

## How Important Is the Coffee Bean in Determining Costs?

The coffee bean is clearly an important part of the cost of packaged ground coffee—but how important? In 1997, the total value of U.S. roasted coffee shipments was about \$6.8 billion (U.S. Census Bureau, Census of Manufacturers, 1997). Materials—including coffee beans, packaging, and fuels—accounted for \$3.88 billion, while total labor costs were \$317 million. Green coffee beans alone cost \$3.15 billion.<sup>5</sup> Since average manufacturer prices were approximately 23 cents per ounce in 1997, this implies that approximately 11 cents per ounce was spent on coffee beans, 3.5 cents on labor and other materials costs, and 9-10 cents constituted the average gross margin.

By 2002, the total value of roasted coffee shipments had fallen to \$3.93 billion, according to the Census of Manufacturers. Materials costs were \$1.96 billion, of which green coffee beans alone accounted for \$974 million. Labor costs were \$299 million. Since the average manufacturer price was 17 cents per ounce in 2002, this implies that approximately 4 cents per ounce was spent on coffee beans, 5.5 cents on labor and other materials costs, and 7-8 cents constituted the average markup. Evidently, the dramatic changes in commodity prices between 1997 and 2002 had a substantial impact on the share of marginal cost accounted for by coffee beans.

The manufacturer's gross margin, defined as the difference between a manufacturer's selling price and the manufacturer's noncapital costs, can be estimated using the Annual Survey of Manufacturers data from the coffee and tea category and dividing the value of total shipments minus material and labor costs by the value of total shipments (table 1).<sup>6</sup> Comparing these estimates with figure 1 indicates that manufacturers' gross margins tend to be particularly low when commodity prices are high (e.g., in 2000) and particularly high when commodity prices are low (e.g., in 2002).

Table 1  
**Coffee and tea manufacturers' gross margin**

Year	Average gross margin
	<i>Percent</i>
1997	39
1998	40
1999	39
2000	39
2001	40
2002	44
2003	35

Source: Authors' analysis of U.S. Census Bureau's Survey of Manufacturers coffee and tea data.

<sup>5</sup>One problem with Census of Manufacturers data from the U.S. Census Bureau is that it is not entirely clear how firms report the cost of green coffee beans used in a particular year. These reports probably reflect historical costs, whereas the relevant statistic from the perspective of economic models of pricing is typically replacement cost.

<sup>6</sup>These estimates are somewhat imprecise because tea is included in the coffee and tea category.