Emerald Emerging Markets Case Studies

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It was May 2012 that Mr Erwan, the new CEO of PT Perkebunan Nusantara XII (PTPN XII) put forward a vision for the plantation company. During this initial tenure, he was fully aware that one of the company's products, Kopi Luwak, was becoming popular:

> [. . .] I am expecting that Kopi Luwak will bring about a revolution in the Indonesian coffee industry, which is represented by our company. This company manages to meet the emerging demand [. . .].

However, the company faced challenges regarding the international market and there were many nagging questions that came to his mind. First, how could the company convince the market that Kopi Luwak is the best coffee in the world? How could the company fulfill the demand from a long queue of customers? How could the company meet the demand and satisfy the conservation needs for a wild animal, the ''luwak''?

The huge potential market

The movie, ''The Bucket List'', stars the actor Jack Nicholson who carries a supply of his favorite beverage with him wherever he goes (www.youtube.com/watch?v=g73XEvtztbs&feature=fvwrel). The movie prompted many people to try the product. The Oprah show featured it as ''The Most Expensive Coffee in the World'' and *Forbes* magazine called this coffee the ''Number One Coffee in the World''.

In New York City (NYC), the coffee costs from $7 to $350 for a cup. In comparison, a specialty espresso or latte drink only costs $4/cup, and $5 for a cup of frapucino at Starbucks or other local coffee shop in NYC. In a London department store, Kopi Luwak costs £50/cup or £324 a kilogram[1]. In Shanghai, this coffee costs 200 yuan a shot (US$32 or equivalent to the average minimum weekly wage) (www.thejakartapost.com/news/2012/03/11/panda-poop-tea-approaching.html). In Indonesia, Rollas Café sells such coffee at Rp120,000 or $10/pack.

The booming of international demand prompted local farmers to establish The Association of Indonesian Coffee Luwak Farmers in 2009. Most of them were small businesses with international market access. The civet coffee was just a tiny part of Indonesia's overall coffee production (*The New York Times*, 2010). It appears that Robusta was the major Indonesian export, which comprised around 325,000 t/annum or 85 percent of total coffee exports. Bengkulu, Lampung and South Sumatera coffees were the Indonesian coffee triangle, followed by newcomers, such as Kintamani coffee, Flores Arabica as well as Priangan coffee.

Indonesian domestic consumption was largely robusta blends with an annual demand of 120,000 t, or only 36 percent of total exports. However, the bargaining position was poor. For instance, in 2007, the local industry was not able to ensure adequate supplies for the domestic market and imported 30,000 t of Vietnamese Robusta (www.teacoffeeasia.com).

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For international comparison, world coffee exports in 2011 were around 9.88 million bags or 16.2 million tons[2]. This means Indonesia's market share was just 2 percent of the global market.

Niche product

Kopi Luwak is a typical niche product. The misspelling of Kopi Luwak has luckily brought it to international attention as a brand. The misspelling of the word ''kopi'' refers to the local word for ''coffee'', while Luwak is the local name for the Asian Palm Civet. As Luwak Coffee comes from Indonesia, the local name becomes more popular as Kopi Luwak though internationally it is known as Kopi Luwak Coffee. Some other misspellings include Kopi Luak. The name springs from the production process, which involves a local animal, a civet which is locally called Luwak.

Kopi Luwak is less bitter than normal coffee, but it is smooth brewed, has an earthy taste and has a rich flavor with hints of chocolate. The unique taste comes from the juiciest coffee cherries which are selected and eaten by the civet. These in turn yield the best beans; the fermentation process in the civet's stomach. The taste is lost if the beans are over roasted.

Through the animal's digestive system, the beans are excreted in its feces. The civet seeks out and eats only the best, ripest coffee cherries. The 10 lb tree-climbing creatures cannot digest the hard and dark beans and excretes these with their feces, but the enzymes in the stomach enter the beans. The internal fermentation brings a unique flavor which lessens the protein and reduces the bitterness of the coffee (Marcone, 2004). Though the harder beans retain their shape, there remains the question of whether Kopi Luwak is safe to drink because of the bacteria found on the beans.

Researchers at the University of Guelph conducted a survey and their report indicated that Kopi Luwak beans are more contaminated than ordinary coffee beans. However, they found that the beans at the supermarket are quite clean due to being very well washed which dislodges the bacteria (www.squidoo.com/kopi-luwak-). In Indonesia, local farmers gather the beans and wash them, then dry them under the sun. The beans are roasted and brewed, resulting in aromatic and smooth coffee beans.

The reason the coffee is so costly is its labor-intensive production process. Rather than harvesting the coffee cherries and extracting the bean by the usual methods, local farmers collect the feces of the civet cats which live on the plantations and pick out the beans (*The Guardian*, 2010). This unique process takes place with the small scale of economy. The local villager gets $600 a pound to collect the rare coffee beans.

To enhance the lucrative enterprise with less labor-intensive methods, some local farmers started caging civets and feeding them coffee beans. However, this process produces ''non-organic'' coffee with an inferior quality. A civet gets stressed if it is kept in a cage. In the jungle, civets naturally select the ripest coffee cherries instead of eating whatever is fed to them when in a cage.

To respond to the international demand, product expansion means the company needs more civets which live in their own local environment. Otherwise, product quality does not meet the standard. The question arises for management whether production needs to be done under the name of conservation.

The company

PTPN XII is a state-owned plantation which grows a number of crops, such as Kopi Luwak, tea and other coffee beans. Located in the Ijen area of East Java, at an altitude of between 3,000 and 6,000 feet above sea level, which is suitable for coffee production. The plantation was established in 1876, following the expansion from an earlier plantation in the 1600s under Dutch colonialism, which brought the Arabica coffee plant in 1696. In 1602, the Dutch East Indian Company (Verininging Oogst-Indies Company (VOC)) managed the plantation[3].

During the plantation expansion in the seventeenth century, there was stiff competition in the world coffee market between VOC and Arab traders. The first exports from Java to Europe took place in 1711. Then, exports rose to 60 t/year during the following decades and VOC monopolized coffee trading between 1725 and 1780. After abolition of the VOC in 1798 the areas were taken over by the Batavian Republic. In the 1800s, these areas became officially the Dutch East Indies, a colony of The Netherlands.

From then onwards, the colonial government focused on the profitable business in coffee, tea, sugar and rubber. The plantation developed in Java and Sumatera Island. As the largest producer in Indonesia, the plantation in Java Island, at an altitude over 1,500 million and temperatures of 16-20°C, is well known for the gourmet Arabica coffee.

King Willem I of The Netherlands introduced the Cultivation System between 1830 and 1870 to make the colony profitable in order to refill the Dutch treasury after a severe economic crisis in The Netherlands. During the Cultuurstelsel (1830-1870), local people were not allowed to pick up the coffee fruit. This sparked off both intense curiosity and, well, revulsion, which triggered the local people to notice a certain species of musang or luwak (Asian Palm Civet). The wild animals ate the coffee fruits at the plantation, and then left the undigested coffee seeds in their feces. The local people collected these dropped seeds, then cleaned, roasted and ground them for their own beverages[4].

Under a new Indonesian Government in the 1950s, the nationalization program took over many contemporary plantations. The Independent movement had brought certain disturbances and individual squatters took over Dutch properties. In order to restore the regime, the administrative body, the Pusat Perkebunan Negara Baru (New Central Agency for Government Estates) was set up by decree of December 10, 1957 to carry out the government control (Domke, 1960).

Resource-based management

PTPN XII is a typical resource-based company[5]. As the largest Kopi Luwak producer in Indonesia, the company relied on 600 civets in four plantation areas, i.e. Kalisat Jampit, Blawan, Pancor and Kayumas. At the plantation, every civet has a name. A civet, which has a four-year life span, costs around $18 at the local market. In 2010, the company tried to transform 2,520 t of Arabica coffee to Kopi Luwak. Compared to local competitors, the company runs the plantation more professionally. The net production capacity of around 2 t/month was not able to meet the huge demand.

A civet is a wild animal like a cat in appearance. Raising a civet is difficult because male civets like to eat baby civets. The most productive age for Kopi Luwak is between two and five years old. The male civet is more productive than the female and the best time for the coffee harvest is between June and August.

In two or three weeks, a civet can eat 2.5 kg of coffee and produces Kopi Luwak of 1.2 kg. If the harvest time is over, the civet can eat local fruits or even rice[6]. However, with the sun drying method, bean drying in small-scale farming operations has a high risk of food contamination. According to the association of Indonesian Kopi Luwak farmers, the total production of Kopi Luwak from Indonesia was around 200 t/annum.

Downstream market

In the local market, the front line of marketing for Kopi Luwak is PT Rolas Nusantara Mandiri as a partnership strategy between the PTPN XII and PTPN VIII. This company manages the downstream market for such commodities, i.e. coffee and tea. PTP VIII has its core business in tea, coffee and palm oil plantations, while PTP XII focuses on rubber, cocoa and tea plantations. In Surabaya, Rolaas café promotes Kopi Luwak in Surabaya, Bandung and Kuta Bali.

In 2012, the company will expand with more six cafés in Java and Bali following amazing sales growth of around $10,000. In 2011, Rollaas Cofe in Tunjungan contributed the highest income of more than $20,000/month. In 2008, most of the Kopi Luwak Arabica was for the local market. In Surabaya, two Rollaas Cafés opened in Tunjungan and City of Tomorrow with Kopi Luwak as one of the products at about $10/cup.

Exports to Japan were about 200 and 100 kg for China market with the price of green bean about $120/kg while the coffee cream was about $250/kg. The company is also involved with the annual Trade Expo at the Jakarta International Expo Center. The booth was the favorite among the visitors and can reach at least $12 million/day. It appears that the café business has to meet the stiff competition.

In local market, the café industry has been growing remarkably over the last decades. With 9.3 percent growth, a number of café businessmen established associations, such as Association of Indonesian café and restaurant businessmen with 120 members or Hotel and Restaurant Association with 290 members. In Bandung, there are more than 2,000 café but 167 had fulfilled the administration while the rest still struggle to meet the business license.

The holding company

The government put forward a plan to set up a holding company with the aim of streamlining the operations of all state plantation companies, including PTPN XII. Along with ownership over the outstanding stock, the holding company will manage 15 state plantation firms with an annual revenue of Rp44 trillion ($5 billion) with the aim of setting a marketing strategy in which PTPN XII was part of the plan[7]. Under the ministry of state-owned companies, the holding company was expected to boost profit from 3.6 trillion in 2011 to 5.3 trillion in 2012. The minister of state-owned company was eager to fulfill its vision to be the largest palm oil exporter and the giant Robusta coffee producer in the world[8].

The stated-owned plantation comprises 14 companies and one proposed company:

1. PTPN I in Aceh is agribusiness with business core of palm oil plantation. It recorded total sales around Rp520 billion (US$55 million) in 2010.
2. PTPN II in Medan Sumatera noted sales in 2010 of around US$20 million and US$100 billion, in export and local markets, respectively. The major products were palm oil, rubber, sugar cane, and tobacco.
3. PTPN III is in Medan Sumatera too. The major commodities were palm oil and rubber.
4. PTPN IV is located in Jambi Sumatera. Focusing on palm oil, tea and cocoa. Following the merger with PTPN VI, VII and VIII in 1996, the company manages 15 palm oil refineries and produces 350 t of oil palm and 250 t of tea.
5. PTPN V in Jambi achieved US$400 billion of sales in 2010 with palm oil and rubber as major commodities.
6. PTPN VI in West Sumatera and Jambi manages 90,000 ha of plantation with four palm oil refineries, three rubber-processing units, and two tea factories.
7. PTPN VII manages five district areas in Lampung, Palembang and South Sumatera. The company produces oil palm, rubber, sugar cane and tea.
8. PTPN VIII in East Java manages 25,900 ha of tea plantation. Located near the capital city, Jakarta, the company also develops ecotourism.
9. PTPN IX in Central Java comprises two divisions of annual plantation (rubber, coffee, cocoa, and tea) and seasonal plantation (sugar cane). In 2010, around US$100 million or 50 percent of its total sales came from sugar cane plantation.
10. PTPN X manages ten sugar manufacturers with the head quarters in Surabaya. Most of the sugar supply comes from local farmers. In 2010, the company managed assets of more than US$200 million.
11. PTPN XI manages 16 sugar manufacturers and produced nearly six million tons of sugar cane in 2010.

12. PTPN XIII runs palm oil business and rubber plantation in West Kalimantan. With nine palm oil refineries, the company produces 386 t/h with nearly 14,000 staff.
13. PTPN XIV has operation areas in Sulawesi and Maluku with a head quarters in Makasar. The business core is sugar and oil palm.
14. PTPN XV is still on planning. The central government set a plan to establish the plantation in Papua.

Notes

1. ''Animal dung coffee at £50 a cup'', *BBC News*, available at: http://news.bbc.co.uk/2/hi/7340005.stm
2. Trade Statistics, available at: www.ico.org/
3. *History of Coffee in Indonesia*, The Special Coffee Association of Indonesia USAID and AMARTA, available at: http://sca-indo.org/history-of-indonesia/
4. National Geographic Traveler Indonesia, November 2010, p. 44.
5. A company with competitive advantage lies primarily in valuable resources (Amit and Soemaker, 1993; Gerald *et al.*, 2010).
6. ''Kisah Kopi Luwak PTPN 12'', *Berita Jatim*, available at: www.bumn.go.id/ptpn12/publikasi/kisah-kopi-luwak-ptpn-12-memanen-jutaan-rupiah-dari-perut-pak-raden/
7. Ministry to Gather State Plantation Firms Under New Holding Company, January 24, 2012.
8. ''Indonesia to create giant palm oil, rubber firm'', *Jakarta Globe*, available at: www.thejakartaglobe.com/business/indonesia-to-create-giant-palm-oil-rubber-firm/495542

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