**Hacienda Flandes: Boom, Decline and Reinvention of a Colombian Coffee Farm**

**Track:** Management Education and Teaching Cases


### Abstract

The case focuses in the story of the second generation of coffee plant growers at the "Hacienda Flandes" in Colombia and describes what the family has gone through since the first generation starts to build the business, until the third generation receives it. The case objective is to develop undergraduate and/or graduate students' critical and strategic thinking in introductory business strategy courses through the story of a family-owned coffee plantation in Colombia, under a changing and competitive environment.

Key words: Business strategies, external environment, strategic analysis **Hacienda Flandes: Boom, Decline and Reinvention of a Colombian Coffee Farm**

**Case A**

In November 5th 2010, the second rainy season hits Colombia. The worst storm in the history of the Hacienda Flandes has ceased, leaving a trail of 26 internal ground collapses, thousands of coffee and banana trees destroyed, and rivers of water and mud sliding down the whole farm. The workers' houses are flooded and the coffee harvest is lost. There is no money to recover what is lost, or even for the payroll.

Miguel, the farm's manager, checks the negative balance in the bank account. He has another payroll due by the end of the week and he also owes the foreman's premium and severance payments for the last 17 years. Moreover, he has other debts with banks, suppliers and informal money lenders, and has spent several years reported at the credit bureaus. His truck is being held by bank orders and his only resource is the farm, an inheritance left by his father. He owns 50% of the "Hacienda Flandes" and 25% of the "Hacienda Malaga", participations that cannot be sold because the family group has not gone through the legal succession process due to lack of money to pay for inheritance taxes which are worth 30% of the properties' market value.

The other two members of the family, his mother and brother, do not have the capacity to support Miguel's debts. Furthermore, neither of them wants to sell their farms' shares because they have strong emotional ties towards them, and both farms are devalued given their current abandonment. Hacienda Flandes is the place where their respective husband and father was born and died, and it is the place where his ashes lie.

After five years of being in charge of both farms, Miguel calls his older brother and says to him: "Carlos, I have been in charge of the farm for more than five years and I have been thinking about my future. I want to change my job and life, so I've decided to return to Cali[a] and take a new direction. I entrust you the farm's management". Although Carlos Jr. let's himself calm down before making any decision, he realizes he has no idea which way to go. Should he rent the farm or work his way back to get the farm back to its feet? How is going to pay the debts Miguel has left? What will happen to the workers and their families? Is it worth it to continue in the coffee business?

**1970 - 1989: First and Second Generation - The Golden Age**

a The Colombian Valle del Cauca Department's capital (See Exhibit 2). A Department is a geopolitical division of territories in Colombia, similar to the states in the U.S.A.

At the top of the Colombian Western Mountain Chain, there are hundreds of thousands of coffee trees covered by a beautiful red sunrise and a buoyant coffee economy. As usual, the co-owner and manager of Hacienda Flandes, Don Asdrubal, gets up very early in the morning to drink his black sugarless coffee, and to think about the family business. It is March 1st, 1977 and the business is going well. The coffee production is at its best and the domestic price of coffee is at the highest value in the whole history (see Exhibit 1). This week, there are 250 people collecting coffee and next week, there will be around 300. It's time to bring his two brothers and give them the news that will change their lives.

Don Asdrubal, Don Carlos Sr. and Don Alfonso, are three of eight brothers from a family that arrived in 1913 from the Caldas Department to settle down in a town called Sevilla, located in the southern Department of Valle del Cauca, escaping from the political violence of the time (see Exhibit 2). The family's father started a coffee and grocery store, and with the income obtained after 40 years, in 1954 he acquired several lots of land which he united and named Hacienda Flandes.

Due to the family's low income, the father couldn't afford his eight children's college education, so Don Asdrubal chooses to help him manage the farm after graduating from high school. Don Alfonso follows a political career[1] and Don Carlos Sr. moves to Popayan, a city in the Colombian in Cauca at the South West of the country to study civil engineering. After graduating in 1948, Don Carlos Sr. works in several Colombian cities enjoying the benefits of being an engineer. In 1963, the father dies and the inheritance is divided among his heirs. That year Don Carlos Sr., Don Asdrubal and Don Alfonso form a partnership to purchase a coffee farm in La Dorada, a town in Caldas to begin their farming careers.

The three brothers have responsibilities well defined in their partnership. Don Asdrubal is dedicated to the general management and finance. Don Alfonso brings his experience in legal, commercial and security issues and is responsible for public and commercial relationships. Don Carlos Sr. is dedicated partly to his profession as an engineer and partly to the farm's operational functions which include growing different types of crops to increase the production, and teaching employees how to plant coffee.

During this period, they try new coffee varieties from Cenicafé[b], which is an organization that considers Flandes as an experimentation farm. In the 70s the farm becomes a pioneer in planting "Caturra variety" coffee in the Valle del Cauca Department, and in the 80s, the brothers experiment with the variety "Colombia F6 and F8". They tested different types of

b National Coffee Research Center created by the FNC in 1938 in order to study aspects of the harvest, profits, grain quality, management and utilization of sub products of coffee exploitation and conservation of natural resources of the Colombian coffee zone. Retrieved on November 20, 2012 in http://www.cenicafe.org/es/index.php/quienes_somos/historia renovation grafting[c], planting distances and other alternative crops such as cocoa, citrus and macadamia trees.[d] Coffee plants are improved by changing from the typical Arabic variety to the "Caturra" variety, a highly productive and less fertilizer demanding coffee. They also harvest vegetables such as onions, tomatoes, corns, beans and yucca to provide food for the farm's casino[e].

From 1970 to 1979, the Colombian coffee price (see Exhibit 1) and coffee production (see Exhibit 3) were very high, particularly during 1975 and 1978, when the second coffee boom[f] occurred. As a consequence of the Brazilian frosts that destroyed their coffee crops in 1977, during those years 125 kg of Colombian Pergamino[g] coffee is worth the equivalent of 3.5 Colombian minimum wages, compared to 2008 where the same amount of coffee is worth one (1) minimum wage (see Exhibit 1).

The income of  Colombian coffee farmers was so high (see Exhibit 4) that the National Government adopts a severe stabilization plan to prevent a sky rocketing 30% annual inflation brought by the coffee boom. The reserve bank levels rise to 60%, restrictions to private external debts are implemented and foreign capital entering the country is limited[2]. The three siblings' partnership multiplies ten-fold, completing seven farms dedicated to coffee production and cattle.

The brothers invest in improving the red bean processing plant and the silos[h], and reduce costs by bringing these two within a single site for collecting and processing coffee. They also purchase trucks to transport coffee within the farms, construct internal roads and buy large quantities of agricultural goods and fertilizers without skimping.

The two annual harvests are clearly defined due to climate's stability. The first one, between April and June is called "Mitaca"[i] and the second one is between September and December, called "harvest of the ending year". All agricultural activities and cash flow are scheduled according to these two harvests.

Most workers are collectors who come from different parts of the Country and they work only during harvest season. Some of them return the following year, while others travel around Colombia in search of better paying crops. Recruiting occurs

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c Renovation grafting is a manual procedure that involves cutting the old branches and stems of the tree to 30 cm of the ground in order to initiate new coffee tree sprouts to increase coffee production.

d When growing coffee, it is a custom to plant other crops in coffee plantations such as banana and citrus trees to protect the coffee trees from the sun, increasing the productivity and the farm's income derived from these alternative plantations.

e The casino is the place where workers are feed. Usually, it is built to prevent to transfer the staff.

f The first coffee boom was 1952-1954.

g Pergamino is the dry coffee grain unthreshed.

h A silo is a gas combustion chamber that also works with coal, petrol or diesel. It is designed for storing and drying coffee grains. The red bean processing plant  is the building where the silos and peeling machines are located.

i The main harvest takes place between September and December, and there is a secondary harvest between April and June is called "mitaca". Retrieved December 15, 2012 in http://www.cafedecolombia.com/particulares/es/la_tierra_del_cafe/regiones_cafeteras/

in the town’s central park, with people shouting "collectors are needed" and those interested, are then transported in dump trucks to the farm where they sleep, eat and work during the season. Right there, working conditions are offered: fixed working hours and price per kilo of coffee collected, which are defined according to the local market price.

Staff management is very strict and is based on performance. People are fired for low yields, for creating conflicts or because the coffee harvest has finished. Sometimes “Chucho”, the farm’s foreman, faces several workers at the time of dismissal. The labor supply is permanently available, cheap and specialized in the coffee harvest, given the years of experience. Five meals a day are served to every person. They sleep in large bedrooms with two bunk beds and two bathrooms in the hallway. On several occasions, when trusted employees face difficult times they receive farm owners support without any expectations of return. These acts generate a special loyalty to the family.

The three brothers get married in the 70s and have children. Following the formation of the new households and the commitments of the newly created marital partnerships, some proposals of capital distribution appear. In 1980 Don Asdrubal gets his two brothers together and asks for the liquidation of the partnership and the division of the goods. Don Asdrubal keeps the cattle business, while Don Carlos Sr. and Don Alfonso decide to continue with the coffee farms, plus the partnership’s bank debts.

Don Carlos Sr. and Don Alfonso continue the partnership until 1982, when Don Alfonso dies[3]. Two years later, Don Alfonso’s children ask Don Carlos Sr. to liquidate the partnership and to divide the property to make use of their heritage, as they are not interested in continuing with the coffee business. When they do it, Don Carlos Sr. receives the coffee plantation called "Hacienda Flandes" and part of a livestock farm, named "Hacienda Malaga". He decides to continue in both the coffee and the cattle businesses, until weather changes, pests and low prices began to change the coffee business landscape.

**1989 - 2000: The collapse of the Coffee Agreement, the arrival of the coffee leaf rust**

By 1989, the Colombian coffee golden age ends and the farms’ profits are no longer the same as those from the early 70's. The debt acquired by Don Asdrubal and Don Alfonso, the depression in the coffee prices, the increasing production costs, and the lack of administrative control, substantially affect the farms’ cash flows. Don Carlos Sr. still maintains the coffee and cattle business, regardless of the situation. However, no one expected what is about to happen in the coffee’s international trade.

The International Coffee Agreement (ICA)[4] - called Coffee Agreement - emerged in 1962 as a mechanism to financially support coffee producers from developing countries with low income per capita. This agreement regulates the coffee supply, so that the grain's stock market price increases and so does these countries' farmers' income; meanwhile, producing countries commit to control their production and to retain their quota of exports production excess.

This support mechanism has several deficiencies though. The first one, the model goes against recent ideological trends in favor of free markets; the second one, there's an inefficient redistribution of resources because economic aid does not go to the desired countries, but to countries that mostly export, and the third one, this mechanism encourages the production at the cost of inventory accumulation in most producing countries.

Under these circumstances, the Coffee Agreement becomes a restrictive barrier for countries producing soft types of coffee, particularly those from Central America, which look for a way to diminish their surplus inventory, selling it at half the price to non-member consuming countries. This causes annoyance in the member consuming countries that start seeking to revise the agreement. They aim at regulating coffee imports, unifying the market, establishing retention of surpluses, and controlling sales, through quotas on exports to non-member countries. On July 3, 1989, the proposal is voted and it doesn't achieve the majority, therefore, due to economic clauses failure, the agreement breaks, giving way to the free market[5].

Consequently, in the first 20 months, world exports raise from 70.8 million bags of 60 kg to 78.9 million and Colombian exports go from 10.3 to 13.7 million (See Exhibit 5). However, the international consumption increases only 1% between 1989 and 1990 as the prices to the final consumer do not reflect the drop in coffee prices[6]. This disparity creates an inventory accumulation of 26% in consuming countries, and an international price fall from $1.39/pound in 1989 to $0.89/pounds between 1990 and 1991. This decrease leads to an overall 46% reduction in the worldwide price level and 8.6% in the Colombian coffee domestic price.

Back in 1927, Colombian coffee growers gather at the Second Coffee Congress and found the National Coffee Growers Federation (FNC). Its mission is to organize and represent the interests of coffee farmers, to promote research and dissemination of scientific and technological knowledge, to support the internal and external coffee market, to promote social development and to coordinate with the national government coffee policies for production and marketing, e.g. reimbursement currency, phytosanitary regulations on coffee exports[7].

Among the FNC achievements are the signatures of International Coffee Agreements such as the Quotas Covenant in 1940, the International Coffee Agreement (Coffee Covenant) in 1962, the creation in 1963 of the ICO (International Coffee

Organization), the creation in 1938 of the National Coffee Research Center, "Cenicafé" (an experimental farm for cultivating and processing coffee identifying its benefits), the creation of the Flota Mercante Grancolombiana[j] (1946-1992), the Agricultural Insurance (1952), the Colombian Fertilizers Industry (1952), the Coffee Bank (1953-2007)[8], the Juan Valdez brand[9] (1959) and the Colombian Coffee logo[10] (1981).

Also in 1927, the Colombian Congress authorizes the Act 76 of 1927, to create a levy of 10 US cents per bag of 60 kg of coffee exported, so that the FNC fulfills its mission. This assessment gives rise to the National Coffee Fund in 1940 to help stabilizing coffee domestic prices, investing in programs and projects[11] and supporting excess fees retention, according to the 1940 Agreement Fees and the Coffee Agreement in 1963[12].

In 1989, the National Coffee Fund has equity close to $1.600 million USD[13] accumulated from the 1985 coffee boom. Nevertheless, after the Coffee Agreement breaks the Fund loses value by $800 million to protect domestic prices over international prices to support coffee farmers. Early in 1991, the Fund's finances begin to be affected due to excess of inventories, the stagnation of international coffee consumption, the lack of liquidity and the buyers' market control[14] (Cárdenas, 1993). These result in a domestic price reduction in the short and medium runs[15]. The domestic market reaches the lowest price of the past 20 years (see Exhibit 1), severely affecting coffee farmers and the coffee industry in general. Despite of this, the National Government and the FNC do not introduce substantial law changes, nor incentivize new coffee projects.

Sadly, the only hope for coffee farmers is that coffee prices react, taking into account there's another frost in Brazil, as the on occurred in 1975. Such hope is becoming increasingly remote given that coffee growers in Brazil moved their plantations from areas In risk of frosting. As a result, the National Coffee Fund is on the verge of bankruptcy.

As if the previous situation is not enough, in 1983 the coffee disease known as "leaf rust" appears first in Chinchina (Caldas) in "Calamar Farm", property of the chairman of the Caldas Coffee Growers Committee[16]. The coffee leaf rust is a disease caused by the fungus *Hemileia vastatrix*[17] which reproduces rapidly under wet conditions (rainy seasons or crops densely populated). It infects with spores on the leaves underside causing premature coffee fall. This fungus, when combined with poor fertilization and poor growing conditions, causes stress and nutritional and follicular imbalance in the coffee tree, affecting adversely the production. The best solution to this problem is to replace the entire plantation by a

j Colombian shipping company carrying on Colombian coffee to the European and Asian markets at preferential rates cheaper than other shipping companies from around the world.

resistant variety, which is very expensive. Due to the winds and the temperate climate, the disease spreads rapidly in Colombia, many farmers go to bankruptcy and farms change ownership[18].

In synthesis, it is a time where several factors threaten to wipe out the entire Colombian coffee growing activity: (i) coffee overproduction, (ii) surplus inventories, (iii) the worst prices in history and (iv) a spreading disease.

Not everything is bad though. Ironically, the arrival of the leaf rust saves the National Coffee Fund. The Colombian Government, through direct policies, reduces taxes to farmers' and to agricultural inputs; it also provides credits to combat the leaf rust and increases the grain's domestic price. Simultaneously, the FNC develops a new variety called "Colombian Variety F6" which is leaf rust resistant and promotes the coffee plantations' renovation of "Caturra Variety" by "Colombia Variety". Through the intermediation of fungicides against the leaf rust, the spreading of the new seed Colombia variety and the governmental aid, the financial stability of the FNC recovers and the coffee replacement program starts (See Exhibit 6).

During the years after the leaf rust attack, Hacienda Flandes debts grow due to the leaf rust disease; high bank interests of about 40%, high production costs and low revenues generated by the low international coffee price also affect the farm. The economic situation worsens and life savings held abroad are reimbursed to solve the cash flow constraints and to replace the coffee "Caturra variety" by the new variety "F6". A year later, the FNC introduces "variety F8" as the grain of "variety F6" leaves very thin and poor quality coffee.

Chucho, the former foreman of Hacienda Flandes resigns after the division of the three brothers and a new foreman, Alberto is hired. Don Carlos Sr. then turns 65 years old and fully trusts Alberto with the farm's management. Given the fact that Don Carlos Sr. doesn't have Don Asdrubal's accounting and management knowledge, he neither keeps track of the administrative and accounting.

Alberto works hard on the business the first year, but he distances from his occupations and starts a messy life. Financial results provide evidence of this situation, but when he is asked for an explanation, Alberto attributes it to the leaf rust, low coffee prices or just the bad time of the Colombian coffee.

As a result, maintenance activities, fertilizers purchase and herbicides begin to demand more capital resources. Since there is no cash flow to finance such requirements, Don Carlos Sr. asks his wife to help him with the farm's accounting. After her internal audit, a number of anomalies prove that Alberto has mismanaged the farm's finances. He was making unauthorized transactions such as selling coffee under his name, buying fuel for a price lesser than the reported value in the invoice, selling farm manure or reporting higher accounting payroll than the actual transactions to collect the difference. Additionally, he lets the grass grow without control and doesn’t give proper care to the new coffee. In 1994, Don Carlos Sr.’s wife fires him, after leaving the farm in a deplorable state. That same year, after 14 years, Chucho is rehired.

When things seemed to be changing, other phenomenon occurs in Colombia. In September 1988 in Nariño[19], the "coffee berry borer", an African-native devastating insect, the size of a pin’s head is detected for the first time in Colombia. There has never been known of such a nefarious insect in the Colombian coffee growing activity. In three years, it spreads out from Nariño to Risaralda Departments, and by 1998, it colonizes 750,000 out of 869.158 hectares[20] nationwide (See Exhibit 7). This insect is characterized by massively penetrating the green coffee beans at the core and by laying its eggs inside, so that the larvae feed on the bean, consuming the total production. In a single bean, it is possible to find 50 to 100 insects form the same mother.

In 1994 the coffee berry borer spikes Hacienda Flandes, and in few weeks it infests the whole plantation. There’s no mature bean, nor green, nor semi-mature, escaping. At first it was thought that the infestation is temporary and that like all insect infestations, it disappears with weather changes. The reality is that instead of disappearing, it increases and spreads to neighboring farms. It has no natural control as wasps, ants or fungi, and there are no techniques known to control its spread. As a result, many farmers have financial losses during the "mitaca."

When the coffee is drilled, retailers buy it as pasilla[k] at one tenth of the coffee’s normal price, but the collection costs are paid as premium coffee. Seeing this situation, Don Carlos Sr. made the decision to stop collecting. He orders to burn all the coffee trees and ceases all activities of planting and cleaning. Other nearby farms don’t do the same and after a year, they are all so indebted that they have to sell or give them as bank’s payment.

By stopping Hacienda Flandes’ investments and activities, the farm barely produces enough income for the payroll. During the following years, Don Carlos Sr. is unable to find a solution to this crisis and given his advanced age, he retires from the farm’s operations and leadership, leaving it to fate.

**<u>2000 – 2005: A new hope appears</u>**

In January 2000, Don Carlos Sr.’s older son, Carlos Jr. takes over Hacienda Flandes management, while simultaneously working in his internship semester in Production Engineering. He invests most of his salary in the farm and every two days

k Pasilla coffee is a low-quality beans that present physical or flavour defects such as pale color, brocade, black holes, broken or chipped pieces. This second type coffee is commonly used to make roasted coffee mixes at a lower cost.

and on the weekends, he goes to the farm to check the cleanup and the payroll. Among the crops found alive are some "Caturra" trees with the leaf rust and coffee berry borer, also the "Colombia F6 and F8 variety", aging banana plants, several macadamia trees in production and other citrus crops. Of all the crops, the one that catches his eye is the macadamia trees that are over 10 meters high and 8 meters in diameter producing macadamian nut.

Carlos Jr. learns that there is a company located in the Valle del Cauca, named “Productos del Alba SA”, dedicated to nuts production and commercialization. He negotiates Hacienda Flandes’ total macadamia production according to a scale variable price, depending on the quality and the international price. Thus, the first contract of non-traditional products was born. During the following nine years Hacienda Flandes sells macadamia in shell and the revenue obtained is used to finance production costs.

Later, Carlos Jr. meets a neighbor who has worked in sugarcane plantation. The neighbor encourages Carlos Jr. to try and experiment with a small corn plantation under his advice. With his credit card Carlos Jr. finances the corn seed purchase to start the first crop. The experiment is not just corn planting and piking[1], as it is traditionally done, but instead it involves a new planting technique. Carlos Jr. also uses a new fertilizer called ammonium sulfate (SAM) that has never been used before to increase the production and reduce the risk of burning the leaves by rain excess or cold weather.

Carlos Jr. and Chucho carry out the project with the minimum staff possible by following his neighbor’s instructions. Seeding takes several weeks, but after plowing the land and sowing the seeds of the corn, workers see the fruits of their labor. Then they extend the use of SAM to other crops. Plants grow fast and corn production is very good, but by harvest, the crop is attacked by birds and half is lost. Despite this, the part that was saved sells well and gets out at breakeven point.

Simultaneously, Carlos Jr. begins a new project to plant 10,000 coffee plants at low cost. There has been a long time since anyone talks about making coffee seedbeds for replanting. However, with a new seedling of 10,000 plants, the revival of the farm begins. They buy the sand and make germination with bamboo grown at the farm and get for free from the FNC the commercial variety called "Supreme". This variety is leaf rust resistant; with a better quality in the bean and a higher production rate compared to variety "F6, F8 and Caturra". This is the first low-cost seedbed in Hacienda Flandes.

Once the seedlings germinate, they are transplanted in black bags measuring half the size of the bags usually used by the FNC. As this bag is much smaller, it substantially reduces the costs of transporting the seedlings to the planting area.

1 Pike planting entails making a hole of 1 cm with a sharp tool and planting the seed Pasilla coffees are grains with defects such as brocades, vinegar, black, broken or chipped. It is a lower-quality coffee used to make mixes.

Additionally, the germination process is replicated every two months allowing planting every four months and at the same time reducing the need for cash flow.

With corn sales, the farm obtains the necessary cash flow to pay for the first 10,000 coffee trees planting, and as the ground is clean, fertilized and has high nitrogen content, planting costs are reduced to half. Six months of age coffee plants benefit from these special conditions without incurring in extra costs. In addition, this coffee also shares the physical space with a bean crop that reduces costs, facilitating and improving fertilization in situ.

At the end of the first six months, Carlos Jr. finishes his university internship and has to return to college. During the following semester he can't travel to the farm to check the crops. However, he entrusts Chucho with the tasks' completion and goals settings. In December 2000, he graduates as a Production Engineer and returns to Cali to look for a job. After four months in Cali, he is hired by a multinational as a production programmer. With this new job he retakes the farm management and with his credit card he finances the fertilizers' purchase and other inputs to continue investing in the crops development. Due to money constraints, the only worker with open-ended contracts is Chucho while the remaining workers vary weekly, depending on farm activities and week's cash flow. People are hired from the town's central park and labor flexibility allows Carlos Jr. to finance the cost of working capital without new loans.

During the following five years Chucho and Carlos Jr. set the objective of planting 70,000 coffee plants at low cost, establishing an activities schedule according to Carlos Jr. salary and the farm's income. They implement the discipline to reducing costs, increasing physical work efficiency and having permanently a coffee seedbed large enough to plant at least 15,000 coffee trees every year.

In addition, the farm is divided into ten production lots depending on their physical state. First, there are the lots close to the main house which have easy access, and then there are the lots that require less effort and finally the lots that are most weedy. This division prioritizes working activities. By then, while nearby farms change coffee crops to other products, the coffee berry borer significantly reduces, to the point that it has practically disappeared.  The new "supreme" variety is resistant to leaf rust and the lack of coffee trees planted at the farm contributes, as well.

Carlos is aware that it would take several years before Hacienda Flandes sees a positive profit due to the remaining negative farm margins and the upcoming investments. He asks himself several questions then:  Is it advisable to continue investing in the coffee business considering the resources involved? What makes this business so attractive and worthwhile to continue?

Should he change his mind and resources to grow a different crop? If so, how could he find the resources to diversify? Despite these questions, Carlos is confident that with discipline and patience, results would gradually show.

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**Case B**

**2005 – 2007: A new management arrives to Hacienda Flandes.**

In early 2006, Don Carlos Sr. asks Miguel to accompany him to "Hacienda Malaga" (the cattle farm) to do a physical inventory of dairy livestock and they discover that the number reported in the balance-sheet does not correspond to the reality. In fact, there is a lower number than the one reported by Chucho. When facing Chucho, he asks for a day to clear it up, but the following morning, his daughter finds him on the floor of the marquee[m] with an unknown substance in his hand. They take him to the emergency room in Sevilla and later on to Cali, where doctors manage to stabilize him and save his life.

When Don Carlos Sr. confronts Chucho, he confesses that he sold some cattle from Hacienda Malaga to meet some new workers payroll that he hired without his authorization at Hacienda Flandes. He states that it wasn't for his own benefit but for the farm's benefit. His original idea is to reinstate the cattle with the Hacienda Flandes future income. However, the surprise audit Don Carlos Sr. and Miguel go through doesn't give him the chance to meet his goals. Feeling responsible for his actions he tries to end his life.

The family gets together to make a decision regarding Chucho. If they fire him, they will have to hire a new foreman and they recalled the bad experience they had with Alberto. But if they give him a chance to redeem himself then, how could they trust him. They take their time, while Chucho is recovering.

To ease the costs, the family chooses to sell Hacienda Malaga's remaining cattle and to rent it or to sell the property. In the absence of a buyer, the Hacienda is rented a few months later and although the price of the rent is low, the decision is convenient because they stop incurring in maintenance costs, while finding a good buyer. Meanwhile, Miguel moves to Sevilla when he doesn't find a job after finishing college. He starts monitoring the farm's work and keeping Don Carlos Sr. abreast of what is happening at Flandes.

A month later, Miguel brings the family together and tells them that in the absence of Chucho, he wants to run Hacienda Flandes because unlike Carlos Jr., he is able to monitor in a daily basis workers and activities. Carlos Jr. refuses to give his brother the financial management considering all the efforts he has invested in Hacienda Flandes' recovery over the last five years and knowing that soon he will reap the fruits of his labor through his perseverance, discipline and patience.

m The marquee is a physical space in the property that is used for parking cars and trucks.

After the confrontation between the two brothers, Don Carlos Sr. intervenes and analyzes the situation. Considering that Miguel has no job, that he is living at the farm and that his arguments make sense, he asks Carlos Jr. to stop fighting with his brother and to give him a chance. Carlos Jr. thinks and agrees, but setting the condition that Miguel has to keep sending him permanent reports on revenues and costs. Miguel accepts the condition if he is allowed to develop his activities and ideas freely. Thus, Miguel becomes the new manager of Hacienda Flandes.

When Chucho recovers the family decides to forgive him and give him a second chance under new working conditions, especially those related to management since Miguel is now in charge.  He also has to report to Miguel and to engage only in Hacienda Flandes' operational management. Chucho thanks the family for the opportunity and promises not to hide information or to make decisions without owners' opinion.

Miguel starts very well between 2006 and 2007. He establishes a schedule of activities to continue with Carlos Jr's projects. With the money earned from Hacienda Malaga's cattle sell and the coffee sales from Flandes, he has the necessary cash flow to sustain Hacienda Flandes costs. He also makes a renegotiation with the bananas' buyer to double the purchasing price. He manages to get government aid for farmers and pays part of the debt owed to the bank from previous loans. Lastly, with the revenues from the coffee harvest, Miguel makes some physical improvements at the farm. He repairs the main house, builds a kiosk and a soccer court, and sells the gasoline truck to buy a newer diesel truck to reduce transportation costs.

Meanwhile, Carlos Jr. starts asking for weekly accounting reports as he has done it from 2001 to 2006. Though Miguel sends them, much of the information is incomplete. There are unspecified expenses, incomes without any support and purchases without bills. Miguel manages all income and expenses information in a notebook, but he doesn't create monthly financial reports or budgets. Carlos Jr. tries to provide feedback to his brother and starts to organize the accounts using a software without success.

In October 29, 2006, Don Carlos Sr. and his wife travel to Sevilla with Miguel. After lunch, Don Carlos Sr. suffers a cardiac arrest and he is taken to the emergency room in Sevilla where they stabilize him. When the doctors take him to the observation room, he suffers another heart attack and dies.

After Don Carlos Sr. passed away, his wife and children gather to make decisions regarding the family's equity and Hacienda Flandes' management. Miguel remains in charge of Hacienda Flandes and as to the family equity; they cannot do the succession process due to lack of liquidity for the property taxes, to pay the attorney fees and the tax windfall.

During that year, Miguel continues with the original plan to cut down the old trees, to continue reseeding coffee, composting and cleaning. Following these activities, he hires many people to work under work-labor contracts and costs increase.

**2007 – 2010: Carlos Jr.'s return**

In 2007, a dry season arrives to Colombia reducing the coffee harvest, and affecting banana production. With declining revenues and increasing costs, the cash flow is severely reduced, affecting Flandes' maintenance. Miguel focuses on the coffee and banana plantations to protect present revenues, but he neglects those newly planted, putting the future production at risk. Later on, he reduces costs by cutting the lots' cleaning, and weed begins to grow uncontrollably.

The lack of weed control allows ants thrive and devastates newly planted cocoa plantations. The lack of income also leads to move the dates for composting, and the germination beds and planting activities of coffee, citrus, banana are suspended. The picture does not look encouraging at all. The farm is declining again and getting it back is becoming increasingly difficult, given the complex situation of liquidity.

To complete these misfortunes, at the end of the year, the police arrests Miguel at a checkpoint on the outskirts of Sevilla and they seize his vehicle used for working and leisure activities. According to the police, the truck had been stolen in Venezuela and illegally brought into the Country. Miguel argues with the seller and he recovers part of the money in cash and part with a used Sedan. Miguel sells the car to his brother and gets a new bank loan to buy another diesel truck, adding pressure on the cash structure of Hacienda Flandes.

In 2008, the farm production has dramatically reduced for lack of maintenance and reseeding. Although the price of coffee and bananas is relatively high, there is not enough production to obtain enough income to repay the loans and the administrative expenses of the farm. Though Chucho and the workers do their best to have more productive crops, their efforts are not enough. The grass over the plants goes beyond capacity and the coffee, citrus and banana production fall.

That same year, Miguel attends a fair in a nearby town with several friends and asks one of them to take him back to Flandes because he has drunk too much and he is not able to drive. His friend is also drunk, drives and falls asleep. They lose control of the truck and crash. Miguel gets hurt, but not seriously. The insurer recognizes the truck's damage as total loss and pays the remaining debt to the bank.

A few weeks after, Miguel returns to Flandes to continue his work and suggests Carlos Jr. and his mother to take a credit from Finagro- a National Government financial institution created to support farmers- to solve their liquidity problems, to catch up with the debts and to continue the planting and cleaning. The loan is approved and disbursed.

With these new resources, he outsources the services to clean up and plant a batch of banana, under Chucho's supervision. The contractor completes the task at hand quickly. To support his brother, Carlos Jr. makes a partial payment of both farms' property taxes, pays some loans with third parties, and the remaining balance is used to buy a new truck, which funds through another bank loan.

Unfortunately, Miguel allocates resources from the Finagro loan for personal uses, runs out of working capital to sustain the newly planted crops and for cleaning. Revenues which come mostly from bananas and coffee sales barely allow him to pay the payroll. Miguel is delayed with the truck's bank payments and gets reported in credit bureaus. He then appeals to an informal private money lender to avoid the truck from getting impound.

Miguel refrains from paying the payroll and uses the already reduced farm's income to pay his debt with the private money lender. When the employees don't receive their wages they call Carlos Jr. and he uses his own money to pay the wages. He also asks Miguel to resign and give back Hacienda Flandes management to him. Miguel disagrees arguing that he owns 50% of the farm. To prevent that Miguel decides to sell his part to a third party and to avoid family conflict, Carlos Jr. accepts Miguel's stays warning him that he will not rescue him financially again if he gets in trouble.

Meanwhile, Chucho and the workers loose motivation due to Miguel's lack of responsibility and leadership. They stay because job opportunities are scarce in the Region. Given the lack of liquidity and the debts' pressure, Miguel agrees to pay them with farm's machines, tools, equipment among other assets.

In April 2010 the first rainy season begins in Colombia. The rainy season is a phenomenon of high-intensity rainfall throughout the Colombian territory. For this phenomenon, the coffee trees do not blossom and there is no harvest at the end of the year. Banana crops planted in 2009 don't produce and the fruits on the tree do not mature. According to the Red Cross International Committee (2011) "in the last trimester of 2010, Colombia has experienced the longest and most devastating rainy season in 40 years[21]". The rains cause floods and large landslides and Sevilla is declared in state of emergency due to the collapse of primary roads and the number of victims.

In Flandes, 26 landslides occurred and roofs collapsed. With no crop by the end of the year, Miguel settles all the staff of the farm, except for Chucho and by mid-October 2010, the bank confiscates the truck for having more than twelve months payments delayed. There is when Miguel decides to call his brother to resign, think about his future and “entrust” him with the farms’ management.

Carlos Jr. supports the idea of Miguel leaving and going back to Cali. He finally has his father’s legacy back and knows he has to start all over again. He doesn’t know what course to take; he doesn’t either know the amount of debts, nor how much the family owes to the workers. He neither knows how unmotivated workers are or how willing they are to work for him again. What could he do to overcome these challenges and bring up the farm again? Is he going to have to sell or rent the farm? Again, the future looks uncertain, but Carlos Jr. is optimistic.

**2010 – 2012: “Falling in order to raise again, is not actually falling” (Chucho, 2010)**

The rainy season ends in November 2010 and Carlos Jr. assesses Hacienda Flandes’ general state. He finds several landslides, abandoned banana and coffee trees, and only 8,000 trees in production out of the 70,000 he delivered in 2005. The workers are complaining for the overdue wages and Miguel – now the family – faces a labor sue for not paying a worker’s proper settlement.

Carlos Jr. reunites with all the workers and informs them that Miguel has returned to Cali so now he is in charge of the farm. He says that his priority is to pay the debts, to recover the farm, and he promises that things will be different from that moment on. Carlos Jr. negotiates with Chucho and other workers and starts paying as soon as new revenues come in to regain workers.

Later, Carlos Jr. and Chucho divide the farm and prioritize tasks based on the lots that are generating more revenue. Then, they limit the hiring of temporary labor and the purchase of inputs to increase cash flow. Three people per week are usually hired but as money is scarce and must be divided among multiple people, sometimes just one or two people are hired.

As for debts to third parties, these exceed by far Flandes’ ability to pay. Carlos Jr. even considers renting Flandes as an alternative to pay debts, but after four months of searching he does not receive formal proposals minimally attractive. Against this backdrop, Carlos Jr. abandons the idea and sets ambitious goals for 2011 and 2012 and although he has no money or labor available, Chucho supports him and says "Let's do it! Falling in order to raise again is not actually falling! Let's turn Flandes into what it was 30 years ago!"

In the following months, the coffee seedlings are made once again with farm's materials and "Castillo Variety" seeds are given for free by the Committee of Coffee Growers. The number of temporary workers varies each week according to Carlos Jr.'s cash flow. He starts to outsource the production's cleaning services. He also recovers the macadamia trees and starts fertilizing and spraying the plantation against weeds trying to lower labor costs. Carlos Jr. decides to rent for a very low price several lots that are weedy and are not a priority for planting or for production. With this idea Chucho gathers interested people in planting corn, yucca and beans in exchange for a one year lease, so that they could maintain the ground completely clean. Under this arrangement, Carlos Jr. cleans 70% of the farm without paying for the job.

At the end of the first year, the coffee seedlings are ready for transplanting. As the lot is clean and paid, the farm only has to pay labor for planting. A person draws[n], another person makes the holes, and another person plants the coffee tree. On average, three people planted 1,300 trees per week, so instead of hiring 23 people to plant 10,400 plants in a week, three people were hired for two months. Apart from making a staggered planting, time is gained to receive some income to dutifully pay the payroll. Hence, revenues start coming from coffee and banana sales from the farm.

When the second rainy season arrives in mid-2011, many roads of the nearby rural area are affected and the local government sends machinery to fix them. Carlos Jr. takes advantage of this situation to seek assistance from the municipality to remove the internal collapse of the farm. The municipality helps him in exchange for fuel and after two weeks of continuous work, they manage to remove almost all the internal collapse at a very low cost (barely 2 minimum wages).

The second rainy season affects many coffee plantations in Colombia because it doesn't allow them flowering or producing coffee. However, since the coffee trees in Flandes are behind in the harvest and newly planted, the cold wave has very positive effects: Coffee trees need plenty of water during the first year of planting, and the prolonged rains in the rainy season are just what Flandes needs.

That same year, Nestlé Colombia launches a campaign for coffee renewal and provides a subsidy to farmers willing to go through their requisites. Carlos Jr. manages to obtain the subsidy and with the money he buys enough fertilizer to use during most of the year in the new coffee plantation.

In the first year, Carlos Jr. plants 19,000 coffee plants in Flandes. In the second year, he plants over 16,000 and by 2012 he accumulates 43,000 and another 35,000 plants that are in the seedbeds. This completes a plantation of 78,000 trees

n The term refers to draw a thick line extending from side to side of the ground to mark the rows from where the tree of coffee or any other crop will be planted. For Flandes, the distances between plants were 1.2 m and between rows it was 1.5 m.

equivalent to 15 coffee acres coffee[o]. The total cost for this investment is approximately 200 minimum wages of which, 80 are financed with Carlos Jr's resources and the remaining with the farm's incomes.

In addition to growing coffee, Carlos Jr. catches up with the payroll, pays debts and seeks new customers to increase the farm's income. Through online publications, he gets new customers willing to pay better prices for the macadamia. Additionally, he diversifies Flandes' crops with 300 fruit trees, 5,000 cocoa plants produced by the Committee of Cocoa Grower of the Valle del Cauca Department, plants one hectare of "Sacha Inchi" a seed of Amazonian origin, containing a high content of omega-3 and a Higuerilla plant hectare to extract castor oil. He also adds two new varieties of bananas and plantains that are sold at a price that doubles that of the common banana. Lastly, he triples the amount of macadamia trees, doing their own germination and hiring an expert in that field.

After 15 months, the Sacha Inchi and the Higuerilla plants begin to produce and Carlos Jr. publishes the offer online, finding a client with experience in manufacturing essential oils from Sacha Inchi, Higuerilla, macadamia and green Colombian coffee. They make an alliance to form a business where Carlos Jr. provides the raw materials and the partner brings knowledge and labor for extracting oil. A few months later, someone contacts him with interest buy Sacha Inchi seeds and seeing the increased demand, he decides to buy a manual machine to shell the seed, reduce labor costs and increase efficiency. Now the challenge was to open markets to these oils in Colombia since, with the exception of macadamia oil, the others are not widely known.

Carlos Jr. sits in Hacienda Flandes' the living room with a cup of black coffee in his hand, while looking through the window to the coffee plantations and the new rows of banana and plantain. He sees how a stunning red sunset that makes him smile extends over the entire Mountain chain. He feels he is going in the right direction but he still has many questions in his mind: Will the coffee business be profitable in the future? What other ideas and alternatives can be implemented to make it sustainable without relying on volatile international market prices? Should he continue diversifying into new products? How can he protect the harvest income with the risk of having weather changes and pests attacks as happened in the past? What should he do to pay still outstanding debts and settle the succession? Were all these efforts worth it?

o One hectare is equal to 10,000 $m^2$ (100m long x 100m wide)

**Exhibit 1. Purchasing power parity of a load of 125 kg of coffee in Colombia and monthly minimum wages (1970-2012).**

Source: By the authors with information from *Cuadro Resumen Salario Mínimo Legal Mensual V. Años 1950 – 2008.* Retrieved December 6, 2012, in http://www.actualicese.com/herramientas/AspectosLaborales/Historico-salario-minimo-Minproteccion.pdf and Colombian Coffee Production, Representative Price of Colombia smooth variety - Monthly from 1913. Retrieved December 6, 2012, in http://www.federaciondecafeteros.org/particulares/es/quienes_somos/119_estadisticas_historicas/

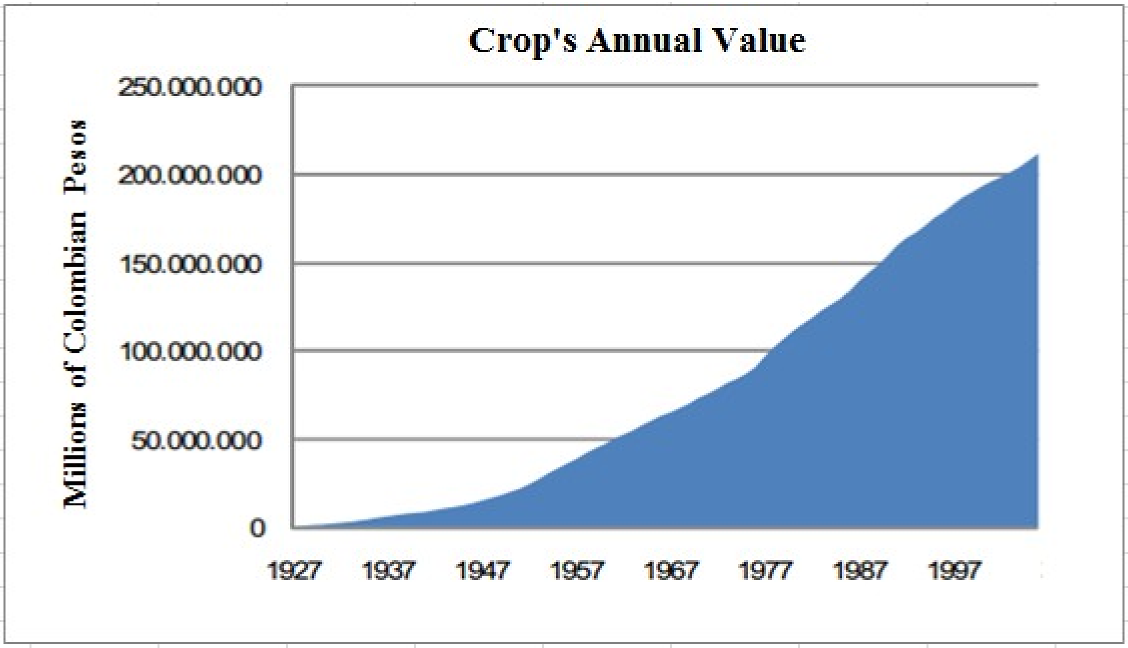
**Exhibit 2. Colombian Political Map**


Source: Retrieved in October 27th, 2014 from http:/ orld.com/colombia/maps/colombia-political-map.jpg

**Exhibit 3. Volume of Production of Green Coffee in Colombia between January 1970 and October 2012.**

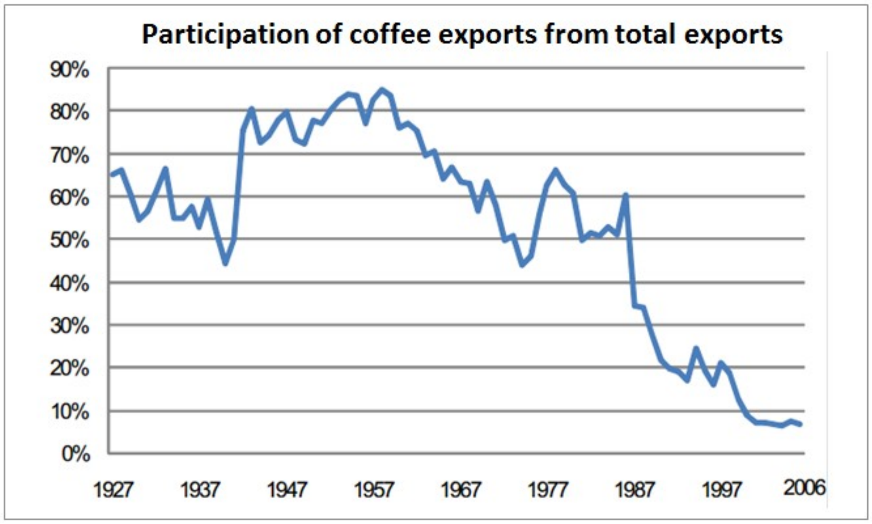
Source: *Producción Colombiana de Café, Volumen mensual desde 1956*. Retrieved December 6, 2012, in http://www.federaciondecafeteros.org/particulares/es/quienes_somos/119_estadisticas_historicas/

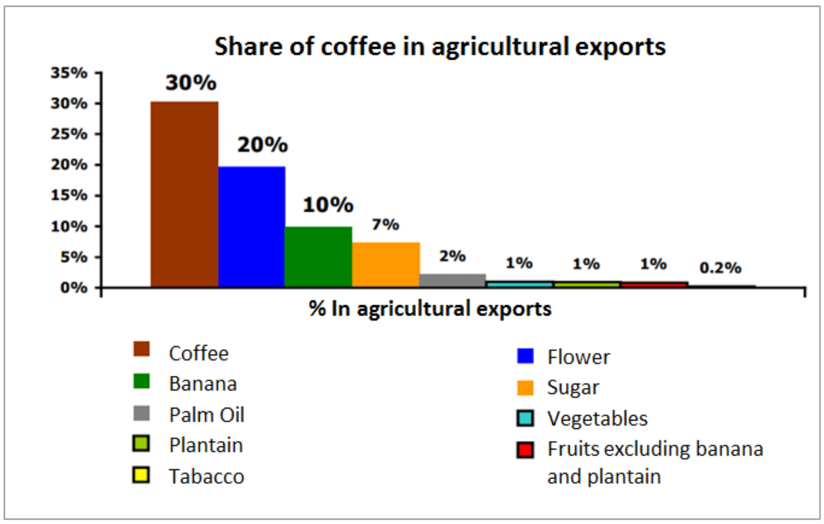
**Exhibit 4. Graph of the cumulative value of the coffee crop at constant prices from 2006 for the period 1927 - 2006 (Accumulated to 2006: $ 211.7 billion pesos)**




Source: *Principales Cifras de la Caficultura Colombiana.* Retrieved January 20, 2013, in http://mailin.cafedecolombia.com/productivo/Inscripc.nsf/792337e17cf5a4f605256d51008185f3/2c078acdd6d20f830525730200816139/$FILE/B-3-Principales%20cifras%20de%20la%20caficultura%20colombiana.pdf

**Exhibit 5. Share of exports of Colombian coffee between agricultural and total exports of Colombia between 1927 and 2006.**




Source: *Principales Cifras de la Caficultura Colombiana.* Retrieved December 20, 2012, in http://mailin.cafedecolombia.com/productivo/Inscripc.nsf/792337e17cf5a4f605256d51008185f3/2c078acdd6d20f830525730200816139/$FILE/B-3-Principales%20cifras%20de%20la%20caficultura%20colombiana.pdf

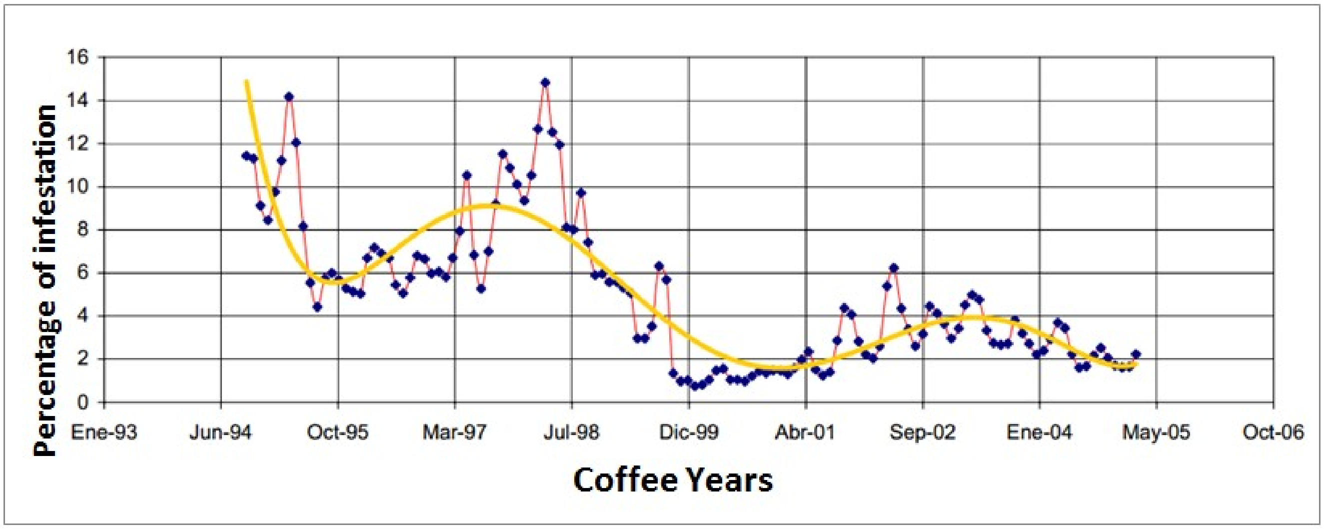
**Exhibit 6. Coffee grown area per Department in Colombia between 2002 and 2011**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010* | 2011* |
|---|---|---|---|---|---|---|---|---|---|---|
| **Antioquia** | 128.0 | 128.1 | 129.3 | 129.8 | 126.3 | 126.9 | 129.1 | 130.6 | 131.1 | 131.2 |
| **Boyaca** | 11.4 | 11.2 | 11.1 | 11.0 | 10.8 | 11.1 | 10.7 | 11.0 | 11.1 | 11.3 |
| **Caldas** | 88.8 | 88.5 | 90.9 | 89.5 | 89.1 | 87.7 | 85.0 | 83.9 | 81.9 | 80.5 |
| **Caquetá** | n/d | n/d | n/d | n/d | n/d | 2.8 | 2.8 | 2.8 | 2.8 | 3.4 |
| **Casanare** | n/d | n/d | n/d | n/d | n/d | 2.6 | 2.6 | 2.6 | 2.6 | 2.7 |
| **Cauca** | 65.7 | 68.5 | 69.9 | 68.9 | 68.0 | 67.8 | 69.8 | 73.3 | 76.2 | 81.2 |
| **Cesar** | 22.4 | 22.2 | 21.8 | 21.5 | 21.1 | 21.5 | 21.9 | 22.5 | 24.2 | 26.2 |
| **Chocó** | n/d | n/d | n/d | n/d | n/d | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| **Cundinamar** | 55.4 | 54.3 | 53.2 | 52.0 | 50.9 | 48.2 | 48.9 | 48.9 | 49.4 | 43.9 |
| **Guajira** | 4.6 | 4.7 | 4.9 | 5.0 | 4.4 | 5.1 | 5.1 | 5.2 | 5.3 | 5.8 |
| **Huila** | 78.2 | 82.2 | 93.9 | 95.9 | 95.1 | 98.1 | 102.5 | 105.0 | 117.8 | 129.2 |
| **Magdalena** | 17.5 | 17.6 | 17.7 | 18.0 | 18.3 | 17.1 | 17.6 | 18.5 | 18.9 | 19.8 |
| **Meta** | n/d | n/d | n/d | n/d | n/d | 2.4 | 2.4 | 2.3 | 2.6 | 3.0 |
| **Nariño** | 23.0 | 24.5 | 26.1 | 26.5 | 26.8 | 27.4 | 29.0 | 31.0 | 33.5 | 35.4 |
| **N. Santande** | 32.1 | 32.1 | 32.1 | 32.1 | 32.1 | 32.1 | 32.6 | 33.6 | 34.0 | 32.9 |
| **Quindio** | 44.5 | 44.7 | 44.6 | 43.0 | 44.0 | 43.3 | 42.4 | 39.8 | 43.4 | 31.1 |
| **Risaralda** | 59.4 | 58.6 | 57.8 | 56.9 | 56.2 | 55.4 | 54.4 | 54.3 | 52.9 | 52.6 |
| **Santander** | 42.1 | 42.4 | 42.8 | 43.3 | 41.2 | 41.1 | 41.5 | 42.7 | 44.6 | 45.2 |
| **Tolima** | 105.6 | 105.4 | 105.3 | 105.2 | 105.1 | 104.3 | 102.8 | 103.9 | 106.8 | 109.9 |
| **Valle** | 86.5 | 85.9 | 85.3 | 84.7 | 84.1 | 82.5 | 77.5 | 75.8 | 75.1 | 75.8 |
| TOTAL | **865.14** | **870.83** | **886.65** | **883.33** | **873.50** | **877.55** | **878.77** | **887.66** | **914,41*** | **921,06*** |

Estimated in December 2010.

Source: *Productores y Cultivos de Café en Colombia, Área Cultivada – anual desde 2002.* Retrieved December 15, 2012, in http://www.federaciondecafeteros.org/particulares/es/quienes_somos/119_estadisticas_historicas/

**Exhibit 7. <u>Chart coffee berry borer infestation in Colombia between 1993 and 2006. Integrated Management of coffee berry borer</u>**




Source: Gerencia Técnica (2005). *Extensión Rural en la Federación Nacional de Cafeteros de Colombia*, pp. 19. Manejo Integrado de la Broca. Retrieved December 28, 2012, in http://www.corpoica.org.co/SitioWeb/Archivos/Foros/ExtensinFederacinCafeteros.pdf

**Exhibit 8. Timeline (1918 – 2012)**

| | |
|---|---|
| 1918 | The first generation arrives to Sevilla |
| 1927 | Foundation of the Colombian Coffee Growers Federation |
| 1938 | Foundation of Cenicafé |
| 1952 | First coffee boom |
| 1954 | Hacienda Flandes Constitution |
| 1959 | Creation of Juan Valdez brand |
| 1962 | Coffee Pact |
| 1963 | Second generation inherits |
| 1970 | Caturra variety is planted |
| 1973 | Chucho starts working in Flandes |
| 1975 | Second coffee boom |
| 1976 | Carlos Jr is born (Don Carlos Sr. son) |
| 1977 | Brazilian frost |
| 1978 | Miguel is born (Don Carlos Sr. son) |
| 1980 | The partnership among the brothers of the second generation ends. Chucho resigns and Alberto is hired |
| 1981 | Logo of "Café de Colombia" is created |
| 1982 | Don Alfonso dies |
| 1983 | Leaf rust appears in Chinchiná Caldas |
| 1988 | Coffee berry borer arrives to Colombia |
| 1989 | Ending of the coffee pact. Beginning of the free market |
| 1994 | Alberto's management finishes and Chucho comes back to Flandes |
| 1994 | Coffee berry borer arrives to Flandes |
| 2000 | Carlos Jr. is the new manager of Flandes and he finishes his undergraduate |
| 2000 | Don Asdrubal dies |
| 2001 | Carlos Jr, sells Macadamia production |
| 2005 | Miguel, Carlos' younger brother finishes his undergraduate |
| 2006 | Miguel is the new manager of Flandes. Chucho tries to kill himself.<br>Don Carlos Sr. dies |
| 2007 | Dry season in Colombia |
| 2008 | Milguel has an accident on the road |
| 2010 | First rainy season in Colombia |
| 2010 | Carlos Jr, takes over the management of the farm |
| 2011 | Second rainy season in Colombia |
| 2012 | 78.000 coffee plants in Flandes. First Sacha Inchi planting, Higuerilla and Cocoa |

Source: The Authors (2013)

**Hacienda Flandes:**
**Boom, decline and Reinvention of a Colombian Coffee Farm**

**Pedagogical Guide Cases A and B**

**Case synopsis:**

The case focuses in the story of the second generation of coffee plant growers at the "Hacienda Flandes" in Colombia and describes what the family has gone through since the first generation that built their fortunes under the protection of the International Coffee Pact in a developing Colombian coffee industry (1970 – 1989).

Later on, from 1989 to 2000, the case narrates the way the Coffee Pact collapses, the coffee borer beetle and the coffee leaf rust arise under severe weather conditions that lead to the first financial crisis derived from external factors. Students then have the opportunity to identify the environmental and the industry changes that affect the business as part of the strategic analysis.

From 2000 to 2010, the second generation takes control over the farm. The first five years are managed by the second generation's first son – Carlos Jr. –, while the last five years are managed by his younger brother Miguel. During this decade, two different administrations take place and one of those leads to a second financial and organizational crisis derived from internal factors.

Finally in 2010, the older son returns as "Hacienda Flandes" General Manager after his brother's resignation, and changes the navigation chart with a tight budget, a renewed leadership and a focalized scope, while dealing with financial, legal and organizational problems left by his younger brother.

This case describes internal and external factors that affect the business and the following strategic actions drawn by the main characters to keep the business through an unfavorable and restricted environment. This case can be used as an example to discuss and analyze external and internal conditions that affect a business, or as an introductory case of generic strategies that result from a strategic analysis.

**Objective**: This case contributes to develop undergraduate and/or graduate students' critical and strategic thinking in introductory business strategy courses through the story of a family-owned coffee plantation in Colombia, under a changing and competitive environment.

**Topics of the Case**
- Analysis of the external environment.
- Analysis of resources, capabilities and distinctive competencies that give a competitive advantage to an organization.
- Generic business strategies.

**Other potential issues:**
- Leadership and management of people
- Family Business Management

**Suggested Reading prior to the case discussion**
- Porter, M. E. 1997. What is Strategy?, vol. 75: 156-157: Harvard Business School Publication Corp.
- Porter, M. E. 2008. The Five Competitive Forces that Shape Strategy. Harvard Business Review, 86(1): 78-93.
- Collis, D. J. & Montgomery, C. A. 2008. Competing on Resources. Harvard Business Review, 86(7/8): 140-150.
- Magretta, J. The five forces competing for profit, HBR Press, 8889BC

**Assignment Questions**
1. Develop an economic analysis of the situation of the coffee sector in Colombia between 1970 and 2012.
2. What internal and external factors affected both positively and negatively the first generation of Hacienda Flandes, between 1970 - 2000?
3. If you were Carlos Jr., what would you do if you get the farm back in the same conditions that he receives it in 2000?

**Case A Discussion**

The instructor may start the discussion with the formulation of a general question for Hacienda Flandes environmental analysis.

1. **Develop an economic analysis of the situation of the coffee sector in Colombia between 1970 and 2012.**
It is suggested to emphasize on the information presented in Exhibit 1 and to analyze the impact of international prices on farmers' purchasing power in the last 40 years. For example, information from Exhibit 1 shows that in 1977 (during the coffee boom), a load of coffee had a purchasing power equivalent to 3.5 minimum wages and for 2012 the same amount only had the purchasing power of one minimum wage.

**2a. What were the external factors directly or indirectly related to the coffee industry that affected the farm during the first crisis (1970 - 2000)?**
Students can work in groups and categorize the environmental factors in general without categorizing them. Then the instructor can synthesize, naming each category and discussing using the PESTLE[p] tool and explaining the contribution of this analysis to the development of a generic business strategy (This is not a comprehensive list).

**External Factors (Overall Environment)**

| POLITICAL | ECONOMIC |
|---|---|
| • Coffee Pact (1962-1989) and OIC (1963).<br>• Developed countries (buyers).<br>• Producing developing countries<br>• Regulatory coffee export quotas.<br>• Lobbying: Toasting companies VS producer countries.<br>• Definition of the policy for coffee production and marketing.<br>• Coffee tax in Colombia (1927). | • Governmental stabilization plan (1978):<br>• Increased reserve requirements to 60%.<br>• Restriction on foreign capital inflows.<br>• Restriction of private external debt.<br>• Coffee price is set internationally.<br>• Exchange rates modified the revenues of producing countries.<br>• Market controlled by buyers.<br>• Formation of FNC to manage the income of the farmers.<br>• Global Excess inventories of coffee. |
| **SOCIAL** | **ENVIRONMENTAL** |
| • Formation of FNC to promote social development and infrastructure in the areas of influence.<br>• 500,000 families in Colombia dependent on this production. | • Rust Disease (1983)<br>• Plague of the coffee berry borer 1988)<br>• Brazilian Frost (1977) |
| **TECHNOLOGICAL** | **LEGAL** |
| • Formation of CENICAFE for research and dissemination of scientific and technological knowledge. | • Phytosanitary Controls<br>• Export regulations |

**2b.) What are the external factors directly related to the coffee industry that affected the farm during the first crisis (1970 -2000)?**
To develop an analysis of the external factors of the industry, it is suggested to guide the discussion with the analysis of Porter's five forces[q] and how they affect market prices and / or production costs. Here we present different factors as positive or negative that demonstrates each force relative power in the industry.

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p Hitt, M., Ireland, D. y Hoskinsson, R.(2011).*Strategic Management: Competitiveness and Globalization.* Canada: South-Western, CENGAGE Learning, 9° Ed.

q Porter, M. E. 2008. *The Five Competitive Forces that Shape Strategy.* Harvard Business Review, 86(1): 78-93.

(-)Strong brand presence (- -)Big capital requirement (- - -)Governm

**Bargaining Power of Customers** Consumers negotiate sales price and coverage guarantees (- - -)Great toasters concentrated in developed countries with oligopoly power (- - -)

ety (+)Providers with reasonable prices, short lead times and high inventories of agricultural products (+)Proximity to the producing farms (+)Large farmers can integrate backwards to reduce

**of Substitute Products** Presence of substitute products such soft drinks, tea and energy drinks (-)Much aggressive advertising and market penetration (-)Diversity of products based on c

**2) What were the internal factors affecting the competitiveness of the farm in the first crisis (1970 - 2000) and why?**

You can ask students to first numbered and justify **the positive resources and capabilities that the farm has** in terms of competitive advantage (what are strengths and their relation to the market).

**Resources:**

- Recursive and autonomous foreman: He has the experience and commitment to work for the interests of the farm, looking for ways to cut costs.
- Fertile and suitable land for various crops: The land has some physicochemical elements that make it special to plant different types of crops (corn, coffee, beans, banana, etc.) using fewer fertilizers than usually recommended, which reduces production costs.
- Privileged Physical location: The property is located at the edge of road, 7 km from the village, which makes the cost of transportation not so expensive and accessible.

**Capabilities:**

- Strong emotional bond between owners and employees. This emotional bond allows developing complex projects with commitment and diligence.

After this analysis, the instructor may ask students to number resources and capabilities **that the farm does not have** and **that are key** in terms of competitive advantage.

**Resources:**

- Working Capital: The lack of working capital limits the ability of operation and development of new crops.
- Rust resistant varieties: The lack of acquisition and renovation of new varieties of coffee, exposes the farm to diseases and pests.
- Preparation and maturity: The second son of the third generation lacks these intangible resources

**Capabilities:**

- System and management control: The lack of system and administrative controls of costs lead to the deterioration of the business incurring in more costs and less revenues.

- Efficient planning of activities: The lack of planning leads to resources not well invested and the cost-benefit relationship deteriorates.
- Innovation in the business processes: There are not stimuli that generate changes in the way they plant, it is held or the crop is harvested.
- Leadership: The lack of leadership from the owner creates a crisis staff "What do we do now?" ending in the collapse of the farm.

2. **Briefly, which do you think the key external and internal factors are, and at level they best describe the situation of the Hacienda Flandes in 2000?**
The synthesis of the discussion in class of the factors above, may be done through a SWOT[r] matrix to identify Strengths, Weaknesses, Opportunities and Threats, and rank them (See chart)

[illegible]

[illegible] diversification. Development of non-traditional crops. Development of agricultural products with higher added value. Developing new sales channels. Certified as a [illegible]

[illegible] Climate changes. New types of diseases and pests. Volatility of domestic coffee price. Increased costs of herbicides and fertilizers. Increased costs of labor. Revalua[illegible]

**3. Make a summary of the status of the farm. (This is not a comprehensive list)**

- There is no cash flow.
- There is no working capital.
- There is no production.
- High indebtedness and financial limitations for accessing credit.
- The purchasing power of a load of coffee is at the lowest level in 30 years
- There is not enough staff to handle all the work on the farm.
- The farm has a single crop.
- The variety of coffee is not rust resistant.
- There is a lack of direction and leadership.

**4. ¿What would you do if you were Carlos Jr.?**
According to the analysis above, Carlos Jr. must pursue a defense strategy of costs as their immediate need was to pay debts and save the farm. Students may suggest differentiation or diversification strategies, but thinking about this type of strategies, given the critical situation of Carlos Jr., is very difficult. Whenever a strategy is proposed, the instructor may use the SWOT matrix and ask the group, is this feasible given these conditions?

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**Case B Discussion**

**Assignment Question**
If you were Carlos Jr., what would you do if you get the farm back in the same conditions that he receives it in 2000?

As part of the activities and readings, the instructor should give the students the Case B (5 pages). After reading it, the discussion may focus on an analysis of the elements used by Carlos Jr. to face the first crisis.

**1. What did Carlos Jr. do to face the first crisis (2000 - 2005)?**
The instructor may compare what students answered in Case A versus what Carlos Jr. actually does:

- Turning the fixed costs of labor into variable costs changing the amount of people per week, according to the cash flow of their work and income of the farm.
- Finding new ways to reduce the variable costs of planting and maintenance of planting (as germination modification, changing mixes of fertilizers and focusing the use of herbicides to control weeds).
- Planting other crops like corn and beans.
- Planting new varieties of coffee which are leaf rust resistant.
- Avoiding the use of insecticides to promote biological controls to control the coffee berry borer.

Then, the instructor may request that in groups of two or three students they solve the following questions and discuss them in class plenary.

**2. Are there new external factors that positively or negatively affected the strategy of Miguel?**
The political, economic and social situation is very similar to case A, however, at the environmental level, the rainy season of 2010 really affected negatively Miguel. Apart from this, the focus of case B should be on the internal analysis.

**3a.) What were the internal factors that led to the second crisis of the Flandes Farm during the second administration from 2005 to 2010?**
**Resources:**

- Recursive and autonomous foreman: The foreman loses autonomy being subject to the orders of the owner who permanently surveillances him.
- Leadership: As the farm begins to decay, the owner loses the leadership and the employees lose the north.
- Product Diversification: Diversification projects that have the function of reducing costs and increasing revenues, they all fail.
- Working capital: the financial resources to pay the costs and to invest are lost, which unbalances the business.

**Capabilities:**

- Control and management systems: Although the manager was in the farm, the cost control and cash flow management was poor.
- Emotional bonds between the owner and the workers: The link is lost and therefore the commitment of workers and the incentive to work due to the lack of motivation.
- Efficient planning: Activities planning is no longer coordinated and aligned with the business.
- Limited sales channels: With few sales channels, the farm loses competitiveness to negotiate better prices for sale.
- Innovation production processes: No spaces are created to change the traditional practices of the farm's operation.

**3b.) What did Carlos Jr. have to do to face the situation of the farm in 2010?**
Carlos Jr. has the same resources and capabilities as defined in case A, and one should further incorporate the following:
**Resources:**

- Crop Diversification: By diversifying, the sources of revenue increased and reduced the fixed maintenance costs increasing cost-benefit.

**Capabilities:**

- Capability to associate with manufacturers of essential oils: Allowing them to enter a new market with higher value added.

- Strong emotional bond between owner and workers: the emotional bond was restored and the incentive to work recovered due to the motivation, rather than salary.
- Process innovation capability: Creating new ways to keep crops reducing the labor costs and increasing the efficiency

**4. Make a list of problems that summarizes the status of the farm. (This is not a comprehensive list)**
- There is no cash flow.
- There is no working capital.
- There is no production.
- There is a high debt and financial limitations in accessing credit.
- There is not enough staff to handle all the work on the farm.
- The farm does not have a monoculture, but the crops are damaged.
- The internal road from the farm is collapsed.
- The houses of the farm need to be repaired.
- There is a lack of direction and leadership.
- There is a general demotivation of the staff.

**5. What actions did Carlos Jr. follow to face the second crisis?**
On the second occasion, Carlos Jr. followed these actions to reduce costs and to diversify:

**Actions aimed at reducing costs:**
- Making strategic alliances with third parties to clean and sustain the crops of coffee without incurring in additional costs.
- Restructuring Miguel's debts with financial institutions for a longer term and lower monthly payments.
- Increasing and focusing in the use of herbicides to reduce the cost of labor.
- Accessing to coffee benefits, such as fertilizer subsidies and free technical support through its association with coffee guild.

**Actions aimed at diversifying and increasing the added value:**
- Diversifying the coffee plantations with banana, plantain, macadamia, castor oil plant, sacha inchi, cacao and citrus (tangerine, lemon, orange).
- Working on the Internet as a new sales channel to reach the final customer.
- Alliancing to extract essential oils of macadamia, sacha inchi, castor oil plant and coffee.
- Buying a machine to split the macadamia and to be able to sell it roasted and carameled.

**Conclusions**
- Emotional ties between owners and employees are drivers of excellence. These ties give the farm a competitive advantage. For example, the psychological contract between Chucho and Carlos Jr. let the business model to be viable in more than one opportunity.
- Businesses may be reinvented despite the greatest adversities. Opportunities for innovation and change can be found.
- Vision, strategy, long-term commitment and a good administrative and financial management of the business are key factors to survive in time. For example, Carlos Jr. went from a monoculture to have a portfolio of traditional and nontraditional products diversifying costs, increasing revenues and mitigating risks.
- Adversity may come from external or internal factors; it is important to detect, analyze and associate them to the business in order to face them.
- Cash flow constraints in small businesses may be seen as opportunities for being more efficient and resourceful.
- To be more competitive is important to look for new sales channels, differentiated or diversified portfolio of leveraged products in the capabilities and resources of the company products.
- Other alternatives aimed at reducing costs consist of innovating process and creating strategic partnerships that complement the business strategy. For example, the arrangements that Carlos Jr. made with the corn and bean farmers in exchange for keeping the coffee crop weed free.

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