

Tea Industry

A Competitiveness Strategy for Sri Lanka's Tea Industry

Developed by The Tea Industry Cluster



Supported and funded by The Competitiveness Initiative, a joint project of the United States Agency for International Development (USAID), Nathan Associates Inc., and J.E. Austin Associates.

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The purpose of this report is to bring about change resulting in tangible benefits to stakeholders in Sri Lanka's tea industry. It presents assessments of opportunities for and constraints on achieving competitiveness and a competitiveness strategy. The recommendations herein chart a path for growth that can resolve near-term barriers and set the stage for medium-term and long-term progress in the tea industry.

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Executive Summary

The competitiveness of Sri Lanka's tea industry is critical to the country's economy. It is Sri Lanka's third largest agricultural industry and second largest exporter, generating US\$673 million in 2000. It also contributes to political, economic, and social stability by providing a livelihood for many of Sri Lanka's rural dwellers, especially women.

Shipping roughly 21 percent of international trade in tea, Sri Lanka is the world's largest exporter. Since the mid-1990s, it has received higher prices than other origins and adds more value between the auction and the port than other tea-producing nations.¹ Its main product is orthodox tea, 90 to 92 percent of which is exported. Ninety percent of exports are in packet form for eventual consumption as loose tea, or in bulk shipments, most of which is further processed, blended, or packaged offshore.

Despite holding nearly one-third of the orthodox tea market and enjoying attractive prices in recent years, the industry is still subject to volatility and long-term price pressures. New entrants such as Vietnam and Malawi, enjoying a comparative advantage in factor conditions, will offer stiff price competition. The Sri Lankan industry, however, has demonstrated its ability to compete by shipping higher quality and higher-value-added products.

To become more competitive, the industry must build on its historic strengths to develop brands, forge marketing alliances, and move closer to the end-consumer in its target markets. Doing so will help shield the industry from price volatility while creating value in the market. In response to these issues, members of the tea industry have devised a strategy for repositioning the industry in world markets. This strategy will be pursued through five strategic initiatives:

¹Weighted average free on board (FOB) price for all teas at the main ports of shipment.

- Position the Industry Closer to the Consumer
- Forge Alliances with National Marketers of Ceylon Tea-rich Blends
- Launch a Rediscovery of Ceylon Teas
- Develop the Workforce
- Restructure the Public–Private Partnership

The first initiative will capture value through branding; the second will use alliances to boost demand for Ceylon-rich teas in target markets; and the third will market Ceylon-rich blends directly to end-consumers through teahouses while building a market image for the teas. These three initiatives will require consumer research, market development, efficient logistics, and streamlined import and export procedures. To support these needs, the fourth initiative will promote the improvement of managerial, marketing, quality control, logistics, and other technical skills; and the fifth initiative will seek to streamline activities from the estate to the shipping point and increase private sector responsibility for research and promotion.

These initiatives are important first steps in strengthening the long-run competitive position of the tea industry. They will create additional value for customers in target markets, increase industry sales and profitability, and make growers, employees, and stakeholders less vulnerable to price volatility.

In arriving at this strategy, the Tea Cluster has operated as an industry forum pursuing the best interests of the industry and has reached consensus on many issues. Two issues remain unresolved—the import of orthodox teas from other origins and privatization of the monitoring of teas before export. Reaching agreement on the import issue is a specified goal. The privatization of monitoring is still being debated.

The Competitive Environment of the Tea Industry

The Sri Lankan tea industry is critical to prosperity in Sri Lanka. Introduced commercially in 1867, tea has been important to the country's economy for 135 years. In 2000, it accounted for 13 percent of Sri Lanka's merchandise exports and earned US\$673 million.² As the country's third largest agricultural industry—representing 9 percent of agricultural GDP and 1.2 percent of overall GDP—it has a disproportionate impact on the economic and social welfare of rural residents. It provides income for smallholders and plantation employees, slows rural-urban migration, and provides a special opportunity for rural women, giving them a place in the workforce and a way to contribute to the livelihood of their families. As such, the tea industry is one of the most important contributors to rural prosperity in Sri Lanka and its competitiveness is of national interest.

The tea industry believes that it can reinforce its competitive position as a provider of premium products and seek opportunities to create additional value through branding, strategic alliances, and closer linkages to consumers. It also believes that the Sri Lankan tea industry can maintain its position as the world export market leader for quality tea by being responsive to changing consumer needs and continuing to upgrade and innovate its products and services to meet those needs, generating prosperity throughout the industry value chain.

The strategy presented in this report is based on a two-year iterative process involving industry members and international agribusiness experts. The process included a review of

²Tea was Sri Lanka's leading export until the 1980s, when it was surpassed in net contribution by apparel. Export values for apparel exceed those for tea by 4:1, but the difference in net export earnings is smaller. In 2000, the apparel sector added locally just under 50 percent of total export values (down from more than 60 percent in 1996); tea adds locally between 75 and 85 percent of the export value.

customer and market trends, an examination of the industry's competitive positioning, and the development of strategic initiatives to begin implementing the industry's strategy. This report reflects views expressed during debates among industry members. Two issues remain unresolved: (1) the import of orthodox teas from other origins, which pits exporters against plantation management companies; and (2) the extent of privatization of cess-funded institutions. The status of these issues is presented in Appendix A.

MARKET TRENDS AND COMPETITIVE POSITIONING

Global Market Context

On average, human beings consume about 176 liters per year of purchased beverages; in the United States annual per capita consumption is climbing to 650 liters.³ Tea represents 21 percent of worldwide human consumption of purchased beverages. The remaining 78 percent consist of milk (20 percent), carbonated beverages (17 percent), beer (14 percent), and coffee (11 percent) with bottled water, juices, sports and energy drinks, wine, and spirits making up the balance.⁴

Assuming developing countries become more affluent, overall demand for purchased beverages can be expected to grow at a slightly higher rate than the population. But affluence also affects what is demanded and its form. For example, as incomes rose in developed markets, refrigeration became widespread and the manufacturers of carbonated beverages and juices aggressively advertised their products. Consumers shifted from "hot and bitter" drinks, such as tea, to "cold and sweet" drinks, such as carbonated beverages and juices.

Affluent consumers in developed markets also feel time constraints. They prefer beverages that require little or no preparation and now spend equal amounts on food and beverages at home and away from home. To ensure consistency, food service providers require a simple way of serving beverages, an especially challenging task with infusions, such as tea.

Tea is the principal beverage in Asia, the Commonwealth of Independent States (CIS), the Middle East, North Africa, and is also drunk widely in developed British Commonwealth countries—Australia, New Zealand, the United Kingdom, and, to a lesser extent, Canada. Coffee is preferred in the United States, Western Europe, and Latin America. Teas and coffees in these markets vary widely in price and quality, with some used as a quick, inexpensive stimulus and others as premium brew for special occasions.

³Economic Research Service of the United States Department of Agriculture.

⁴"The Battle for Share of Throat," *Ferment*, June/July 1999. Research cited in the article was conducted by Canadean Ltd., a market-research company in the United Kingdom.

How tea is prepared also varies by market and region. The tea industry has a small number of products that compete with “cold and sweet” and “ready-to-drink” beverages. In the United States, companies offer bottled and canned iced tea, usually sweetened and flavored. In East Asia, both hot and cold tea is available from vending machines that mix a tea essence with water. In both cases, marketers are targeting young adults, many of whose parents do not drink infusions and who must be introduced to tea for the first time. Rising health consciousness is also conditioning the market for tea. Tea preparation involves boiling water and so purges pathogens normal to tap water in many countries, and antioxidants in tea (flavonoids) might play a role in cancer prevention. In addition, the recent “Rotterdam Study” found that drinking tea may reduce the risk of arteriosclerosis and another study by Boston University School of Medicine concluded that drinking up to four cups of black tea per day improved blood vessel function in those suffering from coronary artery disease.⁵

Sri Lankan Market Context

Sri Lanka is the world’s largest tea exporter with a 21 percent global export market share. Kenya, which produces mainly cut, tear, and curl (CTC) tea—used in tea bags—has a similar market share, in most years just below Sri Lanka’s. Total world tea production in 1999 was 2.7 million tons. Of this, about 44 percent was CTC tea and 31 percent orthodox tea, with green tea making up the balance. Sri Lanka competes mainly in the orthodox tea market where it has a 32 percent market share and is the leading producer.

Sri Lanka receives a price premium for tea relative to most other exporting countries. Analysis of the average free-on-board (FOB) price for tea exports—a more relevant statistic than auction prices—shows that in the last half of the 1990s Sri Lanka achieved a higher price than other supplying nations. Sri Lanka’s relative prices improved in the 1980s and 1990s thanks to government reforms allowing for greater private sector initiative, opening of the CIS market, and the impact of El Niño in Africa in 1992.

Sri Lanka adds significantly more value post-auction than do other tea-producing countries. For example, exporting tea in packets instead of bulk adds value to orthodox tea. An analysis of the differential between FOB export prices and local auction prices in India, Indonesia, Kenya, and Sri Lanka reveals that the Sri Lankan tea industry adds more value by packeting and bagging than do competing countries.

Ten percent of Sri Lanka’s export value is in the form of tea bags or instant tea. Although Sri Lanka is in a leading position for quality orthodox teas, the value of its exports is still

⁵These comments borrow from, “Black tea helps arteries expand,” which appeared in *USA Today* (November 13, 2000) and excerpts of research results circulated at a meeting of the American Heart Association held in New Orleans, Louisiana, November 12, 2000.

subject to price swings similar to those in commodity markets. Market prices in recent years have been attractive, but it is believed that the real price of tea has declined over time. And, as always, some producers are willing to compete on price by accepting lower returns. As more and more producers are attracted by the premium prices paid for Ceylon teas, competition will increase and limit Sri Lankan margins. For example, reports indicate that Vietnam is seeking to increase its tea exports to improve economic livelihood in mountainous regions. Its tea factories have consciously emulated Sri Lanka's manufacturing style. The challenge for Sri Lanka's tea industry is to differentiate and add value to its products, thereby minimizing the impact of price swings and decline and benefiting from stable wholesale prices.

Average yields of green leaf in Sri Lanka, while improving, are significantly less than in Kenya.⁶ The recent privatization of the management of tea estates appears to have boosted industry efficiency, while the smallholder sector continues to be more productive and now accounts for more than 60 percent of production from 40 percent of the area planted to tea.

Strengths, Weaknesses, Opportunities, and Threats

The strengths of Sri Lanka's tea industry include nearly perfect climate, historical skills base, good supporting infrastructure, worldwide reputation, the presence of research and development (R&D) institutes, and knowledge of current markets. Weaknesses include a lack of strong brands, the migration of locally owned processing plants because of restrictions in Sri Lanka, the modest capital base and small scale of many independent tea factories and export operations, and separate identities for producers and exporters. In addition, local investment capital is scarce and interest rates for traditional bank loans are prohibitively high.

Opportunities include growing interest in tea as a natural and healthful beverage, the willingness of some consumers to pay for a differentiated product, and possibilities for adding services to "distributor-owned brands." Threats include continued price pressure, investments in competitor countries, and potential new entrants from low-income countries such as Malawi and Vietnam.

Competitiveness Analysis

Sri Lanka has excellent basic factor conditions for the tea industry. Its great variety in weather and soils has given rise to six major and many minor agroclimatic zones.⁷ Plantations in Sri Lanka, a small island, have easy access to Colombo via a network of all-

⁶In 2000, the average yield in Sri Lanka was 1.45 tons per hectare, in Kenya it was 2.12 tons.

⁷The six major agroclimatic zones are Nuwara Eliya, Uva, Dimbula, Ruhuna, Kandy, and Uda Pussellawa.

weather roads, in contrast to other countries where tea is grown far inland and must be hauled long distances to ports. Colombo's geographical position makes it a potential transshipment point. The industry has explored the possibility of expanding Colombo as a regional service provider (a "tea hub"), importing teas from other origins, then adding value by blending, packaging, and reshipping.

The industry, however, has not been able to make the most of these conditions because *it has not positioned itself but has been positioned by others*. For example, multinational companies tend to mediate among themselves, retailers, and consumers. But the Sri Lankan tea industry has little capacity for monitoring consumer trends in the most lucrative markets. It has also been slow to innovate, upgrade, add value, and move closer to consumers. Most Sri Lankan exporters focus on bulk tea and compete on the basis of price, rather than product development, innovation, or specialization. Even where exporters own a brand, they rely heavily on distributors in the overseas markets served. And only a few Sri Lankan-owned brands have been launched overseas.

Public sector participation in the tea industry has not always promoted international competitiveness. The government assesses the industry to fund R&D at organizations that research and promote tea, but many industry leaders believe that these organizations have not always responded strategically or effectively to the industry's practical, commercial needs. More information and marketing services could strengthen the network of related and supporting industries.

In addition, the industry is still recovering from an era of nationalization, and government policy has often been paternalistic and sometimes politically motivated, especially where it affects numerous rural constituents, such as smallholders and plantation employees. Certain government policies hamper competitiveness directly, for example,

- Government control of the Tea Board denies the industry full control of its future;
- An insufficient share of the funds earmarked for the Ceylon Tea Promotion Bureau is spent on promotion and defense of the term "Ceylon teas" and the lion logo;
- The Tea Commissioner's monitoring of tea export quality restricts exporter flexibility and raises costs;
- The Tea Research Institute spends a significant portion of its budget on issues related to the life chances of rural dwellers and does not concentrate adequately on new production techniques and products;
- Export documentation and bureaucratic procedures are excessive and computerization of the customs process has bogged down;

- The harmonized system of customs codes for tea does not match industry practice and parlance;
- The ineffectiveness of the government in negotiating equitable trade agreements and its inaction—as a member of the World Trade Organization—in defending the industry against discriminatory tariff regimes on processed products, deters further processing in Sri Lanka; and
- The scope of services offered to distributor-owned brands is inadequate.

Sri Lanka is the world's leader in tea exports and is especially strong as the main provider of teas to the traditional tea-drinking markets of the Middle East and the CIS. But international tea marketers have positioned Sri Lanka, like other producing countries, as a supplier of bulk teas. Using further processing and branding to go beyond this assigned role, several Sri Lankan companies have gotten closer to the consumer, captured additional value, and have begun escaping vulnerability to price pressure.

THE COMPETITIVENESS STRATEGY

The competitiveness strategy for Sri Lanka's tea industry takes into account customer and market trends and the industry's competitive position. The strategy is to *reinforce the industry's competitive position as a premium player and seek opportunities to create additional value by repositioning the industry through branding, strategic alliances, and closer linkages to consumers*. The strategy also calls for positioning the industry as the world export market leader for quality tea by being responsive to changing consumer needs and then upgrading and innovating products and services to meet those needs, thereby generating prosperity for all industry stakeholders.

The Competitiveness Goal

The competitiveness goal is to maintain the position of Sri Lanka's tea industry as the quality leader in the orthodox tea market while generating additional value through branding, strategic alliances, and forward integration closer to the end-consumer. The industry will achieve this goal by selling

- Good Ceylon teas from the six agroclimatic zones in the small, specialty tea segment;
- Branded Ceylon teas in consumer packs in the mass market; and
- Blended Ceylon teas in bulk, packets, cartons, or tea bags to national and multinational marketers of Ceylon and other teas whenever Ceylon teas provide the blend's character.

At the same time, the industry will continuously improve the growing, manufacture, valuation, blending, handling, and storage of tea between the estate and the port,

increasingly meeting the needs of the market at lower cost. Progress will be measured by the value the industry generates for its workers and enterprises and for those contributing critical input and services. This value can be measured by

- Exports and share of market (volume and value),
- Price premiums relative to other producing countries,
- Percentage of Ceylon tea sold in branded products,
- Percentage of tea exports packaged in Sri Lanka,
- Productivity in the industry (values generated per person employed), and
- Improvement in production yields per hectare.

The Strategic Initiatives

The Sri Lankan tea industry will reposition itself in world markets through five strategic initiatives:

- Position the Industry Closer to the Consumer
- Forge Alliances with National Marketers
- Launch Rediscovery of Ceylon Teas
- Develop the Workforce
- Restructure the Public–Private Partnership

The first three initiatives will bring the industry closer to the consumer and enable it to capture the value of branding. They respond to a perceived need to market Ceylon teas vigorously and to move the Sri Lankan tea industry closer to the tea drinker.

The first two initiatives may be viewed as alternative routes to the same end—the *establishment and consolidation of Ceylon tea-rich blends in world markets*. The third initiative—which will support the first by promoting the finest Ceylon teas with a positive image that “pulls up” the price of blends—calls for an innovative approach to promoting Ceylon teas, one requiring an entrepreneurial style of marketing and management quite different from the industry’s current style. These three initiatives build on components of the value chain such as consumer marketing (including market research, product handling, and shipping overseas). Forging alliances with national marketers will require sophisticated management of risk, particularly price risk.

The fourth and fifth initiatives will provide the foundation required by the first three. The fourth calls for improving managerial, marketing, quality control, logistics, and other technical skills.⁸ The fifth calls for simplifying customs procedures and the import and

⁸*Towards the Year 2000* and its 1996 update by the Colombo Tea Traders’ Association view workforce development as a priority.

export process, streamlining internal transportation, and restructuring the Sri Lanka Tea Board, the Ceylon Tea Promotion Bureau, and the Tea Research Institute of Sri Lanka. Restructuring will give the private sector more responsibility for research and market development, specifically strategic research and investment in consumer research and market development.

These initiatives will also

- Increase investment in tea processing in Sri Lanka,
- Increase printing of packaging materials and tea bags,
- Rationalize the use of warehousing space,
- Catalyze the need for a private rail cargo system,
- Streamline container movement through the Port of Colombo, and
- Promote the stability that factories and growers need to invest in raising productivity.

In the long run, the evolution of overseas marketing, local processing, and associated businesses could position Sri Lanka as a regional service and trading center or hub of the world tea trade. Such a center would generate revenue from services that support the first two initiatives—blending and packaging, printing, expanded use of auction market information, and, possibly, logistics and finance.

The Tea Cluster

The Sri Lanka Tea Cluster was the catalyst, moderator, and facilitator of consensus in developing the competitiveness strategy, goals, and initiatives. Formed in response to The Competitiveness Initiative, a USAID-funded project, the cluster includes representatives from every part of the tea value chain—from producers to retailers—and government regulators. The cluster is chaired by Michael De Zoysa, Managing Director of Gordon Frazer & Company, Ltd., and Mahen Dayananda, Chairman of Tea Tang Ltd. The cluster will continue to help implement the strategy by convening producers, manufacturers, traders, and other stakeholders and will facilitate debate and analysis where decisions affecting long-term interests of the industry must be made.

Position the Industry Closer to the Consumer

The industry proposes launching high-quality branded teas of Ceylon origin in select national markets, thereby positioning it closer to the consumer, helping it to escape dependence on commodity-like price swings, and enabling it to capture greater value.

WHY THIS INITIATIVE?

The initiative is compelling for several reasons. First, branding offers higher margins than exports of bulk tea. Second, the initiative will help shelter the industry from price swings and provide some insurance against new low-cost entrants that compete on price. Third, it will permit the industry to add more value in the country, create more jobs, and increase the scale and scope of its sales and profits. By positioning Ceylon tea closer to the consumer, the industry will receive direct signals from consumers, spurring product development and innovation.

This initiative builds on the positive experience of Sri Lankan tea exporters who have launched branded, Ceylon tea-rich blends in markets in Australia, the CIS, and the Middle East. The initiative will also help to stabilize and ensure attractive markets for smallholders and plantation producers who may enjoy long-term relationships with exporters that provide a strong incentive for quality and reliability.

Baseline Advantages

Sri Lanka's tea industry has numerous advantages. Sri Lankan tea has a reputation for quality among connoisseurs; Ceylon tea-rich blends are distinguished for their character in key markets, such as the CIS and the Middle East; and the history of Ceylon tea-rich blends

dates back to Thomas Lipton in the nineteenth century. Sri Lanka's climatic, geologic, and agronomic conditions made possible the range of Ceylon teas available today. Moreover, the industry has a high-quality processing capability among branded tea exporters and access to a packaging industry that can meet world standards. This does not mean, however, that all Sri Lankan companies will follow the same strategy.

Market for the Initiative

The market for specialty tea products is growing faster than the market for mass-market tea. The existence of strong brands established by multinationals demonstrates this demand. In beverage industries the market trend for branded products in developed countries is clear. The United States, for instance, is moving to natural, gourmet, and high-quality beverages after a period of standardizing mediocre and overprocessed beverages for a price-sensitive mass market attuned to convenience. For example, demand for high-end, gourmet brands of coffee, such as Starbucks, is very strong, as is demand for beer brands such as Samuel Adams and microbrewery beers in most major urban centers. And the success of brands such as Snapple signaled a reaction against mediocre iced tea as well as standard, synthetic, carbonated beverages at a time when consumers were turning to natural alternatives, including spring water.

The Sri Lankan marketers of Ceylon tea-rich blends in Western markets have found that their products position themselves in the supermarket above the local Unilever market leader and below the quality leader (i.e., Twinings). This positioning suggests that consumers are willing to spend a few more cents per package for better taste or for unique image. As Sri Lankan brands become more successful, multinational and local marketers are likely to compete by promoting their own Ceylon tea-rich blends. The result: overall increase in demand for teas from Sri Lanka.

This, in turn, argues for some form of collaboration between Sri Lankan marketers with competing brands in the same market, or for a tactical allocation of markets, especially the smaller ones. In the absence of cooperation among exporters, Sri Lankan companies may try to steal customers from one another by offering lower prices, a tactic guaranteed to undermine competitiveness.

In addition, marketers of Ceylon tea-rich blends will need to continuously monitor the market while being especially alert to

- Changes in customer lifestyle that could affect the method and frequency of tea consumption;
- Changes in the environment (i.e., upgrading of water quality, changes in the way employees drink at work);

- Competitive moves by marketers, especially the introduction of product variants or the arrival of fast-food chains that feature a beverage other than tea to accompany food; and
- More stringent health regulations for beverages.

Capitalizing on these changes requires vigilant and creative market intelligence and a “learning organization” capable of absorbing information and responding to it.

Supporting Industries and Services

Three main industries support this initiative—the marketing and advertising industry; the packaging and printing industry, which must be paired with counterparts in overseas markets; and the processing equipment industry, including overseas suppliers of equipment. These industries are in place in Sri Lanka but will need to scale up as other companies launch branded teas.

Organization and Consensus-building

The tea industry is characterized by parallel structures—the traditional, “single component” actors and the “integrated” organizations. The traditional system comprises growers, primary processors (factories), their brokers, exporters, and the agents of overseas buyers. By and large, each participant limits its activities to its own component. Management of companies and the skills of managers and employees are usually confined to these activities. The tea auction, the principal coordinating mechanism between buyers and brokers, reinforces this division of labor.

Some marketers of branded tea products are establishing a presence in all components of the tea system, even agricultural production, which nominally permits them to deliver tea from the “garden to the supermarket.” While this claim attracts consumers (and mimics similar claims by coffee merchants and other purveyors of foods), the variability of tea quality and the inability to accurately predict quality limits the option of bypassing the auction and buying directly from growers, a limitation illustrated by the small volumes actually sold this way. Restrictions on blending in Sri Lanka, however, incline tea marketers to establish processing plants overseas so they can respond flexibly to the market.

POLICY AND OPERATIONAL IMPLICATIONS

The tea industry proposes that an autonomous body be established to continuously monitor industry performance and consistently and systematically address sector issues from an industry perspective. One option is to formalize the Tea Cluster or a similar institution as the industry’s principal forum for setting an industry agenda. This autonomous body would

- Assemble representatives from supporting industries and government;
- Catalyze thinking about competitiveness;
- Facilitate the industry's mission, including promotion of constructive dialogue between different and sometimes opposing components of the industry value chain; and
- Facilitate the development of industry action, management, and operational plans.

It would also develop a work plan of continuing and annual tasks in view of the strategic initiatives proposed in this report. An action plan for a tea industry forum is presented in Appendix B.

Policy

For this initiative, the main purpose of the public–private dialogue between the tea industry and the government of Sri Lanka is to communicate the following ideas:

- Selling predominately bulk tea under an opportunistic system risks export revenues declining along with global commodity prices, forcing growers out of business as the farm-gate price drops below the cost of production.
- Sri Lankan entrepreneurs have shown that they are capable of launching and maintaining branded tea products in a number of markets.
- More resources need to be deployed to increase the export share of branded tea products.
- The Ceylon Tea Promotion Bureau and the Tea Research Institute of Sri Lanka should focus their resources on actions that support the development and promotion of new products.
- New entrants to the sale of branded products should be permitted to form alliances with, merge with, or take over companies in the tea system.
- Streamlining logistics—internal transportation, container movement—de-bureaucratizing import export procedures, upgrading the Port of Colombo, and expanding the financial sector will support further processing and value addition.

Operations

Marketing operations need to be upgraded. Companies will need to be able to analyze distinctive consumer preferences, develop products that respond to those preferences; develop product delivery systems that meet local market practices; field marketing and promotion teams; and collect market intelligence.

At the operational level, companies will require access to packeting and bagging capabilities and inventory control. Procurement capability will need to guarantee consistent access to tea of a type and quality that meets consumer needs in the target market. The industry as a whole will need to conduct R&D to be able to modify products in light of changing consumer tastes, develop new tea products, and pursue innovative brewing methods. Companies will need access to investment and working capital, and some cess funds should be dedicated to strategic R&D and promotion. More sophisticated and professional management skills will be required to plan, implement, and coordinate these operational changes.

In the long run, only two or three brands are likely to survive in each market. Survivors will be successful companies that launched and sustained brands or companies that formed alliances in which the Sri Lankan partner became dominant. Success, however, will be determined by the quality of products and service, not ownership.

ADDING VALUE IN THE BUSINESS PROCESS

As shown in Figure 1, this initiative will affect the procurement, distribution, sales and marketing, customer service, and administrative components of the business process value chain.



Figure 1. Value of Positioning the Industry Closer to the Consumer

- **Procurement.** This initiative will require expert blending and purchasing to maintain the consistency of products at acceptable cost. It should also help develop strong relationships with packaging companies.
- **Distribution.** Strong distribution systems (or logistics partnerships) that consistently deliver the promised product in the promised quantities and on time will be important to this initiative.
- **Sales & marketing.** Sophisticated sales and marketing capabilities, including an excellent knowledge of the consumer, need to be developed at the firm and industry level.
- **Customer service.** Brand management requires close interaction with retailers and a timely feedback loop from the consumer. Post-sales customer service and an ability to

respond quickly to customer complaints and needs will protect brand reputation. Also, a good customer service mechanism will facilitate the collection of information for sales and marketing and indicate market shifts.

- **Administration and management.** Proper handling of the influx of customer data generated by a strong brand strategy, combined with the complex systems for procurement and distribution, will lead to more sophisticated monitoring and administrative procedures and better management technology.

INDICATORS OF SUCCESS

This initiative and the next have similar benchmarks. These include (1) the price premium over market commodity leader, coupled with market share in each market or market segment; (2) the percentage of Ceylon tea sold in branded products; and (3) the percentage of branded products sold that are packaged in Sri Lanka.

ACTIONS

To begin pursuing this initiative, Sri Lankan companies must form groups consisting of exporters and plantations that have previously agreed on launching brands. Such groups should have a good mix of management skills and experience, be involved directly in the entire tea system, and pool their financial resources. The groups would define joint values and the roles of collaborating executives. These groups would then

- Identify favorable markets for launching a Sri Lankan brand. An ideal market would be growing with no dominant players and an import regime that does not discriminate against further-processed teas. The most promising markets are in the Middle East and North Africa.
- Select one or two potential markets and conduct detailed market research and tests of proposed products. The willingness of the Ceylon Tea Promotion Bureau to support market entry will be important.
- Identify reliable support partners, including a distributor to handle importation and logistics; an advertising agency to link Ceylon teas with the idiosyncrasies of the national market; and banks in the national market and Sri Lanka. This activity is crucial, especially for a first-time venture abroad.
- Launch a pilot campaign to test the market entry strategy.
- Rollout the product fully, closely monitoring performance and the economic outlook for the country.

TARGETS AND EXPECTED RESULTS

Targets for the initiative include the following:

- Successful launch of one or more brands within two years, preferably in a country that does not have a higher tariff on packeted and bagged tea than bulk tea.
- Increase weighted average value per kilo of branded tea 2:1 above non-branded teas.
- Replicating this process with the launch of additional brands in the coming years.

Expected results include the following:

- Price premium over mass market price leader in the target markets
- Market share in the selected markets
- Greater percentage of all teas sold as branded products
- Higher weighted average FOB value per kilogram of all teas exported
- Higher percentage of teas exported in packets or bags

A timeline for this initiative is presented in Figure 2.

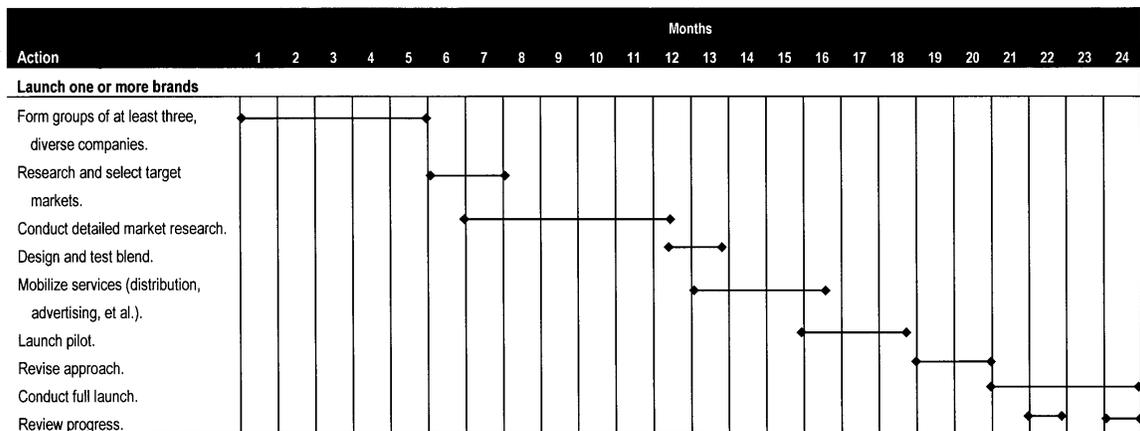


Figure 2. Timeline for Positioning the Industry Closer to the Consumer

Forge Alliances with National Marketers of Ceylon Tea-Rich Blends

The industry proposes that Sri Lankan tea consortia ally themselves with independent, national marketers of tea in selected countries and regions to market Ceylon tea-rich blends. Through such alliances, the Sri Lankan companies would provide marketing services in addition to the procurement, blending, and packaging services they already provide. This initiative moves Sri Lankan exporters closer to the consumer by one component of the tea system.

WHY THIS INITIATIVE?

More than 40 percent of the tea exported from Sri Lanka is shelf-ready, almost all of it in the form of pure Ceylon tea blends. Several Sri Lankan companies have links to overseas companies that specialize in custom packing, some of whom have their own brands. In some markets, this linkage—or relationship to supply a national marketer—may preclude or inhibit a Sri Lankan company from launching its own brand in that market. Custom packing is an acceptable fit with purchasing centered on the Colombo tea auction. This initiative does not require as much change in management attitude and style as the first initiative but capitalizes on industry strength.

In light of the blending practices of marketers, national marketers are likely to require that Ceylon tea-rich blends contain a certain percentage of less expensive similars—at least, at the beginning of the relationship when the marketer is fully in control. A wide range of such teas is produced in South and Southeast Asia, both accessible to Colombo.

When marketers can be convinced to cede control of procurement and blending, the Sri Lankan tea industry is confident that it can improve the quality of custom blends and demonstrate to marketers their greater appeal to consumers. Naturally, this would go hand in hand with appropriate promotion and pricing.

Baseline Advantages

The industry's baseline comparative advantage is built on its position as the world's largest exporter of tea. As a consequence, the industry has a skilled tea blending capability and a high-quality processing and packaging industry that can meet world standards. Increased blending and packaging in Sri Lanka is likely to require

- Improvements in blending operations,
- Logistical improvements in and around the port of Colombo,
- Demonstrating robust performance to national marketers, and
- Eliciting a strong consumer response to better blends.

Specific logistical improvements for the port of Colombo include upgrading its status among ship owners so that it becomes a regular port of call; increasing operational flexibility for imported and re-exported teas as well as traditional exports, which will require a trade-off between timeliness (in having containers alongside to meet carrying vessels) and security; and better use of warehouse space and product control to minimize losses, deterioration, and interest charges.

Eliciting a strong response from consumers to better quality blends will help minimize the risk of national marketers defecting to another packer, or reverting to their own operations. The chances of creating and sustaining such linkages might be improved by allocating markets.

This strategic initiative is more modest than the first, requiring less change in attitudes, but relies heavily on the support of national marketers and is subject to some risk. It may be difficult, for instance, to build longstanding relationships with national marketers, especially in the CIS and the Middle East, especially if they are inclined to follow trends in downgrading tea blends or try to compete with Unilever by emulating it. The security situation will preclude the kind of logistical efficiency required to have Colombo compete with other entrepôts in Europe and the Arabian Gulf, and it may be difficult to lower the cost of working capital to a competitive level.

Market for the Initiative

National tea marketers range from entrepreneurial companies, to family conglomerates, to state-owned enterprises (past and present). Their commitment to blending and packaging in

their own processing plants is also likely to vary, and they are likely to predicate opportunities for custom work in Sri Lanka on increased revenue or volume. National tea marketers have three options: (1) compete on price and position their products as “fighting brands” below the mass market price leader, (2) differentiate their product and position it between the mass market leader and the quality leader, or (3) position it as the quality leader.

Sri Lankan custom blenders and packers will need to define what constitutes value to each national marketer, identify what benefits they bring to the marketer, and package those benefits to suit the marketer. Once an alliance is initiated, a commitment to continuous improvement will require close attention to changes in the way customers perceive value and more consistent and reliable delivery with minimal defects.

Supporting Industries and Services

Three main industries support this initiative—the packing equipment industry, the warehousing and freight forwarding industry, and the packaging materials and printing industry. Sri Lanka depends on India for dryers and Japan for color separators, though a reinvigorated local engineering industry could manufacture both. Similarly, other industries in Sri Lanka would have to expand and upgrade their services as the volume of imported and custom packed tea increases.

Organization and Consensus-building

In the traditional tea system, growers, primary processors, brokers, exporters, and the agents of overseas buyers limit their activities to their own component of the value chain. In principle, any exporter could begin or expand blending and packaging activities without stepping outside its role in the system. Such activity should be based on (1) a comparison of ocean freight, port handling, and processing costs necessary to meet the needs of national marketers; and (2) an appraisal and frequent reassessment of the movement, storage, and blending of teas between factories and destinations.

This initiative appeals more to exporters and traders than others in Sri Lanka’s tea industry. For example, plantation management companies fear that importing less expensive teas from other countries will detract from the image of Ceylon teas and ultimately lower market prices for lower grades and plainer teas. Smallholders would prefer that Ceylon teas and teas of other origin be custom blended in Sri Lanka rather than in another country where operations cannot readily be inspected. Historically, plantations have been suspicious of imports of teas similar to Ceylon teas because they are invariably cheaper and have squeezed out Ceylon teas in many Western markets.

One of the principal tasks in developing this strategy has been to provide a forum where such issues can be openly debated based on a shared understanding of the facts and where reason, not emotion, prevails in decision making.

POLICY AND OPERATIONAL IMPLICATIONS

Policy

For this initiative, public–private dialogue will focus on regulation of the import of teas of other origin to be blended with Ceylon tea for further processing, and the restructuring of the Ceylon Tea Promotion Bureau so its activities support alliances with national marketers. A restructured bureau or its private sector successor would have to agree to share information with a Sri Lankan company's strategic ally.

Operations

Assuming that exporters can obtain tea from other origins without obstruction by government or other participants in the tea industry, remaining constraints include limited processing capability, limited experience dealing with national marketers, the small-scale and modest capital base of many industry participants, and a need to invest in plant and equipment. Specific needs include the following:

- **Operations.** Increased and more sophisticated blending and packaging capacity and greater fluidity in import-blending and packaging and re-export operations.
- **International procurement.** Consistent access to a range of teas requested by national marketers.
- **Marketing** (as applied to at least one market). Evaluation of national marketers and their propensity to purchase custom services; and intelligence on markets indirectly supplied and clients' economic health.
- **Finance.** Access to competitively priced working and investment capital.
- **Management.** Steps to upgrade management and positive attitude to hiring outside the company and even outside the industry.

Urgent needs include assessing existing processing capability, estimating ability to expand in the short-term, and selling to national marketers. In the long run, survivors in national tea markets will be companies that serve a significant market segment and streamline their operations to meet customer needs year after year. In the case of joint ventures, ownership and control are less important than a smooth working relationship between partners.

ADDING VALUE IN THE BUSINESS PROCESS

This initiative will affect the procurement, production, distribution, and sales and marketing elements of the business process value chain (see Figure 3).

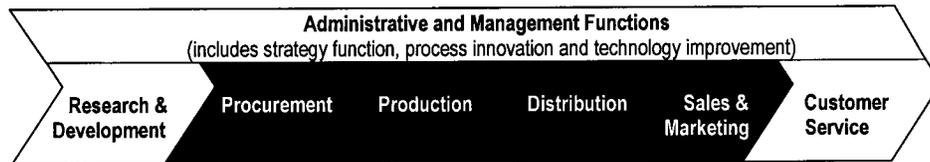


Figure 3. Value of Forging Alliances with National Marketers

- **Procurement.** The initiative will require great flexibility on the supply side and sophisticated systems to manage and grade tea for blending. Obtaining a consistent taste and quality may require the blender to frequently adjust and change purchasing patterns locally and abroad.
- **Production.** This initiative will require ready access to appropriate teas and finely tuned tasting, grading, and blending capabilities to maintain a consistent taste. It will also require significant flexibility in production processes to make blends that match tastes in a wide variety of markets and to adapt quickly to changing needs.
- **Distribution.** As with the first initiative, strong distribution systems that get the right products to the right place, at the right time, and in the right quantity need to be developed.
- **Sales & marketing.** This initiative will require path-breaking surveys and product testing to develop innovative blends and continuing surveys as markets evolve.

INDICATORS OF SUCCESS

The key benchmarks will be (1) volume of tea blended and packed for national marketers, (2) respective market share, (3) share of world custom blending and packaging, and (4) throughput cost for one container of blended tea.

ACTIONS

This initiative appeals to exporters and traders but is best approached through consolidation of the industry value chain. To begin pursuing this initiative, Sri Lankan companies must form groups consisting of exporters and plantation companies with a strong service orientation. Such groups should have a good mix of management skills and experience, be

directly involved in the entire tea system, and pool their financial resources. The groups would define joint values and the roles of collaborating executives. The groups would then

- Identify favorable markets for serving the restaurant, hotel, and institution industry, or for introducing a premium blend at the top end of the mass market. The ideal market would be relatively mature, with established players and possibly an import regime that discriminates against further-processed teas.
- For one or two potential markets, evaluate the national marketers of tea, supermarket chains, restaurant chains, and large institutions to determine their receptivity to a complex service product.
- Conduct detailed research into specific opportunities while researching tea-drinking preferences at home and away from home. This should be a collaborative effort with the Ceylon Tea Promotion Bureau.
- Develop a specific product or service in response to the particular needs and requirements of national marketers.
- Negotiate with prospective national customers, proposing a pilot project followed by an expanded launch.

TARGETS AND EXPECTED RESULTS

Targets for the initiative include the following:

- Initiate at minimum one alliance with a national marketer for a Ceylon-tea rich blend for the foodservice segment within two years.
 - Research and develop a proprietary method of brewing tea in an institutional setting, including the packaging and preparation of the tea and the brewing vessel.
 - Establish a replicable model for such an alliance.
- Initiate an alliance with a national marketer to position a Ceylon tea-rich blend at the top end of the mass market within two years and establish a replicable model for such an alliance.

Expected results include the following:

- Increase in sales volume in the national market
- Increase in market share (if measurable) in the national market by 2 percent
- Higher percentage of exports in a new category or in instant form
- Price premium over mass market price leader in the national market
- Increase market share in the national market by 2 percent
- Higher percentage of teas exported in packets or bags

A timeline for this initiative is presented in Figure 4.

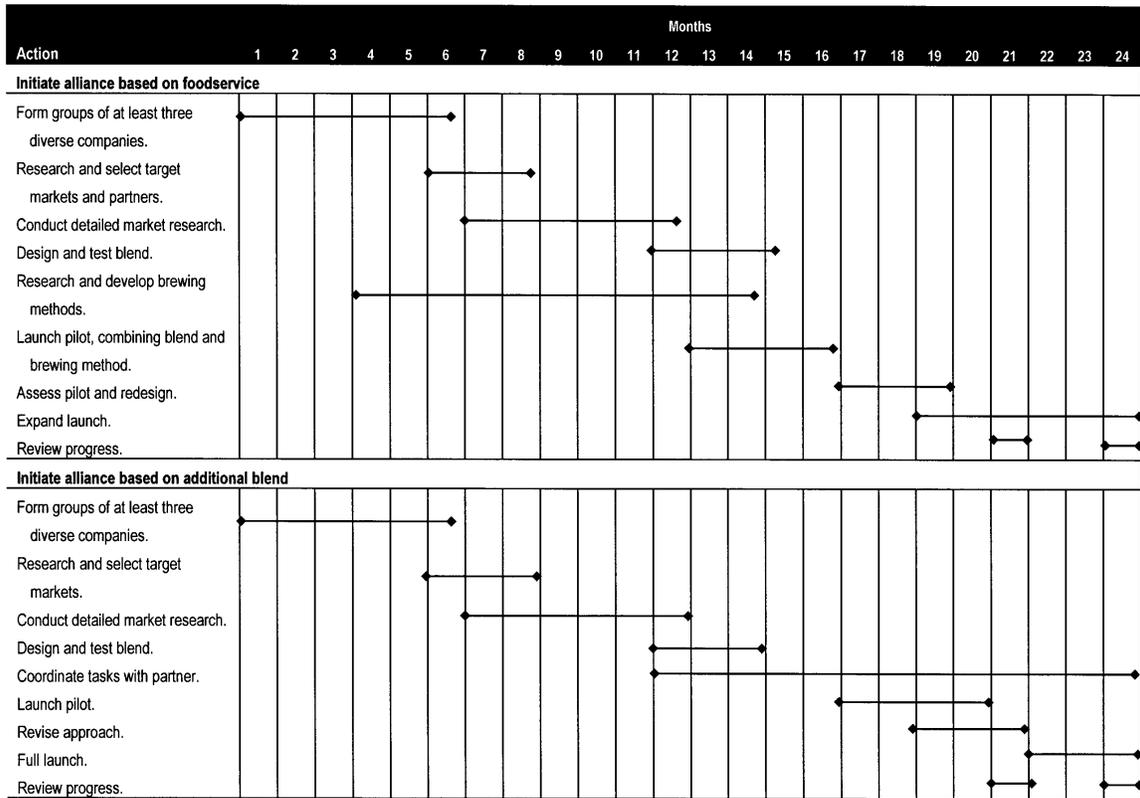


Figure 4. Timeline for Forging Alliances

Launch a Rediscovery of Ceylon Teas

The industry proposes to introduce or reintroduce consumers to Ceylon teas in “teahouses” where they could experience the “romance” of tea in an environment designed around this theme and customized to local tea-drinking customs. By pursuing this initiative, the tea industry and allied state organizations will help position the industry closer to the end-consumer in sophisticated markets and capture value addition while monitoring consumer trends and responding accordingly. The industry will acquaint new generations of consumers with Ceylon teas in unique teahouses similar to coffeehouses, such as Starbucks and Seattle’s Finest in the United States or gourmet coffee bars in Paris that promote Colombian coffee.

The initiative will explore several means of achieving this objective—strategic partnerships with existing franchises such as Starbucks, joint ventures with business groups in target markets, and, in some cases, direct investment in Ceylon teahouses that recreate the unique and exotic location where the tea is grown.

The teahouses will rely not only on the intrinsic quality of Ceylon tea but could also emphasize fair trade practices and culture of a country that has enshrined its social commitment to tea-growing smallholders by providing them with 68 percent of the average auction price of teas from a particular elevation. By building such service components and psychological attributes into the product, the Sri Lankan industry can capture additional value and maintain its commitment to the health, education, and well being of its rural employees, many of whom are women. As Starbucks’ “fair trade” label has shown, Americans and Europeans care about these values and are willing to pay more for products made by people who share them. *Fairness sells*. Sri Lanka already has high standards in this regard—and it is time to let the world know. This can be done only by getting closer to the

consumer. The teahouses could also evoke social life and traditions, selling Sri Lankan batiks, art, music, embroidery, and artisan products to those yearning for contact with a world where there is still time to properly prepare and enjoy a luxurious cup of tea.

WHY THIS INITIATIVE?

Likely to be profitable in its own right, this initiative will also help the industry position Ceylon teas closer to the consumer and defend itself against commodity price competition, while enabling it to exercise more control over its image and the Ceylon brand. The initiative will create an opportunity for learning about consumers and markets, and educating consumers and shaping perceptions. It will provide close linkage to customers by providing them with the direct experience of Ceylon teas and adding value to that experience through appealing intangibles.

The success of similar initiatives in the coffee industry demonstrates that they are feasible ventures in their own right, building demand and persuading consumers to pay higher prices for unique, high-quality products.

Baseline Advantages

As measured by its high market share and by price premiums, Sri Lankan tea already has a clear competitive advantage in premium orthodox teas. Sri Lankan tea gardens that receive international attention include

- Dimbula (Kenilworth, Diyagama, Loinorn, Pettiagalla, Redalla, Somerset, Strathspey, Theresia);
- Galle (Allen Valley, Devonia, Galaboda, Berubeula);
- Nuwara Eliya (Nuwara Eliya Estate, Mahagastotte, Lovers Leap, Tommagong);
- Ratnapura (Ratnapura); and
- Uva (Saint James, Adawatte, Aislaby, Attempettia, Blairmond, Bombagalla, Dyraaba, High Forest, Uva Highlands).⁹

Sri Lanka's underlying climatic, agronomic, and geological conditions result in a range of Ceylon teas that can provide distinct products to different consumers with different tastes, much as customers at Starbucks may prefer Ethiopian, Colombian, or Indonesian coffees for their distinct tastes and aromas.

⁹The estates cited are Sri Lankan gardens recommended by Jane Pettigrew in her book, *The Tea Companion*, Quintet Publishing Limited, London 1997. Except for Mahagastotte, the spellings are Pettigrew's.

The initiative builds on the historical image of Ceylon teas as being of the first rank and Sri Lanka's exotic history and culture. Name recognition for Ceylon teas is sufficient to spark interest in Ceylon teahouses among consumers. In countries where "teahouse" evokes the Victorian era, the concept must be made appealing to a twenty-first century lifestyle.

Market for the Initiative

The potential for Ceylon teahouses varies from country to country. In the major markets for Ceylon teas, CIS and the Middle East, cafe-type restaurants are a relatively easy option for small-scale entrepreneurs. But the life cycle of a Ceylon teahouse will be unpredictable. The attrition rate of single-operation restaurants is very high, and the public eventually grows tired of even the most successful chains. Nevertheless, the initiative will have served its purpose if it succeeds in introducing or reintroducing Ceylon teas to consumers who then become regular drinkers of Ceylon teas.

Supporting Industries and Services

Since franchising cafes falls outside the management experience of most tea companies, promoters of this concept will rely heavily on service companies in law, publicity, restaurant supply, and airfreight, and the recruitment of entrepreneurs and procurement of non-tea items for the Ceylon teahouses.

Organization and Consensus-building

No tea industry participants operate cafes. Some operate retail teashops with tea service offered to customers as part of their operations. The first task will be to explore the concept with experts in beverage house franchising (the CEO of Starbucks for example) in a few key markets to test the receptivity of local chains and entrepreneurs. The next step will be to do a feasibility study of setting up a wholly owned teahouse in key markets—Moscow, Tokyo, London, and New York. The Ceylon Tea Promotion Bureau or in-country donor agency projects might also be able to co-finance such a venture.

The Tea Cluster or a similar broad-based organization could provide an ideal forum for the initial study, planning, and implementation of this initiative and could facilitate contacts with entrepreneurs and franchise organizations in the United States. *Leadership for this initiative will have to emerge early or the initiative will not succeed.* Most companies are likely to support the concept though many may view the business as risky. The test will be whether one or more Sri Lankan companies decides to invest directly in the planning and implementation of this venture in at least one national market.

POLICY AND OPERATIONAL IMPLICATIONS

Policy

This initiative requires action almost entirely from the private sector so policy implications are minimal. If the private sector had more strategic and operational control over the Ceylon Tea Promotion Bureau, the industry could use cess funds for a cooperative investment, lower the barriers to entry, and diminish risk. This raises broader issues—how to promote Ceylon teas or use of the lion logo—related to the use of cess funds for industry development.

Operations

The purpose of the Ceylon teahouse is to promote the long-term competitiveness of the local industry by differentiating the product, building demand in mature markets, and establishing defensible barriers to entry by raising awareness of Ceylon tea-rich blends.

Assuming a market for this kind of teahouse exists in specific national markets, the major constraint is lack of experience in designing and operating teahouses. Participants in the tea planting and trading sectors know little about franchising and serving retail customers in overseas markets. Therefore, identifying strategic partners in these markets will be critical. The first priority is to measure the commitment of tea industry companies to investing time, effort, and money in such a venture and to conducting exploratory conversations with retail, franchise, and beverage experts in target markets.

This initiative requires a thorough appraisal of the potential for a Ceylon teahouse market by market; excellent design skills for the teahouse environment, décor, menu offerings, and presentation; and a viable financial and legal structure for the franchising operation. It also requires the backing of the government's Ceylon Tea Promotion Bureau or restructuring or privatization of the Bureau so that it will be responsive to the initiative.

The funding required would have to be estimated after an evaluation by franchise industry experts in the United States. Estimates will be more exact if similar experts in potential markets are also contacted. At this point, the initial cost of opening such an operation is estimated to require at least \$500,000. In its negotiations with future strategic partners in target markets members of Sri Lanka's tea industry should aim to have those partners partially if not totally absorb this cost.

ADDING VALUE IN THE BUSINESS PROCESS

Tea at the retail level can generate higher sales prices and profit margins than the growing and export of bulk tea. Bulk tea and packeted tea is sold FOB ranging from \$2 to \$3 per

kilogram. When converted into branded tea bags the price ranges from \$6 to \$7 per kilogram. In a teahouse, the selling price would be approximately \$2 to \$4 per tea drink. The case of coffee is instructive. Commodity coffee may be sold FOB today for \$1.35 to \$2 per kilogram, and at a slightly higher range when world prices are higher. Starbucks sells a kilogram of gourmet coffee for \$22 to \$26.

But the real value lies in educating consumers and creating a global brand for Ceylon tea that can translate into higher demand and higher price premiums for Sri Lankan tea. This benefit is what economists call “externality.” Starbucks is making profits on its coffeehouses. But even if it didn’t, producers of gourmet coffee have benefited by the franchise educating consumers, stimulating demand, and persuading people to pay higher prices for higher quality products and services. Therefore, the industry stands to add value in ways that go beyond the value of the tea that actually passes through such establishments.

The focus of this initiative will be on the marketing, management, and customer service segments of the business process value chain (see Figure 5).

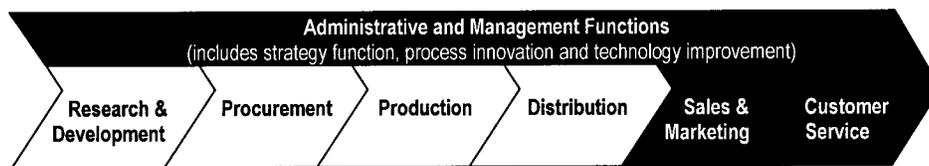


Figure 5. Value of Launching Rediscovery of Ceylon Teas

- **Sales & marketing.** As with brand management, this strategic initiative will require sophisticated sales and marketing capabilities at the firm and industry level.
- **Customer service.** The leap from production and exporting to direct retailing will require impeccable knowledge of the consumer. It may also be an invaluable way to capture knowledge about consumer preferences and anticipate trends.
- **Administration and management** This initiative could turn many members of the Sri Lankan industry from producers, processors, and traders into service providers selling an image, a location, and a product prepared on the spot. This will require significant change in thinking and a flexible management structure.

INDICATORS OF SUCCESS

The key benchmarks for this initiative will be (1) number of customers at each Ceylon teahouse, (2) contribution from each franchisee, (3) free publicity generated by the Ceylon teahouses in each market, and (4) price premiums on Sri Lanka tea exports FOB versus other nations.

ACTIONS

Industry should first hold a workshop to build and test support for the initiative and the teahouse concept. The workshop should result in a list of 8 to 10 geographic markets. Three industry executives should be appointed to oversee the design and implementation of the initiative—one to identify potential joint-venture partners in target markets, one to review the financial cost-benefit analysis, and one to explore sources of financing such as local companies, cess fund co-financing, donor agency financing, venture capital, and destination country joint ventures.

The industry should research and present findings on the most feasible model for proceeding with developing a franchising operation. It should then

- Identify investors in the franchising operation;
- Establish provisional, intermediate goals for each target market;
- Develop a compelling presentation to test the interest of franchise companies and potential strategic partners;
- Decide on benchmarks to measure progress (with criteria for a go or no-go decision established beforehand for each stage); and
- Establish a program to measure progress toward the agreed-upon goals in the target market and to expand the initiative to other markets.

TARGETS AND EXPECTED RESULTS

The target for this initiative is to establish five franchising operations within two years and widen the price premium of Ceylon teas over similar teas or Kenyan teas. Expected results are as follows:

- Most if not all teahouses operating profitably
- Year-on-year increase in the number of customers frequenting each teahouse
- Year-on-year increase in the contribution from each franchisee
- Increase in the FOB value per kilogram of Ceylon teas

The timeline for this initiative is presented in Figure 6.

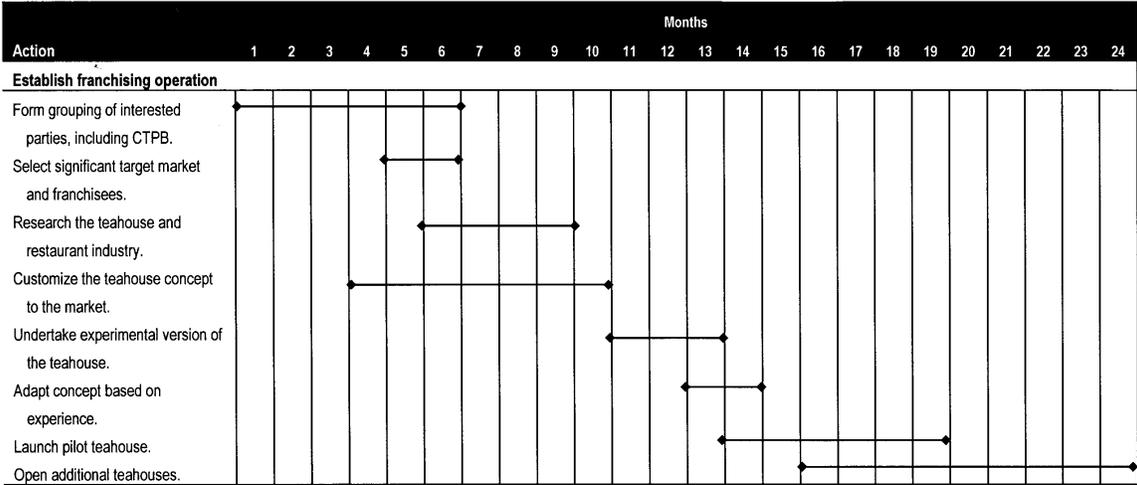


Figure 6. Timeline for Launching Rediscovery of Ceylon Teas

Develop the Workforce

This initiative will provide part of the foundation required by the first three initiatives. The industry proposes developing a market-oriented workforce and achieving peaceful, constructive coexistence of populations in tea estates and surrounding areas. This initiative calls for developing the workforce by improving managerial, marketing, quality control, logistics, and other technical skills. It also focuses on attracting and retaining individuals by providing appropriate remuneration, benefits, and rewards while seeking to mechanize repetitive skills and lower functions.

WHY THIS INITIATIVE?

The tea industry has long recognized the need to invest in human resources, improve human resource management, address skills gaps, and remove the stultifying influence of politics from the wage bargaining process. At the same time, it aspires to improve labor-management relations through better training of management as well as labor. Specific goals include

- Having a market-oriented workforce in every component of the value chain, including smallholders, coordinating actions that serve the overseas customer;
- Developing a plantation and factory culture free of government paternalism and characterized by trust between workers and union representatives to facilitate industry modernization and upgrading of green leaf harvesting and tea manufacture; and
- Harmony between plantations and rural Sri Lanka to facilitate economic and social development.

Achieving these goals will boost productivity throughout the industry, encourage business investment in the workforce, and strengthen relationships between the industry and educators and trainers, which in turn would make them more responsive to its training

needs. It will also lead the industry closer to the most compelling reason for this initiative—a better quality of life for its workforce.

ORGANIZATION AND CONSENSUS-BUILDING

An initial joint session of industry human resource managers, association personnel, and educators and trainers should be held early on to facilitate implementation. Models used in other countries and other agribusiness industries should be used to design and implement the first training needs assessment.

The initiative reflects the consensus expressed in industry documents that workforce development is important. For the last several years, “improvement of the quality of life of the workforce” has been a goal stated in strategy documents of the Colombo Tea Trader’s Association (CTTA).

INDICATORS OF SUCCESS

Benchmarks for this initiative include (1) number of coordinated initiatives to upgrade services and products sold to international markets, (2) annual increases in factory employee productivity, (3) reduced employee turnover at factories, (4) fewer conflicts in communities containing plantations, (5) more graduates and certificate holders among managers and employees, and (6) more specialized tea industry professionals.

ACTIONS

Activities for this initiative will rely heavily on the CTTA in liaison with the

- Tea Exporters’ Association (TEA),
- Planters’ Association of Ceylon (PA),
- Tea Small Holdings Development Authority (TSHDA), and
- Private Tea Factory Owners’ Association (PTFOA).

Educators and trainers outside the industry will include universities, their post-graduate institutions, and training institutes, including the National Institute of Plantation Management, the University of Peradeniya, University of Moratuwa (technical), University of Sri Jayewardenepura, and University of Ruhuna.

Design and Implement Training Needs Assessment

To design and implement training needs assessments, the CTTA, TEA, PA, TSHDA, and the PTFOA will each create a human resources and workforce development committee.

Association members—smallholders, plantations, factories, and trading houses—will identify skills gaps, evaluate their educators and trainers, and make recommendations to the committees based on the competitive challenges they face. Each committee will consolidate these recommendations into an annual assessment that will be distributed to vocational schools, training institutes, and participating universities, including their agricultural faculties.

Strengthen Linkages Between Industry and Educators and Trainers

Linking mechanisms that should be explored include

- Short courses developed by educators and trainers in international business, marketing, human resource management, and labor relations for tea managers, provided as correspondence courses or through distance learning, local business schools, or even study abroad;
- Industry-financed consulting projects for local professors and institutions;
- Guest lecturers from industry;
- Convening a meeting of human resource managers and placement officials from schools and universities to strengthen recruitment and placement;
- Industry participation on curriculum review committees;
- Communicating smallholder, plantation, manufacturing, and trading sector needs for research, building on the training needs assessment; and
- An educational institution specializing in training for specific areas of the tea industry.

Address Labor Issues

Through its human resource and workforce development committees, the CTTA, TEA, PA, TSHDA, and PTFOA will address labor-management relations, worker retention, productivity, and work-life enhancement. The committees will recommend actions to improve human resources. To raise recruitment and retention rates, they will examine ways to improve the quality of life on tea plantations. Working with other private and government initiatives on labor market issues, they will examine alternatives for increasing productivity and investment in worker health, education, and safety to build a good business–labor climate in the industry.

TARGETS AND EXPECTED RESULTS

Targets for this initiative include

- Increased productivity among factory employees, and
- Increased number of tea industry professionals.

Expected results are

- Increased labor productivity as measured by “kilograms of made tea per employee,”
- Less employee turnover at factories,
- Increase in the number of tasters capable of identifying the particular nuances of the range of Ceylon teas available, and
- Increase in the number of graduates of institutions working in the tea industry.

The timeline for this initiative is presented in Figure 7.

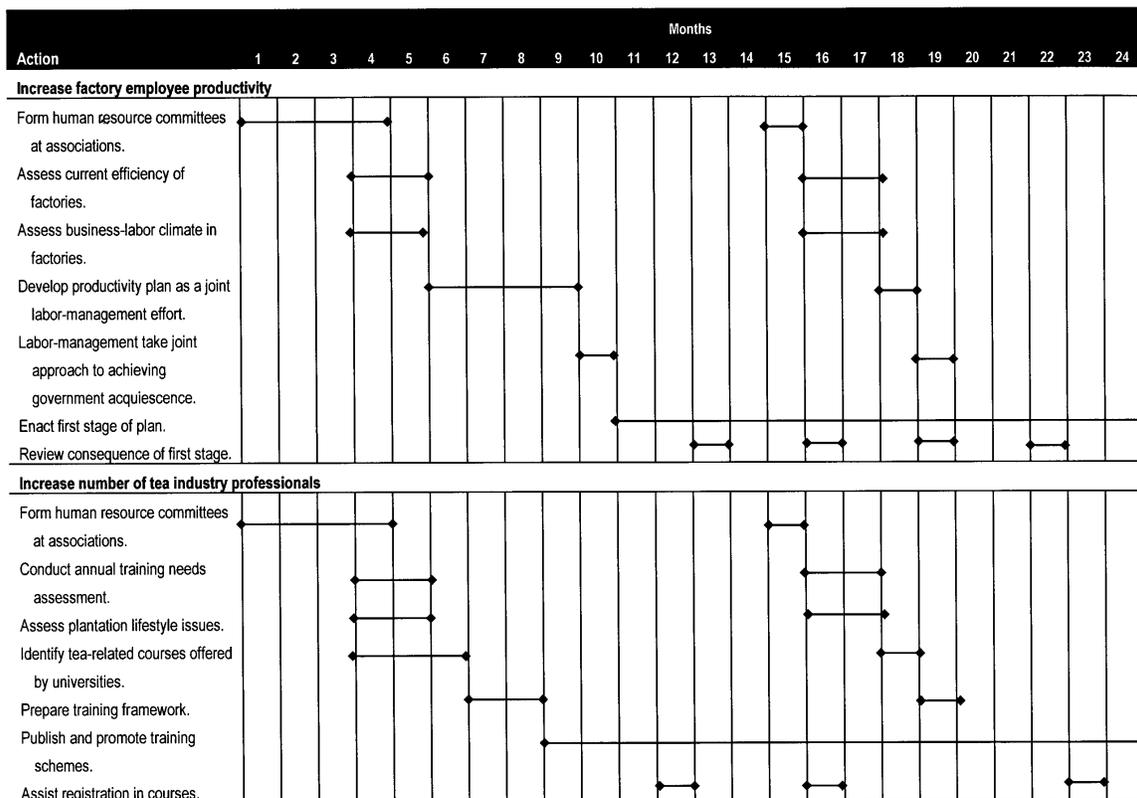


Figure 7. Timeline for Developing the Workforce

Restructure the Public–Private Partnership

This initiative provides part of the foundation necessary for the first three initiatives. The industry proposes to restructure the tea industry’s public–private partnerships so the private sector takes on more responsibility for strategic research and development, promotion, and market development. The public sector will support these efforts by negotiating and defending Sri Lankan products in trade-related discussions and agreements. The initiative will entail restructuring the Sri Lanka Tea Board, the Ceylon Tea Promotion Bureau, and the Tea Research Institute of Sri Lanka, and streamlining logistics from the estate to the shipping point, to include simplifying procedures related to customs, import, and export.

WHY THIS INITIATIVE?

The tea industry is frustrated daily by intrusive government controls, none of which seem to increase international competitiveness. These controls include inspection of containers loaded for export, manual preparation of customs documentation (despite the existence of a tested computerized system), and distortions of trade data caused by inconsistencies between the classification of export products and tea industry usage. Some would prefer the industry to police itself; others prefer maintaining the institutions but increasing industry participation. The industry is also arguing for the cess to be allocated immediately to benefit industry participants in proportion to their contribution—an issue of redistribution. The industry’s approach to the other issues is one of persistence and patience.

The benefits of this initiative are as follows:

- Making the Tea Board directly responsible to the industry would reunite policy with business issues, returning to industry control of its future.

- Requiring the Tea Research Institute to shed its non-tea activities and direct resources to R&D for products and processes would make breakthroughs more likely.¹⁰
- Reaching a “meeting of the minds” about permitting the import of standard and superior grades of orthodox teas would give Sri Lankan exporters more flexibility in serving national distributors and marketers—for whom replacing Ceylon teas with cheaper similars is a fact of life—and possibly permit them to break into new markets.
- Permitting the industry to use a private rail cargo system to transport made teas from factories in the producing regions to Colombo warehouses for sale would streamline logistics while providing more opportunity for using tracking systems, allowing for greater use of existing infrastructure, and allocating resources more efficiently.
- Simplifying export documentation, reducing bureaucratic procedures, and computerizing the customs process would reduce costs and release management time.
- Fine-tuning the harmonized system of customs coding for tea to fit industry practice and parlance would make customs data more valuable for management purposes.
- Effective negotiation of trade agreements and strong action against WTO member or potential member countries with discriminatory trade structures would encourage greater value addition in country and access more markets.

The willingness of Sri Lanka's new government to engage in a public–private dialog aimed at reducing the role of government in business presents an opportunity for the tea industry to propose the policy changes described in this initiative. The industry needs to speak with a single voice to ministries such as the Ministry of Plantation Industries and the Ministry of Enterprise Development, Industrial Policy and Investment Promotion.

ORGANIZATION AND CONSENSUS-BUILDING

The most contentious issue now under industry review is importing of orthodox teas. Reaching a meeting of the minds—rather than a true consensus—on this issue needs to take into account the views of industry members who have invested in processing plants abroad and domestic plantations' fear that importing orthodox teas will depress the auction price for lower quality and plainer teas. The industry is beginning to explore the possibility of establishing a private rail cargo system.

¹⁰The perception in the trade is that the Tea Research Institute has under-performed. Its research into superior clones has concentrated on resistance to disease and higher yield but has tended to neglect the quality of tea. The “TRI shear,” which could increase plucker productivity, and a computer program for control of the rolling process in tea factories developed by the Tea Research Institute will be out in 2002. Laudable though these individual achievements may be, the industry considers them modest for a decade's research.

POLICY AND OPERATIONAL IMPLICATIONS

The Sri Lankan tea industry should ensure that it takes a cohesive approach in implementing strategic proposals financed by donor agencies or initiated by specific sectors of the industry to ensure that activities are coordinated. The design of any strategic project should include tea plantations and tea marketing initiatives.

INDICATORS OF SUCCESS

Success for this initiative would be indicated when (1) the Sri Lanka Tea Board is directly accountable to the tea industry, (2) the Ceylon Tea Promotion Bureau is restructured, (3) the Tea Research Institute is restructured as an industry-centered research body, (4) an industry meeting of the minds on importing standard and superior grade orthodox teas is achieved, (5) logistical efficiencies are achieved from estate to shipping point, (6) bureaucratic export procedures are streamlined, and (7) the harmonized system of customs codes accords with industry usage.

ACTIONS

Actions for this initiative are as follows:

- Agree on precise proposals to present to government.
- Nominate an existing industry representative group—an industry forum or an association such as the CTTA—to endorse the proposals.
- Present the proposals to the Ministry of Plantation Industries or relevant line ministry and begin dialogue for implementation.

TARGETS AND EXPECTED RESULTS

Targets and expected results are as follows:

- Make the Ceylon Tea Board responsible to the industry, reduce industry export costs, and place more “total quality” schemes in practice within two years.
- Restructure the Ceylon Tea Promotion Bureau with industry control within two years.
- Ensure that at least 50 percent of Bureau funds are spent on promotion by the end of the first year.
- Restructure the Tea Research Institute and have it shed all non-tea activities within two years.

- Make online customs clearance available to connected companies by the end of the first year.

The timeline for this initiative is presented in Figure 8.

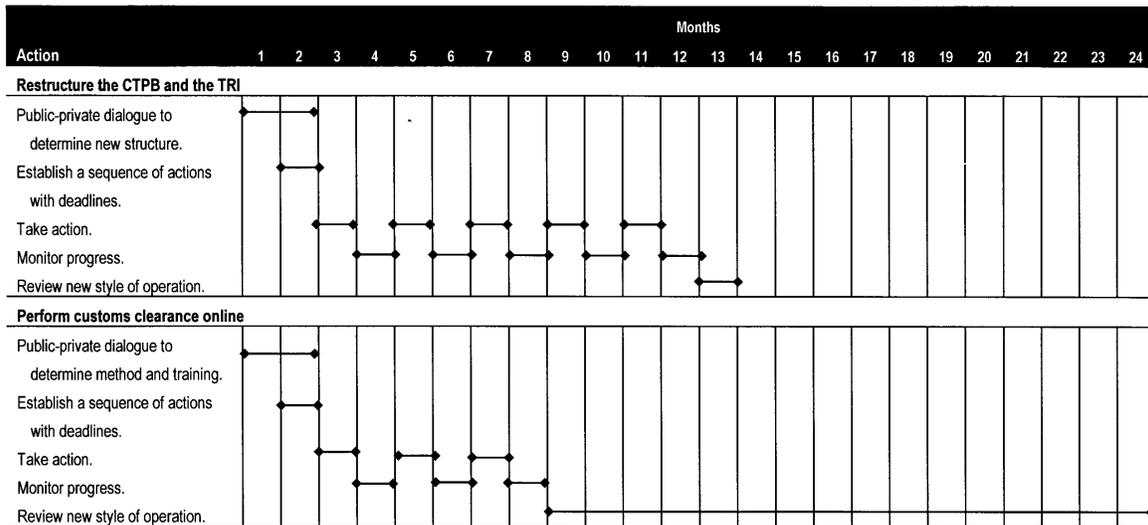


Figure 8. Timeline for Restructuring the Public-Private Partnership

Appendix A. Deregulation and Privatization Benefits and Issues

This appendix summarizes arguments advanced by members of the Tea Cluster and other industry stakeholders regarding deregulation and privatization of certain industry functions.

PRIVATIZATION OF THE CEYLON TEA PROMOTION BUREAU

Benefits

- Financial resources directed to promoting “winning” Sri Lankan-owned brands and Ceylon tea blends sold by national marketers.
- Market surveys undertaken to identify promising national and regional markets and attractive national marketers for Sri Lankan attention.
- Consumer surveys and taste tests conducted to determine promising Ceylon tea blends for specific countries or regions of those countries.
- A global approach developed for matching (1) consumer tea and other beverage tastes, brewing and drinking habits, local water and other idiosyncrasies with (2) the natural attributes of Ceylon teas as customized to local preferences.

Issues

- How should the bureau decide which marketers receive promotional funds?
- How can the state hand over to a private business a national trademark, Ceylon teas, and a national treasure, the lion logo?

- What is to stop the major tea companies from monopolizing the cess money to promote their own products, squeezing out small and medium-sized players or preventing them from starting operations?
- The Bureau should focus on promoting the generic brand “Ceylon Tea” and support initiatives that have industry-wide benefit; promotion of company brands should be the sole responsibility of the company.
- Most exporters lack the capital base to sustain a long-term promotional campaign, a problem that could be partly resolved by opening dialogue with the government to negotiate fiscal incentives (i.e., tax concessions or rebates) that encourage brand development.

Status of Debate

- General agreement that the industry should have a major say in the use of promotional funds, the level of funding, and the share of the allocated cess funds spent on administration of the promotion bureau.
- Privatization of the trademark Ceylon teas and the lion logo is much opposed.

DEREGULATION OF THE IMPORT AND RE-EXPORT OF ORTHODOX TEAS FROM OTHER ORIGINS

Benefits

- Increased business. Companies would be able meet the needs of national marketers for blends other than pure Ceylon teas blends, including forming alliances with such marketers, especially at the beginning of the relationship.
- Increased volume of tea through Colombo and warehouse/blending facilities will result in lower unit cost per kilogram handled and blended and stimulate service businesses.

Issues

- The value of plainer and lower-quality Ceylon teas will be reduced to the level of cheaper similars from other origins.

Status of Debate

- The schism on the subject of importing orthodox teas from other origins can be healed through collaboration between exporters and the plantation companies in some other endeavor (e.g., research projects, lobbying to remove bureaucratic operational barriers).

DEREGULATION OF TEA COMMISSIONER'S OFFICE EXPORT INSPECTIONS**Benefits**

- Tea companies would have control over proprietary products and accept full responsibility for serving their clients.
- It will make it easier for blenders to complete loading containers and improve the timeliness of shipments.

Issues

- Unscrupulous exporters will ship tea inferior to the quality promised.
- Illegal operations, including incorporation of offgrade material and illegal tea into export lots, will be possible.

Status of Debate

- Some believe export inspections should continue to be performed by a state agency but that the industry should have a greater say in the administration of the agency.
- For parties who believe that their operations would be harmed, accepting import of orthodox teas may be contingent on strict monitoring.
- No specific action contemplated until other issues are clarified.

PRIVATIZATION OF THE TEA RESEARCH INSTITUTE OF SRI LANKA**Benefits**

- Research focused on strategic issues—brewing consistent tea for foodservice; linking consumer taste preferences to blending, manufacture, and green leaves; a cultivar resistant to all known diseases that produces superb tea 365 days a year.

Issues

- Government usually conducts basic research (science); industry invests only in areas where it can produce and sell a commercial item or service.
- Fiscal incentives that encourage private sector R&D could also encourage the Tea Research Institute to focus on a research agenda with industry-wide strategic benefit and the private sector to focus on research with near-term commercial value.

Status of Debate

- General agreement that the industry should have a major say in the use of cess funds allocated for research and the Tea Research Institute's agenda through a restructuring of its management with a view to being truly responsive to the strategic direction of the industry it supports.
- Certain plantation management companies appear satisfied with the support provided for improving agricultural practices and field activities.

Appendix B. Action Plan for the Sri Lanka Tea Industry Forum

Attribute of autonomy	Continuing Tasks	Year 1	Years 2 to 5	Period of "wealth creation"
A forum for the tea industry	Promote debate where decisions are to be made in the industry's long-term interest and where the force of the better argument prevails.	Review and refine practices of the Sri Lankan tea cluster or similar institution to comply with the concept of an industry forum.	Formalize cluster or similar institution, maintaining the objectives of TCI as the tea industry's principal forum, setting the industry's agenda and incorporating representatives from supporting industries and the government.	Monitor industry performance and continue to address significant sector issues from an industry standpoint.
Facilitator of mission	Define values that belong to the entire industry and contribute to serving its clientele to forge a vision, identifying which markets to serve and what products to offer.	Engage in a constructive dialogue with different industry components; refine and communicate the provisional mission statement. Identify policy constraints.	Promote acceptance of the mission and review it in light of developments. Communicate mission to the government and begin to resolve policy constraints.	Continuously monitor the mission for relevance. Continue to monitor the political process to ensure policies reflect and support the industry's mission.
Facilitator of action plans	Within the scope of the mission, define viable areas for action, given limited resources.	Plan a model approach and apply in at least one market involving Sri Lankan and national brands and Ceylon teahouses; develop the workforce and analyze limiting policies.	Apply the model to major tea markets; revise and adapt the general approach as appropriate. Link workforce development and policy reform to the model.	Review the model and continue to apply in minor markets. Develop and adapt workforce development and policy reform.
Facilitator of management plans	Define which actions by which actors result in positive and negative competitive outcomes and agree on an "industry dashboard" to guide progress.	Review all actions that actors in the industry need to take to meet their obligations; establish baseline performance measures.	Continuously measure the performance of the industry in all markets and use the information to revise action plans.	Report the industry's performance against measures that have brought success and begin to include other indicators as tea-drinking habits change.
Facilitator of operational plans	Address research and development issues; improve domestic logistics and handling; design a Tea Intelligence Center.	Examine ways of upgrading development, harvesting, manufacturing, blending, handling, and storage. Seek funding for a Tea Intelligence Center.	Upgrade operations, reduce costs; implement the Tea Intelligence Center. Obtain appropriate government support.	Continue encouraging improvement in operations and cost reduction and ensure government investment in industry improvements.

Glossary

CIS	The Commonwealth of Independent States
CTC	cut, tear, and curl
CTTA	Colombo Tea Trader's Association
FOB	free on board
GDP	Gross Domestic Product
PA	Planters' Association of Ceylon
PTFOA	Private Tea Factory Owners' Association
R&D	research and development
TCI	The Competitiveness Initiative
TEA	Tea Exporters' Association
TRI	Tea Research Institute
TSHDA	Tea Small Holdings Development Authority
USAID	United States Agency for International Development
WTO	World Trade Organization

