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Title: Institutional Responses to Market Deregulation: The Case of Illy Caffè and the Brazilian Coffee Sector

Abstract

From the turn of the century until the late 1980's – early 1990's, both the Brazilian and world coffee markets had become increasingly more regulated as the member countries of the International Coffee Organization (ICO) in London used a complex web of quotas and supply controls to stabilize the world green coffee price. These supply controls resulted in a substantial misalignment of incentives. During the 1980's the espresso market expanded rapidly demanding extremely high quality Arabica coffee beans. The rigid ICO imposed quota system constrained producing member countries' ability to respond to these changing consumer demands, as they lacked the necessary quota or mechanisms to provide farmers with the necessary incentives. As a result new non-member countries entered the market to meet the gap. By 1989 the International Coffee Agreement became unsustainable and collapsed amid arguments over quota allocations. Hence, the international and Brazilian coffee markets were suddenly liberalized after a century of regulation. This market liberalization freed incentives and spurred a range of market innovations as private agents on both the supply and demand sides attempted to establish new organizational structures to meet consumers' demands.

This paper develops a conceptual framework based upon the theory of tournaments and analyzes how Illy caffè, an Italian company specializing in the espresso market and well-regarded for its superior quality, successfully established an innovative organizational structure for the procurement of consistently the highest quality Arabica coffee beans in Brazil immediately following the market liberalization. In particular, we focus on the innovative tournament initiative which they implemented in Brazil, a key supplier of Arabica coffee to the world.

Key words: Market failure, pooling equilibrium, deregulation, institutional change, espresso coffee, organizational structure, tournaments.