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Marketing Information Operation in Ethiopia with special reference to the Ethiopia  
Commodity Exchange (ECX) Coffee Trading



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## **Abbreviations & Glossary**

AAU	Addis Ababa University
CEO	Chief Executive Officer
CLU	Coffee Liquoring Unit
DST	Direct Specialty Trade
ECEA	Ethiopian Coffee Exporters Association
ECGPEA	Ethiopian Coffee Growers, Producers & Exporters' Association
ECX	Ethiopia Commodity Exchange
EGTE	Ethiopian Grain Trade Enterprise
EPRDF	Ethiopian People's Revolutionary Democratic Front
FAO	Food Aid Organization
FDRE	Federal Democratic Republic of Ethiopia
FOB	Free on Board
GCC	Global Commodity Chain
GDP	Gross Domestic Product
GNP	Gross National Product
GPN	Global Production Network
HQ	Head Quarter
ICT	Information Communication Technology
IFPRI	International Food Policy Research Institute
IM	Intermediary Member
IT	Information Technology
MoARD	Ministry of Agriculture and Rural Development
MNC	Multinational Company
NEAA	National Exchange Actors Association
NIE	New Institutional Economics
OCFCU	Oromia Coffee Farmers Cooperative Union
PRA	Participatory Rural Appraisal
SCAA	Specialty Coffees Association of America
SMS	Mobile Phone text messages
TED	Technology Entertainment Display
TM	Trading Member
TPLF	Tigray People's Liberation Front
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USD	United States Dollars
WBR	World Bank Report

## **Abstract**

Coffee is of global importance, ranking second to petroleum in world commodity trade. In addition, coffee is of particular importance as a major export commodity in many low-income countries in Latin America, Africa, and Asia (Lucier, 1988). Similarly in Ethiopia, coffee is the most important backbone of the Ethiopia economy, which account for an average 5 percent of GDP, 10 percent of the total agricultural production and 60 percent of export earnings. Since coffee is highly labour-intensive, a very significant part of the population derives its livelihood from coffee, there by playing a significant part on the socioeconomic life of the people and the economic development of the country. With this fact of its crucial importance, the Ethiopia Commodity Exchange (ECX) has included coffee as one of the commodities to be traded on the platform. The ECX is Ethiopia's latest attempt to enhance the performance of agricultural markets. Conceived as a meeting point for buyers and sellers of grains (sesame, haricot beans, maize, wheat) and coffee, This study attempts to examine whether the creation of the ECX, and particularly the Government's decision to make coffee trade through this mechanism mandatory for smallholders, and explains how the ECX market value chain is benefited to the smallholders coffee farmers, , with a particular emphasis on: 1) examining whether the ECX is contributing to address the asymmetrical power relations faced by smallholder producers in the overall coffee market value chain and facilitating a more beneficial integration; 2) the main socioeconomic implications of coffee trading through a national commodity exchange as a policy instrument to promote the coffee subsector and, thus, Ethiopia's agricultural economy. A market value chain approach reveals the inner workings of chain and non-chain actor coordination, with its implications both at the domestic and global level. A new economic sociology approach takes the analysis beyond the logistical bottlenecks to reveal the motivations and interests of particular chain actors and their influence in allowing for change or maintaining the status quo.

**Key Words:** Coffee, Market information, Commodities, Commodity exchange, Market value chain

# Chapter 1      Introduction

Coffee is not just a drink. It's a worldwide commodity. As one of the world's most traded products-second rank position next to petroleum particularly importance as a major export commodity in many low income countries in Latin America, Africa, and Asia (Lucier, 1988).The coffee industry employs millions of people around the world through its growing, processing and trading (ECX, 2011). But while the coffee trade is very important to the politics, survival and economies of many developing world nations, the industry's pricing and futures are decided in conference rooms and on stock exchange floors in some of the world's wealthiest cities.

Linking small producers to markets are widely recognized as a valuable development route (Alemu and Meijernik, 2010). It is for this reason that the Ethiopian Commodity Exchange (ECX), which was officially opened May 2008, was established with an ambitious goal of eliminating food shortages and hunger in Ethiopia by creating an efficient marketing system for agricultural commodities. Barely two months after its launch, the highly praised exchange platform found itself caught in the midst of the complex global coffee trade, an undertaking that is entirely different and farther from its original vision of "revolutionizing" the inefficient domestic commodity market. An important element in making value chains more efficient is to reduce transaction costs and risks. In this regard, the ECX is expected to play an important role as a platform for transparent and cost effective marketing.

In Ethiopia at present, the presence of high transaction costs, relatecccd to the lack of sufficient market coordination between buyers and sellers, the lack of market information, the lack of trust among market actors, the lack of contract enforcement, and the lack of grades and standards, implies that buyers and sellers operate within narrow market channels, that is, only those channels for which they can obtain information and in which they have a few trusted trading partners (Alemu & Meijerink, 2010). Despite market liberalization in the early 1990s, the persistence of high transaction costs and contract risk have resulted in limited arbitrage and weak investments by private traders, leading to limited market volumes, weak responsiveness to price signals and high price volatility, all of which have a negative impact on smallholder producer livelihoods.The initiative to establish the ECX was based on a simple concept. If markets function in such as a way as to reward quality, reduce transaction costs of market participation thus increasing returns to market activity, enable quick capital



turnaround thus increasing market volumes, and reduce risk of market participation, then markets will serve the needs of buyers and sellers and contribute to the well-being of all who participate in the market economy (ECX, 2006). Thus, it is anticipated that ECX will reward quality to producers; reduce transaction costs of market participation thus increasing returns to market activity; enable quick capital turnaround thus increasing market volumes, and reduce risk related to counterparty default and prices, thus increasing market participation; increase information and transparency for all market actors, thus empowering smallholders and other disadvantaged actors.

Markets are good for efficiency, and much progress has been made in market development, especially under private sector leadership (WBR, 2008). However further efficiency gains will need public sector support to bring the necessary public goods, foster institutional innovation, and secure competitiveness. With this fact, the ECX market operation do not always secure socially desirable outcomes, complementary policies are often needed to ensure smallholder participation. A huge need remains to improve the performance of the marketing systems in smallholder sector. Public investments to expand access to rural infrastructure and services- such as rural roads and transport services, physical markets, telecommunications, and electricity- will be essential to reducing transaction costs and physical losses and to enhancing transparency and competitiveness in traditional markets. Technical and institutional innovations that reduce transaction costs and risks also show promise, especially the wider use of information technologies (mobile phones, the internet, and commodity exchanges) and vertical coordination arrangements with individual farmers or producer or organizations(WBR,2008).

Taking the conventional commodity exchange perspective into account, Bibangambah et al. (1992: xiii), define marketing as: “The performance of business activities that direct the flow of goods and services from the producer to the consumer or the user.” From the business management point of view, Bibangambah (1991:17) defines marketing as “The process qualified for identification, prediction and fulfilling customer requirements profitably.” Activities by which agricultural raw materials, food and processed products are made available to ultimate users,” their additional meaning goes beyond the physical conditions of agricultural marketing, mainly indicating the view that products which farmers grow and sell must be stored, transported, and delivered at a given time to place where consumers’ demands

are high. The marketing activities within the production and market systems are performed by a given actor or firm at a specific point of the market channel in a given time (Okosso-Amaa, 1975).

In a similar condition of the coffee market operation in Ethiopia, market operation in the smallholders coffee farmer is back ward. Ethiopia is found in east Africa. According to the world fact book (cia, 2010), the total area of the country is around 1,104,300 sq km. Ethiopia's poverty-stricken economy is based on agriculture, accounting for about 45% of GDP, and 85% of total employment. The agricultural sector suffers from frequent drought and poor cultivation practices. Coffee is crucial to the Ethiopian economy with exports of some



Figure 1 Map of Ethiopia and its bounded neighboring countries

\$350 million in 2006. The country is bounded on the North by Eritrea, on the North East by Djibouti, on the East and South East by Somalia, on the South by Kenya, and on the West by Sudan. Ethiopia's capital city, Addis Ababa, is located near the centre of the country.

Ethiopia relies to a great extent on the trade of primary goods. In the country, agriculture is the dominant factor in terms of food security, livelihoods, sustainable natural resource and national security. The country is known as the birth place of coffee Arabica. According to Worako (2008), coffee has accounted for an average of 5% of gross domestic product (GDP), 10% of the agricultural production and 60% of the total export earnings for the past three or four decades. The subsector affects the livelihoods of approximately one quarter of the population, providing jobs for farmers, local traders, processors, transporters, bankers and exporters.

This research paper intends to study the Ethiopian coffee market operation in light of the recent Ethiopia Commodity Exchange (ECX). The ECX is Ethiopia's latest attempt to enhance the performance of agricultural markets. Conceived as a meeting point for buyers and sellers of grains (sesame, haricot beans, maize, wheat), and coffee, the ECX seeks to organise efficient and transparent market operations and thus –in their words– contribute to solving the country's longstanding problem of starvation (Brown 2009). Although this last part could be a bit of an overstatement, it is important to mention it as it reflects the way in which the Exchange portrays itself. The organizer behind the ECX is Eleni Gabre-Mahdin, an Ethiopian economist who grew up in the United States and decided to go back to her country with a project that, according to her, could revolutionise Ethiopian agriculture by 'helping producers sell easier and faster, get higher prices and thus earn greater income –which would in turn serve as an incentive to increase production'. It is supposed to be an exchange made to suit 'the little guy' (ibid).



Figure 2 Ethiopian Commodity Exchange HQ, Addis Ababa

Even if the ECX is proposed as an innovative institution tailored to the particular requirements of the Ethiopian agricultural commodities, the country has still faced a problem

of lack of efficiency in terms of infrastructure, access to technology and financial and technical services, all these significant challenges pose to its ability to really transform the country's agricultural markets. The Government's decision in December of 2008 (eight months into operations) to trade all of Ethiopia's coffee through the ECX came somewhat as a surprise to some sectors, although documents gathered during the field visit suggest the idea of a specific exchange for coffee goes back to 2003. The decision elevated the profile of the ECX, turning it into a key institution not only for the coordination of buyers and sellers, but also for the linkage with warehousing, grading and information systems. The new exchange created a great deal of tension during its first year of operations, particularly in the relationship between the Government and private exporters, some of which even had their exporting licenses suspended for suspicions of hoarding (Schwaner-Albright, 2009).

Initially the ECX started operating for easily standardised goods, so the introduction of coffee implied new challenges. One of the main challenges for the ECX regarding coffee is that of guaranteeing coffee differentiation and traceability for specialty, fair trade and organic markets, which is lost once coffee is deposited in the ECX warehouses and graded according to regional types and quality. This is currently being addressed through the Direct Specialty Trade (DST), a new platform created by the ECX through which producers of specialty coffee are supposed to transact directly with international buyers. The question is, which producers are able to access the differentiated markets and which ones are stuck to standardised production?

This study attempts to examine whether the creation of the ECX, and particularly the Government's decision to make coffee trade through this mechanism mandatory for private traders, has resulted in significant modifications in the way Ethiopian actors in the coffee value chain interact and in their specific functions, with a particular emphasis on: 1) examining whether the ECX is contributing to address the asymmetrical power relations faced by smallholder producers in the overall coffee market value chain and facilitating a more beneficial integration; 2) the main socioeconomic implications of coffee trading through a national commodity exchange as a policy instrument to promote the coffee subsector and, thus, Ethiopia's agricultural economy.

The study adopts a marketing information operation framework approach, complemented by literature concerned issues of poverty, inequality and terms of incorporation, in order to provide further evidence of the links between worldwide trade and the dependence of developing countries on the production of primary commodities –particularly in Ethiopia. Furthermore, the experience of the ECX is analysed from an economic sociology perspective as a market mechanism embedded in a particular institutional environment and social context, in order to assess whether it will be able to ‘unleash the benefits of the market’ (and for whom).

The main research question is: *what is the role of the ECX in addressing the constraints faced by the Ethiopian coffee sector, and particularly by smallholder coffee producers, to benefit from incorporation into market value chain. In other words, how the ECX is contributed to the smallholders coffee farmers that to improve the smallholders livelihoods and agricultural investment activities?* To answer this question, the study seeks to determine whether and how the creation of the ECX has modified the structure of Ethiopia’s coffee marketing operation chain as well as which actors are most likely to benefit from involvement in it, with a particular emphasis on the participation of smallholder producers. Moreover, the study attempts to establish what strategies the ECX is implementing in order to respond to the country coffee market requirements (both for standard and differentiated coffees) and how it is articulated with Ethiopia’s broader coffee sector policies.

The data for the study was collected during a six-week field visit to Ethiopia that took place from February 1<sup>st</sup> to March 16<sup>th</sup> of 2011. The research methods employed were mainly Ethnographic method of personal participate observation, PRA (Focus Group Personal Conversation), Semi structured and open ended questions through interview both (face to face and phone), and emails from the key respondents, literature research and review (limited with direct literature), and official papers and statistics. The key stakeholders for this study is located in the southern part of the country, Sidama Agricultural districts, in Shebedino, Remeda and Leko rural Kebele Association, which is because the Area is well known by producing quality organic coffee products, and much volume production region. The major key stakeholders for this study are smallholders coffee farmers, cooperative unions, government agents like ECX officers, agricultural extensions and MoARD officers, coffee

exporters, coffee collectors and financial institutions (banks). Given the short time available and the logistical constraints to move around the country, much of the data was collected through targeted interviews and through the snowballing technique from a variety of key actors in the coffee chain, including government institutions, different kinds of private intermediaries, service providers and private sector organisations, both involved and not involved with the ECX. With this study, entirely 78 data was collected. All these data conducted for questions that prepared through interviews (both with individuals and in groups), questions that prepared in semi structured and opened ended, and emailed forms to the key stakeholders. Furthermore, quantitative data regarding the performance of the agricultural sector in Ethiopia, as well as official data regarding local and international coffee trade was gathered both from the primary sources and from the International Coffee Organisation.



Figure 3. Shebedino Rural Kebele smallholders Coffee Producers Community





Figure 4. A Sack of dry red Cherry Coffee Beans

## 1.1 Background of the Ethiopia Commodity Exchange (ECX)

Ethiopia like many other nations in Africa and third world the country relies greatly on the trade of primary goods. The trade of coffee is Ethiopia's largest export, which generates 60% of its total export earnings. Kafa (an Ethiopian name) may be where the word coffee is the original home came from. The quality of coffee produced in the country, such as Harar, Sidamo, and Yirgacheffe, is well appreciated in various markets in the world. The government in Addis Abba has put this most famous commodity produced in the country on the ECX with the objective to give farmers more power, improve farm sector, and increase national revenue to fund infrastructure and other development programs.

ECX was founded in April 2007, with a vision to revolutionize Ethiopia's tradition bound agriculture through creating a new marketplace that serves all market actors, from farmers to traders to processors to exporters to consumers. This market place should be characterized by transparency, integrity, security and efficiency (Alemu & Meijerink, 2010), none of which could be said to describe the traditional trade. To achieve this bold goal, the exchange must transform many parts of the Ethiopian economy. ECX has already built up solutions for warehousing, electronic banking, clearing and settlement of the transactions and transfer of live market data information that are previously unheard of in the country.

The design of Ethiopian Commodity Exchange is a single national multi-commodity exchange based in the capital city of a country (Addis Ababa). It operates on a trading platform using combination of open outcry (floor) and electronic platform. Trade at ECX began in May 2008 with maize and wheat. However, only a few months later a legislative decision was made by the government to transfer all coffee trade, with a few exceptions, from the four decades old Coffee Auction system to the new exchange, effectively redirecting the entire organization's capacity to this commodity for the near future (Rogstadius, 2009). The decision came as the country's vital coffee export was facing an international crisis of confidence, with sales shrinking due to great problems in the areas of quality control, transparency and risk management. The marketing trading is used by exchange members or their agents; it has a network of up to 10 ECX warehouse in the major coffee producing rural areas. The network of 20 ECX electronic price display board terminal centres has up to 200 market information points (Rural Electronic Price Tickers) at district level; it also has internal clearing and settlement system with partner settlement banks (ECX, 2011).

The Commodity Exchange trading system is a ring-based trading system. Trading systems in which members' trade are openly and verbally on a trading floor by 'crying' out their price in a designated area. In this system, all the participants should attend on the trading floor and hence the optimal bargain price is discovered. Shouting is essential to draw attention towards the system being quoted by the trader, so that everybody interested in the system assemble the same place.





Ring based trading systems are localized in nature and accessed by a number participants.

Figure 5. A Sack of dry red Cherry Coffee Beans  
Source: personal observation in the field work

Now, after three year of trade operation, ECX has received both praise and criticism. As the latest market prices are now disseminated to a wide audience using media ranging from the ECX website to radio and electronic price display boards in rural areas, according to (Lulu, D. 2011). Market Data Analysis Manager of ECX, members of ECX could buy and sell their products directly through ECX, with this consequence the middleman have lost much of their upper hand in the trade. In a similar manner, the centralized electronic trade logs all transactions and thus makes it much more difficult for traders to avoid paying taxes on their profits. A shift from trade based on samples of coffee to trade of warehouse receipts and bank deposits has resulted in a no-default system with goods quality and quantity guaranteed by ECX. On the other hand, the same quality control has introduced a delay between when goods are deposited at an ECX warehouse and when they can be sold to the market.

## 1.2 Problem Formulation

As in most countries that implemented trade liberalization, export performance and diversification in Africa remained low. The effects of liberalization have been particularly severe in the agriculture sector, where productivity has notoriously fallen as a result of the extraction by the state, which has negatively affected public investment in agricultural research, extension services, education and infrastructure (Chang 2009). African countries, which have historically been the most affected by falling commodity prices, depend on agricultural commodities for approximately 50% of their export earnings. According to UNCTAD (2008), Africa's market share has dropped from 6 per cent of world exports in 1980 to about 3 per cent in 2007. Within Africa, Sub-Saharan countries are among the most dependent on agriculture for exports. Moreover, because many of these countries are also heavily indebted, their governments are forced to adopt extreme austerity policies, which often reduce expenditure on health, education and infrastructural development – thus perpetuating adverse conditions for participation in overall trade.

In the context of commodity exchange on market operation, this market operation has become an increasingly popular tool in development countries to face 'the commodity problem'. UNCTAD (2007:19) defines commodity exchange as "a market in which multiple buyers and sellers trade commodity-linked contracts on the basis of rules and procedures laid down by the exchange" (UNCTAD 2007). A comparative study on commodity exchanges stress the wide range of development impacts they may have on developing countries in terms of 'price discovery, risk management, investment, development of commodity markets and finance, industrial development, market internationalization and use of IT services' (ibid). Nonetheless, the specific outcomes may vary depending on the needs they are designed to fulfill and the combination of organizations, institutions and regulatory frameworks found in each particular context.

With the context of market operation on Ethiopia coffee trade, even though coffee has economic and social importance for the Ethiopian economy, the market operation on the coffee sector has remained unsatisfactory especially for smallholders coffee growers. This is because there is no significant change in the form of production and processing for several decades. Regarding from the coffee market, International competitiveness in market of coffee

commodity exports has a major challenges for Ethiopia, competitiveness is important because export of coffee is the major source of foreign exchange and thus account more than half of the value of total export. Producers of coffee commodity, however, have faced long term downward trend in prices as global supply outpaced demand. The discouraged coffee market value result in policies regulating the market, and the low base of market infrastructure, lack of adequate marketing information system, high seasonal price variability, and the unorganized sector, high transaction cost, which is mainly caused inadequate transport infrastructure and services in rural areas push up marketing costs, undermining local markets and exports. Trader surveys in Ethiopia find that costs account for 50%-60% of the total marketing costs, poor performance of the state and public institution and inadequate training and education (WBR, 2008).

Coffee is more or less entirely produced in developing countries and mainly consumed in the developed world. According to Worako et al (2008), the world coffee market has been considerable short-term fluctuations in prices, both at the level of international markets as well as markets relevant for coffee producers. Analysis of the world coffee market is difficult, it only has begun rise price since the last four years. This is to describe that coffee price in producing countries has a trend towards lower price that has a negative impact on living standards of millions of people for countries which is mainly the country's economy engaged on coffee export markets like Ethiopia.

Lack of efficient market infrastructure is one of the major problems to coffee market in poor countries like Ethiopia. Consequently, this inadequate market infrastructure is affecting in transport and communication services can give rise to large marketing margins due to high costs of delivering the locally produced commodity to the export port, hindering the transmission of price signals, and thus preventing arbitrage.

### **1.3 Objective**

The overall objective of this research is to assess the coffee marketing value chain between the smallholders coffee farmers and the ECX. And explains how the ECX market value information is benefited to the smallholders coffee farmers. In other words, how the ECX

marketing operation is contributed to the smallholders coffee farmers to improve livelihoods and investment in the agricultural activities.

#### **1.4 Research questions**

Attempts will be made in this study to find answers for the following key questions.

- 1) What are the different marketing services provided by ECX to the smallholders coffee farmers, cooperatives members, assemblers, exporters, and related?
- 2) What has been the performance of the smallholders coffee farmers in the ECX coffee market value chain?
- 3) What are the main constraints that hinder and favourably influence on ECX coffee market?
- 4) To what extent have the smallholders coffee farmers into ECX market value chain have satisfied?
- 5) What are the determinants of ECX member's satisfaction?

#### **1.5 Scope of delimitation of the study**

This study will contribute to the understanding of the ECX coffee market information operation system and major problems and constraints on the market value chain especially to smallholders. ECX, although itself a modern marketing enterprise, operates in a country with poor developed infrastructure (information technology, power and road networks), and low average levels of education; factors which all enforce serious limitations on the field work to access the entire needed information from the organization, agents, and the rural community.

#### **1.6 An overview of the study**

Chapter Two:- Conceptual and theoretical framework: As a background for later analysis, the conceptual and theoretical framework explains the concept of Commodity Exchange marketing information operation and its impact on the small scale farmers' livelihoods improvements, employment opportunity and for the country's food security.

Chapter Three: - Methodology: The discussion in this section concerns the method, how the empirical study was administered. Accordingly, an account for applying a case study approach during the field work is given. The rationale for choice of data collection method,

the process of data collection, data processing and data analyses are also explained in the chapter.

Chapter Four: - Empirical study- description, analysis and discussion: To avoid repetition and to enable an in-depth discussion, the empirical material is presented in form of narratives and embedded into an analysis and discussion with the background of the conceptual framework.

Chapter Five: - Summary and conclusions: summary, conclusions and recommendations are included in this chapter.

## **Chapter 2      Leading the Markets: a literature review**

In order to generate improvements in the supply or quality of any product, one needs to consider all aspects in the chain of events from production to consumption, including both opportunities and constraints, and the demand and supply of necessary products and services.

Taking a value chain approach to economic development and poverty reduction to poor countries like Ethiopia involves addressing the major constraints and opportunities faced by the smallholders coffee farmers, cooperatives unions, processors, exporters and other coffee agents at several levels and points along a coffee market value chain. This will inevitably include a wide range of activities such as ensuring access to the full range of necessary inputs, facilitating access to cheaper or better inputs, strengthening the delivery of business and financial services, enabling the flow of information, facilitating improved market access, or increasing access to higher-value markets or value-added products (RIU, 2011).

In a value chain marketing system, farmers are linked to consumers' needs, working closely with suppliers and processors to produce the specific goods consumers demand. Likewise, through flows of information and products, consumers are linked to the needs of farmers. Under this approach, and through continuous innovation, the returns to farmers can be increased and livelihoods improved. Rather than focusing on profits on one or two links, players at all levels of the value chain can benefit (RIU innovation, 2010).

An integral component of the value chain is the agricultural supply chain, and in the (RIU innovation, 2010) literature these terms value chain and supply chain may at times be used interchangeably, or are at least closely related.

The theoretical perspective in this study has the multi-dimensional in content. But the key approaches are: production theory, institutional (organizational) theory, and marketing functional theory. In production theory, the rate of output is argued to depend on three factors: the state of technology, the quantities and types of resources put into the production process and the efficiency at which those resources are utilised. In institutional approach, it intends a list of some of the specialized people who do marketing tasks. Those involved in handling the commodities and in pricing are often referred to as “middlemen,” regardless of their gender. Middlemen have classifications such as retailers, wholesalers, brokers, commission agents,

and order buyers. Functional approach, it emphasizes the functions performed in marketing. In other words, it focuses on specialized activities within the marketing process. Generally, in the absence of the technological advance, the growth of total output can be explained in terms of growth in total factor inputs (Capalbo and Antole, 1988).

Coffee production can also be affected by price policy that may provide incentives to producers and processors by way of administered remunerative support prices. In this respect, producer prices have to be determined on the basis of costs of production and be reviewed in the light of international prices, exchanges rates and domestic inflation. However, price policy alone can not automatically bring a positive response and increase in production, other factors of production and services are of critical importance in shifting production function to higher levels: transportation infrastructure, research and extension services, agricultural inputs, credit systems, marketing system, and public administration (Bibangambah, 1989).

Rhodes (1998: P.18) asserts that in agricultural marketing system, “marketing require all kind of decisions: Sellers decide what to produce; and how to deal with classified customers. Buyers decide what to buy and if they are commercial buyers such as meat packers, make complex decisions about what, when, where, and how to buy; how to price; and how to deal with classified sellers. These decision makers are organized into individual businesses called firms. Marketing takes place within a market which is defined as all the possible buyers and sellers of a product or commodity, for convenience, the final buyers who buy to consumers are consumers”.

In order to analyze the market, there are two basic ways of analysing marketing issues: the functional and the institutional approach. The functional approach emphasizes the functions performed in marketing that focuses on specialized activities within the marketing process. The method of this approach activity that occur in the marketing process by breaking them down into specific functions: exchange (buying, selling, title transfer), physical (storage, processing, grading, transportation and facilitating (financing, risk-bearing and market research). As such, this approach is very useful for the following purposes: first it considers the job that must be done, it is not concerned by the agency that performs them; secondly by analyzing the functions of various middleman, the approach is helpful in evaluating marketing

costs, thirdly it is useful in understanding the difference in marketing costs of various commodities (Barker, 1989).

Rhodes (1998, p.7) explains functional approach classification into: - i) Exchange functions, such functional approach is classified into buying (procurement) and selling merchandising. ii) Physical functions, this functional approach classified into a) storage b) transportation and c) processing, and iii) Facilitating functions, which is also classified into standardization, b) financing, c) market intelligence gathering, and d) risk bearing.

According to Rhodes (1998: P.7) although the exchange of marketing functions are important, intelligent buying and selling is almost impossible without adequate market information and that involves the functions of marketing intelligence gathering. Most sellers sell from inventories, so storage is essential to their business. The holding of valuable inventories involves risks of value changes; therefore, institutions like ECX have responsible to facilitate risk bearing. Many buyers of agricultural commodities will buy unseen if, and only if, the commodity is graded. So standardization becomes essential. Final consumers are interested in finished products, and not raw materials; thus processing is essential and is quite significant for some commodities. Few products are consumed where they are produced and so must be transported to end users.

The functional approach on the market has several advantages. First, it helps us see what must be done on the market. Those critics who talks glibly of eliminating the middleman (to the presumed such as farmers or consumers) must face the fact that the job would remain to be done even if the middleman were “removed.” It may be, of course, that some efficiencies could be gained by rearranging who performs what functions, and a study of functions may help market participants achieve such gains. Second, the functional approach simplifies a complex economy and shows some similarities that are not apparent when we focus on the who of marketing. We see that most of the players, such as farmers, retailers, processors, and assemblers, are each involved in buying and selling. Moreover, each group of players faces the physical problems of storage and transportation, the problem of financing and risk bearing, and so on (Rhodes 1998, p.7)



Rhodes (1998, p.6) asserts that institutional approach analyses the various agencies and business structures that performs who of the marketing. With the institutional approach, it is easy to list some of the specialized people who do marketing tasks. Those involved in handling the commodities and/or in pricing are often referred to as “middlemen,” regardless of their gender. After all, in the channel between farmers and ultimate consumers, they are in middle. Middlemen have classifications such as retailers, wholesalers, brokers, commission agents, and order buyers. Processors are also an important part of the marketing process because they combine raw materials into the final products that we consume. Their decisions as to product design and merchandising may often be crucial as to how well a particular item sells and, in turn, how much demand there is for a particular farm commodity.

Other important institutions include the government agencies that provide public services, such as market information and commodity grades, and those that regulate various marketing activities. Regulations concern a broad range, from honest weights to product safety. Institution may also be thought of as organized systems of behaviour, such as organized markets, corporations, cooperatives, and marketing orders. An understanding of each of these is essential to an understanding of agricultural marketing (Rhodes 1998, p.7).

In Africa, a mix of agricultural marketing systems are noticed: centrally organized marketing boards, co-operative societies or unions and private traders, but the tendency was to grant monopoly of marketing functions to parastatal boards (Mlay, 1989). Others factors such as the set of ownership of land, the level of individual income, the propensity to procure food prices, demographic pressure, rainfall, drought, diseases and unforeseen uncertainty conditions may affect the coffee production. For instance, high food prices could mean reallocation of ones resources (labour, time, land and financial capital) in favour of food crops.

Clearly, due to a high population growth rate in the case of Ethiopia, it is safe to assume that the demand for food consumption may continue to increase. Given my objectives and field reality I encountered, I chose to analyse marketing issues by focusing on institutional and functional aspect.

The marketing system covers all activities that are run after coffee harvesting until the produce is exported. In this system, all collected individual farmers' productions constitute national production. The latter is sold on the world market and enables the state to get export earnings. On the other hand the amounts of those earnings depend on total national production and world price which both may vary. Alternatively world price and thus export earnings determine the level on which producer products determined. Producer price in turn is a sort of incentive whose levels affects production and thereby exports earnings as asserted by Bibangambah (1989).

## **2.1 A short review of the overall market value framework**

### **Defining Commodity**

A lot has been written about commodities, their connection with trade and development and the organisation of their production processes, yet there does not seem to be a clear consensus regarding what a commodity actually is. A commodity could be simply defined as any kind of good produced to be exchanged in the market rather than for personal use. Daviron and Ponte (2005) define commodities as “goods with a world market where most participants and transactors use the same global quality standard to discover the same measurable quality attributes”. Bernstein (2006a) notes that Daviron and Ponte's elaborations on the features of commodities deal more with the symbolic value of the highly differentiated products that reach the consumerist society and less with producer and intermediate goods.

This study aims to distance itself from definitions such as that of Gordon et al. (1999), which claim that in the context of food and agricultural industries the term commodity refers to products whose price is determined by a specific set of features which makes them homogenous but that can increase profitability through marketing and promotion. In other words, through product differentiation, market segmentation and niche markets, products can become non-commodities. The latter is an example of the recently widespread, and rather misleading, idea of the possibility of de-commoditisation through product differentiation. This definition fails to point out that nothing is intrinsically a commodity (Nevins and Peluso 2008) and that it is rather the process through which value and property rights are assigned to a product, which results in their commoditisation.

## **On ‘governance’**

The global commodity exchange market framework is based on the work of Gereffi and Korzeniewics (1994) and is described as a methodology for studying global economic governance, which has been used across disciplines within social sciences interested in the international organisation of industries in different sectors. According to Ponte, Gibbon and Bair (2008), three main approaches to global commodity market have emerged through the years: governance as driving, governance as coordination and governance as normalisation.

The first approach, originally known as Global Commodity Chain Analysis (GCC), is rooted in Hopkins and Wallerstein’s (1986) world-system theory and their concern for the global division of labour. GCC addressed the way in which inter-organisational networks around a certain commodity interact in the world economy through three key dimensions: 1) the input-output structure and geographical coverage; 2) their internal governance structure (entry barriers and chain coordination); 3) the institutional framework – that is, how local, national and international policies shape the way actors interact in a globalised context (Daviron 2002). It distinguished between two main types of governance structures: producer-driven, more typical of capital-intensive chains in which producers tend to retain control of operations; and buyer-driven, more typical of labour-intensive sectors where actors in charge of marketing, design and retailing are the ones setting entry barriers (Bair 2008).

In recent years, the term overall commodity market has been abandoned in the literature and substituted by that of universal market value chain, which is focused more on the conceptualisation of governance as coordination. Gereffi, Humphrey and Sturgeon (2005) suggest that the structure of overall market value depends upon three main variables: a) the complexity of transactions; b) the ability to codify transactions and c) the capabilities in the supply-base. Based on these variables, they outline five possible categories of governance: market, modular, relational, captive and hierarchy.

Finally, governance as normalisation emerged out of more recent contributions criticising Gereffi, Humphrey and Sturgeon, which emphasised ‘the knowledge content of transactions and the capacities of suppliers’ (Gibbon, Bair and Ponte 2008). The theoretical framework

used by Daviron and Ponte (2005) combines ‘historical political economy’, global commodity market value analysis and Convention Theory. Their work ‘elaborates on the normative environment within which commodity market operates and the broader normative frameworks influencing their designations attached to the products and services they exchange’ (Bair 2008). The introduction of convention theory as a complement of commodity market analysis (Gibbon and Ponte 2005), is as an attempt to counteract the transaction cost economics approach so characteristic of early marketing commodity analysis (Bair 2008).

### **Value distribution: producing material and symbolic quality**

In applying overall commodity value chain to each the specific Ethiopian coffee, Daviron and Ponte (2005) add to the literature on quality and standards by drawing a link between quality and value. By doing this, they are able to go beyond the traditionally measurable attributes of the product itself (appearance, taste, cleanliness, etc.) and its production methods (authenticity of origin, environmental and socio-economic conditions). Using convention theory they explain how value is conveyed at different points in the value chain and in different markets. Gibbon and Ponte (2005) argue that commodity market chains are becoming increasingly ‘buyer-driven’ due to the buyer’s ability to embed complex quality information into widely accepted standards. They develop a typology based on material, symbolic and in-person service quality attributes:

- a. *Material attributes* are understood as measurable attributes that are intrinsic to the product and independent from the buyers. Whereas in new institutional economics approaches standards allow the existence of market transactions, Daviron and Ponte suggest that they also impose constraints on downstream production processes.
- b. *Symbolic quality* attributes are based on reputation and embedded in trademarks (enterprise), geographical identification (consumption of place, in some ways similar to a brand) and sustainability (consumption ethics which work as distinctive labels). Once again, the actors that are capable of defining these standards obtain a key governing position in the value chain.
- c. *In-person service quality* attributes deal with those immaterial characteristics of the commodity, such as the services offered by those in contact with the actual consumers.

The three types of attributes come together when coffee is sold at any given café: material attributes relate to the taste, aroma and appearance; symbolic attributes are linked to the specific brands or establishments and can even be copyrighted; in-person service refers to the relation between the employees and the consumer. This classification is useful to understand the coffee market. Producers of tropical commodities in developing countries are physically detached from the consumption places and hence are unable to obtain gains from the attributes embedded in the product as they go down the chain. Thus, market power is not only about market share but also about the ability to capture the value of symbolic and in-person service attributes (ibid).

To improve or to trade downwards...that is the question

In commodity market chain literature, improving refers to the paths developing nation firms can follow to respond to competition and market requirements in a context of globalisation. Traditionally, these include improving the products, improving the production processes and shifting to new functions (which requires more skills); these strategies are known as the ‘high road’ to improving and deal with the flow of knowledge and information between buyers and suppliers (Gereffi 1999). On the other hand, more recent work by Gibbon and Ponte (2005) suggests that rising production volume and creating economies of scale –which would normally be considered as ‘downgrading’ in commodity market chain literature– could also be considered improving paths as they may be more favourable for developing country producers. Ponte and Ewert (2009) identify two broad orientations in the commodity market value literature regarding improving. The first one relates to the sources of capabilities and accessing new market segments. The second one pays more thought to the conditions that are most likely to lead to ‘a better deal’ for developing country firms participating in commodity market chains.

### **Integrating poverty concerns into ‘market chain theory’**

This section outlines different approaches that constitute important attempts to build a bridge between the transaction cost economics approach that commodity market analysis often draws from and other perspectives closer to economic sociology. The first step is to understand what Nissanke and Thorbecke (2006) call ‘the openness-growth-inequality-poverty nexus’. They assert that although openness through liberalisation of trade and capital movement are generally assumed to have a positive impact on growth through increased exports, imports and enhanced capital flows, positive openness is neither automatically guaranteed nor

universally observable. Likewise, the impacts of inequality on growth have been linked to a wide range of causes: political and social instability leading to lower investment and weak credit markets, underinvestment in human capital (education, health, etc.) leading to low worker productivity, low capacity to shift towards non-agricultural activities. Other channels through which globalization on market produces winners and losers include: differences in cross-border factor mobility associated to global market and power structures, uneven diffusion of technological processes, and the nature of modern information flows. The authors contend that pro-poor growth needs not only to reduce poverty but also decrease inequality, which requires clear pro-poor and redistributive growth policies (ibid).

For example, policy prescriptions such as the ones issued by governments, in compliance with World Bank or IMF programmes and donors alike, say very little about the impacts the terms of integration have on poverty, inequality, gender and the environment. The World Development Report (2008), for instance, prescribes ‘establishing efficient markets and value chains, accelerating smallholder entry to agricultural markets and raising smallholder innovativeness and competitiveness’ as pathways out of poverty. But as Amanor (2009) points out, this prescription for smallholder participation disregards the struggles of the dispossessed making the transition to labour, alternative livelihoods or migration. The agribusiness development agenda fails to examine the processes of exclusion that often result from market governance, differentiation and quality controls.

Kaplinsky (2004) asserts how particular ways in which 3<sup>rd</sup> world nations participate in the process of global production can sometimes result in what he calls ‘immiserising growth’ – that is, ‘increasing economic activity (more output and more employment) but falling economic returns’. The question is how local actors can participate in the overall economy while securing a sustainable and equitable growth. According to Kaplinsky, commodity market chain analysis focusing on governance relations can be useful to identify the major institutional actors and the policy levels that may influence the behaviour of key stakeholders in the marketing chain and examine the particular barriers to entry and rent (ibid). Hickey and du Toit’s (2007) ideas about the linkages between adverse incorporation, social exclusion and chronic poverty are also useful to understand the relationship between impoverished groups and individuals and the social systems (societies, communities, markets and institutions) shaping their lives. In their view, commodity market chain analysis might be useful to

examine the power relations involved in commodity production that determines whether the poor benefit or not.

While main contributors of the commodity market chains literature conclude that working towards an integrated theory will have to be the object of further research, the commodity market value framework offers a useful methodological tool for the analysis of the impacts of globalisation on economic production (Bair 2008). This research will borrow mainly from the application of commodity market value analysis to coffee as proposed by Ponte and Daviron, which emphasises issues of quality standards and upgrading paths and opportunities, especially for actors in developing nations. However, due attention will be paid to the institutional context, mainly the role of the state, not only as a regulatory actor but also as a chain actor itself. The issue of the institutional framework is strongly highlighted by another stream of literature known as global production networks (GPN). GPN in fact emerges as a critique to the lack of the institutional and geographic dimensions in the global marketing commodity literature (ibid). Although GPN aims to distance itself from the global commodity market chain approach, there are also potential complementarities between the two: mainly the possibility of examining how the coordination structures are affected by previously existing forms of power (or new ones arising from them).

## **2.2 The question of embeddedness**

All the reviewed marketing operation literature identifies to some degree with the question of embeddedness in social relations, although there is often biased and sometimes contradictory manner. This section will thus aim to rescue relevant elements from the academic discussions regarding new economic sociology in order to provide a stronger basis for the analysis of the social relations and behaviour of chain and non-chain actors in a given context.

New economic sociology stems from Granovetter's article "Economic Action and Social Structure: The Problem of Embeddedness" (1985). This article revives and broadens Polanyi's (1944) concept of embeddedness, arguing that social structure is often neglected in economic analysis and that economic actions should be 'embedded' in social structures of ongoing interpersonal relations (Granovetter and Swedberg 2001). Drawing on social network ideas, organisation theory and the sociology of culture, Granovetter and Swedberg define new economic sociology as based on two main theoretical concepts: 'embeddedness' and 'the social construction of economic institutions' (ibid). Economic action, they argue, is embedded

in social networks, which are understood as “a regular set of contacts or social connections among individuals or groups” (p. 11). It emerges as a critique to new institutional economics (NIE) represented by the work of Williamson (1975), North (1990) and others, which emphasises institutions as efficient ways to solve market failures.

In NIE the social analysis concerning ‘why actors do what they do’ takes a back seat to a ‘rational choice’ approach. For Granovetter, interpersonal relations within social networks can constrain malfeasance and opportunistic behaviour. Opposing to the formal institutional approach of transaction cost economics to solve the problem of trust, the embeddedness approach proposes informal solutions (Nee 2005).

Granovetter’s approach has however not gone without criticism either. Bair (2008) observes the bias towards the positive aspects of embedded networks, the tendency to under-examine the market as a socially constructed institution shaped by the political, cultural or ideological context and an inclination towards the local dimension. Nee (2005) adds the lack of an explanation for the ‘decoupling’ of economic actors from interpersonal networks to pursue personal interest through market transactions. As a result, more recent contributions, grouped into what is being called ‘new institutionalism in economic sociology’, argue for a more clear emphasis on the mechanisms through which formal institutional structures interact with social networks to shape and govern economic actions (ibid). Institutions, from a social constructionist stance, are regarded not as external realities but rather as the result of a gradual process in which exacting ways of doing things become the norm. Nee defines institutions as “a dominant system of interrelated informal and formal elements –custom, shared beliefs, conventions, norms, and rules– which actors orient their actions to when they pursue their interests”. The alignment of interests, norms and power is thus a condition sine qua non for institutional change.

The use of the ‘embeddedness’ approach to complement the shortcomings of the market operation literature has been a recurring trend in recent years. The case studies edited by Helmsing and Vellema (2011 forthcoming) are examples of different ways to unpack the mechanisms through which particular ‘institutional complexities’ have a bearing on determining the winners and losers in a given chain –that is, on the general developmental outcomes. More specifically thus, this study will be looking at the interaction and



interdependency between social embeddedness and specific aspects of chain governance, such as: the nature and role of the state as a regulator and/or as a chain actor; the role of public and private organisations; the dynamics between public/private interests; the influence of ethnicity, kinship, religion or political affiliation on the coordination between chain actors.

### **2.3 The performativity of markets: putting the puzzle together**

The earlier sections have provided the necessary analytical tools to address the social relations and institutions underpinning markets within specific a context. However, one last concept within economic sociology is relevant for the analysis of the particular case in hand, consisting in the creation of a market exchange for primary commodities: the idea of the performativity of markets –that is, of the relation between market theories and the markets themselves. This concept was coined by Michel Callon in the late 1990s. Callon's (1998:2) central idea is that 'economics performs, shapes and formats the economy rather than observing how it functions'. Following the concept of embeddedness introduced by Polanyi and revisited by Granovetter, Callon also acknowledges that social relations constitute the fundamental environment in which the co-ordination of market transactions takes place, but he argues that society is also the outcome of a process in which the social sciences and the theories they propose are stakeholders. Based on this, he concludes that '*homo economicus*' does exist, but as a social construction capable of mobilising material investments and property rights (legal rights and norms) rather than just a-historical reality (ibid).

Aspers (2007) shows that the idea of theories about the world regularly creating that same reality is not new: Husserl ([1954] 1970) argues that theories are gradually taken for granted and in this way lead to social change; Giddens (1987) claims that social and economic phenomena are 'made to happen' through the knowledgeability of the actors themselves. Aspers believes the limitation of Callon's approach is that it lacks a broader notion of markets (as inclusive of culture, values, etc.) and focuses exclusively on economics performing the widespread neoclassical price mechanism paradigm, thus neglecting the fact that not all markets that are performed follow the neoclassical model. Based on this, he proposes a typology of markets based on two pairs of distinctions that indicate identity, role and market order (Aspers 2007:384-387):

- a. Fixed-role markets: economic actors are identified with a permanent role as a buyer or a seller (example: markets for cars, garments, etc.)
- b. Switch-role markets: economic actors shift roles between seller and buyer (example: stock exchange) A new markets: order is maintained because the identity of the actors is more socially entrenched than the traded commodity
- c. Standard markets: order is maintained because the commodity is a more entrenched social construction than the identity of the actors in the market.
- d. Standard markets: order is maintained because the commodity is a more entrenched social construction than the identity of the actors in the market.

Among the illustrative case studies on the embeddedness and performativity of markets, García-Parapet's ([1987] 2007) analysis of the creation of the strawberry auction at Fontaines-en-Sologne proves quite useful for the analysis of the case hand. She sets out to examine whether the creation of the strawberry auction is the realisation of a market of pure competition or a market mechanism in which social factors intervene all throughout the implementation process. Drawing from the case of the strawberry auction, Table 1 will serve as an analytical matrix that brings together the issues of embeddedness and of performativity in the case of the ECX

Indicators	Descriptions
Context priority to creation of markets	Characterization of the intervening social networks as well as the economic institutional and political environment.
Material investment	Capital, infrastructure, Technology
Social investment	Institutions, laws, norms and regulations
Agent involved	Agents involved in the creation of the markets
Market participation	Social and economical characteristics of the market transactors
Social change introduced	Changes in the involved social network (What changed and what has stayed the same?)

Source. Authors elaboration based on Garcia- Parapet (1987, 2007)

Table 1. Analytical matrix for the characterization for the embededdness of the ECX

The collective theoretical framework presented in this chapter will help in analyzing the social factors that play out in the creation and implementation of the ECX and how they relate to broader structural issues that characterize the Ethiopian agricultural economy.

## Chapter 3      Methodology

Methods in use with this study are almost entirely qualitative. One of the methods used in this research is the value chain approach. It connects companies, groups, and other players working together to satisfy market demands for a particular product or group of products. The other research methods were Ethnographic method of personal participate observation, PRA (Focus Group Personal Conversation), semi structured and open ended questions through interview both (face to face and phone) from various stakeholders involved specially on small-scale coffee farmers and marketing processor like ECX as well as those involved in designing and implementing policy options for coffee, questions through emails to the key respondents, literature research and review (limited with direct literature), and official papers and statistics. Other secondary data on the production of coffee and its exports, market prices delivered was collected. These methods were proposed to get an in depth understanding on questions which quantitative data do not highlight: for example insights or attitudes of farmers, market processor, policymakers, and planners. Overall the method of this study with an anecdote for utilizing a case study approach during the field work, the rationale for choice of data collection method, the process of data collection, data processing and analyses are explained.

### A case study approach

A case study approach focuses on processes or study objects as a whole and not abstracting the parts from their context (Miles and Huberman, 1994). Since the aim of this study is to examine the structure and process of coffee marketing, as a whole, the case study approach is considered useful. The rationale for and significance of the case study approach would be in uncovering some of the constructs, in delving beneath the surface and exploring the meaning and perspectives of coffee marketing actors involved in gradual change. The purpose of a case study approach is to identify the past and the present states of coffee export marketing actors. With regard to this, the ECX market perspective for a study of actors' reactions to state initiated market liberalization programs suggests methods, similar with the perspective's assumptions. Firstly, a marketing perspective requires an in-depth look into the market operations and the privatization process. To understand the impact of the change on the coffee sub-sector, interviewing and questioning through emails to the key respondents with the total

of 78 (both with groups and individuals) informants was proposed. Key informants were selected among people working in coffee chain, extension services, administration, development projects and policy makers. Farmers were selected according to their farm characteristics, gender, settlements situations (different hills), and social status. My intention was to reduce bias as much as possible.

The informants for this study, entirely 78 respondents' data collected, of which 55 were collecting from the smallholders. Whereas the rest 7 from cooperative unions, 6 from Government agents, 5 from ECX officers and the last 5 from others like coffee exporters, banks, etc. The entire all respondents aim to gain an in-depth understanding of the coffee marketing aspects and privatization process, the author made a single trip to Ethiopia. On the field work took about six weeks. Secondly, as a primary method of data collection, the research depended on interviews. The purpose of the interviews was to have local coffee market operation reflect on recent marketing conditions. The other aim was to discuss in detail marketing impacts on small-scale coffee farmers, which accounts contribute about 90% of the country is coffee production (FAO, 2010).

#### Data collection

The information required for this research project was collected from three sources: a) publication from the ECX and other studies in Ethiopia; b) official statistics gathered from coffee producing farmers and mimeographs found in the libraries at Addis Ababa University (AAU), official statistics gathered from coffee exporters found at the national bank of Ethiopia, and c) various information that was brought from documents of the local, and district cooperative unions in Sidama, the southern nation and nationality regions of the country. For all, the aim of collecting documented data from the above sources was to understand events that have been occurring within the coffee sub-sector.

#### Interview smallholders' coffee farming community

In this context, Participatory Rural Appraisal (PRA) tools were utilised particularly for the coffee producers communities in the rural field: a) semi-structured/key informant interviews based on a checklist of points are useful to understand insights of various stakeholders on coffee issues; b) problem/solution analyses was used to know what people perceived as the

main problem in relation to coffee producing and marketing, root causes and their effects. They were also asked to mention what they viewed as solutions. c) Venn diagrams were used to describe various decisions making and their relations to the coffee processors, for example, cooperative unions, coffee agents, ECX coffee market centres, coffee roasters, exporters, and government agents like MoARD. For this, different sized circles (for example the big sized circles shows that relatively very important relation where as the small sized circles has relatively small important to smallholders' coffee production). In other words, the different sized circle was given to small groups of participants who then used the circles to illustrate the relative importance of other groups (ECX officers, extension, traders and processors). The size indicates their importance: the distance on the ground indicates their closeness or not to the coffee growers.

Almost entirely these interviews were done in-groups, even if few of them were done individually. Focus groups (groups of 5-8 persons) were more preferred by some farmers who felt more “empowered” by discussing in groups than responding individually. In this case, questions were introduced not directly in a “conventional way”, but in terms of a topic on which discussions could start. The interviewer intervened sometimes to guide those discussions in a way he liked and took key notes. After each interview, key word elements were developed in detail during the evenings in order to obtain an understanding text.

The other interviewed people were located in ECX offices, Sidama agricultural districts, in Awassa city. The Sidama people live in South Ethiopia. The capital city of Sidama, Awassa, is 275 kms south of the capital city of Ethiopia, Addis Ababa. Sidama is well known globally for the production and supply of organic speciality coffee. The reason is that these regions are the most important regions in terms of quality and quantity of coffee production, and market processor in the country. In 2005, Sidama and Gedeo regions, which are found in the southern part of Awassa, produced over 63,562 tons of coffee according to Central Statistical Agency Ethiopia (Goodo 2007). This is about 10% of the total coffee output for the country during the year (MoARD, 2005). Over 60% coffees produced in Sidama region is washed coffee and ready for export. There is over 89% coffee washing stations in Sidama alone. Thus, about 40% of washed coffee destined to the export market comes directly from the Sidama region (Goodo, 2007).

### Data processing

Processing direct writing notes of the field observation that data were collecting in the form of various sized circles or pictures especially from smallholders' communities was time consuming. The author had to listen to and write out the pictures and notes; thereafter it became necessary to refine the transcription into text that is understood to the picture. The second stage was sending the interview write-up to some of the key stakeholders, for example, smallholders' rural communities, and getting feedback from informants. The last stage was reducing and arranging the text of the cases systematically following the eight interview guide questions. Data from the case studies was systematically gathered in a way that made it possible to document the marketing operation of commodity exchange and implications of the ECX process. The collected data reinforced the main trends of coffee marketing and provided more evidence for the study theme, and qualified the existing information about the coffee marketing environment.

### Analyzing the data

As primary units of analysis, the case studies were come from districts, Sidama, as well as from informants located in and around Awassa city. By residence and occupational location of my family and intimate friends, the major respondents belong to Awassa city. Because the resource endowments and parallel efforts of the process of marketing operation of ECX in Awassa city and other coffee growing city are so similar, a distinct focus would permit full explanation of those related similarities that shape the market policy steering procedures in important ways. Therefore, for the analysis, efforts were concentrated on each of the actors selected from the coffee growing and trading sites of Awassa. During all the fieldwork visits, it was possible to meet with people working at the district cooperative unions, government agencies and private export agencies. District level data gathering also included collecting district wide data from documents. This data provided description of policy implementation strategies employed. Moreover it permitted assessment of coordination of marketing activities and services at the district level, as well as organizational strength and challenges.

## **Chapter 4      The Ethiopian Actors in the coffee chain and how they interact**

To this study I have been organized 78 data's that are collected in the form of interviewee (both face to face and on phone), through mail and in small meetings from focus group targeted coffee workers. These are: smallholders coffee producers, cooperatives, government agents, ECX, and etc.

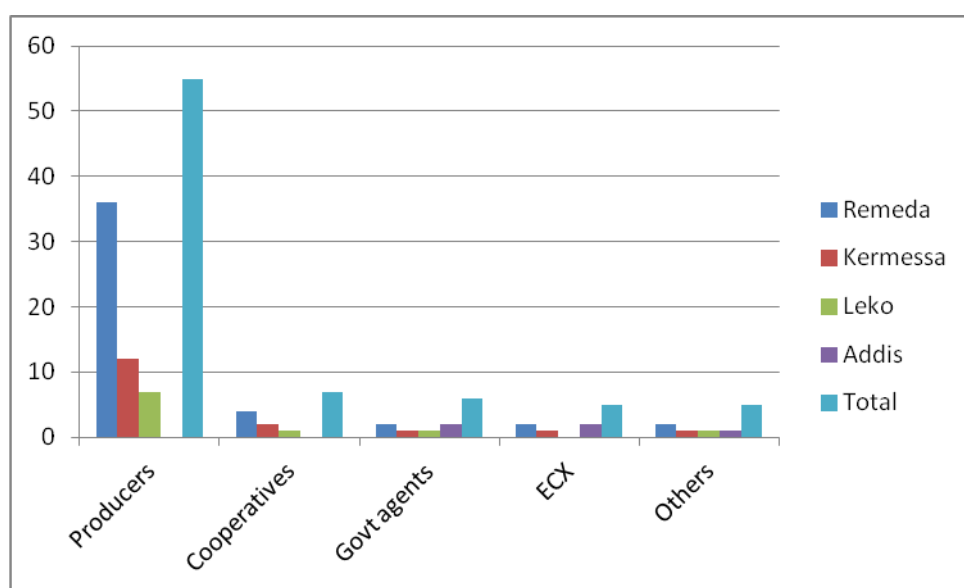
Attempts will be made on this study to find answers for question from ECX are: what are the various stages of the coffee market chains process, and ECX main targets on this market chains?

Once the coffee is bought through ECX from supplier or 'collectors', the coffee buyer or coffee exporters are going to unload the coffee at the warehouse and they process it and sell their buyers abroad and after that, the buyer is going to distribute this coffee to roasters, and the roasters are going to buy this coffee, and the roasters again, roast the coffee and sell to retailers and cafes. Coffee reaches the consumers after this end or after six chains. The aim of ECX targets cutting like the coffee suppliers, collectors, and also middlemen in between and it is eliminating those chains and directly linking the farmers through their own co-operatives and through their union directly to the roasters. As result about 60% of the chain is removed by working through co-operatives.

Attempts will also be made to smallholders' coffee farmers question like, how much do they need for their red cherries, a kilo of red cherries that to improve their life which they are paying a maximum of 8 Ethiopian birr (\$0.48) at this time. And they said, to make us live a better life, to send our children to school, to feed enough and have good clothing and a good life we need for a kilo of red cherry 20 Ethiopian birr (\$1.10) which is the price which they are getting for their red cherry. Last year had been 4 Ethiopian birr (\$0.11). What they are need at this time to improve their life is 5 fold. It doesn't mean better life means having car, having electricity or having a motorbike or it... doesn't mean that. Rather it means at least to feed their family with nutritious food, to have clean water and to have clean clothes, and send their children to school.



Rural association	Producers	Cooperatives	Government agents	ECX	Others
Remeda	36	4	2	2	2
Kermessa	12	2	1	1	1
Leko	7	1	1		1
Addis Ababa			2	2	1
Total	55	7	6	5	5



Inputs that are required for growing coffee products by small holders

Table 2. Key stakeholders for this study

The smallholders coffee producers need the following input costs that are required to produce the coffee products. These major inputs are: seeds, chemicals, loading, and loading, labour, bags, storage, and etc. According to the majority of the smallholder coffee producers (Interview, Awassa, 04.03.2011), the sale of the coffee products in the coffee market couldn't cover the input costs.

Total production of year 2010 per/kgs	% of smallholders that participated in production	% of total cost of production of the amount sold year 2010	% of profits of the amount sold year 2010
>10000	27	85	15
5000–10000	46	92	8
3000-5000	15	98	2
<3000	12	110	-10

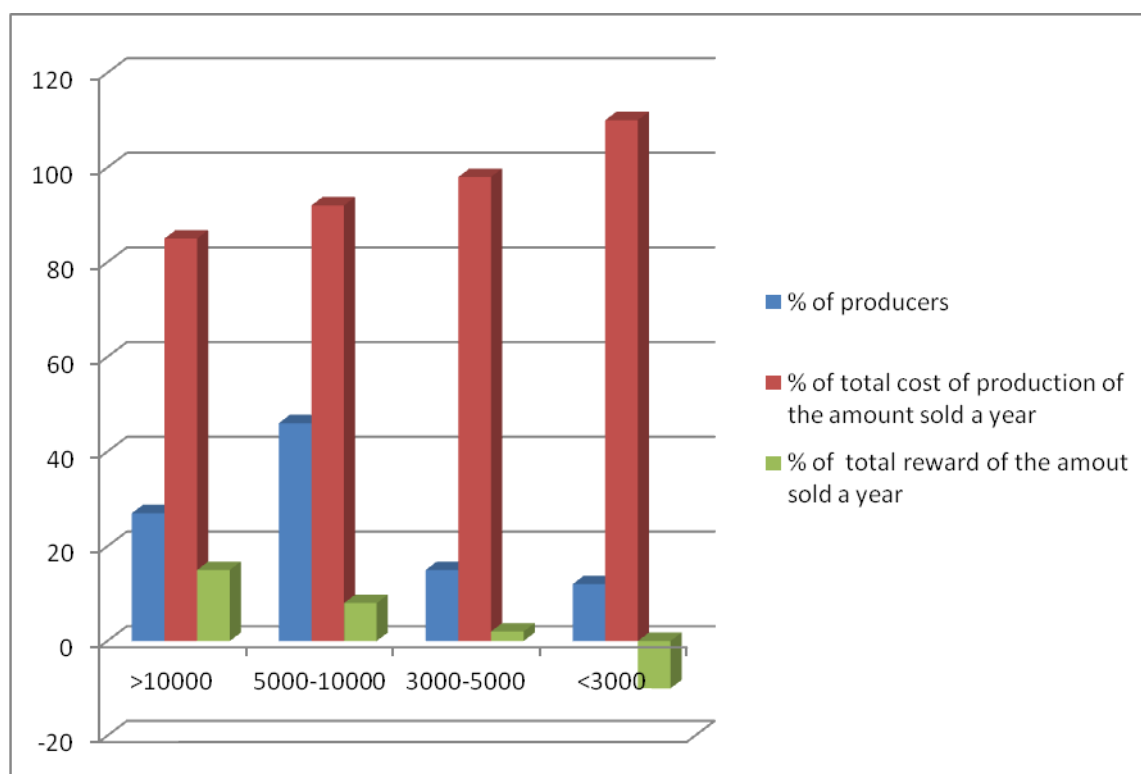


Table 3. The Value of percentage of producers that participate with smallholders cost of production and volume of production in year 2010

Based on analyses of the collected data, about 75% of the smallholders coffee farmers are using both their mobile phone and personal social networks in the community that to get market value chain of the coffee product. While the rest about 25% of the smallholders are

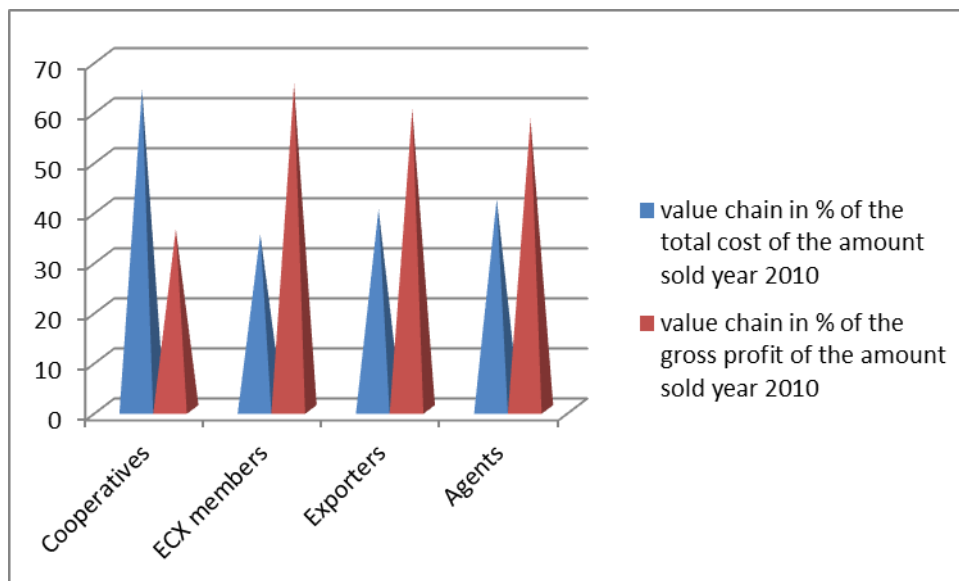
using only personal social networks in the community that to get market value chain of the coffee products, and this result indicates that market value chain of the coffee product from ECX is excluded to smallholders coffee producers.

With cooperative union, who's bought a sit share member from ECX, assemblers, agents, and exporters are a good beneficiary of getting market value chain information from ECX.

Name of market value chain through ECX	% of the total cost of the amount sold year 2010	% of Gross profit of the amount sold year 2010
Co-operative unions	64	36
ECX membrers	35	65
Exporter	40	60
Agents	42	58

Table 4. The value of Percentage to market value chain of the coffee production cost to cooperatives unions, ECX members, exporters and coffee agents

Gross Profit is the difference between the total cost of the coffee products and the sales of market price through ECX.



## The Ethiopian coffee value chain

In a highly fragmented and regulated chain, understanding who does what and who is allowed to interact with whom can be a difficult task. This section will address the major changes in the structure of the coffee value chain since the creation of the ECX. In order to understand the role of ECX in the coffee sector, the first section will provide an overview of the institutional and regulatory framework, the main actors involved in the chain and the new chain structure. The second section describes the ECX as a marketing mechanism for coffee and other commodities and analyses its strengths and weaknesses. The findings presented in this section are based on the interviews conducted during the fieldwork with representatives of the private and public organisations involved in the coffee chain. The researchers conducted by Daviron and Ponte (2005) between 1999-2003, and particularly by Petit (2007), constitute the most important basis for comparison in this study.

### 4.1 Chain restructuring since the creation of the ECX

Liberalization process started in Ethiopia in 1991 with the fall of the socialist Derg regime and the arrival of the Ethiopian People's Revolutionary Democratic Front (EPRDF), which implemented a series of reforms in line with the usual IMF and World Bank prescriptions.

However, liberalization was only partial, as policies to promote the participation of the private sector were combined with strict government controls in certain areas. According to Nicolas Petit's depiction of the Ethiopian value chain in 2006, the reforms were introduced gradually through the years and consisted mainly in the abolition of: the former state monopoly for trade and marketing in favor of private exporting firms, price controls, the quota system for traders and the export coffee tax (2007: 247-247). State control remained firm through: the mandatory National Auction; the strict licensing requirements for collectors, suppliers and exporters; the policy to keep only non-export quality coffee for domestic consumption; and the prohibition for Multinational Corporations (MNCs) to register as exporters (ibid: 246). Many of the mentioned state controls have suffered only minor variations or remain unchanged to this day, keeping the Ethiopian coffee chain highly fragmented and with limited possibilities for vertical integration of producers with final buyers.

Following a period of reorganization of the powers and duties of the institutions involved in the coffee sector, the Government decided to abolish the National Auction in 2008 and to "harmonize coffee marketing with the organizational work of the Ethiopia Commodity Exchange" (FDRE Proclamation n. 602/2008, also known as 'the Coffee Quality Control and Marketing Proclamation', and its Directives 159/2009 and 161/2009). This took place only eight months after the ECX began operating with other primary grains.

The new proclamation aims to establish a more cost effective coffee quality control and marketing system in order to efficiently supply the international market, and to enable coffee producers to increase their income. This can also be read between the lines as a twofold strategy: to strengthen the coffee sector as a one of the main pillars of the economy, and diminishing the effects of market distortions created by private exporters. Interviewees from both the public and the private sectors confirm what Daviron and Ponte (2005) acknowledge was becoming an increasingly common practice among private exporters: to register as suppliers through sister companies, thus ensuring the possibility of reacquiring their own coffee by bidding higher prices, which increases the risk of making the chain non-competitive.

The new regulation introduces important changes in terms of the processes for quality control and coffee transactions. First, quality control procedures are enhanced by adding a pre-

inspection at the locality of production and an official grading at a regional coffee quality and liquoring unit (according to the agro-ecology of the production area). Second, the lawful places for the transactions to take place and the duties and obligations of the different types of actors are specified (such as having the necessary capital and facilities to operate in a given capacity). In this regard, the figure of the collector –formerly recognized as an independent actor operating between the producer and the supplier– is eliminated and collection ascribed to suppliers. Third, a warehousing system is setup where coffee is stored until sold at the ECX.

On the other hand, certain regulations remain unchanged, such as the need to obtain a quality certification prior to export and the prohibition to sell export-quality coffee in the domestic market. Coffee exporters, domestic consumption wholesalers and coffee roasters still require licenses to operate; suppliers are said to require a competence certificate from the corresponding executive body in order to collect, process, store or transport coffee. Above all, strict government regulation remains a means not only to ensure quality but also to guarantee the timely collection of foreign currency. This is evidenced in the new proclamation by the emphasis on requiring suppliers to deliver processed coffee to the ECX within six months of processing, and export coffee purchased or collected from private farms to be sold before the next harvest.

#### ***4.1.1 Mapping of key actors and institutions***

For an easier understanding of how the chain structure has changed, actors will be grouped into five categories: regulatory government institutions and parastatals, private intermediaries, cooperatives, coffee producers and sector associations.

#### **Government Institutions and Parastatals**

The State in the Ethiopian coffee chain has to be analyzed from two different perspectives: as a market regulator and as a chain participant itself. The main regulatory body for the coffee sector is the Ministry of Agriculture and Rural Development (MoARD)<sup>1</sup>, mainly through the Agricultural Marketing Directorate –in coordination with the regional bureaus at the zone and ‘woreda’ levels for aspects regarding extension services and with the Coffee and Liquoring

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<sup>1</sup> Reorganized in 2005 into four sectors: crop production, animal husbandry, natural resources and agricultural marketing

Unit (CLU) for quality control. This has undoubtedly given greater coherence to the general coffee sector policy; however, one of the main constraints posed by the new organizational setup is that the Marketing Directorate is responsible not only for coffee but also for all other agricultural products. Because of its particular complexities, 'coffee demands most of the time and efforts of the staff and would be better managed under a division of its own' (Interview, MoARD Marketing Director, Addis Ababa, 13.03.2011). In addition, the Ethiopia Commodity Exchange Authority (ECEA) emerged as a new regulatory body for the marketing system. Created alongside the ECX and responding directly to the executive power, it has the task to oversee the implementation of the ECX rules, extend licenses to its members and audit its performance.

Regarding the State as chain actor, Petit (2007) points out how the liberalization policies introduced in the 1990s and until 2007 showed a clear tendency towards reducing government involvement and promoting private sector participation. This holds true for certain segments of the chain such as the state farm dating back to the Derg Regime, which according to the MoARD accounts for less than 5% of total production and is now in the process of being privatized. Another example is the dissolution of the coffee purchasing and exporting enterprises in the early 1990s. The government retained only its Coffee Processing and Warehouse Enterprise, whose services are also available to private actors. Therefore, state enterprises have rather discrete roles in the chain and their participation is decreasing, as private actors grow stronger. However, there is one case contradicting the general tendency. The government has since the creation of the ECX re-engaged in coffee exporting through the Ethiopian Grain Trade Enterprise (EGTE), which formerly traded only cereals, legumes and oil seeds with the purpose of stabilizing the domestic grain market. Interviewed EGTE officials (17.08.2010) argue that 'the decision to re-engage in the exporting business came as a response to abuses and malpractices committed by private traders, such as defaulting on contracts, failing to report real income and to repatriate export earnings, tax evasion and even fraud'. The implications of the re-appearance of the State as a chain actor shortly after the creation of the ECX will be analyzed in depth in the next chapter. Hence, only three pre-ECX parastatals remain actively involved in the coffee chain, the fourth -the ECX itself- will be looked at in depth in the following section.

## **Private Intermediaries**

Private intermediaries include all those actors in the chain who play an intermediary role between producers and final consumers at the local and international levels, such as suppliers, private processors, service providers, exporters, wholesalers and roasters

Exporters are clearly the most powerful of the private intermediaries as they hold the contacts with international buyers. They are centralized in Addis Ababa and own their processing plants where coffee is transformed into export quality green beans. Although MNCs are not allowed to buy coffee directly from suppliers, they oftentimes have locally-run representation offices and well-established relationships with exporting firms. However, the most notable change in this group regards suppliers. As noted earlier, coffee collectors –that is, individual agents collecting coffee directly from producers in remote areas– known as '*collectors*', are no longer recognized by law because, according to the MoARD, they do not carry out a value-adding activity. Nonetheless, almost all the interviewees agreed that '*collectors*' most likely continue to perform their duties as employees of suppliers. Even if suppliers now reach the primary markets, their role is considered necessary, as they are able to reach remote areas despite the country's poor infrastructure. In addition, since the creation of the ECX, a wide array of service providers has emerged, particularly around the regional warehouses, as was verified during the transect walk in the Sidama zone.

What has happened /.../is new actors have come up, like transit agents, people who will sit in Sidama and facilitate the loading on behalf of the exporter, transport service providers, freight managers, information people (people who actually stand in front of the tickers and inform others about prices in areas where there are no tickers (Interview, Daniel-Lulu, ECX Market data analysis manager, Addis Ababa, 26.02.2011).

Licensed wholesalers and coffee roasters operate mainly in the domestic market –that is, trading non-export quality coffee. Wholesalers buy coffee from the ECX; roasters can buy either from the ECX or from wholesalers and are allowed to export roasted and grinded coffee, although this market niche is quite minimal.

## **The Cooperative Sector**

In 2001 the government allowed cooperatives to be formed (with support from a USAID-funded project) which could by-pass the national auction and become direct exporters



(Dempsey and Campbell 2001). Their main functions are to help service cooperatives in improving farmer's incomes, establishing producer/buyer linkages, exporting members' coffee and providing a variety of technical services, such as warehousing, transportation, promotion, financing. Social services (health, water and education) are provided for members and their families (Petit 2007). Through this process, cooperatives and smallholders have invested in different certification programs (Fair Trade, organic and others), thus opening the way to more direct relationships between producers and final buyers.

### **Coffee Producers**

Most literature on Ethiopian coffee attributes at least 95% of total coffee production to small-scale farmers. Although there are no recent official surveys, the Ethiopian Coffee Growers, Producers & Exporters' Association (ECGPEA) claims large-scale plantations have grown considerably over the past years and account for approximately 10% of total production, divided in roughly equal parts between the state and commercial farms (Kidan 2009). "Large-scale plantations cover at least 50,000 hectares, out of the total 700,000 hectares covered by coffee in Ethiopia; approximately 30,000 hectares are privately owned, the rest are state plantations" (Interview, Yilma Kidan, General Manager ECGPEA, Addis Ababa, 24.02.2011).

### **Sector associations**

According to an International Food Policy Research Institute (IFPRI) survey, the majority of traders are not organized in formal or informal trade associations; thus sector associations have had a weak role in the marketing system (IFPRI 2003). The transition to the new system may have started to change that. The oldest and most well known is the Ethiopian Coffee Exporters Association (ECEA), whose membership has increased from 65 in 2006 (Petit 2007) to 90 in 2011 (according to its General Manager), including the state-owned EGTE; its members are responsible for 90% of total coffee exports. In addition, the ECGPEA was established in 2007 and has now 70 members with holdings that range from 30 to 5,000 hectares. Most recently, the National Exchange Actors Association (NEAA) which groups all trading members of the ECX, that is suppliers and exporters of pulses, oil seeds, grain and coffee with full ECX membership (ECX 2010a). Aside from providing different services, such as information and training, interviewees state these associations have become more

active as of late and constitute important dialogue spaces between the actors and with policy makers. However, evidence suggests that such dialogue takes place in Addis Ababa circles and usually excludes primary producers associations, whose voices are channeled only through the cooperative unions that represent them.

#### 4.1.2 Chain Structure

From the mapping of the actors, it follows that coffee in Ethiopia can be exported through three main channels: a) private traders, b) farmers' cooperatives, c) large-scale farmers. Figure 1 illustrates coffee flows for each of the channels.

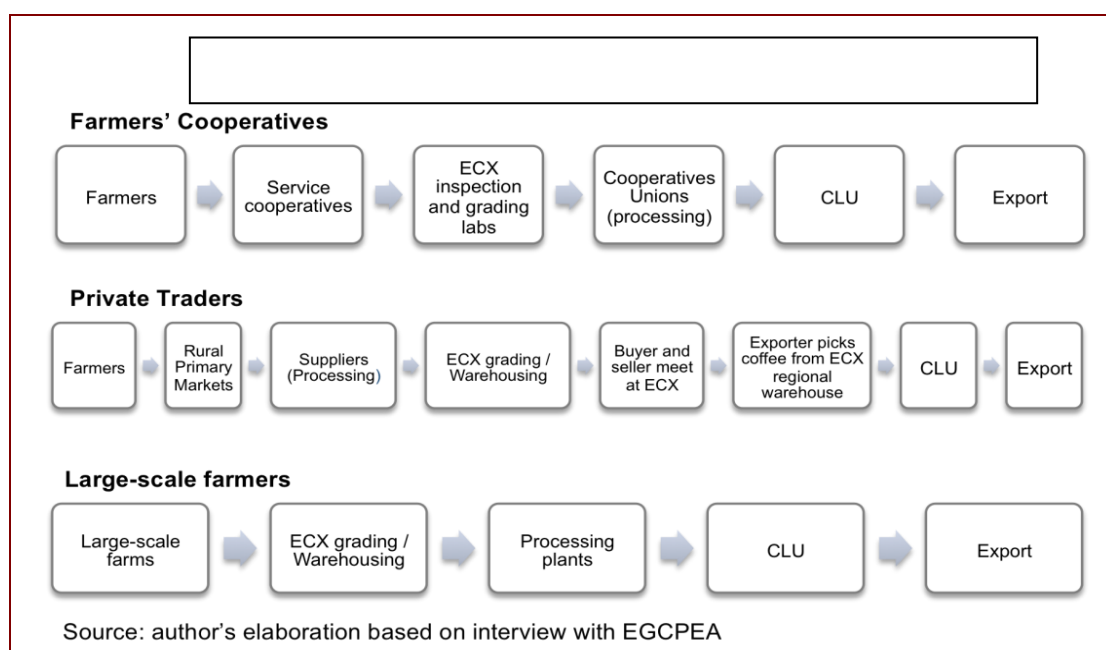


Figure 6. Coffee flows for the difference exporting channels

#### 4.1.3 Quality standards and the issue of traceability

Even before the new coffee proclamation, regulations mandated coffee to be sealed by government officers at the production area before delivery in Addis Ababa or Dire Dawa and checked for moisture before the auction and prior to export (Daviron and Ponte 2005). However, coffee was bought at one price and without incentives for different qualities. The new quality control system, in which coffee is graded according to its agro-ecological zone, type of processing and physical attributes (see Box 2), has helped increase awareness about price differentials in relation to quality. During the first year of operations the sale of specialty

grades (1 to 3) has tripled (Interview, ECX Market data analyses manager, Addis Ababa, 26.02.2011).

**Box 1**  
**Grading Ethiopian Coffee**

The totality of Ethiopian coffee is tested for moisture (above 11.5% coffee is rejected), screened for size (85% of the beans must be above screen 14, the size of the bean Ethiopian coffee is known for) and cupped for taste and aroma by highly trained personnel, both at the regional coffee liquoring units for arrival coffee (i.e. coffee brought by suppliers to the regional warehouse) and by the CLU at its Addis Ababa or Dire Dawa stations. The Dire Dawa station, in the eastern part of the country, is used exclusively for Harar Coffee due to its vicinity to the Djibouti Port.

Based on these criteria coffee is given a grade from 1 to 9, where grades 1 and 3 are specialty coffees, 1 to 5 are export quality, 6 to 9 is domestic consumption coffee and below 9 is 'under grade'.

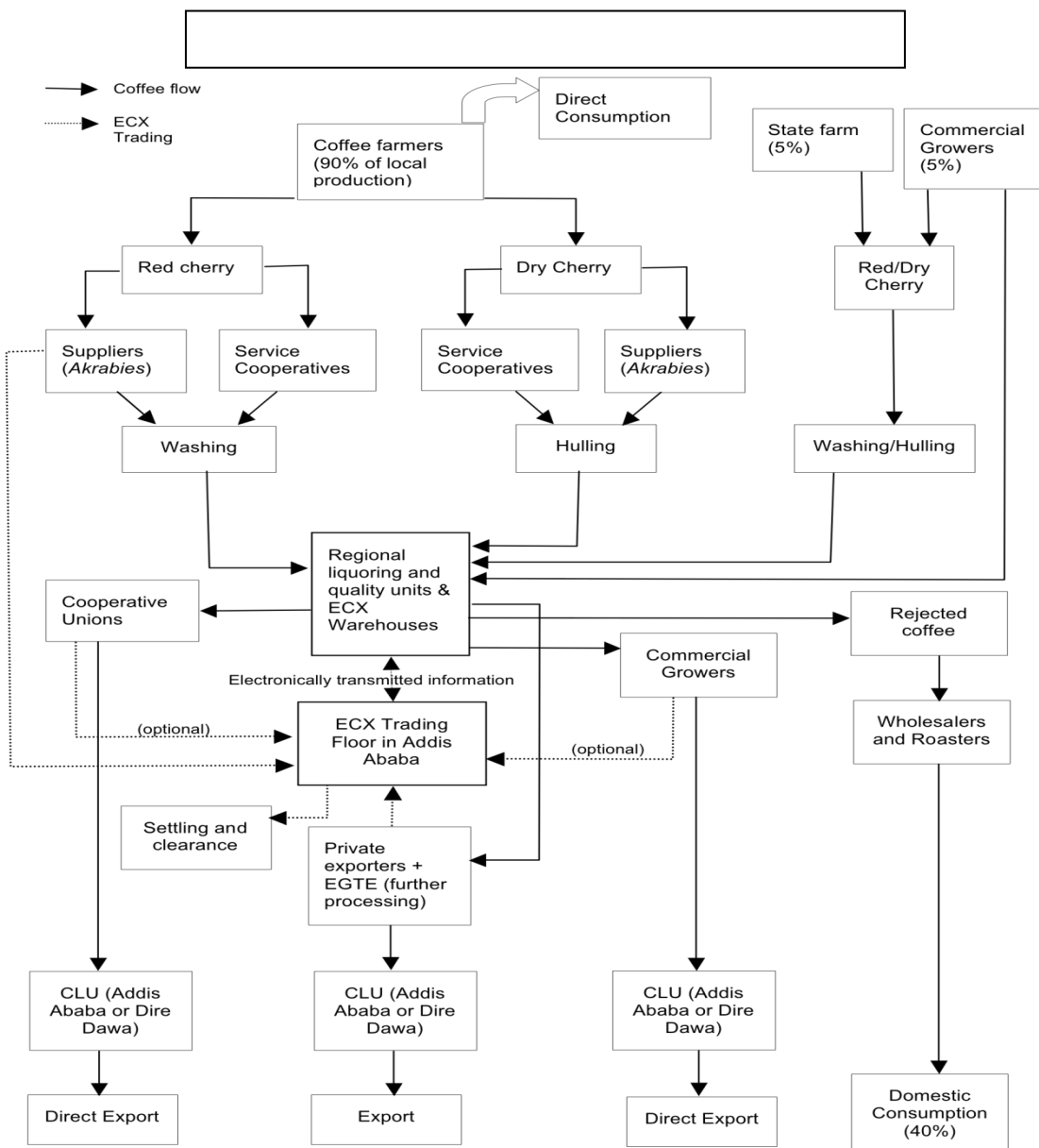
Source: Interviews with CLU (17.02.2011) and Sidama Warehouse managers and cuppers (20.02.2011), MoARD (13.02.2011).

Throughout the years Ethiopian coffees have maintained their place in the market due to their rich genetic varieties and the low use of agrochemicals, which makes them naturally organic. Yet, two important factors are to be considered regarding quality. The first is that there is still room for improvement when it comes to processing. A common problem is 'farmers are not used to see more compensation for more effort of picking red cherries' (Interview, MoARD Marketing Director, 13.02.2011), thus they pick early or from the ground. Extension services aim to teach farmers the link between good processing techniques and final quality, but institutional capacity is limited.

The second factor is the issue of traceability, which is lost once coffee is graded and warehoused. The new system allows for differentiation between coffees coming from different regions, but not from individual producers or farms –a basic requirement for specialty markets, which offer higher price premiums. Despite Ethiopia being 'naturally endowed' for the specialty market, in the current circumstances only commercial growers and cooperative unions are able to offer full traceability, thus Ethiopia's specialty market share is only 20%, compared to Kenya's 40% (the highest in Africa), Guatemala's 60% (the highest in Central America) or Colombia's 33% (the strongest in terms of specialty volume) (ECX 2010b). Estimates suggest that Ethiopia has the potential to increase its specialty coffee production to two thirds of total production, or even 80% of production adding organic or rainforest certified coffee (ibid).

Asked about this potential, the MoARD representative explained the rationale behind the current quality system is to consolidate Ethiopia's place in the standard international coffee market by improving overall quality, although the government might establish an organic certification system in the near future:

We find certification systems are not entirely reliable /.../, people will give certificates without auditing properly and this could hamper the image of the country. So even if there is a premium to be gained, we need to focus on strengthening our institutions and marketing system. Our regulatory directorate is evaluating an organic certification proclamation but our institutions are not strong enough (Interview, MoARD Marketing Director, Addis Ababa, 13.02.2011).



Source: adapted and updated from Petit 2007

Figure 7 Ethiopian coffee marketing chain in 2010

## 4.2 What is the ECX and how does it work?

As prior explained, the ECX has become a key institution to provide the market information link to the coffee product. Thus market chains to commodities product is grown and/or consists presently to further products. Presently according to Gebre-medhin (Addis Fortune, 2011), the ECX is providing a key institution to bargain 47% for coffee, sesame for 44%, haricot bean for 8% and corn for 1%.

The ECX is a state-owned public-private partnership enterprise established as a ‘demutualised corporate entity with clear separation of ownership, membership and management’ and governed by a Board of Directors constituted by relevant public institutions and ECX private members<sup>2</sup>; it operates through the sale of membership seats, which are privately owned -by wholesalers, cooperatives, exporters, processors, food agencies and even the EGTE (ECX 2010a).

According to ECX officials interviewed by Aaron Brown in the PBS Documentary ‘The Market Maker’, the ECX could contribute to eliminate food shortages and hunger in Ethiopia by creating an efficient marketing system for agricultural commodities, and increasing smallholder’s income by allowing them opportune information in order to decide when to sell. The latter may seem as an overstatement, yet it is helpful to understand how the rationale behind the creation of the exchange is based mainly on a New Institutional Economics approach. Gabre-Madhin (2007b) claims that a properly implemented exchange tailored to the country’s particular characteristics and needs can help strengthen the bargaining power of weak groups such as smallholder farmers and more actively engage them in the market economy, but at the same time recognizes that the role of strategic public and private partners is key to achieving the adequate policy mix.

#### ***4.2.1 Performing the ECX?***

In order to understand the basic aspect of how the ECX came to be and how it quickly required such a pivotal role for the coffee sector needs a closer look at the agents involved, the nature of their particular agendas and the material investments surrounding its creation. The organizer behind the ECX is its CEO, Eleni Gabre-Mahdin, an Ethiopian economist who left for the United States at the age 10 and decided to go back to her mother land with a project that, based on her suggestions, could revolutionise Ethiopian agriculture by helping producers sell easier and faster, get higher prices and thus earn greater income (Brown, 2010). Later, as a World Bank official and researcher at the International Food Policy Research

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<sup>2</sup> Including the Ministries of Agriculture, Finance and Economic Development, Trade and Industry, the Commercial Bank of Ethiopia, the EGTE, private exporters and suppliers and a representative of a Cooperative Union.

Institute (IFPRI) in Washington, she dedicated an important part of her career to the study of the Ethiopian grain markets.

Gabre-Madhin (2001) first explained the idea for a commodity exchange in her empirical study of the nature and extent of the transaction costs challenged by traders in Ethiopia and the role of brokers. Later after a few years, she argued that in the light of the low impact of the market reforms of the 1990s on agricultural growth and poverty reduction, Ethiopia needed to move from ‘market reform’ to ‘market development’ through the reinforcement of key institutions such as market information, grades and standards, contract enforcement and regulation (Gabre-Madhin 2005). Earlier to the launch of the ECX in 2008, at the TED Global Conferences<sup>3</sup>, she suggested that the pursuit of pleasure is about freedom of choice and that one way of expressing it is through the markets (Gabre-Madhin 2007b). A kind of such type of concept is then linked to Sen’s (1981) explanation of famines as a problem of lack of ability to acquire food rather than one of availability. There is no hesitation that the ECX became a reality as a result of Gabre-Madhin’s capability to get the government on board and of the essential financial support of international partners such as the World Bank, UNDP and IFPRI. Box 3 summarises the material investments contributed by the various supporting organisations.

**Box 2**  
**Material investments involved in the creation of the ECX**

The ECX was funded by a consortium of financing partners including UNDP, the World Bank, the American and Canadian development agencies, the World Food Programme, and co-financed by the Government of Ethiopia.

Of the USD 24 million needed to establish the ECX, UNDP contributed 3.5 million. The World Bank has invested USD 7 million and helped modernise its operations through the Rural Capacity Building Project, including: software to introduce the SMS (mobile phone text messages), 200 electronic price tickers or display boards in major market places. In addition, it will finance the development of new IT systems to improve the one being currently used in order to support future trading.

Through the ‘Ethiopia Strategy Support Program’, IFPRI financed an economic research programme and conducted extensive technical and analytical support towards the establishment of the ECX

Source: Alemu & Meijerink 2010; IFPRI 2010.

The beginning of two years of operations of ECX has shown that creating a market takes more than material investments and modified regulatory frameworks. The bottlenecks explained above confirm that removing market asymmetries is more than improving access to information and enforcing contracts between two actors in a long market operation. Aspers’ typology of markets is useful to envisage the difficulty of the social embeddedness of the

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<sup>3</sup> TED (Technology, Entertainment and Design) is a non-profit organisation that organises conferences about innovative ideas.

Ethiopian coffee market operation. Buyers and sellers continuously switch from buyers to sellers as coffee moves downstream, but becoming one or the other is determined by factors embedded in specific power relations. Dependent on what segment of the operation is examined, coffee can be considered both a status and a standard market; while the bulk of coffee traded through ECX pertains to the standard typology, specialty, fair trade and organic coffee qualify as status markets in which the quality of the product is fundamentally linked to the people who produced it and their particular social context.

In general the ECX as a marketing system for coffee has intervened in the middle part of the market, primarily by regulating the way in which suppliers and exporters interact. With this fact, evidence gathered through the study suggests that the ECX is inventing changes in the institutional environment in ways that touch power relations between the actors. For instance: the improved bargaining power of suppliers in relation to exporters; the emergence of contract farming with commercial producers; or the new challenges faced by exporters vis-à-vis their global buyers in the specialty market. Vice versa, the interactions between chain actors, embedded in a particular institutional and social context, are constraining a better performing of the market. For instance, small-scale farmers, regardless of a better access to information, still lack the necessary assets, organisational structures and bargaining power to participate in more favourable terms; the tensions between the government and exporters curtail the potential for a mutually beneficial public-private partnership.

The NIE approach adopted by the ECX in terms of removing market asymmetries, reducing transaction costs and ensuring a proper institutional environment reflects the agendas of the technical and financial promoters as well as the economic background of its CEO. Concerning the infrastructural constraints faced by ECX Gabre-Madhin suggests:

‘We have two choices: a) here is one of the poorest countries in the world, our system is too complicated and wants all this basic things that don’t yet exist so let’s only work where there’s great infrastructure and wait until it becomes a middle-income country, or b) let’s go swim in the mud, and because we’re there and making these demands on the infrastructure, that will incentivise the building of the infrastructure to meet our needs.’  
(Publicize, Addis Ababa, 26.07.11)



To anticipate that the system's demand of infrastructure will lead the responsible institutions to find technical solutions to the market constraints is reasonably feasible. Whether these pressures are also pushing power forces to readjust is a more difficult question. The study of this research analyzing is that marketing operation of the coffee market is; however, as every social process, market chain to smallholders coffee producers is much slower and at times more or less imperceptible. Additional change will require considerable concessions from the public and private sectors as the two stronger forces and, most importantly, it will remain unavoidably linked to the political stability of the regime.

#### ***4.2.2 Strengths and weaknesses of the ECX system***

By law, the ECX has become a key institution for the coffee sector, providing a link to: a) an integrated warehousing and receipt system with quality standards that allows the product to be transferred only after its sold; b) an information system which disseminates market information to all market actors; c) a trading platform that guarantees payment against delivery through an electronic system for clearance and settlement in collaboration with partner banks (Alemu and Meijerink 2010). Its promoters claim these features constitute solutions to the bottlenecks that create high transaction costs and coordination risks. Daniel Lulu, market data analyses manager (Interview, Addis Ababa, 26.02.2011) admits no systematic study has been done yet regarding the actual impact of the ECX on transaction costs. However, an assessment can be made of the strengths and weaknesses of the ECX after almost two years of operations. In doing so, a special emphasis will be made on the ECX's role in lifting or reducing constraints for different market actors.

#### **Membership**

Membership is acquired through the purchase of a Membership Seat –i.e. a permanent and transferable right to trade in the Exchange. Full members are allowed to trade in any commodity while limited members (usually smaller actors) can trade only for limited periods, specific commodities and in limited positions as buyer or sellers. In addition, each type of member can be a Trading Member (TM), trading in his or her own account, or an Intermediary Member (IM), trading for him or herself or on behalf of clients (ECX 2010a). Because demand for membership is high, seats are being auctioned from time to time; full membership is currently closed but may be available again in the near future, according to the

ECEA. The membership cost varies depending on the type of member; it was 50,000 Ethiopian Birr (circa USD 3.760<sup>4</sup>) in 2009 but has since increased. According to Alemu and Meijerink (2010: 17) “the OCFCU bought a seat for 200,000 Ethiopian Birr and one businessman in the coffee business was reported to have paid 3.3 million Ethiopian Birr by the end of 2009”. Members are also required a minimum net worth of 500,000 Ethiopian Birr (circa USD38.000) for TMs and 1.000.000 (circa USD75.000) Ethiopian Birr for IMs in order to ensure immediate payment of the contracts.

Consequently, current membership conditions favour well-established traders who are able to fulfill the abovementioned financial requirements. Evidently, farmers are not able to become direct traders at the ECX; at most, they are represented by member cooperative unions. Clients are usually small private traders or traders without member seats, rather than individual or organized farmers. On this matter, Gabre-Madhin argued that ‘what prevents them from direct involvement is their lack of capital to carry out their own processing and to comply with the minimum volume requirements’ (Interview, Addis Ababa, 26.08.2010).

## **Warehousing**

According to ECX, there are currently six warehouses operating for coffee; two more will be opened shortly. Although the warehousing and receipt system has brought order in terms of classifying and grading coffee, interviewees agree there is a considerable weakness in physical infrastructure (roads, grounds facilities, buildings, drainage). A visit to the warehouse in Awassa, one of the most important coffee zones in the Southern region, confirmed the ECX’s strong dependence on physical infrastructure. At the time of the visit, a long line of trucks waiting to enter the liquoring facilities was observed. Warehouse officials claimed the long line obeyed to a high incidence of arrival coffee exceeding the accepted moisture levels due to the rainy season. Moreover, a tour of the liquoring laboratories revealed rather modest facilities and amount of personnel compared to the number of trucks arriving. According to the supervisor, in those conditions their operative capacity was down to 30-40 trucks a day, compared to the normal average of 70. Whether the delays are due to high moisture levels at arrival or by overwhelmed local facilities, they are bound to have negative effects on coffee quality. Gabre-Madhin explains:

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<sup>4</sup> 1 Birr:13 USD

In the case of telecommunications and the financial sector we really have built a communication network system that goes around these infrastructure problems. /.../ If the fibre optic doesn't work we do dial-up, and if that doesn't work we do satellites. /.../ In the case of warehouse function, /.../ we are very vulnerable to this thing we have no control over...physical infrastructure (Interview, Addis Ababa, 26.08.2010).

### **Information System**

The information system, both in the warehouse and trading components, is one of the most evident accomplishments of the ECX. According to ECX Trading Operations Manager, electronic warehouse receipts are transmitted to the ECX Central Depository so inventories are immediately updated as trading takes place. Market prices are displayed at the trading floor and transmitted in real time to market actors via: electronic tickers located in 21 locations around the country, the website and, recently, through mobile phone service. In addition, after the sales take place, the system orders partner banks to transfer funds from the buyer's to the seller's accounts and warehouses to update the seller's inventory.

Establishing a real-time market data system in a country like Ethiopia is certainly an enormous challenge, which seems to have been dealt with through a considerable investment in IT systems, made possible with the financial support of the World Bank and other international organizations (Alemu and Meijerink 2010). Interviewees agree that chain actors now have improved access to updated information regarding market fluctuations and price differentials based on quality. However, from the farmer's standpoint, improved access to information and greater awareness of what should constitute fair prices is no guarantee of automatically getting them.

### **Trading, Clearance and Settlement**

As explained in the introduction section, 'Trading takes place through 'open-cry' bidding in which buyers and sellers use their hands to negotiate prices and quantities; deals are sealed through a clash of palms' (Interview, ECX Trading Operations Manager, Addis Ababa, 6.08.2010). Clearance and settlement of everyday transactions take place through the information system explained above. According to ECX, this ensures the payment to the supplier takes place within 24 hours. Nonetheless, some exporters claim that although the time for monetary transactions has decreased, delivery time of the actual product has

increased due to inadequate infrastructure at the regional warehouses and transportation services.

### **Direct Specialty Trade (DST)**

As mentioned in the previous section, one of the main challenges for the ECX is that of guaranteeing coffee traceability for specialty, fair trade and organic markets. This is currently being addressed through the Direct Specialty Trade (DST)<sup>5</sup>, a new platform created by the ECX through which producers of specialty coffee are supposed to transact directly with international buyers. The DST works through bidding sessions in which small farmer cooperatives and commercial growers may deposit specialty grade coffees at the ECX warehouses. Farmers are supposed to receive a minimum 85% of the final price (ECX 2010b). According to Gabre-Madhin, ‘the two core issues they now face are: a) the farmers’ capacity to regularly produce the quality standard coffees, b) the international buyers’ demand for fully traceable coffee of lower grades’; DST could thus phase out if there is no demand from the actors involved (Interview, Addis Ababa, 25.02.2011).

Another step in responding to criticism about traceability was the agreement signed with the Specialty Coffees Association of America (SCAA) aimed at “developing a specialty coffee strategy which protects the mutual interests of the Ethiopian Coffee sector and specialty coffee buyers” (ECX 2010). When interviewed, Daniel-Lulu (Addis Ababa, 26.02.2011) added ECX would become SCAA’s partner for specialty grading certifications.

### **4.3 Winners and losers in the Ethiopian Market value**

Although the ECX has meant an improvement in terms of order, transparency in market transactions, access to information and the introduction of clear quality standards and grades, there are still important bottlenecks that constrain the coffee market. Furthermore, the result is that small producers are being excluded from the market value. Consequently, about 90 % of the smallholders coffee producer are not even know what ECX is and its objective from the coffee products. In other words, since 2007 the world coffee market had begun rising, the small producers entire revenue had not that much change that compare revenue from the prior year’s revenue with the sale of their coffee products. Rather such change of revenue came up

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<sup>5</sup> Introduced by the ECX in February 2010.

to other intermediaries in the ECX market value chain. Since 2008 the majority of the smallholders coffee producers shifted their producing farm, Instead of growing coffee they shifted to other product called “khat” which has brought very well revenue generating more than the coffee products. Thus, if this situation continues, there is a potential danger that such farmers may replace coffee by the relatively high value crops. Thus, given the government controls the smallholders coffee producers that they can not to produce ‘khat’ which encourages the expansion of an illegal market trend.

	<b>Private Exporters</b>	<b>EGTE (state exporting enterprise)</b>	<b>Suppliers</b>	<b>Small-scale producers</b>	<b>Cooperatives</b>	<b>Commercial Growers</b>
<b>Government</b>	Regulatory  Chain actors competing for a share of the export segment.	Regulatory  Government as chain actor through parastatal enterprise.	Regulatory  As chain actor government buys coffee from suppliers.	Regulatory  Enabler through the provision of extension and research services	Regulatory  Enabler through promotion of the cooperative sector and by granting a direct exporting channel.	
<b>ECX</b>	Mandatory	Mandatory	Mandatory	No direct participation at ECX.	Optional	Optional

Source: author’s elaboration

Table 5. Types of interaction between chain actors in relation to the Government and the ECX

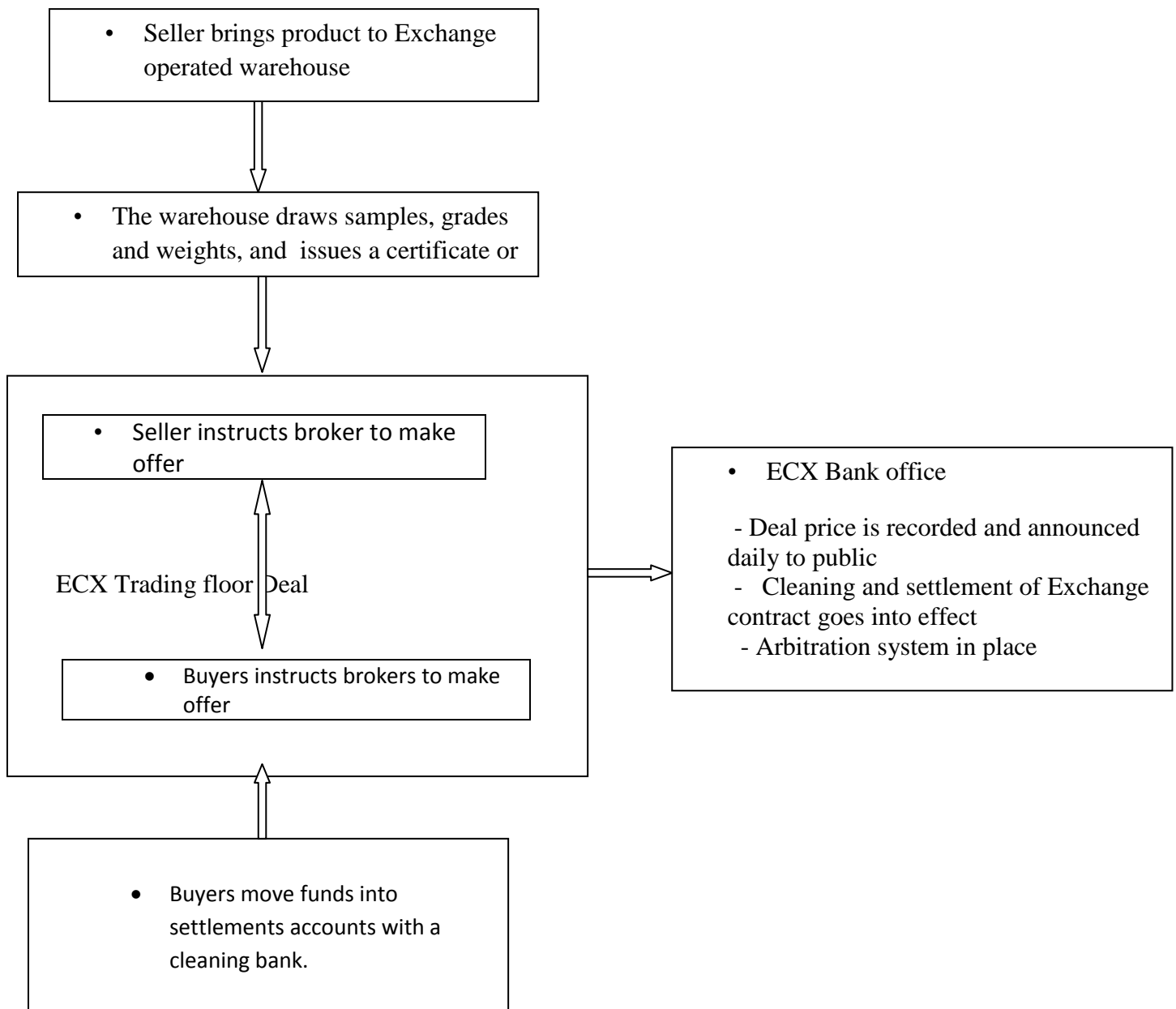


Figure 8. The coffee chain actors in relation to the small producers and ECX logical topology  
Source: (Gebre-medhin, 2006)

#### 4.3.1 Government participation

Extension services need to be developed in order to strengthen agricultural, harvesting and quality control practices. The efforts of the state are insufficient and the extension units (see Table 2 in Chapter 4, MoARD regional bureaus) in each ‘*kebele*’, with only one agent dedicated to crop production, and these cannot adequately cover the specific needs of coffee producers. In reality the state has responsible providing training, information and demonstration, extension services need to reinforce organisational and marketing aspects. Development aid initiatives seem to be filling this gap but in a scattered, overlapped and

often-unsustainable way. Moreover, technical assistance desires to be coupled with agricultural credit. Even though the efforts in the early 1990s to liberalise the financial sector, economic reforms have failed to effectively direct credit to the agricultural sector (Gebre-Selassie 2003). Limited assets and access to credit constrains small-scale farmers to short-term investments and, thus, to lower income activities.

Improper infrastructure facilities in Ethiopia are enormous: the road network needs to be improved in order to connect the coffee producing villages with the market outlets; village markets entirely lack adequate buildings, storage facilities and transportation hubs, parking spaces. Jointly with poor transportation services, poor infrastructure is largely responsible for the delay in coffee delivery from the regional warehouses to the exporter's processing plants. Furthermore, the existence of only two coffee and liquoring stations (in Addis Ababa and in Dire Dawa) has caused processing plants to be centralised in the capital. New CLU stations in different regions would increase the rate at which clearance for export is given, decentralise processing activities and foster regional investment and employment.

#### ***4.3.2 Areas for ECX intervention***

The ECX, functioning from a NIE approach, has worked mainly on lifting what are believed to be the factors that cause market failure, such as poor market information, a weak system to enforce contracts, lack of standards and grades and the lack of the necessary institutions that support proper market operation. However, its system also has bottlenecks to address.

While there will be eight warehouses operating for coffee, to be opened soon new ones would allow for a more even distribution in the grading and storage of arrival coffee. This goes hand in hand with the government's ability to improve the physical infrastructure. Moreover, the ECX needs to operatively reinforce regional liquoring units by expanding their facilities with equipment and personnel. The latter's needs to be increased and continuously trained. Interviewees agreed that improving warehousing functions could help solve the long lines of trucks observed in Awassa and other regional warehouses while better-trained personnel would have a direct effect on coffee quality.

ECX has been successful in introducing various ICT services that allow information transmission in real time. Even so, Internet and telecommunications in general are still quite poor (some times non-existent) in rural areas. Reaching remote areas would require a massive investment: on behalf of the ECX, in terms of getting new electronic tickers and finding new ways of efficiently delivering information to the local level; on behalf of the Government, in terms of the necessary ‘meso’ infrastructure. Even with these technical problems solved, the issue of people learning how to use and benefit from IT services remains.

#### ***4.3.3 Areas for Private Sector Participation***

The capacity for private investment is high throughout the chain, and public-private partnerships could boost it even further. There are massive chain-related entrepreneurial opportunities, such as financial and technical services, commercialisation of coffee by-products and transportation services. Interviewees agree that transportation services are poor, have high costs and are concentrated in capital city. The General Manager of the Awassa Farmers’ Union (Interview, Addis Ababa, 25.02.2011) argued that if transportation companies were decentralised and had operating bases in the different regions, coffee delivery would be more cost and time efficient. There is also immense potential in the domestic consumption side. Now there are a variety of cafés that have sprouted throughout the bustling business areas of Addis Ababa, where coffee is enjoyed Western-style alongside the traditional coffee ceremony, in an attempt to capture the so-called ‘symbolic’ and ‘in-person service’ quality attributes of coffee<sup>6</sup>.

#### **4.4 How DST and power relations affect market chain governance**

With the context of ECX, the DST platform could potentially open new spaces where global buyers could have a direct participation in the Auction. However, the platform allows for interaction with Cooperative Unions and is not open to private exporters. ECX claims it is a way of reinforcing the position of organised small-scale producers. This kind of key point exemplifies the power struggle between the ECX and different specialty buyers. The question is if ECX will respond to international criticism to its standards system by making certain concessions to private exporters and their global clients or if it will continue on the same path,

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<sup>6</sup> Also as a result of the strong Italian influence in Ethiopia.



which could either result in leading global buyers to work closer with cooperatives or in excluding Ethiopia from certain niche markets.

Chain reform is certainly government-driven in Ethiopia; though, because the market value chain is buyer (or roaster driven), domestically exporters have a great deal of power in terms of permeating the desires of the global market upstream. Consequently, within current aspects of Ethiopia, lowering entry barriers to production and trade depends on the ability of chain actors in the different segments to overcome the different bottlenecks at the domestic level.

## Chapter Five: Conclusion

The starting and leveraging points for Ethiopian coffee sector development is the market. A comprehensive market value-chain approach through ECX is an excellent framework to direct business development and market linkages. Linking coffee producers to international markets in an economy such as Ethiopia's where many of the requisites to successful participation in overall markets are so weak requires institutional and capacity building carefully provided to support market value chain expansion. Building the institutions and capacity of the cooperative sector in the case of smallholder exports of specialty coffee was essential to opening a new coffee export channel. The success of the program rests on a combined market value chain and institution building program that includes a comprehensive market development assistance program and a broad-based institutional and capacity building assistance for the producer groups of the cooperatives and unions.

This explanatory study enabled to department of rural development a bit more about the Ethiopia marketing operation and ECX market value chain in coffee trading. The study started by placing the marketing operation of coffee trading in its regional, national, and global context. The ECX is the marketing system, and it's operating in the middle part of regulating the way in which suppliers and exporters interact with each other. The ECX marketing operation approach revealed the inner workings of chain and non-chain actor coordination, with its implications both at the domestic and international level. In other words, farmers with market value chain can be linked to consumers' needs, working closely with suppliers and processors to produce the specific goods consumers demand. Similarly, through flows of information and products, consumers are linked to the needs of farmers. Under the market value chain approach, and through continuous innovation, the returns to farmers can be increased and livelihoods enhanced.

The path chosen by ECX has been to improve the marketing system and to bring its marketing benefit from involvement in it. The particular aims of the ECX have been to specifically address the ways suppliers and exporters transact, with more efficient and transparent ways of trading as the main outcome. Improving access to information and thus strengthening the bargaining power of farmers has come almost as a trickle-down effect. Issues like improving

farmers' agricultural practices, working capital, access to finance, organisational capacities, as well as improving the massive deficiencies in public infrastructure, are widely recognised as necessary elements for promoting a more favourable participation in markets and depend on a variety of actors. However, investment in these areas is nowhere near the radical investments directed toward creating and improving market mechanisms. The State's meagre resources in terms of assistance to farmers tend to be compensated with bilateral or multilateral aid programmes, without a coherent intervention strategy.

Regarding the Ethiopian coffee market value chain remains interesting and unlike from some other African countries because of its ability to partially implement liberalisation, especially by strongly promoting private sector participation, while at the same time maintaining strict government control. Government control is exercised not only through regulations but also through direct government participation in the exports segment. The most visible changes observed through the study lead to a series of new questions as to their short and long-term effects on the chain structure: a) how has the eradication of the legal status of one intermediary actor –the collector or '*supplier*'– impacted the livelihoods of this group and what activities have they moved on to? b) how have farmers' trading networks evolved at the '*kebele*' and how are primary markets working? c) what are the conditions and implications of the emerging out-grower schemes between small-scale farmers and commercial growers? In terms of the ECX as a marketing system, an evaluation of its actual impact on transaction costs after three years of operations would give further elements for future improvement. Further analysis concerning all these issues could give a clearer idea of the possible paths to follow.

The problems in front are many and quite complex. Public and private sector intervention is needed to address the identified bottlenecks: deficient and inadequate infrastructure, weak extension services, not have of access to finance being the more pressing ones. As for in the coffee market, resolving the issue of traceability in a way that satisfies all buyers while strengthening the position of farmers and cooperatives is one of the most complex challenges at the moment.

From the review of literature and data analysis made in the study report, the following facts have become apparent.

- i) Even though Ethiopia's coffee is the best in the world, quality problems due to handling related problems starting from harvest to the final point of sale are still unresolved. For this reason, the major portion of coffee falls in the lowest grades and export of wet-processed coffee is almost constant from year to year; which is an indication of the fact that the number of such wet-processing centers is not expanding. Moreover, almost all coffee exports are in raw form without any value addition;
- ii) The existing coffee auction and inspection system is one of the oldest and have undergone little improvements. It is very centralized and characterized by inadequate warehouses and capacity, less transparent and efficient operations.

Looking at the marketing aspects, Ethiopia's coffee is the least promoted in the world market. There are inadequate information centers and information on coffee supply, qualities, prices, roasters, etc. As a result, the share of Ethiopian farmers in the total value price of coffee has been very minimal

Due to the relatively low price of coffee paid to farmers, many coffee producers have shifted to high value cash crops such as "khat" which is a narcotic plant widely consumed in east Africa but banned throughout the united states and much of Europe. . Thus, if this situation continues, there is a potential danger that such farmers may replace coffee by other the relatively high value crops. Thus, given the government controls the smallholders coffee producers that they can not to produce "khat" which encourages the expansion of an illegal business trend.

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## Appendices

### Appendix 1 –List of Interviews

#### Addis Ababa

- Daniel Lulu, Manager, ECX Market Data Analysis(February, 2011)
- Nigussu G/Egziabher, Managing Director, Commercial Bank of Ethiopia (February, 2011)
- Ato Asseged Taddese, Faculty of Business & Economics, University of Addis Ababa (February, 2011)
- Eyoel Mitiku, Market Analyst ECX (February, 2011)
- Mekonnen Kabtyimer, General Manager, Kalmeks Engineering (August 10, 2010)
- Christopher Jordan, Regional Deputy Director, Coffee Initiative, Technoserve (August 11, 2010)
- Assefa Mulugeta, Director of Marketing Department, MoARD (February 13, 2011)
- Mengistu Tadesse, Director, Coffee Liquoring Unit Addis Ababa (August 17, 2010)
- Gebere Egziabher Abay, Marketing Officer, Ethiopian Grain Trade Enterprise (February 17, 2011)
- Local Representative of an international coffee buyer (February 27, 2011)
- Ghebremedhin Belay, General Manager, Ethiopian Coffee Exporters' Association (February 25, 2011)
- Yilma Kidan, General Manager, Ethiopian Coffee Growers, Producers & Exporters' Association (February 24, 2011)

#### Awassa

- Yenus Mohammed. Leader of the Awassa area coffee plantation group (March 5, 2011)
- Sisay G/Tsadik, Director of ECX Coffee , Awassa (March 5, 2011)
- Mulat Musay, Awassa Agricultural extension leader (March 5, 2011)

#### Telephone Interviews

- Group interview with commercial growers, members of ECGPEA (March 10, 2011)
- Specialty Coffee International Buyer (March 10, 2011)



