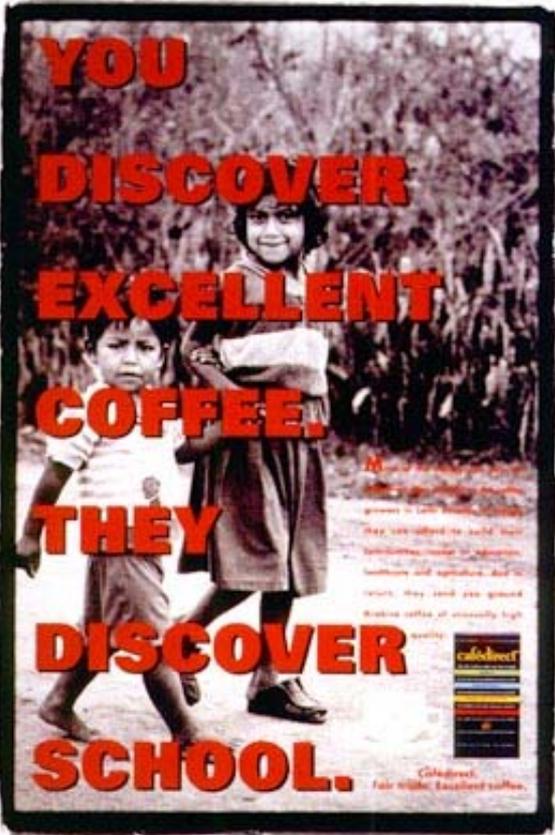
At Penny Newman's arrival Cafédirect was still a very small operation with just a handful of staff. Meetings of the management team were informal. Put yourself in Newman's shoes as she is addressing the Cafédirect's management team.

- Does the customer focus make sense? Can Penny hope to sell fair trade products like shampoo? Evaluate the commercial angle as well as the impact on social performance.
- How should Newman evolve the company's advertising strategy? Compare its approach with that of the market incumbents.
- Should the organization embrace the Fairtrade Foundation label? Consider the advantages and disadvantages of own labels versus third party labels.
- How should Cafédirect develop its distribution strategy? Consider the strengths and weaknesses of its current approach. Do the same for alternative distribution channels.
- As Newman feels the heat from some of the organization's pioneer supporters how should she deal with opposition to change?

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Exhibit B2

Cafédirect's Advertising 1993-1995



Source: (Cafédirect, 2002a)

Exhibit B3
Cafédirect Ltd – Profit and Loss Account

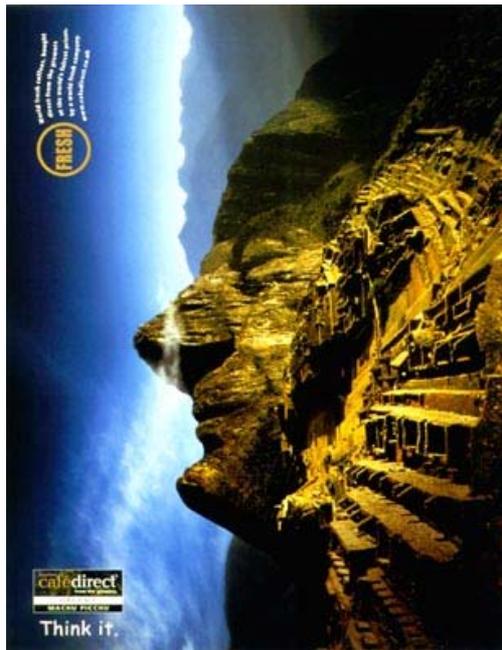
	2000*	1999*	1998*
	£	£	£
Turnover	7.207.000	6.775.000	6.262.000
Cost of sales	-4.361.000	-4.350.000	-4.358.000
Gross Profit	2.846.000	2.425.000	1.904.000
Administrative expenses	-2.507.000	-2.153.000	-1.389.000
Operating Profit	339.000	272.000	515.000
Other interest receivable			
Interest payable and similar	-34.000	-33.000	-93.000
Ordinary profit before taxation	305.000	239.000	422.000
Tax on profit on ordinary activities	-79.000	-49.000	-105.000
Profit after taxation	226.000	190.000	317.000
Dividends (incl non-equity shares)	-26.000	-	-
Retained profit for the year	200.000	190.000	317.000

* year 1 Apr - 31 Mar (12 months)

Source: (Cafédirect, 1999-2001)

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The Fair Trade Story (C)

From Charity Spin-off
to Gourmet Coffee

Inspection copy

From Fair Trade to Direct Trade

Following her arrival at Cafédirect Newman oversaw Cafédirect's re-branding and the introduction of *several new products* (Cafédirect, 2002): In 1998, Teadirect, the first non-coffee product, was introduced, this time using another shareholder, Traidcraft, as the supply chain partner for producer support and quality control. In 1999, realising that its Roast & Ground sales had been declining recently, Cafédirect launched four new Roast & Ground coffees, three of which were organic: the Organic Machu Picchu Mountain Special, Fresh Ground, the Kilimanjaro Mountain Special, Fresh Ground, the Organic Full Roast, Fresh Ground, and the Organic Decaffeinated Freeze Dried Instant. The success of the single-origin gourmet coffees was a sign that Cafédirect's quality was finally getting up to par with other gourmet coffees. In order to guarantee high quality, Cafédirect not only controlled the produce delivered, it also invested heavily in training producers on the ground. Thus Amen Mtui, for example, coffee taster for the Kilimanjaro Native Co-operative Union (KNCU), spent two months training with Twin and Cafédirect in London (Cafédirect, 2000: 5). This enabled him to be in charge of quality control at the co-operative.

Several key achievements in 2000 demonstrated Cafédirect's success in attaining *high quality* (Cafédirect, 2002): Firstly, Cafédirect Medium Roast, Fresh Ground was voted "best coffee" by Best magazine, awarded 5 stars by Prima magazine and voted "favourite coffee" by the UK's leading consumer magazine. Secondly, in December 2000, AC Nielsen reported that Cafédirect was the fastest growing brand in the UK Roast & Ground coffee market, while Teadirect had become the fastest growing brand in the UK tea market. And finally, Costa Coffee Shops decided to sell Fairtrade espresso while at the same time switching the majority of its teas to Teadirect.

"With Costa it took about two years to form a partnership. They were initially concerned that it would harm their reputation and quality. So [we] knew [we] had to prove that we could get the quality they wanted as well as a continuous supply." (Newman, 2002)

The increasing quality of Cafédirect's product made possible the entrance of fair-trade coffee to the mainstream market. However, at the same time it also initiated an important trend that would move it eventually away from its fair-trade roots and transform it into something that might best be described as *direct trade*.

"For Cafédirect, the thing they absolutely got right from the beginning was the name. [...] There's an implied consumer benefit out of fair-trade. What we've normally said about direct trade is that it helps producers. It puts them in closer touch with the market. It empowers them in their operations. What Cafédirect said was, this is a better coffee because it comes direct from the producers." (Bretman, 2002, interview)

Although it took nearly a decade to fully play out, Cafédirect had laid the groundwork for an *inversion of the rationale underlying fair-trade*. Rather than focusing only on the poor producer's benefit, Cafédirect realized that direct trade was also benefiting the customer. By providing long-term contracts and producer education, direct trade allows importers to obtain high quality coffee – year-in and year-out. While most large coffee importers buy coffee

beans on the spot market, direct trade has a built-in supply chain for reliable high-quality gourmet coffee.

Rather than being a mere development instrument, direct trade was a quality management tool. It thus adopted an approach exactly opposite to that of the early fair-trade coffees. The Africafé of the 1970s had been a low-quality powdered coffee produced on old machines that would no longer meet the requirements of the developed market (Wills, 2002, interview). The Cafédirect of 2004 was positioned at the opposite end of the quality spectrum. Cafédirect's journey from fair-trade to direct trade was exemplified by the evolution of its advertising and brand strategy.

A new Communication Approach

It took years of patient development before the smallholders were able to produce high quality coffee. By the late-1990s Cafédirect's *advertising started to shift*. "Perfect Coffee and How to Make it" (see Exhibit C4) was "the first ad in the campaign to really start to address the quality coffee story, focusing as it does on how to make the perfect cup - leaving the 'twist' in the headline to imply, rather than emphasize, the fair-trade message" (Cafédirect, 2004). However, the producer still remained the central theme of these campaigns such as in the photo of the elderly couple on the right-hand side.

It took until 1999, before Cafédirect made the definite step towards *placing the product at the heart of its communication*. The "Fresh Campaign" (Cafédirect, 2004) in Exhibit C5 for the first time fully capitalized on the quality story waiting to be told. Direct relationships make fresher coffee: "With Cafédirect, you get the pick of the crop" (Cafédirect, 2004). Rather than exhibiting *producer advantages*, the picture of a smiling Machu Picchu conveyed *product qualities* – its smell, its freshness, and its exotic origin. At the same time a new brand identity and packaging were launched, moving away from colors associated with charity (Barr, 2002).

The ultimate change came in 2001 when sales for Cafédirect's traditional freeze-dried coffee ran out of steam. Realizing that the product had been in the market for over a decade Cafédirect opted for a *radical repositioning* (Barr, 2002). They chose to rename it Cafédirect 5065, Premium Instant Coffee, which signified the optimal height at which coffee is grown (i.e. 5000-6000 feet).

"The launch of Cafédirect 5065 took place during February 2002 with a poster campaign on the London Underground. The campaign focused on 5065, 'a special place', a place where consumers can escape to when they have a break and a cup of 5065. [...] The 5065 winding road describes the relationship between your cup of coffee and the grower country, and is an escape route for the millions of us who'd like a coffee break (including coffee growers the world over). This poster adaptation was designed to break out of its poster-frame and continue its way up the curved walls and ceilings of London's underground stations, provoking passers-by to look up to the new height of coffee taste." (Cafédirect, 2004)

Cafédirect's repositioning did not go down well with all its constituencies. Some activists "have accused us of selling out and not promoting fair-trade first," acknowledged Newman (2002). The grassroots supporters were concerned that by moving from a fair-trade towards a quality message Cafédirect was actually abandoning its roots. Ian Bretman from the Fairtrade

Foundation argued that this transformation was necessary due to the changing consumer profile.

"As we move beyond the core group of information-hungry consumers into the mainstream market, I don't think fair-trade is as high on the agenda for those consumers. So you have to engage them by selling a product and gradually get them more aware of fair-trade as something they're already buying. [...] If consumers realise it's a fair-trade product [only after they have bought it], you've gotten to the same point but through a different process." (Bretman, 2002, interview)

With a 6% market share Cafédirect Roast & Ground coffee had become the sixth-largest brand and thus started to register on the radar screen of the *commercial players* (Wills, 2002, interview). The Co-op UK, for example, lobbied its traditional coffee supplier, Fine Food Foods International, to buy from registered fair-trade producers, enabling the Co-op to launch its own-brand fair-trade coffee (Hudghton, 2002, interview). Sainsbury's followed suit with its own fair-trade brand soon after (Marketing Week, 2001).

"If you look at Co-op sales in the UK, [...] fair-trade coffee (i.e. Cafédirect and other fair-trade coffee brands) used to account for 10-11% of our total Roast & Ground coffee sales. But that plateaued and we were finding it difficult to grow that any further. [...] We then introduced an own-brand [fair-trade coffee] at a lower price but at the same time gave additional promotion to Cafédirect. And in the next year we managed to double our sales. All fair-trade coffees together now account for 20% of our Roast & Ground coffee sales. [Furthermore], we will be launching a standard granule fair-trade instant coffee in September 2002. Cafédirect only operate in the top tier, the freeze-dried sector. So fair-trade sales have been limited by the fact that it's only been operating in [one] segment [of the instant coffee market]." (Hudghton, 2002, interview)

Hard Choices

While Cafédirect's eyes were set on an expansion, Twin Trading used the Cafédirect model to set up similar ventures for other products in the UK (Wills, 2002, interview). Thus in late 1998, Twin launched the *Day Chocolate Company*, which was partly owned by Kuapa Kokoo, a cocoa co-operative from Ghana (Twin Trading, 2001: 5). Its fair-trade chocolate became a resounding market success similar to Cafédirect in a short space of time. Then in 2001, Twin helped bring *AgroFair*, a fresh-fruit company jointly owned by producers and Solidaridad, a Dutch development agency, to the UK market (AgroFair, 2002; White, 2002, interview).

Yet not all fair-trade ventures were profitable. German *gepa* had been flirting with financial disaster several times in the past years (Watson, 2002, interview). Similarly after a decade of losses *Oxfam* decided in 2001 to bring in pro bono consultants from McKinsey to review its remaining fair-trade buying. While Oxfam had been sourcing some products from outside providers such as Cafédirect or the Day Chocolate Company it had maintained the fair trade import of handicraft in house. However, Kirkley's legacy was binding capital at Oxfam while continuing to lose money.

By 2003, *Cafédirect* was also experiencing problems, however, of a very different kind (Newman, 2004a, interview). Its products had been so successful and its growth so staggering that it continuously needed infusions of working capital. Particularly the prefinancing was

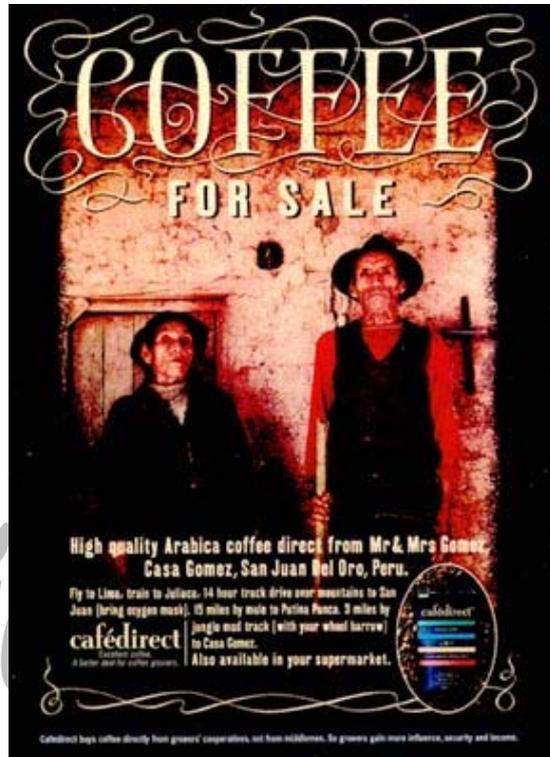
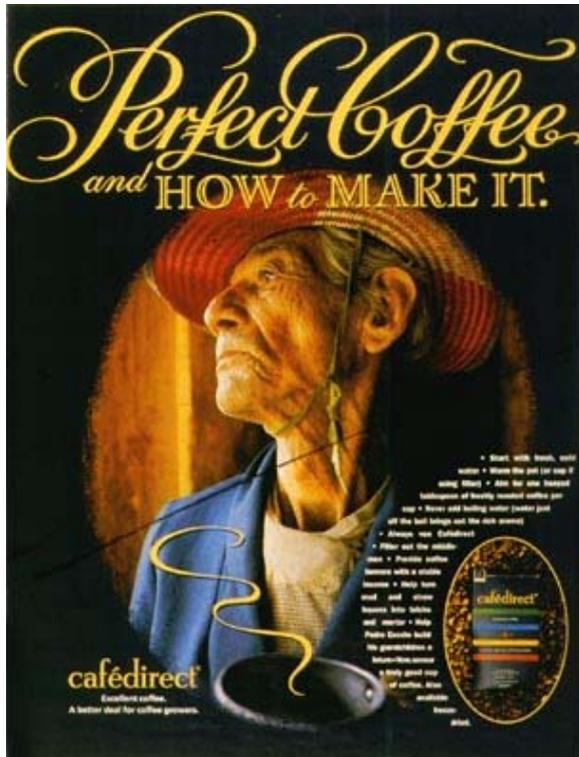
putting strains on the company's financing structure (see Cafédirect's cash flow statements in Exhibit C9). However, in order to grow Cafédirect also urgently needed capital to invest in advertising in order to compete with the market incumbents (Newman, 2004b). The four original founders were reluctant to put in more capital. In the contrary now that Cafédirect was running nicely they would like to put their scarce resources in new projects that were more deserving.

As Cafédirect was considering how it could raise equity different options came to mind. The company could try to find other non-profits, it could go public, or try to find a corporate partner. Furthermore, as the Day Chocolate company was half owned by producers there were several Cafédirect supporters who would like to see ownership of the company being moved to the Third World.

Put yourself in the position of Oxfam and Cafédirect.

- What should Oxfam do about its remaining fair trade activities? By stopping to trade itself Oxfam might put some of its suppliers out of business for good. Others might survive but would have to do so on much less friendly market terms. Many had planned their lives around a permanent relationship with Oxfam.
- At Cafédirect consider what Penny Newman should do to raise more capital. What would the different strategies mean in practice? How would a public share offering change the company's mission and what could Newman do to safeguard her values?

Exhibit C4
Cafédirect's Advertising 1996-1998



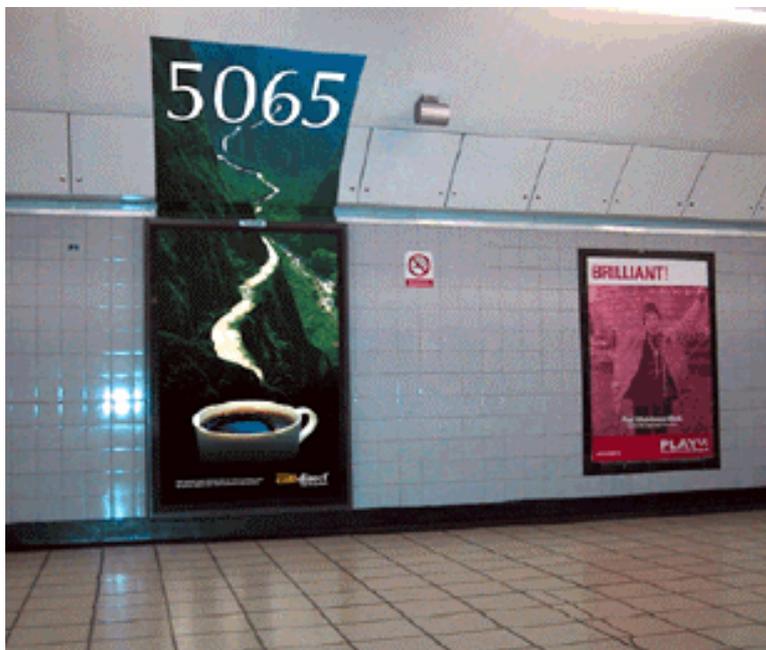
Source: (Cafédirect, 2004)

Exhibit C5
Cafédirect's Advertising 1999-2001



Source: (Cafédirect, 2004)

Exhibit C6
Cafédirect's Advertising 2003



Source: (Cafédirect, 2004)

Exhibit C7
Cafédirect Ltd – Profit and Loss Account

	2003***	2002***	2001**	2000*	1999*	1998*
	£	£	£	£	£	£
Turnover	13.646.454	10.356.179	12.080.779	7.207.000	6.775.000	6.262.000
Cost of sales	-8.570.932	-6.581.132	-7.486.229	-4.361.000	-4.350.000	-4.358.000
Gross Profit	5.075.522	3.775.047	4.594.550	2.846.000	2.425.000	1.904.000
Administrative expenses	-4.525.819	-3.317.273	-4.038.981	-2.507.000	-2.153.000	-1.389.000
Operating Profit	549.703	457.774	555.569	339.000	272.000	515.000
Other interest receivable	4.105	5.144	3.016			
Interest payable and similar	-65.849	-43.468	-46.463	-34.000	-33.000	-93.000
Ordinary profit before taxation	487.959	419.450	512.122	305.000	239.000	422.000
Tax on profit on ordinary activities	-118.914	-103.375	-118.500	-79.000	-49.000	-105.000
Profit after taxation	369.045	316.075	393.622	226.000	190.000	317.000
Dividends (incl non-equity shares)	-9.750	-22.750	-37.375	-26.000	-	-
Retained profit for the year	359.295	293.325	356.247	200.000	190.000	317.000

* year 1 Apr - 31 Mar (12 months)

** year 1 Apr - 30 Sep (18 months)

*** year 1 Oct - 30 Sep (12 months)

Source: (Cafédirect, 1999-2004)

Exhibit C8
Cafédirect Ltd – Balance Sheet

	2003	2002	2001
	£	£	£
Fixed Assets			
Tangible assets	85.726	51.463	61.219
Current assets			
Stocks	3.267.372	1.586.612	1.305.053
Debtors	2.609.494	1.831.739	1.324.651
Cash at bank & in hand	6.212	348.499	193.739
	5.883.078	3.802.850	2.823.443
Creditors: amounts falling due within one year	-3.923.248	-2.168.052	-1.491.726
Net current assets	1.959.830	1.634.798	1.331.717
Total assets less current liabilities	2.045.556	1.686.261	1.392.936
Creditors: amounts falling due after more than one year	-119.105	-119.105	-119.105
	1.926.451	1.567.156	1.273.831
Capital and reserves			
Called up share capital	977.500	977.500	277.500
Profit and loss account	948.951	589.656	1.046.331
Shareholder's Fund	1.926.451	1.567.156	1.273.831
Equity interests	1.828.951	1.469.656	1.176.331
Non-equity interests	97.500	97.500	97.500
	1.926.451	1.567.156	1.273.831

Source: (Cafédirect, 2002-2004)

Exhibit C9
Cafédirect Ltd – Cash Flow Statement and Outstanding Loans

	2003	2002	2001
	£	£	£
Net Cash (outflow)/inflow from operating activities	-1,028,322	391,805	465,758
Returns on investments and servicing of finance			
Interest received	4,105	5,144	3,016
Interest paid	-65,849	-43,468	-46,463
Non equity dividends paid	-	-13,000	-13,000
Net cash outflow for returns on investments and servicing of finance	-61,744	-51,324	-56,447
Taxation	-102,189	-118,600	-79,000
Capital expenditures			
Payments to acquire tangible assets	-73,159	-11,621	-69,560
Net cash outflow for capital expenditure	-73,159	-11,621	-69,560
Equity dividends paid	-	-19,500	-13,000
Net cash (outflow)/inflow before management of liquid resources and financing	-1,265,414	190,760	247,751
Financing			
Purchase or preference shares	-	-	-32,500
Repayment of long-term bank loan	-	-	-65,000
Repayment of other long term loans	-	-	-39,519
			-137,019
(Decrease)/increase in cash in the year	-1,265,414	190,760	110,732

<u>Creditors: amounts due within one year</u>	2003	2002	2001
	£	£	£
Bank loans and overdraft	887,127		
Trade creditors	716,487	576,938	118,500
Corporation tax	120,000	130,275	118,500
Other taxes and social security costs	21,815	29,560	11,401
Other creditors	943,701	792,251	273,173
Accruals and deferred income	1,196,743	638,403	480,262
Dividends payable	37,375	27,625	37,375
	3,923,248	2,168,052	1,491,726

Source: (Cafédirect, 2002-2004)

Exhibit C10
Cafédirect Ltd – Turnover by Market

<u>Geographical markets</u>	2003	2002	18 months
	£	£	2001 £
United Kingdom sales	13,386,013	10,312,907	12,066,727
Overseas sales	260,441	43,272	14,052
	13,646,454	10,356,179	12,080,779

Source: (Cafédirect, 2002-2004)

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