university of hawaii · cooperative extension service · · circular 403

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The authors are indebted to members of the Cooperative Extension Service on the island of Hawaii for their constructive criticism of materials, methods of presentation, and ideas expressed in this publication. Appreciation is especially extended to John Y. Iwane, Herbert M. Hiroshige, Blaine Bradshaw, and Edward T. Fukunaga for their helpful suggestions in reviewing this paper for final draft and publication.

Cooperative Extension Work in Agriculture and Home Economics
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Distributed in Furtherance of the Acts of Congress of May 8 and June 30, 1914
CIRCULAR 403 DECEMBER 1963

# COOPERATIVE ORGANIZATION OF THE KONA COFFEE INDUSTRY

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## *Introduction*

One of the more serious limitations to the orderly development of the Kona coffee industry has been an absence of fundamental means for coordinating production, processing, and marketing. A review of the history of the industry indicates that during periods of good prices, the Kona coffee producers have not felt a very great need to effectively integrate these functions. During the more prosperous times, the producer seemed to be reasonably satisfied with the limited control he exercised over his product after it left the farm. However, in recent years the producers, through his organizational leadership, has been forced to look more critically at the performance of the processing and merchandising functions. This new emphasis has been brought about by worsening price situations and the apparent inability of

*Coordination for the sake of efficiency*

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existing organizations and agencies to provide effective relief. Under the existing arrangements, the Kona coffee industry is represented in the market by a variety of brands, qualities of coffee, and a wide splintering of merchandising firms and individuals, none of whom can effectively represent the Kona product. At present there is no one organization or firm which has control of enough of the product to initiate the action necessary to fully exploit the unique character of Kona coffee.

Kona coffee producers are interested in greater efficiency. They have begun by bringing together people in the industry concerned with developing markets for Kona coffee. They have held conferences with government agencies, during which they have explored some of the possible means for adjusting to changing productions, processing, and marketing conditions.

### *Organization*

One way in which Kona coffee producers could develop a stronger position in the market and thereby increase returns to their industry is to organize. At the outset, it must be recognized that the total supply of Kona coffee is much too small to materially influence world coffee prices. The Kona industry must look for organizational benefits other than those gained by the control of total coffee supplies. The benefits which the Kona industry could realize are those normally secured from market coordination and industry integration.

Coordination and integration can be efficiency measures. It means that the industry would institute methods by which it would control the product through the several stages that Kona coffee now moves from the farm to the consumer. For example, it could mean that the Kona coffee producers might want to control the product at all points up to and including processing, packaging, and marketing. In this way the industry could impose upon itself those disciplines necessary to bring about uniform quality in the Kona product. A

program of grades and standards could be initiated, a standard trademark could be developed, and the product could effectively be differentiated so that the unique qualities of the Kona product may be exploited for the benefit of the producers.

*Organizing at the supply level.*

As a practical consideration there appears to be only one point in the coffee industry, as it now exists, where control of the sort proposed would be realistic or practical. This is at the point or level where producers are able to organize. The reason for establishing controls at this level is simply that through their combined ownership the 800 or so coffee producers in Kona have the opportunity to exert the necessary discipline for initiating needed reforms in production, processing, and merchandising. To develop control at any other point in the system is to disregard the advantage of supply control of the Kona product. Under the latter circumstance it would be highly unlikely that the problems of diversity of either product or organization could be successfully resolved.

Under the existing structure of the Kona coffee industry, a large proportion of the producers belong to one of several cooperatives or sell their product to proprietary corporations or to individual dealers. The challenge is to pull the existing organizations and agencies together into one unified structure. This might be a cooperative. The cooperative idea is a realistic one; it offers a number of attractions not so readily available with alternate means of organization. Among these attractions is the feature that the industry would remain directly in the hands of the producers. Any economies developed could be prorated back to the producer in the form of savings. For example, it might be possible to secure economies by reducing the number of facilities now required to process coffee for the market. Reducing the number of facilities would also mean a reduction in

*The cooperative idea.*

the number of personnel required to operate the underemployed coffee handling and processing establishments. Similarly, it might be practical for the integrating organization to purchase supplies needed by producers in bulk and thereby reduce production costs. Under the cooperative setup the costs now experienced by the several marketing agencies could also be reduced. For example, funds for promoting many different brand labels could be reduced and still more effectively promote a limited number of quality labels. The very fact that the integrating firm holds most of the Kona coffee would give it some bargaining power. In effect, what this would do would be to reduce the competition among Kona coffee producers for the limited markets now existing and place competition where it should be—with other coffees and for new or expanding markets.

*Product control and market coordination.*

*Vertical and horizontal integration.*

In the final analysis, the industry leadership would need to determine the relative benefits from integrating the industry from two points of view, vertical and horizontal integration. First, if vertical integration is considered, it must be determined if returns from functioning in the several stages of production, processing, and merchandising could realistically be expected to return greater savings than would be gained from the second alternative. Under the second alternative the industry might want to consider the effect of their market strength through product control and market coordination. It might be that because the industry is well organized and can more effectively meet the demands of modern merchandising economy in terms of quantities, quality, and other necessary conditions, vertical integration would be limited only to that level where control of the product is guaranteed. The resources, insofar as the Kona coffee industry is concerned, might yield greater benefits to the industry if they were used to expand the initial production and processing at the hori-

zontal integration level. Under the second alternative, the effort is to expand production to meet such increased uses of Kona coffee as might be developed from market coordination.

*Problem of assimilation.*

One of the important questions the industry will want to have answered is, "How should the integrating organization be developed?" An obvious problem will be to assimilate the existing cooperatives and such other agencies as would be interested in a unified organization. Some of the existing agencies have been in existence since the start of coffee operations in Kona. Many leaders of these agencies have made important contributions to the industry. In addition to the factors of tradition and vested interest, there is the real difficulty of disequal values of resources held by the various existing organizations. The different equities of producers in their organizations and facilities would be a further problem area that must be considered in the process of adjustment toward any new arrangement.

### *Organization Design*

In order to arrive at a sound organizational structure it is well to ask just what it is that the organization should do and how it should serve the industry. If organization is truly a solution to certain production, processing, and marketing difficulties, then organization should have identifiable characteristics to serve as criteria in developing a suitable organizational design. The following are some characteristics that should be found in a cooperative organization in the Kona coffee industry:

*Cooperative characteristics for Kona.*

1 The organization should be designed to serve the Kona coffee industry.

2 The organization should contain the necessary flexibility to allow it to provide the industry with marketing, purchasing, processing, and such other services as members and their leadership consider necessary to accomplish their economic objectives.

3 The organization should be able to affiliate itself with other organizations which, in turn, may extend or ex-

pand the economic and control influence of Kona coffee producers, processors, and merchandisers.

4 The organization should be designed to enable members (individuals or corporations) to share the benefits of their association according to patronage or in some other proportions.

5 The organization must develop safeguards to maintain the economic sovereignty of individual members, member corporations, or associated cooperatives to the extent that only those functions or decision-making authorities are carried out which are lawfully delegated by the collective membership through its by-laws.

6 The organization must have the means for limiting the liability of individual or member corporations, including cooperatives, to the amount of capital invested in the organization.

7 The organization must be structured, developed, and operated in such a fashion that it will be acceptable under the legal statutes of the State of Hawaii.

8 The organization must have the means for disciplining itself and its members to develop and maintain product and service quality control, including product grades and standards.

9 The organization should have the means for controlling (within the limits of product's characteristics) production and market timing.

10 The organization must have the means for transferring ownership of member equity from one member to another.

11 The organization must have the means for adequate financing, including funds for facilities, operations, market development, and perhaps production.

12 The organization should consider methods for dealing with non-member products.

13 The organization should clarify the qualifications of people selected for positions of management.

These, among others, are some of the characteristics of organization which might be considered in developing a cooperative for the Kona coffee industry. It is not an all-inclusive list, but it does serve to pinpoint the problems encountered in designing an agency which is meant to serve users rather than return money dividends to investors.

### *Two Patterns of Organization*

Two patterns of cooperative organizations could serve to do the services for the Kona coffee industry. The two are known as the "federated cooperative" and the "centralized cooperative."

The federated structure would simply take existing cooperative organizations, along with their leadership and facilities, and superimpose a new organization. The new organization is, in effect, not an organization of members in the usual sense, but an organization of cooperatives (Figure I).

Figure I shows an organizational arrangement which could include all of the functions the industry might choose to undertake. For example, producers, through their federated body, might decide to process coffee in their cooperatively owned plant. They might also find that it is to their advantage to develop a cooperatively owned label and market the product from Kona through their own marketing facility.

*Advantages of federated co-ops.*

Advantages of the federated design for Kona are:

1 It would bring about greater efficiency—mostly in the area of bulk purchasing and also in increased control of the coffee product.

2 It would make possible the expansion of the number and kinds of services to producers.

3 It could increase the overall business of the industry—particularly as expanded processing brings a larger income into the Kona community.

4 It would facilitate grading and standardization.

5 It would, in effect, integrate the industry vertically into the market in such a way that any revenue or economies from size or greater efficiency could effectively be returned to producers in the form of dividends or cost savings.

6 It could bring about greater stability through coordination and strategic marketing practices.

7 It would have available the present leadership in existing cooperatives, who could continue to serve the industry through their member-owned organizations.

8 It would permit the industry to be controlled by coffee producers. The producers would maintain their interest in the product and strive to improve its quality and saleability.

*Disadvantages of federated co-ops.*

Disadvantages of the federated design for Kona are:

1 It would not give members direct control of the central organization.

2 It would not cut the cost of maintaining some underemployed local facilities and personnel.

3 It would make communication between membership and their organization more complex. Uniformity of

product and services is less effectively accomplished through the more complex federated structure.

The second design, centralized structure, is less complex in that Kona coffee producers would be members of the central organization directly. In effect, the central organization under the Kona situation would constitute a merger of existing firms and cooperatives. Figure II shows this alternative organizational design.

The centralized design has the potential for providing all of the functions possible under the federated arrangement. In addition, most of the disadvantages described for the federated structure are reduced.

*Advantages of centralized co-ops.*

Advantages of the centralized design for Kona are:

1 It would bring about greater efficiency in both marketing and purchasing supplies and services. The central organization would have control of the majority of products in the Kona coffee-producing area.

2 It could expand the number and kinds of services to producers.

3 It would increase the overall business base for the Kona community through expansion of product processing.

4 It would readily provide means for grading and standardizing the product, because product control is at the point of original ownership and would be limited only to the degree to which producers are willing to impose control upon themselves. The focal point for grading could be at that point in product handling before which coffee loses its identity as owned by the individual member.

5 It would integrate the industry vertically and more directly fuse the industry on the horizontal level. Economies and revenues from expanded size would go directly

to producers in the form of patronage dividends or in price benefits resulting from cost savings.

6 It could bring about greater stability through coordination and strategic marketing practices. Uniform labels could most effectively be developed along with effective promotion and sales control.

7 It could reduce the costs of underemployed facilities. To a large degree, costs would be absorbed by the greatly broadened business scope of the overall Kona coffee enterprise. Under the proposed arrangement those people and facilities displaced could, in part, be absorbed by the extended and expanded scope of coffee activity at Kona. For example, each of the functions of marketing, processing, purchasing, etc., could involve the use of additional people.

8 It would give coffee producers themselves the control or the ownership of the industry, along with the benefits of integration. Decisions would be theirs, through democratically elected representatives, to determine how, when, and what will be done with their product.

*Disadvantages.* The disadvantage of the centralized design for Kona is:

1 It would displace the present leadership.

### *Conclusions*

From the point of view of efficiency the centralized cooperative offers the greater benefit. But the choice of organizing into a cooperative which would function as described above or some alternative organizational pattern must and should be the prerogative of Kona coffee producers and such other people directly involved in the industry. It should be pointed out that active study of existing arrangement in present business organizations may point the way to other alternatives. For example, the function of processing might effectively be contracted. The contract might be with a proprietary corporation, a subsidiary, or an existing cooperative, through which the federated or centralized cooperative might affiliate (Figures I and II).

*Organizational design not a panacea.*

It should also be realized that the designs proposed are not panaceas, but rather suggested means by which Kona coffee producers might effectively adjust to the accelerating change taking place in the business community. The ability to react and, in fact, lead and cause reaction requires a streamlined organization with a

*Capable leadership required.*

leadership capable of making sound decisions at the right time, and an organization with a membership willing and able to support such decisions.

Many problems need to be overcome under both the centralized and federated structure. These problems must be faced squarely, requiring good will and concerted cooperation at all levels of the industry. The results of coordinating the Kona coffee industry could be very satisfactory, and the benefits could extend from Kona throughout the whole State.

*Federated plan most practical.*

In relation to what can be done immediately, it might be most practical to adopt the federated pattern. Even though the economizing resulting from this organization may not be spectacular, it would provide for smoother transition from the present splintered arrangement to a much more highly integrated industry both horizontally and vertically. The good will and support of existing management that would be benefited from a federated arrangement might very easily offset any functional or economic gains realized from going directly into a centralized arrangement. It may be that as better understanding is developed of the potentials of coordinating the production, processing, and marketing functions, the members and leadership of the several cooperatives and agencies will voluntarily integrate into a centralized structure. The long-run objective may therefore be a centralized organization, but the short-run problem is organizing. For this, federation may be most practical.

*Long-run objective, centralized plan.*

In the final analysis, the justification for organizing is to gain economic benefits for those who are a party to the organization. The coffee industry does not need more organizations. Rather, it needs a stronger, more effectively integrated organization.

In general, we may ultimately need fewer firms and organizations in Hawaii, not only in the coffee industry

but also in other areas of agricultural production and marketing. Some of the ideas expressed in this publication relating to the coffee industry could be applied as well to other agricultural commodities produced in the State.

### *Some Definitions*

*Cooperation.* As used in this publication, "cooperation" means to work together with others in order to accomplish those economic objectives which are not possible without joint efforts. It means, further, that the benefits from working together will accrue to those people who are a party to the joint effort in some proportion of their contribution to the overall effort.

*Cooperative.* The word "cooperative" is taken to mean an agricultural business organization owned, controlled, and directed for the economic and service benefits of the member-owners. In this publication it means, further, an organization that provides the means of coordinating the production, processing, marketing, and procurement of supplies and services needed by cooperators.

*Cooperator.* In this publication, it usually means a producer of Kona coffee. A "cooperator" is a member of the cooperative who has delegated some authority for performing certain functions to his cooperative in which, along with

other members, he has control through his vote and patronage. This may be an individual, a member of a partnership, a corporation, or another cooperative.

*Integration.* As used in this publication, "integration" means the tying together of various economic activities of the Kona coffee industry so that control is unified in the hands of producers through their cooperative organization.

*Horizontal integration.* "Horizontal integration" means to bring together (into harmony), under some sort of unified control, plants or facilities performing the same or similar function. Example: integration of coffee milling, purchasing supplies, or selling coffee.

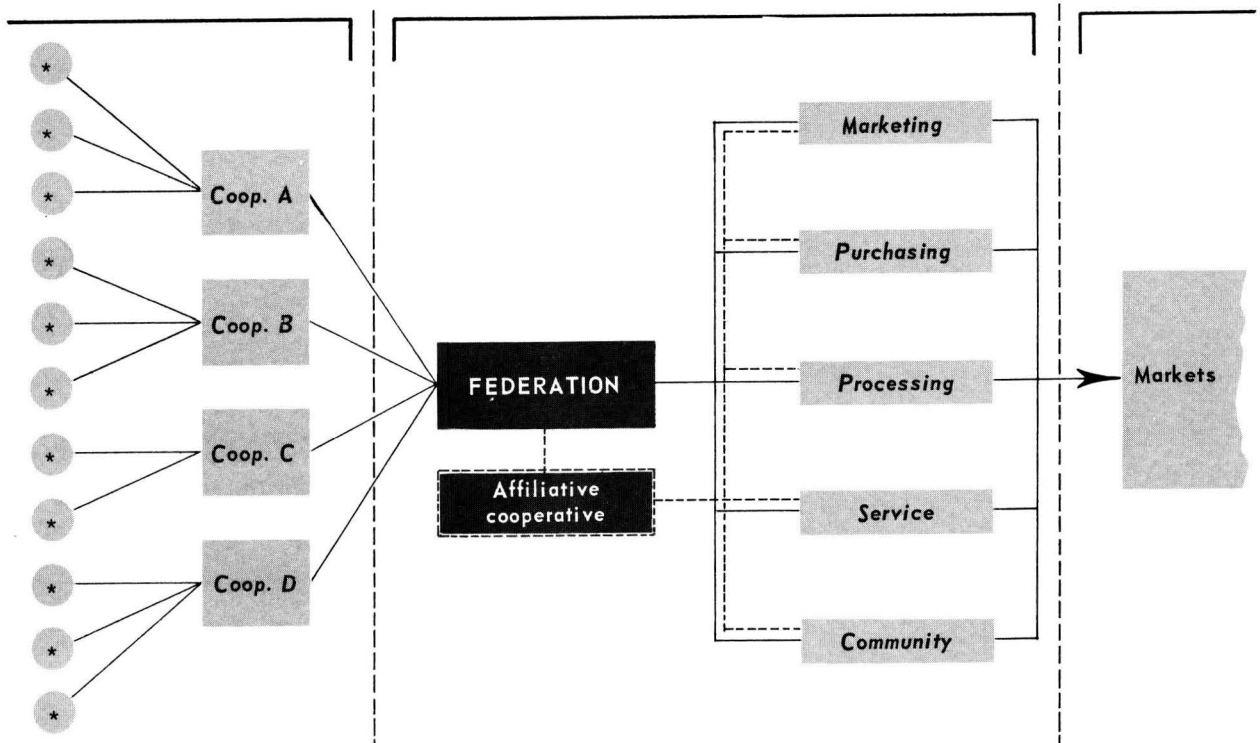
*Vertical integration.* Vertical integration is the tying together of two or more stages or levels of production. Example: integration of production and processing, or of processing and marketing. In the coffee industry, vertical integration may involve production, processing, packaging, and merchandising.

*Market concentration.* Market concentration is the extent to which the Kona coffee industry is integrated at the horizontal level or controlled by producers through their organization. The degree of concentration could be stated in terms of ratios or as a percentage of the total.

*Merger.* A merger is the combining of two or more formerly independent firms or cooperatives under one unified controlling body.

*Patronage.* Patronage is the amount of business transacted by members individually and collectively through their cooperative. It is also a measure of the support of members for their organization and for the policies of their board of directors and management.

Figure I.



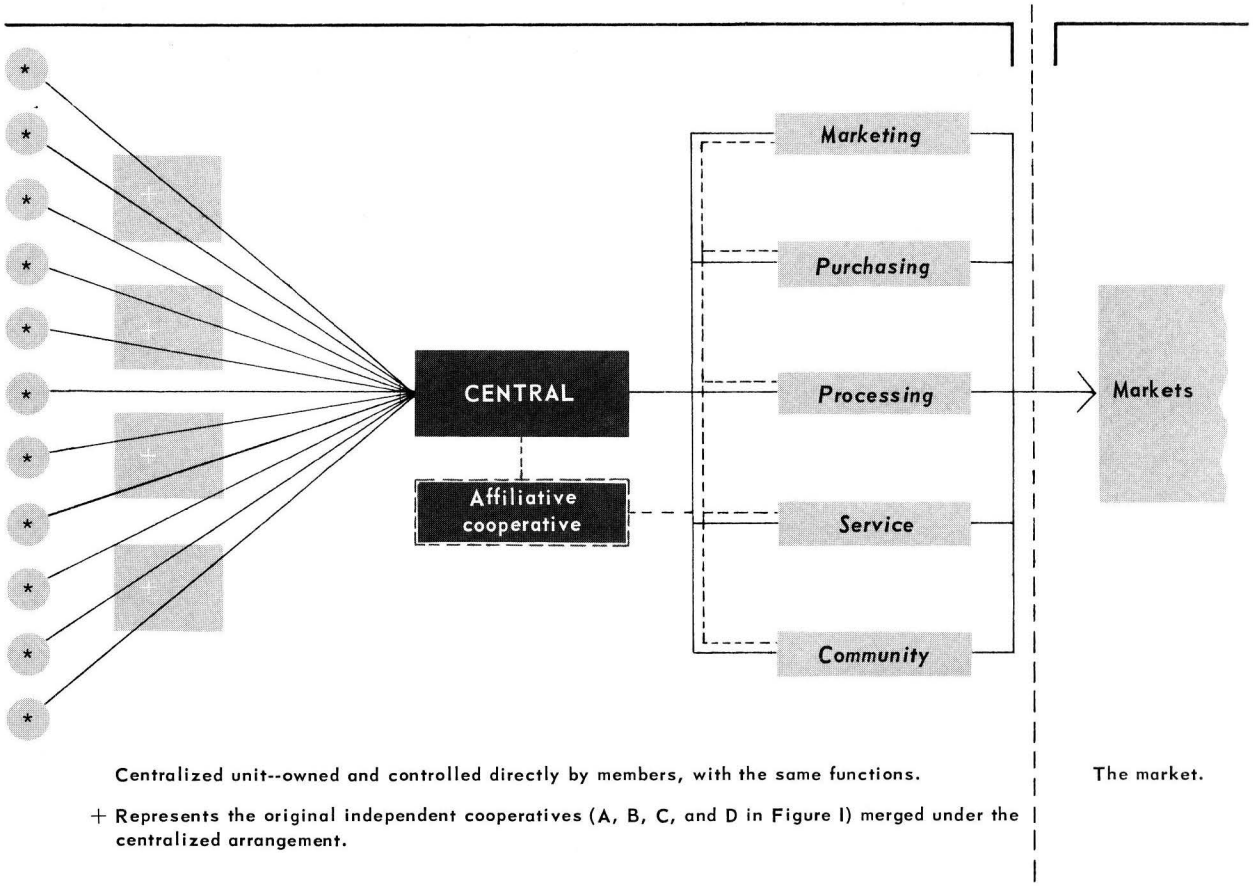

* Members

Autonomous local units--controlled directly by members and their elected representatives. Some members might be corporations.

Federated unit--controlled by representation from local organization--shows potential functions which might be performed by a federated arrangement.

The market.

Figure II.


CENTRAL
Affiliative cooperative
Marketing
Purchasing
Processing
Service
Community
Markets
Centralized unit--owned and controlled directly by members, with the same functions.
The market.
+ Represents the original independent cooperatives (A, B, C, and D in Figure I) merged under the centralized arrangement.