

ACTUALIDAD ASIA

China's Coffee Market Amidst Colombia's Supply Expansion



Abstract

Over the past decade, coffee consumption in China has increased rapidly. The Chinese market potential of high-quality Colombian coffee is determined by consumer trends towards a more “premium” product. This article collates diverse academic sources and conducts an in-depth analysis of the Chinese coffee market to provide Colombian exporters with sufficient evidence on the market potential for Colombian coffee in China.

Keywords:

China, Colombia, Coffee, opportunities.



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Resumen

Durante la última década, el consumo de café en China ha aumentado rápidamente. El potencial del café colombiano de alta calidad en el mercado chino está determinado por la tendencia de los consumidores a un producto más "premium". A través de varias fuentes académicas y un análisis profundo del mercado del café chino, así como la calidad del café colombiano y su éxito en Japón, será evidente que la característica del mercado representa una oportunidad para el café colombiano.

Palabras clave:

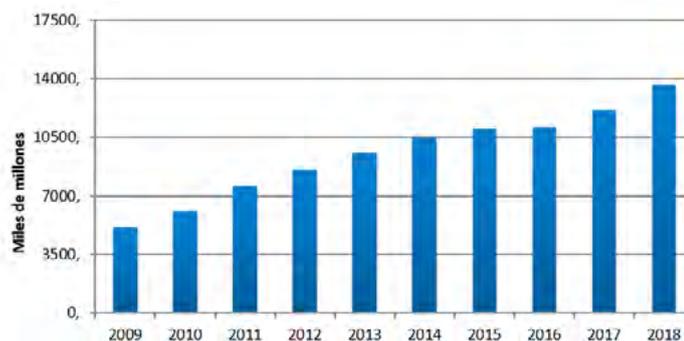
China, Colombia, Café, oportunidades.

Introduction

Over the past decade, Asia and Latin America have embarked on important economic relations. Both continents have become strategic partners, overcoming the barriers imposed by the economic isolation of China and the great distances implied by the Pacific Ocean. China's accession to the World Trade Organization (WTO) in 2001 marked a golden age in trade between these regions. In less than a decade, China became one of Latin America's largest trading partners, second only to the United States.

South and Central American countries have thus recognized the potential of developing strategic alliances with China, a leading player on the global stage with a rapidly growing GDP, taking advantage of their potential as exporters of value-added goods.

Figure 1- China Gross Domestic Product 2009-2018 (current US\$)



Source: The World Bank (China GDP, Current US\$). (April 25, 2020). Retrieved from <https://data.worldbank.org/country/china>

China has experienced steady economic growth, as has China's demand for agricultural goods and products, ensuring that trade will continue to be a central point of its relationship with Latin America. Several things explain this particular trend (Roldan, Castro, Pérez, Echavarría and Evan, 2016: 49-50). Changes in consumption patterns of the Chinese population, resulting from increased purchasing power, provide Latin America with an opportunity to increase and diversify its food supply to China. Furthermore, Latin America has the potential to expand its agricultural production by increasing cultivated hectares and improving agricultural technology.

Along these lines, this article intends to answer the following research question: "What is the potential for Colombian coffee in the Chinese market?" The objective of this study is to acquire decision-making tools applicable to

the coffee trade between Colombia and China, taking into account the current global context and applying theoretical concepts to foreign trade operations in a practical environment.

1. Case study: Colombian coffee in China.

Although China is known as a strong producer and consumer of tea, coffee is one of the most widely consumed beverages in the world and coffee beans are also in high demand in this country. With cafés popping up in every neighborhood in different cities in China, it comes as no surprise that coffee becoming important as traded commodity. Having said this, the insertion of a "coffee culture" into China is therefore viable. A potential market in continuous expansion due to the growth of the middle class and consumer habits that grow increasingly closer to Western market trends represent a considerable opportunity.

1.1 Coffee

The two most important coffee species for the commercial coffee industry are the Arabica and Robusta varieties.

Arabica

There are several Arabica varieties including Bourbon, Typica, Caturra, Mundo Novo, Tico, San Ramon and Jamaican Blue Mountain. This kind of coffee originates in Ethiopia but is produced in equatorial regions around the world, including Colombia. This coffee has a higher value in the international markets, due to its fine, mild and aromatic characteristics. According to the National Coffee Association of USA (2018) it represents about 70% of global production. Total production of Arabica in 2018 was 103,034 thousand bags (60-kg bags) (ICO, 2019)

Robusta

This variety of coffee is produced extensively around the world. Most of its production takes place in Brazil, Central and Western Africa, and parts of Southeast Asia, most predominantly Vietnam and Indonesia. According to NCA (2018) data, Robusta represents 30% of global production and its share is growing due to its use in blends and for instant coffee. Total Robusta production in 2018 was 71,864 thousand bags (60-kg bags), a 5.9% year-on-year increase (ICO, 2019).

1.2. Colombian coffee

With a total production of 13,858 thousand bags (60-kg bags), Colombia was the world's third largest coffee producer (7.92 % of the world's production in 2018). While Brazil and Vietnam have a higher share of global production, Colombia's comparative advantage over these two countries lies in its production of high-end Arabica beans. This is made possible in Colombia by its rich volcanic soil and use of shade-grown¹ cultivation methods.

As with any crop, plant development varies greatly and is determined by the climate and temperature at which they develop. For this reason, the ideal temperature for Colombian grains is between 18 and 24 degrees on average (very common in Colombia's Andean region). These factors favor the devel-



¹ "Shade grown" coffee is coffee that is grown in its natural setting. Coffee plants naturally grow and thrive in the shade from forest canopies with tall trees and diverse habits. In contrast, sun grown coffee can be grown in industrial quantities and is often sprayed with fertilizer and herbicides.

opment of the fruit, ensuring a balanced body and providing correct acidity levels. Colombian coffee is grown mainly on the slopes of the three branches of the Andes Mountains and the Sierra Nevada de Santa Marta. This means that coffee plantations run through the country from North to South. For practical purposes, the area intended for cultivation and collection occupies between 850,000 and 900,000 hectares.

Another important factor in Colombian coffee bean development is the soil in which the plant puts down its roots. Unlike other coffee-producing countries, the Colombian mountains has a wide variety of different soil types. One of their main characteristics is that they mostly derive from volcanic ash, which makes them rich in organic matter and minerals. This provides for good physical conditions, and greatly reduces the need for fertilizers. Good soil aeration is essential for growing quality coffee as it allows the plant to absorb all the nutrients it needs. This is where soil structure takes on special importance. In the case of the Colombian coffee growing region, its structure allows organic material to decompose slowly.

A good supply of rainwater is also essential for growing coffee. Due to its location, Colombia is influenced by the Amazon, the inter-Andean valleys and the Atlantic and Pacific oceans. All these geographical elements favor the existence of humid areas with constant and regular rains, manifested in different types of climates, which create extremely favorable conditions for coffee growing. Moreover, Colombia boasts a climatic phenomenon that does not occur in other coffee producing areas. Colombia is located in the Intertropical Confluence Zone, which is a confluence of winds from the North and South hemispheres, and which translates into two rainy seasons a year in the center of the country. This condition, together with the different types of terrain, helps complete the growing cycle.



Because of its geographic characteristics, most of Colombia's coffee can only be harvested by hand instead of using industrial machinery. This creates an additional differential factor compared to other major coffee-growing countries, like Brazil and Vietnam, where coffee is harvested on a massive scale using industrial machinery.

1.3 Coffee in China

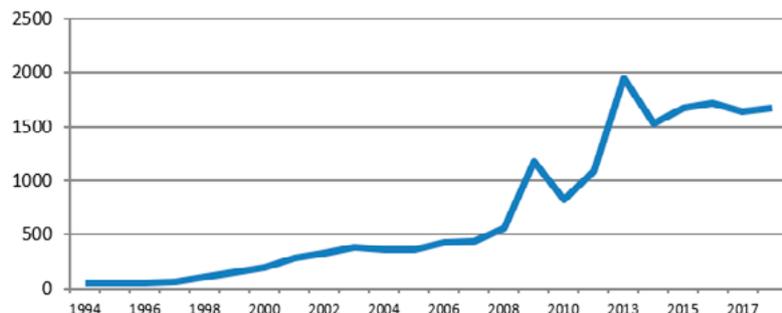
According to the International Coffee Organization, coffee in China is mostly grown in the Yunnan province, and this region accounts for over 95% of China's coffee output. This province is particularly well suited to coffee production because of its location and mountains, geographic conditions that are akin to those found in large producers such as Vietnam. Yunnan province specializes in Arabica coffee, while Robusta is produced elsewhere in China including on Hainan Island.

Figure 2. Coffee production regions in China

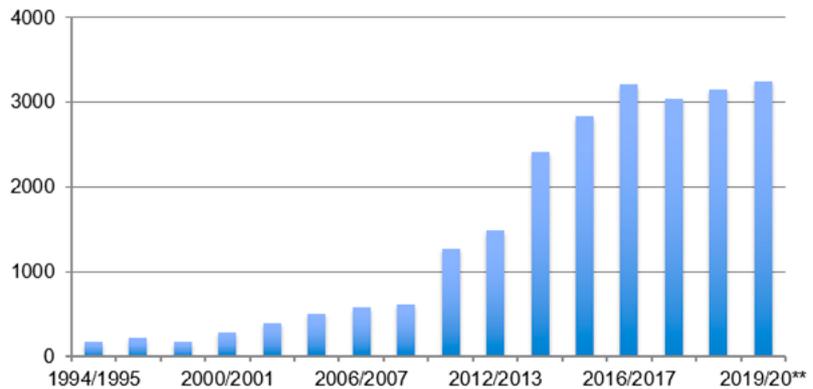


Source: International Coffee Organization (ICO). (2015).

Figure 3. Coffee production in China (in thousands of 60 kg bags)

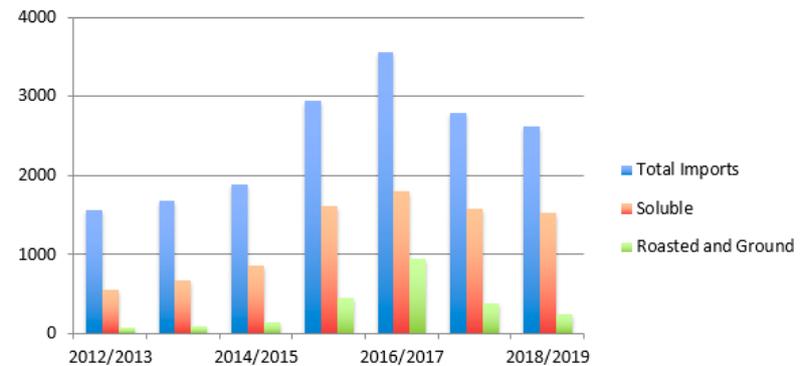


Source: United Nations Food and Agriculture Organization (FAO).

Figure 4. Coffee consumption in China (in thousands of 60 kg bags)

Source: United Nations Food and Agriculture Organization (FAO).

The Chinese coffee market is predominantly made up of instant coffee. However, in recent years, fresh roasted coffee consumption has expanded rapidly. The most popular type of instant coffee is the 3-in-1 (coffee, sugar and creamer). Another important market is associated with the rising popularity of coffee shops where more premium coffees are traded.

Figure 5. Coffee imports by China by form of coffee in 60Kg bags

Source: United State Department of Agriculture. (2019). Coffee: World Market and Trade.

A comparison of consumption and production statistics for China suggests that the market is satisfying most of its demand with local production and that there is an increasing proportion of local production that is being consumed internally. The most important players are multinational companies such as Nestlé and Starbucks. These companies have been investing in Chinese coffee production in Yunnan for years and have developed targeted blends and products.

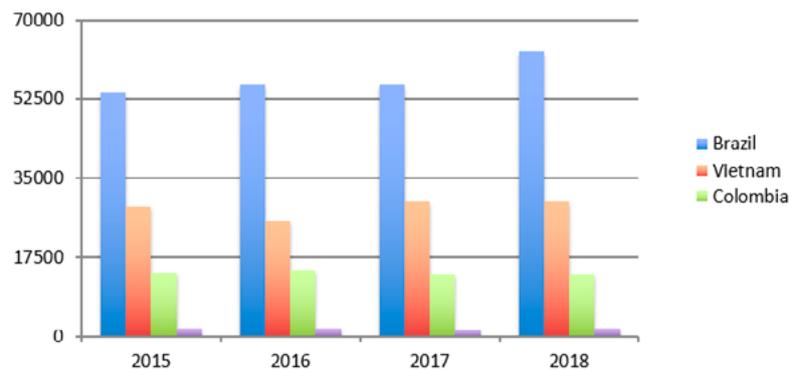
1.4 Market potential

Although Arabica coffee can be grown in China, its position in the local market is still small compared to Colombia. Thus, the coffee produced within China does not represent a competitive threat for manufacturing and marketing companies of Colombian origin. However, the management of the coffee market in China's interior has been in the hands of Nestlé for the past 20 years (now allied with Starbucks). Nestlé established an operation plant in the prov-

ince of Guangzhou in 1988, which has allowed this brand to have a privileged position in the local context and has hindered the entry of other brands.

In terms of origin, according to the International Coffee Organization (2019), the largest supplier of coffee to China is Vietnam, which it accounted for almost half of all imports made from 2009/10 to 2013/14. More than 80% of imports came from just five countries (including re-exports from the US). Based on these origins, it seems likely that the vast majority of coffee imported in China is Robusta, which responds to the local preference for instant coffee. However, it is worth noting that imports from Colombia and Central America have increased significantly in recent years. Based on ICO (2019) figures, China's imports from Colombia and Central America have grown more than 25% per year since 2009/10, and these countries now account for around 5% of China's total imports from the world.

Figure 7. Crop year production by country in thousand 60-kg bags



Source: International Coffee Organization (ICO). Crop year production by country in thousand 60-kg bags.

2. Coffee consumption in China (2004/05 to 2013/14) compared to Japan (1964/65 to 1973/74)

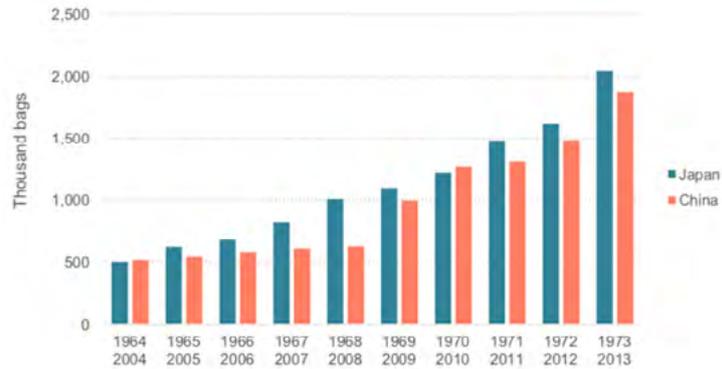
Like present-day China, Japan's economic growth occurred between 1950 and 1960 when it experienced significant development after being devastated during the Second World War. This progress was led by the manufacturing industry, especially by the automotive sector. Japan then saw moderate growth after 1970, where it focused more on updating technology and increased per capita income. During the growth period of the Japanese economy, over 100 million² inhabitants became part of the middle class, living standards improved considerably, and the consumption of all kinds of products increased.

Japan is currently the third largest coffee importer in the world after the United States and Germany, and the fourth largest consumer. It imports coffee from over 40 origins. Their main suppliers are, in order, Brazil, Colombia, Indonesia, Guatemala, Ethiopia and Vietnam. These countries represent 86% of the volume and 82% of the value of total Japanese coffee imports (Roldan, 2008).

The development of the coffee industry in China over this period is comparable to the evolution of coffee demand in Japan in the mid-1990s. As shown in the figure below, coffee consumption levels in China and Japan grew at similar rates over a ten-year period. (Roldan, 2008).

² Roldan A. (2008). El mercado de café en Japón: Oportunidades para el café colombiano. Universidad EAFIT, Centro de Estudios Asia Pacífico. Retrieved from: http://www.eafit.edu.co/centros/asia-pacifico3/Documents/Federacion_Nacional_Cafeteros.pdf

Figure 8. Coffee consumption in China (2004/05 to 2013/14) compared to Japan (1964/65 to 1973/74)



Source: International Coffee Organization (ICO). (2015).

Despite the fact that the coffee market is still in its early stages in China, it is neither impractical nor improbable to think that the success Colombian coffee has had in the Japanese market, could be equaled, if not expanded, within China, especially considering these three important factors: its local presence, the development of specialty coffees for international markets, and the required partnerships with suitable firms.

2.1 Success of Colombian Coffee in Japan:

Japan is the world's fourth largest coffee consumer and the second largest buyer of Colombian coffee after the United States. According to the Japan Coffee Association (AJCA) in Roldan A. 2018, Colombia was the second origin in value of total green coffee imports, with USD 204 million. Taking advantage of the fact that Japanese consumers are willing to reward bean quality, the Colombian Growers Federation³ or FNC for "Federación Nacional de Cafeteros de Colombia" has focused on generating long-term alliances that have expanded sales of differentiated and specialty coffees with premiums for producers.

2.2 Local presence

The success of Colombian coffee in Japan was determined by the Colombian Grower's Federation's strong presence for over 45 years in that country. This shows that a local presence and promotion of Colombian coffee through international exhibitions and fairs is an imperative. Given its importance as a rapidly developing market in China for coffee, with high growth rates, the FNC opened a representative office in Shanghai in 2006, seeking to replicate the success and recognition achieved with Colombian coffee in Japan.

A westernization of consumption habits has opened doors for increasingly sophisticated and differentiated coffee niches. Considering the FNC is the main sponsor of the Chinese barista championship and participates in fairs in major cities such as Shanghai, Beijing and Guangzhou, work done alongside consumer trendsetters including opinion leaders, baristas and judges would result in greater recognition for and availability of Colombian coffee.

³ The Colombian Grower Federation, or FNC for "Federación Nacional de Cafeteros de Colombia", was created in 1927 as part of the national identity and represents coffee grower's interests. It focuses not only on profit generation but also seeks to have a positive social impact through research projects, training, environmental protection and community development.

Projections for Chinese electronic commerce also offers ample opportunities for companies interested in selling and promoting their product over these virtual platforms. China may be the country that carries out and completes the largest number of smartphone transactions in the world. Most Chinese consumers prefer to make purchases in the comfort of their own homes and in the shortest time possible, using their mobile phone as a tool.

2.3 Development of specialty coffees for international markets

As was previously mentioned, one of the key differential factors of Colombian coffee is its collection and selection process. At harvest time, coffee growers choose only ripe coffee beans, making an extra effort to ensure the best coffee quality right from the harvest. It must be pointed out that an added value of Colombian coffee lies in the handpicked beans and the great social impact of this coffee culture, unlike other countries that use mechanized harvesting. The National Federation of Coffee Growers of Colombia accompanies this process from its inception and until the grains are delivered to manufacturing companies for processing.



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Considering the geographical characteristics of Colombian coffee, the FNC defined a specialty coffee program for coffees planted in specific microclimates. These coffees are recognized as preferred by consumers, and command a higher price in the international market, representing greater benefits and wellbeing for coffee farmers. Specialty coffees are classified into three main groups:

Coffee according to origin:

These are coffees that have their origin in a certain geographical area or region to which important characteristics in their soil and climate are attributed; this designation of origin is officially recognized. This scheme is similar to appellations frequently used for wines. These coffees are not mixed with coffees from other origins and are sought for their unique flavor and aroma. They are classified into regional coffees and coffees grown on specific, recognized farms.

Cenicafé⁴ has identified more than 80 different types of ecosystem in Co-

⁴ The Colombian National Coffee Grower's Federation created the National Coffee Research Center, Cenicafé, to study aspects related to production, harvesting, processing, grain quality, handling and use of by-products from coffee farms and natural resource conservation in the Colombian coffee growing region.

lombia, meaning that they are specific geographical areas with special environmental characteristics that can be used to produce special coffee beans with different flavors and qualities. From the buyers' point of view this variability represents an advantage and buyers are willing to pay a price premium for quality.

Sustainable Coffee:

These coffees are recognized for protecting the environment and trying to obtain better prices for coffee growers. They can include organic coffees (that use natural fertilizers and special methods to protect crops), coffees that are environmentally friendly or "eco-friendly" (that protect the environment with excellent agricultural management) and fair trade coffees (these certify their coffee growers internationally guaranteeing a price premium, improving market conditions, and establishing a fixed price per type of coffee.).

Specialty Coffee or Coffee according to preparation

Specialty coffees emerged in the early 1990s in the United States with the birth of the American Specialty Coffee Association, seeking alternatives for differentiation after a price collapse. The coffee industry's strategy became focused on specialty coffees, seeking new spaces that would bring it better prices. The specialty coffee label describes coffees that use differentiated processes, allowing them to be offered at a higher price. For example, coffee may be offered according to the bean size desired by the client, as is the case with Supreme Coffee that offers a larger bean with a consistent flavor.

2.4 Partnerships with appropriate firms

Emerald Mountain is a Colombian brand specifically designed for the Japanese market. The idea of the brand emerged in 1970 during the world expo when FNC executives saw the need to offer a differentiated brand for this market that could compete with recognized established brands. According to Roldán (2008), the Emerald Mountain brand was offered, since its inception, as an exclusive quality roast coffee product, canned to be sold as a gift in major Japanese department stores. In just a few years it became recognized as an excellent quality Colombian brand. In the early nineties, it began to be sold massively, specifically for Coca Cola, as canned liquid coffee⁵ under the Georgia Emerald Mountain brand and offered in millions of vending machines throughout the country.

For years, Georgia Emerald Mountain brand has been the number one canned drink in the Japanese market. According to Roldán's (2008), over 600 million cans were consumed in 2005, and since 1997 this product has been the best-selling drink offered by Coca Cola in this market. Each can of Georgia Emerald Mountain Coffee has an explanation of the coffee's origin, a quality certification and the FNC logo. From a marketing point of view, this has been extremely successful for the promotion of Colombian coffee due to the high coverage of Coca Cola vending machines throughout Japan.

Partnerships between Colombia's coffee producers and appropriate firms in China, such as Western food and beverage multinationals, fast food restaurant chains and convenience stores, can not only help add value to the product, but also provide better advertising or increased access to new market channels. This would also improve operations by lowering overhead costs. In general, partnerships like these can help build financial strength, increase

⁵ In recent years, liquid coffee in Japan has been packaged and canned for presentation as a ready-to-drink product and is mainly sold through vending machines.

income, and share overhead between partners. This type of market entry strategy also helps parties protect their interests by reducing their investment exposure and sharing risk.

3. Conclusion

Opportunities exist for the expansion of a "coffee culture" in China, represented by a continuously expanding potential market, thanks to a growing middle class, and consumer habits that are increasingly closer to Western market trends. Colombia's geographical location favors the existence of humid areas with constant and regular rainfall, with different climate types, providing extremely advantageous conditions for the coffee growing. Although the mountainous terrain makes it difficult to use mechanization for bean collection, it means Colombian coffee is harvested by hand at optimal ripeness and best quality. The soil in which the plant puts down its roots mostly derives from volcanic ash, and is rich in organic matter and minerals. This provides good physical conditions, greatly reducing the need for fertilizers.

The Chinese coffee market is predominantly composed of instant coffee. However, fresh roasted coffee is growing at an increasing rate and specialized cafés are prospering. Nestlé and Starbucks are key players and are investing in Chinese coffee production to supply the local market with specifically targeted blends and products. Nestlé has been in the country for over 20 years and has opened 33 factories. Starbucks dominates the Chinese café market. China also has several homegrown café chains known as Luckin Coffee, which compete with lower prices compared to Starbucks.



Although Arabica coffee can be grown in China, its local market position is still relatively small compared to Colombia. Thus, coffee produced within China itself does not pose a competitive threat for manufacturing and marketing companies of Colombian origin. However, management of the coffee market in mainland China has been in the hands of Nestlé (now allied with Starbucks) for many years.

The largest coffee suppliers to China are Vietnam and Brazil, and, based on those origins, it seems likely the vast majority of coffee imported in China is Robusta, which responds to the preference for soluble coffee. Although Colombia is at a disadvantage in terms of productivity because of its process for handpicking Arabica coffee, this process allows it to offer a superior quality product, potentially providing it with an attractive position in the Chinese market.

The current development of the coffee industry in China is comparable to the evolution of coffee demand in Japan in the mid 1990s. Coffee consumption levels in China and Japan grew at similar rates over a ten-year period. Japan became the world's fourth largest coffee consumer and the second largest buyer of Colombian coffee after the United States. The experience and the strategies used to position Colombian coffee in Japan could serve as a starting point for accessing the Chinese market.

Despite the fact that coffee is still in the early stages in China, it is neither impractical or improbable to think that the success that Colombian coffee has had on the Japanese market could be equaled, if not expanded within in China, especially if three important factors are kept in mind: a local presence, the development of specialty coffees for the Chinese market, and partnerships with appropriate firms.

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