



# Establishing quality sourcing targeting the export arena

## Context

### Coffee through the crisis

The resurgence of specialty coffee in Sri Lanka has been a few years in the making. The growing global consumption of specialty coffee and increasing global prices have made this high-value crop a sought-after produce. Until recently, imports dominated the Sri Lankan roasted coffee market, while locally grown coffee was largely commodity grade. Only two local roasters had established direct sourcing relationships with coffee farmers or invested in central processing of green beans. Farmgate prices (the price that a farmer receives at the point of selling) for both red cherries and green beans operated

on a flat structure—so farmers had no incentive to improve harvesting practices or invest in quality. Moreover, it was a fragmented sector, with no formal coordination to facilitate investment or promote Sri Lankan specialty coffee for export.

Nevertheless, Sri Lanka has the conditions required to grow high-quality arabica coffee and is a smallholder-centric market. Identifying opportunities for inclusive growth, MDF signed its first coffee partnership in 2017 to support quality roasting and processing. In the years since, multiple market actors have invested in building direct sourcing relationships with coffee farmers, improving specialised green bean processing capacity in central processing centres and introducing quality-based farmgate pricing. Stakeholders have also facilitated industry coordination to promote Sri Lankan specialty coffee among domestic consumers and on the global stage. Consequently, since MDF last investigated early signs of the coffee system changes in 2020, Sri Lanka has seen a highly competitive specialty coffee market emerge alongside its traditional commodity coffee market.





Adopt/Adapt

## Partnerships at work

In 2020, MDF partnered with a processor to successfully trial the 'red cherry sourcing model' in which farmers are paid a premium to selectively harvest ripe red cherries without harvesting unripe cherries and without processing it into green beans—as they usually would. This model circumvented the problem of farmers employing suboptimal processing techniques while also saving farmers' time and resources. Adoption of the model has been particularly significant among women farmers, as the labour- and time-saving component is very attractive. MDF assessments show that the model is also preferred by farmers because erratic weather patterns are affecting drying and causing high post-harvest losses. Having the option to sell coffee in cherry form comes as a welcome solution that brings quick cash.

Ensuing partnerships replicated and improved upon the model, leading to an increase in the farmgate price and the introduction of a premium for red coffee cherries. The change to the sourcing model allowed processors to have more control over quality, and MDF engaged in several partnerships with central processors to construct in-house wet mills and drying houses that would aid this process. This enabled partners such as Helanta to secure orders through a local roaster to ship its first export micro lot in 2022. Processors also incorporated quality control methods, such as sorting cherries and green beans, which have expanded flexible employment opportunities for women in coffee communities.

Adaption of the red cherry intervention has been significant, as demonstrated by a recent partnership with Upcountry Brothers Pvt Ltd (UCB). UCB independently hired additional extension officers and employees, constructed a second dry house, expanded the transport fleet for cherry collection and invested in a coffee seedling nursery to expand the supply base.

With demand fast outstripping supply, coffee production needs to increase. Kothmale Nursery successfully transitioned to a commercial sales model—from a government-subsidised model—resulting in all seedling and sapling production being sold at a market-determined price. In 2023, the partner is set to expand operations independently, increasing both output and staff to support commercial operations.

While Sri Lankan specialty coffee shows significant potential, industry coordination remains essential. Following the establishment of the Lanka Coffee Association (LCA) in 2021, MDF worked closely to support LCA and its operations. LCA is now increasingly operating independently; membership increased in 2022, indicative of growing influence in the coffee industry. The membership profile currently consists of key incumbent private sector players from the domestic coffee industry, including roasters with export channels.

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## Expand

### Scaling change

The specialty coffee sector has shown strong signs of expansion through the replication of MDF-introduced innovations among existing market players, as well as new entrants showing signs of similar investments. When MDF entered the industry in 2017, there were only five specialty coffee roasters; as of 2022, this number has risen to 30.

The international market is learning more about Sri Lankan specialty coffee. There were positive responses and inquiries about Sri Lankan coffee from 26 global roasters and green bean buyers following the Melbourne International Coffee Expo in 2022, a testament to the success of investments in sourcing and processing to elevate quality. MDF assessments have also indicated a boost in private sector investment, implying positive uptake and replication at-scale of MDF innovation by both partners and non-partners. Currently, there are active lines of private investment being channelled into coffee nurseries, plantation cultivation and processing.

The red cherry sourcing model is being actively followed by farmers—although challenges remain. MDF monitoring in 2022 found that over 80 per cent of the farmers in a partner's supply base believed selling red coffee cherries had been beneficial for them. However, following a recent spike in green bean prices, processing green beans at the cottage-level is regaining popularity as a method of savings and value storage for farmers hoping to benefit from price fluctuations in the market. In addition, the coffee berry borer pest has been affecting yields, increasing competition for sourcing. In response to this challenge, specialty coffee processors are establishing clusters outside the main hub of Kotmale.

## Respond

### Emerging opportunities for sector growth

In 2022, amid Sri Lanka's economic crisis and the ensuing trade restrictions, an unexpected opportunity arose: in the absence of imported coffee beans, hospitality businesses turned to the domestic market, and the foundation established by MDF partnerships across the specialty coffee value chain enabled locally sourced coffee to become a strong substitute in a space that had previously, almost exclusively, been held by imported varieties. A recent MDF survey of specialty cafes indicates that they would continue to buy and exclusively serve local specialty coffee even if imported beans were made available at competitive pricing.

There are also other market shifts happening in parallel. Encouraged by the opportunities in the local specialty coffee sector and a desire to mitigate business risks emerging from a decline in the competitive advantage enjoyed by tea, several large-scale tea plantations are diversifying into coffee and intercropping. This shift has resulted in demand for coffee seedlings far surpassing the current supply, providing a further incentive for private nurseries to transition into commercial models. Businesses are now looking to invest in new coffee cultivations as well as in inputs such as seedlings. There are also early indications of the Department of Export Agriculture increasing its annual seedling production targets in response to movements in the coffee input market.

## Looking ahead

### Entering the international arena

International demand for Sri Lankan specialty coffee is 'brewing,' albeit gradually. Partners will need to continue to scale and sustain the behaviour changes observed in the specialty coffee sector, maintaining a vision to elevate Sri Lankan specialty coffee as a premium export. While processors are hitting the right flavour notes through refined processing techniques and attracting attention with good cupping scores, further investment will be required to continue to improve quality consistently and at scale. Potential investments in plantations could play a role in building both scale and quality. MDF will continue to offer strategic support to the sector by developing farmer clusters with strong extension models and investing in sharing information with new investors and industry entrants.

At present, processors find catering to domestic demand to be more lucrative than investing in exports. However, MDF's strategy is to continue to drive volumes through investments in nurseries, anticipating that, once domestic demand reaches saturation in terms of both farmers and volumes, processors will realise the economies-of-scale opportunities for increased profitability. Building brand value for 'Sri Lankan specialty coffee' in the international market will lay the foundation for this shift.





